

**COMMISSION STAFF WILL NOT ENFORCE THE CASH
SOLICITATION RULE FOR SOLICITORS OF HEDGE FUND
INVESTORS**

The staff of the Northeast Regional Office of the Securities and Exchange Commission, in a recent outreach meeting with chief compliance officers, announced orally that they would no longer cite registered investment advisers for failing to comply with Rule 206(4)-3 under the Investment Advisers Act of 1940 (the “Cash Solicitation Rule”) in connection with cash payments to persons soliciting investors for hedge funds managed by registered investment advisers.

The Cash Solicitation Rule permits a registered investment adviser to pay a cash fee to a person soliciting clients for the adviser **only if**:

- (a) the solicitor is not subject to court order or administrative sanction; and
- (b) the fee is paid pursuant to a written agreement to which the adviser is a party.

If the solicitor is not an officer, director, employee or partner of the registered adviser, and is not controlling, controlled by or under common control with the adviser, the written agreement must describe the solicitation activities to be undertaken and must require the solicitor to provide the prospective client at the time of the solicitation with:

- (a) a copy of the adviser’s Rule 204-3 written disclosure statement (usually Part II of Form ADV); and
- (b) a copy of a separate disclosure statement describing the affiliation between the adviser and the solicitor, the terms of the solicitor’s compensation and whether and how the fee charged to the client by the adviser differs from fees paid by clients with respect to which the adviser paid no solicitation fees.

In connection with the above, the investment adviser must also receive from the client, before, or at the time of, entering into any written or oral investment advisory contract with such client, a signed and dated acknowledgment of receipt of the adviser’s written disclosure document.

For many years, the Commission staff had taken the position that the Cash Solicitation Rule would apply not only to payments by registered advisers to solicitors referring separate account clients but also where the solicitor is paid a fee for soliciting investors in unregistered funds advised by the registered investment adviser.¹

¹ The Commission indicated the Cash Solicitation Rule could be applicable in this situation in Dana Investment Advisors, Inc., SEC No-Action Letter, 1994 WL 718968 (Oct. 12, 1994).

Under this new policy, the Commission staff will no longer cite investment advisers for failure to comply with the Cash Solicitation Rule in the context of solicitations of hedge fund investors. However, the Commission staff has indicated that the general anti-fraud provisions of the Advisers Act would continue to apply to all advisers, and that compliance with the terms of the Cash Solicitation Rule may be a way to demonstrate that proper disclosure of the fees to solicitors has been made to investors. However, a more abbreviated disclosure of fee arrangements that may not comport precisely with the detailed requirements of the Cash Solicitation Rule should no longer result in the staff citing an adviser for a compliance deficiency.

The Commission staff has also indicated that further guidance in this area may be forthcoming. We will keep you apprised of any further developments in this regard.

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