June 12, 2020

VIA ELECTRONIC SUBMISSION
Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Re: Investment Adviser Advertisements; Compensation for Solicitations (SEC Release No. IA-5407; File No. S7-21-19 (Nov. 4, 2019))

Dear Ms. Countryman:

The American Investment Council (the "AIC") appreciates the opportunity to submit this letter to the Securities and Exchange Commission (the "SEC") to supplement our prior comment letter, dated February 10, 2020 (the "Original Comment Letter") on the proposal (the "Proposed Amendments") to amend Rule 206(4)-1 (the "Advertising Rule") and Rule 206(4)-3 (the "Cash Solicitation Rule") under the Investment Advisers Act of 1940 (the "Advisers Act") along with certain other related amendments.[1]

As noted in our Original Comment Letter, the AIC supports the SEC's goal of modernizing the Advertising Rule to ensure that investors are protected from misleading marketing and other materials. As discussed in detail in our Original Comment Letter, we have significant concerns about the proposal. We believe that it is needlessly prescriptive, particularly with respect to communications to highly sophisticated institutional investors. Set forth below is a summary of our key recommendations, which, if adopted, should result in the implementation of a principles-based regime that is consistent with the SEC's objectives and appropriate for private funds, without in any way diminishing the key protections for investors—particularly retail investors—included in the Proposed Amendments. We also provide certain follow-up clarifications.

[1] Investment Adviser Advertisements; Compensation for Solicitations, SEC Release No. IA-5407; File No. S7-21-19 (Nov. 4, 2019) (the "Proposing Release").

I. Existing anti-fraud provisions under U.S. securities laws are well understood and sufficiently protective of prospective and current investors in private funds, negating the need to create new and additional requirements. The new proposed general prohibitions are of uncertain scope and would lead to unnecessary burdens.

The existing anti-fraud provisions under the U.S. securities laws provide sufficient protection from misleading communications to investors in private equity funds. Section 206 of the Advisers Act incorporates a general anti-fraud provision. Rule 206(4)-8 extends this prohibition to communications to any current or prospective investor in a pooled investment vehicle (including private placement memoranda and related materials, which are designed to attract investors — not clients). These provisions are already regularly cited by staff of the SEC's Office of Compliance Inspections and Examinations in raising a broad variety of concerns related to adviser advertising materials and other investor communications. Current and prospective private fund investors are further protected by anti-fraud provision under Section 17(a) of the Securities Act of 1933 (the "Securities Act"), Section 10b of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. As such, SEC and its staff currently have sufficient authority and opportunity to protect current and prospective private fund investors in matters relating to private fund advisers' advertising materials.

The new general prohibitions in the Proposed Amendments introduce new standards and requirements that are unclear in their scope, since there is an absence of guidance on the new prohibitions' interpretation in the context of the Advertising Rule, and set aside a long history of interpretive guidance and market practice relating to the Advertising Rule. These new general prohibitions appear to go beyond the existing, well understood anti-fraud provision and beyond preventing misleading communications. This expansion is particularly a problem if they are applied to the wide range of communications captured by the broader definition of an "advertisement" in the Proposed Amendments. As discussed in more detail below, the new general prohibitions that appear the most problematic are (i) the requirement that each material claim or statement be substantiated, (ii) the requirement that there be a prominent discussion of any material risks or limitations if an advertisement discusses or implies potential benefits relating to an investment adviser's services, and (iii) the new "fair and balanced" standard with respect to the disclosure of specific investment advice and performance results.

First, as noted in the Original Comment Letter, the proposed general prohibition on any material claim or statement that is unsubstantiated[2] is unclear with respect to its application. The AIC is particularly concerned that this requirement imposes a substantial implicit books and records obligation that would be exacerbated by its application to virtually all (formal or informal) communications of an investment adviser.

Second, the requirement that an "advertisement" that discusses (or implies) potential benefits relating to an investment adviser's services must also prominently discuss any material risks or limitations associated with the potential benefits[3] may be difficult to implement in practice when applied to informal communications. For example, the requirement suggests that any discussion of an investment adviser's services could be viewed as implying benefits, which would

[2] Proposed Rule 206(4)-1(a)(2).
[3] Proposed Rule 206(4)-1(a)(4).

necessitate that all such communications be reviewed by compliance (and potentially by legal counsel) to ensure that material risks are appropriately disclosed. One effect of such an interpretation is that an investment adviser's employees may be unable to engage in any informational e-mail or similar communications with sophisticated investors without relying solely on pre-existing "stock" marketing language or engaging in the burdensome process of obtaining compliance approval for non-standard language. This risks a reduction in transparency and limits an adviser's ability to respond to diligence or similar questions.

In addition, the application of a "fair and balanced" standard with respect to the presentation of specific investment advice and performance results[4] is unclear, particularly when considering communications that are not "traditional" advertisements. Moreover, it may not be clear how the "fair and balanced" standard should be applied to communications by a private fund to its investors with respect to the fund's performance. For example, would the "fair and balanced" standard require the disclosure of other investment products (in which such investors are not invested), related indices, or different time periods from the standard disclosure? Similarly, would a "fair and balanced" standard permit discussing with existing investors the performance of specific investments or permit press releases discussing the purchase or sale of investments? Also unclear is whether disclaimers that would otherwise make a performance presentation not misleading to sophisticated investors would be considered "balanced" in accordance with the "fair and balanced" standard. These concerns also apply with respect to responses to investor inquiries, such as responses to due diligence questionnaires. The implications of such uncertainty are several, including, in particular, (*i*) private fund sponsors may provide less information to investors on fund performance and (*ii*) private fund investors could be required to indirectly bear substantially increased costs of communications due to the required additional review by internal and external compliance and legal counsel.

II. It is inappropriate to subject private funds to the same type of regulation as retail mutual funds. The Proposing Release seems to recognize this but appears to impose aspects of the retail regime on private funds offered to non-retail investors.

The Proposed Amendments draw, in particular, on FINRA rules and Rule 156 under the Securities Act, which were primarily developed to address marketing of mutual funds to retail investors. As the AIC has noted in the past[5], marketing materials designed for private fund investors should not be subject to the same types of regulations applicable to managed accounts or investment vehicles targeted at retail investors. If the SEC believes that the existing anti-fraud provisions are not sufficiently protective of certain investors (such as retail investors), any new prohibitions or requirements should be specifically designed to only apply to marketing materials and communications targeted at such investors.

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4 *See* Proposed Rule 206(4)-1(a)(5) & (6).

5 Letter of the Private Equity Growth Capital Council to Secretary Elizabeth M. Murphy on the proposed amendments to Regulation D, From D and Rule 156 under the Securities Act (Sept. 23, 2013).

III. If the Proposed Amendments are adopted, the AIC requests the following changes related to the definition of an "advertisement."

The SEC should retain the definition of "advertisement" that covers only "traditional" forms of advertising materials and continue to rely on the broad anti-fraud standard for other types of communications.

At a minimum, consistent with existing SEC guidance and market practice, the definition of "advertisement" should exclude (*i*) a communication limited to existing clients/investors and primarily designed to explain the performance of the client/investor's account or investment and (*ii*) responses by an adviser to any unsolicited requests for information, including those that contain performance information or any other kind of information that the adviser determines in good faith to be reasonably related to the request. In both instances, as is currently the case, these communications would remain subject to the general anti-fraud provisions of the Advisers Act and, to the extent applicable, other securities laws.

The definition of an "advertisement" should exclude the proposed "by or on behalf of" prong. Alternatively, the SEC should clarify the circumstances under which third-party content can be attributed to the investment advisers. In particular, the final rule should not attribute content where the investment adviser does not have final editorial control, e.g., where it can recommend but not effect changes or, in the fund-of-funds context, where an unaffiliated fund-of-fund sponsor shares information with its underlying investors and the underlying fund manager does not have any control over the information shared (or the manner in which it is shared) and does not have any information about the ultimate recipients. Finally, the definition should allow editing of third-party content pursuant to a set of neutral, pre-established policies and procedures without attributing the content to the adviser.

We understand that the SEC staff is considering whether the concept of "by and on behalf" should be informed by the "entanglement" theory expressed by the courts and the SEC.[6] We agree that it would be helpful for the SEC to confirm that the responsibility of an adviser for marketing materials prepared and used by third parties should depend primarily on the adviser's level of involvement in the preparation of the materials. However, the "entanglement" theory has resulted in inconsistent outcomes over time, and we believe it presents the same uncertainty and unnecessary breadth as the "by and on behalf" standard discussed in the Proposing Release. Rather, as stated above, we encourage the SEC to clarify the circumstances under which third-party content can be attributed to investment advisers.

IV. The requirement to provide a schedule of fees and expenses should be eliminated.

Private fund sponsors engage in a wide range of strategies and asset classes, and private funds are structured in different ways (including for tax and regulatory reasons). To reflect these differences, the fees and expenses that are charged (and the way they are charged) vary significantly among private fund sponsors. As a result, investors in private equity funds can, and do, negotiate for targeted disclosure of fees and expenses, tailoring disclosure based on the

[6] *See* Commission Guidance on the Use of Company Web Sites, SEC Rel. No. 34-58288 (Aug. 1, 2008); Use of Electronic Media, SEC Rel. No. 33-7856 (April 28, 2000).

specific investments.[7] In fact, investors in private equity have been reluctant to press for "standardized" disclosures (including ILPA's framework). The AIC continues to believe that the negotiation process is robust and provides for a constructive engagement between the parties, and that the SEC does not need to, and should not, amend its rules in a way that would unnecessarily interfere with this process, particularly in light of the sophistication of private equity fund investors.

V. SMAs and other funds that pursue substantially similar investment strategies should not be considered "related portfolios" if they are materially different such that the inclusion of their performance could be misleading.

Related to this issue, as discussed in the Original Comment Letter, the AIC believes that the definition of "related portfolio" should be clarified to make clear that it is not required to include separately managed accounts ("SMAs"), predecessor funds or other related funds or accounts even if these funds have substantially similar investment policies, objectives, and strategies when the investment adviser determines that such other accounts or funds (or the presentation of the performance of such other accounts or funds) are materially different such that their inclusion could be misleading to investors. For example, while SMAs and other funds may have substantially similar investment strategies on their face, they often differ materially with respect to investment process, investment restrictions, fees and expenses, and size so that their performance may be materially different. In addition, there may be material changes in investment teams, investment process, and the implementation details of investment strategies over time.

VI. Investment advisers are subject to broad, robust compliance requirements, and any final rule should not impose unnecessary or duplicative obligations – particularly a requirement that each "advertisement" be reviewed by a designated employee.

A registered investment adviser's compliance policies and procedures adopted under Rule 206(4)-7 under the Advisers Act generally include a process for reviewing private fund marketing materials, and are required to be reasonably designed to prevent violation of the federal securities laws. As such, the requirement that all advertisements be reviewed and approved by a designated employee is duplicative of existing requirements. The suggestion that the review of each advertisement be documented will also impose additional and unnecessary recordkeeping and compliance burdens on firms. These burdens are exacerbated (and, in some cases, impractical) with the new broader definition of "advertisement" under the Proposed Amendments.

7 *See* Letter of the American Investment Counsel to Brent J. Fields, Secretary, Securities and Exchange Commission (Feb. 15, 2019) (discussing the various opportunities that sophisticated investors have and use during the course of negotiations to both ask and receive information and negotiate issues of particular importance).

VII. The Proposed Amendments to the Cash Solicitation Rule should not apply with respect to the solicitation of private fund investors because it does not provide any additional benefit and it merely imposes additional burdens.

The Proposed Amendments to the Cash Solicitation Rule include several provisions that are either duplicative or unnecessary with respect to the solicitation of private fund investors. We discuss each such provision below.

- First, the requirement that the solicitor has not been subject to certain "bad acts"[8] is duplicative of the "bad actor" rule in Rule 506(d) of Regulation D under the Securities Act.

- Second, the requirement that the written agreement with the solicitor require that it "perform [its] duties under the agreement in a manner consistent with the instructions of the investment adviser and the provisions of the [Advisers Act] and the rules thereunder" is (*i*) unnecessary because an investment adviser is already subject to liability under the federal securities laws for the activities of its solicitors[9] and (*ii*) unclear in how the provisions of the Advisers Act apply to the activities of a U.S. registered broker-dealer; such a broker-dealer, for example, may be reluctant to represent that it is acting consistent with a statute with respect to which it is not subject.

- Third, the Proposed Amendments would create a requirement that the solicitor deliver the Form ADV Part 2A (the "Brochure") of a private fund sponsor to the private fund investors; however, based on the decision of the U.S. Court of Appeals for the D.C. Circuit in *Goldstein*, the SEC staff has appropriately taken the position that the Brochure delivery requirement in Rule 204-3 does not require delivery of the Brochure to the investors in a private fund.[10]

- Fourth, the separate written disclosure document required in Rule 206(4)-3(b) is (*i*) unnecessary because a private fund sponsor is already required to make disclosures regarding material conflicts of interest (which would include the conflict of interest regarding the solicitor's compensation) as well as any fees and expenses for which the investor will be directly or indirectly responsible (including the fees paid by the fund or investor to the solicitor) and (*ii*) unduly burdensome, since a private fund sponsor will be required to maintain multiple disclosure documents instead of having the option of a single disclosure document (*e.g.*, the fund's private placement memorandum) with all material conflicts of interest in a single place.

Finally, the AIC again notes that the Proposed Amendments would create issues with respect to non-U.S. solicitors who are otherwise not subject to U.S. federal securities laws (other than the

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8 Rule 206(4)-3(a)(ii).

9 *See, e.g.*, In the Matter of Ranieri Partners LLC and Donald W. Phillips, SEC Release Nos. 34-69091, IA-3563 (Mar. 8, 2013).

10 SEC Staff of the Division of Investment Management, Staff Responses to Questions About Part 2 of Form ADV, available at https://www.sec.gov/divisions/investment/form-adv-part-2-faq.htm, at Question III.2 (citing *Goldstein v. Securities and Exchange Commission*, 451 F.3d 873 (D.C. Cir. 2006)) (posted March 18, 2011).

anti-fraud provisions) and also create unequal competition with respect to non-U.S. private fund sponsors that are not registered under the Advisers Act and able to offer fund interests to U.S. investors in reliance on Regulation D.

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The AIC appreciates the opportunity to comment on the Proposal and would be pleased to answer any questions that you might have concerning our comments.

Respectfully submitted,

Jason Mulvihill

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American Investment Council