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FINANCIAL MARKETS AND FUNDS ADVISORY

SEC Proposes Principles-Based Changes to Investment Adviser Advertising and Solicitation Rules, Seeks Industry Reaction by February 10

December 13, 2019

KEY POINTS

- SEC proposes significant changes to the Advisers Act "Advertising Rule" and "Cash Solicitation" Rule.
- The proposed definition of "Advertisements" expands the types of communications that are considered Advertisements.
- Communications with potential investors in private investment funds will be considered Advertisements subject to this new Rule.
- Principles-based approach replaces four *per se* advertisement prohibitions.
- Testimonials, endorsements and third-party ratings will be allowed, subject to certain conditions.
- The Advertising Rule, for the first time, will impose specific requirements on performance advertising. In the past, performance advertising was governed by SEC staff guidance.
- The Cash Solicitation Rule will apply to private investment fund solicitation arrangements.
- The Cash Solicitation Rule for the first time will include non-cash "compensation" such as directing brokerage or providing entertainment in exchange for client or investor referrals.

On November 4, the Securities and Exchange Commission (SEC) voted to propose amendments to modernize the rules under the Investment Advisers Act of 1940, as amended, (Advisers Act) addressing investment adviser advertisements (Rule 206(4)-1 or the Advertising Rule) and payments to solicitors (Rule 206(4)-3 or the Cash Solicitation Rule). The proposed amendments to Rule 206(4)-1 would significantly change the rules governing investment adviser marketing material, while the proposed amendments to Rule 206(4)-3 predominantly make refinements to the scope, the written agreement content, and disclosure requirements of the Cash Solicitation Rule. Comments may be submitted to the SEC on the proposed changes (collectively, the "Proposals") until February 10, 2020. Below we describe the Proposals.

The Advertising Rule Proposals

A. Definition of Advertisement

1. Expanded Scope of What Constitutes an Advertisement

The Proposals change the definition of "Advertisement" under Rule 206(4)-1 in a manner that expands the types of communications that constitute Advertisements. Currently, Rule 206(4)-1 defines an Advertisement as:

any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell; or (2) any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell; or (3) any other investment advisory service with regard to securities.

In contrast, the Proposals define an Advertisement as: "any communication, disseminated by any means, by or on behalf of an investment adviser, that offers or promotes the investment adviser's investment advisory services or that seeks to obtain or retain one or more investment advisory clients or investors in any pooled investment vehicle advised by the investment adviser."

The proposed definition of Advertisement expands the scope of what constitutes an advertisement in several respects. First, the phrase "disseminated by any means" in the proposed definition would replace the current rule's requirement that an Advertisement be a "written communication" or a "notice or other announcement . . . by radio or television." In the proposing release describing the Proposals (Proposing Release), the SEC explains that, unless specifically excluded by the proposed definition of Advertisement as described below, the "disseminated by any means" language includes all promotional communications, irrespective of how they are circulated including "through emails, text messages, instant messages, electronic presentations, videos, films, podcasts, digital audio or video files, blogs, billboards, and all manner of social media, as well as by paper, including in newspapers, magazines and the mail." The SEC also believes that the "disseminated by any means" language will allow the definition of "Advertisement" to be "flexible enough to remain relevant and effective in the face of advances in technology and evolving industry practices." Second, the proposed definition includes promotional communications to investors in pooled investment vehicles managed by a registered investment adviser. For purposes of the Proposals, a pooled investment vehicle is any private investment fund that would be an investment company but for Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940 (Investment Company Act) . Third, the proposed definition does not require that a communication be to "more than one person" as does the current definition. Finally, the proposed definition's "by or on behalf of an investment adviser" includes communications disseminated by an adviser through a consultant, solicitor affiliate or other intermediary.

Under the Proposals' very broad definition of Advertisement, one-on-one emails or other written communications that promote the adviser's advisory services will be deemed Advertisements. That is a dramatic expansion from the current Rule which only deems a communication to be an advertisement if it is disseminated to more than one person. Furthermore, some commentators believe that private fund offering documents could be deemed Advertisements. Such a position would change long accepted industry understanding that private offering documents do not constitute Advertisements under the Advertising Rule. Indeed, in 1996, the SEC staff stated in two no-action letters that registered investment company prospectuses would not be deemed Advertisements under Rule 206(4)-1 "if they are not designed to maintain existing clients or solicit new clients for the adviser."[1] Similarly, investment advisers have not regarded a private fund's offering documents to be Advertisements if such documents are solely designed to offer interests in the private fund to new and existing investors.

[1] Nicholas-Applegate Mutual Funds, SEC No-Action Letter (August 6, 1996); Munder Capital Management, SEC No-Action Letter (May 17, 1996).

2. *Exceptions to the Advertisement Definition*

The Proposals exclude the following types of communications from the definition of Advertising:

a) Live oral communications that are not broadcast

This exclusion applies to "live oral communications that are not broadcast on radio, television, the internet or any other similar medium" and is designed to carve out face-to-face conversations with clients and potential clients from the Advertising Rule.

b) Responses to unsolicited requests for information

A communication that does no more than respond to an unsolicited request for information as specified by the request would be excluded from the Advertisement definition, other than a communication that includes hypothetical performance (as defined in Section D.4 below) or a communication to a retail person (as defined below in Section D.5) that includes performance results. This exclusion from the Advertising Rule was previously included in a SEC staff no-action letter to the Investment Counsel Association in 2004 (ICA Letter). However, under the ICA Letter, performance information with respect to past specific recommendations of an investment adviser would be excluded from the definition of Advertising even in a communication to retail persons while under the Proposals' exclusion such information could not be included in communications with retail investors.

c) Advertisements, other sales materials and sales literature of registered investment companies and business development companies

This exclusion applies to any sales material within the scope of Rule 482 or Rule 156 under the Securities Act of 1933 (Securities Act) concerning investment companies registered under the Investment Company Act or about business development companies.

d) Any information required to be contained in a statutory or regulatory notice, filing or other communication

This exclusion applies to any information that an investment adviser is required to provide under any statute or regulation under federal or state law including but not limited to Form ADV Part 2A and Form CRS. However, if an investment adviser includes in such a communication information that promotes the adviser's services that is not required to be included under applicable law, such information would be considered an Advertisement.

B. General Prohibitions Applicable to Advertisements

The Proposals replace the Advertising Rule's current four per se prohibitions with principles-based provisions that are designed to prevent fraudulent marketing. Specifically under the Proposals an Advertisement may not:

- make any untrue statement of material fact or omit to state a material fact necessary to make a statement not misleading;
- include a material claim or statement that is unsubstantiated;
- make an untrue or misleading implication about or, being reasonably likely to cause an untrue or misleading inference to be drawn concerning, a material fact relating to the investment adviser;
- discuss or imply any potential benefits without clearly and prominently discussing associated material risks or other limitations;
- include specific investment advice provided by the investment adviser or include or exclude performance results or performance time periods in a manner that is not fair and balanced (Anti-Cherry Picking Provisions); or
- be otherwise materially misleading.

The Anti-Cherry Picking Provisions differ from the current Advertising Rule's prohibition on including past specific recommendations in Advertisements. Under the current Advertising Rule, an investment adviser may not include past specific recommendations that were, or would have been, profitable to anyone unless the Advertisement sets out or offers to furnish information about all recommendations made by the adviser during the preceding period of not less than one year. In no-action letters, the SEC provided exceptions to the past specific recommendations prohibition under certain very limited circumstances. Conversely, the Proposals' Anti-Cherry Picking Provisions allow discussion of recommendations provided they are presented in a fair and balanced manner based on all the facts and circumstances. Thus, the Anti-Cherry Picking Provisions liberalize an investment adviser's ability to refer to specific recommendations.

C. Testimonials, Endorsements and Third-Party Ratings

1. Relaxation of Prohibitions on use of Testimonials, Endorsements and Third-Party Ratings

The Proposals would allow investment advisers to use testimonials, endorsements and third-party ratings in Advertisements, subject to specified disclosures and conditions. The Proposals specifically define "testimonial," "endorsement," and "third-party rating". In contrast, the current Advertising Rule prohibits the use of "testimonials," and does not expressly address endorsements and third-party ratings.

When the SEC adopted the Advertising Rule in 1961, it stated that testimonials "by their very nature emphasize the comments and activities favorable to the investment adviser and ignore those that are unfavorable. This is true even when the testimonials are unsolicited and printed in full." However, as noted in the Proposing Release, testimonials, endorsements and third-party ratings are "widely used and accepted" today in the marketplace for many consumer goods and services outside of the securities and investment industry. Also, technological advances (like the internet and social media platforms) have made using testimonials easier and more widespread, and the SEC recognizes that testimonials and endorsements can be helpful resources when evaluating investment advisers.

2. Definitions

The Proposals define "testimonial" as "any statement of a client's or investor's experience with the investment adviser or its advisory affiliates" and defines "endorsement" as "any statement by a person other than a client or investor indicating approval, support or recommendation of the investment adviser or its advisory affiliates." "Third-party rating" would be defined as a "rating or ranking of an investment adviser provided by a person who is not a related person [of the adviser], and such person provides such ratings or rankings in the ordinary course of its business."

3. Conditions on the Use of Testimonials, Third-Party Endorsements and Third-Party Ratings

In addition to the general Advertising Rule prohibitions discussed above, testimonials and third-party endorsements would be allowed in an Advertisement only if the Advertisement clearly and prominently discloses whether the testimonial or endorsement was given by a client or investor or by a third party and whether compensation of any kind was paid for the endorsement or testimonial.

An Advertisement could include third-party ratings if "the investment adviser reasonably believes that any questionnaire or survey used in the preparation of the third-party rating is structured to make it equally easy for a participant to provide favorable and unfavorable responses" and the Advertisement clearly and prominently discloses 1) the date of, and period of time covered by, the third-party rating; 2) the identity of the third party who created and tabulated the rating; and 3) if compensation of any kind was paid in connection with obtaining or using the third-party rating.

Importantly, the SEC cautioned in the Proposing Release against cherry picking. The Proposing Release states that the SEC believes "that cherry picking testimonials, or otherwise selectively only using the most positive testimonials

available about an adviser, would not be consistent with the general Advertising Rule prohibitions discussed above. "For example, if an adviser were to select a single positive testimonial to highlight in an Advertisement, while excluding all negative testimonials, it is likely to create a misleading inference that the adviser has only received positive testimonials." This suggests that an adviser could, under certain circumstances, be required to include negative testimonials in its advertising in order to avoid a misleading inference that the adviser has only received positive testimonials.

D. Performance Presentations

SEC rules have never spoken to the manner in which advisers should present their performance, although rules do apply as to how investment companies and commodity pools present their performance. A private trade association has promulgated the Global Investment Performance Standards (GIPS), which have never been required by the SEC and have not been widely accepted by private funds.

The SEC's regulation of performance presentations by advisers has been governed by no-action letters and enforcement actions. Many of these no-action letters and enforcement actions are themselves decades old. The Proposals seek to modernize, and in many cases to liberalize, these old standards and replace them with a clearly defined set of standards, as described below.

1. Net of Fees

In the Clover Capital no-action letter, the SEC required that performance be presented net of fees. Later no-action letters created a limited exception to this requirement for one-on-one presentations to sophisticated clients, provided disclosure is also provided illustrating how fees reduce performance.

The proposed Advertising Rule would eliminate these requirements, except for a "retail advertisement," as explained below. Gross of fee performance could be presented in advertising, not just in one-on-one presentations, provided only that the adviser "provides or offers to provide promptly a schedule of the specific fees and expenses (presented in percentage terms) deducted to calculate net performance." This would substantially expand the ability of an adviser to present performance gross of fees in advertising.

2. Related Performance

The Proposals prohibit the inclusion of "related performance" unless all "related portfolios" are included. However, related portfolios may be excluded if 1) the advertised performance results are no higher than if all related portfolios had been included; and 2) the exclusion of such portfolios does not change the performance of the one-, five- and 10-year performance presentations required for retail advertising, as described below.

"Related performance" is defined as "the performance results of one or more related portfolios, either on a portfolio-by-portfolio basis or as one or more composite aggregations of all portfolios falling within stated criteria." A "related portfolio" is defined as "a portfolio" with substantially similar investment policies, objectives, and strategies as those of the services being offered or promoted in the [A]dvertisement." Related portfolio includes, but is not limited to, a portfolio for the account of the investment adviser or its advisory affiliate, as defined in the Form ADV Glossary of Terms."[2] These definitions are similar to the definition of a composite in the GIPS standards, but unlike the GIPS standards, the SEC does not require presentation of the performance of an entire composite.

[2] "Advisory affiliates" are 1) all of an investment adviser's officers, partners or directors (or any person performing similar functions); 2) all persons directly or indirectly controlling or controlled by the investment adviser; and 3) all current employees of the investment adviser (other than employees performing only clerical, administrative, support or similar functions).

3. Extracted Performance

The proposed Advertising Rule would permit the presentation of extracted performance, which is defined as "the performance results of a subset of investments extracted from a portfolio." However, this permission is only available if "the [A]dvertisement provides or offers to provide promptly the performance results of all investments in the portfolio from which the performance was extracted." This is a substantial departure from the GIPS standards and a substantial liberalization from what was generally perceived to be prior industry practice.

4. Hypothetical Performance

Prior law in this area was generally governed by the Clover Capital no-action letter and enforcement actions. Generally, clear disclosure of the limitations of the value of this type of performance advertising was required, but the presentation of such performance was not prohibited. GIPS and FINRA standards generally prohibited the presentation of such performance.

The Proposals would generally permit advertising of hypothetical performance, subject to certain conditions. For the first time, the Advertising Rule would contain a definition of hypothetical performance. Under the Proposals, hypothetical performance means performance results that were not actually achieved by any portfolio of any client of the investment adviser. Hypothetical performance includes, but is not limited to:

- performance derived from representative model portfolios that are managed contemporaneously alongside portfolios managed for actual clients;
- performance that is backtested by the application of a strategy to market data from prior periods when the strategy was not actually used during those periods; and
- targeted or projected performance returns with respect to any portfolio or to the investment services offered or promoted in the Advertisement.

Three conditions apply to the use of hypothetical advertising. Advisers presenting hypothetical performance must:

- adopt and implement policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the financial situation and investment objectives of the person to whom the Advertisement is disseminated;
- provide sufficient information to enable such person to understand the criteria used, and the assumptions made, in calculating such hypothetical performance; and
- provide (or, if such person is a non-retail person, provides or offers to provide promptly) sufficient information to enable such person to understand the risks and limitations of using such hypothetical performance in making investment decisions.

5. Special Rules for Retail Advertising

The proposed Advertising Rule creates a new category of rules for retail advertising. Any advertising is considered retail advertising unless the adviser has adopted policies and procedures reasonably designed to ensure that the advertising is disseminated solely to non-retail persons. A non-retail person is any person who is a qualified purchaser or knowledgeable employee as those terms are defined under the Investment Company Act. Thus, non-retail persons are persons eligible to invest in private funds that rely on Section 3(c)(7) of the Investment Company Act. Accredited investors, as defined under the Securities Act, and qualified clients, as defined under the Advisers Act, will may be considered retail clients unless they also are qualified purchasers or knowledgeable employees.

Retail advertising is subject to the following three requirements that do not apply to non-retail Advertisements:

- if gross of fees performance is presented, net of fees performance also must be presented with equal prominence;[3]
- performance must be presented for one-, five- and 10-years, "except that if the relevant portfolio did not exist for a particular prescribed period, then the life of the portfolio must be substituted for that period;" and
- for hypothetical performance, the adviser must provide, not merely offer to provide, disclosure of the limitations of such performance.

6. Claim SEC Approved

Not surprisingly, no Advertisement can claim that the presentation of performance has been reviewed or approved by the SEC.

E. Portability of Performance

Investment advisers often seek to advertise performance results of portfolios or accounts for which the adviser, its personnel or its predecessor investment adviser firms have provided investment advice in the past as (or at) a different entity (so, called "predecessor performance"). The Proposing Release discusses certain ways in which predecessor performance may be presented in a false or misleading manner. However, the Proposing Release does not include a proposal regarding the use of such performance. Instead, the SEC requests comment on, among other things:

- whether the Advertising Rule should include specific provisions to address the presentation of predecessor performance;
- whether the SEC should require that the individual or individuals who currently manage accounts at the advertising adviser have been "primarily responsible" for achieving the predecessor performance results at the prior firm;
- whether the proposed Advertising Rule's principles-based provisions would sufficiently prevent false or misleading presentation of predecessor performance; and
- whether the books and records rule should be amended to address predecessor performance issues.

The language in the Proposing Release also seems to indicate that current SEC staff guidance on predecessor performance continues to be valid, including the Great Lakes Advisors, Inc., SEC Staff No-Action Letter (Apr. 3, 1992) and the Horizon Asset Management, LLC, SEC Staff No-Action Letter (Sept. 13, 1996). The current SEC staff guidance requires continuity of investment personnel and seems to be inconsistent with the Proposals' principles based approach under which disclosure of all material facts could be sufficient to cure an otherwise misleading presentation of a predecessor's performance results.

F. Internal Review and Approval Requirement

The Proposals require advisers to have an Advertisement reviewed and approved in writing by a designated employee before disseminating the Advertisement, except for Advertisements that are: 1) communications that are disseminated only to a single person or household or to a single investor in a pooled investment vehicle; or 2) live oral communications that are broadcast on radio, television, the Internet or any other similar medium. Although many advisers currently have policies and procedures that require the review or approval of an Advertisement

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[3] Net performance for purposes of the proposed Advertising Rule means

> the performance results of a portfolio after the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant portfolio, including, if applicable, advisory fees, advisory fees paid to underlying investment vehicles, and payments by the investment adviser for which the client or investor reimburses the investment adviser.

before the Advertisement is used, this requirement could impose significant new burdens on advisers that currently outsource the review of marketing material to compliance consultants or attorneys. The Proposals may require that only internal employees, and not outside third-parties (e.g., outside lawyer and consultants), approve the Advertisement.

Cash Solicitation Rule Proposals

The Proposals would generally expand the scope of coverage of the Cash Solicitation Rule,[4] while at the same time modifying certain compliance obligations under the rule and creating two new exemptions.

A. Expanded Scope of Cash Solicitation Rule

Under the Proposals, the Cash Solicitation Rule would be expanded to 1) extend the "solicitor" definition to cover persons who solicit private fund investors for an investment adviser; 2) apply the rule to both cash and non-cash compensation for solicitation activities; and 3) increase the list of disqualifications from acting as a solicitor under the rule.

1. Private Fund Solicitors

Currently, the Cash Solicitation Rule defines a "solicitor" as "any person who, directly or indirectly, solicits any client for, or refers any client to, an investment adviser." However, the Proposals would expand this definition to include solicitation or referral of existing and prospective private fund investors,[5] which could in certain circumstances include persons providing compensated endorsements or testimonials under the proposed revisions to the Advertising Rule. This would mark a reversal of the SEC staff's previously expressed view that the Cash Solicitation Rule does not apply to payments made solely for the solicitation of private fund investors, because such investors are not "clients" of the adviser.[6]

Given that the placement of interests in a private fund constitutes a sale of securities, as noted in the Proposals, many persons who are engaged in the solicitation of private fund investors are already subject to broker-dealer registration requirements, absent an exemption from such registration. The Proposals note the availability of these potential exemptions, but do not otherwise explain why the existing regulatory scheme governing sales of securities is insufficient to serve the client protection aims of the Cash Solicitation Rule.

2. Non-Cash Compensation

The Proposals also would revise the text of the Cash Solicitation Rule, which currently applies to "cash fee[s]" paid to solicitors, to include other forms of non-cash "compensation" that a solicitor might receive. Non-cash compensation can come in various forms, including directing brokerage business to, or recommending that clients invest in proprietary products of, a referring broker-dealer; providing free or discounted advisory services to a solicitor; and rewarding referrals with gift cards, entertainment and other non-cash "prizes," among others. Because these and other types of non-cash compensation may give rise to the same conflicts of interest as cash compensation, the Proposals conclude that clients and investors should receive the same type of disclosure for non-cash compensation arrangements that they currently receive for cash fees.

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[4] The Proposals also indicate that the SEC will no longer take the position that a solicitor who engages in solicitation consistent with the Cash Solicitation Rule will be deemed an associated person of the investment adviser on whose behalf s/he is soliciting and, therefore, not subject to individual registration requirements under the Advisers Act (solely in respect of such solicitation activities). As a result, solicitors would need to reevaluate whether their activities would bring them within the definition of an "investment adviser" under the Advisers Act and, if so, whether they are subject to registration with the SEC. Today, solicitors typically need to conduct a similar analysis at the state law level.

[5] "Private funds" are those funds that would be investment companies under the Investment Company Act, but for Sections 3(c)(1) or 3(c)(7) of that Act. Under the Proposals, the Cash Solicitation Rule would still not apply to the solicitation of existing and prospective investors in registered investment companies or business development companies, although the Proposals request comment on whether the Cash Solicitation Rule should be extended to cover such solicitations and/or solicitation of investors in other types of pooled investment vehicles.

[6] *See* Mayer Brown LLP, SEC Staff No-Action Letter (Jul. 28, 2008).

3. Disqualifications

Two modifications are being proposed to the Cash Solicitation Rule's existing disqualification provisions: 1) expanding the list of disqualifying events that would render a person an "ineligible solicitor" under the Cash Solicitation Rule; and 2) creating a "reasonable care" standard for advisers assessing a solicitor's disqualification status (in lieu of the absolute bar that currently appears in the rule). At present, the only disqualifications referenced in the Cash Solicitation Rule are a subset of those that appear in the disqualification provisions of Sections 203(e) and (f) of the Advisers Act. Under the Proposals, however, the list of disqualifications would be expanded to include specified "disqualifying Commission actions" (generally including SEC bars or findings that the person violated scienter-based antifraud provisions of the federal securities laws or Section 5 of the Securities Act) and "disqualifying events" (which would include the disqualifications currently included in the Cash Solicitation Rule, as well as the entry of certain orders by other federal and state regulators and self-regulatory organizations).

Under the Proposals, persons who are subject to a disqualifying Commission action at the time of the solicitation, and/or who are subject to a disqualifying event, are "ineligible solicitors" (as are persons associated in certain capacities with firms that are ineligible solicitors), and an investment adviser would be prohibited from paying compensation to a person whom the adviser "knows, or, in the exercise of reasonable care, should have known" is an ineligible solicitor. However, the Proposals also would create a conditional carve-out for solicitors who are subject to disqualifications with respect to which the SEC has issued a waiver under the Investment Company Act or an opinion that an otherwise-disqualifying Commission action should not give rise to a disqualification. The Proposals do not prescribe specific procedures or practices for advisers to satisfy the "reasonable care" standard, but discuss the potential use of "questionnaires or certifications, . . . contractual representations, covenants and undertakings," and note that the frequency of such factual inquiries may vary based on the relative risk of using a disqualified solicitor, the cost and difficulty associated with the inquiry, and the efficacy of existing screening and compliance mechanisms.

B. Modifications to Disclosure Requirements

The Proposals also would make certain changes to the disclosure requirements under the Cash Solicitation Rule. Consistent with the current rule, advisers would still be required to enter into a written solicitation agreement with compensated solicitors, containing certain undertakings on the part of the solicitor. However, the Proposals would eliminate the rule's existing requirement that the written agreement include specific undertakings that the solicitor will deliver the adviser's Form ADV Part 2A to solicited clients and perform its services consistent with the adviser's instructions.

The Proposals also would retain the existing requirement that solicitors deliver to the persons they solicit a written disclosure statement, containing specified information about the solicitor and the terms of its relationship with the adviser. In addition to the information currently required in this disclosure statement, the Proposals would add an obligation to disclose any material conflicts of interest on the part of the solicitor arising from the solicitation relationships — for example, if the adviser agrees to refer or direct business to the solicitor or its affiliates in exchange for its solicitation services. In contrast to the existing rule, the Proposals would eliminate the requirement that advisers receive a signed and dated acknowledgment from each solicited client that the client has received the solicitor's disclosure statement. Advisers would still be obligated to have a reasonable basis for believing that the solicitor has complied with its obligations under the solicitation agreement, including the disclosure statement delivery requirement.

C. New Exemptions

Finally, the Proposals would create two new exemptions under the Cash Solicitation Rule. First, under the Proposals, the Cash Solicitation Rule would not apply to solicitors who are entitled to receive $100 or less (or its equivalent, in the case of non-cash compensation) in compensation from an adviser for solicitation activities

over the preceding 12 months. In part, the SEC proposed this exemption because it believes that such "*de minimis*" solicitations would typically constitute testimonials and endorsements for which the compensation would otherwise need to be disclosed under the proposed revisions to the Advertising Rule. The Proposals request comment on the $100 threshold, which is clearly too low to support more than extremely limited, incidental solicitation and referral activity. Second, the Proposals would create an exemption for payments to solicitors where the adviser has a reasonable basis for believing that the solicitor is part of a nonprofit program and is only recouping its costs reasonably incurred in operating that program, subject to certain conditions.

Revisions to Books and Records Requirements and Form ADV

The Proposals also include a number of proposed changes to the Advisers Act books and records rules and Form ADV Part 1A. The proposed amendments to the books and record rules would require that a number of new records be maintained based on the proposed changes to the Advertising Rule and the Cash Solicitation Rule including, among other things, keeping copies of all written approvals of Advertisements and third-party questionnaires and surveys that are used to create third-party ratings for Advertisements. In addition, Item 5 of Form ADV Part 1A is proposed to be amended to require an adviser to report on several of its advertising practices.

Compliance Date

Compliance with the Proposals would not be required until one year after their effective date in order to give investment advisers time to transition to the new requirements. During that interim one-year period, advisers could continue to rely on the existing rules.

Review of Existing No-Action Letters

The Proposing Release lists the many no-action letters issued by the SEC staff in the past on the Advertising and Cash Solicitation Rules, and states that the Division of Investment Management is reviewing these letters to determine if any of them should be withdrawn if the Proposals are adopted.

Conclusion

In general, the Proposals are a welcome modernization of decades old rules and interpretations. However, as noted above, certain aspects of the Proposals raise concerns, such as:

- the elimination of the requirement that a communication be to "more than one person" to be deemed an Advertisement will cause many one-on-one written communications to be deemed Advertisements;
- private fund offering documents could be deemed Advertisements;
- the current exclusion from the definition of Advertisement found in the ICA Letter with respect to responses to unsolicited requests for information would no longer apply to communications with retail investors;
- the SEC's position on portability of performance in the Proposing Release appears to be inconsistent with the Proposals' principles based approach; and
- the internal review and approval requirements for Advertisements may eliminate the ability of investment advisers to fully outsource the review of marketing materials to third parties.

Investment advisers and other industry participants may wish to consider submitting to the SEC comments on these and/or other relevant issues to try to prevent or mitigate their negative consequences. As noted above, the comment period for the Proposals is open until February 10, 2020.

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Contact your Katten attorney or any of the following if you have any questions or would like assistance with submitting a comment letter on the Proposals

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