

Securities and Exchange Commission Adopts Modernized Marketing Rule for Investment Advisers

December 23, 2020

In a December 22, 2020 [release](#) (the “**Release**”), the Securities and Exchange Commission (the “**SEC**”) adopted amendments (the “**Amendments**”) to create a single rule that will replace the current advertising and cash solicitation rules under the Investment Advisers Act of 1940 (the “**Advisers Act**”). The Amendments relate primarily to Rule 206(4)-1 (the “**advertising rule**”) and Rule 206(4)-3 (the “**solicitation rule**”), which have remained largely unchanged since their adoptions decades ago and will now be merged into a single marketing rule under Rule 206(4)-1, as amended (the “**marketing rule**”). The Amendments have important implications for all investment advisers, including private equity and other private fund managers, particularly with respect to presentation of performance and solicitation activities.

According to the Release, the SEC believes that it is appropriate to merge the regulation of investment adviser advertising and solicitation activity under a single marketing rule which, as amended by the Amendments, contains “principles-based provisions designed to accommodate the continual evolution and interplay of technology and advice.” The Amendments allow for the use of certain testimonials, endorsements (which include referral and solicitation activity) and third-party ratings, subject to certain conditions, and include requirements for presentation of performance. The Amendments were adopted with several modifications from the proposed amendments that were originally proposed on November 4, 2019. Notably, in a change from the proposed version, the Amendments do not require internal review and written approval of advertisements prior to dissemination, do not provide separate requirements for performance advertisements used with retail vs. non-retail investors, and contain requirements for advertisements that display predecessor performance, among other things.

Marketing Rule

Definition of Advertisement. According to the Release, the Amendments update the definition of “advertisement” to capture advertising communications to clients and private fund investors (but not advertisements about registered investment companies or business development companies (“**BDCs**”), as well as solicitation activities (e.g., compensated endorsements and testimonials) previously governed by the solicitation rule. The SEC modified the final version of the definition from the proposed version by, among other things, not expanding the definition to include communications addressed to only one person (except with respect to compensated testimonials and endorsements and certain communications that include hypothetical performance) or communications designed to retain existing investors. The amended definition also provides exclusions for: (1) extemporaneous, live, oral communications, (2) information contained in a statutory or regulatory notice, filing or other required communication and (3) communications with hypothetical performance that are provided in response to an unsolicited request for such information from a prospective or current client or investor in a private fund advised by the investment adviser, or in a one-on-one communication with a prospective or current investor in a private fund advised by the investment adviser.

General Prohibitions. Under the Amendments, advertisements disseminated by an investment adviser may not:

1. “Include any untrue statement of a material fact, or omit to state a material fact necessary in order to make the statement made, in light of the circumstances under which it was made, not misleading;
2. “Include a material statement of fact that the adviser does not have a reasonable basis for believing it will be able to substantiate upon demand from the [SEC];

3. “Include 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 investment adviser;
4. “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;
5. “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;
6. “Include or exclude performance results, or present performance time periods, in a manner that is not fair and balanced; or
7. “Otherwise be materially misleading.”

Testimonials and Endorsements, including Solicitations. According to the Release, the Amendments permit testimonials and endorsements for which an adviser provides cash or non-cash compensation, directly or indirectly (e.g., directed brokerage, awards or other prizes, reduced advisory fees) subject to meeting certain conditions. Subject to certain exceptions, such conditions include:

- Required disclosures regarding compensation and conflicts of interest, and whether the person providing the testimonial or endorsement is a current client or investor;
- Adviser oversight regarding compliance with the marketing rule and a written agreement with promoters; and
- Disqualifying provisions prohibiting certain “bad actors” from acting as promoters.

The Amendments provide for limited exceptions for, among other things, testimonials and endorsements disseminated for no compensation or de minimis compensation, and for certain affiliated persons and SEC-registered broker dealers in certain circumstances.

Third-Party Ratings. The Amendments permit third-party ratings under certain circumstances.

Performance Information Generally. The Amendments prohibit the following from being included in any advertisement:

- Gross performance results, unless net performance results are also presented;
- Any performance results, unless presented for specific time periods in most circumstances;
- “Any statement, express or implied, that the calculation or presentation of performance results in the advertisement has been approved or reviewed by the [SEC]”;
- Related performance, unless it includes all related portfolios (i.e., all portfolios with substantially similar investment policies, objectives and strategies as those being offered in the advertisement), with limited exceptions;
- 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 from which the performance was extracted”;
- 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 hypothetical performance is relevant to the likely financial situation and investment objectives of the intended audience of the advertisement,” and the adviser provides certain specified information underlying the hypothetical performance; and
- Predecessor performance, unless there is sufficient similarity between the personnel and accounts at the predecessor adviser and the personnel and accounts at the advertising

adviser, and certain disclosures are included clearly and prominently in the advertisement.

Amendments to Form ADV and the Books and Records Rule

According to the Release, the Amendments also amend Form ADV to “enhance the data available to support [the SEC] staff’s enforcement and examination functions.” The Amendments also update the books and records requirements under Rule 204-2 under the Advisers Act to reflect the amended marketing rule.

Review of Relevant SEC Guidance

According to the Release, certain previously issued no-action letters regarding the application of the advertising rule and the solicitation rule will be withdrawn in connection with the Amendments as those positions are either incorporated into the marketing rule or will no longer apply.

The SEC has provided for a transition period of 18 months from the effective date of the Amendments. Davis Polk is preparing a client memorandum which will include a more detailed discussion of the Amendments.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

Nora M. Jordan	+1 212 450 4684	nora.jordan@davispolk.com
John G. Crowley	+1 212 450 4550	john.crowley@davispolk.com
Leor Landa	+1 212 450 6160	leor.landa@davispolk.com
Gregory S. Rowland	+1 212 450 4930	gregory.rowland@davispolk.com
Michael S. Hong	+1 212 450 4048	michael.hong@davispolk.com
Lee Hochbaum	+1 212 450 4736	lee.hochbaum@davispolk.com
Sarah E. Kim	+1 212 450 4408	sarah.e.kim@davispolk.com
Aaron Gilbride	+1 202 962 7179	aaron.gilbride@davispolk.com
J. Taylor Arabian	+1 212 450 3194	taylor.arabian@davispolk.com