

**Marketing and Referral Arrangements  
From the Investment Adviser's Perspective**

Institute for International Research  
The Compliance Forum for Registered  
Investment Advisers and Hedge Fund Managers

New York, New York  
June 18-19, 2001

Steven W. Stone  
Morgan, Lewis & Bockius LLP  
1800 M Street, NW  
Washington, DC 20036  
(202) 467-7453  
sstone@morganlewis.com

**Marketing and Referral Arrangements  
From the Investment Adviser's Perspective\***

I. The SEC's Cash Referral Fee Rule.

A. Background.

Rule 206(4)-3 under the Advisers Act establishes a "safe harbor" from investment adviser registration for those persons who, on a recurrent basis and for compensation, refer potential clients to an investment adviser, provided the solicitation arrangements meet the requirements of the Rule. Such solicitors would be viewed as associated persons of the investment adviser (at least with respect to their solicitation activities for the investment adviser) and thus would not be required to register individually as investment advisers. *See* Advisers Act Release No. 668 (July 12, 1979), a copy of which is attached.<sup>1</sup>

In adopting Rule 206(4)-3, the SEC recognized that, "with appropriate regulatory safeguards, the payment of cash referral fees [by registered investment advisers] can be permitted consistent with the protection of investors" provided by the general antifraud provisions of Section 206. As discussed below, to ensure that the interests of investors are protected adequately, the Rule requires that prospective advisory clients be informed that the person soliciting for an investment adviser has a financial interest in that solicitation. This disclosure is intended to allow the prospective client to weigh the solicitor's potential bias and to inquire more fully into the basis for the solicitor's recommendation of the investment adviser.

B. Basic Prohibition and Conditions.

Rule 206(4)-3 prohibits a registered investment adviser from paying a cash fee, directly or indirectly,<sup>2</sup>

---

\* Copyright © 2001 Morgan, Lewis & Bockius LLP. All rights reserved.

<sup>1</sup> Consistent with this stance, the SEC staff has also taken the position that broker-dealers receiving cash referral fees for referring clients to investment advisers and not receiving "special compensation" for purposes of the Advisers Act Section 202(a)(11)(C)'s exclusion from the term "investment adviser" of broker-dealers that perform investment advisory services that are solely incidental to their brokerage business and that receive no "special compensation." *See, e.g., Townsend and Associates* (available September 21, 1994); *Koyen, Clarke & Associates, Inc.* (available November 10, 1986).

<sup>2</sup> The SEC staff has treated a number of indirect solicitation arrangements as being subject to the Rule. *See, e.g., Dana Investment Advisors, Inc.* (available October 12, 1994) (declining to grant a no-action letter to an investment adviser requesting to dispense with Rule 206(4)-3's requirements where the equivalent of solicitation fees would be paid by a partnership for which the investment adviser served as general partner); *Advisor Marketing Assoc.* (available November 8, 1989) (declining to grant a no-action letter to wholesaler that marketed investment advisory services to broker-dealers and did not deal with prospective clients directly). The SEC staff has also made it clear that the Rule applies to arrangements, whether formal or informal, but has not expressly cover the payment of non-cash compensation.

to a “solicitor” for solicitation activities on behalf of the adviser, except in accordance with the conditions of the Rule. Technically, the Rule applies to any investment adviser “required to be registered” with the SEC, but requires that an investment adviser be so registered to comply with the Rule. This means that investment advisers that need not be registered with the SEC due to the Investment Advisers Supervision Coordination Act (“Coordination Act”) of the National Securities Markets Improvement Act of 1996 (“NSMIA”) are not subject to the Rule, but may be subject to similar rules at the state level.

A “solicitor” is defined as “any person who, directly or indirectly, solicits any client for, or refers any client to, an investment adviser.”<sup>3</sup> The Rule defines the term “client” to include a “prospective client.” The conditions that must be met before referral fees can be paid depend on the relationship between the adviser and the solicitor. In-house solicitors are subject to the rule, but only a few of its conditions. Outside or third party solicitors are subject to many.

#### 1. Written Agreement.

First, the fee must be paid pursuant to a written agreement between the solicitor and the investment adviser. Additionally, the adviser is required to retain a copy of the written agreement in its records pursuant to the SEC’s record keeping rule, Rule 204-2(a)(10). The contents of the solicitation agreement will depend on the relationship between the investment adviser and the solicitor.

#### 2. No Payments to Disqualified Persons.

As a threshold matter, an investment adviser is prohibited from paying solicitation fees to any person subject to any of the four bases for disqualification specified in paragraph (a)(1)(ii) of the Rule. These bases for disqualification coincide largely -- but not entirely -- with the disciplinary disclosures contained in Form BD and Form ADV. The SEC staff has been willing, on a no-action basis, to permit certain disqualified persons to serve as solicitors where, among other things, the disqualified persons agreed to disclose the disqualification for ten years in the separate written disclosure statement required to be delivered to prospective clients under the Rule (see below).<sup>4</sup>

---

See *JMB Financial Managers, Inc.* (available June 23, 1993).

<sup>3</sup> The SEC staff has in relatively few instances said that certain types of persons would not be solicitors for purposes of the Rule. See, e.g., *Excellence in Advertising, Ltd.* (available December 15, 1986) (stating that advertising firm would not be a “solicitor” where it was to receive flat fees only for launching and administering a national cooperative advertising campaign promoting financial planners in NAFFP); *Int’l Ass’n for Financial Planning* (available June 1, 1998) (determining that trade association which operated a referral program designed to assist consumers to identify qualified financial advisers within their locale was not soliciting clients for specific advisers).

<sup>4</sup> Specifically, such relief typically is conditioned on the solicitor’s representations that it (1) will conduct any solicitation arrangement with any adviser required to be registered under the Advisers Act in compliance with all applicable provisions of Rule 206(4)-3; (2) will use its best efforts to ensure that any adviser with which it has a solicitation arrangement describes such arrangement to the extent required in response to any applicable item of the adviser’s Form ADV; (3) will for ten years discuss the disqualifying matter in any separate written disclosure document that the solicitor is required to deliver under Rule 206(4)-3; and (4) is not currently engaged in any solicitation arrangements that would be subject to Rule 206(4)-3. See, e.g., *Legg Mason Wood Walker, Inc.* (available June 11, 2001); *The Dreyfus Corporation* (available March 9, 2001); *Prudential Securities Incorporated* (February 7, 2001); *Tucker Anthony, Inc.* (December 21, 2000); *J.B. Hanauer & Co.* (December 12, 2000); *Founders Asset Management LLC* (November 8, 2000); *PaineWebber Inc.* (available Dec. 22, 1998); *Carnegie Asset Management, Inc.* (available July 11, 1994); *Salomon Brothers Inc.* (available Jan. 26, 1994); *Hickory Capital Management, Inc.* (available February 11,

At the least, an investment adviser proposing to pay referral fees to a solicitor should obtain from the solicitor a representation that the solicitor is not subject to disqualification as specified in Paragraph (a)(1)(ii) of the Rule. The investment adviser may also wish to screen any solicitors to ensure they are not disqualified. As discussed below, this can be accomplished in many ways, such as by reviewing the solicitor's Form BD or ADV, as applicable, checking with the NASD's public disclosure office, running a search through the disciplinary databases available through LEXIS-NEXIS, and contracting with third-party consultants.

### 3. Alternative Conditions.

In addition to the above requirements, fees may be paid only for the solicitation of impersonal advisory services, unless either of two alternative conditions are met. Rule 206(4)-3 defines "impersonal advisory services" narrowly to mean investment advisory services provided solely by means of written materials or oral statements not purporting to address the investment objectives of a specific client or statistical information expressing no opinions as to the merits of particular securities. *See* Rule 206(4)-3(d)(3); *see also Bond Timing Securities Corp.* (available November 29, 1984). If an investment adviser's services do not fit within the narrow definition of "impersonal advisory services," the solicitation arrangements must be limited to certain persons associated with the investment adviser or comply with the Rule's more demanding disclosure requirements, each as discussed below.

#### a. First Alternative --Arrangements with Associated Persons.

Under the first alternative, an adviser may pay solicitation fees with respect to personal advisory services if the solicitor is a partner, officer, director, or employee of either the investment adviser or a person that controls, is controlled by, or is under common control with the investment adviser, and the solicitor's association with the investment adviser is disclosed to the client at the time of the solicitation. The SEC staff has permitted the deferral to a later time (but not later than when the client signs an investment advisory contract) of this disclosure where disclosure at the time of solicitation is not feasible. *See, e.g., Lincoln National Investment Management Company* (available May 26, 1992). The SEC staff has not, however, permitted dispensing with the requirement that there be a written agreement between the investment adviser and its employees governing the solicitation arrangements. *See, e.g., Merchants Capital Management, Inc.* (available October 4, 1991).

Persons who work for an investment adviser or one of its affiliates who are "independent contractors" for tax purposes may, depending on the facts, be regarded as "employees" for purposes of the Rule if they are supervised and controlled by the investment adviser or its affiliate. Although the Rule uses the term "employee" (as opposed to the broader term "associated person"), the SEC staff has in other contexts read "employee" more broadly to include "independent contractors whose activities are controlled by the [investment adviser]." *Corinne E. Wood* (available April 17, 1986) (*citing The Burney Company* (available February 7, 1977); *George A. Grossman* (available January 22, 1976)).

---

1993); *Oppenheimer & Co., Inc.* (available June 5, 1992); *Kidder, Peabody & Co., Inc.* (available March 30, 1992); *BT Securities Corporation* (available March 30, 1992); *Kidder, Peabody & Co., Inc.* (available October 11, 1990); *First City Capital Corp.* (available February 9, 1990); *Stein Roe & Farnham Inc. & Touche Remnant Holdings Ltd.* (available January 29, 1990); *RNC Capital Management* (available February 7, 1989).

b. Second Alternative -- Arrangements with Outside Solicitors.

As a second alternative, an investment adviser may pay solicitation fees to non-affiliated solicitors if the written agreement with the solicitor contains certain specified provisions. (A sample solicitation agreement for outside solicitors is attached.)

(1) Description of Solicitation Activities.

To satisfy this alternative, the solicitation agreement must include a description of the solicitation activities to be provided and the compensation to be received by the solicitor, and an undertaking by the solicitor that he or she will comply with the investment adviser's instructions and applicable law.

(2) Brochure and Disclosure Statement Delivery.

The agreement must also contain a provision requiring that the solicitor, at the time of the solicitation, deliver to clients and prospective clients current copies of the investment adviser's brochure (*i.e.*, Part II of Form ADV or a substitute brochure).

The agreement must also require that the solicitor deliver to clients and prospective clients, again at the time of the solicitation, a separate written disclosure statement that sets forth the names of the solicitor and the investment adviser, the association between them, and a statement indicating that the solicitor will be compensated for his or her solicitation activities, and describes the *specific* terms for such compensation (including whether all or a portion of the cost of the solicitation fees will be passed on to clients by the investment adviser). The SEC has indicated that, if a specific amount were being paid under Rule 206(4)-3, that amount would be required to be disclosed. If, instead of a specific amount, the solicitor's compensation was to take the form of a percentage of the total advisory fees actually paid by the referred client over a period of time, that percentage and the time period would likewise have to be disclosed. Additionally, if all, or part, of the solicitor's compensation is deferred or contingent upon some future event (such as the client's continuation or renewal of the advisory relationship or agreement), such terms would also have to be disclosed. The adequacy of disclosures in this area is a key focus of the SEC staff's examination and enforcement program.

The SEC staff has refused to grant no-action relief on proposals that the solicitor's disclosures, discussed above, be incorporated in other documents, rather than be set forth in a "separate written disclosure statement" as literally called for by the Rule. The SEC staff, for example, has denied requests that investment advisers that serve as solicitors be permitted to fold the solicitor's disclosures into their Form ADVs. *See, e.g., Dechert Price & Rhodes* (available December 4, 1990); *Stein, Roe & Farnham* (available June 29, 1990). Similarly, the SEC staff has turned down a request to place the solicitor's disclosures only in the investment advisory agreement signed by the client. *See, e.g., E. Magnus Oppenheim & Co.* (available March 25, 1985).

The SEC staff has, by no-action letter, permitted investment advisers (*in lieu of* their solicitors) to deliver copies of the investment advisers' Form ADVs and the solicitors' separate written disclosure statements to prospective clients and, in the case of mass mailings and advertisements, to make such deliveries only when such prospective clients express interest in the investment advisers' services (as opposed to at the time of solicitation). *See, e.g., AMA Investment Advisers, Inc.* (available October 28, 1993); *Moneta Group Investment Advisors, Inc.* (available October 12, 1993) (cash solicitation arrangement with professional associations and credit unions); *E. F. Hutton & Company, Inc.* (available September 27, 1987). The SEC has also permitted the investment advisers' Form ADV (or substitute brochure) to be delivered within one

business day of the referral when, in the interest of administrative efficiency copies of the Form ADVs were maintained at a central office (as opposed to a branch office). *See Charles Schwab & Co., Inc.* (available April 29, 1998). The SEC has said that the solicitor's separate written disclosure statements can be delivered (and the required signed and dated client acknowledgment of receipt obtained) electronically consistent with the guidelines presented in the SEC's May 1996 release on the use of electronic media. *See Securities Act Release No. 7288* (May 9, 1996).

(3) Client Acknowledgment.

Under the second alternative, the investment adviser must also obtain from each client so solicited, prior to or at the time of entering into any written or oral investment advisory contract, a signed and dated statement acknowledging the client's receipt of the investment adviser's brochure and the solicitor's written disclosure statement, copies of which must be retained in the investment adviser's files pursuant to Rule 204-2(a)(15).

4. Supervision Requirements.

Rule 206(4)-3 does not require that an investment adviser supervise the solicitation activities of the solicitor as if the solicitor were one of its own employees (although the Rule, as originally proposed by the SEC, *would have* imposed such a duty of ongoing supervision). However, the Rule does require that the adviser make a *bona fide* effort to ascertain whether the solicitor is in compliance with the terms of the agreement and to have a reasonable basis for believing that the solicitor is in fact in compliance. The question of what constitutes such a *bona fide* effort depends on the circumstances. The SEC has indicated, however, that such a *bona fide* effort would *at least* involve making inquiries of some or all clients referred by the solicitor in order to determine whether the solicitor has made improper representations or has otherwise violated the agreement with the investment adviser.

5. Form ADV Disclosure Requirements.

In addition to the conditions imposed by Rule 206(4)-3 on the payment of solicitation fees by SEC registered investment advisers, Item 13(B) of Part II of Form ADV requires that the investment adviser both disclose that it pays solicitation fees and describe, on Schedule F to the investment adviser's Form ADV, the arrangements under which such fees are paid. These disclosure requirements apply to both SEC and state-registered investment advisers.

II. State Law Issues.

A. State Counterparts to the SEC's Cash Referral Fee Rule.

Many states prohibit an investment adviser from paying a cash fee, directly or indirectly, to a solicitor with respect to solicitation activities in a manner that does not comply with Rule 206(4)-3 under the Advisers Act. *See, e.g.,* Georgia Rule 590-4-8-.17(m); Indiana Regulations § 710 IAC 1-16-22(a)(13); Mississippi Rule 623(Q); *see Also Referral Fees from Investment Advisers*, WISCONSIN MONTHLY BULLETIN (October 1983).

B. State Investment Adviser Agent Registration Issues.

In many states, third-party solicitors have to be registered as investment advisers (or, in the case of individuals, associated with registered investment advisers). Although the Coordination Act preempts state registration of certain persons (referred to as “supervised persons”) who provide investment advice on behalf of an investment adviser and are subject to the investment adviser’s supervision and control, solicitors do not typically provide advice on behalf of the investment advisers for which they solicit. Accordingly, outside solicitors for SEC-registered investment advisers will remain subject to state investment adviser and representative registration requirements unless they are otherwise exempt or eligible to be registered with the SEC.

Even if a solicitor were said to provide advice on behalf of an investment advisor for which he or she solicited (which could expose the investment adviser to greater potential liability for the solicitor’s conduct), the solicitor might still have to be registered at the state level. This is because the Coordination Act specifically preserves each state’s authority to register and regulate “investment adviser representatives” who have a “place of business” within the state.

A broker-dealer should not be subject to federal investment adviser licensing requirements when acting as a “solicitor” and receiving solicitation fees given the SEC’s position in *Koyen, Clarke & Associates, Inc.* (Nov. 10, 1986, saying that solicitation fees are not “special compensation” that would preclude reliance on the broker-dealer exception). If the solicitation activities are covered by the broker-dealer exception from the definition of investment adviser, then the broker-dealer would not be subject to registration with the SEC, and -- significantly -- the states would be precluded from requiring registration under Section 203A(b)(1) of the Investment Advisers Act. That section bars the states from requiring registration of any adviser or supervised person of an adviser “(B) that is not registered under section 203 because that person is excepted from the definition of investment adviser under section 202(a)(11).”

Investment advisers that are subject to state registration and regulation should consider how their solicitation arrangements may affect their own registration requirements in the various states.

The states have increasingly construed the term “investment adviser” for registration and other purposes to include persons who directly or indirectly “hold themselves out” as investment advisers. Other states take the position that persons who “hold themselves out” as investment advisers may not avail themselves of *de minimis* (few clients) or institutional exemptions from registration. (“Holding out” does not, however, disturb an investment adviser’s ability to rely on the Coordination Act’s “national *de minimis*” exemption.) Depending on the circumstances, if an investment adviser hires a solicitor to market its services in a given state, the investment advisor could be viewed as “holding itself out” in that state. By analogy, two influential states--Connecticut and Washington--have taken the position that an investment adviser is deemed to “hold itself out” if its services are offered to the public in such states through wrap fee programs. *See, e.g., Registration Requirements for Independent Investment Advisers Participating in Broker-Dealer Sponsored Wrap Fee Programs*, Connecticut Department of Banking Policy Statement (October 13, 1993).

C. CPA Issues.

In many states, a certified public accountant (“CPA”) may accept the payment of solicitation fees for the referral of clients to an investment adviser. The payment of solicitation fees to a CPA is governed by state accountancy law and, in particular, its code of ethics. The American Institute of Certified Public Accountants

("AICPA") has developed a model standard that has been adopted by most states, and, in many cases, with some modifications.

### III. Retirement Account Issues.

#### A. ERISA Issues.

Payment of solicitation fees for the referral of clients that are pension or other employee benefit plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA") might result in prohibited transactions under ERISA. This concern was noted by the SEC when it first adopted Rule 206(4)-3, but there has been very little guidance from the SEC or the Department of Labor ("DOL") in this area.

Persons who are fiduciaries under ERISA are bound by express fiduciary duties, including the obligation to act "solely in the interest" of the plan and its participants and beneficiaries and for the "exclusive purpose" or "exclusive benefit" of the plan and its participants and beneficiaries (duty of loyalty). In addition, these rules are supplemented with very broad and stringent prohibited transaction rules.

#### 1. Primer on Prohibited Transactions.

Qualified plans and their fiduciaries are subject to the prohibited transaction provisions of Sections 406(a) and (b) of ERISA and Section 4975 of the Internal Revenue Code (the "Code"). In general, Section 406(a) prohibits certain activities between a plan and a "party in interest." The term "party in interest" is defined by ERISA Section 3(14) to include various classes of individuals and entities who can be expected to have interests that conflict with the interests of the plan for which they are parties in interest. For example, a party in interest as to any employee benefit plan includes a fiduciary, counsel, employee or service provider of such plan and certain of their relatives and affiliates. Section 406(b) prohibits plan fiduciaries from engaging in acts involving self-dealing, conflict of interest and other specific violations of ERISA's "exclusive benefit" rule.

Specifically, Section 406(a)(1) provides that, except as provided in Section 408, "[a] fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect . . . (C) Furnishing of goods, services, or facilities between the plan and a party in interest; [or] (D) Transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan."

In addition, Section 406(b) of ERISA provides that a fiduciary with respect to a plan shall not "(1) deal with the assets of the plan in his own interest or for his own account ("self-dealing"); (2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interest are adverse to the interests of the plan or the interests of its participants or beneficiaries (conflict of interest); or (3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan" ("kickbacks"). The prohibitions of Section 406(b) are broader in scope than the activities proscribed by Section 406(a) and supplement Section 406(a) by imposing on parties in interest who are fiduciaries a duty of undivided loyalty to the plans for which they act.

Violations of the prohibited transaction rules can result in onerous excise tax penalties, equitable remedies (injunction) and, in extreme cases, criminal penalties.

2. Application to Solicitation Arrangements.

a. Fiduciaries.

Section 406(b) of ERISA would prohibit a plan fiduciary from receiving solicitation fees for referring to an investment adviser a plan for which he or she serves as a fiduciary. Since the solicitor's entitlement to fees would be conditioned on the plan's actually hiring and paying advisory fees to an investment adviser, the hiring of an investment adviser would indicate that the fiduciary was dealing with plan assets "in his own interest or for his own account," or receiving "consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan," activities that are clearly prohibited under Sections 406(b)(1) and (3). In addition, it would appear that a prohibited transaction would result even if the decision to hire the participating investment adviser was made by a second, disinterested fiduciary.

The receipt of a solicitation fee by a plan fiduciary could also expose the plan fiduciary to criminal liability under Section 1954 of Title 18 of the U.S. Code. This Section makes it a crime for plan fiduciaries and other persons associated with an employee benefit plan to receive or solicit anything of value in return for influencing decisions or actions of the plan.

Even though an investment adviser paying solicitation fees to a plan fiduciary is not a direct violation of ERISA's prohibited transaction provisions, the investment adviser may be subject to aiding and abetting liability under Federal and state law on the theory that, by offering solicitation fees, the investment adviser induced the violations by the fiduciary.

As a general matter, to alleviate possible prohibited transaction concerns, investment advisers should not pay solicitation fees to any person who is a fiduciary with respect to an ERISA plan being referred by such person. Depending on the facts, it may be possible, however, to pay solicitation fees to a fiduciary without there being a violation of Sections 406(b)(1) or (3) if the fiduciary disgorges the solicitation fees to the ERISA plan to which he or she is a fiduciary, or otherwise applies the fees as a credit against other fees properly payable to the fiduciary by the plan. Cf. DOL Advisory Opinion 96-15A to Frost National Bank.

b. Non-Fiduciary Service Providers.

The applicability of ERISA's prohibited transaction provisions to the receipt of solicitation fees by third parties (including service providers to a plan) who are not fiduciaries to the plan in exchange for referring a plan to an investment adviser is less clear than in the absolute prohibition in the case of plan fiduciaries. In a DOL information letter, the DOL considered whether, under ERISA Sections 406(a) and 404(a)(1), it was permissible for a service provider (in that case a public accountant for employee benefit plans) to receive a finders fee from unaffiliated banks for the referral of plan deposits. *See* DOL Information Letter to Eugene Rubin, East New York Savings Bank (Dec. 9, 1980). In this DOL information letter, the DOL took the position that, because Section 406(a)(1)(D) of ERISA prohibits the transfer to or use by or for the benefit of a party in interest of any assets of an employee benefit plan, if plan fiduciaries invest plan funds in a certain account for the purpose of allowing a party in interest to obtain a finders fee, a prohibited transaction would occur. In addition, the DOL suggested that the transfer of funds by a plan fiduciary for the purpose of obtaining a fee for a third party might be an act that would also violate the exclusive benefit rule of Section 404(a)(1) of ERISA. This is significant because, even if Section 406(a)(1)(D) did not apply to a given case because the person receiving the referral fee was not a service provider to the referred plan, the exclusive benefit rule of Section 404(a)(1) would still prohibit the plan fiduciary from investing plan assets to benefit such individual.

Nonetheless, absent some evidence to the contrary, an investment adviser probably can make a reasonable determination, with proper representations and warranties, that the plan's investment was not principally motivated by payment of a solicitor's fee. The exclusive benefit rule of ERISA does not prohibit a transaction merely because it confers an "incidental," or secondary, benefit on an otherwise unaffiliated person.

In addition, in the care of a non-fiduciary solicitor, it is also necessary to consider the nature of the solicitor's fee arrangement in determining whether the arrangement raises ERISA concerns. Specifically, it would be a breach of fiduciary duty, and could be a prohibited transaction, for the plan's authorizing fiduciary to agree to payment of a fee that is not "reasonable," either in amount or duration. For example, some solicitors seek to obtain a recurring annual payment for so long as the plan remains invested with the adviser. In these cases, the fee might be considered unreasonable unless the solicitor continues to perform meaningful services to the plan so as to justify the fee.

3. Possible Approaches to Dealing With Prohibited Transaction Concerns.

To alleviate possible prohibited transaction concerns arising in connection with the payment of solicitation fees for the account of a pension plan under ERISA, it is important to document the following facts:

a. Fact One: That the solicitor is not a fiduciary with respect to the referred plan.

This fact is best documented by having the solicitor represent that he or she is not a fiduciary with respect to the referred plan. This may be accomplished by inserting into the solicitation agreement language to the effect that, by referring a plan, the solicitor is deemed to represent that he or she is not a fiduciary with respect to the plan. However, the adviser needs to be comfortable that the solicitor fully understands the nature of its representation.

The above representation should be backed up by (a) an acknowledgment by the named fiduciary that the solicitor is not a fiduciary to the plan; and (b), since a person can inadvertently become a “fiduciary” to a plan if, depending on the facts, the plan or its named fiduciaries relies on the person’s advice, a representation from the named fiduciary that he or she did not rely on any recommendation by the solicitor as the principal basis in choosing the investment adviser. These representations could be incorporated into account opening documents or the client acknowledgment required by Rule 206(4)-3, discussed above.

Moreover, an investment adviser paying solicitation fees with respect to the referral of a plan should review the plan’s documentation to ensure that the solicitor is not indicated as being a fiduciary with respect to the plan.

- b. Fact Two: That the named fiduciary did not choose the investment adviser for the purpose of allowing the solicitor to obtain the solicitation fee.

This fact can be documented by a representation from the named fiduciary incorporated into account opening documents or the client acknowledgment required by Rule 206(4)-3, as discussed above.

#### B. Governmental Plans.

##### 1. Prohibited Transaction Rules.

Even though governmental plans are not subject to the prohibited transaction provisions of ERISA or the Code, many states have adopted equivalent provisions designed to prevent self-dealing and conflicts of interest on the part of plan fiduciaries. Accordingly, the same general principles should be followed when dealing with governmental plans (although it would be wise to consult with local counsel to ensure that the given laws are not even more stringent).

##### 2. State and Municipal Conflict of Interest and Anti-Bribery Laws.

Aside from laws based on ERISA’s prohibited transaction provisions, states and municipalities have increasingly tightened their laws pertaining to conflicts of interest and bribery in connection with the award of government contracts and other privileges. Payment of solicitation fees to governmental employees or, in some cases, former government employees, could trigger these prohibitions. Accordingly, in connection with a referral of a state or municipal plan, investment advisers should scrutinize closely any proposal that they pay a solicitation fee to any person who, for example, has been within the past several years a civil servant or an elected official or has been retained to provide professional services to the plan, or will share any part of the solicitation fees with anyone who is or was so affiliated with the plan.

#### IV. “Pay to Play” Restrictions.

The SEC proposed Rule 206(4)-5 that would effectively prohibit investment advisers and their solicitors from making political contributions to governmental officials with influence over the award of advisory contracts for government clients. The proposal is intended to eliminate “pay to play,” which the SEC believes undermines merit-based selection processes and is inconsistent with high standards of ethical conduct. The rule is modeled on Rule G-37 of the Municipal Securities Rulemaking Board, which effectively prohibits pay to play by broker-dealers in the municipal securities market. While the rule’s intent to eliminate egregious conduct is laudable, it will impose a substantial monitoring and compliance burden on advisory firms that manage money for government clients.

Proposed Rule 206(4)-5 generally would prohibit an adviser from providing advisory services for compensation to a government client<sup>5</sup> for two years after the adviser or certain related persons make a political contribution to government officials with influence over the selection process. Importantly, an adviser's "related persons" would include the adviser's partners, executive officers, and solicitors (internal or external) for the adviser, as well as any political action committee they control. Technically, the rule does not prohibit political contributions, but it prohibits an investment adviser from being *compensated* by a government client where a contribution has been made.<sup>6</sup>

A. Basic Prohibitions.

The rule's prohibitions would apply to contributions and fund raising by an investment adviser and related persons. A "contribution" is defined to include anything of value given to influence a federal, state, or local election, including the payment of debts incurred in an election and transition or inaugural expenses incurred by a successful candidate. The rule also would apply to contributions to state and local political parties, but not other parties (unless the contribution is earmarked for an official). There is a *de minimis* exception for contributions by key employees/persons of \$250 or less per election if they are entitled to vote for the candidate (e.g., they could contribute \$250 in a primary election and \$250 more in a general election for the same candidate). The rule would not apply to contributions made prior to the rule's effective date.

The SEC can, upon application, exempt an adviser from the rule's prohibitions if they are triggered inadvertently or if their application is inconsistent with the rule's intended purpose<sup>7</sup>. In addition, SEC-registered advisers who have government clients would be required to keep certain records regarding any political contributions.

B. Government Officials Covered by the Rule.

The rule defines a government "official" to include an incumbent, candidate or successful candidate for elective office of a government entity if the office (or an appointee) is responsible for, or can influence, the selection of an investment adviser for a government client. Executive and legislative officers who hold a position with influence over the selection of an investment adviser generally are subject to the rule,. Whether a particular official has "influence" over the awarding of a contract depends on the scope of authority of the office, not the individual.<sup>8</sup>

---

<sup>5</sup> A "government client" includes all state and local governments, their agencies and instrumentalities, and all government pension plans and other collective government funds. Where a government client invests in a private investment company, the rule treats the investment in the same manner as if the government entity entered into an advisory contract directly with the adviser.

<sup>6</sup> Indeed, the SEC notes that an adviser who violates the rule may be required, under its fiduciary duties, to continue to provide advisory services without charge to a public fund for a reasonable period of time until the fund finds a new adviser.

<sup>7</sup> Under the proposal, an adviser applying for an exemption could place fees in an escrow account for the period between the date of the violation and the date on which the SEC determines whether to grant an exemption. If granted, the adviser would receive the fees; if denied, the fees would be returned to the government client.

<sup>8</sup> For example, if authority to select and terminate an adviser is completely delegated to a public fund's staff and an official has no ability to influence the selection, the official would not be covered by the rule.

V. Selected Business and Legal Issues Arising in Contract Negotiations.

A. Who bears the burden of documenting whether a client was actually referred by a solicitor?

Sometimes it is helpful to set up a reporting mechanism to help avoid disputes in this area -- such as when a solicitor claims to have referred a client who was already in contact with the investment adviser or was referred to the investment adviser (perhaps by another solicitor who is likewise claiming a fee on that referral).

B. Exclusivity.

Some solicitors insist on having exclusive arrangements, although, depending of the base of prospects being pursued, it may be possible to get them to settle on an exclusive territory. Conversely, some investment advisers want to restrict their solicitors from representing other investment advisers with similar investment styles or philosophies.

C. Dispute Resolution.

Disputes over who “landed” a client can easily spill over into litigation and unwanted publicity. For this reason, and to limit legal costs, it may be preferable to provide that disputes will be settled by arbitration (which can often provide a less “public” manner of resolving disputes than through the court system).

D. Trailing and So-Called “Momentum” Fees.

Many solicitors want their fees to continue after the termination of their solicitation agreements and, in some instances, want fees on clients who were purportedly “in the works” but had yet to hire the investment adviser when the solicitation agreement was terminated. Aside from business issues affecting the desirability of such fee arrangements, as noted above, Rule 206(4)-3 prohibits an investment adviser from paying a solicitation fee to a solicitor unless there is a written agreement satisfying certain conditions. This requirement of the Rule could be invoked, if necessary, to quash demands for this type of continuing compensation. Theoretically, however, it might be possible to structure the payment of these types of fees pursuant to a “non-solicitation” agreement providing that the terminated solicitor would be entitled to continuing compensation only for so long as he or she were not subject to a disqualification and did not directly or indirectly solicit any prospective or current client of the investment adviser.

E. Restrictions on Marketing Materials.

Solicitors often want latitude in fashioning marketing materials on the background and performance of investment advisers for whom they solicit, and some individuals have been overly aggressive in this area. Investment advisers should be sure that their solicitor, if a firm, has a solid compliance program and if not, the adviser should insist that all written materials be pre-cleared by the investment adviser and, as appropriate, usage guidelines established (*e.g.*, even if an investment adviser is comfortable with a solicitor disseminating the investment adviser’s “gross” performance figures, the investment adviser should make sure that the solicitor only distributes such figures in one-on-one communications).

## VI. How to Evaluate a Solicitor.

An investment adviser should review the background and practices of any solicitor it proposes to engage to ensure that the investment adviser is comfortable with the solicitor's practices -- as well as assure itself that the solicitor is not a disqualified person.

### A. Review the Solicitor's Form ADV.

Given the current regulatory setting, most solicitors should be registered as investment advisers (or associated with registered investment advisers). An investment adviser should review the Form ADV for any solicitor with whom it proposes to deal. The manner in which the solicitor has filled out the Form ADV will tell a lot about how knowledgeable the solicitor is about regulatory aspects of the investment advisory business and how serious the solicitor takes such matters. The solicitor's responses to the disciplinary questions in Form ADV are also important in documenting that the solicitor is not subject to a disqualification.

### B. Brokerage Firm Approval

If the solicitor is an individual who works for a brokerage firm and is conducting solicitation activities apart from his or her firm, the investment adviser should ask for a copy of the solicitor's notice to the firm of his or her solicitation activities (under NASD Rule 40 or 43, as applicable) and any letter or notice from the firm approving these activities. Many brokerage firms limit their agents' solicitation activities to referrals of investment advisers that have been vetted by the firms or may seek to supervise their agents' solicitation activities. If the solicitor is subject to these sort of requirements but has not given notice of his or her solicitation activities, this should certainly be considered when evaluating the solicitor's integrity.

### C. References.

An investment adviser should request references -- both from other investment advisers to which the solicitor has referred business, as well as from consultants and clients with whom the solicitor has dealt in the past.

### D. Prior Disputes.

An investment adviser may wish to ask the solicitor to disclose any disputes with other investment advisers or clients in which the solicitor has been involved in connection with his or her solicitation activities. Although some solicitors may fail to divulge these sort of disputes, others will volunteer information if they fear that news of such disputes is already circulating within the investment community.

### E. Miscellaneous "Due Diligence".

Finally, an investment adviser might want to search various databases and sources of public information for information concerning the solicitor. These sources include the NASD "hotline" (Telephone: 800/289-9999) and the disciplinary and litigation libraries in LEXIS-NEXIS (*e.g.*, DOCKET Library, SANCTN file).

Overall, the best approach is to "know your solicitor" and choose a reputable and experienced firm.

**REQUIREMENTS GOVERNING PAYMENTS OF  
CASH REFERRAL FEES BY INVESTMENT ADVISERS**

SECURITIES AND EXCHANGE COMMISSION  
INVESTMENT ADVISERS ACT OF 1940  
Release No. 688  
1979 SEC LEXIS 1103

July 12, 1979

*ACTION: Adoption of rules.*

**SUMMARY:** The Commission is (1) adopting a new rule ("cash referral fee rule") under the Investment Advisers Act of 1940 ("Advisers Act") which makes it unlawful, except under specified circumstances and subject to certain conditions, for an investment adviser to make a cash payment to a person ("solicitor") who directly or indirectly solicits any client for, or refers any client to, an investment adviser, and (2) amending the recordkeeping rule under the Advisers Act to require an investment adviser to maintain certain records relating to the solicitation of clients under the cash referral fee rule.

**EFFECTIVE DATE:** September 30, 1979.

**FOR FURTHER INFORMATION CONTACT:** Michael J. Eizelman, Esq. or Thomas D. Maher, Esq. (202-755-3507), Office of Investment Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549.

**SUPPLEMENTARY INFORMATION:** On February 2, 1978, the Commission issued a notice (Investment Advisers Act Release No. 615) n1 that it had under consideration the adoption of a new Rule 206(4)-3 n2 under the Advisers Act n3 which would set forth conditions under which an investment adviser could pay a cash referral fee to a person who solicits clients for him. The Commission also indicated that, as an alternative, it was considering a rule which would completely prohibit cash payments by investment advisers to persons who solicit cash payments by investment advisers to persons who solicit clients for them.

n1 43 FR 6095, February 13, 1978.

n5 The Commission is also amending Rule 204-2 under the Advisers Act to require that the adviser

n2 17 CFR 275.206(4)-3. The Commission also proposed an amendment to Rule 204-2 under the Act [17 CFR 275.204-2] to require an investment adviser to maintain certain records relating to the solicitation on clients under proposed Rule 206(4)-3.

n3 15 U.S.C. 80b-1, et seq.

As stated in Advisers Act Release No. 615, the Commission has received interpretive requests concerning the applicability of the Advisers Act to arrangements pursuant to which an investment adviser compensates another person for recommending the adviser to a client or prospective client. In view of the frequency of such requests, the conflicts of interest presented by such arrangements, and the failure of the Advisers Act to address specifically the propriety of such arrangements, the Commission determined that it would be useful, both for the Commission and the investment advisory industry, to institute a rulemaking proceeding addressing the applicability of the Advisers Act to cash payments for such referral services. n4

n4 The release specifically did not address the question of when, if at all, persons referring clients to investment advisers could properly be compensated by means of directed brokerage, rather than cash payments. As noted in Advisers Act Release No. 615, the cash referral fee rule should not be taken as an indication that the use of clients' brokerage to pay referral fees is proper.

Upon consideration of the public comments, the Commission determined not to adopt a rule totally prohibiting the payment of cash referral fees by investment advisers, but instead to adopt new Rule 206(4)-3 delimiting the circumstances under which an investment adviser, directly or indirectly, may pay such a fee to someone who, directly or indirectly, solicits clients for, or refers clients to, the adviser. Rule 206(4)-3 prohibits any investment adviser required to be registered pursuant to Section 203 of the Advisers Act from making a cash referral fee payment to a solicitor unless certain conditions, which are described below, are satisfied. n5

maintain copies of disclosure documents furnished by solicitors and acknowledgments received by clients.

Furthermore, copies of the agreement between the adviser and the solicitor must be maintained under existing paragraph (a)(10) of Rule 204-2.

## DISCUSSION

### *I. Cash Referral Fees*

**Proposed Prohibition.** The initial issue presented by the Commission in Advisers Act Release No. 615 was whether payment of cash referral fees should be prohibited, or instead permitted subject to regulatory safeguards. The overwhelming majority of commentators favored the regulation of cash referral fees.

Many commentators expressed the view that reasonable disclosed cash referral fees, like expenditures for advertising and other methods of developing new business, should be considered to be an acceptable part of an investment adviser's overhead. A total prohibition, it was said, might have anti-competitive consequences since large investment advisers with in-house sales staffs would have an advantage over smaller advisers, and this advantage would not necessarily bear any relationship to the quality and price of the service offered. In addition, some commentators maintained that a total prohibition on cash referral fees would place investment advisers at a disadvantage with respect to banks, insurance companies, and broker-dealers. It was also suggested that a prohibition of cash fees might lead to use of other, possibly undisclosed, methods of compensation, such as directed brokerage. n6

n6 See note 4 supra.

On the other hand, a few commentators contended that the payment of cash referral fees involves unacceptable conflicts of interest and should not be permitted under any circumstances. Although referral fee arrangements pose conflict of interest problems, the Commission is not persuaded that such arrangements are necessarily fraudulent and therefore should be prohibited. Rather, the Commission is of the view that, with appropriate regulatory safeguards, the payment of cash referral fees can be permitted consistent with the protection of investors, and that an outright prohibition of such fees would unnecessarily restrict the ability of investment advisers to make their services known to potential clients. n7 Accordingly, the Commission has

determined to adopt proposed Rule 206(4)-3 with modifications discussed below.

n7 One commentator suggested that the rule should take the form of a safe harbor. In support of this position, it was argued that the interests of investors in connection with solicitation activities might be protected by means other than those specified in the rule, and that such other means should not be precluded since they might be preferable from a business standpoint. However, because of the potential for abuse which exists in connection with payments for solicitation services, the Commission believes that specific regulatory safeguards are needed and that for that reason a safe harbor rule in this area would not be appropriate.

**Cash referral fee rule.** Paragraph (a) of Rule 206(4)-3 limits the circumstances under which an investment adviser may pay a cash referral fee, directly or indirectly, to a solicitor. A solicitor is defined in paragraph (d)(1) of the rule as "any person who, directly or indirectly, solicits any client for, or refers any client to, an investment adviser." no The rule as adopted also contains a definition of "client," in paragraph (d)(2), to make clear that term includes prospective clients.

n8 This definition is similar to that contained in the proposed rule. It has been modified slightly, in part to make clear that a person could Be a solicitor within the meaning of the rule if he supplies the names of clients to an investment adviser, even if he does not specifically recommend to the client that he retain that adviser.

The rule applies to any investment adviser required to be registered pursuant to Section 203 of the Advisers Act. n9 It prohibits the payment of cash referral fees to solicitors unless four conditions are met. The first three conditions apply to all cash referral fee payments subject to the rule.

n9 Some commentators suggested that the rule should apply to all advisers, whether registered or not. In most if not all cases, however, an adviser who engaged a solicitor would be holding himself out as an investment adviser and thus would not be excepted from registration under Section 203(b)(3) of the Advisers Act [15 U.S.C. 80b-3(b)(3)], which is the most commonly relied upon exception from registration, even if he had fewer than fifteen clients during the preceding twelve months.

The first condition, set forth in paragraph (a)(1)(i) of the rule, is that the investment adviser be registered under the Advisers Act. Accordingly, the rule prohibits cash referral fee payments to a solicitor by an investment adviser required to be registered but who is not so registered.

The second condition, set forth in paragraph (a)(1)(ii), prohibits payment of cash referral fees to a solicitor who is subject to a statutory disqualification. The solicitor cannot be a person (i) subject to a Commission order issued under Section 203(f) of the Advisers Act [15 U.S.C. 80b-3(f)], or (ii) convicted within the previous ten years of any felony or misdemeanor involving conduct described in Section 203(e)(2)(A)-(D) of the Advisers Act or (iii) who has been found by the Commission to have engaged, or has been convicted of engaging, in any of the conduct specified in paragraphs (1), (4), or (5) of Section 203(e) of the Advisers Act, or (iv) is subject to an order, judgment or decree described in Section 203(e)(3) of the Advisers Act [15 U.S.C. 80b-3(e)(1)(5)]. n10

n10 The statutory disqualification condition has been modified in response to comment letters which objected to certain portions of the proposed language as being, among other things, unduly vague.

As noted in Advisers Act Release No. 615, a finding that a person has engaged in the conduct specified in Section 203 only authorizes and does not require the Commission to bar such persons from being associated with a registered investment adviser. The Commission would entertain, and be prepared to grant in appropriate circumstances, requests for permission to engage as a solicitor a person subject to a statutory bar.

The third condition, set forth in paragraph (a)(1)(iii), requires cash referral fees to be paid pursuant to a written agreement to which the investment adviser is a party. The written agreement must be kept as part of the investment adviser's books and records, pursuant to paragraph (a)(10) of Rule 204-2 under the Advisers Act. n11

n11 This and other recordkeeping requirements relating to cash referral fees are discussed infra.

The fourth condition is stated in the alternative. Even if the first three conditions are met, cash referral fee This exclusion for impersonal advisory services reflects the Commission's understanding that prospective clients normally would be aware that a

payments are still prohibited unless they are made in one of three circumstances specified in this final condition. These circumstances are discussed below.

Impersonal advisory services. The first circumstance, set forth in paragraph (a)(2)(i) of the rule, relates to impersonal advisory services. This paragraph permits such payments to be made to a solicitor who solicits clients only for the provision of impersonal advisory services. The term "impersonal advisory services" is defined in paragraph (d)(3) of the rule to mean (i) written materials or oral statements which do not purport to meet the objectives or needs of specific clients, (ii) statistical information containing no expression of opinions as to the investment merits of particular securities, or (iii) any combination of the foregoing services.

Under this paragraph, a registered investment adviser who offers any impersonal advisory services may pay cash referral fees to solicitors. In addition, a registered investment adviser who offers a full line of advisory services, including impersonal services, may pay cash referral fees to a solicitor whose solicitation activities relate exclusively to the investment adviser's impersonal advisory services. On the other hand, an investment adviser would not be permitted under paragraph (a)(2)(i) of the rule to pay cash referral fees to a solicitor whose solicitation activities were not limited to the adviser's impersonally advisory services, even though the client might ultimately receive only impersonal advisory services. n12

n12 For example, an investment adviser who manages client accounts and publishes an advisory newsletter might engage a solicitor to solicit persons with respect to either or both of these services. The adviser could pay a fee under paragraph (a)(2)(i) of the rule if the solicitor recommended only the newsletter to a prospective client. If the solicitor recommended both the account management and newsletter services of the adviser to a client, a referral fee could not be paid pursuant to paragraph (a)(2)(i) even if the client decided to purchase the newsletter only. A fee might be paid, however, pursuant to the provisions of paragraph (a)(2)(iii) which sets forth the conditions applicable to fees paid to third party solicitors for other than impersonal advisory services.

person selling such services was a salesman who was paid to do so. The proposed exemption was supported by almost all commentators who addressed it and it is

being adopted with only minor changes. However, instead of a total exemption from the requirements of the rule, cash referral fees can be paid pursuant to paragraph (a)(2)(i) only if the three conditions in paragraph (a)(1) are met. That is, such payments can only be made by a registered investment adviser, pursuant to a written agreement, to a solicitor who would not be subject to a statutory disqualification under Section 203(e) or (f) of the Advisers Act.

Persons affiliated with the adviser. Paragraph (a)(2)(iii) of the rule sets forth the second circumstance when a registered investment adviser may pay a cash referral fee. Under this provision, an investment adviser may pay such a fee to a solicitor who is (i) a partner, officer, director or employee of the adviser or (ii) a partner, officer, director or employee of a company which controls, is controlled by, or is under common control with, such investment adviser. As a condition of cash referral fees being paid, the solicitor must disclose his status as partner, officer, director or employee of the investment adviser or the company which controls, is controlled by, or is under common control with the investment adviser. If the solicitor is associated with such an affiliated company rather than with the investment adviser directly, the nature of the affiliation between that company and the investment adviser must also be disclosed. n13

n13 An investment adviser is reminded that existing provisions of Advisers Act's recordkeeping requirements may apply to solicitation activities engaged in under paragraph (a)(2)(ii) of the rule. Thus, for example, the written agreement required in paragraph (a)(1)(iii) must be maintained as part of an investment advisers' books and records pursuant to paragraph (a)(10) of Rule 204-2. In addition, an investment adviser is required pursuant to paragraph (a)(12) of Rule 204-2 to maintain a record of securities transactions of any person who is an "advisory representative" as defined in that rule.

This paragraph represents a change from the proposed rule. As proposed, Rule 206(4)-3(a)(1) would have excluded from the written disclosure provisions of the rule only employees of the investment adviser whose primary duties relate to the investment advisory business of the adviser or who were clearly identified as sales representatives for the adviser. The reason for limiting the exemption to such employees or sales representatives of the adviser was that prospective clients would be aware of the natural predilection of

such employees to recommend their employers, whether or not the client received specific disclosure that the employee would be compensated for bringing in new business.

The narrowness of the exemption as proposed was criticized by a number of commentators. It was argued that the rule would present difficulties in classifying employees, and that the employee's bias and the likelihood of compensation would be apparent to prospective clients regardless of the employee's normal duties. Commentators also suggested that the exemption from written disclosure and recordkeeping requirements should be extended to persons associated with certain affiliates of the adviser when the affiliation is disclosed to the client. It was argued that there is little basis for assuming that potential clients will be any less aware of the inherent bias when an employee recommends an adviser who is a person associated with his employer than when he recommends the advisory services of his own employer.

In light of the comments, the Commission has concluded that the objective circumstances surrounding all employees of the adviser and certain close affiliates are such as to ensure that prospective clients would be aware of the solicitor's bias. As long as a client is aware that the recommended adviser is the solicitor's employer or a close affiliate of the solicitor's employer, there appears to be little need to require the imposition of additional disclosure and recordkeeping requirements regardless of the specific duties of the solicitor. Therefore, the rule as adopted does not impose such additional requirements with respect to payments made to any solicitor who is a partner, officer, director or employee of the recommended adviser and who is identified as such, or who is a partner, officer, director or employee of a company controlling, controlled by, or under common control with the investment adviser, provided that there is disclosure of the solicitor's relationship with the company and of that company's relationship with the recommended investment adviser.

Third party solicitors. The third circumstance in which cash referral fees may be paid is set forth in paragraph (a)(2)(iii) of the rule. This provision governs payments to solicitors (for other than impersonal advisory services) who are not partners, officers, directors or employees of the adviser or a person closely affiliated with the adviser. This provision has been substantially modified in response to public comments.

Under paragraph (a)(2)(iii)(A) as adopted, an investment adviser may pay a cash fee to a solicitor if the investment adviser enters into a written agreement with the solicitor which (i) describes the solicitation activities to be engaged in on behalf of the adviser, (ii) contains an undertaking by the solicitor to perform his duties under the agreement in a manner consistent with the instructions of the investment adviser and the provisions of the Advisers Act and rules thereunder, and (iii) requires that the solicitor, at the time of the solicitation, deliver to the client a current copy of the adviser's written disclosure statement ("brochure") required by Rule 204-3 [17 CFR 275.204-3] (the "brochure rule") and a separate written disclosure document containing the information required by paragraph (b) of the rule, which is described below.

In addition, paragraph (a)(2)(iii)(B) requires the investment adviser to receive from the client, prior to 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 investment adviser's brochure and the solicitor's written disclosure document. As proposed, the rule would have required that the acknowledgment be received prior to the inception of the advisory relationship. In response to comments, the rule has been amended to require receipt of the acknowledgment no later than, but not necessarily prior to, the inception of the advisory relationship.

The proposed rule did not contain a provision requiring the solicitor to deliver a copy of the adviser's brochure, since the Commission had not yet adopted Rule 204-3 requiring the delivery of a brochure. The Commission believes that the requirement that the solicitor deliver a current copy of the adviser's brochure will be useful to clients and will not impose an undue burden upon solicitors or investment advisers. n14 Furthermore, delivery of a brochure by the solicitor will, in most cases, satisfy the investment adviser's obligation to deliver a brochure to the client under Rule 204-3.

n14 It should be noted that, even if the information required in the solicitor's written disclosure statement is contained in the investment adviser's brochure, that information would nonetheless have to be supplied to the client in a separate document. The Commission believes that such separate disclosure is necessary in order to ensure that the client's attention will be directed to the fact that a cash referral fee is being paid.

Upon consideration, the Commission agrees and has decided to require disclosure of the fee arrangement

Finally, paragraph (a)(2)(iii)(C) requires the investment adviser to make a bona fide effort to ascertain whether the solicitor is in compliance with the terms of the agreement and to have a reasonable basis for believing that the solicitor is in compliance.

The proposed rule would have required the investment adviser to supervise the solicitation activities of the solicitor "as if the solicitor were one of its own employees." This requirement was criticized by a number of commentators, many of whom argued that it was impractical and might be inconsistent with a solicitor's status as an independent contractor. The Commission now recognizes that this proposed provision may be somewhat impractical in light of the circumstances. Nevertheless, the Commission believes that supervision is necessary to protect the interests of investors. Sufficient protection can be achieved by requiring that the adviser make a bona fide effort to ascertain that the solicitor has complied with the agreement entered into pursuant to the rule, and that the adviser take appropriate action if the solicitor has not so complied, without requiring that the adviser supervise the solicitor as if he were one of the adviser's own employees.

The questions of what would constitute such a bona fide effort would, of course, depend upon the circumstances. In general, however, it would seem that such a bona fide effort would, at a minimum, involve making inquiries of some or all clients referred by the solicitor in order to ascertain whether the solicitor has made improper representations or has otherwise violated the agreement with the investment adviser.

As proposed in Advisers Act Release No. 615, the rule would have required the periodic delivery of an updated disclosure statement if additional fees were to be paid with respect to an advisory agreement which was extended beyond the period of the initial advisory agreement or beyond one year, whichever was less, notwithstanding that the terms of such fee arrangement, including its duration, had been disclosed in the disclosure statement initially furnished to the advisory client. This requirement was criticized as imposing a substantial administrative burden which was unnecessary because of the simple nature of the matter disclosed.

only at the time of the solicitation regardless of the nature of the fee to be paid. The disclosure of the

solicitor's financial interest in the client's choice of an investment adviser is important at the time the solicitation in order for the client to evaluate properly the solicitor's recommendation. However, the client's decision to continue an advisory relationship, once established, will presumably be based upon the solicitor's prior recommendation or the continuing nature of the solicitor's compensation for that recommendation. n15

n15 However, if the solicitor received separate compensation, in addition to that which had previously been disclosed, for recommending that the client continue an advisory relationship already established, that would constitute payment for another distinct solicitation and all the requirements of the rule would again have to be complied with.

Deleted from the final rule is a paragraph that would have required the adviser to have a reasonable belief that the client is capable of evaluating the information in the disclosure document. Several commentators suggested, and the Commission agrees, that it can reasonably be assumed that advisory clients are capable of evaluating the fact that the solicitor is to receive a fee for the solicitation of the client, and that a specific requirement in this regard is unnecessary.

Content of written disclosure document. Paragraph (b) of the rule specifies the content of the disclosure document to be given to prospective clients by the third party solicitor. The disclosure document must include the name of the solicitor, the name of the investment adviser, and the nature of the relationship between the solicitor and the investment adviser. In addition, this document must disclose the fact that the solicitor will receive compensation, the terms of the compensation arrangement, and indicate whether the client will pay a specific charge or a higher advisory fee because a solicitor recommended the investment adviser to the client.

The content of the disclosure document is substantially unchanged from the rule as proposed. Despite the criticism of some commentators, the Commission believes that the terms of the compensation paid or to be paid to the solicitor are relevant to a prospective client's evaluation of the solicitor's recommendation. Thus, if a specific amount of compensation were being paid, that amount would be required to be disclosed. If, instead of a specific

The cash referral fee rule requires an adviser to receive from a client referred by a third party solicitor

amount, the solicitor's compensation was to take the form of a percentage of the total advisory fee over a period of time, that percentage and the time period would have to be disclosed. If all, or part, of the solicitor's compensation is deferred or it contingent upon some future event, such as the client's continuation or renewal of the advisory relationship or agreement, such terms would also have to be disclosed.

Investment advisers and solicitors who intend to rely upon the cash referral fee rule are reminded, and the rule specifically provides in paragraph (c), that nothing in the rule is to be deemed to relieve any investment adviser or solicitor of any fiduciary or other obligation which he may have under any law. n16

n16 The rule is not intended to suggest the scope and nature of any obligations an adviser or solicitor might have under the securities laws or under other laws. For this reason, and in response to a comment, the rule as adopted omits the proposed rule's reference to a solicitor's obligation to recommend an adviser "best suited" to a client. With respect to the possible relevance of other laws, the Commission notes that, where the solicited client is a pension plan or other employee benefit plan, payment of a fee to the solicitor might, depending upon the circumstances, result in a prohibited transaction under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1954 (Code). The rule being adopted of course provides no relief from ERISA or the Code.

## *II. Recordkeeping Requirements*

In proposing the cash referral fee rule, the Commission also proposed a related amendment to Rule 204-2 under the Advisers Act, the recordkeeping rule. That amendment is being adopted in somewhat modified form.

Rule 204-2(a)(10) currently requires an investment adviser to keep, for five years, copies of all written agreements relating to the business of the investment adviser as such. Since the written agreements with solicitors entered into under the newly adopted cash referral fee rule will relate to the business of the investment adviser, they will be subject to the recordkeeping provisions of Rule 204-2(a)(10) and an amendment to the recordkeeping requirements with respect to such agreements is unnecessary.

an acknowledgment that the client has received from the solicitor a copy of the adviser's current brochure and a

separate written disclosure document containing the information required by paragraph (b) of Rule 206(4)-3. The Commission is amending Rule 204-2 by adding a new paragraph (a)(15), requiring that an investment adviser keep copies of both such client acknowledgments and the written disclosure statements furnished by solicitors. n17

n17 The adviser's brochure must be retained pursuant to existing paragraph (a)(14) of Rule 204-2.

### *III. Status of Solicitors under the Advisers Act*

As noted in Advisers Act Release No. 615, certain staff interpretative positions concerning the applicability of the Advisers Act to referral arrangements have stated that a solicitor must either be registered under the Advisers Act or a person associated with an investment adviser n18 as defined in Section 202(a)(17) of the Advisers Act [15 U.S.C. 80b-2(a)(17)]. n19 In that release the Commission expressed the view that a solicitor who engaged in solicitation activities in accordance with paragraph (a)(3) of the proposed rule would be a person associated with an investment adviser and therefore would not be required to register as an adviser under the Advisers Act solely as a result of those activities. The Commission's view that such solicitors would be associated persons of an adviser was based upon the investment adviser's responsibility to supervise the activities of the solicitors. Since the rule as adopted also contains a requirement, albeit somewhat different from the one contained in the proposed rule, that an investment adviser oversee the activities of third party solicitors, and since such a solicitor's activities would be conducted in accordance with his agreement with the investment adviser, the Commission is of the view that a solicitor who engages in solicitation activities in accordance with paragraph (a)(2)(iii) of the rule being adopted will be, at least with respect to those activities, an associated person of an investment adviser and therefore will not be required to register individually under the Advisers Act solely as a result of those activities. n20

n18 E.g., Connecticut Investment Management Inc., January 12, 1977; G. Serafini Investment Consultants, Inc., October 28, 1976; and Evaluation Associates, Inc., June 21, 1976. Under certain limited circumstances, however, the staff has taken no-action positions whereby it has not insisted upon registration of solicitors who would not otherwise be deemed to be a person associated with the adviser. See, e.g., Old Boston Management Corporation, July 8, 1977; Clifford

Shaw & Associates, Inc., October 27, 1976; and Investors Diversified Services Advisory Corporation, August 8, 1975.

n19 Section 202(a)(17), in part, defines a "person associated with an investment adviser" to include "any partner, officer, or director of such investment adviser (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such investment adviser, including any employee of such investment adviser. . . ."

n20 If a solicitor were a partner, officer, director or employee of the investment adviser he would, of course, be within the definition of a person associated with an investment adviser. The same would seem to be true, in most cases, of solicitors who were partners, officers, directors, or employees of persons controlling, controlled by, or under common control with the investment adviser. The status of solicitors for impersonal advisory services only would depend on the facts and circumstances. The staff of the Commission is prepared to consider no action inquiries regarding the registration of solicitors.

### *IV. Effective Date*

Certain of the requirements in the new cash referral fee rule relate to brochures prepared by investment advisers pursuant to Rule 204-3. That rule does not become effective until July 31, 1979. In addition, the Commission anticipates that investment advisers will want to review their solicitation arrangements and, where necessary, conform such arrangements to the rule. Therefore, the effective date of new Rule 206(4)-3 and the accompanying amendments to Rule 204-2(a) is being delayed until September 30, 1979.

### **AUTHORITY**

**AUTHORITY:** The Commission hereby amends Rule 204-2(a) and adopts Rule 206(4)-3 pursuant to the authority contained in Sections 204, 206, and 211 of the Advisers Act [15 U.S.C. 80b-4, 80b-6 and 80b-11(a)].

### **COMMISSION ACTION**

**PART 275 -- RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940** Part 275 of Chapter II of Title 17 of the Code of Federal Regulations is amended as follows:

1. By adding paragraph (a)(15) to § 275.204-2 to read as follows:

§ 275.204-2 *Books and records to be maintained by investment advisers.*

(a) \* \* \*

(15) All written acknowledgments of receipt obtained from clients pursuant to § 275.206(4)-3(a)(2)(iii)(B) of this chapter and copies of the disclosure documents delivered to clients by solicitors pursuant to § 275.206(4)-3 of this chapter.

2. By adding § 275.206(4)-3 to read as follows:

§ 275.206(4)-3 *Cash payments for client solicitations.*

(a) It shall be unlawful for any investment adviser required to be registered pursuant to Section 203 of the Act to pay a cash fee, directly or indirectly, to a solicitor with respect to solicitation activities unless:

(1) (i) the investment adviser is registered under the Act;

(ii) The solicitor is not a person (A) subject to a Commission order issued under Section 203(f) of the Act, or (B) convicted within the previous ten years of any felony or misdemeanor involving conduct described in Section 203(e)(2)(A)-(D) of the Act or (C) who has been found by the Commission to have engaged, or has been convicted of engaging, in any of the conduct specified in paragraphs (1), (4) or (5) of Section 203(e) of the Act, or (D) is subject to an order, judgment or decree described in Section 203(e)(3) or the Act; and

(iii) such cash fee is paid pursuant to a written agreement to which the adviser is a party; and

NOTE: The investment adviser shall retain a copy of each written agreement required by this paragraph as part of the records required to be kept under § 204-2(a)(10) of this chapter.

(2) such cash fee is paid to a solicitor:

(i) with respect to solicitation activities for the provision of impersonal advisory services only; or

(ii) who is (A) a partner, officer, director or employee of such investment advisor or (B) a partner, officer, director or employee of a person which controls, is controlled by, or is under common control with such investment adviser; provided that the status of such solicitor as a partner, officer, director or employee of

such investment adviser or other person, and any affiliation between the investment adviser and such other person, is disclosed to the client at the time of the solicitation or referral; or

(iii) other than a solicitor specified in paragraph (a)(2)(i) or (ii) above if all of the following conditions are met:

(A) The written agreement required by paragraph (a)(1)(iii) of this section: (1) describes the solicitation activities to be engaged in by the solicitor on behalf of the investment adviser and the compensation to be received therefor; (2) contains an undertaking by the solicitor to perform his duties under the agreement in a manner consistent with the instructions of the investment adviser and the provisions of the Act and the rules thereunder; (3) requires that the solicitor, at the time of any solicitation activities for which compensation is paid or to be paid by the investment adviser, provide the client with a current copy of the investment adviser's written disclosure statement required by § 275.204-3 of this chapter ("brochure rule") and a separate written disclosure document described in paragraph (b) of this rule.

(B) The investment adviser receives from the client, prior to, 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 investment adviser's written disclosure statement and the solicitor's written disclosure document.

NOTE: The investment adviser shall retain a copy of each such acknowledgment and solicitor disclosure document as part of the records required to be kept under § 204-2(a)(15) of this chapter.

(C) The investment adviser makes a bona fide effort to ascertain whether the solicitor has complied with the agreement, and has a reasonable basis for believing that the solicitor has so complied.

(b) The separate written disclosure document required to be furnished by the solicitor to the client pursuant to this section shall contain the following information:

(1) The name of the solicitor;

(2) The name of the investment adviser;

(3) The nature of the relationship, including any affiliation, between the solicitor and the investment adviser;

(4) A statement that the solicitor will be compensated for his solicitation services by the investment adviser;

(5) The terms of such compensation arrangement, including a description of the compensation paid or to be paid to the solicitor, and

(6) The amount, if any, for the cost of obtaining his account the client will be charged in addition to the advisory fee, and the differential, if any, among clients with respect to the amount or level of advisory fees charged by the investment adviser if such differential is attributable to the existence of any arrangement pursuant to which the investment adviser has agreed to compensate the solicitor for soliciting clients for, or referring clients to, the investment adviser.

(c) Nothing in this section shall be deemed to relieve any person of any fiduciary or other obligation to which such person may be subject under the law.

(d) For purposes of this section,

(1) "Solicitor" means any person who, directly or indirectly, solicits any client for, or refer any client to, an investment adviser.

(2) "Client" includes any prospective client.

(3) "Impersonal advisory services" means investment advisory services provided solely by means of (i) written materials or oral statements which do not purport to meet the objectives or needs of the specific client, (ii) statistical information containing no expressions of opinions as to the investment merits of particular securities, or (iii) any combination of the foregoing services.

By the Commission.

## SAMPLE SOLICITATION AGREEMENT\*

[Investment Adviser Letterhead]

[Date]

[Solicitor]  
[Street Address]  
[City, State & Zip Code]

Attention: [Contact Person]

Re: **Referral Arrangements**

Gentlemen:

We are pleased that you are interested in referring prospective investment advisory clients (“prospects”) to [Investment Adviser] (“IA”). The purpose of this letter is to describe the terms under which [Solicitor] (“you”) will refer prospects to IA.

1. You will contact prospects you believe are appropriate for IA and, consistent with any fiduciary or other obligations you may owe to those prospects, will recommend that the prospects entertain proposals for IA’s investment advisory services. You will notify IA promptly in writing of the name and address of any prospect to whom you have made such a recommendation (each such notification is referred to in this Agreement as a “Referral Notice”). You will also ensure that the prospects to which you recommend IA’s services are resident in jurisdictions listed on the “List of States in Which IA’s Services May be Marketed,” attached as Exhibit A, which IA may modify from time to time. You will also help IA in establishing relationships with prospects referred by you.

2. If during the term of this Agreement a prospect referred by you to IA becomes a Client of IA within [six] months of IA’s receipt of a Referral Notice first identifying the prospect, IA will pay a referral fee to you equal to \_\_\_\_% of the investment advisory fees received from time to time by IA from the prospect. IA will pay referral fees within 30 days of the receipt of investment advisory fees from the prospect. As used in this Agreement, a “prospect referred by you to IA” means a prospect that (i) was first identified and contacted by you for IA; (ii) has been identified on a Referral Notice furnished by you to IA pursuant Paragraph 1 above; (iii) has signed and dated an Acknowledgment of Receipt, a copy of which has been delivered to IA by you pursuant to Paragraph 5 below; and (iv) if so requested, has confirmed to IA that it was initially solicited by

---

\* This model agreement is made available for your assistance and convenience only and not as a substitute for your legal counsel. This model agreement is not intended to meet the specific needs of particular investment advisers or their specific clients. The agreement should be used only with the ongoing advice and consultation of appropriately licensed and experienced attorneys at law. © 2001 Morgan, Lewis & Bockius LLP. All rights reserved.

[Solicitor]

[Date]

Page 11

you. You will bear all expenses incurred by you in soliciting prospects under this Agreement, except in those limited instances where IA specifically agrees in writing to reimburse you for reasonable travel, entertainment or other expenses. Notwithstanding any provision of this Agreement to the contrary, IA will not be obligated to pay you any referral fee if, in the opinion of IA's legal counsel, such payment would violate any law, rule or regulation to which IA is subject.

3. You will perform your services under this Agreement in accordance with this Agreement, IA's instructions, the Investment Advisers Act of 1940, as amended (the "Act"), and Securities and Exchange Commission ("SEC") rules and regulations thereunder, and applicable federal, state or local law.

4. You will not be an employee, agent or officer of IA but will have the status of an "independent contractor." You will not render any investment advice on behalf of IA. You are not authorized to act on behalf of or bind IA except as provided in this Agreement. You are not authorized to enter into any agreement or undertaking on behalf of IA. No investment advisory agreement will become effective until it is accepted by IA at its offices in [City/State].

5. You will provide to each prospect who agrees to entertain a proposal for services by IA: (a) Part II of IA's Form ADV (or a substitute brochure prepared by IA); and (b) your Disclosure Statement required by Rule 206(4)-3 under the Act, a specimen copy of which is attached as Exhibit B. You will also obtain from each prospect and promptly forward to IA a signed and dated Acknowledgment of Receipt of the documents referred to above. You will not make any representations regarding IA that are false or misleading or in any way inconsistent with the written materials provided by IA, including Part II of IA's Form ADV (or a substitute brochure prepared by IA), nor will you deliver to prospects any written materials concerning IA that have not been specifically approved in advance by IA in writing.

6. IA represents and warrants that it is registered, and agrees to maintain its registration, as an investment adviser with the SEC and the jurisdictions listed on Exhibit A, or has been advised by legal counsel that it is validly exempt or excluded from such registration.

7. You represent, warrant and agree that you have reviewed and understand the statutory and regulatory provisions under applicable federal and state law governing investment advisory activities. You will take all steps necessary to ensure that each of your employees and agents reviews such statutory and regulatory provisions before engaging in solicitation activities on behalf of IA.

8. You hereby make, and with the submission of each Referral Notice pursuant to Paragraph 1 above you will be deemed to have repeated, the following representations, warranties and covenants:

(A) You are registered as an investment adviser with the SEC and the applicable states (including those states listed on Exhibit A) or have been advised by legal counsel that you are validly exempt or excluded from such registration.

(B) With respect to any prospect identified on a Referral Notice that is a state or municipal entity, neither you nor any of your officers, directors, employees, affiliates or agents (i) has been within the past 2 years a civil servant or an elected official of such entity or has been retained to provide professional services to such entity; or (ii) will share any part of the referral fee paid pursuant to this Agreement with any person who

[Solicitor]

[Date]

Page 12

is, or within the past 2 years has been, a civil servant or an elected official of such entity or a person who has been retained to provide professional services to such entity.

(C) With respect to any prospect identified on a Referral Notice that is a Retirement Plan (as defined below), neither you nor any of your officers, directors, employees, affiliates or agents is a fiduciary, trustee or administrator of such prospect or an employer of any employee covered by such Retirement Plan. For purposes of this Agreement, "Retirement Plan" means any pension plan (including a 401(k) plan) or other employee benefit plan governed by the Employee Retirement Income Security Act of 1974 ("ERISA"), an account for a tax-qualified retirement plan (including a Keogh plan) under Section 401(a) of the Internal Revenue Code of 1986 (the "Code") and not covered by ERISA, or an individual retirement account under Section 408 of the Code.

(D) Neither you nor any of your officers, directors, employees, affiliates or agents is a person who is or has been (a) subject to a SEC order issued under Section 203(f) of the Act; (b) convicted within the previous ten years of any felony or misdemeanor involving conduct described in Sections 203(e)(2)(A)-(D) of the Act; (c) found by the SEC to have engaged, or been convicted of engaging, in any of the conduct specified in paragraphs (1), (5) or (6) of Section 203(e) of the Act; or (d) subject to an order, judgement or decree described in Section 203(e)(3) of the Act (individually or collectively a "Statutory Disqualification"). You will promptly notify IA in writing if you or any of your officers, directors, employees, affiliates or agents becomes subject to a Statutory Disqualification and will promptly refund to IA any referral fees previously paid by IA after such time you or any of your officers, directors, employees, affiliates or agents becomes subject to a Statutory Disqualification.

9. During the term of this Agreement, without IA's prior written consent you will not represent any other person in the solicitation of new business for investment advisory services that represent the same investment philosophy or style of investing as currently implemented by IA. On IA's request, you will promptly furnish to IA written statements that disclose the investment philosophies and styles of investing of those other persons on behalf of which you solicit investment advisory business.

10. This Agreement will continue in effect until terminated as described below. IA or you may terminate this agreement on 30 days written notice to the other. IA may terminate this Agreement immediately on written notice to you if you are in breach of any representation, warranty or covenant in this Agreement. This Agreement will terminate automatically if any representation or warranty by you contained in Paragraph 8(D) ceases to be true and correct in all respects. Termination of this Agreement will not affect your obligation to refund referral fees under Paragraph 8(D) above.

11. All notices required to be delivered under this Agreement will be delivered in person or by U.S. mail, overnight courier, telecopier (with a hard copy in the U.S. mail), in each case prepaid and addressed as follows (or to such other addresses as the parties may specify to one another in writing):

If to IA:

[Investment Adviser]

[Street Address]

[City, State & Zip Code]

Telecopier: [Telecopier No.]

If to You

[Name]

[Street Address]

[City, State & Zip Code]

Telecopier: [Telecopier No.]

[Solicitor]

[Date]

Page 13

Attention: [Contact Person]

Attention: [Contact Person]

12. You will indemnify IA and its directors, officers and employees, and hold them harmless against any loss, liability or expense incurred by any of them arising out of or in connection with any breach by you of this Agreement or any act, omission or violation of law by you or your officers, directors, employees, affiliates or agents, as well as the costs and expenses of investigating and defending against any claim, suit, action or proceeding in which such loss, liability or expense is asserted against IA or its officers, directors or employees.

13. This Agreement is made and will be governed under the internal laws of [State]. This Agreement may not be assigned without the written consent of the non-assigning party, and any purported assignment violating this provision will be void. If any provision of this Agreement is or becomes inconsistent with any present or future law, rule or regulation of any governmental or regulatory body having jurisdiction over the subject matter of this Agreement, the provision will be deemed rescinded or modified in accordance with any such law, rule or regulation. In all other respects, this Agreement will continue in full force and effect. No provision of this Agreement may be waived or modified unless in writing and signed by the party against whom such waiver or modification is sought to be enforced. Either party's failure to insist on strict compliance with this Agreement or any continued course of conduct on its part will in no event constitute or be considered a waiver by such party of any right or privilege. This Agreement contains the entire understanding between the parties concerning the subject matter of this Agreement. Your representations, warranties and obligations hereunder will survive the termination of this Agreement. This Agreement may be signed in one or more counterparts, all of which will be considered one and the same agreement, and will become effective when one or more of such counterparts have been signed by each party and delivered to the other party.

14. [Any dispute relating to the validity, enforcement or interpretation of this Agreement will be determined by final and binding arbitration before the [City/State] office of American Arbitration Association ("AAA") in accordance with the Commercial Arbitration rules of the AAA then in effect. Judgment upon arbitration awards may be entered in any court, state or federal, having jurisdiction. The prevailing party in any arbitration and other legal proceeding authorized by this Paragraph will be entitled to its reasonable attorneys' fees and other reasonable legal costs and expenses.]

Please confirm your agreement with the above terms by signing and returning one copy of this Agreement.

Very truly yours,

[Investment Adviser]

By: \_\_\_\_\_

Accepted and agreed as of the date first written above:

[Solicitor]  
[Date]  
Page 14

[SOLICITOR]

By: \_\_\_\_\_

Title: \_\_\_\_\_

**List of States in Which IA's Services May be Marketed**

[Listing of States]

---

**Disclosure Statement**

[Solicitor] proposes to introduce you to [Investment Adviser] ("IA") for the purpose of your possibly becoming an investment advisory client of IA. IA asks that we disclose to you the nature of our arrangements with IA.

We have an arrangement with IA under which we refer prospective clients to IA in exchange for a referral fee of \_\_\_\_% of the fees received by IA from clients referred by us. The referral fees paid by IA are not passed on to clients referred by us, but the presence of these arrangements may affect IA's willingness to negotiate below its standard investment advisory fees and, therefore, may affect the overall fees paid by referred clients.

[Solicitor] and IA are not affiliated. In addition, [Solicitor] is not authorized to provide investment advice on behalf of IA or to act for or bind IA. No investment advisory agreement with IA will become effective until accepted by IA at its offices in [City/State].

**Acknowledgment of Receipt**

I acknowledge receipt of Part II of [Investment Adviser]'s Form ADV (or a substitute brochure), as well as a copy of [Solicitor]'s Disclosure Statement describing the arrangements between [Solicitor] and [Investment Adviser].

Signature

Date

(Printed Name)

Signature (If Joint Account)

Date

(Printed Name)

