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November 05, 2018

SEC Staff Warns About Cash Solicitation Rule Compliance

Periodically, SEC staff issue alerts describing deficiencies observed during exams, as a tool to help advisers improve their compliance programs. The Office of Compliance Inspections and Examinations issued [a Risk Alert](#) identifying common deficiencies in adviser compliance with [Rule 206\(4\)-3](#) under the Investment Advisers Act of 1940 (the "Cash Solicitation Rule"), and suggesting that deficiencies in this area could indicate that an adviser is struggling with its fiduciary duties to clients under Sections 206(1) and 206(2) of the Advisers Act.

Requirements of the Cash Solicitation Rule

Generally, Rule 206(4)-3 prohibits registered investment advisers from paying a cash fee, directly or indirectly, to a person who solicits clients for the adviser, unless the adviser and solicitor have a written agreement, and the solicitor is not a disqualified person. The Cash Solicitation Rule can be implicated when the solicitor is internal or external, and applies to solicitation for advisory relationships ([and not fund investments](#)). When the solicitor is a "third party" solicitor (that is, not an officer, director or employee of the advisory business), additional requirements apply:

- The solicitation agreement must describe the solicitation activities and the compensation the solicitor will receive;
- The solicitation agreement must require the solicitor to give prospective client a copy of the adviser's "brochure" and a separate written disclosure statement that describes (in sufficient detail) how the solicitor is compensated (the "solicitor disclosure document");
- The adviser must receive from the client, before or when entering into an agreement with the client, a signed and dated acknowledgement that the client received the brochure and the solicitor disclosure document; and
- The adviser must make a bona fide effort to confirm that the solicitor has complied with the solicitation agreement and must have a reasonable basis to believe that the solicitor has complied.

Deficiencies Cited in the Alert

Common deficiencies involving third party solicitors noticed during adviser examinations include:

- Solicitor disclosure documents were not delivered to prospective clients, or did not contain the necessary information, such as
 - a description of the relationship between the solicitor and the adviser;
 - a description of the solicitor's compensation arrangement, or sufficient detail about how the adviser compensates the solicitor; and
 - the additional solicitation cost that a solicited client would be charged, in addition to the advisory fee.
- Advisers have not received client acknowledgements, or they were not received, signed or dated in a timely manner. Some client acknowledgements that were undated or were dated after the entry into the advisory contract.
- Some advisers paid cash fees to a solicitor without a solicitation agreement or under an agreement that omitted required terms, including:
 - The solicitor's undertaking to perform its duties consistent with the adviser's instructions;
 - A description of the solicitor's permitted activities and compensation to be paid for those activities; and

- A term requiring the solicitor to provide prospective clients with the adviser's brochure and the solicitor disclosure document.
- Some advisers did not appear to make "bona fide" efforts to confirm that solicitors complied with the solicitation agreement and did not have a reasonable basis to conclude that they had complied. OCIE staff noted that some advisers could not describe any efforts undertaken to ascertain solicitors' compliance.

Conclusion

Advisers paying solicitors for client introductions should be careful to structure their programs to meet the Cash Solicitation Rule. Paying for solicitation can also implicate registration requirements, either for investment adviser representative registration, or for broker dealer registration (which can be an issue if the introduction leads to an investment in a private pooled vehicle).

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