



**NEW YORK  
CITY BAR**

**COMMITTEE ON  
COMPLIANCE**

**PATRICK T. CAMPBELL**  
**CHAIR**  
45 ROCKEFELLER PLAZA  
NEW YORK, NY 10111  
PCAMPBELL@BAKERLAW.COM

**ADAM FELSENTHAL**  
**SECRETARY**  
165 MASON STREET, 3RD FLOOR  
GREENWICH, CT 06830  
AFELSENTHAL@GPPFUNDS.COM

**COMMITTEE ON PRIVATE  
INVESTMENT FUNDS**

**REBECCA SILBERSTEIN**  
**CHAIR**  
919 THIRD AVENUE  
NEW YORK, NY 10022  
RFSILBERSTEIN@DEBEVOISE.COM

**JENNIFER GRAFF**  
**SECRETARY**  
919 THIRD AVENUE  
NEW YORK, NY 10022  
JGRAFF@DEBEVOISE.COM

**COMMITTEE ON INVESTMENT  
MANAGEMENT REGULATION**

**BARRY P. BARBASH**  
**CHAIR**  
787 SEVENTH AVENUE  
NEW YORK, NY 10019-6099  
BBARBASH@WILLKIE.COM

**JUSTIN L. BROWDER**  
**SECRETARY**  
1875 K STREET, N.W.  
WASHINGTON, DC 20006-1238  
JBROWDER@WILLKIE.COM

February 10, 2020

Ms. Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street N.E.  
Washington, D.C. 20549-1090

**Re: Investment Adviser Advertisements; Compensation for Solicitations (Investment Adviser Act Release No. 5407 (November 4, 2019)): File No. S7-21-19**

Dear Ms. Countryman:

The Committee on Compliance, the Committee on Investment Management Regulation, and the Committee on Private Investment Funds of the Bar Association of the City of New York (collectively, the “Committees”) submit this letter in response to the request of the Securities and Exchange Commission (the “Commission”) for comment in response to Investment Adviser Act Release No. 5407 (November 4, 2019) in which the Commission proposed amendments to its investment adviser advertising and cash solicitation fee rules under the Investment Advisers Act of 1940 (the “Advisers Act”) and related amendments to its investment adviser books and records rule and registration form (collectively, the “Proposals” or the “Proposing Release”). The Committees are composed of lawyers with diverse perspectives on investment management issues, including attorneys from law firms, counsel and compliance professionals to financial services firms, investment company complexes and investment advisers.

**I. SUMMARY**

The Proposals seek to amend Rule 206(4)-1, which governs investment adviser advertisements (the “Advertising Rule”); Rule 206(4)-3, which governs investment adviser’s

cash solicitation fee arrangements (the “Solicitation Rule”); Rule 204-2, which sets out investment adviser’s books and records obligations (the “Books and Records Rule”); and Form ADV, the investment adviser registration and disclosure form. The proposed amendments would be the first substantive amendments to the Advertising Rule and the Solicitation Rule since each was adopted in 1961 and 1979, respectively. The Commission states in the press release for the Proposals that they are intended to address changes in technology, the expectations of investors seeking advisory services, and the evolution of industry practices. The Committees provide comments on certain aspects of the Proposals, as detailed below.

The Committees appreciate the opportunity to comment on the Commission’s Proposals. The Committees support the Commission’s objective to address market developments and to improve the quality of information available to investors, enabling them to make more informed choices.<sup>1</sup>

## II. PROPOSALS TO THE ADVERTISING RULE

The Proposals would replace the current Advertising Rule’s broad prohibitions on certain content, such as past-specific recommendations, with a combination of new principle-based provisions and more tailored requirements. The Proposals set out several structural and procedural changes such as a new, broader definition of “advertisement,” the extension of investment advisers’ obligations under the Advertising Rule to communications with investors in pooled investment vehicles, and a new requirement for advertisements to be reviewed and approved by a designated employee of an investment adviser before dissemination. In addition, the Proposals include changes relating to presentation of performance and hypothetical performance.

### a. Definition of “Advertisement”

The Committees agree that the definition of an “advertisement” should be updated to reflect market and technological developments that have occurred over the past five decades. We believe, however, that the new definition of “advertisement” in the Proposals to the Advertising Rule (the “Proposed Advertising Rule”) is overly broad and could lead to significant and unnecessary confusion by legal and compliance professionals who are responsible for providing guidance on advertisements to investment advisers.

The current definition of “advertisement” in the Advertising Rule is relatively broad, and includes:

*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*

---

<sup>1</sup> See Press Release, “SEC Proposes to Modernize the Advertising and Cash Solicitation Rules for Investment Advisers” (Nov. 4, 2019) <https://www.sec.gov/news/press-release/2019-230>. (All links were last visited on February 10, 2020).

*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.*<sup>2</sup>

While broad, the current definition of “advertisement” is expressly limited to (i) a written communication that is “addressed to more than one person,” and (ii) which offers materials or investment advisory services that relate to “securities.” Notably, both exclusions are eliminated in the Proposed Advertising Rule. The Proposed Advertising Rule would 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.*

**b. The Proposed New Definition Should Not Eliminate the Exception for Communications to One Person**

An important cornerstone of the current definition of “advertisement” is that it is a written communication *addressed to more than one person*. That is, any written communication addressed to only one person is expressly *not* an advertisement. In this regard, we believe that the new definition under the Proposed Advertising Rule should remain consistent with the current definition and retain this exclusion.

As noted in the Proposals, when the Advertising Rule was first adopted in 1961, the Commission intentionally excluded communications to a single person out of concern that a broad definition could have a chilling effect on communications. The Commission had initially considered a very broad definition but rejected this approach in the final version, noting that the definition was not intended to include “a personal conversation with a client or prospective client, or a personal letter sent to only one person.”<sup>3</sup> In the experience of the members of the Committees, the exclusion for communications addressed to one person has become since the 1960s a bedrock of current industry practice. Investment advisers have come to rely on this provision and have developed long-standing practices and procedures around one-on-one meetings and/or communications. The Commission’s discarding this element of the Advertising Rule in the Committees’ view would be highly disruptive to investment adviser compliance. It would also create a significant administrative burden<sup>4</sup> for legal and compliance personnel. In particular, investment advisers would need to comply with the newly-expanded Books and

---

<sup>2</sup> 17 CFR § 275.206(4)-1(b).

<sup>3</sup> See Prohibited Advertisements, Release No. IA-119 (Aug. 8, 1961) <https://www.sec.gov/news/digest/1961/dig080861.pdf>.

<sup>4</sup> This letter frequently cites to the increased administrative burden of the Proposed Advertising Rule, which may conflict with Section 202(c) of the Advisers Act that requires the Commission to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation.

Records Rule under the Proposals, which would require them to maintain a copy of each advertisement disseminated directly or indirectly to one or more persons.<sup>5</sup>

We submit that such an expansion of, and fundamental change to, the definition of an “advertisement” is unnecessary as all communications by investment advisers are already subject to the anti-fraud provisions of Section 206 of the Advisers Act as well as other anti-fraud provisions of the federal securities laws, regardless of whether such communication is considered an advertisement.

**c. The Proposed New Definition Should Not Include Communications That Merely “Promote” the Investment Adviser’s Services**

Another cornerstone of the current definition under the Advertising Rule is that to be an “advertisement,” a communication must contain an “offer” relating to securities – either an offer of certain materials relating to the purchase or sale of securities (*i.e.*, a report or chart), or an offer of the investment adviser’s investment management services (also with regard to securities). We read the proposed definition as expanding the definition significantly by eliminating this limitation and including any communication that merely “promotes” the investment adviser’s investment management services, while at the same time eliminating the requirement that materials or the offer of services being disseminated relate to securities.

Including materials that merely “promote” investment management services in the definition of an advertisement would, we believe, likely result in confusion among compliance professionals and investment management lawyers as to what kinds of communications qualify as advertisements. Investment advisers frequently promote their firm for purposes wholly unrelated to specific securities recommendations and/or the solicitation or retention of clients. For example, investment advisers to private equity funds frequently seek to promote their firm to entrepreneurs and intermediaries to solicit deal flow and investment opportunities. Investment advisers may also seek to promote their firms to attract new employees or improve their name recognition. Under the Advertising Rule, it is understood that not all communications are advertisements. However, under the Proposed Advertising Rule, these sorts of communications could be interpreted to be directly or indirectly “promoting” the investment adviser’s investment management services within the meaning of the new definition of advertisement. Indeed, virtually any communication could, in our view, be deemed to indirectly “promote” an investment adviser and its services. The Committees believe that the Commission should retain the limitation that a communication must contain an “offer” relating to securities.

**d. The Proposed Advertising Rule Should Not Require Written Pre-Approval of Advertisements by a Designated Employee, as the Administrative Burdens and Costs on Investment Advisers and Chief Compliance Officers are Significant, and Outweigh the Benefits**

The Proposed Advertising Rule would require any advertisement to be reviewed and approved in writing by a designated employee of the investment adviser before such

---

<sup>5</sup> See proposed Rule 204-2(11)(i) within the Proposing Release.

advertisement could directly or indirectly be disseminated.<sup>6</sup> We acknowledge that the Proposed Advertising Rule has limited exceptions for (i) communications disseminated only to a single person, household, or investor in a pooled investment vehicle, and (ii) live oral communications broadcast on radio, television, the internet, but we are concerned about the additional compliance, administrative, operational and recordkeeping burdens, as well as costs this new requirement would create.

The Commission states in the Proposing Release that the designated employee required to review and approve advertisements “should be competent and knowledgeable regarding the proposed rule’s requirements.”<sup>7</sup> We believe, given the current structures in place under the Advisers Act, as discussed below, coupled with expertise contemplated by the Commission, this responsibility will in all likelihood fall upon the investment adviser’s chief compliance officer (“CCO”), who is already responsible for administering the investment adviser’s compliance program required by Rule 206(4)-7 under the Advisers Act, among other things.<sup>8</sup> It is important to remember that CCOs perform their responsibilities under the specter of personal liability. It is against this backdrop that one must examine the Proposed Advertising Rule’s new requirements.

The Commission’s stated intention in proposing that all advertisements be reviewed and approved in writing before being disseminated is that it “may reduce the likelihood of advisers violating the proposed rule,” noting that it is important for investment advisers to “have a process in place designed to promote compliance with...the requirements of the proposed rule.”<sup>9</sup> We believe the written pre-approval of advertisements is unnecessary for several reasons, including that all investment advisers are already subject to the anti-fraud provisions of Section 206 of the Advisers Act and all communications are already subject to SEC examination and enforcement. Furthermore, investment advisers are required by Rule 206(4)-7 to “adopt and implement written policies and procedures reasonably designed to prevent violations of the [Advisers Act]...and designate a [CCO] to administer [its] policies and procedures.”<sup>10</sup> As the Commission noted in the adopting release for Rule 206(4)-7, the “rule requires advisers to consider their fiduciary and regulatory obligations under the Advisers Act” when formalizing its policies and procedures.<sup>11</sup>

---

<sup>6</sup> See proposed Rule 204-1(d) within the Proposing Release.

<sup>7</sup> Proposing Release, p. 192.

<sup>8</sup> CCOs are also responsible for annual reporting under Form ADV, enforcement of the investment adviser’s code of ethics, Forms PF, 13H, 13F, soon Form CRS, and tracking regulatory developments. In addition, CCOs must also contend with a growing array of state-level rules and regulations focused largely (although not exclusively) on consumer privacy and data protection. States such as California, Massachusetts, Nevada and many others have adopted stringent yet different regulatory regimes, creating a complicated patchwork of rapidly-changing rules and regulations that a CCO must navigate. CCOs are also responsible for compliance with an increasing number of broadly applicable non-U.S. laws, including but not limited to the European Union’s General Data Protection Regulation and, for alternative investment firms that at all market in the European Union, the Alternative Investment Fund Managers Directive. CCOs of investment advisers that manage commodities or futures are also responsible for overseeing compliance with Commodity Futures Trading Commission rules and regulations in addition to National Futures Association requirements.

<sup>9</sup> Proposing Release, p. 192.

<sup>10</sup> 17 CFR § 275.206(4)-7.

<sup>11</sup> Compliance Programs of Investment Companies and Investment Advisers, Release No. IA-2204 (February 5, 2004) (<https://www.sec.gov/rules/final/ia-2204.htm>).

Given the current obligations imposed on investment advisers under the Advisers Act, we believe the proposed amendments are unnecessary and any benefit in terms of investor protection will be marginal, and outweighed by the lack of clarity and ambiguity that a new regulatory regime for advertisements will impose on an investment adviser in light of the additional operational, administrative and compliance burdens and costs placed on investment advisers.

Further, the Advertising Rule is a complex, highly nuanced, fact intensive area of the law. It is our experience and belief that many CCOs rely heavily on in-house and outside counsel to guide them through advertising rules and requirements, including in connection with performance advertising, disclaimers, portability of performance and other aspects of the Advertising Rule. We believe this will continue to hold true if some, all, or none of the changes in the Proposed Advertising Rule are implemented. As such, we believe that requiring written approval of each advertisement would result in investment advisers calling upon their outside law firms more frequently to get their sign-off on each advertisement before it is distributed. We are particularly concerned because, as described below, if the Proposed Advertising Rule is adopted we believe many investment advisers would need to draft two sets of advertisements – one for Retail Persons and another for Non-Retail Persons. This will increase the operational and administrative burdens on firms, increase costs, and generate a large volume of memoranda from counsel, emails and other correspondence, all with minimal corresponding increase in investor protections.

**e. A “Qualified Purchaser” Standard for Non-Retail Advertisement**

The Proposed Advertising Rule would create two categories of advertisements, each subject to differing levels of regulation. “Retail Advertisements” are defined as any advertisement other than a Non-Retail Advertisement.<sup>12</sup> Retail Advertisements are subject to content restrictions designed to empower Retail Persons<sup>13</sup> with information allowing them “to understand better the presentation of performance results and the limitations inherent in such presentations.”<sup>14</sup> “Retail Persons” (*i.e.*, those who are deemed to need the protections of the Advertising Rule’s content restrictions) is defined as any person other than a (i) a “qualified purchaser” or (ii) a “knowledgeable employee,” both as defined under the Investment Company Act of 1940 (“Investment Company Act”) and the rules promulgated thereunder. Under the Proposed Advertising Rule, Retail Advertisements would face restrictions in some respects comparable to those in existence today (*i.e.*, net investment performance results must be included with equal prominence alongside gross performance results), but in other respects more stringent than are in effect today (*i.e.*, significant restrictions on the use of hypothetical performance).

33

---

<sup>12</sup> See proposed Rule 206(4)-1(e)(13) within the Proposing Release (“Retail advertisement means any advertisement other than a non-retail advertisement.”).

<sup>13</sup> See, proposed Rule 206(4)-1(e)(14) within the Proposing Release (“Retail person means any person other than a non-retail person.”).

<sup>14</sup> Proposing Release, p. 108.

On the other hand, under the Proposed Advertising Rule, Non-Retail Advertisements<sup>15</sup> are largely free of such requirements. That is, investment advisers could have wide latitude to present information in Non-Retail Advertisements as they see fit (subject to Section 206(4) of the Advisers Act) including, for example, using gross performance results without accompanying net performance results. A Non-Retail Advertisement is an advertisement for which the adviser “has adopted and implemented policies and procedures reasonably designed to ensure that the advertisement is disseminated solely to non-retail persons.”<sup>16</sup>

Under the Proposed Advertising Rule, the only way that it appears that an investment adviser could appropriately operate outside the regulatory regime for Retail Advertisements would be to adopt policies and procedures designed to ensure such communications are disseminated only to qualified purchasers or knowledgeable employees. As described below, we believe that there are potential operational, administrative, and compliance burdens associated with having two standards for advertisements as well as a significant potential for errors. That said, while we are not opposed to differing categories of advertisements, we believe that the Investment Company Act’s “qualified purchaser” standard is not the appropriate threshold for a Non-Retail Advertisement. We believe this standard is too high, and inconsistent with current standards contained in the Advisers Act. We also believe that the Proposed Advertising Rule would require investment advisers to adopt additional policies and procedures – creating a burden that would not be outweighed by any significant benefit to investors.

**f. The Proposed Advertising Rule Should Provide An “Accredited Investor” or “Qualified Client” Standard for Non-Retail Advertisement**

If the Commission wishes to have two different categories of advertisements with differing standards of regulation, we agree that it would be appropriate to use existing statutory and regulatory definitions to the extent possible. We believe the Commission should not create a new definition solely for use in distinguishing between a Retail Advertisement and Non-Retail Advertisement. For the reasons described below, we believe either the “accredited investor” standard under the Securities Act of 1933 (“Securities Act”) or the Advisers Act’s “qualified client” standard would be a more appropriate threshold than the “qualified purchaser” standard described in the Proposed Advertising Rule.

Under the Securities Act, “accredited investors” are deemed to have sufficient knowledge and financial sophistication to make them “capable of evaluating the merits and risks” of a prospective investment without the specific protections afforded by the Securities Act with respect to public offerings of securities. An “accredited investor” generally includes entities with

---

<sup>15</sup> See, proposed Rule 206(4)-1(e)(7) within the Proposing Release (“Non-retail advertisement means any advertisement for which an investment adviser has adopted and implemented policies and procedures reasonably designed to ensure that the advertisement is disseminated solely to non-retail persons.”).

<sup>16</sup> See proposed Rule 206(4)-1(e)(8) within the Proposing Release (Non-retail person means a (i) “qualified purchaser,” as defined in section 2(a)(51) of the Investment Company Act and taking into account rule 2a51-1 under the Investment Company Act; and (ii) “knowledgeable employee,” as defined in rule 3c-5 under the Investment Company Act of 1940.).

at least \$5 million in total assets, or natural persons with at least \$1 million in net worth or income in excess of \$200,000 (or \$300,000 jointly with a spouse) in each of the two most recent years with a reasonable expectation of reaching the same income level in the current year.<sup>17</sup> Last year, the Commission proposed amendments intended to “update and improve” the definition of an accredited investor to include, among other categories, persons with certain professional certifications or designations.<sup>18</sup>

In the Committees’ experience, advertisements are frequently disseminated in connection with an offering of securities governed by the Securities Act. Many investment advisers to private funds neither solicit nor accept non-accredited investors, and adopt policies and procedures designed to determine whether a potential new investor meets the “accredited investor” threshold. In this regard, we note that the Commission has established principles-based guidelines enabling an issuer to conclude it has taken reasonable steps to verify an issuer’s status as an accredited investor, as well as published other guidance relating to the “accredited investor” threshold. Because dissemination of an advertisement is closely related to an offering of securities, the Securities Act’s “accredited investor” would seem to represent an appropriate threshold to distinguish a Retail Advertisement from a Non-Retail Advertisement.

If the Commission is concerned that an accredited investor standard would be too low, the Advisers Act already has a higher standard for determining client sophistication, the “qualified client” standard under Rule 205-3. The definition of “qualified client” generally includes entities and natural persons having at least \$1 million under the management of an investment adviser, or a net worth (jointly with a spouse in the case of a natural person) of more than \$2.1 million. Qualified clients may enter into an advisory contract with a registered investment adviser that provides for compensation based on a share of capital gains on, or capital appreciation of, the funds of a client (also known as performance compensation or performance-based fees). Because many registered investment advisers seek a performance fee based on appreciation of client funds, it is common for advisers to have implemented policies and procedures designed to determine whether a potential new client meets the “qualified client” threshold. Moreover, because both the Advertising Rule and the “qualified client” definition fall under the Advisers Act, we submit that a “qualified client” standard is more appropriate than the “qualified purchaser” standard. When Rule 205-3 was adopted in 1985, the Commission stated that the qualified client standard “would limit the availability of the exemption to clients who are financially experienced and able to bear the risks of performance fee arrangements.”<sup>19</sup> The Commission presumed that these clients, because of their wealth, financial knowledge, and experience, are less dependent on the protections provided by the Advisers Act’s restrictions on performance fee arrangements.<sup>20</sup>

---

<sup>17</sup> 17 CFR § 230.501(a).

<sup>18</sup> See SEC Proposed Rule “Amending the “Accredited Investor” Definition,” Release Nos. 33-10734; 34-87784; File No. S7-25-19.

<sup>19</sup> Exemption To Allow Registered Investment Advisers to Charge Fees Based Upon a Share of Capital Gains Upon or Capital Appreciation of a Client’s Account, Release No. IA-996 (Nov. 14, 1985) at Sections I.C and II.B.

<sup>20</sup> *Id.*

**g. A “Qualified Purchaser” Standard is Too High a Threshold for Non-Retail Advertisement**

The “qualified purchaser” standard is notably higher than the prior two standards – generally limited to entities with at least \$25 million in investments<sup>21</sup> and natural persons with \$5 million in investments.<sup>22</sup> The Commission’s primary rationale for adopting the qualified purchaser standard is the Commission’s belief that (i) their “access to analytical and other resources generally provides them with the opportunity to ask questions of, and receive information from, the appropriate advisory personnel,” and (ii) they “are regularly in a position to negotiate the terms of their arrangements with investment advisers.” The Commission did not elaborate on the “specialized and extensive analytical and other resources” that qualified purchasers have. We believe that both accredited investors and certainly qualified clients have access to resources comparable to those accessible by qualified purchasers. In particular, accredited investors and qualified clients have access to paid consultants and investment advisers fully capable of considering and analyzing performance data contained in a Non-Retail Advertisement, even if the information provided is complex and nuanced.

Further, we believe the negotiating leverage a potential client possesses is only one fact in assessing whether the recipient of a communication from an investment adviser should be deemed sophisticated enough (or have access to sufficient resources) to decipher performance data without the protections afforded to recipients of other advertisements under the Advertising Rule. We believe that both accredited investors and qualified clients meet this standard, and that either of these standards could be implemented with significantly less disruption than a qualified purchaser standard.

**h. Two Standards of Advertisements**

Although we understand the policy rationale behind two different standards of advertisements, we believe that the two standards set out in the Proposed Advertising Rule will create a significant administrative burden on investment advisers, many of which will, as a practical matter, need in response to the two standards to have two different sets of advertisements. We are also concerned about how the dual standard would be implemented, and what consequences would be associated with a Non-Retail Advertisement being inadvertently disseminated to a Retail Person.

We believe that an investment adviser with both Retail Person and Non-Retail Person clients (for example, a fund manager offering interests in parallel Section 3(c)(1) and Section 3(c)(7) funds) would subject all communications to the higher Retail Person standard. For example, advisers to private funds frequently do not know whether a prospective investor is a qualified client or qualified purchaser until after the investor submits a qualification statement (whether separately or as part of a subscription agreement). Or an investment adviser may begin advertising to Non-Retail Persons and then, for any number of reasons, switch to pursuing Retail

---

<sup>21</sup> “Investments” here is as defined by Rule 2a51-1 under the Investment Company Act

<sup>22</sup> “Knowledgeable employees,” the second category of persons that are Non-Retail Persons, are limited to employees of the adviser or affiliates of the adviser, and as such will not be discussed at length in this letter.

Person investors. This would require retooling the marketing materials to a higher standard at a cost of time and resources.

These issues will increase the compliance burden on the investment adviser and the CCO, increase the administrative and operational burdens and will result in increased legal costs. This seems in direct contradiction to the Commission's current efforts to harmonize private offerings of securities. We also believe that requiring an investment adviser to adopt policies and procedures reasonably designed to ensure a Non-Retail Advertisement is disseminated solely to Non-Retail Persons is burdensome, and will prove difficult to implement. Certain clients (particularly institutional clients) will clear the "qualified purchaser" threshold, but it will likely be difficult to ascertain the qualified purchaser status of other clients at the time an advertisement is being disseminated. Moreover, just because a client or investor in a pooled investment vehicle was a qualified purchaser in the past does not necessarily mean they are still a qualified purchaser at the time the advertisement is being disseminated.

### **III. GENERAL PROHIBITIONS**

Proposed Rule 206(4)-1 under the Advisers Act contains general prohibitions of certain advertising practices described in the proposal as "a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts." The Commission stated that it developed the prohibited practices from its experience with the current Advertising Rule, its review and consideration of investment adviser advertisements, FINRA rule 2210, rule 156 under the Securities Act, and its experience with private fund advertising practices.

This new set of proposed general prohibitions will, we believe, make the advertising rules more difficult to follow as they appear to be duplicative of existing anti-fraud provisions of the Advisers Act. Moreover, these new prohibitions are broad and would seem to be subject to varying interpretations.

Proposed Advertising Rule 206(4)-1 would replace the current Advertising Rule's five prohibitions with a list of seven, broad prohibitions with respect to: (1) untrue statements and omissions of material facts necessary to make the statement made, in light of the circumstances under which it was made, not misleading; (2) unsubstantiated material claims or statements; (3) untrue or misleading implications or causing an untrue or misleading inference to be drawn about a material fact relating to the investment adviser; (4) advertisements discussing or implying any potential benefit without also disclosing associated material risks or limitations; (5) referring to specific investment advice in a manner that is not fair and balanced; (6) including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced; and (7) advertisements that are otherwise materially misleading.

Notably, the prohibitions in the Proposed Advertising Rule are, to a large extent, already covered by the existing anti-fraud provisions of the Advisers Act. Section 206 of the Advisers Act has been "[a] principal tool of the Commission in establishing standards of conduct for

persons meeting the Advisers Act's definition of investment adviser."<sup>23</sup> Apart from an amendment in 1997,<sup>24</sup> Rule 206(4)-1 has not been changed since its adoption in 1961. In the intervening 59 years, the prohibitions in Rule 206(4)-1 have become industry standards and shaped client expectations.

For example, Proposed Advertising Rule 206(4)-1(a)(1) prohibits omitting "a material fact necessary in order to make the statement made, in the light of the circumstances under which it was made, not misleading." This kind of prohibition seems duplicative when assessed in the context of the existing anti-fraud provisions of the Advisers Act contained in Section 206 and the rules thereunder. Sections 206(1) and (2) of the Advisers Act prohibit investment advisers from "employ[ing] any device, scheme, or artifice to defraud any client or prospective client" and "engag[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." In addition, Section 206(4) of the Advisers Act, under which the Advertising Rule and several other rules have been promulgated, prohibits investment advisers from "engag[ing] in any act, practice, or course of business which is fraudulent, deceptive, or manipulative." Moreover, we believe the Commission, by adding "in the light of the circumstances under which it was made," would subject investment advisers' determinations to be second guessed with the benefit of hindsight.

The portions of the Proposed Advertising Rule that are not covered by Section 206 of the Advisers Act and Rule 206(4)-1 would, we believe, expand the regulatory burden on investment advisers without a corresponding benefit to investors. For example, section (a)(2) of the Proposed Advertising Rule requires material claims or statements to be substantiated. It is unclear how the materiality standard would apply to the numerous claims and statements made by investment advisers when advertising to prospective clients. How, for example, does an investment adviser substantiate its views on the market, testimonials and endorsements?<sup>25</sup> These expressions of opinion are uniquely difficult to substantiate. The extent of substantiation required to meet the Proposed Advertising Rule is also unclear. This provision could apply to an investment adviser's market views or economic outlook, such as how the adviser expects the markets to react, and would be burdensome and difficult for the adviser to substantiate if those views are not realized.

Many SEC staff no-action letters over several decades have become important guideposts for investment advisers with respect to preparing and distributing advertisements. This effective guidance related to Rule 206(4)-1 would be lost if, per the Proposed Advertising Rule, many SEC staff no-action letters issued with respect to Rule 206(4)-1 are withdrawn. For example, Clover Capital Mgmt., Inc. (October 28, 1986), Stalker Advisory Services (January 18, 1994), F. Eberstadt & Co., Inc. (July 2, 1978), TCW Group (November 7, 2008), and Franklin Management, Inc. (December 10, 1998), have in the Committees' experience established

---

<sup>23</sup> Barry P. Barbash and Jai Massari, *The Investment Advisers Act of 1940: Regulation By Accretion*, 39 Rutgers L.J. 626, 630 (2008).

<sup>24</sup> See Rules Implementing Amendments to the Investment Advisers Act of 1940, Release No. IA-1633 (May 15, 1997).

<sup>25</sup> See proposed Rule 206(4)-1(b)(1) within the Proposing Release.

industry standards and shaped client expectations. These letters provide detailed guidance on numerous topics beyond the set of generalized prohibitions in the Proposed Advertising Rule. For example, the Clover Capital Mgmt. Inc. letter provides very detailed rules for using portfolio model results in advertising, most of which are not carried into Proposed Advertising Rule sections (a)(3) [misleading implications] and (a)(6) [fair and balanced performance results]. Losing this guidance will make compliance burdensome and uncertain and potentially confuse clients.

Finally, the Proposed Advertising Rule incorporates specific prohibitions and language from FINRA rule 2210. Proposed sections (a)(5) and (a)(6) take the “fair and balanced” language from FINRA rule 2210, and sections (a)(2) and (a)(4) are taken entirely from FINRA rule 2210. Our concern is that FINRA’s rules regulating broker-dealers were drafted to operate within a different regulatory regime than the Advisers Act. Investment advisers must operate under fiduciary duties imposed under the Advisers Act (and, often, state laws) that are different from those imposed on broker-dealers. Furthermore, FINRA publishes interpretations and guidance with respect to its rules (including rule 2210), which may differ from the Commission’s interpretations and guidance with respect to Rule 206(4)-1 and other provisions of the Advisers Act. If the Proposed Advertising Rule contains provisions explicitly modeled after FINRA rule 2210, interpretive queries would become a recurring issue and ongoing compliance burden for investment advisers (*e.g.*, what is “fair and balanced” in the context of Proposed Advertising Rule 206(4)-1(a)(5) when that term is taken from FINRA rule 2210(d)(1)(A)).

#### **IV. PERFORMANCE PRESENTATIONS**

##### **a. The Proposed Advertising Rule Should Clarify That Targeted Returns, Backtested Returns and Representative (or Model) Returns are Not Hypothetical Performance, and Should be Subject to Different Standards**

The Proposed Advertising Rule defines hypothetical performance as “performance results that were not actually achieved by any portfolio of any client of the investment adviser”; this includes projected returns (which we view as equivalent to hypothetical performance in the typical sense of the term), targeted returns, backtested returns and model returns. The Proposed Advertising Rule would permit the presentation of “hypothetical” performance only under certain conditions – *i.e.*, the investment adviser must: (1) 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 recipient (“Tailoring Policies and Procedures”), (2) provide sufficient information to enable the recipient to understand the criteria used (calculation methodology) and assumptions made in calculating such hypothetical performance, tailored to the recipient (the “Calculation Information”) and (3) provide to Retail Persons (and offer to provide promptly upon request to Non-Retail Persons) sufficient information to enable the recipient to understand the risks and limitations of using hypothetical performance in making investment decisions, tailored to the recipient (the “Risk Information”). We believe that targeted returns, backtested returns and model returns should not be subject to the same requirements as hypothetical returns.

Targeted returns reflect returns that an investment adviser seeks to achieve, and can be determined based on a combination of many considerations, including past performance, but also comparisons to the investment adviser's experience managing other similar products, an investment adviser's expectations about the performance of its investment professionals, a view of market conditions, and an analysis of the available investment pipeline, which collectively inform the investment adviser's "intention", as opposed to "expectation" of returns. On the other hand, hypothetical (*i.e.*, projected) returns represent a mathematical projection of what the expected returns would be, based on various assumptions. The requirement that Tailoring Policies and Procedures be adopted with respect to targeted returns, when the potential investor's financial situation and investment objectives are taken into account, does not seem appropriate, as targets represent the investment adviser's intent in managing the fund or account, which may be unrelated to the composition of the investor base. It also may not be appropriate to provide Calculation Information for targeted returns, as the determination may not be formulaic and may be based on proprietary analyses and the investment adviser's assessment of its business. The risk that this information might provide insights into the investment adviser's business practices and trade secrets may have a chilling effect on its desire to share such information, even if the information would be useful to investors.

Backtested returns are a conditional analysis of prior data and one way of "stress testing" the investment methodology that the investment adviser intends to employ in the future, as opposed to hypothetical "expected" performance. We acknowledge that a basis exists for providing Risk Information and Calculation Information with respect to backtested returns (subject to our general concerns noted below regarding tailoring such information to recipients); however, given that it is constructed after the fact and is not a projection of future performance, Tailoring Policies and Procedures may not be as appropriate. The backtested returns are one way to apply the intended investment methodology, and after providing all of the assumptions and calculations used for backtested returns, it is unclear what "additional analysis and due diligence" would be required for an investor to understand the presentation of backtested performance when it is self-contained and does not imply any expected returns.

Representative performance is a presentation of "model" portfolios managed contemporaneously alongside portfolios managed by the investment adviser for actual clients, which do not reflect decisions made by the investment adviser in managing actual accounts. As noted in the Proposed Release, model performance may present a portfolio constructed without the effect of certain factors, such as the timing of cash flows or client-specific restrictions that may not be relevant to a particular investor. We believe that, as with backtested performance, because model performance does not imply expected returns and is a self-contained presentation that provides calculations and risks, Tailoring Policies and Procedures may not be as appropriate.

**b. The Proposed Advertising Rule Should Not Require Tailoring Policies and Procedures, Calculation Information and Risk Information Tailored to the Recipient**

We believe that Tailoring Policies and Procedures, Calculation Information and Risk Information tailored to the recipient when disseminating "hypothetical" returns places an undue burden on investment advisers to conduct diligence of client resources and capabilities that will

negatively affect both investment advisers and investors, and will make it less likely that an investment adviser will share such information. This burden may be somewhat mitigated when “tailoring” is sufficient if different standards apply to pre-established categories of investors, such as Retail and Non-Retail Persons. However, the rule encourages investment advisers to provide only “sophisticated” investors with enhanced information rights, disadvantaging investors who may seem less sophisticated but who are nonetheless capable of understanding this information. We believe that a better approach would be an emphasis on disclosure, without any limitation on sharing information.

**c. The Proposed Advertising Rule Should Not Require Calculation Information for Projected Performance to Include Probabilities of Future Events**

The Proposed Advertising Rule would require Calculation Information to include any assumptions on which the projected performance rests, including likelihood of future events. While there are implicit assumptions made about the probability of events in performance projections (*i.e.*, that the projection is within some range of reasonableness), we believe it is a better approach to have appropriate disclosures describing the reasons for choosing to show a projection based on particular assumptions. Establishing probabilities for events may not be something that investment advisers undertake in the regular course of constructing projections and, as long as the assumptions are clearly provided, any speculation of likely outcomes may make projections more misleading by implying some “likelihood” when no basis exists for such determination.

**d. The Proposed Advertising Rule Should Not Require Production of a Schedule of Fees and Expenses When Presenting Gross Performance to Non-Retail Persons**

The Proposed Advertising Rule requires that, in connection with any presentation of gross performance in an advertisement disseminated to Non-Retail Persons, the advertisement “provides or offers to provide promptly a schedule of the specific fees and expenses deducted to calculate net performance”. The Committees appreciate and support that the Proposed Advertising Rule would not require a side-by-side comparison of gross performance versus net performance for Non-Retail Persons. However, as acknowledged in the Proposing Release, Non-Retail Persons “have access to analytical and other resources, and therefore the capacity to evaluate gross performance as advertised” and are “regularly in a position to bargain for and obtain additional information when considering performance information in an advertisement and to negotiate the terms of their agreements with investment advisers, including the amount of fees and expenses that they may reasonably expect to incur”. We agree with this assessment, and believe that it does not provide meaningful additional protection to require providing a schedule of fees and expenses to Non-Retail Persons. Showing both gross and net performance in equally prominent ways is currently sufficient to alert a Non-Retail Person that fees and expenses may significantly reduce performance. In addition, determining the information to include in such a schedule presents challenges in many circumstances, in particular when an investment adviser is launching a product within a new strategy (and selecting a relevant subset of investments from a broader portfolio or multiple portfolios) or when the investments being presented were previously part of a proprietary investment program and held on an investment adviser’s balance

sheet (without any third party investors). In these circumstances, any schedule of fees and expenses would be hypothetical by nature and potentially could be misleading. We believe that Non-Retail Persons are in a position to negotiate for appropriately tailored disclosures based on their particular needs in relation to the specific performance presentation.

**e. The Proposed Advertising Rule Should Not Require Prescribed Time Periods for Performance Presentations**

The Proposed Advertising Rule requires that presentations to Retail Persons of performance of a portfolio (or composite of related portfolios) show results for one, five- and -10-year time periods, each presented with equal prominence and ending on the most recent practicable date, unless such portfolio (or composite of related portfolios) were not in existence at such time, and would instead require the presentation of the life of the portfolio to be substituted for such time period. We understand the rationale behind these requirements, but we believe that applying a “one size fits all” approach to performance presentations may create misleading presentations. For example, presentations of the most recent one-year performance of a private equity fund may not be useful if the investment theses for portfolio investments play out over a longer period of time, as they often do. As another example, presentations of older performance for hedge funds with broad investment objectives, when the weighting of different asset classes within the hedge fund’s portfolio have shifted over time, may not be meaningful. We believe that a better approach, from both the perspective of the investment adviser and potential investors, would be for the investment adviser to present performance in a way that it considers the most meaningful, which it is best positioned to do, and provide disclosure on the choice of time periods.

\* \* \*

The Committees appreciate the opportunity to comment on the Proposals. The Committees applaud the comprehensive effort of the Commission and its staff to modernize the rules under the Advisers Act addressing investment adviser advertisements to reflect changes in technology, the expectations of investors seeking advisory services, and the evolution of industry practices. If we can be of any further assistance in this regard, please contact Patrick Campbell at [PCampbell@bakerlaw.com](mailto:PCampbell@bakerlaw.com), Rebecca Silberstein at [rfsilberstein@debevoise.com](mailto:rfsilberstein@debevoise.com), or Barry Barbash at [BBarbash@willkie.com](mailto:BBarbash@willkie.com).

Respectfully,

Patrick T. Campbell  
Chair, Compliance Committee

Rebecca Silberstein  
Chair, Private Investment Funds Committee

Barry P. Barbash  
Chair, Investment Management Regulation Committee

**Drafting Subcommittee:**

Michael Didiuk, Investment Management Regulation Committee

Jennifer Graff, Private Investment Funds Committee

Scott Gluck, Compliance Committee

Nicola Knight, Investment Management Regulation Committee

Christopher Michailoff, Investment Management Regulation Committee

cc:     The Honorable Jay Clayton  
          The Honorable Hester M. Peirce  
          The Honorable Elad L. Roisman  
          The Honorable Allison Herren Lee  
          Dalia Blass, Director, Division of Investment Management, U.S. Securities and Exchange  
          Commission