RIA Compliance Consultants

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Investment Advisers Act Rule 206(4)-1 – Amendments to Advertising/Marketing Rules

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Agenda

- Overview and General Provisions
- Form ADV Reporting and Record Retention
- Testimonials, Endorsements and Promoters
- Performance Marketing
- Resources

General Provisions

Q: Which investment adviser firms are covered by the SEC's new marketing rule?

A: The SEC's new marketing rule (Rule 206(4)-1) applies to all investment advisers registered, or required to be registered, with the SEC.

The SEC's marketing rule does not apply to exempt reporting advisers ("ERAs") or others not required to register with the SEC.

Furthermore, the new marketing rule does not apply to the marketing of registered investment companies or business development companies.

A state registered investment adviser should consult with its state securities regulators as to whether the state securities regulator will be following the SEC's lead with respect to the new marketing rule.

General Provisions

Q: When must my firm comply with the SEC's marketing rule?

November 4, 2022

General Provisions

Q: Does the rule require my compliance staff to review and pre-approve marketing?

A: No. Although this requirement was included in the proposed marketing rule, the SEC determined that the other provisions of the marketing rule will adequately protect investors without imposing the burden of a pre-approval requirement.

General Provisions

Q: Does my firm need to have written compliance policies and procedures related to marketing and advertising?

A: Yes. Your firm needs to have written policies and procedures designed to comply with the new marketing rule and customized to your firm's actual practices.

General Provisions

Q: Does the SEC's marketing rule distinguish between advertisements sent to retail or non-retail clients of the investment adviser?

A: No. However, the SEC expects the investment adviser's communications, including advertisements, to be tailored to its intended audience. An advertisement by an investment adviser for retail clients might include different information or be presented in a different format than an advertisement intended for a more sophisticated audience, even though both advertisements must comply with the conditions and requirements of the SEC's marketing rule.

General Provisions

Q: What are the major substantive changes of the SEC's new marketing rule compared to the SEC's current advertising and solicitor rules?

A: The definition of "advertisement" under the SEC's marketing rule has two prongs.

First, an advertisement includes any direct or indirect communication that an investment adviser makes to more than one person, or to one or more persons if the communication includes hypothetical performance, that offers the investment adviser's investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the investment adviser or offers new investment advisory services with regard to securities to current clients or investors in a private fund advised by the investment adviser (subject to exceptions discussed in the following slides).

Second, an advertisement includes any endorsement or testimonial for which an investment adviser provides compensation, directly or indirectly.

General Provisions

Q: Are there any exclusions from the new definition of “advertisement”?

A: Yes.

The SEC’s marketing rule covers all advertisements by an investment adviser registered with the SEC regardless of the means of dissemination. Emails, text messages, instant messages, electronic presentations, videos, films, podcasts, digital audio or video files, blogs, billboards, social media, and paper communications, such as newspapers, magazines and the mail, are all covered by the SEC’s marketing rule.

The SEC’s marketing rule has an **exception** for live, extemporaneous and oral communications from the definition of advertising. Live, extemporaneous, oral communications include discussions and remarks that are not prepared in advance but do not include prepared remarks or speeches, nor any slides or other written materials that are distributed or presented to an audience. Live, extemporaneous communications that are written, such as text messages or online chats are similarly not eligible for the exception. However, the exception does apply to live, extemporaneous, oral communications regardless of whether such communications occur in person or over broadcast, such as non-prepared remarks that are made over live webcast.

A previously recorded oral communication disseminated by the adviser would not qualify for the exception, even if it was live, oral and extemporaneous at the time it was recorded.

General Provisions

Q: Are my firm's one-on-one communications considered advertisements under the SEC's marketing rule?

A: Generally, no, unless it includes hypothetical performance. The SEC has noted, however, that mass communications by an investment adviser that are nominally tailored to appear customized (e.g., by including the client's name in the salutation but with little or no other customization) will not be considered one-on-one communications. Any duplicated insert included in an otherwise customized communication would be subject to the rule.

A communication is considered one-on-one if made to a single natural person or to multiple natural persons representing a single entity or account, such as multiple natural persons at a company that is a client or an account that belongs to a married couple that shares the same household.

General Provisions

Q: What are the general prohibitions under the SEC's marketing rule?

A: The SEC's marketing rule prohibits the following:

• Making an untrue statement of a material fact, or omitting a material fact necessary to make the statement made, in light of the circumstances under which it was made, not misleading;

• Making a material statement of fact that the adviser does not have a reasonable basis for believing it will be able to substantiate upon demand by the SEC;

• Including information that would reasonably be likely to cause an untrue or misleading implication or inference to be drawn concerning a material fact relating to the adviser;

• Discussing any potential benefits without providing fair and balanced treatment of any associated material risks or limitations;

• Referencing specific investment advice provided by the adviser that is not presented in a fair and balanced manner;

• Including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced; and

• Including information that is otherwise materially misleading.

General Provisions

Q: Under the SEC's marketing rule, is my firm responsible for only advertisements or statements it makes directly?

A: No. Under the SEC's marketing rule, your firm can also be held responsible for indirect communications, including those made by third parties, if you "adopt" the communication or "entangle" yourself in the preparation of the communication. Adoption occurs when a firm approves or endorses a communication. Entanglement occurs when a firm involves itself in the preparation of the third-party communication.

Whether your firm is responsible for a particular advertisement depends on the facts and circumstances. If, for example, you provide comments on a marketing piece, but the third party does not accept such comments or otherwise makes unauthorized modifications, your firm will not be responsible for the third party's subsequent modifications that were made independently of you and that you did not approve. In contrast, mere formatting changes made by a third party would not typically absolve your firm of responsibility for the advertisement.

In limited cases, you are permitted to edit an existing third-party communication without such edits resulting in attribution of that communication to your firm, if such revisions are based on pre-established, objective criteria (i.e., editing to remove profanity, defamatory or offensive statements, threatening language, materials that contain viruses or other harmful components, spam, unlawful content, or materials that infringe on intellectual property rights, or editing to correct a factual error) that are documented in your policies and procedures and are not designed to favor or disfavor the investment adviser. In these circumstances, the SEC would not view your firm as endorsing or approving the remaining content by virtue of such limited editing.

General Provisions

Q: Are posts made by third parties to my firm's webpage or social media account(s) attributable to my firm?

A: Whether such posts or comments are attributable to the investment adviser depends on the facts and circumstances. For example, merely permitting all third parties to post public commentary to the investment adviser's website or social media page would not cause such content to be attributable to the investment adviser, so long as the investment adviser does not selectively delete or alter the comments or their presentation and is not involved in the preparation of the content. Similarly, even if the investment adviser has the ability to sort or otherwise alter the presentation of public comments, the investment adviser would not be responsible unless it in fact does so.

General Provisions

Q: Are social media posts on a supervised person's personal account attributable to my firm under the SEC's marketing rule?

A: The SEC has indicated that if the investment adviser adopts and implements policies and procedures reasonably designed to prevent the use of a supervised person's social media accounts for marketing the investment adviser's advisory services, it generally would not view such communication as the adviser marketing its advisory services. Such policies and procedures might include prohibiting supervised persons from using personal social media accounts to market advisory services, conducting training (including attestations), and periodically reviewing the content of its supervised persons' personal social media accounts.

Form ADV Reporting and Record Retention

Q: What new information must be reported on the Form ADV as a result of the new marketing rule?

A: The following information will now be required in Item 5 of the Form ADV, Part 1:

- Whether any advertisements include performance results;
- Whether any advertisements include reference to specific investment advice provided by the investment adviser;
- Whether any advertisements include testimonials, endorsements, or third-party ratings;
- Whether the investment adviser pays or otherwise provides cash or non-cash compensation, directly or indirectly, in connection with the use of testimonials, endorsements, or third-party ratings;
- Whether any advertisements include hypothetical performance;
- Whether any advertisements include predecessor performance.

Form ADV Reporting and Record Retention

Q: How long must marketing records be maintained?

A: Advertising records must be maintained by an investment adviser in an easily accessible place for a period of not less than **five years** (with the first two years in an appropriate office of the investment adviser) from the end of the fiscal year during which the investment adviser last published or otherwise disseminated the advertisement.

Form ADV Reporting and Record Retention

Q: What new records will my firm be expected to keep under the SEC's marketing rule?

A: Investment advisers must make and keep records of all advertisements they disseminate under the SEC's marketing rule. In the case of **oral advertisements**, the investment adviser may retain a copy of any written or recorded materials used by the investment adviser in connection with the oral advertisement, in lieu of obtaining and preserving a recording of the oral communication. If the oral advertisement includes a compensated oral testimonial or endorsement, the investment adviser may keep a record of the disclosures provided to investors, in lieu of obtaining and preserving a recording of the oral communication. Whenever an investment adviser's disclosures for a testimonial or endorsement are not included in the advertisement itself, the investment adviser must retain copies of the disclosures provided to investors.

Further, an investment adviser must make and keep any communication or other document related to its determination that the investment adviser has a reasonable basis for believing that a testimonial or endorsement complies with rule 206(4)-1 or that a **third-party rating** complies with rule 206(4)-1(c)(1).

With regard to **third party ratings**, in the event the adviser obtains a copy of the questionnaire or survey used by the third party to develop its ratings, the investment adviser must retain a copy in its records.

In addition, the marketing rule requires investment advisers to maintain written communications relating to the **performance or rate of return of any portfolios** (as defined in the marketing rule), and to maintain accounts, books, internal working papers, and other documents necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any portfolios. Similar requirements apply to the retention of records relating to hypothetical performance and predecessor performance.

Investment advisers that rely on the partial disclosure exemption for **affiliated personnel**, must keep a record of the names of all affiliated personnel and document their affiliates' status at the time the investment adviser disseminates the testimonial or endorsement.

Form ADV Reporting and Record Retention

Q: Is my firm required to keep a file substantiating all material claims made in its advertisements?

A: No. An investment adviser is required to have a reasonable basis to believe that they can substantiate material claims of fact upon demand by the SEC. An investment adviser is not required to substantiate material claims of opinion, nor does it need to proactively develop and maintain a file of substantiating materials for every advertisement – provided it has a reasonable basis to believe it could provide such substantiation on demand.

It is important to note, **however**, that the SEC has indicated that if an investment adviser is unable to substantiate the material claims of fact made in an advertisement on demand, the SEC will presume that the adviser did not have a reasonable basis for its belief. An investment adviser should implement policies and procedures to ensure it can substantiate all material claims of fact in its advertisement, as well as memorialize its contemporaneous reasonable belief regarding such substantiation at the time the advertisement is disseminated.

Testimonials, Endorsements and Promoters

Q: Are testimonials or endorsements permitted under the SEC's new marketing rule?

A: Yes. The SEC's marketing rule permits testimonials and endorsements subject to certain disclosure, oversight, and disqualification requirements.

Testimonials, Endorsements and Promoters

Q: What is the difference between a testimonial and an endorsement?

A: A **testimonial** is any statement by a **current client** of the investment adviser or investor in a private fund advised by the investment adviser: (i) about the client or investor's experience with the investment adviser or its supervised persons (ii) that directly or indirectly solicits any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser; or (iii) that refers any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser.

The SEC's marketing rule defines an **endorsement** is any statement by a **person other than a current client** of the investment adviser or investor in a private fund advised by the investment adviser that: (i) indicates approval, support, or recommendation of the investment adviser or its supervised persons or describes that person's experience with the investment adviser or its supervised persons; (ii) directly or indirectly solicits any current or prospective client or investor in a private fund for the investment adviser; or (iii) refers any current or prospective client of, or an investor in a private fund advised by, the investment adviser.

For purposes of the marketing rule, whether a communication by a former client is a testimonial or endorsement depends on the facts and circumstances at the time of dissemination, such as whether the statement refers to recent prior experience or an experience further removed from the time of dissemination.

Testimonials, Endorsements and Promoters

Q: Under the SEC's marketing rule, can my firm permit the use of "like," "share," or "endorse" features on a third-party website or social media platform?

A: Yes. An investment adviser may permit the use of "like," "share," or "endorse" features on a third-party website or social media platform without implicating the final rule, so long as the investment adviser merely enables the feature(s) and does not manipulate them to highlight favorable content and/or suppress negative content.

Testimonials, Endorsements and Promoters

Q: Would an infrequent recommendation from a service provider, such as a lawyer or accountant, be considered a testimonial or endorsement under the SEC's marketing rule?

A: Provided there is indirect or direct compensation, yes. The frequency of referral is not determinative, although the partial exemption for de minimis compensation might apply.

Testimonials, Endorsements and Promoters

Q: Is there a de minimis exemption for solicitors under the SEC's marketing rule?

A: Yes, a partial exemption is available in cases where the promoter is compensated $1,000 or less (or the equivalent value in non-cash compensation) during the preceding twelve months. A testimonial or endorsement that is disseminated for de minimis compensation is not subject to the disqualification provisions or the written agreement requirement but must still comply with the disclosure and oversight provisions of the SEC's marketing rule.

Testimonials, Endorsements and Promoters

Q: What disclosures are required by the investment adviser when disseminating a testimonial or endorsement under the SEC's marketing rule?

A: Investment advisers are required to "clearly and prominently" disclose (1) whether a testimonial or endorsement was given by a client or investor or a non-client or investor; and (2) if applicable, that compensation was provided by or on behalf of the investment adviser in connection with the testimonial or endorsement. In addition, a brief statement of any material conflicts of interest on the part of the person giving the testimonial or endorsement must also be made clearly and prominently.

To be clear and prominent, these disclosures should be included within the testimonial or endorsement itself (or at the same time as an oral testimonial or endorsement) in a size and font at least as prominent as the testimonial or endorsement itself. The specific format of the disclosure may be tailored to the type of advertisement. For example, the SEC has noted a disclosure for an advertisement on a mobile device may be "clear and prominent" if the viewer is automatically redirected to view the disclosure prior to viewing the substance of the advertisement. Other disclosures, which can provide useful information but are not integral to the SEC's concerns about testimonials and endorsements, can be provided by hyperlink or other separate disclosure.

Under the marketing rule, the required disclosures must be provided at the time the testimonial or endorsement is disseminated. In cases involving a promoter or solicitor, either the investment adviser or the solicitor is permitted to make the required disclosures. However, if the investment adviser does not make the disclosures, it must have (and document) a reasonable belief that the solicitor is making the disclosures.

Testimonials, Endorsements and Promoters

Q: Are layered disclosures permitted (e.g., using a hyperlink rather than including the disclosures within the four corners of the advertisement)?

A: Disclosures that are not subject to the “clear and prominent” standard, such as those regarding material risks, may use layered disclosures. In one example given by the SEC, an advertisement could identify one benefit of an investment adviser’s services, accompany the discussion of the benefit with fair and balanced treatment of material risks associated with that benefit within the four corners of that advertisement, and then include a hyperlink to additional content that discusses additional benefits and additional risks of the adviser’s services in a fair and balanced manner. Each layer of the disclosure should present the risks and benefits in a fair and balanced manner. An investment adviser should not, for example, present only benefits in the first layer, while placing a discussion of risks and limitations behind a hyperlink.

Testimonials, Endorsements and Promoters

Q: What is my firm's oversight requirement for testimonials and endorsements?

A: An investment adviser is not required to oversee all activities of a third party but remains responsible for ensuring its advertisement(s) comply with the SEC's marketing rule.

An investment adviser must have a reasonable basis for believing that a testimonial or endorsement complies with the rule, including testimonials or endorsements made for de minimis compensation. A reasonable basis could be established, for example, by periodically making inquiries of a sample of investors solicited or referred by the promoter in order to assess whether that promoter's statements comply with the rule. Similarly, the investment adviser might include provisions in a written agreement with the solicitor that give the investment adviser the right to restrict the content of the solicitor's testimonials or endorsements and/or review testimonials or endorsements prior to dissemination.

Testimonials, Endorsements and Promoters

Q: Would a lead generation firm or adviser referral network be a testimonial or endorsement?

A: Yes, assuming there is direct or indirect compensation, these arrangements most likely would be considered an endorsement. In the final rule release, the SEC has noted these types of firms and referral networks may tout the advisers included in their network, guarantee that the advisers meet the network's eligibility criteria, and/or offer to "match" an investor with one or more advisers, resulting in compensated solicitation and referral activities.

Testimonials, Endorsements and Promoters

Q: Is a promoter or solicitor required to register as an investment adviser under the SEC's marketing rule?

A: The final marketing rule does not include a presumption that a person providing an endorsement or testimonial meets, or does not meet, the definition of investment adviser. However, a promoter or solicitor may, depending on the facts and circumstances, be acting as an investment adviser within the meaning of section 202(a)(11) of the Advisers Act. Similarly, some promoters may meet the definition of "associated person" of an investment adviser, depending on the facts and circumstances.

Any promoter must determine whether it is subject to statutory or regulatory requirements under federal law, including the requirement to register as an investment adviser pursuant to the Advisers Act. A promoter also must determine whether it is subject to certain state securities laws, including state registration as an investment adviser and any applicable state licensing requirements applicable to individuals.

Testimonials, Endorsements and Promoters

Q: Under the SEC's marketing rule, is my firm required to present an equal number of negative testimonials alongside positive testimonials in an advertisement, or otherwise balance endorsements with negative statements?

A: No. Instead, your firm should consider the context and totality of information presented in order to avoid any misleading implications or inferences. For example, an investment adviser might choose to include a disclaimer that the testimonial was not representative and then direct the recipient to a representative sample of the testimonials about the adviser.

Testimonials, Endorsements and Promoters

Q: Does the SEC's marketing rule affect solicitations to private fund investors?

A: **Yes.** Private funds and private fund investors are covered under the marketing rule, specifically with regard to testimonials and endorsements. Given that the prior solicitation rule did not cover private fund investors, adjustments will need to be made by investment advisers and solicitors for private funds.

Not all communications to private fund investors would be advertisements under the marketing rule. Information included in private placement memoranda about the material terms, objectives, and risks of a fund offering is not considered an advertisement, nor are account statements, transaction reports, and other similar materials delivered to existing private fund investors, or presentations to existing clients concerning the performance of funds they have invested in.

Testimonials, Endorsements and Promoters

Q: Under the SEC's marketing rule, what type of compensation must be disclosed when solicitations occur?

A: Both cash and non-cash compensation must be disclosed. Non-cash compensation that must be disclosed can include (but is not limited to) gifts or entertainment, reduced fees or fee waivers, directed brokerage, prizes or sales awards. Compensation must be disclosed regardless of whether the compensation is contingent on the solicited person executing a new advisory relationship or investment in a private fund.

Non-cash compensation does not include attendance at training and education meetings, including company-sponsored meetings such as annual conferences, unless such attendance is provided in exchange for solicitation activities.

Testimonials, Endorsements and Promoters

Q: Does the SEC's marketing rule expand the definition of "disqualified persons"?

A: Yes. The SEC's marketing rule for investment advisers is somewhat broader than the disqualification provisions of the prior solicitation rule, as it applies to all compensated testimonials and endorsements. Further, if the disqualified person is an entity, the disqualification extends to certain of the entity's employees, officers, directors, general partners, and elected managers. Conversely, an entity that is not an ineligible person will not become an ineligible person solely because its employee, officer, or director is an ineligible person.

There is a ten year look back for disqualifying events from the time of dissemination of the advertisement. The frequency with which an investment adviser must monitor eligibility and the steps an investment adviser must take to assess disqualifying events will vary depending on the facts and circumstances, with the expectation that the investment adviser will exercise "reasonable care".

In the event that a promoter is newly disqualified under the marketing rule, an investment adviser may continue to pay trailing compensation for solicitations that were made prior to the marketing rule's effective date, provided the adviser complied with rule 206(4)-3 as in effect at the time.

Testimonials, Endorsements and Promoters

Q: Under the SEC's marketing rule, does a solicitor need to deliver the investment adviser's Form ADV Part 2 brochure to a prospective client?

A: No. This requirement has been eliminated.

Testimonials, Endorsements and Promoters

Q: Can investment advisers use third party ratings in advertisements under the SEC's marketing rule?

A: Yes, subject to certain requirements. The rule prohibits the use of third-party ratings in an advertisement, unless the adviser provides certain disclosures and conducts due diligence to ensure the ratings are not cherry picked or unfairly prepared. The third party must not be a "related person" as defined in the Form ADV Glossary and must provide ratings in the ordinary course of business.

Testimonials, Endorsements and Promoters

Q: Can an investment adviser use case studies under the SEC's marketing rule?

A: Yes, subject to the general prohibitions and restrictions for performance advertising (if the case study includes performance). Under the SEC's marketing rule, case studies by investment advisers must avoid cherry picking and should be presented in a fair and balanced manner as determined by the facts and circumstances, such as the sophistication of the intended recipient.

Performance Marketing

Q: Are there new requirements for advertising performance by investment advisers under the SEC's marketing rule?

A: Yes. Performance information must be presented by an investment adviser in a fair and balanced manner, subject to specific requirements with regard to gross and net performance, prescribed time periods, related performance, extracted performance, hypothetical performance, and predecessor performance. No statements are permitted that imply the SEC has reviewed or approved the investment adviser's presentation of performance results. Investment advisers are not required to disclose proprietary or confidential information when discussing performance (e.g., by disclosing every specific investment in a portfolio).

Performance Marketing

Q: Can investment advisers use performance advertising under the SEC's marketing rule?

A: Yes, subject to multiple conditions. The SEC's marketing rule prohibits an investment adviser from including the following in any advertisement:

• Gross performance, unless the advertisement also presents net performance;

• Any performance results, unless they are provided for specific time periods in most circumstances;

• Any statement that the SEC has approved or reviewed any calculation or presentation of performance results;

• Performance results from fewer than all portfolios with substantially similar investment policies, objectives, and strategies as those being offered in the advertisement, with limited exceptions;

• Performance results of a subset of investments extracted from a portfolio, unless the advertisement provides, or offers to provide promptly, the performance results of the total portfolio;

• Hypothetical performance (which does not include performance generated by interactive analysis tools), unless the investment adviser adopts and implements policies and procedures reasonably designed to ensure that the performance is relevant to the likely financial situation and investment objectives of the intended audience and the adviser provides certain information underlying the hypothetical performance; and

• Predecessor performance, unless there is appropriate similarity with regard to the personnel and accounts at the predecessor adviser and the personnel and accounts at the advertising adviser. In addition, the advertising adviser must include all relevant disclosures clearly and prominently in the advertisement.

Performance Marketing

Q: What are the different types of hypothetical performance?

A: The SEC has defined hypothetical performance to mean:

(A) Performance derived from **model portfolios**;

(B) Performance that is **back-tested** by the application of a strategy to data from prior time periods when the strategy was not actually used during those time periods; and

(C) **Targeted or projected** performance returns with respect to any portfolio or to the investment advisory services with regard to securities offered in the advertisement.

Performance Marketing

Hypothetical performance does **not** include:

(A) An interactive analysis tool where a client or investor, or prospective client, or investor, uses the tool to produce simulations and statistical analyses that present the likelihood of various investment outcomes if certain investments are made or certain investment strategies or styles are undertaken, thereby serving as an additional resource to investors in the evaluation of the potential risks and returns of investment choices; provided that the investment adviser:

(1) Provides a description of the criteria and methodology used, including the investment analysis tool's limitations and key assumptions

(2) Explains that the results may vary with each use and over time;

(3) If applicable, describes the universe of investments considered in the analysis, explains how the tool determines which investments to select, discloses if the tool favors certain investments and, if so, explains the reason for the selectivity, and states that other investments not considered may have characteristics similar or superior to those being analyzed; and

(4) Discloses that the tool generates outcomes that are hypothetical in nature.

Resources

- SEC Rule 206(4)-1. https://www.ecfr.gov/current/title-17/chapter-II/part-275/section-275.206(4)-1
- SEC Proposed Rule Release, *Investment Adviser Advertisements; Compensation for Solicitations*, November 4, 2019. https://www.sec.gov/rules/proposed/2019/ia-5407.pdf
- SEC Final Rule Release, *Investment Adviser Marketing*, December 20, 2020. https://www.sec.gov/news/press-release/2020-334
- SEC's Division of Investment Management's *Marketing Compliance Frequently Asked Questions.* https://www.ecfr.gov/current/title-17/chapter-II/part-275/section-275.206(4)-1
- SEC's Division of Investment Management's *Investment Adviser Marketing: A Small Entity Compliance Guide:* https://www.sec.gov/investment/investment-adviser-marketing

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