Investment Adviser Advertising Rule
Adopted Amendments
December 2020

The SEC finalized amendments to Rule 206(4)-1, the advertising rule, under the Investment Advisers Act of 1940. The rule has not been materially amended since its adoption over forty years ago, and this amendment seeks to modernize the rules that govern investment adviser advertisements and payments to solicitors. The amendments create a single rule that replaces the current advertising and cash solicitation rules (Rule 206(4)-1 and Rule 206(4)-3, respectively). In part, the amendments replace the prescriptive nature of the advertising rule with a more principles-based approach. In addition, the revised rule replaces certain no-action letters that have historically established guidance with respect to adviser advertisements. Following are highlights regarding the final amendments, particularly as they relate to private fund advisers, private wealth managers and family offices.

Definition of Advertisement & Exclusions

The revised definition of an advertisement now more broadly includes any direct or indirect communication an investment adviser makes that: (i) offers the investment adviser's investment advisory services to prospective clients or private fund investors, or (ii) offers new investment advisory services to current clients or private fund investors. In addition, the definition generally includes any endorsement or testimonial for which an adviser provides cash and non-cash compensation directly or indirectly (e.g., directed brokerage, awards or other prizes, and reduced advisory fees). Of note, the definition expressly includes information that offers or promotes private funds and adviser managers. In contrast, the definition specifically excludes:

- Live oral communications that are not broadcast on radio, television or the internet;
- Responses to unsolicited requests for specific information (such as an investor-specific DDQ), other than performance presentations or communications that include hypothetical performance;
- Marketing materials regarding registered investment companies or business development companies;
- Information required to be included in statutory or regulatory notices or filings (such as Form ADV);
- Generic brand content, educational material and market commentary, private placement memoranda, private fund account statements, transaction reports, and other similar materials delivered to existing private fund investors, and presentations to existing clients concerning the performance of funds they have invested in; and
- Communications designed to retain current investors.

In addition, although not specifically excluded from the definition, pitch books or other materials accompanying PPMs could fall within the definition of an advertisement.

Retail vs. Non-Retail Advertisements

The proposed amendment would have distinguished between those materials prepared for clients or investors who are "qualified purchasers" or "knowledgeable employees" ("non-retail persons")

compared to materials that are prepared for clients or investors with a lower level of sophistication ("retail persons"). In the final rule, the SEC decided not to distinguish the treatment of retail and non-retail advertisements.

General Prohibitions

The amended rule includes general provisions, which are largely consistent with current standards and best practices, that prohibit the following:

- Including any untrue statement or omitting material facts;
- Including unsubstantiated material claims and statements;
- Including untrue or misleading implications or references;
- Discussing benefits without disclosing material risks or other limitations;
- Discussing specific investments if not fair and balanced;
- Including or excluding performance results or time periods if not fair and balanced; and
- Otherwise utilizing materially misleading advertisements.

Performance Presentations

Performance presentations are required to adhere to the general prohibitions above as well as other specific conditions as follows. The adopting release notes that the SEC expects advisers to include relevant disclosures in performance presentations to ensure such information is not misleading but chose not to require specific disclosures or legends but rather utilize a principles-based approach. The SEC has also adopted updates to Form ADV to indicate whether an adviser presents performance in its advertisements.

All advertisements must:

- Present performance net of management fees and applicable expenses (using actual fees or a model fee representing the highest fee charged) with equal prominence whenever providing gross performance;
- Avoid stating, expressing or implying SEC review or approval of performance;
- Include, when providing related performance, all related portfolios or exclude portfolios only so long as the reported performance is no higher than had they been included;
- Provide, when presenting extracted performance, or offer to promptly provide the entire portfolio. Gross and net performance must be calculated over the same time period and using the same type of return;
- Provide performance for 1-, 5- and 10-year periods (or since inception, as applicable) ending on the most recent practicable date with equal prominence (**advisers may rely on an exemption when marketing performance of a private fund**); and
- Describe the type of return presented and relevant information regarding how it is calculated.

Hypothetical performance:

- Hypothetical performance, including targets and projections, would be permitted only if the adviser:
    - Implements policies and procedures to ensure that such information is relevant to the recipient;
    - Provides sufficient "calculation information" to enable the recipient to understand the criteria and assumptions utilized in making such calculations;

- Provides (or offers to provide) sufficient "risk information" to enable the recipient to understand the risks and limitations of using such information.

Portability Rules

The amendment permits presenting performance from a prior firm if the following requirements are satisfied:

- The person or persons who were primarily responsible for achieving the prior performance results manage accounts at the advertising adviser;
- The accounts managed at the predecessor investment adviser are sufficiently similar to the accounts managed at the advertising adviser that the performance results would provide relevant information to investors;
- All accounts that were managed in a substantially similar manner are advertised unless the exclusion of any such account would not result in materially higher performance and the exclusion of any account does not alter the presentation of any prescribed time periods; and
- The advertisement clearly and prominently includes all relevant disclosures, including that the performance results were from accounts managed at another entity.

In addition, advisers should consider the extent to which other provisions of the advertising rule, such as the general prohibitions (including those pertaining to the fair and balanced presentation of information), apply to any display of predecessor performance.

Notably, the SEC considered the necessary books and records to substantiate such performance, recognizing that advisers may not have all the underlying performance data from the prior firm. The SEC will newly require an adviser to retain records to support the performance presented. In the SEC's view, in order to avoid misleading presentations of predecessor performance, an adviser must have access to the books and records underlying the performance. This concept was applied more generally under the final rule, which will also require that an adviser have a reasonable basis for believing that it will be able to substantiate (upon demand by the SEC) all material statements of fact contained in an advertisement.

Specific Investments

The final rule replaces the current prohibition on discussing past specific investments that were profitable with a principles-based requirement that would require any discussions of specific investments to be presented in a fair and balanced manner. While the release notes several approaches an adviser may choose that would satisfy the fair and balanced standard, it specifically states that these approaches are not the only way to comply with the provision, and whether or not a presentation is fair and balanced will vary based on the facts and circumstances as well as the nature and sophistication of the audience.

Testimonials, Endorsements & Ratings

Unlike the current rule that strictly prohibits client testimonials, in recognition of the changes in technology and social media, the rule permits testimonials (by clients/investors), endorsements (by non-clients or non-investors, such as portfolio company management teams) and third-party ratings, subject to the general prohibitions above and clear and prominent disclosure of the following:

- Whether the testimonial or endorsement was given by a client/investor or non-client/non-investor (as applicable);
- Whether the person making the statement or providing the rating received cash or non-cash compensation;
- A brief statement of any material conflicts of interest on the part of the person giving the testimonial or endorsement resulting from the investment adviser's relationship with such person.
- The date on which a rating was given and time period covered by the rating; and
- The identity of the third-party that created and tabulated the rating.

The final rule requires disclosure of the material terms of any compensation arrangement, including a description of the compensation provided or to be provided, directly or indirectly, to the person for the testimonial or endorsement, including referral and solicitation activity previously covered under the cash solicitation rule. In addition to the disclosure requirements, and consistent with the proposed amendments to the cash solicitation rule, investment advisers will be prohibited from compensating ineligible persons for testimonials and endorsements and will be required to have a written agreement with certain persons providing testimonials and endorsements. However, in contrast to the proposed amendments, these disqualification and written agreement provisions are applicable only if the compensation is greater than $1,000 (or the equivalent value in non-cash compensation). The proposed amendment provided a full exemption for solicitation activities performed for de minimis compensation, which was proposed as $100 or less.

The final definition of testimonial includes any statement by a current client or private fund investor about the client's or private fund investor's experience with the investment adviser or its supervised persons. The definition of endorsement includes any statement by a person other than a current client or private fund investor that 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. The definitions of testimonial and endorsement do not include client lists and would not include testimonials or endorsements with respect to related persons of advisers (such as LinkedIn endorsements of an individual employee). The SEC has also adopted updates to Form ADV to indicate whether an adviser uses testimonials, endorsements or third-party ratings in its advertisements.

Social Media Updates & Associated Persons Implications

The amended rule allows advisers to include a hyperlink in an advertisement to an independent webpage on which third-party content sits. At the same time, an adviser's hyperlink to third-party content that the adviser knows contains an untrue statement of material fact or materially misleading information would be considered fraudulent and deceptive under Section 206 of the Advisers Act and other applicable anti-fraud provisions.

Permitting all third parties to post public commentary to the adviser's website or social media page would not render such content attributable to the adviser, so long as the adviser does not selectively delete or alter the comments or their presentation and is not involved in the preparation of the content. In addition, if a social media platform allows the investment adviser to sort the third-party content in a way that shows favorable content more prominently, but the investment adviser does not actually do such sorting, then the ability to sort content would not, by itself, render such content attributable to the adviser. In addition, if an adviser merely permits the use of "like," "share," or "endorse" features on a third-party website or social media platform, SEC staff would not interpret the adviser's permission as implicating the final rule.

Conversely, if the investment adviser takes affirmative steps to involve itself in the preparation or presentation of the comments, to endorse or approve the comments, or to edit posted comments, those comments would be attributed to the adviser.

In regard to personal social media accounts, the SEC has noted concerns that it could be difficult for an investor to differentiate a communication of the associated person in his/her personal capacity from a communication the associated person made for the adviser. Nonetheless, if the adviser adopts and implements policies and procedures reasonably designed to prevent the use of an associated person's social media accounts for marketing the adviser's advisory services, the SEC generally would not view such communication as the adviser marketing its advisory services.

To achieve effective supervision and compliance, the SEC recommends prohibiting such communications, conducting periodic training, obtaining attestations, and periodically reviewing content that is publicly available on associated persons' social media accounts.

Compliance Review & Approval of Advertisements

The proposed rule would have required that all advertisements be reviewed and approved prior to use and documentation of such review maintained. However, in the final rule the SEC elected not to adopt the proposed pre-use approval requirement or the associated recordkeeping requirement.

Form ADV Update

The SEC is adopting amendments to Item 5 of Form ADV Part 1A to improve information available to the SEC and the public about advisers' marketing practices. The SEC is adopting a new subsection L to Item 5 of Form ADV to require an adviser to state whether any of its advertisements include performance results, a reference to specific investment advice, testimonials, endorsements, or third-party ratings. Additionally, the SEC is amending the Form ADV Glossary to incorporate the final rule's definitions for "advertisement," "endorsement," "hypothetical performance," "testimonial," "third-party rating," and "predecessor performance." Because new subsection L is included under Item 5 of Form ADV, advisers will be required to update responses to these questions in their annual updating amendment only.

Compliance Timeline

The final rule is effective May 4, 2021 and provides an 18-month transition period between the effective date of the rule and the November 4, 2022 compliance date. Certain SEC no-action letters and other staff guidance, or portions thereof will be withdrawn as of the compliance date, as those positions are either incorporated into the final rule or will no longer apply. In addition, as the SEC is rescinding the solicitation rule, the staff no-action letters that address that rule will be nullified. On April 14, 2021, the Division of Investment Management issued guidance, in the form of Marketing Compliance Frequently Asked Questions (***FAQ***), which will be updated from time to time. The FAQ noted that advisers may not elect to comply with some of the new marketing rule requirements before the compliance date but not comply with others.