

# SEC Modernizes Investment Adviser Marketing and Solicitation Rules

Alert

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On December 22, 2020, the SEC created a [new merged rule](#) (Marketing Rule) that replaces two rules under the Advisers Act, rule 206(4)-1 (Marketing Rule), originally adopted in 1961, and rule 206(4)-3 (Solicitation Rule), originally adopted in 1979. The Marketing Rule reflects market, technological and regulatory changes that have occurred since the rules were originally adopted.

The Marketing Rule includes an expanded definition of an adviser advertisement including for example communications from private fund advisers to their investors; seven principles-based prohibitions that apply to all advertisements; guidance for adviser use of testimonials, endorsements and third-party ratings in advertisements; and requirements for performance advertising.

In addition, the SEC is adopting amendments to Form ADV to include additional disclosure to the SEC regarding advisers' marketing practices, as well as amendments to the books and records rule of the Advisers Act.

## DEFINITION OF AN "ADVERTISEMENT"

The final Marketing Rule divides the definition of an advertisement into two prongs. An advertisement is defined as the following:

- Any direct or indirect communication an investment adviser makes that: a) offers the adviser's investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the adviser, or b) offers new investment advisory services with regard to securities to current clients or private fund investors. The first prong excludes most one-on-one communications and specifically excludes:

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- Communications involving hypothetical performance, provided that either such communication is (a) provided in response to an unsolicited request; or (b) to a private fund investor one-on-one
- Extemporaneous, live or oral communications
- Information contained in a statutory or regulatory notice, filing or other required communication, so long as the information is designed to satisfy the requirements of the notice, filing, or other required communication
- The second prong includes any testimonial or endorsement for which an adviser directly or indirectly provides cash or non-cash compensation, including oral communications and one-on-one solicitation activities. Information contained in a statutory or regulatory notice, filing or other required communication is excluded from the second prong advertisement definition

## ADVERTISEMENT PROHIBITIONS

The Marketing Rule adopts seven principles-based general prohibitions that apply to all advertisements. The prohibitions are based on historic anti-fraud principles under federal securities laws. An advertisement may not:

- Contain any untrue statement of material fact, or omission of a material fact that, in light of the statement, would make the statement not misleading
- Contain a material statement of fact that the adviser does not reasonably believe it will be able to substantiate upon demand by the SEC
- Contain information reasonably likely to cause an untrue or misleading implication or inference to be drawn based on a material fact relating to the investment adviser
- Contain a discussion of potential benefits to clients or investors without also providing a fair and balanced treatment of material risks or limitations associated with potential benefits
- Contain a reference to specific investment advice provided by the investment adviser when the advice is not presented in a fair and balanced manner
- Contain or exclude performance results, or presenting performance time periods, in a manner that is not fair and balanced
- Be otherwise materially misleading

Importantly, an investment adviser needs only to act with negligence to violate the rule. Scierter (intent) is not required.

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## INVESTMENT PERFORMANCE ADVERTISING

To address special concerns with performance advertising, the Marketing Rule adopts particular requirements and restrictions for performance advertising including:

- Presentations of gross performance must be accompanied by net performance of at least equal prominence and portrayed in a format designed to facilitate comparison with the gross performance.
- Net performance must be calculated over the same time period, using the same type of return and methodology, as the gross performance.
- Except for performance results of a private fund, performance results must be presented in one-, five-, and ten-year time periods with equal prominence.
- Any implied or express statement that the calculation or presentation of performance results in an advertisement have been reviewed or approved by the SEC is prohibited.
- If an adviser advertises the performance of a related portfolio (i.e. a portfolio with substantially similar investment policies, objectives, and strategies as those of the services), the performance of all related portfolios must be included, subject to certain exceptions.
- Extracted performance (i.e. performance results of a subset of investments extracted from a portfolio) is not permitted, unless the advertisement includes the performance results of the total portfolio from which the performance was extracted, subject to certain exceptions.
- Hypothetical performance (i.e. performance results not actually achieved by any portfolio of the adviser) is not permitted, unless the hypothetical information is relevant to the likely financial situation and investment objectives of the advertisement's intended audience and the adviser takes certain steps to address its potentially misleading nature.
- Predecessor performance (i.e. performance of an investment that was not advised at all times during the period shown by the advertising adviser), is only permitted when each of the following occurs:
  - The persons primarily responsible (i.e. the person or group who makes investment decisions) for achieving the prior performance results also manage the accounts at the advertising adviser.
  - The accounts are sufficiently similar and managed in a substantially similar manner as the advertised accounts.
  - The advisers clearly and prominently include all relevant disclosures and indicate that the performance results were from accounts managed at a different entity.

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## TESTIMONIALS, ENDORSEMENTS AND THIRD-PARTY RATINGS

The Marketing Rule includes guidance to avoid misleading advertisements regarding client testimonials, endorsements, and the use of third-party ratings.

## FORM ADV; BOOKS AND RECORDS RULE; POLICIES AND PROCEDURES

The SEC is amending Form ADV to require advisers to address separately whether its advertisements include testimonials, endorsements and third-party ratings, and whether the adviser provides cash or non-cash compensation in connection with such activities. Advisers must also state whether any of its advertisements include hypothetical performance and predecessor performance, respectively.

Under the amendment to the books and records rule, advisers must make and keep records of all disseminated advertisements. If the advertisement was provided orally, the adviser can satisfy the Marketing Rule by retaining a copy of any written or recorded materials used in connection with the oral advertisement. Advisers must maintain such records for at least five years. The first two years of storage must take place in the office where the advertisement was published or disseminated.

To ensure compliance with the Marketing Rule, compliance policies and procedures "should include objective and testable means reasonably designed to prevent violations" of the Marketing Rule.

## EXISTING STAFF NO-ACTION LETTERS

Certain previously issued no-action letters regarding the prior advertising and solicitation rules will be withdrawn, and the guidance provided in those letters is either incorporated into the Marketing Rule or will no longer apply. A list of the letters to be withdrawn will be available on the SEC's website.

## EFFECTIVE DATE

The Merged Marketing Rule will be 60 days after publication in the Federal Register. Advisers will have an 18-month period after the effective date to comply with the final rule.

For more information on Form ADV or the new marketing rule, please contact [Eric Mikkelson](#), Gerry Griffith or the Stinson LLP contact with whom you regularly work.

## CONTACT

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## RELATED CAPABILITIES

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