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Advisers Act Cash Solicitation Rule Not Applicable to Private Funds Under New SEC Letter

On July 28, 2008, the SEC staff issued an industry-favorable no-action letter (the "Interpretive Letter") stating that Rule 206(4)-3 under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), commonly known as the "Cash Solicitation Rule," does not apply when an SEC-registered investment adviser pays a person to solicit prospective investors for a private fund.[1] Under this Interpretive Letter, registered advisers to private funds will now be able to avoid compliance with the technical requirements of the rule, but should continue to disclose (in Form ADV Part II or offering memoranda) material aspects of solicitation arrangements to meet Advisers Act disclosure obligations.

The Cash Solicitation Rule generally prohibits registered investment advisers from compensating solicitors for solicitation activities unless conditions specified in the rule are followed, including:

- the compensation must be paid pursuant to a written agreement between the registered adviser and the solicitor specifying the solicitor's compensation and activities;
- the solicitor must deliver a separate written disclosure document at the time of the first solicitation of an investor disclosing, among other things, the solicitor's compensation, and the adviser's ADV Part II or brochure. The solicitor must receive from the investor a signed and dated acknowledgement of the disclosure delivery; and
- the solicitor must not be subject to certain statutory disqualification provisions under the Advisers Act.

In prior no-action letters, the SEC staff interpreted the requirements of the Cash Solicitation Rule as applying to payments made by a registered investment adviser to a solicitor to solicit prospective private fund investors.[2] The Interpretive Letter supersedes the views expressed in those letters and acknowledges that while the language of the Cash Solicitation Rule may be read as applying to private funds, the SEC staff does not believe the Cash Solicitation Rule should apply in the context of soliciting investors to invest in private funds. The Interpretive Letter cites the language of the Cash Solicitation Rule and the decision in *Goldstein, et al. v. Securities and Exchange Commission*,[3] among other reasons, in finding that investors in a private fund are not "clients" of the investment adviser under the Cash Solicitation Rule.

Under this new Interpretive Letter, SEC-registered investment advisers may (in most cases) disregard the technical requirements of the Cash Solicitation Rule when making cash payments to

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a solicitor to solicit prospective private fund investors. However, the Cash Solicitation Rule may still apply in situations where a registered investment adviser makes a cash payment to a solicitor for solicitation activities relating to investment pools *and* managed accounts. The SEC staff specifically stated that a "facts and circumstances" analysis would be necessary in such situations. The Cash Solicitation Rule may also apply if an investment adviser enters into a separate investment advisory contract with clients directly in connection with such clients' investment in a private fund managed by the investment adviser.

It is important to note that although the Cash Solicitation Rule generally will not apply to private funds, Section 206 of the Advisers Act, and in particular the Advisers Act anti-fraud rule, generally will require the solicitor and/or the adviser to disclose to prospective investors material facts relating to the investment, which usually will include the existence of the solicitation arrangement and related compensation and conflicts of interest. Investment advisers should therefore continue to disclose solicitation arrangements to prospective investors (*e.g.*, in the investment adviser's ADV Part II and/or in the fund's offering memorandum).

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1 The Interpretive Letter amended a previous letter issued on July 15.

2 *See, e.g., Dana Investment Advisers, Inc.*, SEC No-Action Letter (October 12, 1994); *Dechert Price & Rhodes*, SEC No-Action Letter (December 4, 1990); and *Stein Roe & Farnham Inc.*, SEC No-Action Letter (June 29, 1990).

3 *Goldstein, et al. v. Securities and Exchange Commission*, 451 F.3d 873 (D.C. Cir. 2006). For an analysis of this decision, see the June 27, 2006 Private Equity Newsletter, *available at*: http://www.kirkland.com/siteFiles/kirkexp/publications/2289/Document1/PEN_6.27.06_FINAL.pdf.

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