

§ 275.206(4)-3

17 CFR Ch. II (4-1-06 Edition)

a limited partnership (or limited liability company, or another type of pooled investment vehicle) that is subject to audit (as defined in section 2(d) of Article 1 of Regulation S-X (17 CFR 210.1-02(d)) at least annually and distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) within 120 days of the end of its fiscal year, or in the case of a fund of funds within 180 days of the end of its fiscal year; and

(4) *Registered investment companies.* You are not required to comply with this section (17 CFR 275.206(4)-2) with respect to the account of an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 to 80a-64).

(c) *Definitions.* For the purposes of this section:

(1) *Custody* means holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them. Custody includes:

(i) Possession of client funds or securities, (but not of checks drawn by clients and made payable to third parties,) unless you receive them inadvertently and you return them to the sender promptly but in any case within three business days of receiving them;

(ii) Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian; and

(iii) Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives you or your supervised person legal ownership of or access to client funds or securities.

(2) *Independent representative* means a person that:

(i) Acts as agent for an advisory client, including in the case of a pooled investment vehicle, for limited partners of a limited partnership (or members of a limited liability company, or other beneficial owners of another type of pooled investment vehicle) and by law or contract is obliged to act in the

best interest of the advisory client or the limited partners (or members, or other beneficial owners);

(ii) Does not control, is not controlled by, and is not under common control with you; and

(iii) Does not have, and has not had within the past two years, a material business relationship with you.

(3) *Qualified custodian* means:

(i) A bank as defined in section 202(a)(2) of the Advisers Act (15 U.S.C. 80b-2(a)(2)) or a savings association as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)) that has deposits insured by the Federal Deposit Insurance Corporation under the Federal Deposit Insurance Act (12 U.S.C. 1811);

(ii) A broker-dealer registered under section 15(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)(1)), holding the client assets in customer accounts;

(iii) A futures commission merchant registered under section 4f(a) of the Commodity Exchange Act (7 U.S.C. 6f(a)), holding the client assets in customer accounts, but only with respect to clients' funds and security futures, or other securities incidental to transactions in contracts for the purchase or sale of a commodity for future delivery and options thereon; and

(iv) A foreign financial institution that customarily holds financial assets for its customers, provided that the foreign financial institution keeps the advisory clients' assets in customer accounts segregated from its proprietary assets.

(4) *Fund of funds* means a limited partnership (or limited liability company, or another type of pooled investment vehicle) that invests 10 percent or more of its total assets in other pooled investment vehicles that are not, and are not advised by, a related person (as defined in Form ADV (17 CFR 279.1)), of the limited partnership, its general partner, or its adviser.

[68 FR 56700, Oct. 1, 2003; 68 FR 61555, Oct. 28, 2003, as amended at 69 FR 72088, Dec. 10, 2004]

§ 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) through (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), (5) or (6) of section 203(e) of the Act, or (D) is subject to an order, judgment or decree described in section 203(e)(4) of 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 §275.204-2(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 adviser 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) of this section 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 §275.204-2(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

§ 275.206(4)-4

17 CFR Ch. II (4-1-06 Edition)

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 any law.

(d) For purposes of this section,

(1) *Solicitor* means any person who, directly or indirectly, solicits any client for, or refers 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.

(Secs. 204, 206, and 211 of the Advisers Act (15 U.S.C. 80b-4, 80b-6 and 80b-11(a)))

[44 FR 42130, July 18, 1979; 54 FR 32441, Aug. 8, 1989, as amended at 62 FR 28135, May 22, 1997; 63 FR 39716, July 24, 1998]

§ 275.206(4)-4 Financial and disciplinary information that investment advisers must disclose to clients.

(a) It shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Act (15 U.S.C. 80b-6(4)) for any investment adviser registered or required to be registered under section 203 of the Act (15 U.S.C. 80b-3) to fail to disclose to any client or prospective client all material facts with respect to:

(1) A financial condition of the adviser that is reasonably likely to impair the ability of the adviser to meet contractual commitments to clients, if the adviser has discretionary authority (express or implied) or custody over such client's funds or securities, or requires prepayment of advisory fees of more than \$500 from such client, 6 months or more in advance; or

(2) A legal or disciplinary event that is material to an evaluation of the ad-

viser's integrity or ability to meet contractual commitments to clients.

(b) It shall constitute a rebuttable presumption that the following legal or disciplinary events involving the adviser or a management person of the adviser (any of the foregoing being referred to hereafter as "person") that were not resolved in the person's favor or subsequently reversed, suspended, or vacated are material within the meaning of paragraph (a)(2) of the rule for a period of 10 years from the time of the event:

(1) A criminal or civil action in a court of competent jurisdiction in which the person—

(i) Was convicted, pleaded guilty or nolo contendere ("no contest") to a felony or misdemeanor, or is the named subject of a pending criminal proceeding (any of the foregoing referred to hereafter as "action"), and such action involved: an investment-related business; fraud, false statements, or omissions; wrongful taking of property; or bribery, forgery, counterfeiting, or extortion;

(ii) Was found to have been involved in a violation of an investment-related statute or regulation; or

(iii) Was the subject of any order, judgment, or decree permanently or temporarily enjoining the person from, or otherwise limiting the person from, engaging in any investment-related activity.

(2) Administrative proceedings before the Securities and Exchange Commission, and other federal regulatory agency or any state agency (any of the foregoing being referred to hereafter as "agency") in which the person—

(i) Was found to have caused an investment-related business to lose its authorization to do business; or

(ii) Was found to have been involved in a violation of an investment-related statute or regulation and was the subject of an order by the agency denying, suspending, or revoking the authorization of the person to act in, or barring or suspending the person's association with, an investment-related business; or otherwise significantly limiting the person's investment-related activities.

(3) Self-Regulatory Organization (SRO) proceedings in which the person—