INVESTMENT ADVISERS GET NO-ACTION RELIEF SUPPORTING PAYMENT OF FINDER'S FEES IN CONNECTION WITH INVESTMENT POOLS

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On July 15, 2008, the Office of Chief Counsel, Division of Investment Management of the Securities and Exchange Commission (the "SEC Staff") issued an Interpretative Letter concerning the applicability of Rule 206(4)-3 of the Investment Advisers Act of 1940 (the "Advisers Act"). Rule 206(4)-3 (known as the "Cash Solicitation Rule") prohibits a registered investment adviser from paying a cash fee to a "finder" who refers clients to the adviser unless the conditions of Rule 206(4)-3 are satisfied. These conditions include the requirements that (i) the adviser enter into a written agreement with the finder, (ii) the finder provide prospective investors with the adviser's Form ADV Part II and a separate disclosure document describing the finder's arrangement with the adviser, and (iii) the adviser obtain the investor's acknowledgement of receipt of this disclosure document at the time of the initial solicitation.

In the Interpretative Letter, the SEC Staff indicated that it believes Rule 206(4)-3 does not apply to cash payments by an adviser to finders who solicit investors for an investment pool managed by that adviser because these investors are not "clients" of the adviser. Typical investment pools are registered investment companies, hedge funds and private equity funds. This reverses prior guidance where, in a prior no-action letter (Dana Investment Advisers, Inc. (October 12, 1994)), the SEC Staff indicated that Rule 206(4)-3 would apply to advisers who pay a finder who refers investors to an investment pool managed by the investment adviser. The SEC Staff's reasoning in that no-action letter was that the solicited investors were considered at least indirect clients of the adviser because

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they were subject to the advisory fee charged by the adviser for managing the investment pool.

In the new Interpretative Letter (Mayer Brown LLP), the SEC Staff stated three reasons for reversing its position: (1) neither of the releases proposing and adopting the Cash Solicitation Rule contained a statement suggesting such an application; (2) the Cash Solicitation Rule was implemented to deal specifically with solicitations that would result in the solicited person signing an investment advisory contract with the adviser (investors in investment pools do not "typically" sign investment advisory contacts with the investment adviser for the pool); and (3) the text of the Cash Solicitation Rule uses the terms "client" and "prospective client" (instead of "investor" and "prospective investor") which "strongly suggests" that it was intended to apply to solicitations that result in the signing of an investment advisory contract.

The SEC Staff made it clear that its analysis is supported by the decision of the U.S. Court of Appeals for the District of Columbia in Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006), which held that investment pool investors are not "clients" of the pool's investment adviser for purposes of Rule 206 of the Advisers Act. The SEC Staff opined that references in Rule 206(4)-3 to "client" and "prospective client" should have a similar interpretation.

Importantly, the SEC Staff emphasized that an adviser's payment to a "finder" for soliciting or referring investors for an investment pool will depend on the facts and circumstances of the particular situation. In its view, the "most pertinent facts and circumstances" would relate to the arrangement between the solicitor and the adviser, the nature of the relationship between the adviser and the prospective investor, and the purpose of the cash payment. In addition, the SEC Staff indicated that even if Rule 206(4)-3 does not apply to a particular situation, the finder may generally be required by Section 206 to disclose to the investor material facts relating to conflict of interest.

Finally, the Interpretive Letter expresses no view on whether the finder would be required to register as a broker under the Securities Exchange Act of 1934, as amended, and applicable state law.

The Interpretive Letter is not a rule, regulation or statement of the SEC and binds only the Office of the Chief Counsel, Division of Investment Management with respect to the persons addressed by the letter and the specific facts presented.

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