SEC Marketing Rule

Regulation Overview and Key Requirements

Regulation Overview

SEC's new Marketing Rule, 206(4)-1, modernizes the rules that govern investment adviser advertisements and payments to solicitors which were adopted over 40 years ago. The new rule recognizes how advertising and referral practices have evolved with the increasing use of electronic media and mobile communications and will serve to improve the quality of information available to investors.

The amendments create a single rule that replaces the current advertising rule, 206(4)-1, and cash solicitation rule, 206(4)-3. As part of the updates, it has also made amendments to the investment adviser registration form (Form ADV), and the books and records rule (Rule 204-2).

The rule's effective date was May 4, 2021 with a compliance date of Nov 4, 2022.

Definition of Advertisement

The Marketing Rule updates the definition of advertisement in 2 prongs:

(1) Communications traditionally treated as investment adviser advertising, and

(2) Compensated testimonials and endorsements previously covered by the cash solicitation rule.

Advertising Rule	Any direct or indirect communication an investment adviser makes that: (i) offers the investment adviser's investment advisory services with regard to securities to prospective clients or private fund investors, or (ii) offers new investment advisory services with regard to securities to current clients or private fund investors.
Cash Solicitation	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).

Testimonials and Endorsements

The updated rule prohibits the use of testimonials and endorsements in an advertisement, unless the adviser satisfies certain disclosure, oversight, and disqualification provisions:

Disclosure

Advertisements must clearly and prominently disclose whether the person giving the testimonial or endorsement:

(1) Is a current client,

(2) Whether the promoter is compensated by cash or non-cash, and

(3) Any material conflicts of interest resulting from the advisor's relationship with such person.

The terms of compensation and description of conflicts of interest are also required to be disclosed. There are exceptions from the disclosure requirements for SEC-registered broker-dealers under certain circumstances. The rule eliminates the current rule's requirement that the adviser obtain acknowledgements from each investor that they received the disclosures.

Oversight & Written Agreement

An adviser that uses testimonials or endorsements in an advertisement must oversee compliance with the marketing rule. An adviser also must enter into a written agreement with promoters, except where the promoter is an affiliate of the adviser or the promoter receives de minimis compensation (i.e., $1,000 or less, or the equivalent value in non-cash compensation, during the preceding twelve months).

Disqualification

The rule prohibits certain "bad actors" from acting as promoters, subject to exceptions where other disqualification provisions apply.

Third-Party Ratings

The Marketing Rule prohibits including third-party ratings in an advertisement, unless the investment adviser complies with the rule's general prohibitions, provides disclosures, and satisfies certain other conditions.

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General Advertising Practice Prohibitions

General Prohibitions

The Marketing Rule replaces four prescriptive prohibitions contained in the initial advertising rule with seven principles-based prohibitions. The new marketing rule will prohibit the following advertising practices:

	General Prohibitions	Examples
1	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;	Compensating a person to refer investors to the adviser by stating that the person had a "positive experience" with the adviser when such person is not a client of the advisor;
2	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 Commission;	Making a statement that its portfolio managers each hold a particular certification or that it offers a certain type or # of investment products without records to substantiate it;
3	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;	Making a series of statements in that literally are true when read individually, but whose overall effect creates an untrue or misleading implication about the investment adviser;
4	Discussing any potential benefits without providing fair and balanced treatment of any associated material risks or limitations;	Only discussing the benefits of the services and not including sufficient information about the material risks that the client may face;
5	Referencing specific investment advice provided by the adviser that is not presented in a fair and balanced manner;	Sharing a "thought piece" to describe specific advice provided in response to a major market event without providing contextual information;
6	Including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced;	Presenting performance results over a very short period of time (e.g., two months), or over inconsistent periods of time to portray performance not reflective of the advisors' general results;
7	Including information that is otherwise materially misleading.	Including accurate disclosures in an advertisement but presenting them in a font size that is too small to read.

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Specific Requirements and Restrictions for Performance Advertising

Performance Advertising

The Marketing Rule includes additional requirements and restrictions for performance advertising, as SEC believes the presentation of performance could lead reasonable investors to unwarranted assumptions resulting in misleading advertisement. The rule prohibits including in any advertisement:

- Gross performance, unless the advertisement also presents net performance;
- Any performance results, unless they are provided for one-, five- and ten-year time periods or are the performance results of a private fund;
- Any statement that the Commission has approved or reviewed any calculation or presentation of performance results;
- The presentation of "related performance", which is the performance of portfolios similar to the offered strategy or fund, unless the related performance includes all portfolios with substantially similar investment policies, objectives, and strategies;
- 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 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.

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Additional Information

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