

> Client Alert

SEC Modernizes Marketing and Advertising Rules for Investment Advisers

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In an effort to clarify and codify decades-old guidance and set forth a consistent principles-based standard that recognizes how modern investment advisers communicate with clients and prospective clients, the SEC adopted new rules replacing the current advertising and cash solicitation rule. Investment advisers have long been frustrated with the overly broad nature of the current rule which failed to articulate a specific standard by which they could make disclosures, such as performance data, offering testimonials and third-party ratings.

While the SEC's focus on preventing the dissemination of misleading material information to investors remains paramount, the new rule, applying only to registered investment advisers or those required to be registered, gives investment advisers certain latitude in preparing their marketing materials.

Definition of "Advertisement"

The new rule broadly defines "advertisement" in two ways: first, as any communication from an investment adviser, directly or indirectly, in which the investment adviser offers investment advisory services to either new investors or additional investment advisory services to existing investors (in both cases, including investors in private funds); and second, as any endorsement or testimonial pursuant to which an investment adviser provides cash and non-cash compensation (addressing activity which had previously been considered solicitation under the cash solicitation rule).

The SEC intends the revised rule to be flexible in how advertisements are defined, allowing for future changes in technology that may impact how investment advisers market to clients. Motivated by a desire not to impede adviser/investor communications, the revised rule excludes live, extemporaneous oral communications and one-on-one communications from the definition of "advertisement", except with respect to compensated testimonials and certain

communications that include hypothetical performance information. This exception applies to communications whether in-person, streamed, or broadcast but does not extend to prepared remarks or scripted speeches. Note that while generally a private placement memorandum is not deemed to be an "advertisement" by the SEC, the SEC has noted that information included within a private placement memorandum could be deemed to be an advertisement.

The new rule also requires that all advertisements within its scope be recorded or retained and maintained for five years, in accordance with its general recordkeeping rules.

Content of "Advertisements"

While the new rule maintains that all disclosure must be made in a fair and balanced manner, by removing the *per se* prohibitions on certain types of communications and using a principles-based approach to analyzing advertisements, it opens the door for investment advisers to

use testimonials, third party ratings and various types of performance data more meaningfully, provided that the investment adviser has certain protocols in place to ensure that the information is communicated in a non-misleading fashion.

First, third-party ratings may now be presented if specific criteria are met, namely that the investment adviser has a reasonable basis for believing that any underlying data that has been used to develop the ratings has been designed so that it is equally easy for participants to provide both favorable and negative responses, and is not designed to produce a predetermined result. Such third-party ratings must be accompanied by a clear and prominent disclosure rating, specify a period of time upon which the rating was based, provide the identity of the third-party who created and tabulated the rating and describe any compensation paid by the adviser in connection with obtaining or using the rating, either directly or indirectly. Second, testimonials may be used in advertisements if they prominently and clearly disclose whether the person giving the endorsement (the “promoter”) is a client of the investment adviser, whether the promoter is being compensated for its testimonial and any additional pertinent information regarding conflicts of interests. Promoters must enter into a written agreement with the investment adviser, unless the promoter is an affiliate of the investment adviser. Further, certain “bad actors” may not be promoters. The prior requirement that investment advisers must obtain an acknowledgement of receipt of the disclosure from each investor has been eliminated.

Finally, the rule clarifies the types of performance data and how such performance data may be presented to investors, which historically has been a challenging area for investment advisers to navigate. In many cases, existing guidance has been reaffirmed, such as the requirement to show net performance if gross performance is being presented and the prohibition on showing performance data from fewer than all portfolios with substantially similar investment policies. However, hypothetical performance data, predecessor performance and the presentation of certain subsets of investments extracted from a portfolio is now permitted, provided that tailored measures are taken to ensure that none of the information is misleading to investors. The presentation of performance data has been standardized, and now requires investment advisers to present the data in prescribed time periods (1 year, 5 year and 10 year). Importantly, this standardization does not apply to private funds.

Investment advisers should continue to maintain robust and well-detailed supporting documentation for all factual information in marketing materials and emphasize where statements are opinions and not facts.

Compliance and Effectiveness

The revised rule takes effect 60 days after publication in the Federal Register but the SEC has provided an 18-month transition period from the effective date for investment advisers to become compliant.

Investment advisers and related compliance professionals should take steps to familiarize themselves with the new rule in order to both maintain a robust compliance program as well to avail themselves of new possibilities of how to market their products to current and new investors.