

INVESTMENT FUNDS ALERT

SEC STAFF INTERPRETS CASH SOLICITATION RULE AS INAPPLICABLE TO SOLICITATIONS RELATING SOLELY TO INVESTMENT FUNDS



On July 15, 2008, the staff of the Securities and Exchange Commission's (SEC) Division of Investment Management released a long-anticipated interpretative letter¹ that confirms that Rule 206(4)-3 (the "cash solicitation rule") under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), does not apply to cash payments by a registered investment adviser to a solicitor that relate solely to the solicitation of investors in a fund managed by the adviser. Prior to the interpretative letter, the application of the cash solicitation rule to solicitations to invest in funds had been in doubt because of the U.S. Court of Appeals for the D.C. Circuit's determination that a "client" under the Advisers Act is a fund (rather than a fund's investors) in its June 2006 decision in *Goldstein v. the Securities and Exchange Commission*.²

THE CASH SOLICITATION RULE

The cash solicitation rule prohibits the payment of a cash fee to a person who, directly or indirectly, solicits any client for, or refers any client to, a registered investment adviser unless the solicitor is paid in accordance with several conditions, including that the solicitor is not subject to any statutory disqualifications and that the solicitor's cash fee is paid pursuant to a written agreement. The rule also generally requires a written disclosure of the relationship between the solicitor and the investment adviser and, in many cases, requires disclosure of the compensation agreement and delivery of the investment adviser's written disclosure statement.

SEC INTERPRETATION OF THE CASH SOLICITATION RULE

In the interpretative letter, the staff of the SEC applied the definition of "client" from the *Goldstein* decision and concluded that the cash solicitation rule should not be interpreted to apply to solicitations solely of investors or prospective investors in funds. In reaching this conclusion, the staff indicated that the SEC's statements in adopting the cash solicitation rule and the construction of the plain language contained therein strongly suggested that the cash

¹ Mayer Brown LLP, SEC Interpretive Letter, WSB File No. 0714200804 (July 15, 2008).

² 451 F.3d 873 (D.C. Cir. 2006).

solicitation rule was intended to apply only to solicitations and referrals in which the solicited or referred persons might ultimately enter into investment advisory contracts with the investment adviser.

The interpretative relief is, however, limited to circumstances in which an investment adviser is solely compensating a solicitor for referring investors or potential investors in a fund. The SEC will look to the facts and circumstances of the particular case (such as the nature of the agreement with the solicitor, whether the investment adviser accepts managed accounts and the relationship with the solicitor) to determine if the solicitation “solely” relates to participation in a fund and does not relate to managed accounts.

As a result of the interpretative letter, registered investment advisers that only manage funds will no longer have to include the representations and compliance procedures contemplated by the cash solicitation rule in agreements with solicitors, such as placement agent agreements.

CONTINUING OBLIGATIONS OF INVESTMENT ADVISERS OF FUNDS

Although the interpretative letter provides some clarity and relief to investment advisers of funds, it does not affect an investment adviser’s other regulatory obligations to investors in funds, including but not limited to the following-

- **Broker-Dealer Regulation:** Persons who are in the business of finding investors for issuers are required to register as a broker-dealer with the SEC; a self-regulatory organization, such as the Financial Industry Regulatory Authority, Inc.; and/or a state’s securities regulator. The interpretative letter explicitly does not address broker-dealer regulation. Investment advisers should be especially cognizant of broker-dealer regulation because all issuers will be required to provide the Central Registration Depository number for each person receiving sales compensation relating to its offered securities via revised Form D starting on March 16, 2009.
- **Conflicts of Interest:** Investment advisers remain obligated to disclose to their clients and prospective clients material facts relating to conflicts of interest. If a solicitor is deemed to be in the business of recommending securities to potential investors in funds, the solicitor may be an investment adviser that must disclose its conflicts of interest to the referred or solicited person.
- **Anti-Fraud Rules:** Investment advisers remain subject to the anti-fraud provisions of the Advisers Act, which prohibit the making of any untrue statement of a material fact or the omission of a material fact necessary to make the statements not misleading, to any investor or prospective investor in a fund, and other federal and state anti-fraud provisions relating to the offer of securities. Accordingly, investment advisers should consider whether arrangements with solicitors, particularly a solicitor’s compensation for referring a potential investor to a fund, are adequately disclosed.

CONTACT INFORMATION

If you have any questions regarding this topic, please contact:

Mark H. Barth	212.872.1065	mbarth@akingump.com	New York
David M. Billings	44.20.7012.9620	dbillings@akingump.com	London
Jan-Paul Bruynes	212.872.7457	jpbruynes@akingump.com	New York
James A. Deeken	214.969.4788	jdeeken@akingump.com	Dallas
Christopher M. Gorman-Evans	44.20.7012.9656	cgorman-evans@akingump.com	London
Barry Y. Greenberg	214.969.2707	bgreenberg@akingump.com	Dallas
Ira P. Kustin	212.872.1021	ikustin@akingump.com	New York
Arina Lekhel	212.872.8018	alekhel@akingump.com	New York
Burke A. McDavid	7.495.783.7835	bmc david@akingump.com	Moscow
Prakash H. Mehta	202.887.4248	pmehta@akingump.com	Washington, D.C.
Russell W. Parks Jr.	202.887.4092	rparks@akingump.com	Washington, D.C.
Lisa A. Peterson	817.886.5070	lpeterson@akingump.com	Dallas
Eliot D. Raffkind	214.969.4667	eraffkind@akingump.com	Dallas
Fadi G. Samman	202.887.4317	fsamman@akingump.com	Washington, D.C.
William L. Sturman	212.872.1035	wsturman@akingump.com	New York
Ann E. Tadjweski	212.872.1087	atadjweski@akingump.com	New York
Simon Thomas	44.20.7012.9627	swthomas@akingump.com	London
Stephen M. Vine	212.872.1030	svine@akingump.com	New York

Austin	Beijing	Dallas	Houston	London	Los Angeles	Moscow
New York	Philadelphia	San Antonio	San Francisco	Silicon Valley	Taipei	Washington, D.C.