
Hughes Hubbard & Reed

New Investment Adviser Marketing Rule Sets Evergreen, Principles-Based Framework

Client Advisories

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On December 22, 2020, the Securities and Exchange Commission adopted new Rule 206(4)-1 (the “Marketing Rule”) to replace and integrate the current advertising and cash solicitation rules, and to set forth a modern, evergreen framework for investment adviser marketing, adaptable to evolving technology and industry practices. In due course, the Staff will also identify no-action letters whose guidance is replaced by the new rule and the adopting release. The adopting release is available [here](#).

New Definition of “Advertisement”. The Marketing Rule defines “advertisement” as—

1. Any direct or indirect communication an adviser makes to more than one person (or to just one person if the communication includes hypothetical performance) that offers the adviser’s securities advisory services to prospective clients or prospective private fund investors, or offers new securities advisory services to existing clients or existing investors in the adviser’s private funds, excluding—
 - a. extemporaneous, live, oral communications;
 - b. 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 required communication; and
 - c. a communication that includes hypothetical performance, if provided in response to an unsolicited request for such information from a current or prospective client or private fund investor, or to a current or prospective private fund investor in a one-on-one communication; and
2. Any endorsement or testimonial for which an adviser provides direct or indirect compensation, other than 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 required communication.

Principles-Based Prohibitions for All Advertisements. In lieu of the present advertising rule’s approach, which

deems four types of communication misleading per se, the Marketing Rule proscribes seven types of content, based on familiar principles of investor protection. It states that an advertisement may not include—

1. Any untrue statement of a material fact or have material omissions;
2. Any material statement of fact that the adviser does not have a reasonable basis for believing it can substantiate upon demand by the Commission;
3. 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;
4. Discussion of potential benefits to clients or investors connected with or resulting from the adviser's services or methods without fair and balanced treatment of material risks or limitations associated therewith;
5. Reference to specific investment advice provided by the adviser in a manner that is not fair and balanced;
6. Performance results (or exclude performance results), or present performance time periods, in a manner that is not fair and balanced; or
7. Any content that is otherwise materially misleading.

Tailored Requirements for Performance Advertising. When advertising performance results, an adviser may not —

1. Present gross performance unless it also presents net performance, calculated over the same time period, using the same type of return and methodology, with equal prominence, and in a format that facilitates comparison with the gross performance;
2. Present performance results of a portfolio or a composite aggregation of related portfolios (other than a private fund), unless the advertisement includes results for the same portfolio or composite for one-, five- and ten-year periods, with equal prominence and ending on a date that is no less recent than the most recent calendar year-end;
3. Make any statement, express or implied, that the calculation or presentation of performance has been approved or reviewed by the Commission;
4. Present related performance, unless it includes all related portfolios, with certain exceptions;
5. Present extracted performance, unless it provides, or offers to provide promptly, the result of the total portfolio from which the performance was extracted;
6. Present hypothetical performance, unless it has policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the intended audience; provides sufficient information to enable the intended audience to understand the criteria and assumptions used; and provides sufficient information to enable the intended audience to understand the risks and limitations of using such hypothetical performance in making investment decisions; or
7. Present predecessor performance, unless the person or persons who were primarily responsible for achieving the prior results manage accounts at the advertising adviser; the predecessor accounts are sufficiently similar such that the results would be relevant; there is no cherry picking of predecessor accounts; and the advertisement discloses that the results were from accounts managed at another entity.

There are also new definitions for gross performance, net performance, related performance, extracted performance, hypothetical performance, and predecessor performance.

Tailored Requirements for Use of Testimonials, Endorsements, and Third-Party Ratings. The Marketing Rule rescinds the cash solicitation rule (Rule 206(4)-3) and regulates the solicitation of advisory clients or private fund investors (subject to exceptions for affiliates and persons regulated as broker-dealers) as a form of endorsement. Under the Marketing Rule, an advertisement may not include any testimonial or endorsement, and an adviser may not provide direct or indirect compensation for a testimonial or endorsement, unless there are certain required disclosures about the source, compensation, and conflicts of interest pertinent to the testimonial or endorsement; a written agreement between the adviser and the person who is compensated for giving the testimonial or

endorsement; no events disqualifying any person who was compensated for the testimonial or endorsement; and a reasonable basis to believe that the testimonial or endorsement complies with the Marketing Rule. An advertisement may not include any third-party rating unless there are certain required disclosures, and the adviser has a reasonable basis to believe that the questionnaire or survey used to prepare the rating is not designed to produce a biased or predetermined result.

There are also new definitions for testimonial, endorsement, disqualifying event, and third-party rating.

Books and Records. The Commission also adopted a companion amendment to Rule 204-2, to update the books and records requirement for advertisements, consistent with the goals of the Marketing Rule. Advisers must create and keep records or copies of all advertisements; any questionnaire or survey used in the preparation of third-party ratings; any advertised predecessor performance and documentation to support performance calculations; disclosures provided to clients or investors pursuant to the Marketing Rule, if such disclosures are not included in the advertisement itself; documentation substantiating the adviser's reasonable basis for believing that each third-party rating, testimonial, or endorsement used in an advertisement complies with the Marketing Rule; and the names of all persons who are control persons of the adviser or are partners, officers, directors, or employees of the adviser or the adviser's control persons.

Form ADV. The Commission also adopted an amendment to Form ADV to improve public information about the adviser's marketing practices and to facilitate SEC examination of compliance with the Marketing Rule. The new disclosures need only be included in the adviser's annual ADV update.

Effective Date and Transition. The Marketing Rule will be effective 60 days after publication in the Federal Register. Advisers will have an 18 month transition period to conform their marketing practices to the Marketing Rule.

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