

MAYER BROWN LLP — INTERPRETIVE LETTER

Investment Advisers Act of 1940 — Rule 206(4)-3

July 28, 2008

RESPONSE OF THE OFFICE OF CHIEF COUNSEL DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 20087251738

Mayer Brown LLP

File No. 132-3

This letter replaces the letter that we issued to you on July 15, 2008 ("Original Letter").¹ We are replacing the Original Letter to make minor, non-substantive changes to it.² This letter does not, however, alter the relief granted in the Original Letter. This letter should be deemed to be issued as of the date of the Original Letter, July 15, 2008.

By letter dated July 7, 2008, you request that we clarify that Rule 206(4)-3 under the Investment Advisers Act of 1940 ("Advisers Act") does not apply to an investment adviser's cash payment to a person solely to compensate that person for soliciting investors to invest in an investment pool³ managed by the adviser.

You state that several staff members of the Securities and Exchange Commission ("Commission") have orally expressed the view that Rule 206(4)-3 does not apply to the payment of a cash fee by an investment adviser to a person solely to compensate that person for soliciting investors to invest in an investment pool managed by the adviser.⁴ You believe that these statements are consistent with statements recently made by the U.S. Court of Appeals for the District of Columbia Circuit in *Goldstein, et al. v. Securities and Exchange Commission* ("Goldstein").⁵ You express concern, however, that certain SEC staff no-action letters⁶ suggest that Rule 206(4)-3 applies to cash payments by registered advisers to persons who solicit investors to invest in investment pools. Consequently, you request that we clarify that Rule 206(4)-3 does not apply to cash payments by a registered investment adviser to a person solely to compensate that person for soliciting investors to invest in an investment pool managed by the adviser.

DISCUSSION

Section 206(4) of the Advisers Act makes it unlawful for any investment adviser to engage in any act, practice or course of business that is fraudulent, deceptive or manipulative, and authorizes the Commission by rules and regulations to define and prescribe means reasonably designed to prevent such acts, practices and courses of business. Rule 206(4)-3 under the Advisers Act makes it unlawful for any investment adviser that is required to be registered under Section 203 of the Advisers Act (for purposes of this letter, a "registered investment adviser") to pay a cash fee, directly or indirectly, to a solicitor⁷ "with respect to solicitation activities" unless the payments are made in compliance with conditions specified in the Rule. The Commission intended for Rule 206(4)-3 to address the conflicts of interest inherent in certain cash solicitation arrangements.⁸

We believe 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. While the Rule literally could apply to such payments, we believe that the Commission did not intend for the Rule to apply to those payments, for a number of reasons. First, neither the Proposing Release nor the Adopting Release contains any statement directly or indirectly suggesting that the Rule would apply to investment advisers' cash payments to others solely to compensate them for soliciting investors for investment pools managed by the advisers. While not dispositive of the issue, we believe that the absence of any such statements by the Commission suggests that it did not intend that the Rule should apply to such payments. Second, the Rule is designed so as to clearly apply to solicitations and referrals in which the solicited or referred persons might ultimately enter into investment advisory contracts with

the investment adviser,⁹ yet investors in investment pools (as such) do not typically enter into investment advisory contracts with the investment advisers of the pools. Third, the Rule's use of the terms "client" and "prospective client," rather than "investor" or "prospective investor," also strongly suggests that the Rule was intended to apply to solicitations and referrals in which the solicited or referred persons might ultimately enter into investment advisory contracts with the investment adviser.

Furthermore, the Goldstein decision supports the conclusion that the Rule generally does not apply to advisers' cash payments to others solely to compensate them for soliciting investors to invest in investment pools managed by the advisers. In Goldstein, the court indicated that, for purposes of Section 206 of the Advisers Act, investors in a pooled investment vehicle are not "clients" of the investment adviser of the pool. Similarly, we believe that the references to "client" and "prospective client" in Rule 206(4)-3 under the Advisers Act should not be interpreted to include investors in investment pools or prospective investors in investment pools.

Whether a registered investment adviser's cash payment to a person is being made 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 will depend upon all of the facts and circumstances of the particular case. In our view, the most pertinent facts and circumstances generally 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 solicited/referred person, and the purpose of the adviser's cash payment to the soliciting/referring person.

For example, the Rule would not appear to apply to a registered adviser's cash payment to a person for referring other persons to the adviser where the adviser manages only investment pools and is not seeking to enter into investment advisory relationships with other persons, and the adviser's cash payment, under the adviser's arrangement with the referring person, compensates the referring person solely for referring the other persons to the adviser as investors or as prospective investors in one or more of the investment pools managed by the adviser.¹⁰ In contrast, the Rule would appear to apply if the adviser manages or seeks to manage investment pools and individual accounts, is seeking to enter into investment advisory relationships with other persons, and the adviser's cash payment, under the adviser's arrangement with the referring person, compensates the referring person for referring the other persons as prospective advisory clients. Again, whether the Rule applies or not would depend upon all of the facts and circumstances of the particular situation.

Even if Rule 206(4)-3 does not apply to a particular situation, the soliciting/referring person may generally be required by Section 206 of the Act to disclose to the investor or prospective investor material facts relating to conflicts of interest. Depending upon the facts and circumstances, a soliciting/referring person may be "advising others ... as to the advisability of investing in ... securities" within the meaning of Section 202(a)(11) of the Advisers Act,¹¹ and thus may be an investment adviser subject to Section 206 of the Advisers Act. As interpreted by the courts and the Commission, Section 206 requires investment advisers to disclose to their clients and prospective clients material facts relating to conflicts of interest.¹²

To the extent that the view we express in this letter is inconsistent or conflicts with views that we have expressed previously, see, e.g., note 6, *supra*, our view today supersedes them.¹³

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Endnotes

¹ Mayer Brown LLP, Our Ref. No. 20087141629, SEC Staff No-Action Letter (July 15, 2008).

² This letter replaces the reference to "206(4)(a)(1)(iii)" (in footnote 8 of the Original Letter, which corresponds to footnote 10 of this letter) with "206(4)-3(b)". It also makes other minor, non-substantive changes in the same footnote.

3 As used in this letter, the term "investment pool" is an investment company, as defined under Section 3(a)(1) of the Investment Company Act of 1940 ("Investment Company Act"), or a company that would be an investment company but for an exclusion from the definition of investment company provided by Section 3(c) of the Investment Company Act.

4 See, e.g., Compliance Reporter, Plaze Says Letter On Cash Solicitations Was Misinterpreted (July 14, 2006) and comments made by Commission staff members at the Commission's CCO Outreach Program on June 29, 2006.

5 451 F.3d 873 (D.C. Cir. 2006). In Goldstein, the court vacated as arbitrary Rule 203(b)(3)-2 under the Advisers Act, which required investment advisers to certain investment pools to count the shareholders, limited partners, members or beneficiaries of the pools as "clients" for purposes of Section 203(b)(3) of the Act. In doing so, the court reasoned that the shareholders, limited partners, members or beneficiaries of such pools could not reasonably be considered to be "clients" of the pools' investment advisers. *Id.* at 881.

6 See, e.g., Dana Investment Advisors, Inc., SEC Staff No-Action Letter (Oct. 12, 1994); Dechert Price & Rhoads, SEC Staff No-Action Letter (Dec. 4, 1990); Stein Roe & Farnham Incorporated, SEC Staff No-Action Letter (June 29, 1990).

7 Rule 206(4)-3(d)(1) under the Advisers Act defines "solicitor" to mean "any person who, directly or indirectly, solicits any client for, or refers any client to, an investment adviser." Section 202(a)(16) of the Advisers Act defines "person" to mean "a natural person or a company." Rule 206(4)-3(d)(2) under the Advisers Act defines "client" to include any prospective client.

8 See Requirements Governing Payments of Cash Referral Fees by Investment Advisers, Advisers Act Release No. 615 (Feb. 2, 1978) ("Proposing Release"); Requirements Governing Payments of Cash Referral Fees by Investment Advisers, Advisers Act Release No. 688 (July 12, 1979) ("Adopting Release").

9 For example, subsection (a)(2)(B) of the Rule requires that the investment adviser must receive certain acknowledgements from the client, "prior to, or at the time of, entering into any written or oral investment advisory contract with such client..." (emphasis added).

10 If Rule 206(4)-3 under the Advisers Act does not apply to such an investment adviser, it follows that, among other things, the referring person would not be required by the Rule to provide the investor or the prospective investor with either the separate written disclosure document specified in Rule 206(4)-3(b) under the Act or the investment adviser's written disclosure statement specified in Rule 204-3 under the Act.

11 Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Advisers Act Release No. 1092 (Oct. 8, 1987) (footnote omitted).

12 See, e.g., Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., et al., 375 U.S. 180, 194 (1963).

13 You have not asked, and this letter does not address, whether a person's receipt of cash compensation from an investment adviser of an investment pool for soliciting or referring investors or prospective investors to invest in the pool would result in the person being considered a "broker" under Section 3(a)(4) of the Securities Exchange Act of 1934.

Incoming Letter

The Incoming Letter, in Acrobat format, is available at:

<http://www.sec.gov/divisions/investment/noaction/2008/mayerbrown070708-206-incoming.pdf>