King & Spalding
Client Alert

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SEC Investment Adviser Marketing Rule: Compliance Date is Nov. 4, 2022

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In late 2020, the SEC adopted[1] rule amendments that require SEC-registered investment advisers to, by November 4, 2022, switch their compliance regimes from the SEC's current Advertising and Cash Solicitation Rules (Rules 206(4)-1 and 206(4)-3, respectively) to that of the new Marketing Rule (numbered 206(4)-1). The Marketing Rule represents both significant continuity with and a significant departure from the current rules.

Departures include:

- *Investor solicitations by private fund "promoters"* are within scope of the Rule, including but not limited to solicitations by broker-dealer placement agents. Advisers must think through, together with their promoters, how to structure compliance. Solicitations for investments in private funds had been outside the scope of the Cash Solicitation Rule.
- *Testimonials* are now permitted, giving additional flexibility with respect to third-party posts on adviser social media.
- *Case studies*: the per se prohibition on past specific recommendations is no more, now replaced by a fair-and-balanced standard. However, the SEC indicated that it does not view the Rule as a substantive departure from the positions in existing Staff no-action letters regarding past specific recommendations.
- A *new Form ADV Part 1A section* to complete.

See Part I (Definition of Advertisement Under the Rule); Part II (General Content Standards); Part III (Third-Party Solicitations); Part IV (Third-Party Ratings); Part V (Performance Advertising); Part VI (Portability of Performance); Part VII (Recordkeeping); Part VIII (No-Action Letters' Fate); Part IX (Other Provisions); Part X (Concluding Thoughts). Skip to Charts on: General Content Standards; Private Fund Promoter Communications; Performance Communications; Portability of Performance.

This alert summarizes the new rule and its departures from current regulation, and highlights key compliance/operational steps advisers might consider in respect of the same.

Advisers[2] are permitted to choose to comply with the Marketing Rule prior to the compliance deadline, but, if an adviser does so, it must apply the Marketing Rule in its entirety.

I. DEFINITION OF "ADVERTISEMENT" UNDER THE RULE

1.1 Rule Text

The Marketing Rule's obligations apply to communications that are "advertisements", as the term is defined in the Rule. [3]

The Rule's definition of advertisement has two prongs: a communication meeting either the below-described "general prong" or the "endorsement/testimonial prong" is an advertisement, and thus within the Rule's scope:

- General Prong: Any direct or indirect communication an investment adviser makes to more than one person that: (i) 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 ("private fund investors"), or (ii) offers new investment advisory services with regard to securities to current clients or private fund investors. [emphasis added]
  - The "to more than one person" limitation does not apply if communications involve *hypothetical performance,* other than in the context of one-on-one communications with private fund investors and responses to unsolicited requests for such information.
- Endorsement/Testimonial Prong: Any *endorsement* or *testimonial* for which an investment adviser provides compensation, directly or indirectly, but does not include any information contained in a statutory or regulatory notice, filing, or other required communication, provided that such information is reasonably designed to satisfy the requirements of such notice, filing, or other required communication.

The SEC stated that the Rule's definition was intended in part to be technology agnostic (the Advertising Rule's definition refers to circulars, letters, radio, and television).

1.2 Key Substantive Take-Aways

- One-on-One Communications Generally Excluded: The SEC had proposed to expand the Rule's scope to apply to one-on-one communications with prospective customers/private fund investors. Following comments, the SEC retained the current Advertising Rule's exclusion of one-on-one communications from the definition of "advertisement," except as discussed above (i.e., certain communications with hypothetical performance). *What is a one-on-one communication*? Not defined in the Rule, but the SEC provided some examples of what would not be a one-on-one communication in the adopting release: Bulk emails that are nominally directed at or addressed to only one person, but are in fact widely disseminated to numerous investors, would not be a one-on-one communication. Similarly, customizing a template presentation or mass mailing by filling in the name of an investor and/or including other basic information about the investor would not result in a one-on-one communication.
  - Communications with current customers are excluded unless the communications offer new advisory services.
- "Indirect communications" of Advisers; Advisers to Private Funds That Use Placement Agents or Other Promoters: The general prong of the definition includes communications that an adviser makes indirectly.

As such, communications that are distributed by placement agents with respect to private funds may raise nuanced and important questions as to whether the communications are subject to the Marketing Rule. On one end of the spectrum is a communication that is prepared by an adviser and provided to the placement agent for distribution. Such communication is a Marketing Rule advertisement. The adopting release also provides that where the adviser has participated in the creation or dissemination of a communication, or authorized it, the communication would be an adviser communication. See pages 17 et seq. of the adopting release for further discussion.

- RIC and BDC Advertisements Excluded from the Rule's Coverage: Largely as proposed, the final Rule will apply to certain communications sent to private fund investors, but will not apply to advertisements about registered investment companies or business development companies, which continue to be regulated separately.
- Supervised Person Social Media: With respect to social media, the adopting release notes that 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 services, the SEC generally would not view such social media posts as the adviser marketing its services. The SEC noted in the release that to achieve effective supervision and compliance with respect to supervised person social media, an adviser may consider also conducting periodic training, obtaining attestations, and periodically reviewing content that is publicly available on associated persons' social media accounts.
- Third-Party Comments on Adviser Social Media: From the adopting release: "Whether content posted by third parties on an adviser's own website or social media page would be attributed to the investment adviser also depends on the facts and circumstances surrounding the adviser's involvement. For example, permitting all third parties to post public commentary to the adviser's website or social media page would not, by itself, 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 an adviser merely permits the use of 'like,' 'share,' or 'endorse' features on a third-party website or social media platform, we 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."
- Brand Content: The adopting release notes that materials that offer brand content (e.g., displays of the advisory firm name in connection with sponsoring sporting events, supporting community service activities, or supporting philanthropic efforts) that are designed to raise the profile of the adviser generally, but do not offer securities advisory services, would not constitute advertisements.
- Market Commentary: The adopting release notes that communications that offer only market commentary are unlikely to offer securities advisory services, describing market commentary as material that aims to inform current and prospective investors, including private fund investors, of market and regulatory developments in the broader financial ecosystem. However, the SEC noted that it would view an article or white paper that provides general market commentary and concludes with a description of how the adviser's securities-related services can help prospective investors invest in the market, as offering the adviser's services.
- PPMs: The SEC noted that information included in a PPM about the material terms, objectives, and risks of a fund offering is not an advertisement. However, the SEC noted that whether particular information

included in a PPM constitutes an advertisement of the adviser depends on the relevant facts and circumstances. For example, if a PPM contained related performance information of separate accounts the adviser manages, that related performance information is likely to constitute an advertisement, per the adopting release.

- Communications of a Registered Offshore Adviser Regarding Non-U.S. Clients: The SEC noted that it previously stated, and continued to take the position, that most of the substantive provisions of the Advisers Act do not apply with respect to the non-U.S. clients (including funds) of a registered offshore adviser.

1.3 Possible Compliance Next Steps

- Updating compliance manual to note the definition of advertisement under the Rule.
- Social Media:
  - To seek to avoid any regulatory view that associated person social media is an advertisement by the adviser, adopt and implement policies and procedures reasonably designed to prevent the use of an associated person's social media accounts for marketing the adviser's services.
  - Review adviser social media account policies with respect to actions taken in respect of third-party content posted on adviser social media pages, to avoid any implication that a third-party's comments/actions may be viewed as adviser advertisements.
- Consider which types of the adviser's historic communications could be advertisements under the Rule, and discuss how to ensure compliance with the Rule's requirements going forward.
- If the adviser uses placement agents (or other promoters) to solicit interest in private funds managed by the adviser, the adviser and such promoter should understand and be aligned on the process for preparing and distributing marketing materials and be aligned on views as to whether those materials will be subject to the Marketing Rule, the FINRA ruleset, or both or neither. If the communication will be a Marketing Rule advertisement, the adviser will need to maintain appropriate records of the same.

II. "GENERAL PROHIBITIONS": THE GENERAL CONTENT STANDARDS OF THE MARKETING RULE

2.1 Rule Text

The Marketing Rule establishes seven principles-based general prohibitions for all advertisement content:

Topic	Text of Prohibition	Rule Paragraph
Untrue material statements and omissions	• Include any untrue statement of a material fact, or omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which it was made, not misleading.	-(a)(1)
Unsubstantiated material statements of fact	• Include a material statement of fact that the adviser does not have a reasonable basis for believing it will be able to substantiate upon SEC demand.	-(a)(2)

Topic	Text of Prohibition	Rule Paragraph
Untrue or misleading implications or inferences	• Include information reasonably likely to cause an untrue or misleading implication or inference to be drawn concerning a material fact.	-(a)(3)
Discussion of any potential benefits without fair and balanced treatment of material risks or material limitations.	• Discuss any potential benefits to clients or investors connected with or resulting from the investment adviser's services or methods of operation without providing fair and balanced treatment of any material risks or material limitations associated with the potential benefits.	-(a)(4)
Anti-Cherry Picking	• Include a reference to specific investment advice provided by the investment adviser where such investment advice is not presented in a manner that is fair and balanced.	-(a)(5)
Anti-Cherry Picking, Performance	• Include or exclude performance results, or present performance time periods, in a manner that is not fair and balanced.	-(a)(6)
Catch-all	• The catch-all provision prohibits any advertisement that is otherwise materially misleading.	-(a)(7)

2.2 Key Substantive Take-aways

- Nature of the audience relevant to how the content standards are applied. Although the Marketing Rule's text does not distinguish between retail and non-retail communications (after the proposing release had proposed such a distinction), the adopting release states that the nature of the audience to which the advertisement is directed is a key factor in determining how the general prohibitions should be applied, noting that, for instance, the amount and type of information that may need to be included in an advertisement directed at retail investors may differ from the information that may need to be included in an advertisement directed at institutional investors.
- Past specific recommendations no longer "per se" prohibited but must meet "fair and balanced" standard. The current Advertising Rule's per se prohibition inclusion of past specific recommendations is replaced by the Marketing Rule's general prohibitions' requirement that any such reference be "fair and balanced." "Fair and balanced" is a phrase that will be familiar to broker-dealers from the content standards of FINRA Rule 2210 (Communications with the Public).[4] The adopting release provides some guidance regarding compatibility of advertisement of past specific recommendations with the "fair and balanced" requirement:
  - **Case Studies:** Case studies are permitted, but the SEC stated that "it would not be fair and balanced for an adviser to present case studies only reflecting profitable investments (when there are also similar unprofitable investments). To meet the fair and balanced standard, an adviser may, for example, disclose the overall performance of the relevant investment strategy or private fund for at least the relevant period covered by the list of investments."

- **Nature of Audience:** The SEC stated: "In determining how to present information in a fair and balanced manner, advisers should consider the facts and circumstances of the advertisement, including the nature and sophistication of the audience. For example, in an advertisement intended for a retail investor, an adviser may include certain disclosures to help the investor understand that past specific investment advice does not guarantee future results such as an explanation of the particular or unique circumstances of the previous investment advice and how those circumstances are no longer relevant. Less detailed disclosure may be needed in an advertisement solely for sophisticated institutional investors, who more likely understand the risks associated with past specific investment advice."
- **Footnote Disclosure**: An advertisement that highlights one period of extraordinary performance with only a footnote disclosure of unusual circumstances that have contributed to such performance may not be fair and balanced, depending on whether there are other sufficient clear and prominent disclosures.
- **Past Specific Recommendation No-Action Letters**: The SEC implied in the adopting release (see page 81) that compliance with the conditions of past Staff no-action letters on past specific recommendations (e.g., *Franklin Management*, *TCW Group*) is sufficient to comply with the General Prohibitions in respect of past specific recommendations. While advisers may wish to refer to these letters for examples, the SEC agreed with commenters that an adviser may satisfy the fair and balanced standard in other ways.
- Pages 79 through 82 of the Adopting Release provide further guidance that may be helpful.

2.3 Possible Compliance Next Steps

- Update compliance manual to include the text of the General Prohibitions; update provisions on past specific recommendations to reflect new approach of the Marketing Rule.
- Consider training for associated persons who may draft or approve advertisements on the Rule's General Prohibitions, SEC guidance regarding use of case studies, required disclosures for the same, and consideration of the nature of the audience in applying general content standards.

III. TESTIMONIALS/ENDORSEMENTS: PRIVATE FUND PROMOTER "ENDORSEMENTS" ARE SUBJECT TO THE RULE

3.1 Rule Text

The Marketing Rule rewrites the rule-book for compensated testimonials and endorsements.

Under the current rule-set:

- Testimonials are prohibited, subject to exceptions that have been carved out over the years through guidance.
- Third-party solicitations (i.e., endorsements) of advisory clients are regulated under the Cash Solicitation Rule, while third-party solicitations for private funds are not expressly regulated under the Advertising or Cash Solicitation Rules.

Under the Marketing Rule:

Testimonials are permitted under the Marketing Rule, subject to conditions: A "testimonial" is defined under the Marketing Rule as:

> *[a]ny statement by a current client 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.*

Third-party solicitation ("endorsement") regulation is changing: An "endorsement" is defined under the Marketing Rule as:

> *[a]ny statement by a person other than a current client 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 to be a client of, or an investor in a private fund advised by, the investment adviser; or (iii) 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 definition of endorsement captures solicitations by broker-dealer placement agents for private fund investments, which previously were expressly not regulated under the Advisers Act.

The status of a communication as a compensated testimonial or endorsement implies certain disclosure, disqualification, and adviser oversight responsibilities, as described below.

Conditions for use of compensated endorsements or testimonials:

- Certain Required Disclosures (subject to conditional exceptions for broker-dealers):
  - *"Clear and Prominent Disclosures"*: (i) whether the testimonial was given by a current client or private fund investor, or whether the endorsement was given by a person other than a current client or private fund investor, as applicable; (ii) that cash or non-cash compensation was provided for the testimonial or endorsement, if applicable; and (iii) 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.
    - In order to meet the Rule's "clear and prominent" standard, the disclosures must be at least as prominent as the testimonial or endorsement, and the disclosures must be included within the testimonial or endorsement (or, in the case of an oral testimonial or endorsement, provided at the same time).[5]
  - *"Other Disclosures"*: (i) 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; and (ii) a description 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 and/or any compensation arrangement.
    - Unlike the disclosures subject to the "clear and prominent" requirement, these disclosures do not need to be within the testimonial or endorsement, and can be disseminated concurrently with the testimonial or endorsement.
    - Guidance on "material terms of any compensation arrangement" from the adopting release:

- If a specific amount of cash compensation is paid, the advertisement should disclose that amount.
- If the compensation takes the form of a percentage of the total advisory fee over a period of time, then the advertisement should disclose such percentage and time period.
- Moreover, if all or part of the compensation is deferred or contingent on a certain future event, such as an investor's continuation or renewal of its advisory relationship, agreement, or investment, the advertisement should disclose those terms.
- If a person, such as a broker-dealer, refers clients to advisers that recommend the broker-dealer's or its affiliate's proprietary investment products or recommend products that have revenue sharing or other pecuniary arrangements with the broker-dealer or its affiliate, the disclosures must say so.

- Disqualification: An investment adviser may not compensate a person, directly or indirectly, for a testimonial or endorsement if the adviser knows, or in the exercise of reasonable care should know, that the person giving the testimonial or endorsement is an ineligible person, as that term is defined in the Marketing Rule, at the time the testimonial or endorsement is disseminated, subject to certain exemptions described in this sentence's footnote.[6]
- Adviser Oversight and Compliance: The investment adviser must have (i) a reasonable basis for believing that the testimonial or endorsement complies with the Rule's requirements, and (ii) a written agreement with any person giving a testimonial or endorsement that describes the scope of the agreed-upon activities and the terms of compensation for those activities.
- Exceptions for Endorsements/Testimonials by SEC-registered broker-dealers: If the endorsement is provided by an SEC-registered broker-dealer, certain exemptions may apply. The following chart describes the application of the Rule's requirements in respect of private fund solicitations to broker-dealer and non-broker-dealer promoters:

	Promoter is a U.S. broker-dealer whose endorsements are recommendations subject to Regulation Best Interest (i.e., to a "retail customer" as defined under Reg. BI)	*Promoter is a U.S. broker-dealer. Will make endorsements to investors that are not "retail customers" under Reg. BI*	*Promoter is not a U.S. broker-dealer*
Clear and Prominent Disclosures	Not required	Required	Required

	Promoter is a U.S. broker-dealer whose endorsements are recommendations subject to Regulation Best Interest (i.e., to a "retail customer" as defined under Reg. BI)	*Promoter is a U.S. broker-dealer. Will make endorsements to investors that are not "retail customers" under Reg. BI*	*Promoter is <u>not</u> a U.S. broker-dealer*
Other Disclosures	Not required	Not required	Required
Marketing Rule Disqualification Provisions	Compliance not required, if broker-dealer is not subject to "statutory disqualification" as defined in Section 3(a)(39) of the Exchange Act	Compliance not required, if broker-dealer is not subject to "statutory disqualification" as defined in Section 3(a)(39) of the Exchange Act	Apply
Written Agreement required	Yes	Yes	Yes

3.2 Possible Compliance Next Steps

- Update policies and procedures to reflect the Marketing Rule's definitions of endorsement and testimonial, and the conditions that attach to the use of each in advertisements.
- <u>Private funds that use promoters</u>: By bringing promoters' solicitations of prospective investors for private funds within the scope of the Rule's definition of "endorsement", the Marketing Rule imposes a new area of compliance focus to advisers. The adviser and promoter should seek alignment on (i) how the required disclosures (if any) will be delivered to solicited investors, (ii) what systems and/or amendments to written agreements will be established to permit the adviser to have a reasonable basis to believe that the Rule's requirements in respect of endorsements are complied with.
- <u>No brochure delivery requirement</u>**:** Unlike the current Cash Solicitation Rule, the Marketing Rule does not require that the written agreement require promoters to deliver the adviser's Brochure.
- The elimination of the per se prohibition on testimonials significantly modernizes the Advisers Act regime around social media "likes" and other public commentary on social media, permitting firms significant additional flexibility. Firms may wish to evaluate whether to adjust their policies in light of the expanded flexibility.

IV. THIRD-PARTY RATINGS: DILIGENCE AND DISCLOSURE REQUIREMENTS

4.1 Rule Text

The Rule prohibits an advertisement from including any "third-party rating" unless the adviser:

- Has a reasonable basis for believing that any questionnaire or survey used in the preparation of the third-party rating is structured to make it equally easy for a participant to provide favorable and unfavorable

responses, and is not designed or prepared to produce any predetermined result. The SEC stated that this "due diligence requirement" could be satisfied by accessing the questionnaire or survey that is used in preparing the rating, but that that is not the only way to comply with the Rule's due diligence requirement. The SEC noted that some ratings firms may not be willing to share such information, and the adopting release sets forth other manners in which an adviser could satisfy the due diligence standard at page 161.

- Disclosures: Clearly and prominently[7] discloses, or the investment adviser reasonably believes that the third-party rating clearly and prominently discloses:
  - The date on which the rating was given and the period of time upon which the rating was based;
  - The identity of the third party that created and tabulated the rating; and
  - If applicable, that compensation has been provided directly or indirectly by the adviser in connection with obtaining or using the third-party rating.

4.2 Possible Compliance Next Steps

- If a firm may use third-party ratings, the compliance manual should be updated to reflect the new requirements.
- Marketing materials that use third-party ratings may need to be updated to reflect the Rule-mandated disclosures. The adviser would also need to be comfortable that it has complied with the due diligence requirement.

V. PERFORMANCE ADVERTISING

5.1 Rule Text

The Rule's general prohibitions, discussed above, prohibit an adviser from including or excluding performance results, or presenting time period for performance, in a manner that is not fair and balanced.

The Rule also contains certain specific prohibitions for performance advertising, as described in the following chart.

Type of performance information	Rule Requirements	Notes
Any	• The Rule's General Prohibitions, discussed in Part I above, prohibit an adviser from including or excluding performance results, or presenting time period for performance, in a manner that is not fair and balanced.	Advisers must keep in mind the General Prohibitions when using any kind of performance information, in addition to the requirements for specific types of performance information discussed in the rows below.
Gross performance	• Any presentation of *gross performance* is prohibited unless the advertisement also presents *net performance* with at least equal prominence to, and in a format designed to facilitate comparison with, the gross performance.	Gross performance is defined as "*the performance results of a portfolio (or portions of a portfolio that are included in extracted performance, if applicable) before the deduction of all fees and expenses that a client or investor has paid or would have paid in connection*

Type of performance information	Rule Requirements	Notes
	• The net performance must be calculated over the same time period, and using the same type of return and methodology, as the gross performance.	*with the investment adviser's investment advisory services to the relevant portfolio.*" The Rule does not prescribe any particular calculation of gross performance, provided that the obligations of the Rule's General Prohibitions apply. Net performance means: see definition set out below the chart.
Related performance	• The Rule conditions the use of *related performance* on the inclusion of all *related portfolios*, subject to the ability to exclude any related portfolios if the advertised performance results are not materially higher than if all related portfolios had been included, and the exclusion does not alter the presentation of any of prescribed time periods. • The Rule allows advisers to report related performance either as a composite aggregation of all portfolios falling within stated criteria (*e.g.*, a composite constructed to meet the CFA Institute's GIPS standards) or on a portfolio-by-portfolio basis.	Related performance is defined as "*the performance results of one or more related portfolios, either on a portfolio-by-portfolio basis or as a composite aggregation…*" Related portfolio is defined as "*a portfolio with substantially similar investment policies, objectives, and strategies as those of the services being offered in the advertisement.*"
Extracted performance	• The Rule prohibits the use of any *extracted performance*, unless the advertisement provides, or offers to provide promptly, the performance results of the total portfolio from which the performance was extracted.	Extracted performance is defined as "*the performance results of a subset of investments extracted from a portfolio.*"
Hypothetical performance	• The Rule prohibits any use of *hypothetical performance* unless the investment adviser: – Adopts and implements policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the likely	Hypothetical performance means "*performance results that were not actually achieved by any portfolio of the adviser. Hypothetical performance includes, but is not limited to: (A) Performance derived from model portfolios; (B) Performance that is backtested by the application of a*

Type of performance information	Rule Requirements	Notes
	financial situation and investment objectives of the intended audience of the advertisement; – Provides sufficient information to enable the intended audience to understand the criteria used and assumptions made in calculating such hypothetical performance; and – Provides (or, if the intended audience is an investor in a private fund, provides or offers to provide promptly) sufficient information to enable the intended audience to understand the risks and limitations of using such hypothetical performance in making investment decisions. • In presenting hypothetical performance information, the advertisement need not comply with the conditions imposed on related performance, extracted performance, or the time-period requirements.	*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. However, hypothetical performance does not include certain qualifying interactive analysis tools, or predecessor performance.*" See row below re target returns.
Target returns	• Treated as a form of hypothetical performance. See row above.	Adopting release: "The conditions we are adopting with respect to the use of hypothetical performance are principles-based, allowing the adviser to tailor the disclosure to the type of performance used in the advertisement. For example, in the case of an advertisement that presents targeted returns, which are generally aspirational in nature and not necessarily based on 'criteria and assumptions,' to meet this disclosure requirement an adviser's disclosure could state that criteria and assumptions were not used… We believe that providing hypothetical performance in advertisements only to those investors with the resources and financial

Type of performance information	Rule Requirements	Notes
		expertise to assess targets or projections will help avoid scenarios where an investor might be misled into thinking that such performance is guaranteed." [emphasis added] For any communications to be distributed by SEC-registered broker-dealers, note that FINRA Rule 2210 prohibits "predictions or projections of performance."

- Definition of Net Performance: Net performance means "the performance results of a portfolio (or portions of a portfolio that are included in extracted performance, if applicable) after the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant portfolio, including, if applicable, advisory fees, advisory fees paid to underlying investment vehicles, and payments by the investment adviser for which the client or investor reimburses the investment adviser."[8]
- Performance disclosure requirements: Although the rule does not prescribe disclosure requirements for net and gross performance presentation, the adopting release notes certain disclosures that may be appropriate depending on facts and circumstances:
  - "Depending on the facts and circumstances, disclosures may include: (1) the material conditions, objectives, and investment strategies used to obtain the results portrayed; (2) whether and to what extent the results portrayed reflect the reinvestment of dividends and other earnings; (3) the effect of material market or economic conditions on the results portrayed; (4) the possibility of loss; and (5) the material facts relevant to any comparison made to the results of an index or other benchmark." The release further noted that, "an adviser generally should disclose what elements are included in the return presented so that the audience can understand, for example, how it reflects cash flow and other relevant factors. Similarly, if an adviser's presentation of gross performance does not reflect the deduction of transaction fees and expenses, an adviser should disclose that fact to avoid being misleading if it would not be clear to the investor from the context of the advertisement."
- Prescribed time periods for performance results: The performance results in advertisements are required to cover one-, five-, and 10-year periods (or life of the portfolio, if shorter). Private funds are excepted from these time period requirements, but the General Prohibitions' prohibition on including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced does apply to private fund advertisements.

5.2 Key Substantive Take-aways

- Generally Consistent with Existing Staff Guidance: The performance provisions of the Marketing Rule generally track existing Staff guidance and reflect one of the SEC's goals in adopting the Marketing Rule, which was to consolidate Staff guidance in the text of the Rule itself.

5.3 Possible Compliance Next Steps

- Update compliance manuals to reflect the Rule's requirements with respect to the specific types of performance information.
- Continue to apply the General Prohibitions' requirements with respect to presentation of performance information, and whether any particular disclosures should be included. SEC Staff, in our experience, is particularly focused on presentation of performance information.

VI. PORTABILITY OF PERFORMANCE

- Among the performance results that an investment adviser may seek to promote are those of groups of investments or accounts for which the adviser, its personnel, or its predecessor investment adviser firms have provided investment advice in the past as or at a different entity. For example, an adviser may seek to advertise performance achieved by its investment personnel when they were employed by another investment adviser.
- Under the Advertising Rule, the SEC Staff had issued several key no-action letters permitting the advertisement of such predecessor performance, subject to conditions. The Marketing Rule's treatment of predecessor performance generally conforms to that guidance.

6.1 Rule Text (and comparison with Advertising Rule no-action guidance)

- Definition of "Predecessor Performance": "investment performance achieved by a group of investments consisting of an account or a private fund that was not advised at all times during the period shown by the investment adviser advertising the performance."
- The following chart sets forth the relevant Marketing Rule provisions and compares them with the relevant Staff guidance under the Advertising Rule.

Topic	Advertising Rule Staff Guidance (Horizon Asset Mgmt; Great Lakes Advisors)	Marketing Rule
Same person or persons primarily responsible for performance	• The person or persons who manage accounts at the successor adviser were also those primarily responsible for the prior performance results • Where more than one person is responsible for the performance, there is a "substantial identity of personnel" responsible for achieving the prior performance	• No substantive change (*the person or persons who were primarily responsible for achieving the prior performance results manage accounts at the advertising adviser*)
Similarity to advertised accounts/vehicles	• The accounts managed at the predecessor adviser are so similar to the accounts currently under management that the performance	• No substantive change (*the accounts managed at the predecessor investment adviser are sufficiently similar to the accounts managed at the advertising investment adviser that*

Topic	Advertising Rule Staff Guidance (Horizon Asset Mgmt; Great Lakes Advisors)	Marketing Rule
	results would provide relevant information to prospective clients	*the performance results would provide relevant information to clients or investors*)
Anti-cherry-picking	• All accounts that were managed in a substantially similar manner are advertised unless the exclusion of such account would not result in a materially higher performance	• Adds reference to required time periods (*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 applicable time periods prescribed in paragraph (d)(2) of the rule, which imposes requirement to provide results for one-, five-, and ten-year periods, if available, or lifetime if not*)
Consistent with Staff interpretations	• The advertisement is consistent with Staff interpretations with respect to the advertisement of performance results	• Not included (*the Marketing Rule supersedes prior guidance*)
Disclosures	• The advertisement includes all relevant disclosures, including that the performance results were from accounts managed at another entity	• Adds clear and prominent requirement (*the advertisement "clearly and prominently" includes all relevant disclosures, including that the performance results were from accounts managed at another entity*)
Recordkeeping	• An adviser that uses its predecessor's performance must have access to records substantiating the performance.	• Adviser must retain records that substantiate support the performance presented; an adviser must have access to the books and records underlying the performance, per the adopting release at notes 764-65.

6.2 Key Substantive Take-Aways

- Substance of requirements around portability of performance largely unchanged from current no-action letter guidance under the Advertising Rule.

6.3 Possible Compliance Next Steps

- Update compliance manuals to reflect the new language and rule references of the Marketing Rule's provisions regarding predecessor performance.

VII. RECORDKEEPING

7.1 Rule Text

- In addition to amending the Marketing Rule, the SEC also amended its books and records rule (Rule 204-2, the "Recordkeeping Rule") in respect of the Marketing Rule. Perhaps the most significant change is that the amended Recordkeeping Rule requires records to be maintained of all advertisements, whereas the previous iteration of the rule only required advisers to retain advertisements sent to ten or more persons.
- In response to comments, the SEC confirmed that it would be permissible for an adviser to store records using e-mail archives (including in cloud storage or with a third-party vendor), provided that the adviser can promptly produce records in accordance with the recordkeeping rule and statements of the Commission.
- The revised Recordkeeping Rule requires advisers to retain certain records, including:
  - Originals of all written communications received and copies of all written communications sent by such adviser relating to predecessor performance, the performance or rate of return of any or all managed accounts, portfolios, or securities recommendations;
  - A copy of all advertisements (and written or recorded materials used or disclosures provided for oral advertisements);
  - A copy of any questionnaire or survey used in the preparation of a third-party rating included in any advertisement in the event that the adviser obtains such a copy;
  - Documentation substantiating the adviser's reasonable basis for believing that a testimonial or endorsement complies with the Rule's requirements;
  - 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;
  - Records of who the "intended audience" is pursuant to the hypothetical performance and model fee provisions of the Marketing Rule;
  - Among other types of records.

7.2 Possible Compliance Next Steps

- Review compliance manual provisions regarding the Recordkeeping Rule to ensure that Marketing Rule-related amendments are reflected.
- Advisers would be well-served to maintain a file of all "as-distributed" versions of advertisements to facilitate compliance with SEC examination requests, even if those advertisement would naturally be maintained in e-mail archives that comply with the Recordkeeping Rule.

VIII. NO-ACTION LETTERS' FATE

8.1 Rule Text

- One of the goals of the Marketing Rule was to set out, in the "four corners" of the rule, the requirements of the rule; rather than market participants (and practitioners) needing to be familiar with a host of no-action letters and Staff interpretations.

- To that end, SEC Staff is withdrawing a 17-page table's worth of no-action letters and other Staff guidance. These include, but are not limited to, letters regarding the Cash Solicitation Rule, portability of performance, and other performance advertising.

8.2 Possible Compliance Next Steps

- Review compliance manuals for any provisions that expressly reference Staff no-action letters that are being withdrawn, or which are based on such Staff guidance.

IX. OTHER PROVISIONS

- Review and approval of advertisements: Unlike the proposed version of the Rule, the Rule as adopted does not require review and approval of advertisements by the adviser prior to use. An adviser must, however, implement policies and procedures reasonably designed to prevent violation of the Advisers Act, including the Marketing Rule.
- Amendments to Form ADV: The SEC added a new section to Form ADV Part 1A, "Marketing Activities". Advisers will be required to complete the same in the first annual updating amendment of Form ADV following their adoption of the Marketing Rule.

X. CONCLUDING THOUGHTS

We hope that you find this summary a helpful resource in your team's review of policies and processes in respect of the new Marketing Rule.

Our team would be glad to discuss any questions you may have as these important changes come into focus in the course of 2022.

[1] The adopting release (IA-5653) is available at https://www.sec.gov/rules/final/2020/ia-5653.pdf.
[2] The Marketing Rule applies only to SEC-registered investment advisers; it does not apply to investment advisers that are Exempt Reporting Advisers. This alert refers to "advisers" or "investment advisers" for convenience.
[3] All communications of U.S. investment advisers (including Exempt Reporting Advisers) are subject to the general antifraud provisions of the Advisers Act, but only "advertisements" of registered investment advisers are subject to the Marketing Rule.
[4] However, the adopting release states that: "While in some cases advisers may wish to consider FINRA's interpretations related to the meaning of 'fair and balanced' for issues we have not specifically addressed, FINRA Rule 2210 and its body of decisions are not controlling or authoritative interpretations with respect to our final rule."
[5] With respect to hyperlinked disclosures, the SEC stated that it believes such disclosures should appear close to the associated statement such that the statement and disclosures are read at the same time, rather than referring the reader somewhere else to obtain the disclosures. In cases in which an oral testimonial or endorsement is provided, it would be consistent with the clear and prominent standard if the disclosures are provided in a written format, so long as they are provided at the time of the testimonial or endorsement.
[6] The disqualification provisions do not apply if the provider of the testimonial/endorsement (i) is a SEC-registered broker-dealer and is not subject to a Statutory Disqualification, as that term is defined in Exchange Act Section 3(a)(39), or (ii) is a covered person under Regulation D Rule 506(d) with respect to a Regulation D offering.
[7] In order to be clear and prominent, the disclosures required by the Rule for third-party ratings must be at least as prominent as the third-party rating.
[8] For purposes of the Rule, net performance: (i) may reflect the exclusion of custodian fees paid to a bank or other third-party organization for safekeeping funds and securities; and/or, (ii) if using a model fee, must reflect one of the following: (A) The deduction of a model fee when doing so would result in performance figures that are no higher than if the actual fee had been deducted; or (B) The deduction of a model fee that is equal to the highest fee charged to the intended audience to whom the advertisement is disseminated. The definition of net performance does not permit net performance that reflects a model fee that is not available to the intended audience. In response to a commenter, Staff noted that it believes that capital gains taxes paid outside of the portfolio are not fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services (and are therefore not required to be deducted in the calculation of net performance).