

**THOMPSON  
HINE**

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**INVESTMENT MANAGEMENT  
UPDATE****Clarification of Cash Solicitation Rule**

In an interpretive letter, the staff of the Securities and Exchange Commission clarified that an investment adviser may make a cash payment to a person solely to compensate that person for soliciting investors to invest in a registered investment company, hedge fund, private equity fund, common trust fund or collective trust fund (each an “investment pool”) managed by the adviser without complying with Rule 206(4)-3 under the Investment Advisers Act of 1940 (the “Advisers Act”).<sup>1</sup> The letter states that to the extent that the new interpretive position is inconsistent or conflicts with views previously expressed by the staff, the interpretive letter supersedes the previous positions.<sup>2</sup>

**THE CASH SOLICITATION RULE**

Rule 206(4)-3 generally prohibits a registered investment adviser from paying a cash fee, directly or indirectly, to a solicitor with respect to solicitation activities unless the payments are made in compliance with the conditions specified in the rule. These conditions include the requirements that the investment adviser enter into a written agreement with the solicitor, that the solicitor provide clients or prospective clients with the adviser’s Form ADV Part II and a separate written disclosure document describing the solicitation arrangement between the investment adviser and the solicitor, and that the investment adviser obtain the client’s acknowledgement of receipt of the written disclosure document at the time of the initial solicitation.

**NEW INTERPRETATIVE POSITION**

The interpretive letter clarifies that the staff believes that Rule 206(4)-3 generally does not apply to a registered investment adviser’s cash payment to a person solely to compensate that person for soliciting investors or prospective investors for, or referring investors or prospective investors to, an investment pool managed by the adviser. The staff gave the following reasons for its conclusion:

- Neither the proposing nor adopting releases for Rule 206(4)-3 suggest that the rule would apply to cash payments by an investment adviser to others solely as compensation for soliciting investors to invest in investment pools managed by the adviser;
- Rule 206(4)-3 is designed for situations where the solicited or referred person enters into an advisory relationship directly with the investment adviser, and investors in investment pools do not typically enter into advisory relationships with the investment advisers of the investment pools; and
- The decision of the U.S. Court of Appeals for the District of Columbia in *Goldstein, et al. v. Securities and Exchange Commission*, which held that investors in investment pools are not clients of the investment adviser of the pool, supports the view that Rule 206(4)-3 should not be interpreted to include cash payments for soliciting investors to invest in investment pools managed by the pool’s adviser.<sup>3</sup>

**LIMITATION ON THE INTERPRETIVE POSITION**

The staff emphasized, however, that whether an investment adviser’s cash payment to a person is made *solely* to compensate that person for soliciting investors to invest in an investment pool managed by the



adviser depends on the facts and circumstances of the particular case.<sup>4</sup> In the staff's view, Rule 206(4)-3 would continue to apply if compensation paid to a solicitor is not solely for referrals to investment pools. For example, the rule would apply if an adviser manages or seeks to manage both investment pools and separate accounts, is seeking investment advisory relationships and pays compensation to solicitors for referring prospective advisory clients.

In addition, the staff states that even if Rule 206(4)-3 does not apply to a particular situation, the solicitor may be required by the anti-fraud requirements of Section 206 of the Advisers Act to disclose to an investor or prospective investor any material facts relating to conflicts of interest, including disclosure of all compensation paid to the solicitor.

Finally, the interpretive letter expresses no view on whether a person receiving cash compensation from an investment adviser of an investment pool for soliciting or referring investors or prospective investors to invest in the pool would be required to register as a broker under the Securities Exchange Act of 1934 and applicable state law.

#### **FOR MORE INFORMATION**

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<sup>1</sup> The interpretation applies to investment companies, as defined under Section 3(a)(1) of the Investment Company Act of 1940 (the "1940 Act") and any company that would be an investment company but for an exclusion from the definition of investment company by Section 3(c) of the 1940 Act.

<sup>2</sup> Mayer Brown LLP (July 15, 2008).

<sup>3</sup> 451 F.3d 873 (D.C. Cir. 2006).

<sup>4</sup> The most pertinent facts and circumstances, in the staff's view, will be those relating to the nature of the arrangement between the soliciting/referring person and the investment adviser; the nature of the relationship between the investment adviser and the soliciting/referring person; and the purpose of the adviser's cash payment to the soliciting/referring person.