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## The SEC's New Marketing Rule: Key Takeaways

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## Background of the Rule

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- The SEC adopted Amendments to Rule 206(4)-1 under the Investment Advisers Act of 1940 to modernize the regulation of investment adviser advertising and solicitation. The amendments merged the cash solicitation rule into the amended Advertising rule, creating a single “Marketing Rule” in Rule 206(4)-1.
- The changes will likely require all registered investment advisers to reassess their policies and procedures, marketing materials, solicitation and marketing arrangements, and any other methods by which advisers communicate with current and prospective clients and investors.

# Summary of Changes



Advertising and solicitation activities are now merged into a single rule. The Rule includes communications with private fund investors.

The definition of advertisement is significantly expanding and will include compensated endorsements and testimonials where compensation includes cash or non-cash payments or benefits.

The Rule replaces per se prohibitions with more principles-based, general prohibitions.

Testimonials and endorsements must satisfy certain disclosure, oversight and disqualification provisions.

Third party ratings are permissible as long as the adviser provides certain disclosures and satisfies certain criteria.

The rule requires several conditions for performance, including that net performance accompany gross performance in any advertisement.



# Definition of Advertisement

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- The Marketing Rule redefines “advertisement”:
  - (i) **any direct or indirect communication an investment adviser makes to more than one person, or to one or more persons if the communication includes hypothetical performance,**
    - (a) **that offers the investment adviser’s advisory services with regard to securities to prospective clients or investors in a private fund advised by the investment adviser**
    - (b) **or offers new investment advisory services with regard to securities to current clients or investors in a private fund advised by the investment adviser, and**
  - (ii) **any endorsement or testimonial for which an investment adviser provides compensation, directly or indirectly.**
- **\*Note: There are 2 prongs to this definition & “advertisement” is defined broadly.**



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## Advertisement – 1<sup>st</sup> Prong



- One-on-one communications are excluded in Part (i) of the definition, **unless** the communication includes hypothetical performance information that is not provided:
  - In response to an unsolicited investor request; or
  - To a private fund investor.
- Extemporaneous, live, oral communications are not included in Part (i) of the definition.
- 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 is excluded.

- The Marketing Rule has replaced the prohibitions of the Advertising Rule with more principles-based, general prohibitions. There are 7 prohibitions:
  1. Material Misstatements or Material Omissions
  2. Facts that Cannot be Substantiated upon SEC Demand
  3. Materially Misleading to a Reasonable Investor
  4. Discussions of Investment Benefits that are not Fair and Balanced
  5. References to Specific Investment Advice that are not Fair and Balanced
  6. Performance Presentations that are not Fair and Balanced
  7. Otherwise Materially Misleading Advertisements



## “Principles-based” Approach

- The New Rule takes a “principles-based” approach and does not delineate per se prohibitions.
- No-action letters will be withdrawn or modified.
- The SEC does not view the principles of the general prohibitions to be substantive departures from the positions in existing staff no-action letters and guidance.
- An Information Update was released in October 2021:  
<https://www.sec.gov/files/2021-10-information-update.pdf>





# Performance Advertising

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- **Presentation of gross performance is prohibited unless the adviser also presents net performance:**
  - With at least equal prominence to, and in a format designed to facilitate comparison with, the gross performance; and
  - Calculated over the same time period and using the same type of return and methodology as, the gross performance results.
- **This net performance requirement applies to all advertisements.**
- **Calculating Net Performance**
  - The presentation of net performance generally must reflect all fees and expenses borne by a client or private fund investor, with a limited exception for fees paid for third-party custodial services.
  - A model fee may be used to calculate net returns if the model fee is equal to the highest fee charged to the intended audience to whom the advertisement is disseminated.
    - If an investment adviser intends to charge a higher fee to the intended audience than actual fees it charged in the past, the adviser must use the highest potential fee that it will charge the investors or clients receiving the advertisement.

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- **The new Marketing Rule requires one-, five-, and ten-year time periods for the presentation of performance results in an advertisement. This applies to the performance results of any portfolio.**

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- **The results of the prescribed time periods must be presented with equal prominence and end on the most recent practicable date.**

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- **The prescribed time period must end on a date that is no less recent than the most recent calendar year-end.**

- **Therefore, an adviser that complies with GIPS standards may present annual returns for the past ten years as of the most recent calendar year end, in addition to performance results for the final rule's required one-, five- and ten-year time periods.**

- **Hypothetical Performance includes model, back-tested, targeted, and projected performance.**
- **Hypothetical Performance is prohibited unless:**
  1. The adviser adopts and implements policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the likely financial situation and investment objectives of the intended audience of the advertisement;
    - *The adviser must keep a record of the intended audience*
  2. The adviser provides sufficient information to enable the intended audience to understand the criteria used and assumptions made in calculating such hypothetical performance; and
  3. The adviser provides sufficient information to enable the intended audience to understand the risks and limitations of using hypothetical performance in making investment decisions
    - *If the audience is a private fund investor, the information may be offered to be provided promptly*





# Performance Advertising

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## Additional Performance Information

Related Performance	Related performance is only permitted if all related portfolios are included, unless the advertised performance results are not materially higher than they would be if all related portfolios were included and the prescribed time periods for the performance returns are not
Extracted Performance	Performance results of the total portfolio from which the performance was extracted must be provided (or be offered to be promptly provided)
Portability of Performance	Presenting predecessor performance is prohibited unless there is similarity between the personnel and accounts at the predecessor adviser and the personnel and accounts at the advertising adviser
Statements About Commission Approval	Statements that the calculation or presentation of performance results in the advertisement has been reviewed or approved by the Commission are prohibited (whether express or implied)



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## Advertisement – 2<sup>nd</sup> Prong



- Part (ii) of the definition includes extemporaneous, live, oral communications.
- This includes oral communications and one-on-one communications to capture traditional one-on-one solicitation activity, in addition to solicitations for non-cash compensation.
- 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 is excluded.

# Testimonials and Endorsements – Understanding the Requirements & Exceptions



	Clear and Prominent Summary Disclosure	Additional Disclosure of Material Terms of Compensation Arrangement	Written Agreement with the Promoter	Adviser Oversight and Compliance	General Prohibitions	Promoter cannot be Disqualified or Ineligible
Compensation (cash and non-cash)	✓	✓	✓	✓	✓	✓
De minimis Compensation (\$1,000 or less during the preceding 12 months)	✓			✓	✓	
Adviser Affiliate				✓	✓	✓
Broker-Dealer making a testimonial or endorsement to a non-retail customer	✓		✓	✓	✓	
Broker-Dealer making a recommendation under Reg BI			✓	✓	✓	

## 3 disclosures must be made clearly and prominently:

1. If cash or non-cash compensation was provided for the testimonial or endorsement (compensated testimonials or endorsements disseminated through a social media platform are included, and must be clearly and prominently labeled as a paid testimonial or endorsement)
2. A brief statement disclosing any material conflicts of the person giving the testimonial or endorsement because of the relationship they have with the adviser
3. The testimonial was given by a current client (or private fund investor) OR the endorsement was given by a person other than a current client (or private fund investor). \*Note: Only client/non-client status is required, not name of the promoter

## 2 additional required disclosures:

1. Material terms of any compensation arrangement, including a description of the compensation provided or to be provided (directly or indirectly) to the promoter for the testimonial or endorsement
2. Description of any material conflicts of interest on the part of the promoter resulting from the adviser's relationship with the promoter and/or any compensation arrangement

# Books and Records



Rule 204-2 of the Advisers Act has been amended to expand on recordkeeping obligations. Advisers are required to retain:

- Records of all distributed advertisements sent to **more than one person**;
  - **Written or recorded materials used or disclosures provided for oral advertisements (alternative method for oral advertising)**;
- All written communications relating to the performance or the rate of return of any portfolio;
- **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**;
- Documentation of communications relating to predecessor performance
- Any communication or other document related to the adviser's determination that it has a reasonable basis for believing a testimonial, endorsement, or third-party rating complies with the requirements of the Marketing Rule
- *For third-party ratings*: A copy of any questionnaire or survey used in preparation of the third-party rating – **only if the advisor obtains a copy from the third-party.**

Advisers are permitted to store records using email archives, provided that the adviser can promptly produce records in accordance with the Rule and SEC guidance.





## Additional Requirements if Using Hypothetical Performance:

- Supporting records that display hypothetical performance:
  - Advisers are required to retain all information (provided or offered) pursuant to the hypothetical performance provisions
- Record of who the intended audience is

- The New Rule does not have explicit pre-approval requirements, **but you do need policies and procedures for supervising your advertising.**
- The SEC is encouraging advisers to adopt “objective and testable” compliance policies and procedures, such as internal pre-review and approval, risk-based sampling, pre-approved templates, and periodic reviews.
- **Certain considerations when creating a supervisory program...the size of your advisor; how much advertising you do; your audience; review timing.**
- **Training is critical**



## Advisers will be Required to Disclose Advertising and Marketing Practices in Form ADV Part 1A

- Part 1A of Form ADV will be updated to include a new Item 5.L, which will require disclosure by advisers of certain advertising practices, including information about an adviser's use in its advertisements of performance results, testimonials, endorsements, third-party ratings, and references to its specific investment advice.

The new information will be required in the adviser's first annual Form ADV update after the Marketing Rule's transition period ends. For advisers with a calendar fiscal year, this will be March 2023.

## Review

Review the rule and analyze how the changing requirements will affect your practices.

## Adopt

Adopt and/or update advertising policies and procedures to comply with new Rule.

## Prepare

Prepare to be in compliance with the Rule and the revised Books and Records Rule no later than November 4, 2022.

## Train

Train marketing and investment relations personnel on the new Rule.

## Look

Look for further guidance from Vigilant as well as the SEC.



# Compliance Date

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- The Marketing Rule was published in the Federal Register on March 5, 2021.
- The effective date is May 4, 2021.
- Final compliance is required by November 4, 2022.
- The SEC has stated that firms are not able to pick and choose which parts of the new rule they wish to adopt. If a firm is interested in adopting a specific part of the rule early, it will need to adopt the entire rule.





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**Any Questions?**