

OCIE Issues Risk Alert on Compliance Deficiencies Relating to the Cash Solicitation Rule

Written by Robert G. Sawyer, Ayah K. Zaidi

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On October 31, 2018, the Securities and Exchange Commission's Office of Compliance Inspections and Examinations (OCIE) released a Risk Alert summarizing the most common deficiencies relating to Rule 206(4)-3 (the "Cash Solicitation Rule") of the Investment Advisers Act of 1940 (the "Advisers Act") identified during a review of deficiency letters from investment adviser examinations completed over the last three years.

Under the Cash Solicitation Rule, investment advisers required to be registered under the Advisers Act may not pay a cash fee to any person who solicits clients for the adviser unless certain conditions are met, including that the fee be paid pursuant to a written solicitation agreement to which the adviser is a party. When an adviser uses a third-party solicitor, the following additional requirements must be met: (1) the solicitation agreement must contain certain required provisions such as a description of the solicitation activities; (2) the solicitation agreement must require the solicitor to provide the prospective client with a copy of the adviser's brochure and a solicitor disclosure document emphasizing the solicitor's financial interest in the client's choice of adviser; (3) before entering into an agreement with a client, the adviser must receive a signed and dated acknowledgment from the client that the adviser's brochure and the solicitor disclosure document were received; and (4) the adviser must make a bona fide effort to confirm, and have a reasonable basis for believing, that the solicitor has complied with the solicitation agreement.

Advisers utilizing a paid solicitor should take particular note of the deficiencies below, which were identified as the most frequent compliance issues relating to the Cash Solicitation Rule:

- **Solicitor disclosure documents:** The OCIE staff observed instances where advisers' third-party solicitors did not provide solicitor disclosure documents to prospective clients or provided documents that did not contain all required information, such as (1) the nature of the relationship between the adviser and the solicitor; (2) the specific terms of the compensation arrangement between the adviser and the solicitor; and (3) the solicitation cost that the client would be charged in addition to the advisory fee.
- **Client acknowledgments:** The OCIE staff noted instances where advisers did not timely receive a signed and dated acknowledgment that the client received the adviser brochure and the solicitor disclosure document or where client acknowledgments were either undated or dated **after** the client entered into an investment advisory contract.
- **Solicitation agreements:** The OCIE staff highlighted instances where advisers paid cash fees to a solicitor without a solicitation agreement or in accordance with an agreement with a third-party solicitor that did not include required provisions, such as (1) an undertaking by the solicitor to perform its duties under the solicitation agreement pursuant to the adviser's instructions; (2) a description of the solicitor's activities and the compensation that will be paid; and (3) a requirement that the solicitor give clients a copy of the adviser's brochure and the solicitor disclosure document.
- **Bona fide efforts to ascertain solicitor compliance:** The OCIE staff observed instances where advisers were unable to describe any efforts they made to confirm that third-party solicitors complied with solicitation agreements.

With respect to advisers to private funds, we do remind you that per prior guidance issued by the SEC, the Cash Solicitation Rule will not apply to arrangements solely to solicit investors for the applicable fund as such investors will not be "clients" within the meaning of the Advisers Act. Nonetheless, the existence and material facts of such arrangements should be disclosed to prospective investors in accordance with the anti-fraud principles set forth in Section 206 of the Advisers Act and Rule 206(4)-8 thereunder.

In light of the observations made by the OCIE staff, advisers should review their policies and procedures to ensure compliance with the Cash Solicitation Rule, and make improvements where necessary. The full text of the Risk Alert is available [here](#).

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