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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275 and 279

[Release No. IA-5653; File No. S7-21-19]

RIN: 3235-AM08

Investment Adviser Marketing

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (the "Commission" or the "SEC") is adopting amendments under the Investment Advisers Act of 1940 (the "Advisers Act" or the "Act") to update rules that govern investment adviser marketing. The amendments will create a merged rule that will replace both the current advertising and cash solicitation rules. These amendments reflect market developments and regulatory changes since the advertising rule's adoption in 1961 and the cash solicitation rule's adoption in 1979. The Commission is also adopting amendments to Form ADV to provide the Commission with additional information about advisers' marketing practices. Finally, the Commission is adopting amendments to the books and records rule under the Advisers Act.

DATES: *Effective date*: This rule is effective May 4, 2021.

Compliance dates: The applicable compliance dates are discussed in section II.K.

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SUPPLEMENTARY INFORMATION: The Commission is adopting amendments to 17 CFR 275.206(4)-1 (rule 206(4)-1) and 17 CFR 275.204-2 (rule 204-2) under the Investment Advisers Act of 1940 [15 U.S.C. 80b-1 *et seq.*],[1] and amendments to 17 CFR 279.1 (Form ADV) under the Advisers Act. The Commission is rescinding 17 CFR 275.206(4)-3 (rule 206(4)-3) under the Advisers Act.

[1] Unless otherwise noted, when we refer to the Advisers Act, or any section of the Advisers Act, we are referring to 15 U.S.C. 80b, at which the Advisers Act is codified. When we refer to rules under the Advisers Act, or any section of those rules, we are referring to title 17, part 275 of the Code of Federal Regulations [17 CFR part 275], in which these rules are published.

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I. INTRODUCTION

We are adopting an amended rule, rule 206(4)-1, under the Advisers Act, which addresses advisers marketing their services to clients and investors (the "marketing rule"). The marketing rule amends existing rule 206(4)-1 (the "advertising rule"), which we adopted in 1961 to target advertising practices that the Commission believed were likely to be misleading.[2] The rule also replaces rule 206(4)-3 (the "solicitation rule"), which we adopted in 1979 to help ensure clients are aware that paid solicitors who refer them to advisers have a conflict of interest.[3] We have not substantively updated either rule since adoption.[4] In the decades since the adoption of both rules, however, advertising and referral practices have evolved. Simultaneously, the technology used for communications has advanced, the expectations of investors shopping for advisory services have changed, and the profiles of the investment advisory industry have diversified.

Our marketing rule recognizes these changes and our experience administering the advertising and solicitation rules. Accordingly, the rule contains principles-based provisions designed to accommodate the continual evolution and interplay of technology and advice. The

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2 Advertisements by Investment Advisers, Release No. IA-121 (Nov. 1, 1961) [26 FR 10548 (Nov. 9, 1961)] ("Advertising Rule Adopting Release").

3 *See* Requirements Governing Payments of Cash Referral Fees by Investment Advisers, Release No. 688 (July 12, 1979) [44 FR 42126 (Jul 18, 1979)] ("1979 Adopting Release").

4 The advertising rule has been amended once, when the Commission revised the introductory text of paragraph (a) as part of a broader amendment of several rules under the Advisers Act to reflect changes made by the National Securities Market Improvement Act of 1996. Rules Implementing Amendments to the Investment Advisers Act of 1940, Release No. IA-1633 (May 15, 1997) [62 FR 28112, 28135 (May 22, 1997)] ("Release 1633"). We have not amended the solicitation rule since adoption.

rule also contains tailored restrictions and requirements for certain types of advertisements, such as performance advertising, testimonials and endorsements, and third-party ratings. Compensated testimonials and endorsements, which include traditional referral and solicitation activity, will be subject to disqualification provisions. We believe the final marketing rule will allow advisers to provide existing and prospective investors with useful information as they choose among investment advisers and advisory services, subject to conditions that are reasonably designed to prevent fraud.

Finally, we are adopting related amendments to Form ADV that are designed to provide the Commission with additional information about advisers' marketing practices, and related amendments to the Advisers Act books and records rule, rule 204-2.

Advertising and Solicitation Rules and Proposed Amendments

Advertisements can provide existing and prospective investors with useful information as they contemplate whether to utilize and pay for investment advisory services, whether to approach particular investment advisers, and how to choose among their available options. At the same time, advertisements present risks of misleading investors because an investment adviser's interest in attracting investors may conflict with the investors' interests, and the adviser is in control of the design, content, format, media, timing, and placement of its advertisements. As a consequence, advertisements may mislead existing and prospective investors about the advisory services they will receive, including indirectly through the services provided to private funds.[5] The advertising rule was designed to address the potential harm to investors from misleading advertisements.

[5] The final rule covers marketing activities by investment advisers to clients and prospective clients as well as investors and prospective investors in private funds that those advisers manage. *See* 15 U.S.C. 80b-2(a)(29) (defining a "private fund" as "an issuer that would be an investment company, as defined in

Advisers also attract investors by compensating individuals or firms to solicit new investors. Some investment advisers directly employ individuals to solicit new investors on their behalf, and some investment advisers arrange for related entities or third parties, such as broker-dealers, to solicit new investors. The person or entity compensated has a financial incentive to recommend the adviser to the investor.[6] Without appropriate disclosure, this compensation creates a risk that an investor would mistakenly view the recommendation as being an unbiased opinion about the adviser's ability to manage the investor's assets and would rely on that recommendation more than the investor would if the investor knew of the incentive. The solicitation rule was designed to help expose to clients the conflicts of interest posed by cash compensation.

The concerns that motivated the Commission to adopt the advertising and solicitation rules still exist today, but investment adviser marketing has evolved with advances in technology. In the decades since the adoption of both the advertising and solicitation rules, the use of the internet, mobile applications, and social media has become an integral part of business communications. Consumers today often rely on these forms of communication to obtain information, including reviews and referrals, when considering buying goods and services. Advisers and third parties also rely on these same types of outlets to attract and refer potential customers.

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section 3 of the Investment Company Act of 1940, but for section 3(c)(1) or 3(c)(7) of that Act"). Unless we specify otherwise, for purposes of this release, we refer to any of these persons generally as "investors," and we refer specifically to investors in private funds managed by those advisers as "private fund investors."

6 While we traditionally referred to those who engaged in compensated solicitation activity under the current solicitation rule as "solicitors," we use the term "promoter" in this release to refer to a person providing a testimonial or endorsement, whether compensated or uncompensated. We also use the term "provider" at times when discussing a person providing an uncompensated testimonial or endorsement.

The nature and profiles of the investment advisory industry and investors seeking those advisory services have also changed since the Commission adopted the advertising and solicitation rules. Some investors today rely on digital investment advisory programs, sometimes referred to as "robo-advisers," for investment advice, which is provided exclusively through electronic platforms using algorithmic-based programs. In addition, passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") required many investment advisers to private funds that were previously exempt from registration to register with the Commission and become subject to additional provisions of the Advisers Act and the rules thereunder. Private funds and their advisers often hire promoters to obtain investors in the funds. Referral practices also have expanded to include, for example, various types of compensation, including non-cash compensation, in referral arrangements.

In light of these developments, we proposed amendments to the advertising rule to: (i) modify the definition of "advertisement" to be more "evergreen" in light of ever-changing technology; (ii) replace four *per se* prohibitions with general prohibitions of certain advertising practices applicable to all advertisements; (iii) provide certain restrictions and conditions on testimonials, endorsements, and third-party ratings; and (iv) include tailored requirements for the presentation of performance results, based on an advertisement's intended audience.[7] The proposed rule also would have required internal review and approval of most advertisements. Finally, we proposed amendments requiring each adviser to report additional information regarding its advertising practices in its Form ADV.

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[7] *See* Investment Adviser Advertisements; Compensation for Solicitations, Release No. IA-5407 (Nov. 4, 2019) [84 FR 67518 (Dec. 10, 2019)] ("2019 Proposing Release").

Additionally, we proposed amendments to the solicitation rule to: (i) expand the rule to cover solicitation arrangements involving all forms of compensation, rather than only cash compensation; (ii) expand the rule to apply to the solicitation of current and prospective investors in any private fund, rather than only to "clients" (including prospective clients) of the investment adviser; (iii) eliminate requirements duplicative of other rules; (iv) include exceptions for *de minimis* payments and certain non-profit programs; and (v) expand the types of disciplinary events that would trigger the rule's disqualification provisions.

We received more than 90 comment letters on the proposal.[8] The Commission also received feedback flyers from individual investors on investment adviser marketing and from smaller advisers on the proposal's effects on small entities.[9] Commenters generally supported modernizing these rules and agreed with our general approach. Many commenters, however, expressed concern that several aspects of the proposed amendments to the advertising rule would increase an investment adviser's compliance burden.[10] For example, some commenters suggested removing the proposed internal pre-use review and approval requirement and narrowing the proposed definition of "advertisement."[11] Others requested that we provide additional guidance on various topics, such as how the general prohibitions will apply in certain

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8 The comment letters on the 2019 Proposing Release (File No. S7-21-19) are available at https://www.sec.gov/comments/s7-21-19/s72119.htm.

9 The feedback forms are available in the comment file at https://www.sec.gov/comments/s7-21-19/s72119.htm.

10 *See, e.g.*, Comment Letter of Wellington Management Company LLP (Feb. 10, 2020) ("Wellington Comment Letter"); Comment Letter of Fidelity Management Research Company LLC (Feb. 10, 2020) ("Fidelity Comment Letter");

11 *See, e.g.*, Comment Letter of Investment Adviser Association (Feb. 10, 2020) ("IAA Comment Letter"); Comment Letter of the National Society of Compliance Professionals (Feb. 7, 2020) ("NSCP Comment Letter").

scenarios.[12] Commenters also expressed concern that the proposed amendments to the solicitation rule would significantly expand several aspects of the existing rule. For example, some commenters argued that the proposed definition of "solicitor" was too broad and suggested alternatives or limitations.[13] Others disagreed with the proposed expansion of the rule to include non-cash compensation and solicitations of private fund investors.[14] Commenters also recommended modifications to the disqualification provisions, such as aligning them with disqualification provisions in our other rules and limiting the scope of affiliate disqualification.[15]

Commenters generally supported our approach to permit testimonials and endorsements;[16] however, they highlighted the difficulty in assessing when compensated testimonials and endorsements under the proposed advertising rule would also trigger the application of the proposed solicitation rule.[17] Commenters argued that applying both rules to the same conduct is duplicative and burdensome.[18] Some commenters suggested that we

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12 *See, e.g.*, Comment Letter of LinkedIn Corporation (Feb. 10, 2020) ("LinkedIn Comment Letter"); Comment Letter of the North American Securities Administrators Association (NASAA) (Feb. 10, 2020) ("NASAA Comment Letter").

13 *See, e.g.*, Comment Letter of Financial Services Institute (Feb. 12, 2020) ("FSI Comment Letter"); Comment Letter of SIFMA Asset Management Group on proposed solicitation rule (Feb. 10, 2020) ("SIFMA AMG Comment Letter I").

14 *See, e.g.*, Comment Letter of Fried, Frank, Harris, Shriver & Jacobson LLP (Feb. 10, 2020) ("Fried Frank Comment Letter"); Comment Letter of Sidley Austin LLP (Feb. 10, 2020) ("Sidley Austin Comment Letter").

15 *See, e.g.*, Comment Letter of Credit Suisse Securities (USA) LLC (Feb. 10, 2020) ("Credit Suisse Comment Letter"); SIFMA AMG Comment Letter I.

16 *See, e.g.*, Comment Letter of the Small Business Investor Alliance (Feb. 7, 2020) ("SBIA Comment Letter"); Comment Letter of the Consumer Federation of America (Feb. 10, 2020) ("Consumer Federation Comment Letter").

17 *See, e.g.*, Comment Letter of SIFMA Asset Management Group on proposed advertising rule (Feb. 10, 2020) ("SIFMA AMG Comment Letter II"); Comment Letter of Joseph H. Nesler (Jan. 15, 2020) ("Nesler Comment Letter").

18 *See e.g.*, FSI Comment Letter; SIFMA AMG Comment Letter II.

regulate endorsements and testimonials only under the advertising rule,[19] whereas others suggested various ways to limit the conduct that would be subject to both rules.[20]

Merged Marketing Rule

After considering comments, we are adopting a rule with several modifications.[21] We believe it is appropriate to regulate investment adviser advertising and solicitation activity through a single rule: the marketing rule. This approach is designed to balance the Commission's goals of protecting investors from misleading advertisements and solicitations, while accommodating current marketing practices and their continued evolution.

- The final marketing rule will include an expanded definition of "advertisement," relative to the current advertising rule, that will encompass an investment adviser's marketing activity for investment advisory services with regard to securities. We have determined not to expand the definition of advertisement to include communications addressed to one person as proposed, and instead will retain the current rule's exclusion of one-on-one communications from the definition, except with regard to compensated testimonials and endorsements and certain communications that include hypothetical performance information.[22] In addition, the definition will not include communications designed to retain

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19 *See, e.g.*, IAA Comment Letter; SIFMA AMG Comment Letter II; Comment Letter of Mercer Advisors (Feb. 10, 2020) ("Mercer Comment Letter"). *See also* FSI Comment Letter.

20 *See e.g.*, SIFMA AMG Comment Letter II; FSI Comment Letter; IAA Comment Letter; Comment Letter of the Money Management Institute (Feb. 10, 2020) ("MMI Comment Letter"); Nesler Comment Letter.

21 The final rule will apply to all investment advisers registered, or required to be registered, with the Commission. Like the proposal, the final rule will not apply to advisers that are not required to register as investment advisers with the Commission, such as exempt reporting advisers or state-registered advisers.

22 Hypothetical performance information that is provided in response to an unsolicited investor request or to a private fund investor in a one-on-one communication is excluded from the first prong of the definition of advertisement.

existing investors. The final definition also will include exceptions for extemporaneous, live, oral communications; and information contained in a statutory or regulatory notice, filing, or other required communication.

- Largely as proposed, the final rule will apply to certain communications sent to clients and private fund investors, but will not apply to advertisements about registered investment companies or business development companies.
- A set of seven principles-based general prohibitions will apply to all advertisements. These are drawn from historic anti-fraud principles under the Federal securities laws and are tailored specifically to the type of communications that are within the scope of the rule.
- The final rule will permit an adviser's advertisement to include testimonials and endorsements, subject generally to the following conditions: required disclosures; adviser oversight and compliance, including a written agreement for certain promoters; and, in some cases, disqualification provisions. We are adopting partial exemptions for *de minimis* compensation, affiliated personnel, registered broker-dealers, and certain persons to the extent they are covered by rule 506(d) of Regulation D under the Securities Act with respect to a securities offering.
- An adviser's advertisement may include a third-party rating, if the adviser forms a reasonable belief that the third-party rating clearly and prominently discloses certain information.
- The final rule will apply to performance advertising and will require presentation of net performance information whenever gross performance is presented, and performance data over specific periods. In addition, the final rule will impose

requirements on advisers that display related performance, extracted performance, hypothetical performance, and – in a change from the proposal – predecessor performance. We are not adopting, however, the proposed separate requirements for performance advertising for retail and non-retail investors.

- We are amending the recordkeeping rule and Form ADV to reflect the final rule and enhance the data available to support our staff's enforcement and examination functions.
- In a change from the proposal, the final rule will not require investment advisers to review and approve their advertisements prior to dissemination.
- Finally, certain staff no-action letters will be withdrawn in connection with the final rule as those positions are either incorporated into the final rule or will no longer apply.

II. DISCUSSION

A. Scope of the Rule: Definition of "Advertisement"

1. Overview

Under the final marketing rule, the definition of an advertisement includes two prongs.[23] The first prong includes 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 investors in a private fund advised by the investment adviser ("private fund investors"), or (ii) offers new investment advisory services with regard to securities to current clients or private fund investors.[24] This prong will capture traditional advertising, and will not include one-on-one communications, unless the communication includes hypothetical

[23] *See* final rule 206(4)-1(e)(1)(i) and (ii).

[24] *See* final rule 206(4)-1(e)(1)(i).

performance information that is not provided: (i) in response to an unsolicited investor request or (ii) to a private fund investor. It also excludes (i) extemporaneous, live, oral communications; and (ii) 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.[25]

The new second prong will cover compensated testimonials and endorsements, which will include a similar scope of activity as traditional solicitations under the current solicitation rule.[26] This prong will include oral communications and one-on-one communications to capture traditional one-on-one solicitation activity, in addition to solicitations for non-cash compensation. It will exclude certain information contained in a statutory or regulatory notice, filing, or other required communication.[27]

2. Definition of Advertisement: Communications Other than Compensated Testimonials and Endorsements

Proposed rule 206(4)-1(e)(1) would have defined an advertisement as any communication, disseminated by any means, by or on behalf of an investment adviser, that offers or promotes the investment adviser's investment advisory services or that seeks to obtain or retain one or more investment advisory clients or private fund investors, subject to certain enumerated exclusions. Although some commenters supported the proposed definition,[28] most

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25 *See* final rule 206(4)-1(e)(1)(i)(A) and (B).

26 *See* final rule 206(4)-1(e)(1)(ii). As discussed below, uncompensated testimonials and endorsements that are included in certain adviser communications would meet the first prong of the definition of advertisement. *See infra* "Adoption and entanglement" section.

27 *See* final rule 206(4)-1(e)(1)(ii).

28 *See, e.g.*, SBIA Comment Letter; Consumer Federation Comment Letter; Comment Letter of the Institutional Limited Partners Association (Feb. 10, 2020) ("ILPA Comment Letter").

commenters stated that it was overly broad.[29] Some commenters stated that the proposed definition would chill adviser communications to existing investors, increase compliance burdens for advisers, and complicate communications with various third parties.[30]

After considering comments, we are making several modifications to hone the scope of the rule to the communications that have a greater risk of misleading investors, ease compliance burdens that commenters suggested would result from the proposed rule's scope, and facilitate communications with existing investors.

a. *Specific Provisions*

In a textual (but not substantive) change from the proposal, the final rule will not include the phrase "disseminated by any means" and instead will reference any direct or indirect communication the adviser makes. We believe these two formulations carry the same meaning, but understand from commenters that the phrase "direct or indirect" is more familiar to advisers. This reference to direct or indirect communications will replace the current advertising rule's requirement that an advertisement be a "written" communication or a notice or other announcement "by radio or television." We are deleting references in the current advertising rule to specific types of communications to ensure that the final rule reflects modern communication methods, rather than the methods that were most common when the Commission adopted the current rule (*e.g.*, newspapers, television, and radio). Commenters generally did not

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29 *See, e.g.*, Wellington Comment Letter; Pickard Djinis Comment Letter; Comment Letter of Managed Funds Association and Alternative Investment Management Association (Feb. 10, 2020) ("MFA/AIMA Comment Letter I").

30 *See, e.g.*, Fidelity Comment Letter; NSCP Comment Letter; IAA Comment Letter.

oppose omitting the current rule's references to specific methods of communication and supported such modernization of the current rule.[31]

This revision will expand the scope of the current rule to encompass all offers of an investment adviser's investment advisory services with regard to securities regardless of how they are disseminated, with the limited exceptions discussed below. An adviser may disseminate such communications through emails, text messages, instant messages, electronic presentations, videos, films, podcasts, digital audio or video files, blogs, billboards, and all manner of social media, as well as by paper, including in newspapers, magazines, and the mail. We recognize that electronic media (including social media and other internet communications) and mobile communications play a significant role in current advertising practices. We also believe this revision will help the definition remain evergreen in the face of evolving technology and methods of communication.

i. Any direct or indirect communication an investment adviser makes

The first prong of the final marketing rule's definition of "advertisement" includes an adviser's direct or indirect communications. In addition to communicating directly with prospective investors, we understand that investment advisers often provide intermediaries, such as consultants, other advisers (*e.g.*, in a fund-of-funds or feeder funds structure), and promoters, with advertisements for dissemination. Those advertisements are indirect communications because they are statements provided by the adviser for dissemination by a third party. This

[31] *See, e.g.*, NYC Bar Comment Letter; Comment Letter of the Financial Planning Association (Feb. 10, 2020) ("FPA Comment Letter").

aspect of the definition also will capture certain communications distributed by an adviser that incorporate statements or other content prepared by a third party.[32]

The final rule text reflects a change from the proposal, which would have applied to any communications "by or on behalf of" an adviser.[33] Commenters generally suggested that we remove the "on behalf of" clause from the definition, citing concerns that advisers would not be able to collaborate with third parties to prepare and disseminate advertising materials and that it would stifle communications between advisers and certain third parties.[34] Certain commenters requested safe harbors for communications with the press and removal of profane or illegal materials.[35] Commenters also requested clarification on how the rule would apply to funds-of-funds, model providers, solicitors, and employee use of social media.[36]

We believe communications that investment advisers use to offer their advisory services have an equal potential to mislead – and should be subject to the rule – regardless of whether the adviser communicates directly or indirectly through a third party, such as a consultant, intermediary, or related person.[37] Likewise, an adviser should not be able to avoid application of

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32 *See infra* "Adoption and entanglement" section.

33 *See* proposed rule 206(4)-1(e)(1).

34 *See, e.g.*, SIFMA AMG Comment Letter II; FSI Comment Letter; Comment Letter of the CFA Institute (Feb. 24, 2020) ("CFA Institute Comment Letter"); Comment Letter of ICE Data Pricing & Reference Data, LLC (Feb. 10, 2020) ("ICE Comment Letter").

35 *See, e.g.*, LinkedIn Comment Letter; Comment Letter of Resolute Investment Managers (Feb. 10, 2020) ("Resolute Comment Letter"); IAA Comment Letter.

36 *See, e.g.*, Comment Letter of the American Investment Council (Feb. 10, 2020) ("AIC Comment Letter"); Nesler Comment Letter; SIFMA AMG Comment Letter II; CFA Institute Comment Letter.

37 Section 208 of the Advisers Act states that "[i]t shall be unlawful for any person indirectly, or through or by any other person, to do any act or thing which it would be unlawful for such person to do directly…" *See, e.g.*, In the Matter of Profitek, Inc., Release No. IA-1764 (Sept. 29, 1998) (settled order) (The Commission brought an enforcement action against an investment adviser, asserting that it directly or indirectly distributed materially false and misleading advertisements, including by submitting performance information in questionnaires submitted to online databases that were made available to subscribers

the rule when it incorporates third-party content into its communications.[38] To address commenters' concerns about the clarity of the standard, however, we replaced "on behalf of" with "directly or indirectly." Our view is that these phrases largely have the same meaning, but that "directly or indirectly" is more commonly used, broadly understood, and consistent with the language in the current rule. In addition, we believe that the phrase "direct or indirect communication an investment adviser makes" better focuses on an adviser's participation in making a particular communication subject to the rule.

Whether a particular communication is a communication made by the adviser is a facts and circumstances determination. Where the adviser has participated in the creation or dissemination of an advertisement, or where an adviser has authorized a communication, the communication would be a communication of the adviser. For example, if an adviser provides marketing material to a third party for dissemination to potential investors, the communication is a communication made by the adviser. In addition, we would generally view any advertisement about the adviser that is distributed and/or prepared by a related person as an indirect communication by the adviser, and thus subject to the final rule.[39] Although the final marketing rule will not require an adviser to oversee all activities of a third party, the adviser is responsible for ensuring that its advertisements comply with the rule, regardless of who creates or disseminates them.

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nationwide and by providing misleading performance information to a newspaper that reported the performance in an article.).

38 *See infra* "Adoption and entanglement" section.

39 An adviser's "related person" is defined in Form ADV's Glossary of Terms as "[a]ny *advisory affiliate* and any *person* that is under common *control* with [the adviser's] firm." Italicized terms are defined in the Form ADV Glossary. *See* Form ADV Glossary.

An adviser might collaborate with a third party to prepare marketing materials in other circumstances that would not constitute dissemination by an adviser. If an adviser provides comments on a marketing piece, but a third party does not accept the adviser's comments or the third party makes unauthorized modifications, the adviser will not be responsible for the third party's subsequent modifications that were made independently of the adviser and that the adviser did not approve.[40] This analysis would be based on the facts and circumstances. Formal authorization of dissemination, or lack thereof, by the adviser is not dispositive, although it would be considered part of the analysis.

Commenters sought clarification on how the definition of "advertisement" would apply in the fund-of-funds and master-feeder contexts.[41] If an adviser to an underlying fund provides marketing materials to the adviser of a fund-of-funds (or a feeder fund) and the adviser to the fund-of-funds (or a feeder fund) provides those materials to investors, the underlying fund adviser would be responsible for the material it prepared or authorized for distribution.[42] The underlying fund adviser would not be responsible for modifications the adviser of the fund-of-funds made to the underlying fund adviser's original advertisement if the underlying fund adviser did not approve the adviser's edits. Similarly, a third-party model provider would not be responsible for modifications the end-user adviser made to the third-party model used in an advertisement if done without the model provider's involvement or authorization.

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40 However, the adviser will remain responsible for the accuracy of the marketing material provided to and disseminated by the third party even if the third party makes formatting changes that do not affect the content of that marketing material or prominence of particular disclosures therein.

41 *See, e.g.*, AIC Comment Letter; Comment Letter of JG Advisory Services, LLC (Jan. 9, 2020) ("JG Advisory Comment Letter").

42 In this discussion, the acquiring fund adviser (or the adviser to, or sponsor of, a feeder fund in a master-feeder structure) generally would be treated as an intermediary and not as an investor in the underlying fund (or the master fund in a master-feeder structure).

Adoption and entanglement

Depending on the particular facts and circumstances, third-party information also may be attributable to an adviser under the first prong of the final rule. For example, an adviser may distribute information generated by a third party or a third party could include information about an adviser's investment advisory services in the third party's materials. In these scenarios, whether the third-party information is attributable to the adviser will require an analysis of the facts and circumstances to determine (i) whether the adviser has explicitly or implicitly endorsed or approved the information after its publication (adoption) or (ii) the extent to which the adviser has involved itself in the preparation of the information (entanglement).[43]

An adviser "adopts" third-party information when it explicitly or implicitly endorses or approves the information.[44] For example, if an adviser incorporates information it receives from a third party into its performance advertising, the adviser has adopted the third-party content, and the third-party content will be attributed to the adviser.[45] An adviser is liable for such third-party content under the marketing rule just as it would be liable for content it produced itself.[46] In

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43 *See* Interpretive Guidance on the Use of Company Web Sites, Release No. IC-28351 (Aug. 1, 2008) [73 FR 45862 (Aug. 7, 2008)] ("2008 Release") ("[W]hether third-party information is attributable to a company depends upon whether the company has: (1) involved itself in the preparation of the information, or (2) explicitly or implicitly endorsed or approved the information."); Use of Electronic Media, Release No. 34-42728 (Apr. 28, 2000) [65 FR 25843 (May 4, 2000)] ("2000 Release") at nn.52, 54; Use of Electronic Media for Delivery Purposes, Release No. 34-36345 (Oct. 6, 1995) [60 FR 53458 (Oct. 13, 1995)] ("1995 Release").

44 *See* 2008 Release, *supra* footnote 43.

45 *See, e.g.*, In the Matter of BB&T Securities, LLC, Release No. IA-4506 (Aug. 25, 2016) (settled order) (The Commission brought an enforcement action against an SEC-registered investment adviser alleging that it negligently relied on a third party's materially inflated, and hypothetical and backtested, performance track record in preparing advertisements that the adviser sent to advisory clients and prospective clients.).

46 *See infra* section II.B.

addition, an adviser may have "entangled" itself in a third-party communication if the adviser involves itself in the third party's preparation of the information.[47]

Nevertheless, we would not view an adviser's edits to an existing third-party communication to result in attribution of that communication to the adviser if the adviser edits a third party's communication based on pre-established, objective criteria (*i.e.*, editing to remove profanity, defamatory or offensive statements, threatening language, materials that contain viruses or other harmful components, spam, unlawful content, or materials that infringe on intellectual property rights, or editing to correct a factual error) that are documented in the adviser's policies and procedures and that are not designed to favor or disfavor the adviser.[48] In these circumstances, we would not view the adviser as endorsing or approving the remaining content by virtue of such limited editing.

Guidance on social media

Questions about whether a communication is attributable to an adviser may commonly arise in the context of an adviser's use of websites or other social media. For example, an adviser might include a hyperlink in an advertisement to an independent webpage on which third-party content sits. An adviser should consider the adoption and entanglement concepts discussed above to determine whether the hyperlinked third-party content would be attributed to the adviser.[49] At the same time, an adviser's hyperlink to third-party content that the adviser knows or has reason to know contains an untrue statement of material fact or materially

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47 *See* 2000 Release, *supra* footnote 43 ("[L]iability under the 'entanglement' theory would depend upon an issuer's level of pre-publication involvement in the preparation of the information.").

48 For example, an adviser could not have a policy to remove only negative comments about the adviser.

49 We previously stated that an adviser should consider the application of rule 206(4)-1, including the existing prohibition of testimonials, before including hyperlinks to third-party websites on its website or in its electronic communications. *See* 2008 Release, *supra* footnote 43.

misleading information would also be fraudulent or deceptive under section 206 of the Act and other applicable anti-fraud provisions.

Whether content posted by third parties on an adviser's own website or social media page would be attributed to the investment adviser also depends on the facts and circumstances surrounding the adviser's involvement.[50] For example, permitting all third parties to post public commentary to the adviser's website or social media page would not, by itself, render such content attributable to the adviser, so long as the adviser does not selectively delete or alter the comments or their presentation and is not involved in the preparation of the content.[51] We believe such treatment of third-party content on the adviser's own website or social media page is appropriate even if the adviser has the ability to influence the commentary but does not exercise this authority. For example, if the social media platform allows the investment adviser to sort the third-party content in such a way that more favorable content appears more prominently, but the investment adviser does not actually do such sorting, then the ability to sort content would not, by itself, render such content attributable to the adviser. In addition, if an adviser merely permits the use of "like," "share," or "endorse" features on a third-party website or social media platform, we would not interpret the adviser's permission as implicating the final rule.

Conversely, if the investment adviser takes affirmative steps to involve itself in the preparation or presentation of the comments, to endorse or approve the comments, or to edit posted comments, those comments would be attributed to the adviser. This would apply to the

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50 Other content that offers or promotes the adviser's services on an adviser's own website or social media page would likely meet the definition of "advertisement" under the final rule.

51 *See supra* "Adoption and entanglement" section (discussing an adviser's ability to edit third-party material based on objective criteria).

affirmative steps an adviser takes both on its own website or social media pages, as well as on third-party websites. For example, if an adviser substantively modifies the presentation of comments posted by others by deleting or suppressing negative comments or prioritizing the display of positive comments, then we would attribute the comments to the adviser (*i.e.*, the communication would be an indirect statement of the adviser) because the adviser would have modified third-party comments with the goal of marketing its advisory business. However, as discussed above, we would not view an adviser's merely editing profane, unlawful, or other such content according to a neutral pre-existing policy as the adviser adopting the content.

Some commenters sought assurances that the definition of advertisement would not cover an adviser's associated persons' activity on their personal social media accounts.[52] We have concerns that, under certain circumstances, it could be difficult for an investor to differentiate a communication of the associated person in his/her personal capacity from a communication the associated person made for the adviser. With respect to social media postings to associated persons' own accounts, it would be a facts and circumstances analysis relating to the adviser's supervision and compliance efforts. If the adviser adopts and implements policies and procedures reasonably designed to prevent the use of an associated person's social media accounts for marketing the adviser's advisory services, we generally would not view such communication as the adviser marketing its advisory services.[53] To achieve effective supervision and compliance, an adviser may consider also prohibiting such communications, conducting

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52 *See, e.g.*, SIFMA AMG Comment Letter II; LinkedIn Comment Letter; IAA Comment Letter. We believe that our modifications to the first prong of the definition of advertisement also will alleviate commenters' concerns as there are now fewer scenarios in which communications on employee social media accounts would meet the definition of advertisement.

53 An associated person who, notwithstanding these policies and procedures, engages in communications inconsistent with the rule may, depending on the facts and circumstances, be held responsible for violations of the rule.

periodic training, obtaining attestations, and periodically reviewing content that is publicly available on associated persons' social media accounts.

ii. To more than one person

Consistent with the current rule's exclusion of one-on-one communications, the first prong of the final definition of "advertisement" generally does not include communications to one person. While our proposed rule would have treated communications directed to "one or more" persons as advertisements, commenters generally opposed this expansion.[54] In particular, commenters argued that subjecting one-on-one communications to the requirements of the proposed rule would create untenable burdens given the proposed review and approval obligation (including enhanced recordkeeping requirements).[55] Commenters also stated that it would chill adviser/investor communications.[56] According to commenters, scoping a one-on-one communication into the rule would require advisers to review each communication to determine whether it is an advertisement, which could prevent an adviser from providing timely information to investors and satisfying its fiduciary obligations.[57] We received comments that communications to existing investors are already subject to the anti-fraud provisions of the

54 *See, e.g.*, IAA Comment Letter; AICPA Comment Letter.

55 *See, e.g.*, Comment Letter of Commonwealth Financial Network (Feb. 10, 2020) ("Commonwealth Comment Letter") (stating that the lack of complete overlap with FINRA rules would make compliance especially burdensome for dual registrants); Comment Letter of the National Regulatory Services (Feb. 10, 2020) ("NRS Comment Letter"). Commenters also noted that advisers have adopted long-standing practices in reliance on the existing exclusion of one-on-one communications. *See, e.g.*, Comment Letter of the New York City Bar (Feb. 10, 2020) ("NYC Bar Comment Letter").

56 *See, e.g.*, IAA Comment Letter (stating that the proposed rule "would blur the line between client servicing and marketing"); Wellington Comment Letter; Fidelity Comment Letter; MFA/AIMA Comment Letter I.

57 *See, e.g.*, CFA Institute Comment Letter; Comment Letter of the Council of Institutional Investors (Feb. 11, 2020) ("CII Comment Letter").

Advisers Act, and therefore communications to existing investors need not be subject to the final rule.[58]

After considering the comments, we have determined to exclude one-on-one communications from the first prong of the definition and retain the "more than one" language in the current advertising rule, unless such communications include hypothetical performance information that is not provided: (i) in response to an unsolicited investor request or (ii) to a private fund investor. We have made this change to avoid the possibility that the rule would impede typical communications between advisers and their existing and prospective investors. An adviser might have been dis-incentivized to communicate regularly with its investors if it believed it would have to analyze every communication for compliance with the proposed rule.[59]

Because we are excluding one-on-one communications from the first prong of the definition of advertisement under most circumstances, we are modifying the proposed exclusion for an adviser's responses to unsolicited requests.[60] Although commenters generally supported the exclusion and recommended expanding it,[61] we believe excluding most one-on-one communications addresses commenter concerns in a more comprehensive manner than the unsolicited request exclusion would have addressed them. The definition will exclude an adviser's responses to an unsolicited investor request for hypothetical performance information,

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58 *See, e.g.*, SIFMA AMG Comment Letter II.

59 As discussed below, we also have eliminated the element of the proposed rule that would apply to communications to retain investors.

60 *See* proposed rule 206(4)-1(e)(1)(ii). We proposed to exclude from the definition of "advertisement" any communication by an investment adviser "that does no more than respond to an unsolicited request" for "information specified in such request about the investment adviser or its services" other than a communication to a retail person that includes performance results or a communication that includes hypothetical performance.

61 *See, e.g.,* Wellington Comment Letter; MFA/AIMA Comment Letter I; IAA Comment Letter.

as well as hypothetical performance information provided to a private fund investor in a one-on-one communication, as discussed below. Unless subject to this or another exclusion, the definition of advertisement will capture communications that include hypothetical performance information even in a one-on-one communication.[62]

We also recognize that advisers have one-on-one interactions with prospective investors and that prospective investors may ask questions of an adviser or ask for additional information. In adopting the current advertising rule, the Commission limited the definition of "advertisement" due to concerns that a broad definition could encompass even "face to face conversations between an investment counsel and his prospective client."[63] The Commission stated that it would not include a "personal conversation" with a client or prospective client.[64] We believe that the same concerns that influenced the Commission's prior approach continue to exist. We also believe that the remaining provisions of the definition, as well as other provisions of the Federal securities laws, are adequate to satisfy our investor protection goals with respect to communications directed only to a single individual or entity.[65]

The one-on-one exclusion in the definition's first prong applies regardless of whether the adviser makes the communication to a natural person with an account or multiple natural persons representing a single entity or account.[66] The exclusion applies to a single adviser and a single investor. For example, if an adviser's prospective investor is an entity, the exclusion permits the

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62 *See* final rule 206(4)-1(e)(1)(i)(A)-(C).

63 *See* Prohibited Advertisements, Release No. IA-119 (Aug. 8, 1961) [26 FR 7552, 7553 (Nov. 15, 1961)].

64 *Id.*

65 *See, e.g.*, section 206 of the Act; rule 206(4)-8 under the Act.

66 *See, e.g.*, MFA/AIMA Comment Letter I; IAA Comment Letter (stating that the Commission should "make clear in the adopting release that the same communication to multiple natural persons representing a single institution or client/account counts as a communication to a single person").

adviser to provide communications to multiple natural persons employed by or owning the entity without those communications being subject to the rule. For purposes of this exclusion, we also interpret the term "person" to mean one or more investors that share the same household. For example, a communication to a married couple that shares the same household would qualify for the one-on-one exclusion.[67]

Some commenters advocated that we increase the "more than one" threshold from the current rule to communications with "more than ten" or "more than 25" persons.[68] They argued that such a change would reduce compliance costs and better align with traditional concepts of advertising.[69] We decline to make this change. The exclusion from the first prong of the definition of advertisement for one-on-one communications will allow an adviser to engage in routine investor communications and have personal conversations with prospective investors, without subjecting those communications to the final marketing rule's requirements. However, we continue to believe that the final rule should cover typical marketing communications, even if sent to a limited number of persons. Creating a higher threshold, as suggested by commenters, may incentivize advisers to limit communications to just below the threshold number of persons, and may defeat the purposes of our final rule.

While the first prong of the final rule will generally not apply to communications to one person, changes in technology since the adoption of the existing rule permit advisers to create communications that appear to be personalized to single investors and are "addressed to" only one person, but are actually widely disseminated to multiple persons. While communications

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67 *See, e.g.,* rule 30e-1(f) under the Investment Company Act.

68 *See, e.g.,* IAA Comment Letter (suggesting the more than 25 person threshold because FINRA rule 2210 uses this approach and stating that consistency would ease compliance burdens).

69 *See, e.g.,* FPA Comment Letter.

such as bulk emails or algorithm-based messages are nominally directed at or "addressed to" only one person, they are in fact widely disseminated to numerous investors and therefore would be subject to the final rule.[70] Similarly, customizing a template presentation or mass mailing by filling in the name of an investor and/or including other basic information about the investor would not result in a one-on-one communication.

Likewise, an adviser cannot use duplicate inserts in an otherwise customized communication in an effort to circumvent application of the rule.[71] For example, if an adviser maintains a database of performance information inserts or tables that it uses in otherwise customized investor communications, the adviser must treat the duplicated inserts as advertisements subject to the rule. Of course, if the adviser provides an existing investor with performance information pertaining to the investor's account, the rule would not apply because this is a one-on-one communication.[72]

One commenter expressed concern that the public dissemination of a seemingly one-on-one communication could subject the communication to the final rule.[73] We believe that if, for example, an adviser responds to a request for proposal ("RFP") from an entity and the entity subsequently makes such responses available to the public pursuant to a Freedom of Information

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70 *See, e.g.,* NSCP Comment Letter.

71 The fact that there may be some similarities in the information provided in one-on-one communications, however, will not result in the application of the rule to those communications.

72 In addition, the communication does not fall within the definition of advertisement because the purpose of the communication is not to offer services to a new investor or to provide new services to an existing investor. *See infra* section II.A.2.a.iv.

73 *See* Resolute Comment Letter (seeking clarification on the treatment of "account statements and similar reports intended for Non-Retail Persons, such as public entities, that are required to make such information publicly available"). If the entity is an existing investor of the adviser, communications to the entity would not be considered an advertisement unless the communications offer or promote new advisory products or services of the adviser.

Act request or other public disclosure requirements, this would not be an advertisement merely by virtue of the entity's disclosure.[74] An adviser should consider adopting compliance policies and procedures that are reasonably designed to determine whether a communication nominally directed to a single person is actually a communication to more than one person, or contains duplicated inserts as part of that communication. In these circumstances, the duplicated information is an advertisement because it is sent to more than one person and would not qualify for the exclusion.

Because of the specific concerns raised by hypothetical performance, hypothetical performance information would not qualify for the one-on-one exclusion unless provided in response to an unsolicited investor request or to a private fund investor.[75] Hypothetical performance included in all other one-on-one communications that offer investment advisory services with regard to securities must be presented in accordance with the requirements discussed below.

We proposed a similar approach for hypothetical performance provided in response to an unsolicited request under the proposed definition of advertisement.[76] Some commenters suggested that the Commission permit an adviser to provide hypothetical performance in response to unsolicited requests to eliminate the need to assess the requirements related to hypothetical performance.[77] These commenters stated that the need to assess these requirements

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74 *See also supra* section II.A.2.a.i for a discussion of an adviser's direct or indirect communications.

75 *See infra* section II.E.6. These communications would be eligible for the exclusions from the definition of advertisement for extemporaneous, live, oral communications and regulatory notices in final rule 206(4)-1(e)(1)(i)(A) and (B).

76 *See* 2019 Proposing Release, *supra* footnote 7, at section II.A.2. (proposing that communications to any person that contain hypothetical performance would not qualify for the unsolicited request exclusion to the extent they contain such results); proposed rule 206(4)-1(e)(1)(ii)(B).

77 *See* IAA Comment Letter; ILPA Comment Letter.

would slow down the flow of information to investors, require investors to provide more information earlier in the diligence process, or limit the hypothetical performance information shared in response to such an unsolicited request. Some commenters stated that private fund investors often seek hypothetical performance information, particularly targets and projections, to evaluate private fund investments.[78] After considering these comments, we believe that, in most circumstances, the protections for hypothetical performance should be available to investors receiving communications that include offers of investment advisory services with regard to securities, to the extent such offers include hypothetical performance information. We believe our modifications to the first prong of the definition of advertisement and to the requirements for presenting hypothetical performance, discussed below, will reduce the associated compliance burdens for providing hypothetical performance information to investors and will, therefore, alleviate some of commenters' concerns.

However, where an investor affirmatively seeks hypothetical performance information from an investment adviser and the investment adviser has not directly or indirectly solicited the request, hypothetical performance information provided in response to the request will be excluded from the definition of advertisement under the final rule.[79] In the case of an unsolicited request, an investor seeks hypothetical performance information for the investor's own purposes, rather than responding to a communication disseminated by an adviser offering its investment advisory services with regard to securities. Similarly, where the hypothetical performance

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78 *See* IAA Comment Letter; Comment Letter of Managed Funds Association and Alternative Investment Management Association (Sept. 11, 2020) ("MFA/AIMA Comment Letter III").

79 Any affirmative effort by the investment adviser intended or designed to induce an investor to request hypothetical performance information would render the request solicited and thus not eligible for this exclusion.

information is provided in a one-on-one communication to a private fund investor, we believe a private fund investor will have the ability and opportunity to ask questions and assess the limitations of this information. In these limited circumstances, we do not believe it is necessary to treat the hypothetical performance information as an advertisement subject to the rule.[80]

iii. Offers investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the investment adviser

The marketing rule's definition of "advertisement" includes communications that offer the investment adviser's investment advisory services. As discussed in more detail below, we are implementing a number of changes from the proposal, which would have defined advertisements to include communications that offer or promote the investment adviser's investment advisory services or that seek to obtain or retain one or more investment advisory clients or investors in any pooled investment vehicle advised by the investment adviser.[81] First, we are limiting the application of this element of the definition to communications directed to prospective clients or prospective private fund investors, rather than existing clients or private fund investors to avoid an overbroad application of the rule. Accordingly, this aspect of the final rule will retain the current rule's scope.

Second, we also are not adopting the "or promote" wording from the proposed definition of advertisement. Commenters generally opposed including the term "promote," suggesting that this term could expand the definition of "advertisement" to cover certain materials not subject to

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80 The hypothetical performance information would be subject to the Advisers Act's anti-fraud provisions and rule 206(4)-8 under the Advisers Act.

81 *See* proposed rule 206(4)-1(e)(1).

the current rule,[82] the text of which is limited to communications that "offer" advisory services.[83] As we indicated in the proposal, the "offer or promote" clause reflects the current rule's application and was designed to capture communications that are commonly considered advertisements.[84] We added the "or promote" wording to the proposed definition for clarity, but after considering comments we realize this wording may instead cause confusion. For example, commenters sought clarification that statements about an advisory firm's culture, philanthropy, or community activity would not fall within the definition of advertisement.[85] We did not intend for our proposed definition and the inclusion of the term "promote" to include such communications. Accordingly, the final rule will not include the term "promote" as it is our intent to retain the current rule's scope in this respect.[86]

Third, consistent with the current rule, we are limiting the application of the definition to offers about an investment adviser's investment advisory services *with regard to securities*. We were persuaded by commenters who urged us to retain the current rule's scope, arguing that expanding the definition to cover services that are not related to securities could result in an overbroad application of the rule.[87] Importantly, however, the anti-fraud provisions of the Act

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82 *See*, *e.g.*, MFA/AIMA Comment Letter I; Comment Letter of Association for Corporate Growth (Feb. 10, 2020) ("ACG Comment Letter").

83 Under the current advertising rule, an "advertisement" includes any written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers "any other investment advisory service with regard to securities." *See* current rule 206(4)-1.

84 *See* 2019 Proposing Release, *supra* footnote 7, at section II.A.2.

85 *See* SIFMA AMG Comment Letter II; FSI Comment Letter.

86 *See SEC v. C.R. Richmond & Co*., 565 F.2d 1101, 1105 (9th Cir. 1977) ("Investment advisory material which promotes advisory services for the purpose of inducing potential clients to subscribe to those services is advertising material within [the current rule].").

87 *See* NYC Bar Comment Letter; ACG Comment Letter.

and related rules continue to apply to an adviser's advertisements and other communications about its other non-securities related services.[88]

Finally, the definition will not include communications that seek to obtain one or more investment advisory clients or investors in any pooled investment vehicle advised by the investment adviser. We determined that this clause was superfluous of the rest of the definition; we believe these communications are captured within an adviser's offer of investment advisory services with regard to securities to prospective investors in a private fund advised by the adviser.[89]

iv. Offers new investment advisory services with regard to securities to current clients or investors in a private fund advised by the investment adviser

The proposed definition of "advertisement" included communications that seek "to obtain or retain" investors. Commenters generally stated that the "or retain" clause would unnecessarily include communications made in the ordinary course of an adviser providing services to current investors as all communications with current investors are, at least in part, designed to both service and retain investors.[90]

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88 *See* section 206 of the Act; rule 206(4)-8 under the Act. *See also* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-5248 (June 5, 2019) [84 FR 33669 (July 12, 2019)] ("Fiduciary Interpretation") (stating that "[t]he investment adviser's fiduciary duty is broad and applies to the entire adviser-client relationship."), at n.17 (citing *SEC v. Lauer*, 2008 WL 4372896, at 24 (S.D. Fla. Sept. 24, 2008) "'Section 206 of the Advisers Act does not require that the activity be 'in the offer or sale of any' security or 'in connection with the purchase or sale of any security.'"").

89 As discussed below, the definition of advertisement in the final rule also will not include communications designed to "retain" investors. *See infra* section II.A.2.a.iv.

90 *See, e.g.,* Wellington Comment Letter; IAA Comment Letter; JG Advisory Comment Letter (stating that "the rule should treat communications to existing investors differently from communications to prospective investors").

Several commenters asked us to confirm the scope of the definition as applied to communications with existing investors.[91] For example, some commenters suggested an exclusion for all communications with existing investors,[92] while others supported a more limited exclusion for routine investor communications.[93] Commenters generally agreed that the rule should treat communications with existing investors that offer new or additional advisory services as advertisements.[94] Commenters that supported a complete or partial exclusion for communications to existing investors stated that such communications are part of the advisory service and not advertisements.[95]

We agree that the rule should treat only those communications that offer *new* or *additional* advisory services with regard to securities to current investors as advertisements because they raise the same concerns as other advertisements. Our intent is not to chill ordinary course communications with current investors. We believe that other protections prevent advisers from engaging in activities that mislead or deceive existing investors.[96] For example,

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91 *See, e.g.,* SIFMA AMG Comment Letter II (discussing market commentary, investment outlooks, performance reviews); JG Advisory Comment Letter (seeking clarification on whether the proposed definition would scope in monthly or quarterly letters to existing investors where such letters discuss account performance and include market commentary).

92 *See, e.g.,* MFA/AIMA Comment Letter I.

93 *See, e.g.,* MMI Comment Letter.

94 *See, e.g.,* Wellington Comment Letter; IAA Comment Letter; Pickard Djinis Comment Letter.

95 Our staff has indicated that it would not recommend enforcement action under the current rule with respect to written communications by an adviser to an existing investor about the performance of securities in the investor's account because such communications would not be "offers" of advisory services, and instead are "part of" those advisory services (unless the context in which the communication is provided suggests otherwise). *See* Investment Counsel Association of America, Inc., SEC Staff No-Action Letter (Mar. 1, 2004) ("ICAA Letter"). Any staff guidance or no-action letters discussed in this release represent the views of the staff of the Division of Investment Management. They are not a rule, regulation, or statement of the Commission. Furthermore, the Commission has neither approved nor disapproved their content. Staff guidance has no legal force or effect; it does not alter or amend applicable law, and it creates no new or additional obligations for any person.

96 *See*, *e.g.*, section 206 of the Advisers Act; rule 206(4)-8 under the Advisers Act.

existing and prospective advisory clients receive the anti-fraud protections of the Advisers Act and an adviser's fiduciary duty.[97] Accordingly, under the final rule a communication to a current investor is an advertisement when it offers *new* or *additional* investment advisory services with regard to securities. We believe that this modification will allow advisers to continue to provide current investors with timely information regarding their accounts and the market without subjecting those communications to the marketing rule.[98]

In summary, we view an adviser seeking to offer new or additional investment advisory services with regard to securities to current investors as posing the same risks to investors as an adviser seeking to offer such services to new investors and therefore we believe this activity warrants the same treatment under the final marketing rule.

v. Brand content, general educational material, and market commentary

Other commenters asked us to confirm that brand content, general educational material, and market commentary are not advertisements under the rule.[99] Whether a communication is an advertisement depends on the facts and circumstances (*e.g.*, whether the communication "offers" the adviser's investment advisory services with regard to securities). Generally, generic brand

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97 *See* Fiduciary Interpretation, *supra* footnote 88. *See also* IAA Comment Letter; Pickard Djinis Comment Letter.

98 Their exclusion from the definition of advertisement will not prevent these account statements or transaction reports from being subject to the other provisions of the Federal securities laws, including section 17(a) of the Securities Act or section 10(b) of the Exchange Act (and rule 10b-5 thereunder), to the extent those provisions would otherwise apply. Likewise, regardless of whether a communication to an existing or prospective investor is an "advertisement" under the marketing rule, the communication is subject to the anti-fraud provisions of section 206 of the Act and the aforementioned provisions of the Federal securities laws.

99 *See, e.g.,* SIFMA AMG Comment Letter II; JG Advisory Comment Letter; MMI Comment Letter; IAA Comment Letter; MFA/AIMA Comment Letter I.

content, educational material, and market commentary would not meet the revised definition of an advertisement.

Brand content. Determining whether a communication including "brand" content (*e.g.*, displays of the advisory firm name in connection with sponsoring sporting events, supporting community service activities, or supporting philanthropic efforts) is an advertisement would depend on the facts and circumstances.[100] If such a communication is designed to raise the profile of the adviser generally, but does not offer any investment advisory services with regard to securities, the communication would not fall within the definition of an advertisement under the rule. For example, a communication that simply notes that an event is "brought to you by XYZ Advisers" would not qualify as an advertisement, as it is not offering any advisory services with regard to securities.

General educational information and market commentary. We believe that the same analysis applies for communications that provide only general educational information and market commentary.[101] Educational communications that are limited to providing general information about investing, such as information about types of investment vehicles, asset classes, strategies, certain geographic regions, or commercial sectors, do not constitute offers of an adviser's investment advisory services with regard to securities.

Similarly, materials that provide an adviser's general market commentary (including during press interviews) are unlikely to offer advisory services with regard to securities. Market commentary aims to inform current and prospective investors, including private fund investors,

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100 *See* SIFMA AMG Comment Letter II.

101 *See, e.g.,* SIFMA AMG Comment Letter II; Mercer Comment Letter; IAA Comment Letter; Wellington Comment Letter.

of market and regulatory developments in the broader financial ecosystem. These materials also help current investors interpret market and regulatory shifts by providing context when reviewing investments in their portfolios, and educate investors.[102] In contrast, for example, we would view an article or white paper that provides general market commentary and concludes with a description of how the adviser's securities-related services can help prospective investors invest in the market as offering the adviser's services. Accordingly, that portion of the white paper would be an advertisement.

b. *Exclusions*

The rule will generally exclude two types of communications from the first prong of the definition of advertisement: (i) extemporaneous, live, oral communications; and (ii) information required by statute or regulation.[103]

i. Extemporaneous, live, oral communications

In a change from the proposal, the definition of advertisement will not include extemporaneous, live, oral communications, regardless of whether they are broadcast and regardless of whether they take place in a one-on-one context and involve discussion of hypothetical performance. We proposed an exclusion for live, oral communications that are not broadcast on radio, television, the internet, or any other similar medium. Commenters generally supported the exclusion, but had questions about certain aspects. For example, some commenters expressed concern about the treatment of written materials that accompany or are

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102 *See, e.g.,* MMI Comment Letter (emphasizing the importance of allowing general market commentary to provide investors with the tools to challenge the assumptions of those who counsel them on financial management).

103 As discussed above, the rule also excludes from the first prong of the advertisement definition a communication that includes hypothetical performance that is provided in response to an unsolicited investor request for such information or to a private fund investor in a one-on-one communication. *See* final rule 206(4)-1(e)(1)(i)(C)*(1)* and *(2)*.

used to prepare for oral presentations, stating that treating such materials as advertisements would hamper an adviser's ability to prepare for a presentation.[104] Other commenters questioned the scope of the exclusion, with some arguing that it was too narrow[105] and others arguing that it was too broad.[106]

The goal of the exclusion for live, oral communications was to avoid treating extemporaneous statements as advertisements, in light of the difficulties in ensuring that they comply with the requirements of the rule, and to avoid chilling adviser communications with investors. If remarks are extemporaneous, they cannot be simultaneously monitored for regulatory compliance, and to require otherwise may simply cause advisers to cease extemporaneous speech to the overall detriment of investors. However, we believe that communications prepared in advance can and should be subject to the rule. Accordingly, the final exclusion will apply only to extemporaneous, live, oral communications.[107]

Extemporaneous communications do not include prepared remarks or speeches, such as those delivered from scripts.[108] In addition, slides or other written materials that are distributed

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104 *See, e.g.,* MFA/AIMA Comment Letter I; AIC Comment Letter (stating that "written materials prepared in conjunction with any live oral communications should not be considered 'advertisements' and should be able to rely on the exclusion if (*i*) they are in draft form, (*ii*) they are internal documents not created for distribution, or (*iii*) all or portions of their content may not be provided to any prospective or current investor.").

105 *See* SIFMA AMG Comment Letter II (arguing that it is not clear how to define communications that are broadcast and widely disseminated versus those that are not); AIC Comment Letter.

106 *See, e.g.,* NASAA Comment Letter; CFA Comment Letter; ILPA Comment Letter.

107 A communication need not be in-person to qualify for the exclusion so long as it is live and oral. For example, a phone call or live video communication between an adviser and an investor could qualify for this exclusion.

108 As discussed in the recordkeeping section below, a live, oral communication by an adviser that is not extemporaneous (but that otherwise satisfies the definition of advertisement) would be an advertisement and a record of the advertisement must be maintained pursuant to rule 204-2(a)(11)(i)(A). The record of the advertisement could be a copy of the prepared remarks, other written preparatory materials, or a recording of the oral communication.

or presented to the audience would also be included as advertisements if they otherwise meet the definition. On the other hand, live, extemporaneous, oral discussions with a group of investors or interviews with the press that are not based on prepared remarks will be eligible for the exclusion. This approach aligns with the purpose of the exclusion, which is to avoid a chilling effect on extemporaneous, oral speech that might occur if such communications were required to comply with the requirements of the final rule.

Some commenters recommended that we further expand the exclusion to apply to certain written communications.[109] While we appreciate that other modern communication methods facilitate instantaneous written conversations (*e.g.*, text messages, chat), this exclusion is limited to extemporaneous, live, oral communications, because in those circumstances a speaker often does not have sufficient time to edit and reflect on the content of the communication.[110]

Some commenters suggested that we exclude all broadcast communications and adopt an approach similar to FINRA.[111] Commenters also sought guidance on the meaning of the following terms: "broadcast"[112] and "widely disseminated."[113] In response to commenters' concerns, we are not adopting the requirement that the live, oral communication is "not broadcast." We believe the concerns that prompted this exclusion apply equally to

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109 *See, e.g.,* AIC Comment Letter (stating that live written communications (*e.g.,* live text chats) should also qualify for the exclusion in order to reflect modern communication methods).

110 We consider a communication to still be "oral" even if closed captioning is used, but not if the oral communication is transcribed and the transcription is then directly or indirectly redistributed by the adviser. *See, e.g.,* Mercer Comment Letter (seeking clarification that closed captioning would not prevent a communication from qualifying for the exclusion).

111 *See, e.g.,* SIFMA AMG Comment Letter II; Fidelity Comment Letter.

112 *See, e.g.,* Fidelity Comment Letter (noting that (i) advisers may use various forms of technology to communicate with clients, including web chats or videos and (ii) further limiting the exclusion "would capture routine communications between advisers and their clients merely because of the medium in which they are being conducted."); SIFMA AMG Comment Letter II (arguing that it is not clear how to define communications that are broadcast and widely disseminated versus those that are not).

113 *See, e.g.,* SIFMA AMG Comment Letter II; Consumer Federation Comment Letter.

extemporaneous, live, oral communications regardless of whether they are broadcast. We also believe that the exclusion should not allow an adviser to avoid application of the rule for a previously prepared live, oral communication in a non-broadcast setting, such as a luncheon seminar designed to attract new investors. In addition, commenters raised a variety of concerns with identifying whether a communication is broadcast in light of modern media tools, suggesting that line drawing as to when a communication is broadcast may be challenging in practice.[114] As a result, the exclusion will apply to a broadcast communication, such as a webcast, that is an extemporaneous, live, oral communication.

The exclusion will apply to "live" oral communications, as proposed. Accordingly, previously recorded oral communications disseminated by the adviser would not qualify as live because the adviser had time to review and edit the recording before such dissemination and thus can ensure compliance with the marketing rule. In these circumstances, an adviser would need to treat its subsequent dissemination of the recording as an advertisement under the rule if the recording offers the adviser's investment advisory services with regard to securities. However, we believe that an oral communication would be "live" even if there is a time lag (*e.g.*, streaming delay), a translation program is used, or adaptive technology is used to create a personal transcription (*e.g.*, voice to text technology or other tools that assist the deaf, hard-of-hearing, or hearing loss communities).

ii. Information contained in a statutory or regulatory notice, filing, or other required communication

The final rule excludes from the definition of advertisement "[i]nformation contained in a statutory or regulatory notice, filing, or other required communication, provided that such

114 *See, e.g.,* SIFMA AMG Comment Letter II; Fidelity Comment Letter.

information is reasonably designed to satisfy the requirements of such notice, filing, or other required communication."[115] In response to commenters, we have broadened the proposed exclusion, which would have applied to "[a]ny information required to be contained in a statutory or regulatory notice, filing, or other communication."[116] Commenters generally supported the proposed exclusion,[117] but recommended we expand it to ease compliance burdens and avoid duplicative regulation that would have resulted from applying another layer of review to mandatory filings.[118]

Specifically, commenters stated that compliance personnel would have difficulty determining exactly which information contained in a regulatory filing is strictly and explicitly required by applicable law versus which information is not (and would therefore be subject to the rule). In response to these comments, we broadened the exclusion to cover information in a statutory or regulatory, notice, filing or other required communication, provided the information is *reasonably designed* to satisfy the requirements, rather than information *required to be*

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115 Final rule 206(4)-1(e)(1)(i)(B). As with the exclusion for extemporaneous, live, oral communications, the exclusion for regulatory notices will apply regardless of whether the notice includes a discussion of hypothetical performance.

116 Proposed rule 206(4)-1(e)(1)(iv).

117 *See, e.g.*, Mercer Comment Letter; NRS Comment Letter.

118 *See, e.g.*, Comment Letter of Ropes & Gray LLP (Feb. 10, 2020) ("Ropes & Gray Comment Letter"); (noting that the proposal raises questions as to what information is required in Commission filings, especially for publicly traded advisers); Comment Letter of BlackRock, Inc. (Feb. 10, 2020) ("BlackRock Comment Letter") (same); SIFMA AMG Comment Letter II (noting that advisers are already subject to legal duties and potential liability for information included in regulatory filings making it unlikely that advisers would include excess information in such filings).

contained in such a communication.[119] For example, information reasonably designed to satisfy the requirements of Form ADV Part 2 or Form CRS will not be an advertisement.[120]

This exclusion will apply to information that an adviser provides to an investor under any statute or regulation under Federal or state law, including rules promulgated by regulatory agencies. We generally do not believe that communications that are prepared as a requirement of statutes, rules, or regulations should be viewed as advertisements under the final rule.[121] However, if an adviser includes in such a communication information that is not reasonably designed to satisfy its obligations under applicable law, and such additional information offers the adviser's investment advisory services with regard to securities, then that information will be considered an "advertisement" for purposes of the rule.

3. Definition of Advertisement: Compensated Testimonials and Endorsements, Including Solicitations

To reflect the merger of the two rules, the final rule's definition of "advertisement" includes a new second prong that applies to "any endorsement or testimonial for which an investment adviser provides compensation, directly or indirectly" subject to an exclusion for certain regulatory notices, filings, and other required communications.[122] A compensated testimonial or endorsement will meet the definition of advertisement's second prong regardless of whether the communication is made orally or in writing, to one or more persons.[123] By

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119 *See* final rule 206(4)-1(e)(1)(i)(B).

120 *See* Form CRS Relationship Summary; Amendments to Form ADV, Release No. IA-5247 (June 5, 2019) [88 FR 33573 (July 12, 2019)] ("Form CRS Adopting Release") (noting that the relationship summary is designed to serve as disclosure, rather than marketing material).

121 However, information that is required to be provided or offered by the final rule will not qualify for this exclusion. For example, final rule 206(4)-1(d)(2) requires an adviser to provide performance results over one-, five-, and ten-year periods. This information is part of the advertisement and subject to the rule.

122 Final rule 206(4)-1(e)(1)(ii).

123 *See id*. The definition of advertisement's second prong includes a testimonial or endorsement for which an adviser directly or indirectly provides *de minimis* compensation (as defined below). However, these types

contrast, an uncompensated testimonial or endorsement would have to meet the elements of prong one in order to be considered an "advertisement."

a. *Definitions of Testimonial and Endorsement*

The final definition of testimonial includes any statement by a current client or private fund investor about the client's or private fund investor's experience with the investment adviser or its supervised persons.[124] The definition of endorsement includes any statement by a person other than a current client or private fund investor that indicates approval, support, or recommendation of the investment adviser or its supervised persons or describes that person's experience with the investment adviser or its supervised persons.[125] This scope of how these activities are defined is similar to the proposal, with a few changes described below, including adding solicitation and referral activities drawn from the proposed definition of solicitor.

These definitions include statements about the adviser's "supervised persons," rather than the proposed inclusion of statements about the adviser's "advisory affiliates."[126] One commenter recommended this change, stating that an endorsement or testimonial regarding a supervised

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of testimonials and endorsements will be exempt from some of the final rule's prescribed conditions for testimonials and endorsements. *See infra* section II.C.5.

124 Final rule 206(4)-1(e)(17)(i). We proposed to define "testimonial" as "any statement of a client's or investor's experience with the investment adviser or its advisory affiliates, as defined in the Form ADV Glossary of Terms." *See* proposed rule 206(4)-1(e)(15).

125 Final rule 206(4)-1(e)(5)(i). We proposed to define "endorsement" as "any statement by a person other than a client or investor indicating approval, support, or recommendation of the investment adviser or its advisory affiliates, as defined in the Form ADV Glossary of Terms." *See* proposed rule 206(4)-1(e)(2). To align the definitions of testimonial and endorsement better, and address situations where an endorser who is not a client nevertheless provides statements about the endorser's experience with the adviser, the final definition of endorsement includes any statement made by a non-investor that describes the endorser's experience with the adviser or its supervised persons, like under the definition of testimonial.

126 Final rule 206(4)-1(e)(5)(i) and (17)(i). Under the final rule, supervised person has the same meaning as in section 2(a)(25) of the Act. Final rule 206(4)-1(e)(16). *See also* proposed rule 206(4)-1(e)(2) and (15) (referring to advisory affiliates).

person is more likely to provide relevant information to an investor than a statement about an adviser's advisory affiliate.[127]

We received a variety of comments about the statements these definitions would capture. One commenter supported a broad approach that would include statements about an adviser's traits, such as trustworthiness, to reflect the commenter's belief that prospective clients typically select an adviser based on emotion.[128] Another commenter requested that we limit the definitions to include only statements that explicitly discuss the adviser's services or capabilities as an adviser.[129]

Under the final marketing rule, testimonials and endorsements will include opinions or statements by persons about the investment advisory expertise or capabilities of the adviser or its supervised persons.[130] Testimonials and endorsements also include statements in an advertisement about an adviser or its supervised person's qualities (*e.g.*, trustworthiness, diligence, or judgment) or expertise or capabilities in other contexts, when the statements suggest that the qualities, capabilities, or expertise are relevant to the advertised investment advisory services. We believe that an investor would likely perceive these statements as relevant to the adviser's investment advisory services.[131]

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127 *See* Pickard Djinis Comment Letter.

128 *See* Comment Letter of William A. Jacobson, Esq., Clinical Professor of Law, Cornell Law School, and Director, Cornell Securities Law Clinic (Feb. 3, 2020) ("Prof. Jacobson Comment Letter").

129 *See* SIFMA AMG Comment Letter II.

130 Complete or partial client lists that do no more than identify certain of the adviser's clients or private fund investors will not be treated as testimonials. *See also* 2019 Proposing Release, *supra* footnote 7, at 78.

131 *See* Dan Gallagher, Staff No-Action Letter (pub. avail. July 10, 1995) (stating that the staff could not assure that it would not recommend enforcement action for a violation of rule 206(4)-1 if the letter writer used client testimonials describing its character and skills in relation to matters other than the letter writer's role as an investment adviser). *See also* Guidance on the Testimonial Rule and Social Media, Division of Investment Management Guidance Update No. 2014-04 (Mar. 2014) ("IM Staff Social Media Guidance") (withdrawing staff position in the Gallagher Staff No-Action Letter). *See infra* section II.J.

The definitions of testimonial and endorsement under the final rule also include solicitation and referral activities drawn from the proposed definition of solicitor.[132] After considering comments on the overlapping scope of testimonials, endorsements, and solicitations under the proposed advertising and solicitation rules, we are adding solicitation activities to the definitions of testimonial and endorsement. The definition of testimonial includes any statement by a current client or private fund investor that directly or indirectly solicits any investor to be the adviser's client or a private fund investor, or refers any investor to be the adviser's client or a private fund investor. The definition of endorsement includes any such statements by a person other than a current client or private fund investor. This change will address compensated testimonials and endorsements under one rule with one set of conditions. For example, a person providing an endorsement or testimonial under the final rule might be a firm that solicits for an adviser (such as a broker-dealer or a bank), an individual at a soliciting firm who engages in solicitation activities for an adviser (such as a bank representative or an individual registered representative of a broker-dealer), or both. Other examples could be an unaffiliated fund-of-funds or a feeder fund that solicits investors in an underlying fund or a master fund, respectively.

b. *Cash and Non-Cash Compensation*

The second prong of the final marketing rule's definition of advertisement is triggered by any form of compensation – whether cash or non-cash – that an adviser provides, directly or indirectly, for an endorsement or testimonial. This mirrors the types of compensation that we stated would trigger the proposed solicitation rule and the proposed advertising rule's

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132 Final rule 206(4)-1(e)(5)(ii) and (iii), and (e)(17)(ii) and (iii). *See also* proposed rule 206(4)-3(c)(4) (proposing to define "solicitor" as "any person who, directly or indirectly, solicits any client or private fund investor for, or refers any client or private fund investor to, an investment adviser"). Both the proposal's definition of "solicitor" and the final rule's inclusion of solicitation and referral activities are drawn from the current cash solicitation rule's definition of "solicitor," with the exception that the current rule does not apply to solicitation of private fund investors. *See* rule 206(4)-3(d)(1).

compensation disclosure requirement in connection with a testimonial, endorsement, or third-party rating.[133] As we stated about both proposed rules, compensation an adviser provides, directly or indirectly, for these activities can incentivize a person to provide a positive statement about, solicit an investor for, or refer an investor to, the investment adviser.[134] Therefore, we believe that the marketing rule's protections should apply.

Some commenters agreed that non-cash compensation creates the same conflicts of interest as cash compensation for solicitation.[135] These commenters also agreed that investors should be made aware of the solicitor's conflict of interest regardless of the form of compensation. Other commenters, however, raised concerns about extending the rule to cover certain forms of non-cash compensation, such as gifts and entertainment,[136] or non-transferable advisory fee waivers in connection with refer-a-friend arrangements.[137] Some commenters argued that the final rule should only apply to solicitations for which the adviser provides incentive-based compensation tied to the funding of an advisory account and the solicitation

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133 *See* 2019 Proposing Release, *supra* footnote 7, at section II.A.4 and II.B.2 and text accompanying n.172.

134 *See id*. at n.372. The proposed solicitation rule would have applied to an adviser's direct and indirect compensation to a solicitor for any solicitation activities. *See* proposed rule 206(4)-3(a). The current cash solicitation rule also covers direct and indirect cash compensation. *See* rule 206(4)-3(a). Similarly, our proposed advertising rule would have required disclosure, if applicable, that cash or non-cash compensation has been provided by or on behalf of the adviser in connection with obtaining or using the testimonial or endorsement. *See* proposed rule 206(4)-1(b)(1)(ii).

135 *See* Consumer Federation Comment Letter; Mercer Comment Letter.

136 *See* MFA/AIMA Comment Letter I; MMI Comment Letter (stating that the rule should not apply to an adviser that sends a gift to a third-party adviser or broker-dealer with which it routinely does business, and such third party completely unrelatedly refers a client to the adviser, unless the third party has a reasonable expectation that it will receive some form of compensation from the adviser in exchange for that referral).

137 *See* IAA Comment Letter (also recommending that the rule exclude refer-a-friend programs that involve a small amount of compensation per referral). While the final marketing rule will apply to all compensated refer-a-friend programs (regardless of the form of compensation), we expect that many advisers that engage in these programs will fall under the *de minimis* exemption, and be subject to fewer conditions than other compensated testimonials and endorsements. *See infra* footnote 481.

activities are directed at specific clients.[138] Commenters generally opposed applying the proposed solicitation rule to communications to investors in private funds, which we address below.[139]

Forms of compensation under the final marketing rule will include fees based on a percentage of assets under management or amounts invested, flat fees, retainers, hourly fees, reduced advisory fees, fee waivers, and any other methods of cash compensation, and cash or non-cash rewards that advisers provide for endorsements and testimonials, including referral and solicitation activities.[140] They also include directed brokerage that compensates brokers for soliciting investors,[141] sales awards or other prizes, gifts and entertainment, such as outings, tours, or other forms of entertainment that an adviser provides as compensation for testimonials and endorsements. In addition, compensated endorsements and testimonials may or may not be contingent on the endorsement or testimonial resulting in a new advisory relationship or a new investment in a private fund. We believe that non-cash compensation, including forms of entertainment, can incentivize persons to provide a positive statement about an adviser, or make a referral or solicitation on an adviser's behalf and should be included in the rule to make clients

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138 *See* SIFMA AMG Comment Letters I & III; FSI Comment Letter.

139 *See infra* section II.A.4.

140 *See* 2019 Proposing Release, *supra* footnote 7, at nn.357 and 358 and accompanying text (discussing, for example, refer-a-friend programs).

141 Advisers are currently required to disclose to clients in the Form ADV brochure if they consider, in selecting or recommending broker-dealers, whether they or a related person receives client referrals from a broker-dealer or third party. As proposed, broker-dealers or dual registrants that receive brokerage for solicitation of client accounts in wrap fee programs that they do not sponsor will be subject to the final marketing rule if they solicit those clients to participate in the wrap fee program. *See* 2019 Proposing Release, *supra* footnote 7, at section II.B.2

aware of such incentive. Whether an adviser provides cash or non-cash compensation in exchange for a testimonial or endorsement depends on the particular facts and circumstances.[142]

Some commenters requested that we exclude training or meetings that educate solicitors about the adviser's services, even if there are some incidental benefits associated with such training.[143] We continue to believe, as we stated in the 2019 Proposing Release, that attendance at training and education meetings, including company-sponsored meetings such as annual conferences, will not be non-cash compensation, provided that attendance at these meetings or trainings is not provided in exchange for solicitation activities.[144]

Some commenters also raised concerns about potentially conflicting regulations for advisers dually registered as broker-dealers with respect to the inclusion of sales awards as non-cash compensation under the proposed solicitation rule.[145] While we acknowledge that other Commission rules for broker-dealers address concerns underlying non-cash compensation in the context of recommendations, the final marketing rule covers a broader range of activities and types of promoters.[146] Thus, we do not believe that an exemption for sales awards or contests

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142 Although commenters did not specifically address to what extent compensation paid to an adviser's personnel, such as an employee, would implicate the proposed solicitation rule, we are clarifying that compensation for purposes of prong two of the definition of advertisement will not include regular salary or bonuses paid to an adviser's personnel for their investment advisory activities or for clerical, administrative, support or similar functions.

143 *See, e.g.*, MMI Comment Letter; MFA/AIMA Comment Letter I (discussing training for certain fund-of-funds arrangements); SIFMA AMG Comment Letter III (encouraging the Commission to draw from a FINRA 2016 proposal relating to non-cash compensation, which the commenter states includes conditions such as prior approval, attendance not being preconditioned on the achievement of certain sales targets, appropriate location (whether an office or other facility) and no payment for additional guests).

144 *See* 2019 Proposing Release, *supra* footnote 7, at n.360.

145 *See* SIFMA AMG Comment Letters I & III (requesting alignment with FINRA's 2016 non-cash compensation rule proposal); FSI Comment Letter.

146 *See, e.g.*, Regulation Best Interest, Release No. 34-86031 (June 5, 2019) [84 FR at 33400 (July 12, 2019)] ("Regulation Best Interest Release") (adopting rule 15l-1 under the Exchange Act, requiring broker-dealers to establish written policies and procedures reasonably designed to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities

from the final marketing rule would be appropriate on these grounds. As discussed further below, however, we are adopting a partial exemption for broker-dealers from the rule's disqualification provisions. We are also adopting partial exemptions from the disclosure provisions when a broker-dealer provides a testimonial or endorsement to a retail customer that is a recommendation subject to Regulation Best Interest ("Regulation BI") under the Securities Exchange Act of 1934 (the "Exchange Act") and from certain disclosure requirements when a broker-dealer provides a testimonial or endorsement to a person that is not a retail customer (as that term is defined in Regulation BI).[147]

Other commenters stated non-cash compensation could capture benefits that advisers provide in the ordinary course of business unrelated to any solicitation activity.[148] Relatedly, some commenters considered our proposed view of "indirect" compensation overly broad, particularly with respect to non-cash compensation.[149] These commenters recommended that we apply the final rule only to compensation an adviser provides to a solicitor after its solicitation activities, unless the solicitation agreement between the adviser and solicitor specifically includes compensation provided prior to the solicitation; or replace the solicitation rule's reference to compensation that an adviser provides "indirectly" with compensation that is direct

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or the sale of specific types of securities within a limited period of time, noting that these compensation practices create high-pressure situations for associated persons to increase the sales of specific securities or specific types of securities within a limited period of time and thus compromise the best interests of their retail customers). The policies and procedures required thereunder must also be reasonably designed to identify and mitigate any conflicts of interest associated with the broker-dealer's recommendations to retail customers that create an incentive for the broker-dealer's associated persons to place their interest or the interest of the broker-dealer ahead of the retail customer's interest. *Id*.

147 *See id*. Regulation BI defines a retail customer as a "natural person, or the legal representative of such natural person." *See id*., at 768.

148 *See, e.g.*, MFA/AIMA Comment Letter I; Fidelity Comment Letter; Fried Frank Comment Letter; IAA Comment Letter; Mercer Comment Letter; SIFMA AMG Comment Letter I.

149 *See, e.g.,* SIFMA AMG Comment Letters I & III; FSI Comment Letter.

or "in connection with solicitation activities."[150] Others expressed concerns that, under our proposed solicitation rule, every mutually beneficial arrangement between an investment adviser and a potential facilitator of client relationships would be subject to scrutiny for indicia of *quid pro quo* solicitation.[151]

We believe the timing of compensation relative to an endorsement or testimonial is relevant in determining whether an adviser is providing compensation for the testimonial or endorsement. In addition, we believe that there will be a mutual understanding of a *quid pro quo*, whether explicit or inferred based on facts and circumstances, for most compensated endorsements or testimonials.[152] However, we decline to draw bright lines around either the timing of the compensation or the establishment of a mutual understanding. We believe such bright lines would unnecessarily limit the final rule and would encourage advisers to structure their arrangements to avoid application of the rule in situations where it would otherwise apply. In addition, we believe that in many cases compensation will be in connection with testimonials and endorsements. We decline to remove the word "indirectly" from the rule for the same reasons discussed above.[153]

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150 *See* SIFMA AMG Comment Letter III.

151 *See, e.g.*, MFA/AIMA Comment Letter I; Mercer Comment Letter.

152 We would expect that, where required, the written agreement would be evidence of such a mutual understanding in most circumstances. *See infra* section II.C.3.

153 For example, an adviser will be subject to the rule's provisions for compensated testimonials and endorsements when the adviser's parent company pays a third party to endorse the adviser to the third party's network of members that are prospective clients. *See* final rule 206(4)-1(b). Such indirect compensation could include the adviser's parent company providing representatives to the third party and compensating them to promote the adviser's business.

c. *Activities that Constitute a Testimonial or Endorsement*

Some commenters requested guidance on whether certain activities would constitute solicitation or referral activities under the proposed amendments to the solicitation rule.[154] Since the combined marketing rule includes statements that solicit investors for, or refer investors to, an investment adviser as testimonials or endorsements, we are addressing these comments in the context of these definitions.

For example, some commenters questioned whether lead-generation firms or adviser referral networks (collectively, "operators") would fall into the scope of the rule. One commenter described these operators as networks operated by non-investors where an adviser compensates the operator to solicit investors for, or refer investors to, the adviser.[155] Another commenter described these operators as for-profit or non-profit entities that make third-party advisory services (such as model portfolio providers) accessible to investors, and stated that the operators do not promote or recommend particular services or products accessible on the platform.[156] In both examples, the operator's website likely meets the final marketing rule's definition of endorsement. An operator may tout the advisers included in its network, and/or guarantee that the advisers meet the network's eligibility criteria. In addition, because operators

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154 *See, e.g.*, FSI Comment Letter; SIFMA AMG Comment Letter I; MFA/AIMA Comment Letter I; Fried Frank Comment Letter; IAA Comment Letter.

155 *See* Commonwealth Comment Letter. This commenter stated that such operators typically offer to "match" an investor with an adviser. When an investor clicks on a link, the investor provides information to the operator (*e.g.*, age, investable assets, and goals) and the operator matches the investor to one or more advisers participating in the service. Advisers generally pay a flat fee and/or a per-lead fee to receive matches of potential investors from the operator.

156 *See* MMI Comment Letter (stating that in some cases, the operator charges an administrative or service fee to the investment advisers whose products and services are accessible through the operator).

typically offer to "match" an investor with one or more advisers compensating it to participate in the service, operators typically engage in solicitation or referral activities.[157]

Similarly, a blogger's website review of an adviser's advisory service would be a testimonial or an endorsement under the final marketing rule because it indicates approval, support, or a recommendation of the investment adviser, or because it describes its experience with the adviser.[158] If the adviser directly or indirectly compensates the blogger for its review, for example by paying the blogger based on the amount of assets deposited in new accounts from client referrals or the number of accounts opened, the testimonial or endorsement will be an advertisement under the definition's second prong.[159] Depending on the facts and circumstances, a lawyer or other service provider that refers an investor to an adviser, even infrequently, may also meet the rule's definition of testimonial or endorsement.

On the other hand, where an adviser pays a third-party marketing service or news publication to prepare content for and/or disseminate a communication, we generally would not treat this communication as an endorsement under the second prong of the definition of "advertisement."[160] Similarly, a non-investor selling an adviser a list containing the names and contact information of prospective investors typically would not, without more, meet the definition of endorsement.[161] This activity typically would not fall within the plain text of the definition of endorsement (*e.g.*, the seller does not indicate approval, support, or

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157 *See* final rule 206(4)-1(e)(5)(ii) and (iii) and (17)(ii) and (iii).

158 *See* final rule 206(4)-1(5)(i) and (17)(i).

159 *See* final rule 206(4)-1(e)(1)(ii).

160 However, such a communication would be an advertisement under the first prong of the definition of "advertisement." *See supra* section II.A.2.

161 *See* Nesler Comment Letter.

recommendation of the investment adviser, or describe its experience with the adviser, or engage in the solicitation or referral activities described therein).

One commenter requested an exclusion from the definition of solicitor under the proposed solicitation rule for an investment consultant that administers a RFP to aid one or more investors in selecting an investment adviser or a private fund investment vehicle.[162] The commenter stated that the investor typically hires the consultant (the "agent"), subject to the understanding that the investor will only enter into a transaction with an investment adviser that agrees to pay the expenses of the agent for providing this service.[163] In these circumstances, we do not believe the adviser typically compensates the agent to endorse the adviser because the investor engages the agent to evaluate the adviser based on criteria that the investor provides.[164]

d. *Exclusion for Regulatory Communications; Inclusion of One-on-one and Extemporaneous, Live, Oral Communications*

The second prong of the definition of advertisement excludes any 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.[165] As with the same exclusion in the first prong of the definition, this

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162 *See* IAA Comment Letter (alternately requesting, in the absence of an exclusion, clarification as to status under the proposed solicitation rule). This commenter stated that these agents facilitate submissions by investment advisers in the RFP process and prepare reports for prospective investors regarding investment advisers under consideration. Furthermore, in many cases the adviser must enter into an agreement with the agent to participate in the RFP process.

163 We understand that the consultant is typically not an advisory client of the advisers it selects to participate in the RFP process, and therefore the final rule's testimonial provision would usually not apply.

164 Though a *quid pro quo* is not always determinative of whether the compensation element of this prong of the definition of advertisement is satisfied, these facts suggest a lack of *quid pro quo* and, without more, would not implicate the second prong of the definition. The adviser in this scenario will likely also not implicate the first prong of the definition of advertisement because the adviser is not making a direct or indirect communication to more than one person that offers the investment adviser's investment advisory services with regard to securities to investors. *See* final rule 206(4)-1(e)(1)(i). *See also supra* section II.A.2.

165 *See* final rule 206(4)-1(e)(1)(ii).

exclusion reflects our belief that communications that are prepared as a requirement of statutes, rules, or regulations should not be viewed as advertisements under the rule.

Unlike the first prong of the definition of advertisement, however, this prong does not exclude extemporaneous, live, oral communications or one-on-one communications. These types of communications are precisely what the second prong of the definition seeks to address, along with other types of endorsement and testimonial activities. The current solicitation rule has also addressed these types of communications. In addition, the second prong does not exclude communications that include hypothetical performance information.

Compensated testimonials and endorsements have the potential to mislead given a promoter's financial incentive to recommend the adviser. Without appropriate safeguards, a compensated testimonial or endorsement creates a risk that the investor would mistakenly view the promoter's recommendation as being an unbiased opinion about the adviser's ability to manage the investor's assets and would rely on that recommendation more than the investor otherwise would if the investor knew of the promoter's incentive.

Finally, some commenters requested an exclusion from the proposed solicitation rule for persons registered with the Commission as broker-dealers under the Exchange Act.[166] We continue to believe that the final rule's investor protections should apply to compensated endorsements and testimonials by any person, including a registered broker-dealer. However, we are adopting a partial exemption from the rule's disqualification provisions for certain compensated testimonials and endorsements made by a registered broker-dealer.[167] We also are

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166 *See* Credit Suisse Comment Letter (citing the "robust regulatory framework" already applicable to SEC-registered broker-dealers); MFA/AIMA Comment Letter I.

167 *See infra* section II.C.5.

adopting a partial exemption from the rule's disclosure provisions when a broker-dealer provides a testimonial or endorsement to a retail customer that is a recommendation subject to Regulation BI.[168]

e. *Investment Adviser and Broker-Dealer Status and Registration for Persons who Provide Endorsements or Testimonials*

We proposed to withdraw our position that a solicitor who engages in solicitation activities in accordance with paragraph (a)(2)(iii) of the cash solicitation rule will be, at least with respect to those activities, an associated person of an investment adviser and therefore will not be required to register individually under the Advisers Act solely as a result of those activities (the "1979 position").[169] Although the 1979 position will no longer apply upon the rescission of the current solicitation rule, we are not adopting a similar position with respect to endorsements and testimonials under the final marketing rule.

A promoter may, depending on the facts and circumstances, be acting as an investment adviser within the meaning of section 202(a)(11) of the Act.[170] Investment adviser status and registration questions require analysis of the applicable facts and circumstances, including, for example, whether a person is "advising" others within the meaning of section 202(a)(11) of the Act.[171] A promoter also may be acting as a broker or dealer within the meaning of section

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168 *See id.*

169 *See* 2019 Proposing Release, *supra* footnote 7, at n.346. Two commenters argued that, as a matter of statutory interpretation, solicitors fall within the Act's definition of "person associated with an investment adviser." *See* SIFMA AMG Comment Letter II; Credit Suisse Comment Letter.

170 Depending on the facts and circumstances, a promoter may also be acting as an investment adviser under applicable state law.

171 Commission staff previously stated that a person providing advice to a client as to the selection or retention of an investment manager or managers also, under certain circumstances, would be deemed to be "advising" others within the meaning of section 202(a)(11) of the Act. S*ee* Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Release No. IA-1092 (Oct. 8, 1987) [52 FR 38400 (Oct. 16, 1987)], at footnote 6 and accompanying text. However, solicitation of clients may *not* involve providing investment advice on behalf of an adviser. *See* Release 1633, *supra* footnote 4, at text

3(a)(4) or 3(a)(5) of the Exchange Act, for example, when soliciting investors for, or referring investors to, an adviser or a private fund advised by the adviser. Any promoter must determine whether it is subject to statutory or regulatory requirements under Federal law, including the requirement to register as an investment adviser pursuant to the Act and/or as a broker-dealer pursuant to section 15(a) of the Exchange Act, respectively. If the promoter is a supervised person of the adviser for which it is providing a testimonial or endorsement, the promoter does not need to separately register with the Commission as an investment adviser solely as a result of his or her activities as a promoter.[172] A promoter also must determine whether it is subject to certain state law and certain FINRA rules, including any applicable state licensing requirements applicable to individuals.[173] To be clear, we are *not* making a presumption that a person providing an endorsement or testimonial meets the definition of investment adviser or broker-dealer and must register under the Act or the Exchange Act, respectively. Nor are we making a presumption that such person may or may not be an associated person of a registered investment adviser. Indeed, we agree that some promoters may meet the definition of associated person of

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accompanying n.123. *See also* Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion to the Definition of Investment Adviser, Release No. IA-5249 (June 5, 2019) [84 FR 33669 (July 12, 2019)].

172 An adviser's registration with the Commission covers its supervised persons, provided that their advisory activities are undertaken on the adviser's behalf.

173 Most states impose registration, licensing, or qualification requirements on investment adviser representatives who have a place of business in the state, regardless of whether the investment adviser is registered with the Commission or the state. *See* Staff of the U.S. Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Jan. 2011), available at https://www.sec.gov/news/studies/2011/913studyfinal.pdf, at 86. *See also* rule 203A-3(a)(1) (definition of "investment adviser representative"). In some states, a third-party solicitor will be subject to state qualification requirements to the extent state investment adviser statutes apply to solicitors. *See* Release 1633, *supra* footnote 4, at text accompanying n.125.

an investment adviser depending on the facts and circumstances.[174] Others may not.[175] Under the final marketing rule, if an adviser determines that a person providing an endorsement or testimonial is an associated person, the adviser should have requisite control of such person.[176]

4. Investors in Private Funds

Both prongs of the definition of "advertisement" will expressly include marketing communications to private fund investors. The term "private fund" is defined in section 202(a)(29) of the Advisers Act and means an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 ("Investment Company Act"), but for section 3(c)(1) or 3(c)(7) of that Act. This is consistent with the scope of the proposed amendments to the solicitation rule.[177] We are not adopting the broader scope of the proposed amendments to the advertising rule, which generally would have applied to advertisements sent to investors in "pooled investment vehicles," as defined in rule 206(4)-8 under the Act.[178] In connection with these changes, we have eliminated the need for the proposed exclusion for advertisements, other sales materials, and sales literature of registered investment companies

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174 *See* Nesler Comment Letter (arguing that an SEC-registered adviser should be entitled to treat a non-employee solicitor as an "associated person" as long as the adviser exercises control and supervision over such solicitor in connection with the performance of its solicitation activities).

175 *See* Pickard Djinis Comment Letter (describing that solicitors that perform paid unscripted media campaigns on behalf of advisers, may not be under the adviser's control). Such a paid solicitor may not be a "person associated with the investment adviser," depending on the facts and circumstances.

176 *See* rule 204A-1(a) (requiring adviser codes of ethics that, among other things, require supervised persons to comply with applicable Federal securities laws).

177 *See* proposed rule 206(4)-3(c)(2).

178 *See* proposed rule 206(4)-1(e)(9). *See also* definition of "pooled investment vehicle" in rule 206(4)-8 under the Act.

("RICs") and business development companies ("BDCs") that are within the scope of rule 482 or 156 under the Securities Act of 1933 ("Securities Act").[179]

Although we used different terms in each proposal, the scope of the proposals effectively would have covered only certain communications to private fund investors. In our advertising rule proposal, we included all pooled investment vehicles and then excepted RIC or BDC advertisements that were subject to rule 482 or 156 under the Securities Act.[180] We did not seek to apply the proposed solicitation rule to promotional activity involving RICs and BDCs because we believed that the primary goal of the proposal was already satisfied by other regulatory requirements.[181] Most notably, prospective investors in RICs and BDCs sold through a broker-dealer or other financial intermediary already receive disclosure about the conflicts of interest that may be created due to the fund or its related companies paying the intermediary for the sale of its shares and related services.[182]

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179 Commenters recommended that the final rule exclude all communications to investors in RICs and BDCs because the statutory anti-fraud provisions and other Commission rules apply to these communications. *See, e.g.*, IAA Comment Letter; Comment Letter of the European Fund and Asset Management Association (Feb. 13, 2020) ("EFAMA Comment Letter") (suggesting that the final rule also exclude non-U.S. funds that are publicly offered (including UCITS)); ICI Comment Letter (recommending that the Commission exclude all registered fund communications from the scope of the rule, including sales literature subject to rule 34b-1 under the Investment Company Act and generic advertisements subject to rule 135a under the Securities Act). Given the regulatory framework applicable to communications to investors in RICs and BDCs, we do not believe the additional protections of the Advisers Act marketing rule are necessary.

180 *See* 2019 Proposing Release, *supra* footnote 7, at section II.A.; proposed rule 206(4)-1(e)(9).

181 *See* 2019 Proposing Release, *supra* footnote 7, at section II.B.3.

182 *See* Item 8 of Form N-1A. *See also* FINRA rule 2341(l)(4) (generally prohibiting member firms from accepting any cash compensation from an investment company, an adviser to an investment company, a fund administrator, an underwriter or any affiliated person (as defined in section 2(a)(3) of the Investment Company Act) of such entities unless such compensation is described in a current prospectus of the investment company).

Commenters generally opposed applying the two rules to communications to private fund investors.[183] They stated that existing, general anti-fraud provisions provide sufficient protection and any additional regulation would be unnecessary and duplicative.[184] Other commenters supported explicitly including private funds in the scope of the rules, arguing that doing so would provide important protections to investors in these funds.[185]

We recognize that rule 206(4)-8 prohibits advisers to private funds from making misstatements or materially misleading statements to investors in those vehicles.[186] An adviser's general anti-fraud obligations to investors in private funds under rule 206(4)-8 parallel an adviser's general anti-fraud obligations to all clients and prospective clients under section 206 of the Act. Accordingly, although the final marketing rule overlaps with the prohibitions in rule 206(4)-8 in certain circumstances, just as it overlaps with section 206 with respect to an adviser's clients and prospective clients, we believe it is important from an investor protection standpoint to delineate these obligations to all investors in the advertising context and provide a framework for an adviser's advertisements to comply with these obligations

By including marketing communications to private fund investors, the final rule will provide more specificity (and certainty) regarding what we believe to be untrue or misleading

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183 *See, e.g.,* AIC Comment Letter; MFA/AIMA Comment Letter I; Comment Letter of the National Venture Capital Association (Feb. 14, 2020) ("NVCA Comment Letter"); IAA Comment Letter.

184 *See, e.g.,* AIC Comment Letter (citing rule 206(4)-1(a)(5) and rule 206(4)-8 under the Advisers Act); NVCA Comment Letter (citing rule 156(b)(3)(ii) under the Securities Act).

185 *See, e.g.,* ILPA Comment Letter; SBIA Comment Letter. *See also* Consumer Federation Comment Letter; EFAMA Comment Letter (supporting additional protections for investors in pooled investment vehicles, but seeking an exception for certain non-U.S. domiciled funds).

186 Section 206(4) of the Advisers Act authorizes the Commission to adopt rules and regulations that "define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative." 15 U.S.C. 80b-6(4). *See* rule 206(4)-8(a)(1). We are adopting this rule under the same authority of section 206(4) of the Advisers Act on which we relied in adopting rule 206(4)-8. *See* Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles, Release No. IA-2628 (Aug. 3, 2007) [75 FR 44756 (Aug. 9, 2007)].

statements that advisers must avoid in their advertisements.[187] The general prohibitions, for example, will provide advisers with a principles-based framework to assess private fund advertisements and will provide greater clarity, compared to the anti-fraud provisions of the Act, on marketing practices that are likely misleading.[188] This approach is consistent with some commenters who stated that the Commission should finalize rules in a manner that provides guidance to advisers on how to comply with a principles-based approach without creating overly prescriptive requirements that can be difficult to apply in practice.[189]

We understand that many private fund advisers already consider the current staff positions related to the current advertising rule when preparing their marketing communications.[190] As a result, we believe that our application of the final rule to advertisements to private fund investors would result in limited additional regulatory or compliance costs for many of these advisers.

We also believe that the modifications from the proposal will reduce potential costs and alleviate commenters' concerns regarding the application of the final rule to an adviser's advertisements to private fund investors. For example, the first prong of the definition of advertisement will not include one-on-one communications to private fund investors or

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187 For example, rule 206(4)-8 prohibits investment advisers to pooled investment vehicles from engaging in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle. The final rule will include more specific provisions in the context of advertisements. *See* final rule 206(4)-1(b) through (d). To the extent that an advertising practice would violate a specific restriction imposed by the final rule, rule 206(4)-8 may already prohibit the practice.

188 We recognize that a single investor could invest in both private funds managed by the adviser and other products (*e.g.*, separately managed accounts) managed by the adviser. The final rule would ensure that advisers apply the same principles-based framework across products and services, which could reduce advisers' compliance burdens.

189 *See* MFA/AIMA Comment Letter III. *But see supra* footnotes 183-184.

190 *See* SBIA Comment Letter; NRS Comment Letter.

communications with existing investors; as such, those communications will be subject to rule 206(4)-8 and not the advertising rule.[191] The first prong of the definition of advertisement also excludes live, oral, extemporaneous communications. Further, we are not adopting a requirement for an adviser to pre-review all advertisements prior to dissemination or requirements for retail versus non-retail advertisements, as discussed below.[192] Collectively, we believe these changes appropriately scope advertisements that would be subject to the rule.

Not all communications to private fund investors would be advertisements under the final rule. Most commenters stated that private placement memoranda ("PPMs") should not be treated as advertisements.[193] We agree that information included in a PPM about the material terms, objectives, and risks of a fund offering is not an advertisement of the adviser.[194] Private fund account statements, transaction reports, and other similar materials delivered to existing private fund investors, and presentations to existing clients concerning the performance of funds they have invested in (for example, at annual meetings of limited partners) also would not be considered advertisements under the final rule. However, pitch books or other materials accompanying PPMs could fall within the definition of an advertisement.

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191 These communications also are subject to various statutory and regulatory anti-fraud provisions, such as section 17(a) of the Securities Act, section 10(b) of the Exchange Act, and rule 10b-5 thereunder.

192 *See infra* sections II.E. and II.G. *See also* NYC Bar Comment Letter (discussing the administrative and compliance burdens and costs associated with applying the standards for Retail Advertisements and Non-Retail Advertisements (each as defined below) for private funds under the proposed advertising rule).

193 *See, e.g.*, MFA/AIMA Comment Letter I; AIC Comment Letter; Proskauer Comment Letter.

194 PPMs are subject to the anti-fraud provisions of the Federal securities laws. *See also supra* footnote 88 (discussing an adviser's fiduciary duties). Whether particular information included in a PPM constitutes an advertisement of the adviser depends on the relevant facts and circumstances. For example, if a PPM contained related performance information of separate accounts the adviser manages, that related performance information is likely to constitute an advertisement.

Some commenters sought clarification that due diligence rooms and their contents would not be considered advertisements.[195] While due diligence rooms themselves are not advertisements, it is possible that some of the information they contain could qualify as an advertisement if the materials satisfy the requirements of the advertisement definition.

Some commenters recommended expanding the final rule to other types of unregistered pooled investment vehicles, and one commenter specified which other types of unregistered pooled investment vehicles should be subject to the rule.[196] While these commenters generally supported the idea of extending the scope of the rule, they did not explain why. Accordingly, we believe that the scope of the final rule is appropriate at this time.

A commenter specifically sought confirmation that the proposed rules would not apply to an adviser whose principal office and place of business is outside the United States (offshore adviser) with regard to *any* of its non-U.S. clients even if the non-U.S. client is a fund with U.S. investors.[197] This commenter and others also asked the Commission to clarify the application of the proposals to communications with non-U.S. investors in funds domiciled outside of the United States.[198] We have previously stated, and continue to take the position, that most of the

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195 *See, e.g.*, MFA/AIMA Comment Letter I; IAA Comment Letter; ILPA Comment Letter (seeking clarification that non-promotional material contained in a data room would not be subject to the rule).

196 *See, e.g.,* EFAMA Comment Letter (supporting the Commission's proposal to increase protections to investors in collective investment schemes, but recommending that the Commission exclude (i) non-U.S. domiciled publicly offered, closed-end and open-end investment funds, including UCITS, and (ii) alternative investment funds and other non-U.S. domiciled funds that would be an investment company, as defined in section 3 of the Investment Company Act, but for sections 3(c)(1) or 3(c)(7) of that Act); ILPA Comment Letter (recommending expanding to funds excluded from the definition of investment company by reason of section 3(c)(5) or 3(c)(11) of the Investment Company Act).

197 *See* Sidley Austin Comment Letter; *see also* Registration Under the Advisers Act of Certain Hedge Fund Advisers, Release No. IA-2333 (Dec. 2, 2004) [69 FR 72054, 72072 (Dec. 10, 2004)] ("Hedge Fund Adviser Release").

198 *See* IAA Comment Letter; EFAMA Comment Letter.

substantive provisions of the Advisers Act do not apply with respect to the non-U.S. clients (including funds) of a registered offshore adviser.[199] This approach was designed to provide appropriate flexibility where an adviser has its principal office and place of business outside of the United States.[200] We believe it is appropriate to continue to apply this approach in this context. For an adviser whose principal office and place of business is in the United States (onshore adviser), the Advisers Act and rules thereunder apply with respect to the adviser's U.S. and non-U.S. clients.[201]

B. General Prohibitions

We are adopting, largely as proposed, the general prohibitions of certain marketing practices as a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts. We believe these practices are associated with a significant risk of being false or misleading. We therefore believe it is in the public interest to prohibit these practices, rather than permit them subject to specified conditions. The general prohibitions will apply to all advertisements to the

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199 *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Release No. IA-3222 (June 22, 2011) [76 FR 39645 (July 6, 2011)] (Most of the substantive provisions of the Advisers Act do not apply to the non-U.S. clients of a non-U.S. adviser registered with the Commission.); Hedge Fund Adviser Release, *supra* footnote 197 (stating that the following rules under the Advisers Act would not apply to a registered offshore adviser, assuming it has no U.S. clients: compliance rule, custody rule, and proxy voting rule and stating that the Commission would not subject an offshore adviser to the rules governing adviser advertising [17 CFR 275.206(4)-1], or cash solicitations [17 CFR 275.206(4)-3] with respect to offshore clients); American Bar Association, SEC Staff No-Action Letter (Aug. 10, 2006) (confirming that the substantive provisions of the Act do not apply to offshore advisers with respect to those advisers' offshore clients (including offshore funds) to the extent described in those letters and the Hedge Fund Adviser Release); IM Information Update No. 2017-03.

200 *See* Hedge Fund Adviser Release, *supra* footnote 197 (noting that U.S. investors in an offshore fund generally would not expect the full protection of the U.S. securities laws and that U.S. investors may be precluded from an opportunity to invest in an offshore fund if their participation would result in full application of the Advisers Act and rules thereunder, but that a registered offshore adviser would be required to comply with the Advisers Act and rules thereunder with respect to any U.S. clients it may have).

201 *See, e.g.*, Hedge Fund Adviser Release *supra* footnote 197.

extent that an adviser directly or indirectly disseminates such advertisement. Specifically, in any advertisement, an 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 the 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 by the Commission;

(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.

As noted in the proposal, to establish a violation of the rule, the Commission will not need to demonstrate that an investment adviser acted with scienter; negligence is sufficient.[202]

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[202] *See SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992). As we noted when we adopted rule 206(4)-8, the court in *Steadman* analogized section 206(4) of the Advisers Act to section 17(a)(3) of the Securities

Many commenters supported the prohibitions' principles-based framework.[203] However, other commenters found the proposed general prohibitions confusing and redundant and suggested streamlining them into fewer standards (or eliminating them altogether) and relying on the general anti-fraud standard instead.[204] After considering comments, we are making certain modifications, as discussed below. We continue to believe that prohibiting certain marketing practices is appropriate and that the final provisions provide important requirements for investment advisers and protections for investors. In our view, the general prohibitions provide greater clarity on marketing practices that are likely misleading compared to just relying on the anti-fraud provisions of the Act. We also believe that the general prohibitions we are adopting provide appropriate flexibility and regulatory certainty for advisers considering how to market their investment advisory services.

In applying the general prohibitions, an adviser should consider the facts and circumstances of each advertisement. The nature of the audience to which the advertisement is directed is a key factor in determining how the general prohibitions should be applied.[205] For

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Act, which the Supreme Court had held did not require a finding of scienter (*citing Aaron v. SEC*, 446 U.S. 680 (1980)). *See also Steadman* at 643, n.5. In discussing section 17(a)(3) and its lack of a scienter requirement, the *Steadman* court observed that, similarly, a violation of section 206(2) of the Advisers Act could rest on a finding of simple negligence. *See also* Fiduciary Interpretation, *supra* footnote 88, at n.20.

203 *See, e.g.*, Wellington Comment Letter; ILPA Comment Letter; IAA Comment; NRS Comment Letter; and NAPFA Comment Letter.

204 *See, e.g.*, MFA/AIMA Comment Letter I; Comment Letter of Managed Funds Association and Alternative Investment Management Association (May 8, 2020) ("MFA/AIMA Comment Letter II"). One commenter also argued that withdrawing the SEC staff no-action letters would create confusion and lack of guidance. NYC Bar Comment Letter (citing, for example, Clover Capital Mgmt., Inc., SEC Staff No-Action Letter (Oct. 28, 1986) ("Clover Letter"), Stalker Advisory Services, SEC Staff No-Action Letter (Jan. 18,1994) (Stalker Letter"), F. Eberstadt & Co., Inc., SEC Staff No-Action Letter (July 2, 1978) ("Eberstadt Letter"), TCW Group, SEC Staff No-Action Letter (Nov. 7, 2008) ("TCW Letter"), and Franklin Management, Inc., SEC Staff No-Action Letter (Dec. 10, 1998) ("Franklin Letter"). However, we do not view the principles of the general prohibitions to be substantive departures from the positions in existing staff no-action letters and guidance.

205 The nature of the audience would be relevant if an adviser chooses to tailor the content of an advertisement to a specific audience because the content is not appropriate for a broader audience. FINRA has a similar

instance, the amount and type of information that may need to be included in an advertisement directed at retail investors may differ from the information that may need to be included in an advertisement directed at sophisticated institutional investors.

We discuss below each of the general prohibitions and the comments we received.

1. Untrue Statements and Omissions

As proposed, the final rule will prohibit advertisements that include any untrue statements of a material fact, or that omit a material fact necessary in order to make the statement made, in the light of the circumstances under which it was made, not misleading.[206] One commenter argued that this prohibition would be duplicative of sections 206(1) and (2) of the Advisers Act, which prohibit advisers from "employ[ing] any device, scheme or artifice to defraud any client or prospective client" and "engag[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."[207] However, we view this prohibition as complementary to, rather than duplicative of, the statutory anti-fraud prohibitions cited by the commenter.[208] We continue to believe that this prohibition, together with the other general prohibitions under the rule, is appropriately designed to prevent

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requirement under its General Standards regarding Communications with the Public. *See* FINRA rule 2210(d)(1)(E) ("Members must consider the nature of the audience to which the communication will be directed and must provide details and explanations appropriate to the audience.").

206 Final rule 206(4)-1(a)(1).

207 NYC Bar Comment Letter. This commenter also noted that section 206(4) prohibits investment advisers from "engag[ing] in any act, practice, or course of business which is fraudulent, deceptive, or manipulative."

208 While we acknowledge there may be circumstances that are covered by both the anti-fraud prohibitions and this provision, we believe that this provision helps provide specificity when addressing an adviser's marketing activities. In addition, to the extent possible, this rule can serve as a resource for identifying an adviser's obligations with respect to marketing generally, and thus we believe that retaining this general prohibition will serve to assist advisers in meeting their compliance obligations.

fraud under the Act, specifically in the context of marketing. Moreover, this provision retains the substance of current rule 206(4)-1(a)(5).[209]

As with similar anti-fraud provisions in the Federal securities laws, whether a statement is false or misleading depends on the context in which the statement or omission is made.[210] For example, as under the current rule, advertising that an adviser's performance was positive during the last fiscal year may be misleading if the adviser omitted that an index or benchmark consisting of a substantively comparable portfolio of securities experienced significantly higher returns during the same period. To avoid making a misleading statement, the adviser in this example could include the relevant index or benchmark or otherwise disclose that the adviser's performance, although positive, significantly underperformed the market.[211]

Under the final rule, it would be misleading for an adviser to compensate 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 or private fund investor of the adviser for its advisory services. To avoid making such a statement misleading, the adviser could disclose that the experience does not relate to any advisory services. It would also be misleading for an adviser to use a promoter's testimonial or endorsement that the adviser knows or reasonably should know

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209 Current rule 206(4)-1(a)(5) prohibits an advertisement that contains any untrue statement of a material fact and uses similar wording as other anti-fraud provisions in the Federal securities laws. *See, e.g.*, 17 CFR 240.10b-5; 15 U.S.C. 77q(a)(2); 17 CFR 230.156(a); rule 206(4)-8.

210 When we use the phrase "false or misleading statements" in this release, we are referring to this general prohibition against advertisements that include any untrue statements of a material fact, or omissions of a material fact necessary in order to make a statement, in the light of the circumstances under which it was made, not misleading.

211 Although one commenter stated that an adviser should be required to show returns of an appropriate benchmark for the same periods as presented for the adviser's performance, we do not believe that it is necessary to prescribe such disclosures and that such decisions should be left at the discretion of the adviser, subject to the general prohibitions of the final rule and the general anti-fraud provisions of the Federal securities laws. *See* CFA Institute Comment Letter. Accordingly, we are not requiring the inclusion of a relevant index or benchmark to avoid making any presentation of performance misleading.

to be fraudulent, misleading, or untrue, regardless of whether the adviser compensates the promoter. For instance, an adviser may not provide a testimonial on its website where a client falsely claims that the client has worked with the adviser for over 20 years when the adviser has only been in business for five years.

The current rule contains an explicit prohibition on advertisements that contain statements to the effect that a report, analysis, or other service will be furnished free of charge, unless the analysis or service is actually free and without condition.[212] We continue to believe that this practice will be captured by the final rule's prohibition on untrue statements or omissions. As a result, the final rule will not contain separate explicit prohibitions of such statements. In addition, depending on the disclosures provided and the extent to which an adviser in fact does provide investment advice solely based on such materials, it may be false or misleading under this provision to represent, directly or indirectly, in an advertisement that any graph, chart, or formula can by itself be used to determine which securities to buy or sell.[213]

2. Unsubstantiated Material Statements of Fact

The proposed rule would have prohibited advertisements that include any material claim or statement that is unsubstantiated.[214] Commenters argued that the proposed "substantiation"

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212 *See* current rule 206(4)-1(a)(4); *see also* Dow Theory Forecasts, Inc., SEC Staff No-Action Letter (May 21, 1986) ("Dow Theory Letter") (staff declined to provide no-action recommendation where an offer for "free" subscription was subject to conditions).

213 An adviser's use of graphs, charts, or formulas to represent, directly or indirectly, that such graphs, charts, or formulas can in and of themselves be used to determine which securities to buy or sell, or when to buy or sell them, is explicitly prohibited in the current rule. *See* current rule 206(4)-1(a)(3) (also prohibiting an advertisement from representing, directly or indirectly, that any graph, chart, formula or other device being offered will assist any person in making his own decisions as to which securities to buy, sell, or when to buy or sell them, without disclosing the limitations and difficulties with respect to the use of such a graph, chart, formula or other device).

214 *See* proposed rule 206(4)-1(a)(2).

requirement would be overly burdensome.[215] For example, two commenters argued that it would require advisers to obtain evidence to support every claim or statement in an advertisement out of uncertainty as to what might be "material."[216] Commenters also found the requirement unclear, questioning whether, for example, such a prohibition would effectively foreclose any statements of opinion.[217] We are sensitive to commenters' concerns regarding the burdens and lack of clarity of this proposed provision. As a result, we are making two changes to the requirement.

First, we are limiting the substantiation requirement to matters of material *fact* rather than any material claim or statement. We do not believe that this would be unduly burdensome for advisers as such material statements of fact, as opposed to opinions, should be verifiable. For instance, material facts might include a statement that each of its portfolio managers holds a particular certification or that it offers a certain type or number of investment products. Claims about performance would also be statements about material facts.[218] Conversely, statements that clearly provide an opinion would not be statements of material fact.

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215 *See, e.g.*, MFA/AIMA Comment Letter I (stating that this requirement would greatly increase cost and operational burdens and curb the flow of information to clients and investors); FPA Comment Letter; NVCA Comment Letter; Fried Frank Comment Letter.

216 *See* MFA/AIMA Comment Letter I; Fried Frank Comment Letter.

217 *See, e.g.*, MFA/AIMA Comment Letter I; FPA Comment Letter; Fried Frank Comment Letter.

218 For example, we would view performance returns included in an advertisement to be material statements of fact that an adviser would need a reasonable basis for believing that it will be able to substantiate. Because current rule 204-2(a)(16) already requires the maintenance of records "to support the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any…advertisement," we believe that any recordkeeping burden related to performance information included in an advertisement will not be significantly new or altered. *See* current rule 204-2(a)(16). Final rule 204-2(a)(16) will similarly require advisers to retain records or documents necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts, portfolio or securities recommendations presented in any advertisement. *See* final rule 204-2(a)(16).

Second, we are requiring advisers to have a *reasonable basis* to believe that they can substantiate material claims of fact *upon demand* by the Commission.[219] This change is designed to reduce burdens on advisers and allow them to avoid the need to develop and maintain a file of substantiating materials for every advertisement.[220]

Advisers would be able to demonstrate this reasonable belief in a number of ways. For example, they could make a record contemporaneous with the advertisement demonstrating the basis for their belief.[221] An adviser might also choose to implement policies and procedures to address how this requirement is met. However, if an adviser is unable to substantiate the material claims of fact made in an advertisement when the Commission demands it, we will presume that the adviser did not have a reasonable basis for its belief. We believe that the burden on advisers to have a reasonable basis for believing they will be able to substantiate a material statement of fact upon demand by the Commission is justified by the importance of ensuring that advisers do not advertise material claims of fact that cannot be substantiated and the need to facilitate our staff's examination of advisers.

3. Untrue or Misleading Implications or Inferences

The proposed rule would have prohibited any advertisement that includes an untrue or misleading implication about, or is reasonably likely to cause an untrue or misleading inference

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219 Final rule 206(4)-1(a)(2). Demand by the Commission includes demand by the Commission's examiners or other representatives. The adviser's obligation to produce such materials on demand will last as long as the relevant advertisement needs to be retained under the recordkeeping rule. *See* current rule 204-2(e)(1).

220 *See, e.g.*, MFA/AIMA Comment Letter I; NVCA Comment Letter.

221 Some advisers likely will (and some already do) maintain records to substantiate non-performance material statements of fact included in an advertisement when the advertisement is created; however, this is not required as long as the adviser has a reasonable basis for believing it will be able to substantiate the information upon demand by the Commission.

to be drawn concerning, a material fact relating to an investment adviser.[222] After considering comments, we are adopting this prohibition but modifying it to add the reasonableness standard to "implication," and not only to "inference."[223] Accordingly, the final rule will prohibit an adviser from including, in any advertisement, information that would reasonably be likely to cause an untrue or misleading implication or inference to be drawn concerning a material fact relating to an investment adviser.[224]

One commenter suggested eliminating this prohibition altogether and instead relying on the prohibition against untrue statements or omissions, stating that it is difficult to enforce when something is "implied" or "inferred."[225] However, we continue to believe that this prohibition appropriately addresses certain activities that would not be subject to the first prohibition, such as those raised in previous staff no-action letters.[226] For example, this provision will prohibit an adviser from making a series of statements in an advertisement that literally are true when read individually, but whose overall effect is reasonably likely to create an untrue or misleading

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222 *See* proposed rule 206(4)-1(a)(3).

223 *See* Flexible Plan Investments Comment Letter II.

224 Final rule 206(4)-1(a)(3). An adviser's statements in an advertisement also are subject to section 208(a) of the Act, which generally states that it is unlawful for a registered investment adviser to represent or imply that it has been sponsored, recommended, or approved by any agency of the United States. Section 208(b) of the Act generally states that Section 208(a) shall not be construed to prohibit a person from stating that he is registered with the Commission as an investment adviser if the statement is true and if the effect of his registration is not misrepresented. Nevertheless, an adviser's use of the phrase "registered investment adviser" (or the initials "RIA" or "R.I.A.") to state or imply that it has a level of professional competence, education or other special training could be misleading under the final rule.

225 CFA Institute Comment Letter.

226 *See, e.g.,* Clover Letter (stating the use of performance results in an advertisement in the staff's view would be false or misleading if it implies, or a reader would infer from it, something about the adviser's competence or about future investment results that would not be true had the advertisement included all material facts); Stalker Letter (stating that copies of articles printed in independent publications that contain performance information of an adviser would be prohibited if they implied false or misleading information absent additional facts); Eberstadt Letter (stating that advertisements could be misleading if they imply positive facts about the adviser when additional facts, if also provided, would cause the implication not to arise).

inference or implication about the investment adviser.[227] For instance, if an adviser were to state accurately in an advertisement that it has "more than a hundred clients that have stuck with me for more than ten years," we believe it may create a misleading implication if the adviser actually has a very high turnover rate of clients. Additionally, this provision will prohibit an adviser from stating that all of its clients have seen profits, even if true, without providing appropriate disclosures if it only has two clients, as it may be reasonably likely to cause a misleading inference by potential clients that they would have a high chance of profit by hiring the adviser as well.

Commenters requested more guidance regarding when advertised testimonials would comply with this general prohibition.[228] Two commenters argued that it would effectively eliminate an adviser's ability to use testimonials if advisers had to present negative testimonials alongside positive ones, particularly in the context of online and social media platforms.[229]

We do not believe that the general prohibition requires an adviser to present an equal number of negative testimonials alongside positive testimonials in an advertisement, or balance endorsements with negative statements in order to avoid giving rise to a misleading inference, as certain commenters suggested.[230] Rather, the general prohibition requires the adviser to consider the context and totality of information presented such that it would not reasonably be likely to

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227 *See* In the Matter of Spear & Staff, Inc., Release No. IA-188 (Mar. 25, 1965) (settled order) (the Commission brought an enforcement action against an investment adviser asserting, in part, that the adviser's advertisements, which recounted a number of factually accurate stories highlighting the outstanding investment success of certain selected clients collectively created "illusory hopes of immediate and substantial profit").

228 *See* AIC Comment Letter ("The Proposing Release does not suggest how an adviser may ascertain whether a testimonial is representative of that adviser's investors. Such a determination may require that an adviser poll or survey a material sample of its investors."); IAA Comment Letter; SIFMA AMG Comment Letter I; Comment Letter of Truth in Advertising, Inc. (Feb. 10, 2020) ("TINA Comment Letter").

229 *See* SIFMA AMG Comment Letter II and IAA Comment Letter.

230 *See, e.g.*, IAA Comment Letter; SIFMA AMG Commenter Letter I.

cause any misleading implication or inference. General disclaimer language (*e.g.*, "these results may not be typical of all investors") would not be sufficient to overcome this general prohibition. However, one approach that we believe would generally be consistent with the general prohibitions would be for an adviser to include a disclaimer that the testimonial provided was not representative, and then provide a link to, or other means of accessing (such as oral directions to go to the relevant parts of an adviser's website), all or a representative sample of the testimonials about the adviser.

As discussed in further detail in section II.B.5. below, we believe this provision (along with the other provisions discussed below) will prohibit "cherry picking" of past investments or investment strategies of the adviser – that is, including favorable results while omitting unfavorable ones in a manner that is not fair and balanced.

4. Failure to Provide Fair and Balanced Treatment of Material Risks or Material Limitations

The proposed rule would have prohibited advertisements that discuss or imply any potential benefits connected with or resulting from the investment adviser's services or methods of operation without clearly and prominently discussing associated material risks or other limitations associated with the potential benefits.[231] We are generally retaining this requirement with some modifications in response to comments.[232]

Some commenters suggested eliminating this prohibition, arguing that it is redundant since Form ADV Part 2 already requires the disclosure of material risks.[233] Commenters also expressed concern that this prohibition would expand the amount of required disclosures,

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231 Proposed rule 206(4)-1(a)(4).

232 *See* final rule 206(4)-1(a)(4).

233 *See, e.g.*, Ropes & Gray Comment Letter and MFA/AIMA Comment Letter I.

dramatically lengthen advertisements, and overwhelm the content included in the advertisement.[234] One commenter recommended removing "or imply" from this prohibition, stating that it would be difficult for the Commission staff to prove something is implied.[235] Several commenters requested that the Commission permit the use of hyperlinks and layered disclosures to satisfy the requirement that the necessary disclosures be made "clearly and prominently," arguing that such an approach would be consistent with the Commission's stated goal of modernizing the advertising rule.[236] Commenters also suggested that requiring an adviser to include detailed risk disclosures required under the proposed general prohibition in a clear and prominent manner may not be feasible in certain formats without the use of hyperlinks.[237]

In response to these concerns, we have modified this provision to prohibit advertisements that discuss any potential benefits 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.[238] We continue to believe that advertisements should provide an accurate portrayal of both the risks and benefits of the adviser's services. However, as proposed, the prohibition may have led advisers to provide overly voluminous disclosure of associated material risks, as well as overly inclusive disclosure

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234 *See* MFA/AIMA Comment Letter I.

235 CFA Institute Comment Letter.

236 *See, e.g.,* Fidelity Comment Letter; Ropes & Gray Comment Letter; IAA Comment Letter; Comment Letter of T. Rowe Price (Feb. 10, 2020) ("T. Rowe Price Comment Letter"); LinkedIn Comment Letter; SIFMA AMG Comment Letter II.

237 *See, e.g.*, MFA/AIMA Comment Letter I; LinkedIn Comment Letter; Ropes & Gray Comment Letter.

238 Final rule 206(4)-1(a)(4). For the sake of clarity, the materiality standard will explicitly apply to both the risks and the limitations.

of "other limitations." We believe this could have resulted in lengthy, boilerplate disclosure that could reduce the salience of the risk and limitation information for investors.

Because we are requiring fair and balanced treatment of material risks or material limitations associated with the benefits advertised, we no longer believe the requirement to "clearly and prominently" provide material risk disclosures is necessary.[239] The proposed prohibition was designed to mitigate the risk that an adviser's advertisement might discuss only the benefits of its services but not include sufficient information about the material risks that the client may face. We believe that the requirement to provide benefits and material risks in a fair and balanced manner similarly achieves this goal. In addition, it will promote a more digestible discussion for investors by making clear that advisers need not discuss every potential risk or limitation in detail, but must instead discuss the material risks and material limitations associated with the benefits in a fair and balanced manner.[240]

We expect that this approach will help facilitate layered disclosure. For example, an advertisement could comply with this requirement by identifying one benefit of an adviser's services, accompany the discussion of the benefit with fair and balanced treatment of material risks associated with that benefit within the four corners of that advertisement, and then include a hyperlink[241] to additional content that discusses additional benefits and additional risks of the adviser's services in a fair and balanced manner. So long as each layer of a layered

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239 As we discussed in the proposal, this general prohibition was drawn from FINRA rule 2210's general standards. *See* FINRA rule 2210(d)(1)(D). The final rule's use of "fair and balanced" is more closely aligned with FINRA 2210, and accordingly, we believe that advisers that are familiar with those standards may be able to use that experience as a guide in complying with this requirement.

240 For example, if an adviser states that it will reduce an investor's taxes through its tax-loss harvesting strategies, the adviser should also discuss the associated material risks or material limitations, including that any reduction in taxes would depend on an investor's tax situation.

241 In addition to hyperlinks, advisers may use other tools to provide investors with layered disclosure, including QR codes or mouse-over windows.

advertisement complies with the requirement to provide benefits and risks in a fair and balanced manner, providing hyperlinks to additional content would meet the requirement of this general prohibition. However, an adviser should not use layered disclosure or hyperlinks to obscure important information. For instance, it would not be sufficient to advertise only an adviser's past profits on a webpage and then include a hyperlink to another page that included all material risks and material limitations as that would violate the fair and balanced presentation requirement.

We are also removing the term "imply" from this general prohibition, which a commenter found unclear.[242] Removing the term imply will make this provision more consistent with similar requirements with which many advisers are already familiar.[243] In addition, we believe that the other general prohibitions (including the prohibition on information that could cause a misleading implication or inference to be drawn), address the concerns that led us to include the term imply in this general prohibition at proposal.

We believe this prohibition differs in scope from the disclosures required by Form ADV. For example, Item 8 of Form ADV Part 2A requires material risk disclosures more specifically with respect to investing in securities and certain investment strategies and risks involved. Moreover, an investment adviser must provide its brochure prepared in accordance with Form ADV to its *clients*, but not to *investors* in private funds it manages. The marketing rule's prohibition requires risk disclosures related to any potential benefits advertised to both clients and private fund investors. We believe that providing such disclosures in advertisements is necessary in order to avoid misleading potential investors as well as existing investors in connection with new services or investments.

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242 *See* CFA Institute Comment Letter.

243 *See* rule 156(b)(3)(i); FINRA rule 2210(d)(1).

5. Anti-Cherry Picking Provisions: References to Specific Investment Advice and Presentation of Performance Results

The final rule contains, as proposed, two other provisions designed to address concerns about investment advisers presenting potentially cherry-picked information in advertisements.

a. *References to Specific Investment Advice*

As proposed, the final rule will prohibit a reference in an advertisement to specific investment advice that is not presented in a fair and balanced manner.[244] Commenters supported replacing the current rule's *per se* prohibition against past specific recommendations with this principles-based restriction on the presentation of specific investment advice.[245] One commenter also supported the new fair and balanced standard.[246] However, some commenters requested more guidance on how to satisfy the fair and balanced standard.[247] Other commenters requested clarification that the principles from certain staff no-action letters would not be the sole means to comply with the fair and balanced standard.[248] One commenter asked whether we intend to incorporate the body of judicial or administrative decisions regarding FINRA rule 2210 and other similar provisions.[249]

We continue to believe this limitation requiring advertisements to have only fair and balanced inclusions of, or references to, specific investment advice is appropriate. The factors

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244 *See* final rule 206(4)-1(a)(5).

245 *See, e.g.*, MFA/AIMA Comment Letter I; IAA Comment Letter; T. Rowe Price Comment Letter.

246 NRS Comment Letter.

247 *See, e.g.*, ILPA Comment Letter (requesting clarification in the context of private equity funds); NASAA Comment Letter; Consumer Federation Comment Letter.

248 *See* MFA/AIMA Comment Letter I; T. Rowe Price Comment Letter (noting that an adviser could mention security selections in a fair and balanced manner without complying with past staff positions).

249 *See* NASAA Comment Letter. The phrase "fair and balanced" is used in FINRA rule 2210, which requires, among other things, that broker-dealer communications "must be fair and balanced and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service." *See* FINRA rule 2210(d)(1)(A).

relevant to when an advertisement's presentation of specific investment advice is fair and balanced will vary depending on the facts and circumstances. We provide examples of such factors below to illustrate the principles.[250] While in some cases advisers may wish to consider FINRA's interpretations related to the meaning of "fair and balanced" for issues we have not specifically addressed, FINRA Rule 2210 and its body of decisions are not controlling or authoritative interpretations with respect to our final rule.

i. Examples regarding the presentation of past specific investment advice

An advertisement that references favorable or profitable past specific investment advice without providing sufficient information and context to evaluate the merits of that advice is not fair and balanced. For example, an adviser may wish to share a "thought piece" to describe the specific investment advice it provided in response to a major market event. This would be permissible under the final rule, provided the advertisement included disclosures with appropriate contextual information for investors to evaluate those recommendations (*e.g.*, the circumstances of the market event, such as its nature and timing, and any relevant investment constraints, such as liquidity constraints, during that time).

One practice currently used by advisers is to provide unfavorable or unprofitable past specific investment advice in addition to the favorable or profitable advice.[251] An adviser also

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250 For selecting and presenting performance information, these factors are in addition to the requirements and restrictions on presentation of performance discussed in section II.A.5. *See* final rule 206(4)-1(c). In addition, other provisions of the general prohibitions may prohibit a reference to specific investment advice, depending on the facts and circumstances. *See* 2019 Proposing Release, *supra* footnote 7.

251 As stated in the proposal, an adviser may consider the current rule's required disclosures when furnishing a list of all past specific recommendations made by the adviser within the immediately preceding period of not less than one year. *See* rule 206(4)-1(a)(2). However, the final rule will not require that an adviser include such disclosures, and such disclosures will not be the only way of satisfying paragraph (a)(4).

may consider listing some, or all, of the specific investment advice of the same type, kind, grade, or classification as those specific investments presented in the advertisement.

As an example, an investment adviser might provide a list of certain investments it recommended based upon certain selection criteria, such as the top holdings by value in a given strategy at a given point in time. The criteria investment advisers use to determine such lists in an advertisement, as well as how the criteria are applied, should produce fair and balanced results. We continue to believe that consistent application of the same selection criteria across measurement periods limits an investment adviser's ability to reference specific investment advice in a manner that unfairly reflects only positive or favorable results.[252] For example, in deciding what to include in an advertisement, an adviser may wish to apply non-performance related selection criteria across portfolio holdings, such as listing them on an alphabetical or rotational basis.[253]

Some commenters questioned whether this aspect of the final rule would permit case studies, which are popular in the private equity industry.[254] We believe that case studies and any other similar information about the performance of portfolio companies are specific investment advice, subject to this general prohibition. For example, it would not be fair and balanced for an adviser to present, in an advertisement, case studies only reflecting profitable investments (when

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252 An investment adviser should be mindful of the general prohibitions when selecting the measurement periods as well.

253 Our staff has previously stated that it would not recommend enforcement action under rule 206(4)-1 relating to an advertisement that includes performance-based past specific recommendations based on certain representations, including that the adviser would use objective, non-performance based criteria to select the specific securities that it lists and discusses in the advertisement. *See* Franklin Letter. Although an adviser may find such staff positions helpful in complying with the final rule, the final rule does not include requirements corresponding to the specific representations in the Franklin letter.

254 *See* AIC Comment Letter; ILPA Comment Letter.

there are also similar unprofitable investments). To meet the fair and balanced standard, an adviser may, for example, disclose the overall performance of the relevant investment strategy or private fund for at least the relevant period covered by the list of investments. Case studies that include performance information also will be subject to the final rule's restrictions and requirements for performance advertising.[255]

In determining how to present information in a fair and balanced manner, advisers should consider the facts and circumstances of the advertisement, including the nature and sophistication of the audience. For example, in an advertisement intended for a retail investor, an adviser may include certain disclosures to help the investor understand that past specific investment advice does not guarantee future results such as an explanation of the particular or unique circumstances of the previous investment advice and how those circumstances are no longer relevant. Less detailed disclosure may be needed in an advertisement solely for sophisticated institutional investors, who more likely understand the risks associated with past specific investment advice.

In response to the commenters who asked for clarification that the methods described in past staff no-action letters on presenting past specific recommendations would not be the only way to meet the fair and balanced standard,[256] we are not prescribing any of the factors in those letters under the final rule. While advisers may wish to refer to these letters for examples, we agree with commenters that an adviser may satisfy the fair and balanced standard in other ways.[257]

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255 *See* final rule 206(4)-1(d).

256 *See* MFA/AIMA Comment Letter I; T. Rowe Price Comment Letter.

257 For example, our staff has stated that it would not recommend enforcement action under the current rule with respect to charts in an advertisement containing an adviser's best and worst performers in certain

The final rule applies to any reference in an advertisement to specific investment advice given by the investment adviser, regardless of whether the investment advice is current or occurred in the past. This provision will apply regardless of whether the advice was acted upon, or reflected actual portfolio holdings, or was profitable. In addition, the provision applies to discretionary investments because the adviser is implementing its recommendation or advice in such a context.[258] We continue to believe that including current as well as past references to specific investment advice in the final rule is appropriate because it avoids questions about when a current recommendation becomes past, which arise under the current advertising rule. In addition, we continue to believe that selective references to current investment recommendations in advertisements could mislead investors in the same manner as selective references to past recommendations.

b. *Presentation of Performance Results*

As proposed, the final rule will prohibit an investment adviser from including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced in an advertisement.[259] One commenter supported the proposed prohibition,[260] while two others argued that the fair and balanced standard is subjective and difficult to enforce

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circumstances. *See* the TCW Letter. Our staff has also stated that it would not recommend enforcement action under current rule 206(4)-1 relating to an advertisement that includes performance-based past specific recommendations if the adviser uses objective, non-performance based criteria to select the specific securities that it lists and discusses in the advertisement in certain circumstances. *See* Franklin Letter.

258 We understand there has been confusion under the current advertising rule's prohibition against past specific "recommendations" as to whether an adviser makes a "recommendation" when it implements its strategy in a discretionary account because an adviser would not contact its client to make a recommendation that the client then either chooses to implement or decline. We believe an adviser's recommendation, or investment advice, is implicit in the exercise of discretion.

259 *See* final rule 206(4)-1(a)(6).

260 *See* Ropes & Gray Comment Letter.

in this context.[261] Some commenters requested more guidance by way of example to demonstrate how performance advertising could comply with the fair and balanced standard.[262]

We continue to believe that this prohibition appropriately addresses the concern that an adviser may "cherry-pick" the periods used to generate performance results in advertisements.[263] As with specific investment advice, the factors that are relevant to whether an advertisement's reference to performance information is presented in a fair and balanced manner will vary based on the facts and circumstances. For example, presenting performance results over a very short period of time (*e.g.*, two months), or over inconsistent periods of time, may result in performance portrayals that are not reflective of the adviser's general results and thus generally would not be fair and balanced. Additionally, an advertisement that highlights one period of extraordinary performance with only a footnote disclosure of unusual circumstances that have contributed to such performance may not be fair and balanced, depending on whether there are other sufficient clear and prominent disclosures, as discussed below.[264]

In cases where additional information is necessary for an investor to assess performance results, failure to provide such information in an advertisement is not consistent with the fair and balanced standard. For example, in order to provide investors with a fair and balanced portrayal of its performance results, an adviser should consider providing information related to the state

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261 Consumer Federation Comment Letter; NASAA Comment Letter.

262 CFA Institute Comment Letter; Ropes & Gray Comment Letter; NASAA Comment Letter; ILPA Comment Letter.

263 An advertisement that includes only favorable performance results or excludes only unfavorable performance results may also be "misleading" to the extent that such an advertisement would reasonably be likely to cause an untrue or misleading implication or inference to be drawn concerning the investment adviser that would not be implied or inferred were certain additional facts – *i.e.*, any performance results excluded from the advertisement – disclosed. *See* final rule 206(4)-1(a)(3).

264 *See* Amendments to Investment Company Advertising Rules, Release No. IC-26195 (Oct. 3, 2003) [68 FR 57760 (Oct. 6, 2003)].

of the market at the time, any unusual circumstances, and other material factors that contributed to such performance. In section II.E, we discuss further specific requirements and conditions for portrayals of certain types of performance in advertisements that we are also adopting as part of this final rule.

6. Otherwise Materially Misleading

Finally, we are adopting a catch-all provision, as proposed, that will prohibit any advertisement that is otherwise materially misleading.[265] We did not receive any comments on this catch-all provision. We continue to believe this prohibition will help ensure that materially misleading practices not specifically covered by the other prohibitions will be addressed. For example, if an adviser provided accurate disclosures, but presented them in an unreadable font, such an advertisement would be materially misleading and prohibited under this provision.

Because we are prohibiting a variety of specific types of advertisement practices within the general prohibitions, most of which include an element of materiality, as discussed above, we are focusing the catch-all provision on only those advertisements that are otherwise *materially* misleading. We continue to believe that limiting the catch-all to materially misleading advertisements will be more appropriate within the overall structure of the prohibitions while still achieving our goal of prohibiting misleading conduct that may affect an investor's decision-making process. We also continue to believe that, in light of the rule's prohibition on making untrue statements and omissions of material fact, including "false" is unnecessary in the catch-all provision as it is already covered by another prohibition.[266]

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265 Final rule 206(4)-1(a)(7).

266 *See* final rule 206(4)-1(a)(1).

C. Conditions Applicable to Testimonials and Endorsements, Including Solicitations

1. Overview

Consistent with the proposal, the final rule permits advisers to include testimonials and endorsements in an advertisement, subject to the rule's general prohibitions and additional conditions.[267] These conditions differ depending on whether the testimonial or endorsement is compensated or uncompensated, which is similar to the framework we proposed.[268]

Numerous commenters supported the proposed expansion from the current advertising rule to permit advisers to include testimonials and endorsements in advertisements.[269] Commenters explained that consumer preferences have shifted to rely increasingly on third-party resources to inform purchasing decisions.[270] Other commenters opposed permitting any testimonials or endorsements, paid or unpaid, in adviser advertisements.[271] These commenters were concerned that permitting advisers to advertise paid testimonials and endorsements would increase puffery and cause a "race to the bottom" for advisers seeking paid endorsements.[272]

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267 Statements made by an adviser that would be prohibited under the final rule's general prohibitions of certain marketing practices would also be prohibited in an adviser's advertisement if made by a third party in a covered testimonial or endorsement. For example, as we stated in the Proposing Release, we would generally view an advertisement as unlikely to be presented in a manner that is fair and balanced if it contains a testimonial, endorsement, or third-party rating that references performance information or specific investment advice provided by the adviser that was profitable but is not representative of the experience of the adviser's investors. 2019 Proposing Release, *supra* footnote 7, at section II.A.2.e.

268 Final rule 206(4)-1(b).

269 *See, e.g.*, Consumer Federation Comment Letter; IAA Comment Letter; LinkedIn Comment Letter; Fidelity Comment Letter; TINA Comment Letter.

270 *See* Consumer Federation Comment Letter; IAA Comment Letter.

271 *See* Comment Letter of TABR Capital Management, LLC (Jan. 6, 2020); Comment Letter of the Institute for the Fiduciary Standard (Feb. 10, 2020) ("Fiduciary Institute Comment Letter").

272 *See* NAPFA Comment Letter; Mercer Comment Letter (arguing that permitting paid endorsements will lead to largest advisers vying for endorsements from celebrities and popular "financial gurus").

As discussed above, we have expanded the definitions of both testimonial and endorsement to include certain solicitation activity.[273] This expansion recognizes the overlap between our approach to solicitation under the proposal and compensated testimonials and endorsements.[274] It is also designed to capture solicitation activities that previously have been subject to the cash solicitation rule and subject them to the marketing rule. The final rule includes conditions for an adviser's use of testimonials and endorsements designed to address concerns raised by commenters. These conditions include disclosure requirements to make prospective clients and investors aware of the conflicts of interest associated with testimonials and endorsements and a requirement that an investment adviser have a reasonable basis to believe that the testimonial or endorsement complies with the marketing rule. In addition, because we believe compensated testimonials and endorsements present a heightened risk for conflicts and misleading investors, the final rule will prevent advisers from using certain compensated testimonials and endorsements made by certain "bad actors" and other ineligible persons. The final rule will also require that an investment adviser have a written agreement with certain persons giving a testimonial or endorsement for compensation above the *de minimis* threshold.[275]

2. Required Disclosures

The final rule will require advertisements that include any testimonials or endorsements to provide disclosures of certain information similar to what was proposed under each of the advertising and solicitation rules, subject to certain exceptions, as discussed below. Specifically,

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273 *See supra* section II.A.3.

274 Final rule 206(4)-1(e)(6) and (16).

275 *See* final rule 206(4)-1(b) (imposing disclosure, adviser oversight, and disqualification conditions). This approach derives from the current solicitation rule. *See also* final rule 206(4)-1(b)(4)(i).

the final rule will require that the investment adviser disclose, or reasonably believe that the person giving the testimonial or endorsement discloses, the following at the time the testimonial or endorsement is disseminated:

(i) Clearly and prominently:

(A) That the testimonial was given by a current client or private fund investor, and the endorsement was given by a person other than a current client or private fund investor, as applicable;

(B) That cash or non-cash compensation was provided for the testimonial or endorsement, if applicable; and

(C) A brief statement of any material conflicts of interest on the part of the person giving the testimonial or endorsement resulting from the investment adviser's relationship with such person;

(ii) The material terms of any compensation arrangement including a description of the compensation provided or to be provided, directly or indirectly, to the person for the testimonial or endorsement; and

(iii) A description of any material conflicts of interest on the part of the person giving the testimonial or endorsement resulting from the investment adviser's relationship with such person and/or any compensation arrangement.[276]

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[276] Final rule 206(4)-1(b)(1). We proposed the final disclosure requirements separately under the proposed amendments to the advertising rule and solicitation rule. The proposed advertising rule amendments would have required disclosures that: (1) the testimonial was given by a client or investor, and the endorsement was given by a non-client or non-investor, as applicable; and (2) if applicable, cash or non-cash compensation has been provided by or on behalf of the adviser in connection with obtaining or using the testimonial or endorsement. *See* proposed rule 206(4)-1(b)(1). The proposed amendments to the solicitation rule would have required disclosure of the terms of the compensation arrangement and description of any material conflicts of interest. *See* proposed rules 206(4)-3(a)(1)(iii)(D) and (E).

We are not adopting the proposed requirement under the solicitation rule to disclose the amount of any additional cost to the investor as a result of solicitation for the reasons discussed below.[277] We believe that disclosures are needed to inform and protect investors effectively when they are presented with testimonials and endorsements. We also share the concerns raised by some commenters that permitting paid testimonials and endorsements would increase the likelihood that personal bias will mislead investors.[278] To address these issues in particular, we are adopting two disclosure requirements that we proposed under the solicitation rule – the disclosure of compensation arrangements and material conflicts of interest – under the final rule. We believe that these disclosures will benefit investors by providing them with a fuller context when presented with a testimonial or endorsement, without overly burdening those providing the testimonial or endorsement.

Some commenters suggested that we should align our disclosure approach with FINRA's rule 2210 to ease the compliance burdens of investment advisers that are registered broker-dealers or affiliated with broker-dealers.[279] However, instead of aligning our disclosures with FINRA's, such as FINRA's specific, standardized disclosures in rule 2210(d)(6),[280] we believe the final rule should provide advisers with a broad framework within which to determine how best to present testimonials and endorsements so they are not false or misleading. Accordingly, we are not adopting standardized disclosure requirements under our final rule. As a result,

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277 *See* proposed rule 206(4)-3(a)(1)(iii)(F).

278 *See* NAPFA Comment Letter; Mercer Comment Letter.

279 MMI Comment Letter; Mercer Comment Letter.

280 FINRA's rule 2210(d)(6) requires, among other things, that a testimonial disclose the following: (i) the fact that it may not be representative of the experience of other customers; (ii) the fact that the testimonial is no guarantee of future performance or success; and (iii) if more than $100 in value is paid for the testimonial, the fact that it is a paid testimonial. FINRA rule 2210(d)(6)(B).

dually registered advisers and broker-dealers, that are not subject to the exemptions discussed below, that provide testimonials and endorsements with the disclosures required by FINRA should consider what additional or different disclosures they would need to make to comply with the final marketing rule.[281]

a. *Clearly and Prominently*

The final rule will require that particular disclosures with respect to testimonials and endorsements be made clearly and prominently.[282] The proposed advertising rule would have required clear and prominent disclosure of: (1) whether the testimonial or endorsement was given by a client or investor or a non-client or investor; and (2) if applicable, that compensation was provided by or on behalf of the adviser in connection with the testimonial or endorsement.[283] The proposed solicitation rule would have required that, under the terms of the written agreement, the solicitor or adviser provide the investor at the time of solicitation activities with a separate disclosure that includes, among other matters, the terms of any compensation arrangement, including a description of the compensation provided or to be provided to the solicitor, and a description of any potential material conflicts of interest on the part of the solicitor resulting from the investment adviser's relationship with the solicitor and/or the compensation arrangement.[284] In merging the two rules under the final rule, we have determined

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281 For example, unlike under FINRA rule 2210, an adviser would be required to disclose the material terms of compensation for a testimonial, even where a person receives *de minimis* compensation, under the final marketing rule.

282 *See* final rule 206(4)-1(b)(1)(i). If the promoter provides the disclosures, the investment adviser must reasonably believe that the promoter provides such disclosures clearly and prominently. *See* final rule 206(4)-1(b)(1).

283 *See* proposed rule 206(4)-1(b)(1).

284 *See* proposed rule 206(4)-3(a)(1)(iii).

to preserve that testimonials and endorsements must provide for certain concise disclosures to be made clearly and prominently as well as for certain additional disclosures to be made at the time the testimonial or endorsement is disseminated.

We continue to believe that certain required disclosures should be made clearly and prominently to help prevent misleading testimonials and endorsements.[285] In addition to the two disclosures required under the proposed advertising rule, we also are requiring that a brief statement of any material conflicts of interest on the part of the person giving the testimonial or endorsement be made clearly and prominently. In order to be clear and prominent, the disclosures must be at least as prominent as the testimonial or endorsement. In other words, we believe that the "clear and prominent" standard requires that the disclosures be included *within the testimonial or endorsement*, or in the case of an oral testimonial or endorsement, provided at the same time.[286]

As discussed above, many commenters requested more flexibility with respect to hyperlinked disclosures under the clear and prominent standard.[287] With respect to the disclosures for testimonials and endorsements that are subject to the clear and prominent standard, we believe such disclosures must be provided clearly and prominently within the

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285 We believe this will help reduce the risk of having misleading testimonials or endorsements in addition to the general prohibitions, which prohibit advertisements from being materially false or misleading. *See* 206(4)-1(a).

286 *See infra* section II.C.2.f. (discussing oral testimonials and endorsements). The discussion in this section also applies to other parts of the final rule that include a clear and prominent disclosure standard, including the required disclosures related to third-party ratings and predecessor performance. Accordingly, such required disclosures should be included within the advertisement.

287 *See* section II.B.4. (discussing commenters' concerns with respect to the clear and prominent standard).*See, e.g.*, MMI Comment Letter; T. Rowe Price Comment Letter; Fidelity Comment Letter; IAA Comment Letter.

testimonial or endorsement.[288] Specifically, we believe such disclosures should appear close to the associated statement such that the statement and disclosures are read at the same time, rather than referring the reader somewhere else to obtain the disclosures. In cases in which an oral testimonial or endorsement is provided, it would be consistent with the clear and prominent standard if the disclosures are provided in a written format, so long as they are provided at the time of the testimonial or endorsement.[289] The requirement to provide the disclosures with respect to testimonials and endorsements "clearly and prominently" may necessitate formatting and tailoring based on the form of the communication.[290]

However, after considering comments, we are requiring advisers to provide only certain disclosures regarding testimonials and endorsements clearly and prominently, as discussed in more detail below.[291] We believe that the disclosures required to be provided clearly and prominently are integral to the concerns associated with testimonials and endorsements in an advertisement. Our approach is consistent with the Federal Trade Commission's ("FTC") guidance, which also requires disclosures that are integral to the claim to accompany the claim to

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288 *See* final rule 206(4)-1(b)(1)(i)(A) through (C).

289 Accordingly, in the case of a compensated oral testimonial or endorsement, the adviser may, instead of recording and retaining the entire oral testimonial or endorsement, make and keep a record of the disclosures provided to investors. *See* final rule 204-2(a)(11)(i)(A)(*2*). *See also infra* section II.C.2.f and II.I. (discussing oral testimonials and endorsements). If an adviser or promoter provides an investor with written disclosures in connection with an oral testimonial or endorsement, instead of delivering the disclosures orally, the adviser or promoter should alert the investor to the importance of the disclosures, particularly with respect to the disclosures that must be provided clearly and prominently. *See* final rule 206(4)-1(b)(1)(i). If an adviser did not inform the investor about the importance of such disclosures, it would violate the general prohibition against false or misleading statements. *See* final rule 206(4)-1(a)(1).

290 An advertisement intended to be viewed on a mobile device, for example, may meet the standard in a different way than one intended to be seen as a print advertisement (*e.g.,* a person viewing a mobile device could be automatically redirected to the required disclosure before viewing the substance of an advertisement).

291 *See infra* section II.C.2.a.i. through iii. (discussing status as a client or non-client, fact of compensation, and statement of material conflicts of interest).

prevent deception.[292] We also believe that these disclosures can be provided succinctly within the testimonial or endorsement such that advisers may advertise their services using modern technology and platforms that limit the size or characters of an advertisement. Moreover, we expect that succinctly providing these disclosures will promote their salience and impact. Other required disclosures, which provide investors with additional useful information but that are not integral to the concerns related to these advertisements, may be provided through hyperlinks, in a separate disclosure document or any other similar methods.

i. Status as a Client or Non-Client

Similar to what we proposed under the advertising rule, the final rule will require clear and prominent disclosure that a testimonial was given by a current client or investor, and that an endorsement was given by a person other than a current client or investor.[293] We believe that this disclosure will provide investors with important context for weighing the relevance of the testimonial or endorsement. For example, an investor might reasonably give more weight to a statement made about an adviser by a current investor rather than someone who was never an investor.[294] Additionally, without clearly attributing an endorsement to someone other than an

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[292] *See, e.g.*, Fidelity Comment Letter; IAA Comment Letter; SIFMA AMG Comment Letter II (suggesting that we adopt, or adopt an approach consistent with, the FTC approach to hyperlinks). *See also* Federal Trade Commission, Dot Com Disclosures Guidance Update (Mar. 2013). While the FTC guidance permits the use of hyperlinks, it generally allows the use of hyperlinks to provide disclosures that are "not integral to the triggering claim" and places a number of conditions on the ability to provide hyperlinks.

[293] Final rule 206(4)-1(b)(1)(i)(A). *See* proposed rule 206(4)-1(b)(1)(i). The promoter may be an entity or a natural person.

[294] Client status will be assessed at the time that a testimonial or endorsement is disseminated. However, depending on the facts and circumstances, a former client may be considered a client for these purposes. For example, if a person is giving a statement about his or her recent prior experience with the adviser, the communication could be treated as a testimonial.

investor, the advertisement could mislead investors who may assume the endorsement reflects the endorser's experience as an investor.[295]

The proposed solicitation rule would have required disclosure of the name of the solicitor.[296] However, similar to the proposed advertising rule, the final rule will not require the disclosure of the name of the promoter.[297] We did not receive any comments on the requirement under the proposed solicitation rule to disclose the name of the solicitor. We expect that advisers may still choose to disclose the full name of the promoter because disclosing the name of the promoter could help an investor assess the reputation or other qualifications of the person. However, we believe our final approach is appropriate for privacy reasons and takes into account cases where a promoter may not wish to give his or her name.[298] We also believe that in cases where a name is not provided, the rule's general prohibitions will protect investors from fraudulent or misleading testimonials or endorsements. An investor may also give less weight to that particular testimonial or endorsement.

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295 Testimonials and endorsements are subject to the rule's general prohibitions. Whether a testimonial or endorsement 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 would depend on the facts and circumstances. For instance, it would be misleading for an adviser to provide investors with a testimonial claiming a positive experience with the adviser by a former client, without mentioning that the person has not been a client for 20 years.

296 *See* proposed rule 206(4)-3(a)(1)(iii)(B). The proposed rule would have also required disclosure of the adviser's name. Proposed rule 206(4)-3(a)(1)(iii)(A).

297 Final rule 206(4)-1(b)(1)(i) through (ii). The proposed advertising rule would have only required disclosure of the client or non-client status of the person providing the testimonial or endorsement and whether compensation has been provided for the testimonial or endorsement. *See* proposed rule 206(4)-1(b)(1).

298 In the case of testimonials and endorsements where compensation paid is above the *de minimis* threshold, advisers are required to maintain a written agreement with a promoter. *See* final rule 206(4)-1(b)(2)(ii) and (b)(4)(i). In such cases, the agreement would provide a record of the name of such promoter. *See* rule 204-2(a)(10), which currently requires that advisers retain "[a]ll written agreements (or copies thereof) entered into by the investment adviser with any client or otherwise relating to the business of such investment adviser as such."

ii. Fact of Compensation

Similar to what we proposed under the advertising rule, the final rule will require clear and prominent disclosure that cash or non-cash compensation was provided for the testimonial or endorsement, if applicable.[299] Similar to the disclosure of a promoter's status as a current investor or person other than a current investor, we continue to believe that this disclosure will provide investors with important context for weighing the relevance of the testimonial or endorsement. Two commenters specifically supported requiring advisers to disclose whether they paid for testimonials or endorsements under the proposed advertising rule.[300] One of these commenters stated that without requiring clear and prominent disclosure that a particular testimonial or endorsement is effectively a "paid-for advertisement," investors would not be able to determine whether they are consuming an authentic, unbiased review of the adviser.[301] We agree, and we believe that this simple but clear disclosure is one that is both beneficial for investors and easy to implement for advisers, including on space-constrained platforms. For example, when providing a testimonial or endorsement on a social media platform, an adviser must clearly and prominently label the testimonial or endorsement as being a paid testimonial or endorsement.

iii. Statement of Material Conflicts of Interest

The final rule will require clear and prominent disclosure of a brief statement of any material conflicts of interest on the part of the promoter resulting from its relationship with the investment adviser.[302] Similar to the other disclosures subject to the clear and prominent

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299 Final rule 206(4)-1(b)(1)(i)(B). *See* proposed rule 206(4)-1(b)(1)(ii).

300 Consumer Federation Comment Letter; SBIA Comment Letter.

301 Consumer Federation Comment Letter.

302 Final rule 206(4)-1(b)(1)(i)(C).

standard, we expect this disclosure to be succinct. For example, it would be sufficient for an adviser to simply state that the testimonial or endorsement was provided by an affiliate of the adviser, or that the promoter is related to the adviser, if this relationship is the source of the conflict.[303]

We believe the required disclosures result in information that informs and protects investors, yet can be provided succinctly within the testimonial or endorsement. We also believe this form of layered disclosure enhances the salience of this information and may help investors better focus on the presence of conflicts of interest than requiring potentially more lengthy disclosures. We require a fuller description of any material conflicts of interests resulting from the promoter's relationship with the adviser and/or the promoter's compensation arrangement with the adviser as part of the disclosures provided with respect to testimonials or endorsements, but this is not subject to the clear and prominent standard.[304]

b. *Material Terms of Compensation Arrangement*

The final rule will require disclosure of the material terms of any compensation arrangement, including a description of the compensation provided or to be provided, directly or indirectly, to the person for the testimonial or endorsement.[305] This provision is based on the disclosure requirement of the proposed solicitation rule. The proposed solicitation rule would have required the disclosure of the terms of any compensation arrangement, including a description of the compensation provided or to be provided to the solicitor.[306] Some commenters

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303 We expect this brief statement of any material conflicts of interest to be substantially shorter than the description of any material conflicts of interest that is required, as discussed below. *See* final rule 206(4)-1(b)(1)(ii).

304 *See* final rule 206(4)-1(b)(1)(iii).

305 Final rule 206(4)-1(b)(1)(ii).

306 *See* proposed rule 206(4)-3(a)(1)(iii)(D).

stated that the disclosure requirement was overbroad and unclear.[307] For instance, one commenter stated that it is unclear whether an adviser should disclose reimbursing a solicitor for third-party expenses in the solicitation process under this requirement.[308] The final rule requires disclosure of compensation provided, directly or indirectly, for the testimonial or endorsement. If payment of third-party expenses is part of the compensation arrangement for the testimonial or endorsement, then such payment should be disclosed under the final rule.

If a specific amount of cash compensation is paid, the advertisement should disclose that amount.[309] If the compensation takes the form of a percentage of the total advisory fee over a period of time, then the advertisement should disclose such percentage and time period.[310] With respect to non-cash compensation, if the value of the non-cash compensation is readily ascertainable, the disclosures should include that amount. Moreover, if all or part of the compensation, cash or non-cash, is payable upon dissemination of the testimonial or endorsement or is deferred or contingent on a certain future event, such as an investor's continuation or renewal of its advisory relationship, agreement, or investment, then the advertisement should disclose those terms.[311]

In response to this requirement under our proposed solicitation rule, one commenter argued that requiring detailed disclosures about compensation arrangements would result in

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307 *See, e.g.*, Comment Letter of Flexible Plan Investments, Ltd. on proposed solicitation rule (Feb. 10, 2020) ("Flexible Plan Investments Comment Letter I"); Comment Letter of Proskauer Rose LLP (Feb. 10, 2020) ("Proskauer Comment Letter").

308 Flexible Plan Investments Comment Letter I.

309 This is consistent with the Commission's position regarding the disclosure requirements under the existing cash solicitation rule. *See* 1979 Adopting Release, *supra* footnote 3, at text accompanying nn.15 and 16.

310 This is similar to the Commission's position under the existing cash solicitation rule. *See* 1979 Adopting Release, *supra* footnote 3, at text accompanying nn.15 and 16.

311 This is also similar to the Commission's position under the existing cash solicitation rule. *See* 1979 Adopting Release, *supra* footnote 3, at text accompanying nn.15 and 16.

lengthy disclosures that would be confusing for, and irrelevant to, investors.[312] The commenter suggested that the rule require solicitors to disclose only that they are receiving compensation for the solicitation. This commenter stated that this disclosure would adequately alert investors to the inherent conflict of interest associated with such compensation. At the same time, several commenters considered additional compensation information about a compensated solicitor's referral, including the amount paid to the solicitor for referring the adviser, whether there would be any additional cost to the investor, and the solicitor's relationship to the adviser, "very important."[313]

Although we believe that a simple disclosure that compensation was provided is sufficient for purposes of the clear and prominent disclosures, we continue to believe that the disclosure related to the terms of the compensation arrangement help convey to the investor the nature and magnitude of the person's incentive to refer the investor to the adviser.[314] The incentive might vary based on the structure of the compensation arrangement. A promoter that receives a flat or fixed fee from an adviser for a set number of referrals might have a different incentive in referring to the adviser than another that receives a fee, such as a percentage of the investor's assets under management, for each investor that becomes a client of, or a private fund investor with, the adviser. Furthermore, trailing fees (*i.e.*, fees that are continuing) that are contingent on the investor's relationship with the adviser continuing for a specified period of time present additional considerations in evaluating the promoter's incentives. It would be

312 *See* Proskauer Comment Letter.

313 *See* Investment Adviser Marketing Feedback Form.

314 As stated in our proposal, the materiality of the incentive to solicit investors to an investor's evaluation of the referral depends on the type and magnitude of the compensation. We believe that the description of a compensation arrangement will be helpful for investors to consider the types and levels of incentives present. 2019 Proposing Release, *supra* footnote 7, at section II.B.4.

relevant to an investor to know that a promoter continues to receive compensation after the investor becomes a client of, or private fund investor with, the adviser, as well as the period of time over which the promoter continues to receive compensation for such solicitation. A longer trailing period can present a greater incentive to solicit the investor. In addition, if, as part of the compensation arrangement between the adviser and promoter, an investor would pay increased advisory fees for becoming a client as a result of the promoter's testimonial or endorsement, then this information would be relevant so that the investor can make such considerations when choosing an adviser.[315]

After considering comments, we are requiring that the disclosures only include the *material* terms of any compensation arrangement. Accordingly, these disclosures need not include immaterial aspects of a compensation arrangement. These disclosures also need not include detailed information about the calculation of the compensation payable to each person giving a testimonial or endorsement; they need not be lengthy to convey the magnitude and nature of the conflict. In addition, these disclosures should not include all compensation arrangements that an adviser has with any and all promoters, as one commenter suggested, but rather should include only information about the relevant compensation arrangement between an adviser and a specific promoter in order for the disclosure to be effective.[316] As modified, this provision will require disclosures about any compensation arrangement with a promoter *for its testimonial or endorsement*.

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315 If the amount of increased fees for the investor is known or could reasonably be obtained, then such amount should be disclosed as part of this requirement.

316 Proskauer Comment Letter (stating that this requirement would result in "very extensive" disclosures, particularly if an adviser has multiple arrangements with multiple solicitors).

An adviser may arrange to compensate a third-party marketing company to advertise and refer potential clients to the adviser. If the compensation arrangement calls for a percentage of fees collected from the referred clients, then the disclosures should state so and describe what that percentage is. An adviser may also have a directed brokerage arrangement with a third-party brokerage firm, in which the adviser will direct brokerage to the firm as compensation for the firm's solicitation of clients for, or referral of clients to, the adviser.[317] In these cases, the adviser or firm should disclose the material terms of this arrangement, including a brief description of the compensation provided or to be provided to the firm. As part of the disclosure of the material terms of the compensation, the disclosure should state the range of commissions that the firm charges for investors directed to it by the adviser. Furthermore, if the solicitation or referral is contingent upon the firm receiving a particular threshold of directed brokerage (and other services, if applicable) from the adviser, the disclosure should say so. Additional disclosure would be required, for example, if the firm and the adviser agree that as compensation for the firm's endorsement of the adviser, the adviser's directed brokerage activities would extend to other clients such as the solicited client's friends and family.

The final rule will require the advertisement to disclose compensation that the adviser provides directly or *indirectly* to a person for a testimonial or endorsement.[318] For example, if an individual solicits an investor and the adviser compensates a related person of that individual for such solicitation (such as an employer or another entity that is associated with the individual), the adviser or individual will need to include this compensation in its disclosures. If a person, such as a broker-dealer, refers clients to advisers that recommend the broker-dealer's or its affiliate's

317 Such activities will fall under the definition of endorsement.

318 *See* final rule 206(4)-1(e)(1)(ii).

proprietary investment products or recommend products that have revenue sharing or other pecuniary arrangements with the broker-dealer or its affiliate, the disclosures must say so.[319] Regardless of whether the adviser's arrangement is with an individual or the individual's firm, compensation to the firm for any testimonial or endorsement will constitute compensation under the rule, as it would be likely to affect the individual's salary, bonus, commission or continued association with the firm.

c. *Material Conflicts of Interest*

The proposed solicitation rule would have required a description of any potential material conflicts of interest on the part of the solicitor resulting from the investment adviser's relationship with the solicitor and/or compensation arrangement.[320] We have slightly modified this proposed requirement by removing the word "potential" from "potential material conflicts of interest," as discussed in detail below. Accordingly, the final rule will require a description of any material conflicts of interest on the part of the person giving the testimonial or endorsement resulting from the investment adviser's relationship with such person and/or any compensation arrangement.[321]

One commenter to the proposed advertising rule requested that we broaden the disclosure provision and require disclosure of all "material connections," stating that there are types of connections besides the fact of compensation that could "materially affect the weight or

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319 *See also* Fiduciary Interpretation, *supra* footnote 88, at 23 ("an adviser must eliminate or at least expose through full and fair disclosure all conflicts of interest which might incline an investment adviser – consciously or unconsciously – to render advice which was not disinterested.").

320 Proposed rule 206(4)-3(a)(1)(iii)(E).

321 Final rule 206(4)-1(b)(1)(iii). The materiality standard applies to the investor(s) being solicited by the promoter. In other words, if an investor would consider a particular conflict of interest on the part of the promoter to be material to his or her decision to choose an investment adviser, then such conflict of interest should be disclosed.

credibility" of a testimonial or endorsement.[322] With respect to the proposed solicitation rule requirement, some commenters supported making clear to investors that a conflict of interest may result from an adviser's relationship with the solicitor and/or their compensation arrangement.[323] Others stated that the disclosure of potential material conflicts of interest would likely be redundant with the required disclosure of the terms of any compensation arrangement.[324] Commenters also argued that such a requirement would result in disclosure that is too lengthy without much benefit.[325] These commenters stated that registered investment advisers and broker-dealers who act as solicitors are already subject to similar disclosure obligations under Form ADV Part 2 and Regulation BI, respectively.[326]

We believe our modification of removing the word "potential" from the proposed requirement will help reduce the burden on advisers as well as the length of the disclosures without eliminating any material information provided to investors. We do not believe the compensation arrangement disclosure alone is sufficient as it merely implies the conflict. Rather, there should be explicit disclosure that the promoter, due to such compensation, has an incentive to recommend the adviser, resulting in a material conflict of interest. Additionally, we believe a promoter could have other material conflicts of interest based on a relationship with the investment adviser that could affect the credibility of the testimonial or endorsement.

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322 *See* TINA Comment Letter.

323 *See* Proskauer Comment Letter; Mercer Comment Letter.

324 *See, e.g.*, MFA/AIMA Comment Letter I.

325 *See, e.g.*, Fidelity Comment Letter.

326 *See, e.g.*, Fidelity Comment Letter, which also stated that Form CRS would be an additional place where investors may find similar information.

Accordingly, to the extent that there is *any* material conflict of interest, the rule will require a description of such material conflict of interest.

We recognize that persons who are also registered as investment advisers or broker-dealers have other disclosure obligations relating to conflicts of interest, such as the requirements of Form ADV.[327] We do not believe that disclosures provided in Form ADV would sufficiently satisfy this provision. For example, although Form ADV Part 2 requires disclosure of material conflicts of interest, the disclosure required by the form is limited to conflicts related to relationships with specific personnel such as the adviser's supervised persons and related persons.[328] Moreover, we do not believe that an adviser that is acting as a promoter would be required to deliver its Form ADV Part 2 to a person the adviser was soliciting to become a client of another investment adviser. On the other hand, in circumstances where Regulation BI applies to a broker-dealer's activity as a promoter, we believe the Disclosure Obligation under Regulation BI is sufficiently similar to satisfy the disclosure provisions under our final rule.[329]

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327 Such persons would also have disclosure obligations under the anti-fraud provisions of the Federal securities laws. If a person meets the definition of "investment adviser," as defined under section 202(a)(11) of the Advisers Act, such person has a fiduciary duty to clients, regardless of whether the adviser is registered or required to be registered, and is thus liable under the anti-fraud provisions of the Advisers Act and other Federal securities laws for failure to disclose conflicts of interest.

328 *See, e.g.*, Item 4.A. of Form ADV, Part 2 (requires disclosure if a relationship between adviser and supervised person's other financial industry activities creates a material conflict of interest with clients); Item 5.E of Form ADV, Part 2 (requires disclosure of conflict of interest to the extent that the adviser or any of its supervised persons accepts compensation for the sale of securities or other investment products); Item 10.C. of Form ADV, Part 2 (requires description of material conflict of interests with related persons, as defined in Form ADV, and only if the relationship or arrangement with the related person creates a material conflict of interest with clients); Item 10.D. of Form ADV, Part 2 (requires disclosure of material conflict of interest if the adviser receives compensation from or has other business relationships with other advisers).

329 The Disclosure Obligation requires that a broker-dealer disclose in writing all material facts about the scope and terms of its relationship with a retail customer, including the material fees and costs the customer will incur as well as all material facts relating to its conflicts of interest associated with the recommendation, including third-party payments and compensation arrangements. *See* Regulation Best Interest Release, *supra* footnote 146, at 14. *See also infra* section II.C.5. (discussing exemptions).

Accordingly, as discussed below, we are adopting a partial exemption from the final rule's required disclosures in certain circumstances.[330]

We had proposed under the solicitation rule to require disclosure of the amount of any additional cost to the investor as a result of the testimonial or endorsement. We did not receive any comments on this proposed requirement. After further contemplation, we believe that such a requirement under the final rule, which would apply to all testimonials and endorsements, would create burdens that are not commensurate with the benefits of the disclosure and are accordingly eliminating this requirement.[331] Such costs could vary by client and over time, making it difficult for advisers to disclose concisely in an advertisement. Moreover, to the extent that an adviser knows or reasonably should know that an investor would pay increased advisory fees as a result of its compensation arrangement or relationship with a promoter, then such disclosures would be made under another provision of the rule as discussed above.[332]

d. *Reasonable Belief*

Under the final rule, an adviser that does not provide the required disclosures must reasonably believe that the promoter discloses the required information. We proposed a reasonable belief standard under the advertising rule and continue to believe that the standard is appropriate in ensuring that the required disclosures are provided.[333]

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330 *See infra* section II.C.5. (discussing exemptions). To the extent that a broker-dealer's testimonial or endorsement under rule 206(4)-1 is a recommendation to a retail customer of a securities transaction or investment strategy involving securities by a broker-dealer, the Disclosure Obligation under Regulation BI would apply to the broker-dealer's testimonial or endorsement.

331 This will be a change from the current solicitation rule's requirement that the solicitor state whether the client will pay a specific fee to the adviser in addition to the advisory fee, and whether the client will pay higher advisory fees than other clients (and the difference in such fees) because the client was referred by the solicitor. *See* current rule 206(4)-3(b)(6).

332 *See* section II.C.2.b. (discussing material terms of compensation arrangement disclosure).

333 *See* proposed rule 206(4)-1(b)(1) and (2) (each requiring a reasonable belief standard for investment advisers). *See also* proposed rule 206(4)-3(a)(2) (requiring a reasonable basis for believing that solicitor has complied with the written agreement requirement).

To have a reasonable belief, an adviser may provide the required disclosures to a promoter and seek to confirm that the promoter provides those disclosures to investors. For example, if a blogger or social media influencer is endorsing and referring clients to the adviser through his or her website or platform, the adviser may provide such blogger or influencer with the required disclosures and confirm that they are provided appropriately on his or her respective pages. The adviser may choose to include provisions in its written agreement with the promoter, requiring the promoter to provide the required disclosures to investors.[334] The aforementioned ways are only examples of how an adviser may demonstrate that it has a reasonable belief.

e. *Timing of Disclosures*

Under the final rule, the required disclosures with respect to testimonials and endorsements must be delivered at the time the testimonial or endorsement is disseminated.[335] The proposed solicitation rule would have required delivery of a separate solicitor disclosure at the time of any solicitation activities (or in the case of a mass communication, as soon as reasonably practicable thereafter).[336] Given that the final rule requires certain disclosures to be included within the testimonial or endorsement per the clear and prominent standard, rather than delivered separately, as discussed below, we are not adopting the proposed alternative to provide the disclosures as soon as reasonably practicable thereafter in the case of mass communications.

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334 *See* final rule 206(4)-1(b)(2)(ii). To the extent that the promoter's testimonial or endorsement falls under the *de minimis* exemption, advisers would not be required to, but may choose to, enter into a written agreement and include such provisions. Final rule 206(4)-1(b)(2)(ii) and (b)(4)(i).

335 Final rule 206(4)-1(b)(1). This is similar to the existing cash solicitation rule, which requires that the solicitor disclosure be delivered at the time of any solicitation activities. *See* current rule 206(4)-3(a)(2)(iii)(A).

336 Proposed rule 206(4)-3(a)(1)(iii).

We continue to believe the timing of disclosures is important.[337] If the disclosures are not provided at the time the testimonial or endorsement is disseminated, many of the disclosures may not have the same impact on investors.[338] Some commenters to the proposed solicitation rule suggested that the rule require delivery of solicitor disclosure after a prospective client expresses interest in the adviser's services or becomes a client of the adviser, rather than at the time of solicitation.[339] We decline to make this change as we continue to believe these disclosures should be provided at the time of dissemination of the testimonial or endorsement to protect against investor confusion.[340]

f. *No Separate Disclosure Requirement*

We are not adopting the proposed requirement for a separate solicitor's disclosure.[341] In light of the merger of the advertising and solicitation rules, we believe that requiring certain disclosures be provided clearly and prominently within the testimonial or endorsement, and other

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337 The timing for several aspects of the proposed solicitation rule was "at the time" of solicitation. *See* 2019 Proposing Release, *supra* footnote 7, at section II.B.4 (discussing solicitor disclosure), section II.B.5. (discussing written agreement), section II.B.6. (discussing adviser oversight and compliance) and section II.B.7 (discussing disqualification).

338 The current solicitation rule requires that the solicitor deliver the solicitor disclosure "at the time of any solicitation activities." Rule 206(4)-3(a)(2)(ii).

339 *See* IAA Comment Letter; Flexible Plan Investments Comment Letter I ("…delivery should simply be required before the recipient of the solicitation or referral becomes a client of the adviser."); Nesler Comment Letter.

340 The exemption for broker-dealers subject to Regulation BI would allow for the related disclosures to be provided prior to or at the time of a recommendation, which may, in some cases, precede a particular testimonial or endorsement for private fund investors. However, unless the broker-dealer had made previous recommendations subject to Regulation BI to the investor, the testimonial or endorsement would likely be the first time the investor is receiving the disclosure. *See* Regulation Best Interest Release, *supra* footnote 146 ("Broker-dealers could meet the Disclosure Obligation by making certain required disclosures of information regarding conflicts of interest to their customers at the beginning of a relationship, and this form of disclosure may be standardized. However, if standardized disclosure, provided at such time, does not sufficiently identify the material facts relating to conflicts of interest associated with any particular recommendation, the disclosure would need to be supplemented so that such disclosure is tailored to the particular recommendation.").

341 *See* proposed rule 206(4)-3(a)(1)(iii). The current solicitation rule also requires delivery of a separate disclosure.

disclosures be otherwise provided, is a more practical and effective approach to informing investors and clients.[342] For example, if an adviser compensates a podcast host for endorsing the adviser in its podcast or as an advertisement during the podcast, including certain of the required disclosures in the podcast itself would give greater prominence to these disclosures and have a greater impact on the potential investor than a separate disclosure document with all of the required disclosures.

Commenters raised concerns about separate solicitor disclosure, noting that the extra documentation would burden investment advisers and overwhelm clients.[343] These commenters also suggested providing flexibility to include the disclosures within other solicitation materials or incorporating the solicitor disclosure into other required disclosures, such as the Form ADV Part 2A. We believe that it would reduce the effectiveness of the disclosures for testimonials and endorsements to allow them all to be included within other solicitation materials given our view that particular disclosures should be provided clearly and prominently.

In a change from the proposal, the final rule will not permit the delivery of the solicitor disclosure as soon as reasonably practicable after the time of any solicitation activities in the case of a mass communication. We believe that the changes under the final rule, such as the elimination of a separate disclosure requirement, eliminate the need to provide a different delivery requirement for the required disclosures. In fact, as noted above, we believe that the required disclosures should be provided at the time that such testimonial or endorsement is disseminated in all cases in order to have a meaningful impact on investors.

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342 *See* final rule 206(4)-1(b)(1)(i). *See also* section II.C.2.a. (discussing clear and prominent standard).

343 *See, e.g.*, MFA/AIMA Comment Letter I; SIFMA AMG Comment Letter I (responding to our request for comment in the Proposing Release as to whether the disclosure should be separate, as proposed).

Under the proposed solicitation rule, either the adviser or the solicitor would have been able to give the disclosures. Commenters generally supported this flexibility.[344] Accordingly, under the final rule, either the adviser or the promoter may provide the required disclosures, subject to the other conditions of the rule.[345] We do not believe the impact of the disclosures will be undermined by permitting either the adviser or the promoter to provide the disclosures.

Our final rule does not require an adviser or promoter to present the required disclosures in paper.[346] One commenter stated that an investor would not grasp the importance of the disclosure if it is not in a paper document.[347] We disagree that electronic or oral communication cannot be effective. We believe that providing flexibility regarding disclosure format is necessary to allow the disclosures to be provided at the time of dissemination of a testimonial or endorsement. We also believe that our adopted disclosure requirements will be adaptable to different types of testimonial and endorsement arrangements. Because disclosures must be clear

344 *See, e.g.*, SIFMA AMG Comment Letter I; IAA Comment Letter.

345 *See* final rule 206(4)-1(b)(1). This is also similar to the proposed advertising rule, which required that the investment adviser clearly and prominently disclose *or* reasonably believe that the testimonial or endorsement clearly and prominently disclosed certain information. *See* proposed rule 206(4)-1(b)(1).

346 If the disclosures are made in writing, we have stated that an "in writing" requirement could be satisfied either through paper or electronic means consistent with existing Commission guidance on electronic delivery of documents. *See* Regulation Best Interest Release, *supra* footnote 146, at text accompanying nn.499-500. If delivery of the required disclosure is made electronically, it should be done in accordance with the Commission's guidance regarding electronic delivery. *See* Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples Under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, Release No. 34-37182 (May 9, 1996) [61 FR 24644 (May 15, 1996)]; *see also* 2000 Release, s*upra* footnote 43; and *see also* 1995 Release, s*upra* footnote 43.

347 *See* NASAA Comment Letter ("Emails, text messages, instant messages, electronic presentations, videos, podcasts, and other modern methods of communications … do not adequately ensure that the investor will read, hear, or understand the importance of the disclosures. Furthermore, these and similar electronic communications are ill-suited to allowing the client to retain a copy of the disclosure in a form and location that can easily be recalled when necessary.").

and prominent, the final rule mitigates concerns that investors will not read or hear electronic disclosures.

Regardless of the format, the adviser will be required, under the Act's books and records rule, to make and keep true, accurate, and current copies of the advertisement.[348] In some circumstances, a copy of the advertisement (*i.e.*, the testimonial or endorsement) may include all of the required disclosures with respect to the testimonial or endorsement.[349] In the case of a compensated oral testimonial or endorsement, the adviser may, instead of recording and retaining the entire oral testimonial or endorsement, make and keep a record of the disclosures provided to investors.[350] Additionally, in response to one commenter,[351] we are clarifying that if an adviser disseminates the required disclosures orally in connection with an oral testimonial or endorsement, the adviser may choose, consistent with applicable law, to record the oral disclosures either prior to or at the time of the dissemination of the testimonial or endorsement.[352]

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348 To the extent that a testimonial or endorsement is disseminated by an adviser indirectly through a third party, an adviser should retain such records as well. *See* final rule 204-2(a)(11)(i)(A), which requires that advisers retain a copy of each advertisement.

349 In addition to the disclosures that are required to be provided clearly and prominently within the testimonial or endorsement, an adviser may choose to provide the other disclosures that are not subject to the clear and prominent standard within the testimonial or endorsement. *See supra* section II.C.2.a. (discussing clear and prominent standard). In circumstances in which an adviser does not provide the other disclosures within the advertisement, an adviser would be required to maintain such disclosures under the recordkeeping rule. *See* final rule 204-2(a)(15)(i).

350 *See* final rule 204-2(a)(11)(i)(A)(*2*). If the required disclosures are provided in a written format, then only the written disclosures would need to be maintained. If the required disclosures are provided orally, however, this record need not necessarily be an actual recording of the oral disclosures provided, but must contain the fact that the oral disclosures were provided, the substance of what was provided, and when.

351 *See* Nesler Comment Letter (asking the Commission to clarify that if disclosures are provided orally, such disclosure in oral form needs to be recorded prior to being provided to a client, and not at the time it is provided to the client).

352 In order to avoid duplicative records, advisers may maintain records of a script or reading of a script of disclosures provided orally.

3. Adviser Oversight and Compliance

All testimonials and endorsements, including those that are compensated and those that are uncompensated and meet prong one of the definition of advertisement, will be subject to an adviser oversight and compliance provision under the final rule.[353] The final rule will require the investment adviser to have: (i) a reasonable basis for believing that any testimonial or endorsement complies with the requirements of the rule, and (ii) a written agreement with any person giving a compensated testimonial or endorsement that describes the scope of the agreed upon activities and the terms of the compensation for those activities when the adviser is providing compensation for testimonials and endorsements that is above the *de minimis* threshold.[354] The oversight requirement we are adopting is similar to the proposed oversight requirement and the current solicitation rule's oversight requirement, but differs in several respects to address commenters' concerns and to reflect the merger of the two rules.[355]

First, the adviser oversight condition will require that the adviser have a reasonable basis for believing that the testimonial or endorsement complies with the requirements of the final rule, rather than the terms of a written agreement as proposed. The proposal would have replaced the solicitation rule's current requirement that the written agreement contain an undertaking by the solicitor to perform its duties under the agreement in a manner consistent with the provisions of the Act and the rules thereunder with the requirement that the solicitor agree to perform its solicitation activities in accordance with sections 206(1), (2), and (4) of the

353 Final rule 206(4)-1(b)(2) and (4).

354 Final rule 206(4)-1(b)(2).

355 *See* current rule 206(4)-3(a)(2)(iii)(C) (requiring that the investment adviser make a bona fide effort to ascertain whether the solicitor has complied with the agreement, and have a reasonable basis for believing that the solicitor has so complied.).

Act.[356] We believe that explicitly requiring advisers to oversee third-party advertisements for compliance with the specific restrictions and requirements in the marketing rule, rather than the broader anti-fraud provisions, more appropriately and precisely addresses the risks posed by such advertisements.

The question of what would constitute a reasonable basis for believing that the testimonial or endorsement complies with the requirements of the final rule would depend upon the facts and circumstances. For instance, in the context of solicitation or referral activity, we believe that, as under the solicitation rule, a reasonable basis could involve periodically making inquiries of a sample of investors solicited or referred by the promoter in order to assess whether that promoter's statements comply with the rule.[357] An adviser could implement policies and procedures to form a reasonable basis for believing the testimonial or endorsement complies with the rule. An adviser also could include terms in its written agreement with the promoter to help form such a reasonable belief. Such agreements could provide mechanisms, for example, to enable advisers to pre-review testimonials or endorsements, or otherwise impose limitations on the content of those statements.[358]

Second, the final rule will require that an adviser pay any compensation over the *de minimis* threshold for a testimonial or endorsement pursuant to a written agreement with the person (aside from certain affiliates) giving the testimonial or endorsement. As proposed, the final rule will require that the written agreement describe the scope of the agreed upon activities

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356 *See* rule 206(4)-3(a)(2)(iii)(C).

357 1979 Adopting Release, *supra* footnote 3, accompanying nn.14 and 15.

358 However, the oversight requirement contains two prongs with separate obligations. Although certain mechanisms in the written agreement, if implemented, could lead the adviser to have a reasonable basis for believing that any testimonial or endorsement complies with the requirements of the rule, having a written agreement by itself would not satisfy the first prong of the oversight requirement.

and the terms of the compensation for those activities. Also as proposed, the final rule will not require that the written agreement require the promoter to deliver the adviser's brochure. We continue to believe that this requirement is duplicative of an adviser's delivery obligation under rule 204-3, the Act's brochure rule.

The final rule, however, will not require that the written agreement require the promoter to deliver a separate written disclosure document as proposed (and as required under the current solicitation rule).[359] Instead we are requiring advertisements that include testimonials or endorsements to provide certain disclosures at the time they are disseminated. Thus, we do not believe the rule should also prescribe in the written agreement that these disclosures are delivered in a separate document.[360] In many cases, we believe the adviser itself will be providing the disclosures. Therefore, this approach will provide the adviser with flexibility in determining whether and how to address these disclosures in its written agreement with a promoter.

Consistent with the final rule's principles-based approach, this streamlined requirement provides more flexibility for an adviser to determine how to tailor its written agreement with its promoters.[361] We believe that advisers are better situated to tailor their oversight approach based on the types of testimonials and endorsements used and the risks in their particular arrangements. For the same reasons, as proposed, the final rule will not incorporate the current solicitation rule's requirement for the adviser to obtain a signed and dated acknowledgment from the client

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359 *See* rule 206(4)-3(a)(2)(iii); *see* proposed rule 206(4)-3(a)(1).

360 *See supra* section II.C.2.f.

361 For example, the written agreement requirement could be met through a written private placement agreement that describes the scope of the agreed upon activities and the terms of the compensation for those activities.

that the client has received the required disclosure.[362] This principles-based approach is consistent with the Act's compliance rule, which requires advisers to adopt and implement compliance policies and procedures, but does not mandate specific elements of such policies and procedures.[363]

One commenter supported a flexible and principles-based approach to adviser oversight.[364] Several commenters supported our proposed approach to streamline the required provisions of the written agreement, such as by removing the provision requiring the solicitor to deliver the adviser's brochure.[365] Another commenter opposed the proposed requirement that the written agreement require the adviser to oversee the solicitor for compliance with the Act's anti-fraud provisions, arguing that this is a regulatory function, not an advisory function.[366] Some commenters also specifically supported removing the current rule's requirement that an adviser obtain a signed and dated acknowledgment.[367] Two commenters, however, opposed the proposed oversight requirement, arguing that it would be burdensome and overbroad to require the adviser to oversee compliance with a written agreement.[368] One commenter argued that it would impose a new monitoring cost on advisers, which they will ultimately pass along to

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362 *See* rule 206(4)-3(a)(2)(iii)(B).

363 Under the compliance rule, each adviser that is registered or required to be registered under the Act is required to adopt and implement written policies and procedures reasonably designed to prevent the adviser and its supervised persons from violating the Advisers Act and the rules thereunder. Rule 206(4)-7. *See* 2019 Proposing Release, *supra* footnote 7, at section II.B.6. Advisers should address their marketing practices in their policies and procedures under the compliance rule.

364 MFA/AIMA Comment Letter I.

365 Mercer Comment Letter; SIFMA AMG Comment Letter II; Nesler Comment Letter; IAA Comment Letter.

366 Mercer Comment Letter.

367 MFA/AIMA Commenter Letter I; SIFMA AMG Comment Letter II.

368 Mercer Comment Letter; SIFMA AMG Comment Letter II.

investors.[369] Another commenter claimed that requiring advisers to contact a sample of clients to ascertain whether solicitors were complying with the written solicitation agreement would be awkward and burdensome.[370]

We believe the modifications to the adviser oversight condition discussed above address commenters' concerns. These changes are consistent with our overall approach to shift to a principles-based rule and leverage the Act's existing compliance rule.[371] We disagree with commenters' assertion that this oversight requirement imposes a novel burden on advisers or is not an advisory function, considering the current solicitation rule's oversight provision and the Advisers Act compliance rule. We continue to believe that the oversight provision will protect investors' interests by requiring advisers to monitor third-party statements that constitute adviser advertisements (whether compensated or uncompensated) for compliance with the rule's requirements, especially when the adviser does not disseminate the testimonials or endorsements directly.[372]

4. Disqualification for Persons Who Have Engaged in Misconduct

The final marketing rule prohibits an adviser from compensating a person, directly or indirectly, for a testimonial or endorsement if the adviser knows, or in the exercise of reasonable care should know, that the person giving the testimonial or endorsement is an ineligible person at the time the testimonial or endorsement is disseminated.[373] Under the final rule, an "ineligible

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369 SIFMA AMG Comment Letter II.

370 Mercer Comment Letter.

371 Rule 206(4)-7. *See* Compliance Programs of Investment Companies and Investment Advisers, Release No. IA-2204 (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)] ("Compliance Program Adopting Release").

372 In addition, any endorsements and testimonials by third parties that are advertisements, or are part of an advertisement, will be subject to the recordkeeping obligations of rule 204-2, as discussed below. *See infra* section II.I.

373 Final rule 206(4)-1(b)(3).

person" is a person who is subject either to a "disqualifying Commission action" or to any "disqualifying event,"[374] and, as discussed below, certain of that person's employees and other persons associated with an ineligible person.

The final marketing rule's disqualification provisions follow a structure similar to the proposed solicitation rule's disqualification provisions, with the following changes. First, to reflect the incorporation of solicitation and referral activities into the final marketing rule's definitions of endorsements and testimonials, the final rule applies the disqualification provisions to persons providing compensated testimonials and endorsements (*i.e.*, compensated promoters). Second, under the final rule, certain Commission cease and desist orders will be disqualifying events (rather than disqualifying Commission actions, as proposed), and compensated promoters subject thereto may be eligible for the final rule's conditional carve-out applicable to disqualifying events. Third, the final rule conforms the proposed ten-year lookback period across all disqualifying events, aligning to advisers' disciplinary disclosure reporting on Form ADV Part 1A.[375] Fourth, the final rule's definition of ineligible person will not apply to certain control affiliates of the ineligible person. Fifth, the final rule will exempt from the disqualification provisions compensated promoters that are broker-dealers registered with the Commission in accordance with section 15(b) of the Exchange Act, provided that they are not subject to statutory disqualification as defined in the Exchange Act. It will also exempt any

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374 Final rule 206(4)-1(e)(9). *See* final rule 206(4)-1(e)(3) and (4) for the defined terms "disqualifying Commission action" and "disqualifying event."

375 Commenters' requests for not applying the proposed rule to certain existing solicitation arrangements are addressed in a separate section, below.

person covered by rule 506(d) of Regulation D with respect to a rule 506 securities offering, provided the person's involvement would not disqualify the offering under that rule.[376]

Commenters generally supported the disqualification of compensated promoters that are "bad actors," noting the importance of protecting investors from their influence in soliciting clients or investors for investment advisers.[377] We believe compensated testimonials and endorsements raise the same concerns about misleading investors as compensated solicitations, and the final rule treats solicitations within the scope of the terms testimonial and endorsement. We are therefore adopting a final rule that prohibits advisers from compensating bad actors for testimonials and endorsements, including solicitations.

We did not propose, and we are not adopting, disqualification provisions for providers of *uncompensated* testimonials and endorsements. It has been, and continues to be, our view that the disqualification provisions are needed most where there are financial incentives for a promoter to engage in fraudulent conduct to persuade an investor to hire an investment adviser or invest in an investment adviser's private fund.[378] For testimonials and endorsements that lack financial incentives, we believe the burden of assessing whether a promoter is disqualified would likely not be justified by the risk that the promoter would engage in fraudulent conduct. We believe that the final rule's other provisions applicable to testimonials and endorsements (*i.e.*,

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376 *See* rule 506(d) of Regulation D under the Securities Act ("rule 506(d) of Regulation D"). Consistent with the approach discussed below, the final rule's disqualification provision, paragraph (b)(3), will not disqualify any broker-dealer or any covered person for purposes of the final rule for any matter(s) that occurred prior to the effective date of the rule, if such matter(s) would not have disqualified such person under rule 206(4)-3(a)(1)(ii), as in effect prior to the effective date of the rule. *See infra* section II.C.4.f.

377 *See* NAPFA Comment Letter; NRS Comment Letter; MFA/AIMA Comment Letter I; IAA Comment Letter; SIFMA AMG Comment Letter I; MMI Comment Letter; Consumer Federation Comment Letter. Some commenters, however, disagreed with particular aspects of the proposed disqualification provisions, discussed below.

378 *See* 2019 Proposing Release, *supra* footnote 7, at text accompanying nn.26-27.

required disclosures and adviser oversight and compliance), in combination with the final marketing rule's general prohibitions, are sufficient to address the risks that *uncompensated* testimonials and endorsements may present in misleading investors.

Some commenters recommended that the proposed solicitation rule exempt registered broker-dealers altogether, stating that applying the rule to broker-dealers would result in duplicative regulation.[379] Some also recommended that the Commission conform the final rule to the disqualifying events set forth in rule 506(d) of Regulation D under the Securities Act[380] for solicitors of investors in private funds who would be newly subject to the solicitation rule, or that we provide an exemption from the final rule's disqualification provisions for persons that are subject to rule 506 of Regulation D.[381] They stated that having one set of disqualifying events for solicitors that are subject to both the final solicitation rule and rule 506 of Regulation D would streamline compliance processes for such solicitors.

As discussed below, we agree that registered broker-dealers acting as compensated promoters need not be subject to the disqualification provisions of both the Advisers Act marketing rule and the Exchange Act.[382] Accordingly, the final rule contains an exemption from

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379 *See e.g.*, MFA/AIMA Comment Letter I; Sidley Austin Comment Letter; SIFMA AMG Comment Letter I. *See also infra* section II.C.5, which discusses commenters' concerns about overlapping requirements for broker-dealers, particularly with respect to disclosures. One commenter stated that most solicitors who place private fund interests are broker-dealers already subject to the statutory disqualifications in section 3(a)(39) of the Exchange Act, but did not comment on the comparability of the statutory disqualification provisions. *See* IAA Comment Letter.

380 *See* rule 506(d) of Regulation D.

381 *See* MMI Comment Letter; SIFMA AMG Comment Letter I & III; FSI Comment Letter; Credit Suisse Comment Letter. Another alternative that commenters suggested was codification of existing no-action letters for broker-dealers and other solicitors. *See infra* section II.C.4.e (discussing the final rule's conditional exception from the definition of disqualifying event).

382 *See infra* section II.C.5.c. (discussing that broker-dealers are subject to disqualification for a variety of misconduct under the Exchange Act section 3(a)(39), that the Exchange Act is particularized to broker-dealer activity, and that we believe such disqualification provisions will serve the same policy goal as the disqualification provisions under this rule).

the disqualification provisions for registered broker-dealers, provided they are not subject to a statutory disqualification under the Exchange Act's disqualification provisions. We similarly agree that persons covered by rule 506(d) of Regulation D with respect to a rule 506 securities offering need not be subject to both the disqualification provisions of the Advisers Act marketing rule and the bad actor disqualification provisions of rule 506 of Regulation D with respect to their participation in the offering.[383] Accordingly, the final rule also contains an exemption from the disqualification provisions for any person that is covered by rule 506(d) of Regulation D with respect to a rule 506 securities offering, provided the person's involvement would not disqualify the offering under that rule.[384] This exemption applies to persons covered by rule 506(d) of Regulation D only to the extent they are acting thereunder in a rule 506 securities offering. For example, a broker-dealer acting as a placement agent for a private fund in a rule 506 securities offering that is covered by this exemption will only be covered with respect to the broker-dealer's testimonials and endorsements made in its capacity under rule 506(d) of Regulation D as part of the offering.

While we believe these exemptions will avoid regulatory overlap that would yield little benefit, we recognize that each disqualification regime is unique and will apply differently to compensated promoters regulated thereunder.[385] Because each disqualification regime is

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383 *See id.* (discussing that these covered persons are subject to disqualification for a variety of misconduct under rule 506(d) of Regulation D, that rule 506(d) of Regulation D is particularized to activities in connection with certain securities offerings, and that we believe such disqualification provisions will serve the same policy goal as the disqualification provisions under this rule).

384 Final rule 206(4)-1(b)(4)(iv). *See* rule 506(d)(1) of Regulation D. *See also infra* section II.C.5.

385 For example, the final rule's disqualification provisions and rule 506 of Regulation D apply to certain Commission orders that restrict a person's activities (*e.g.*, supervisory or compliance bars or suspensions), whereas the Exchange Act's disqualification provisions do not. *See, e.g.*, final rule 206(4)-1(e)(3); rule 506(d)(1)(ii); section 3(a)(39) of the Exchange Act. In addition, the Exchange Act disqualification provisions are triggered by activities of employees and other associated persons, similar to the final rule's application to "ineligible persons," but rule 506 of Regulation D is triggered by events involving partners,

particularized to the activity thereunder, our final rule's exemptions defer to these other disqualification provisions where applicable.

a. Knowledge or Reasonable Care Standard

No commenters objected to the proposed solicitation rule's introduction of a knowledge or reasonable care standard for the disqualification provisions, which we proposed to replace the current solicitation rule's strict liability standard.[386] One commenter specifically supported the proposed standard.[387] Others commented on the proposal's requirement that an adviser make the assessment about a solicitor's eligibility status "at the time of solicitation."[388] One commenter supported this timing,[389] while another commenter stated that this timing would present an undue burden on advisers that may interpret the provision as requiring continuous monitoring of their solicitors.[390] Another commenter agreed with the Commission's approach in the proposal to not prescribe the level, method, or frequency of required due diligence.[391]

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directors, and certain officers, but not other employees or associated persons. *See* final rule 206(4)-1(e)(9)(i)(A); rule 506(d)(1); section 3(a)(39)(E) of the Exchange Act. As another example, while the look-back periods under the final rule and the Exchange Act's statutory disqualification extend for ten years, some of the look-back periods under rule 506 of Regulation D extend for ten years, and others extend only for five years. *See, e.g.*, final rule 206(4)-1(e)(4); rule 506(d)(1)(i) and (ii); section 3(a)(39)(F) of the Exchange Act.

386 *See* 2019 Proposing Release, *supra* footnote 7, at text accompanying n.456. Under the proposed solicitation rule, an adviser could not compensate a solicitor, directly or indirectly, for any solicitation activity if the adviser knows, or, in the exercise of reasonable care, should have known, that the solicitor is an ineligible solicitor. *See* proposed rule 206(4)-3(a)(3).

387 *See* NRS Comment Letter.

388 *See* NAPFA Comment Letter; FSI Comment Letter; MFA/AIMA Comment Letter I. Under the proposed solicitation rule, the definition of "ineligible solicitor" meant, in part, "[a] person who *at the time of the solicitation* is subject to a disqualifying Commission action or is subject to any disqualifying event." Proposed rule 206(4)-3(a)(3)(ii)(A).

389 *See* NAPFA Comment Letter.

390 *See* MFA/AIMA Comment Letter I (stating that a requirement to make an assessment at the time of solicitation would exceed the "reasonable care" standard).

391 *See* FSI Comment Letter.

We continue to believe that including a reasonable care standard preserves the benefits of a disqualification provision, while reducing the likelihood that advisers will inadvertently violate the provision (*i.e.*, due to disqualifying events that they would not, even in the exercise of reasonable care, have known existed). Our final marketing rule generally maintains the proposed solicitation rule's knowledge or reasonable care standard with one modification to reflect its application to compensated testimonials and endorsements.[392] Instead of tying the standard to the "time of solicitation," the final marketing rule ties it to the time the compensated endorsement or testimonial is disseminated.[393] We believe this timing is appropriate because it mirrors the timing of the final marketing rule's required disclosures for testimonials and endorsements.[394] Furthermore, we believe that the time of dissemination is often when a compensated testimonial or endorsement by a bad actor could mislead a client or investor. For example, if a person provides a compensated testimonial or endorsement of an adviser in a face-to-face meeting with a potential advisory client, the time of dissemination (*i.e.*, the meeting) is the point at which the client could be misled.

In some instances, an adviser may be obligated to compensate the promoter for a period after the dissemination of a testimonial or endorsement. For example, a promoter may continue to receive trailing compensation as a percentage of a client's assets under management with the adviser for the duration of time that client continues to use the adviser. If a compensated

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392 The proposed solicitation rule defined "ineligible solicitor", in part, as a person who "at the time of the solicitation*"* is subject to a disqualifying Commission action or is subject to any disqualifying event. *See* proposed rule 206(4)-3(a)(3)(ii)(A).

393 *See* final rule 206(4)-1(b)(3). The final marketing rule also moves the timing of the reasonable care requirement to the operative disqualification provision, instead of including it within the definition of "ineligible person." *See id*.

394 Final rule 206(4)-1(b)(1). *See supra* section II.C.2.

promoter was subject to a disqualifying event or disqualifying Commission action at the time of dissemination, but the adviser did not know, or have reason to know, of such event, then the adviser may make trailing payments resulting from such dissemination.[395]

The final marketing rule will not require an adviser to monitor the eligibility of compensated promoters on a continuous basis, as one commenter suggested. The frequency with which an adviser must monitor eligibility and the steps an adviser must take in making this assessment will vary depending on what constitutes the exercise of reasonable care in a particular set of facts and circumstances. Advisers could likely take a similar approach to monitoring promoters as they take in monitoring their own supervised persons, though advisers may assess the eligibility of their supervised persons more frequently in light of their obligations to report promptly certain disciplinary events on Form ADV.[396]

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395 Under the final marketing rule, an adviser may pay trailing compensation for solicitations that were made prior to the marketing rule's effective date, provided the adviser complied with rule 206(4)-3 as in effect at the time. For example, if a solicitor was not disqualified under rule 206(4)-3 at the time of a solicitation, but the solicitor would have been an ineligible person at the time of solicitation under the final marketing rule solely because of a change in the scope of events that trigger disqualification, the adviser may provide trailing compensation. Commenters advocated for this approach. *See* IAA Comment Letter; MMI Comment Letter.

396 Registered investment advisers ascertain their supervised persons' disciplinary history in order to report disciplinary events on Form ADV, which advisers must update by filing additional amendments promptly if the disciplinary information becomes inaccurate in any way. *See* Form ADV: General Instructions. Instruction 4. Certain registered investment advisers are also required to deliver to retail investors a relationship summary disclosing information about the firm. *See* rule 204-5. Form ADV, Part 3 requires that an adviser state "Yes" if it or any of its financial professionals currently disclose, or are required to disclose, disciplinary information in its Form ADV, and that the adviser take certain steps to update its relationship summary and inform the Commission and its retail investors whenever any information in the relationship summary becomes materially inaccurate. *See* Form ADV, Part 3: Instructions to Form CRS, General Instruction 8 and Item 4. In addition, if a person is subject to certain disciplinary events and the Commission has issued an order that, for example, censures or places limitations on the activities of that person, it is unlawful for any investment adviser to permit such a person to become, or remain, a person associated with the investment adviser without the consent of the Commission, if such investment adviser knew, or in the exercise of reasonable care, should have known, of such order. *See* section 203(f) of the Act.

The frequency of inquiry could vary depending upon, for example, the risk that a person could become an ineligible person and the impact of other screening and compliance mechanisms already in place.[397] In some cases where an endorsement or testimonial is posted on a public website and disseminated over a long period, it may not be practical for an adviser to update its inquiry continuously. In this case, we would expect an adviser to update its inquiry into the compensated promoter's eligibility at least annually while the endorsement or testimonial is available to clients and investors in order to demonstrate that it did not know, or have reason to know, that the promoter was ineligible at the time of dissemination.[398] If the adviser has reason to believe that the compensated promoter is an ineligible person, then the exercise of reasonable care would require the adviser to inquire promptly into the promoter's eligibility under the rule.[399]

Like the proposed solicitation rule, the final marketing rule will require that an adviser inquire into the relevant facts; however, it does not specify what method or level of due diligence or other inquiry is sufficient to exercise reasonable care. For example, advisers generally have an in-depth knowledge of their own personnel gained through the hiring process and in the course of the employment relationship. In such circumstances, further steps generally would not be required in connection with a compensated endorsement or testimonial by such personnel. Factual inquiry by means of questionnaires or certifications, perhaps accompanied by contractual

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397 Advisers should address such methods in their policies and procedures under the Act's compliance rule. *See* rule 206(4)-7.

398 However, this adviser would have to conduct its inquiry more often than annually if there is information or other indicators suggesting changes in circumstance that would be disqualifying under the rule.

399 If a promoter notifies an adviser that it is subject to a disqualifying event or disqualifying Commission action, the adviser would have knowledge of the promoter's status as an ineligible person and the final rule would prohibit the adviser from compensating the promoter.

representations, covenants and undertakings, may be sufficient in other circumstances, particularly if there is no information or other indicators suggesting bad actor involvement.

b. *Ineligible Person*

Like the proposed solicitation rule, the final marketing rule applies the definition of ineligible person not only to the person subject to the disqualifying event or disqualifying Commission action, as both terms are discussed below, but also to certain persons associated with an ineligible person.[400] An ineligible person includes a person who is subject to a disqualifying Commission action or is subject to any disqualifying event. It also includes any employee, officer, or director of an ineligible person and any other individuals with similar status or functions within the scope of association with an ineligible person. If the ineligible person is a partnership, the definition includes all general partners. If the ineligible person is a limited liability company managed by elected managers, the definition includes all elected managers. Unlike the proposed rule, the definition does not include persons that directly or indirectly control, or are controlled by, an ineligible person.

One commenter supported the proposed definition of ineligible solicitor.[401] Some commenters, however, expressed concern that the proposed solicitation rule would disqualify solicitors solely because their affiliates are ineligible solicitors, when their affiliates are not involved with or connected to the solicitation.[402] These commenters stated that such potential disqualification would disadvantage larger, more established solicitors that have multiple affiliated entities, and that smaller standalone solicitors would therefore have a competitive

400 *See* final rule 206(4)-1(e)(9). *See also* proposed rule 206(4)-3(a)(3)(ii).

401 *See* NAPFA Comment Letter.

402 *See* Credit Suisse Comment Letter; MFA/AIMA Comment Letter I; IAA Comment Letter.

advantage. They also stated that disqualification by affiliation, as proposed, would disadvantage investors through lack of choice.

After considering comments, we agree that the final rule should not apply to a disqualified person's control affiliates. These affiliates may operate independently from the person providing the compensated testimonial or endorsement, and may be uninvolved with an adviser's arrangement to compensate that person for the testimonial or endorsement. However, any compensation arrangement structured to avoid the final rule's restrictions, depending on the facts and circumstances, would violate section 208(d) of the Act's general prohibitions against doing anything indirectly which would be prohibited if done directly.[403]

Under the final rule's definition of ineligible person, an entity that is not an ineligible person will not become an ineligible person solely because its employee, officer, or director (or an individual with a similar status or functions) is an ineligible person. However, any employee, officer, director, or person with similar status or functions that is an ineligible person may not directly or indirectly receive compensation for a testimonial or endorsement (*e.g.*, by receipt of a share of profits the entity receives from the testimonial or endorsement, or as a bonus tied to the entity's overall profits without setting aside revenue from testimonials and endorsements).[404]

In addition, we are clarifying that, in the case of an entity that is an ineligible person, the final rule's definition of ineligible person will apply to that entity's employees, officers, and directors (and persons with similar status or functions) associated with the ineligible person, but

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403 Section 208(d) of the Act.

404 *See* final rule 206(4)-1(b)(3). This principle also applies if the entity is a partnership, to all general partners; and if the entity is a limited liability company managed by elected managers, to all elected managers.

only within the scope of that association.[405] In some cases, for example, an employee may be associated with two different firms, one of which is an ineligible person and the other is not. Under the final rule, if the employee is not herself an ineligible person, she may conduct compensated testimonial and endorsement activity on behalf of the firm that is not an ineligible person, because she would not be conducting that activity within the scope of her association with the ineligible person.

The final marketing rule adopts, without change from the proposal, the provisions of the definition applying to general partners and elected managers of a partnership and limited liability company, respectively.[406] Commenters did not respond to these aspects of the definition.

c. *Disqualifying Commission Action*

Under the final rule, like the proposed rule, a disqualifying Commission action is any Commission opinion or order barring, suspending, or prohibiting a person from acting in any capacity under the Federal securities laws.[407] Commenters stated that advisers have historically engaged solicitors that are subject to Commission actions or orders that address disqualifying

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405 Final rule 206(4)-1(e)(9) (defining ineligible person, in part, as "[a] person who is subject to a disqualifying Commission action or is subject to any disqualifying event," and "[a]ny employee, officer, or director of the ineligible person and any other individuals with similar status or functions within the scope of association with the ineligible person.")

406 Final rule 206(4)-1(e)(9). *See also* proposed rule 206(4)-3(a)(3)(ii).

407 Final rule 206(4)-1(e)(3). The imposition of a bar, suspension, or prohibition may appear in an opinion of the Commission or in an administrative law judge initial decision that has become final pursuant to a Commission order. In both cases, such a bar, suspension, or prohibition is a disqualifying Commission action under the final rule. In addition to associational bars or suspensions, these include, for example, officer and director bars imposed in Commission cease and desist orders, limitations on activities imposed under section 203(e) or 203(f) of the Advisers Act that prevent persons from acting in certain capacities, penny stock bars imposed under section 15(b) of the Exchange Act, and investment company prohibitions imposed under section 9(b) of the Investment Company Act. In addition, under the final rule, if the Commission prohibits or suspends an individual from acting in a specific capacity under the Federal securities laws (*e.g.*, as a supervisor or compliance officer), such prohibition will be a disqualifying Commission action, even if the Commission has not barred or suspended the individual from association with an investment adviser, broker-dealer or other registrant.

events under the cash solicitation rule, but that do not bar, suspend, or prohibit the solicitor from acting in any capacity under the Federal securities laws.[408] These commenters requested that we continue to permit advisers to engage solicitors subject to these types of Commission actions to avoid disturbing the existing balance between protecting investors and aiding market efficiency.

We agree with commenters that the final rule should permit advisers to engage compensated solicitors and other compensated promoters that are subject to certain Commission orders, provided that the Commission has not barred, suspended, or prohibited the compensated promoter from acting in any capacity under the Federal securities laws, and subject to conditions under the final rule. We are therefore relocating within the rule – from the definition of disqualifying Commission action, as proposed, to the definition of disqualifying event – Commission cease and desist orders from committing or causing a violation or future violation of any scienter-based anti-fraud provision of the Federal securities laws, and Section 5 of the Securities Act.[409] This change will subject these orders to the final rule's conditional carve-out, if available, which aligns the rule's treatment of these orders with the final rule's other disqualifying events. We believe that these cease and desist orders could call into question a person's trustworthiness or ability to act as a compensated promoter,[410] and that the final rule's conditional carve-out, discussed below, will address the risks of compensating a promoter subject to such an order. No one commented specifically on the proposed inclusion of this provision.[411]

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408 *See* Mercer Comment Letter; Credit Suisse Comment Letter. *See infra* section II.C.4.e (discussing the final marketing rule's conditional carve-out).

409 *See* final rule 206(4)-1(e)(4)(v). *See also* proposed rule 206(4)-3(a)(3)(iii)(A)(1).

410 *See* 2019 Proposing Release, *supra* footnote 7, at text accompanying n.467.

411 *But see supra* footnote 381 (discussing that some commenters advocated for conforming the rule's disciplinary provision with rule 506 of Regulation D under the Securities Act, which includes similar cease

d. *Disqualifying Event*

The final rule's disqualifying events are substantially similar to what we proposed, except for conforming the look-back period across all disqualifying events to ten years prior to the time the person disseminates the testimonial or endorsement. In addition, as noted above, we are including Commission cease and desist orders from committing or causing a violation or future violation of any scienter-based anti-fraud provision of the Federal securities laws, and Section 5 of the Securities Act as disqualifying events (rather than disqualifying Commission actions). Under the final marketing rule, therefore, a disqualifying event generally includes a finding, order, or conviction by a United States court or certain regulatory agencies that a person has engaged in any act or omission referenced in one or more of the provision's five prongs.

A disqualifying event is any of five categories of events that occurred within ten years prior to the person disseminating an endorsement or testimonial.[412] The first is a conviction by court of competent jurisdiction within the United States of any felony or misdemeanor involving conduct described in paragraph (2)(A) through (D) of section 203(e) of the Act.[413] The second is a conviction by a court of competent jurisdiction within the United States of engaging in, any of the conduct specified in paragraphs (1), (5), or (6) of section 203(e) of the Act.[414] The third is the entry of any final order by any entity described in paragraph (9) section 203(e) of the Act,[415] or by the U.S. Commodity Futures Trading Commission or a self-regulatory organization (as

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and desist orders, in connection with the proposed rule's new application to broker-dealers soliciting investors in private funds).

412 Final rule 206(4)-1(e)(4).

413 Final rule 206(4)-1(e)(4)(i).

414 Final rule 206(4)-1(e)(4)(ii).

415 Final rule 206(4)-1(e)(4)(iii). We made a non-substantive change from the proposal to cross reference the Advisers Act statutory provision rather than repeat the wording of the statutory provision in the final rule.

defined in the Form ADV Glossary of Terms), of the type described in paragraph (9) of section 203(e) of the Act. The fourth is the entry of an order, judgment or decree that is described in paragraph (4) of section 203(e) of the Act, and that is in effect at the time of such dissemination by any court of competent jurisdiction within the United States.[416] The fifth is a Commission order that a person cease and desist from committing or causing a violation or future violation of (i) any scienter-based anti-fraud provision of the Federal securities laws, including without limitation section 17(a)(1) of the Securities Act, section 10(b) of the Exchange Act, section 15(c)(1) of the Exchange Act, and section 206(1) of the Act, or any other rule or regulation thereunder, or (ii) Section 5 of the Securities Act.[417] A disqualifying event does not include any of these events with respect to a person that is also subject to: an order pursuant to section 9(c) of the Investment Company Act with respect to such event; or a Commission opinion or order with respect to such event that is not a disqualifying Commission action, provided in each case that certain conditions are met.[418]

The disqualifying events in the final rule incorporate a familiar framework for advisers evaluating promoters. As proposed, the rule's disqualifying events are drawn from section 203(e) of the Act, which is a basis for Commission action to censure, place limitations on the activities, or revoke the registration of any investment adviser or its associated persons.[419] The final rule also includes actions of two types of regulatory entities not referenced in section 203(e) of the Act – specifically, the Commodity Futures Trading Commission (CFTC) and self-

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416 Final rule 206(4)-1(e)(4)(iv).

417 Rule 206(4)-1(e)(4)(v).

418 Rule 206(4)-1(e)(4)(vi).

419 *See* section 203(e) and (f) of the Act.

regulatory organizations – as we had proposed. Certain disciplinary actions by these organizations are included in Form ADV Part 1A's disciplinary history disclosures,[420] which all registered investment advisers must complete for themselves and for their advisory affiliates.[421] Only one commenter commented specifically on the addition of disciplinary actions by the CFTC, and supported it.[422] No one commented specifically on the inclusion of disciplinary events by self-regulatory organizations. However, the final rule refers to self-regulatory organization as defined in the Form ADV Glossary of Terms, rather than the term defined in the Exchange Act, as proposed.[423] We believe that compensated promoters that are advisers must be familiar with the Form ADV definition,[424] which is the same as the Exchange Act definition except that the Form ADV definition includes commodities exchanges and excludes the Municipal Securities Rulemaking Board.[425] The inclusion of commodities exchanges also aligns with the final rule's inclusion of the CFTC in the disciplinary events provisions.

As discussed above, we are including in this definition a Commission cease and desist order from committing or causing a violation or future violation of scienter-based anti-fraud provision of the Federal securities laws or of Section 5 of the Securities Act, which we had

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420 *See* Form ADV Part 1A, Item 11 (requiring disclosure of certain actions related to the Commodity Futures Trading Commission (CFTC) and self-regulatory organizations).

421 The term advisory affiliates is defined in the Form ADV Glossary of Terms, in part, as (1) all of your officers, partners, or directors (or any person performing similar functions); (2) all persons directly or indirectly controlling or controlled by you; and (3) all of your current employees (other than employees performing only clerical, administrative, support or similar functions). Form ADV Part 2 also requires information about the disciplinary history of the adviser and its personnel. *See* e.g., Form ADV Part 2A, Item 9.

422 *See* Consumer Federation Comment Letter.

423 *See* proposed rule 206(4)-3(a)(3)(iii)(B)(3).

424 *See* the Form ADV Glossary of Terms (defining Self-Regulatory Organization as "[a]ny national securities or commodities exchange, registered securities association, or registered clearing agency.").

425 *See* Exchange Act section 3(26). The Form ADV definition also aligns with the definition of self-regulatory organization used in Form BD for broker-dealers. *See* Form BD, Explanation of Terms.

proposed to be disqualifying Commission actions. We continue to believe that including violations or future violations of these provisions protects investors from compensated promoters' bad acts that are likely to have the most effect on investors' review of a promoter's compensated testimonial or endorsement.

Like those in the proposed rule, the final marketing rule's "disqualifying events" are limited to actions of courts of competent jurisdiction within the United States, and of certain regulatory and self-regulatory organizations within the United States. Only one commenter commented on this aspect of the proposed rule, and supported it.[426]

In a change from the proposed rule, the final rule's look-back period will apply to all of the rule's "disqualifying events," rather than only to some. We received no comments on the proposed look-back period, but we are conforming the period across the definition to ease advisers' compliance with the rule by providing a consistent framework for compliance. A ten-year look-back period is included in section 203(e) of the Advisers Act.[427] Advisers also apply this look-back period when reporting to the Commission their disciplinary history and the disciplinary history of all of their advisory affiliates.[428] In addition, we are making a change to the fourth prong of the definition of disqualifying event to specify that this prong applies only to any order, judgment, or decree described therein that is in effect at the time the testimonial or

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426 *See* NRS Comment Letter. A person subject to a regulatory action by a foreign court or regulatory or self-regulatory organization may become be an ineligible person under the final rule, to the extent that the Commission uses its authority to bar, suspend, or prohibit that person from acting in any capacity under the Federal securities laws. *See* the final rule's definition of disqualifying Commission action.

427 Sections 203(e)(2) and (3) of the Act (containing a ten-year look-back period for convictions for certain felonies and misdemeanors).

428 Form ADV Part 1A, Item 11.

endorsement is disseminated. This change aligns this prong of the definition of disciplinary event with the provision of the Advisers Act that it references.[429]

In addition, we are making a change from the proposed solicitation rule's look-back period to tie it to the time the testimonial or endorsement is disseminated, rather than to the time of solicitation. As discussed above, this change in timing will not result in a substantive change in timing for solicitations delivered orally, for which the time of solicitation and the time of dissemination are generally the same. This change conforms the look-back period to other aspects of the final marketing rule.[430] Specifically, we believe that the same rationale for tying the final rule's reasonable care knowledge requirement to the dissemination of a compensated testimonial or endorsement applies here. Therefore, a disqualifying event is any of the final rule's enumerated disciplinary events that occurred within ten years prior to dissemination of an endorsement or testimonial.

e. *Conditional Exception from Definition of "Disqualifying Event"*

The final rule provides a conditional carve-out from the definition of disqualifying event, adapted from the proposed solicitation rule. The carve-out permits an adviser to compensate a promoter that is subject to certain disqualifying actions, when the Commission has issued an opinion or order with respect to the promoter's disqualifying action, but not barred or suspended the promoter or prohibited the promoter from acting in any capacity under the Federal securities laws, subject to conditions. Specifically, the carve-out applies to a person that is subject to (A) an order pursuant to section 9(c) of the Investment Company Act with respect to a disciplinary action

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429 *See* section 203(e)(4) of the Act.

430 *See supra* sections II.C.2 (discussing the disclosure requirements for testimonials and endorsements) and II.C.4.a (discussing the reasonable care knowledge standard).

that would otherwise be a disciplinary event; or (B) a Commission opinion or order with respect to such action that is not a disqualifying Commission action, provided that, for each type of order or opinion described therein, certain conditions are met.[431] The conditions are that: (1) the person is in compliance with the terms of the order or opinion including, but not limited to, the payment of disgorgement, prejudgment interest, civil or administrative penalties, and fines; and (2) for a period of ten years following the date of each order or opinion, the advertisement containing the testimonial or endorsement must include a statement that the person providing the testimonial or endorsement is subject to a Commission order or opinion regarding one or more disciplinary action(s), and include the order or opinion or a link to the order or opinion on the Commission's website.[432]

This conditional carve-out is substantively similar to the proposed solicitation rule's carve-out from the definition of ineligible solicitor, with two changes The first change is that the final rule requires that the promoter be "in compliance with," rather than, as proposed, that a solicitor "has complied with," the terms of the order or opinion. The final rule will therefore permit a compensated promoter to apply the conditional carve-out if the promoter has complied with all of the terms of the applicable opinion or order that are required to be completed at the time the testimonial or endorsement is disseminated, even if there are additional terms of the applicable order or opinion that are, at that time, not yet required to be completed. We believe that the carve-out should not benefit promoters that are not in good standing under the terms of their Commission opinion or order.

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431 Final rule 206(4)-1(e)(4)(vi). The conditions apply to each applicable type of order, and opinion or order, described in paragraphs (A) and (B) therein. *See* final rule 206(4)-1(e)(4)(vi).

432 *Id*.

Second, we revised the disclosure requirement of the conditional carve-out. The final rule's disclosure condition is designed to provide investors with notice that the promoter has disciplinary action(s) and direct the investor to additional information. We revised the disclosure condition to reflect that the final rule does not require a separate solicitor disclosure, as proposed for compensated solicitations. It also reflects that the final rule's disqualification provisions apply to a broader population of promoters than solicitors and that advisers may advertise compensated testimonials and endorsements through space-constrained media. Accordingly, because there is no longer a separate solicitor disclosure requirement, the final rule requires the disclosure about disciplinary action(s) as part of the advertisement, rather than included in a separate solicitor disclosure. Further, because a testimonial or endorsement may appear in space-constrained media, the required disclosure is more concise than proposed. Instead of requiring a separate description of the acts or omissions that are the subject of, and the terms of, the opinion or order, the advertisement containing the testimonial or endorsement under the final rule must include a statement that the promoter is subject to a Commission opinion or order regarding one or more disciplinary action(s), and include the order or opinion or a link to the order or opinion on the Commission's website.[433] We believe the final rule's disclosure will make salient the fact that the promoter is subject to disciplinary action(s), while directing the investor to the facts and circumstance in the Commission opinion or order. An advertisement containing testimonial or endorsement disseminated electronically should include the opinion or order or an electronic link directly to the opinion or order on the Commission's website.

Some commenters requested we adopt a carve-out that aligns with advisers' long-established practice of engaging solicitors subject to Commission actions where the Commission

433 *Id*. *See also* proposed rule 206(4)-3(a)(3)(iii)(C)(2)(ii).

order or opinion does not bar, suspend, or prohibit a person from acting in any capacity under the Federal securities laws.[434] One commenter did not oppose the proposed carve-out, but urged the Commission to use its authority to issue non-disqualifying Commission actions only in the most exceptional of circumstances.[435]

We believe that when the Commission has issued an opinion or order with respect to a person's disqualifying conduct but not barred or suspended the person or prohibited the person from acting in any capacity under the Federal securities laws, it is appropriate to likewise permit such person to engage in activities related to compensated testimonials and endorsements. This approach obviates the need for the Commission to consider how to treat under the final rule a person with these disciplinary events. However, in the event that the Commission has not previously evaluated the disqualifying event and neither the promoter nor any person on its behalf has previously sought a waiver under the Investment Company Act with respect to the disqualifying event, such person may contact the Commission to seek relief.

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434 *See* Credit Suisse Comment Letter; Mercer Comment Letter. *See* also Dougherty & Co., LLC, SEC Staff No-Action Letter (Mar. 21, 2003), revised by Dougherty & Co., LLC, SEC Staff No-Action Letter (July 3, 2003) (collectively, the "Dougherty Letter"). In the Dougherty Letter, Commission staff stated that it would not recommend enforcement action under section 206(4) and rule 206(4)-3 if an investment adviser pays cash solicitation fees to a solicitor who is subject to an order issued by the Commission under section 203(f) of the Advisers Act, or who is subject to a "Rule 206(4)-3 Disqualifying Order," based on certain representations. The staff described a Rule 206(4)-3 Disqualifying Order as an order issued by the Commission in which the Commission has found that the solicitor: (a) has been convicted of any felony or misdemeanor involving conduct described in section 203(e)(2)(A) through (D) of the Advisers Act; (b) has engaged, or has been convicted of engaging, in any of the conduct specified in paragraphs (1), (5), or (6) of section 203(e) of the Advisers Act; or (c) was subject to an order, judgment, or decree described in section 203(e)(4) of the Advisers Act. Representations included that no Rule 206(4)-3 Disqualifying Order bars or suspends the solicitor from acting in any capacity under the Federal securities laws, and that, for a period of ten years following the date of each Rule 206(4)-3 Disqualifying Order, the solicitor or the investment adviser with which it has a solicitation arrangement subject to the cash solicitation rule discloses the order to each person whom the solicitor solicits.

435 *See* Consumer Federation Comment Letter.

Commenters that addressed this provision generally supported it, noting the appropriateness of disclosure as a remedy for solicitors subject to non-disqualifying Commission actions.[436] One commenter, however, stated that the ten-year disclosure period is overly punitive, and requested that we reduce the disclosure period to five years.[437] We are adopting a ten-year look-back, however, because that period is consistent with the look-back period for the rule's disqualifying events, which is based on the look-back in the certain of the Act's statutory disqualification provisions and the rules for reporting to the Commission disciplinary history of advisers and their advisory affiliates.[438] We believe that this period provides for a sufficient period after the disqualifying event that the past actions of the ineligible person may no longer pose as significant a risk.

f. *Application to Existing Events*

The final rule will not apply to pre-effective date conduct that would otherwise trigger the disqualification provisions, as we proposed.[439] The final rule's disqualification provision, paragraph (b)(3), will not disqualify any person for purposes of the final rule for any matter(s), that occurred prior to the effective date of the rule, if such matter(s) would not have disqualified such person under rule 206(4)-3(a)(1)(ii), as in effect prior to the effective date of the rule.[440] As discussed above, the final rule's disqualifying events are slightly broader than those under the

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436 *See* Credit Suisse Comment Letter; SIFMA AMG Comment Letter; Mercer Comment Letter.

437 *See* SIFMA AMG Comment Letter I ("The ten year time period is significant, and may have the effect of forcing such persons out of business rather than making them come into compliance.").

438 *See supra* footnotes 427 and 428 (discussing the ten-year lookback).

439 As discussed below, the staff is also stating its view that it will not object if certain third parties that have been operating in a manner consistent with certain staff no-action letters under the existing cash solicitation rule, which will be nullified due to the rescission of the solicitation rule, provide compensated testimonials and endorsements under the new rule notwithstanding otherwise disqualifying events. *See infra* section II.J.

440 Final rule 206(4)-1(b)(3). Such a person will not be an "ineligible person" due to that conduct.

current solicitation rule. For example, the solicitation rule's disqualification provisions do not include the entry of a final order of the CFTC or a self-regulatory organization, whereas the final rule includes such conduct.[441] We agree with commenters that it would be inappropriate to apply the final rule's broader disqualification provisions retroactively to prior conduct—such as a pre-effective date CFTC order—when such conduct had not disqualified that solicitor under the solicitation rule.[442] In this case, the rule will not disqualify a person for prior conduct that did not cause disqualification at that time under the solicitation rule.

However, we disagree with some commenters who requested that we grandfather all ongoing solicitation arrangements entered into prior to the final rule's effective date. Commenters argued that without a broad grandfathering provision, the final rule would require firms to renegotiate agreements with solicitors that had not been subject to the current rule when executed.[443] Commenters' approach would effectively provide a blanket exemption that permits solicitation activities to continue indefinitely without complying with the final rule, if a solicitor performs such activity pursuant to a pre-effective date solicitation arrangement.[444] Unlike the scenario discussed above, we believe this would exempt post-effective date solicitation activity that we explicitly intend to capture in the final rule.

5. Exemptions

Under the final rule, we are adopting exemptions from certain conditions for compensated testimonials and endorsements by an adviser's affiliated personnel and for *de*

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441 *Compare* current rule 206(4)-3(a)(1)(ii), *with* final rule 206(4)-1(e)(5)(iii).

442 *See* IAA Comment Letter; Credit Suisse Comment Letter.

443 *See, e.g.*, FSI Comment Letter; IAA Comment Letter.

444 However, *see supra* footnote 395 and accompanying text for a discussion of trailing compensation.

minimis compensation.[445] We are also adopting a partial exemption from certain conditions for testimonials and endorsements by a registered broker-dealer. The final rule will not exempt testimonials and endorsements related to the provision of impersonal investment advice or nonprofit programs.[446] Although some commenters suggested that we adopt additional exemptions for participants in refer-a-friend programs,[447] publishers (*e.g.*, bloggers),[448] and those who refer clients from networking relationships,[449] we do not believe general exemptions for these categories are appropriate. We believe that the final exemptions appropriately balance the risks of the use of compensated testimonials and endorsements with the benefits and protections of the final rule.

a. *Affiliated Personnel*

Similar to the proposed solicitation rule, the final rule will partially exempt a testimonial or endorsement by an adviser's partners, officers, directors, or employees, or a person that controls, is controlled by, or is under common control with the investment adviser, or is a partner, officer, director or employee of such a person.[450] For this exemption to apply, the affiliation between the investment adviser and such person must be readily apparent to or disclosed to the client or investor at the time the testimonial or endorsement is disseminated and the investment adviser must document such person's status at the time the testimonial or

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445 The proposed rule would have provided four exemptions under the solicitation rule for: (1) impersonal investment advice; (2) advisers' in-house solicitors and other affiliated solicitors; (3) *de minimis* compensation; and (4) nonprofit programs. Proposed rule 206(4)-3(b).

446 *See* final rule 206(4)-1(b).

447 *See* IAA Comment Letter.

448 *See* IAA Comment Letter.

449 MMI Comment Letter.

450 For ease of reference, we refer to these persons in the release as "affiliated persons" or "affiliated personnel."

endorsement is disseminated.[451] This is a partial exemption because the testimonial or endorsement will be exempt from the final rule's disclosure requirements, but it still will be necessary to comply with the adviser oversight and disqualification provisions.[452] Commenters were generally supportive of retaining this current partial exemption under the solicitation rule.[453]

As proposed under the solicitation rule, we are modifying the current rule to permit an adviser to rely on the exemption not only when the affiliated status is disclosed to the investor, but also when such relationship is readily apparent to the investor.[454] We continue to believe that, in such cases, a requirement to disclose a person's status as an affiliated person would not result in a benefit to the investor, and would create compliance burdens for the adviser and person giving the testimonial or endorsement. Commenters generally agreed with our approach, noting that disclosures regarding status are unnecessary because of the obvious and close relationship of some affiliates.[455] However, commenters also suggested more guidance on the meaning of "readily apparent."[456]

What constitutes "readily apparent" will depend on the facts and circumstances. The relationship between an affiliated person and the adviser may be readily apparent to an investor, such as when an in-house solicitor shares the same name as the advisory firm or a person operates under the same name brand as the adviser. An affiliated relationship also may be

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451 Final rule 206(4)-1(b). The proposed solicitation rule would have provided a partial exemption for an adviser's in-house solicitors and other affiliated solicitors. *See* proposed rule 206(4)-3(b)(2).

452 However, an adviser's affiliated persons will not be required to comply with the written agreement requirement under the adviser oversight and compliance provision. *See* final rule 206(4)-1(b)(4)(ii). *See also* proposed rule 206(4)-3(b)(2). The proposed rule would have created an exemption from the disclosure requirements by virtue of the exemption from the written agreement requirement.

453 *See, e.g.*, SIFMA AMG Comment Letter I; Proskauer Comment Letter.

454 Final rule 206(4)-1(b)(4)(ii).

455 *See, e.g.*, SIFMA AMG Comment Letter I; Proskauer Comment Letter; Mercer Comment Letter.

456 SIFMA AMG Comment Letter I; Fidelity Comment Letter.

readily apparent when a person is clearly identified as related to the adviser in its communications with the investor at the time the testimonial or endorsement is disseminated. For example, the person's affiliation would be readily apparent if a business card distributed to investors at the time the testimonial or endorsement is disseminated clearly and prominently states that the person is a representative of the adviser. There may be other situations where the relationship between the adviser and its affiliated personnel is well known.

One commenter suggested that there be a presumption that an adviser and its affiliated person's relationship is readily apparent to an investor if the adviser has disclosed the affiliation in its Form ADV brochure.[457] However, we are not adopting such a presumption because the client may not have read the Form ADV brochure at the time the testimonial or endorsement is disseminated.

In certain situations, the adviser's relationship with an affiliated person is not readily apparent, such as when the person is a representative of the adviser but operates its marketing activities through its own DBA name or brand, and the name of the adviser is omitted or less prominent.[458] If an adviser's and its affiliated person's relationship is not readily apparent, the adviser or affiliated person must disclose the affiliation in order to avail itself of the rule's partial exemption.

As proposed under the solicitation rule, we are expanding the current partial exemption for affiliated persons to cover any person that controls, is controlled by, or is under common control with, the investment adviser that is compensating the person pursuant to the final rule.[459]

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457 Fidelity Comment Letter.

458 Such persons could be employees or independent contractors.

459 Final rule 206(4)-1(b)(4)(ii).

One commenter explicitly supported this expansion.[460] We continue to believe that the rule should treat a person that controls, is controlled by, or is under common control with, the investment adviser, similarly to any partners, officers, directors or employees of such affiliated person.

One commenter suggested that we include an adviser's independent contractors under this partial exemption.[461] However, another suggested that we limit the exemption to an adviser's supervised persons.[462] We believe that the supervision and control an adviser exercises over an endorsing independent contractor may vary among different advisers and independent contractors. If the adviser exercises substantially the same level of supervision and control over an independent contractor as the adviser exercises over its own employees with respect to its marketing activities, the partial exemption would be available.

We continue to believe, and commenters generally agreed, that when an investor is aware that a person endorsing the adviser is affiliated with the adviser, disclosures are not necessary to inform the investor of the person's bias in recommending such adviser.[463] An investor is on notice that an in-house solicitor has a stake in soliciting the investor for its own firm. In these instances, the policy goals underlying the disclosure element of the final rule would already be satisfied.

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460 *See* Fidelity Comment Letter.

461 SIFMA AMG Comment Letter I. We requested comment on whether we should define "employee" to include an adviser's independent contractors or provide that this partial exemption for in-house personnel applies to an adviser's independent contractors. 2019 Proposing Release, *supra* footnote 7, at section II.B.7.

462 *See* Mercer Comment Letter.

463 *See* SIFMA AMG Comment Letter I; Proskauer Comment Letter; Mercer Comment Letter.

As proposed under the solicitation rule, the final rule's disqualification provisions will apply to affiliated personnel.[464] One commenter expressed concern that this approach would be overly restrictive and suggested that the rule also should exempt certain affiliated personnel from the disqualification provisions.[465] This commenter stated that there is greater control and opportunity to train and rehabilitate affiliated personnel. We do not believe that the availability of training justifies exempting affiliated personnel from the disqualification provisions, and in other circumstances under the Federal securities laws the availability of such training does not affect affiliated personnel's disqualification.

Some affiliated persons with disciplinary events under the final rule will be disqualified from association with an investment adviser independent of the final rule, if the Commission has barred or suspended those persons from association with an investment adviser under section 203(f) of the Act. However, other affiliated persons with such disciplinary events may not be subject to such Commission action and, absent the application of the rule's disqualification provisions, would be permitted to endorse an adviser as an affiliated person, notwithstanding their disqualifying event. After considering comments, including those from our Investor Feedback Flyers, we believe that the disqualification provisions should apply to compensated testimonials and endorsements, regardless of whether the marketing activity is conducted by a person affiliated or unaffiliated with the adviser.[466]

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464 *See* final rule 206(4)-1(b)(3). *See also* proposed rule 206(4)-3(b)(2).

465 SIFMA AMG Comment Letter I.

466 *See* Investment Adviser Marketing Feedback Form. Question 15 asks "How important is it to know the following information about a paid salesperson's referral?" and lists among other things, "Whether the solicitor has been disciplined for financial-related misconduct." Commenters were given the option to answer on a scale of 1-5, with 1 meaning "Very Important" and 5 meaning "Not Important." There was also an option to answer "Don't Know." More than two-thirds of the respondents indicated that this disciplinary information was "Very Important."

Unlike the proposed solicitation rule, however, the final rule will subject affiliated persons to a part of the adviser oversight and compliance provision, which will require that the investment adviser have a reasonable basis for believing that the testimonial or endorsement complies with the requirements of the rule.[467] We believe that this part of the oversight and compliance provision will help reduce the risk that any testimonials or endorsements do not comply with the final rule, particularly with respect to certain affiliates that may not be subject to the adviser's compliance policies and procedures. However, similar to the proposed solicitation rule, the final rule will not subject affiliated personnel to the written agreement requirement under the adviser oversight and compliance provision.[468] Although we did not receive any comments on this particular modification under the proposed in-house and other affiliated personnel exemption, we continue to believe that advisers should not be required to enter into written agreements with their own affiliated persons in order to avail themselves of this partial exemption. We also continue to believe that such a requirement under the current rule creates additional compliance obligations for the adviser and its affiliated persons that are not justified by any corresponding benefit.

Finally, we are adopting a new requirement, largely as proposed under the solicitation rule, that in order to avail itself of this partial exemption, an adviser must document an affiliated person's status contemporaneously with disseminating the testimonial or endorsement.[469] One commenter criticized this requirement as unnecessary and unduly burdensome, stating that the

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467 *See* final rule 206(4)-1(b)(2)(i)).

468 *See* final rule 206(4)-1(b)(4)(ii).

469 Final rule 206(4)-1(e)(2). The proposed solicitation rule would have required that "the adviser documents such solicitor's status *at the time the adviser enters into the solicitation arrangement*." Proposed rule 206(4)-3(b)(2)(ii) (emphasis added).

Commission should either remove it or clarify the form and type of documentation expected.[470] We are not requiring a specific form of documentation to record an affiliated person's status. We continue to believe that this approach affords advisers the flexibility to develop their own policies and procedures or use existing records to document such status.

Advisers may wish to document this status through various means. For example, an adviser's policies and procedures regarding affiliated personnel may require that the adviser document a person's status on an internal form at the time that the adviser or affiliated person disseminates the testimonial or endorsement. However, an adviser does not need to create a new form of separate documentation to satisfy this requirement. For example, to the extent that an affiliated person's status is notated through corporate records, employee payroll records, Central Registration Depository ("CRD"), or any other similar records and licensing for investment adviser representatives, then such records would suffice so long as such records are kept current.

Similar to our approach under the disqualification provisions applicable to testimonials and endorsements, we believe that the time of dissemination is the most appropriate time for an adviser to know about, or exercise reasonable care to determine, whether personnel is affiliated. The rule does not require an adviser to monitor the affiliated status of a person on a continuous basis. Instead, an adviser could conduct periodic inquiries to confirm that any testimonials or endorsements provided in reliance on this exemption are by affiliated personnel.

b. *De Minimis Compensation*

The final rule will have a partial exemption for the use of testimonials or endorsements that are for zero or *de minimis* compensation.[471] Specifically, a testimonial or endorsement that

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470 MMI Comment Letter.

471 Final rule 206(4)-1(b)(4)(i).

is disseminated for no compensation or *de minimis* compensation will not be subject to the disqualification provisions or the written agreement requirement, but must comply with the disclosure and oversight provisions.[472] The proposed solicitation rule would have provided a full exemption for solicitation activities performed for *de minimis* compensation, which we proposed as $100 or less.[473]

Commenters generally supported the proposed *de minimis* exemption. However, commenters also suggested modifications to increase the utility of the exemption.[474] For example, some commenters suggested raising the proposed *de minimis* threshold amount, arguing that $100 would be too low.[475] One commenter, while generally supporting the idea of a *de minimis* exemption, stated that tracking the exemption would be difficult in certain situations where advisers may make donations on behalf of clients who refer new prospective clients.[476] Another commenter stated that the exemption would only offer a superficial benefit because compensation paid to a solicitor would trigger required disclosure under the advertising rule since solicitor referrals often involve testimonials or endorsements.[477] One commenter suggested eliminating the exemption altogether, arguing that small dollar values still create conflicts between a solicitor and the solicited investor.[478]

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472 *See supra* footnote 123 (stating that a testimonial or endorsement for which an adviser provides *de minimis* compensation will be an advertisement under the second prong of the definition of advertisement).

473 Proposed rule 206(4)-3(b)(3). Under the proposed *de minimis* compensation exemption, the solicitation rule would not have applied if the solicitor complied with certain conditions.

474 *See, e.g.*, Comment Letter of Wealthfront Corp. (Mar. 3, 2020); SIFMA AMG Comment Letter I; MMI Comment Letter; and Flexible Plan Investments Comment Letter I.

475 *See, e.g.*, Comment Letter of MarketCounsel (Feb. 10, 2020) ("MarketCounsel Comment Letter"); SIFMA AMG Comment Letter I; IAA Comment Letter.

476 NAPFA Comment Letter.

477 SBIA Comment Letter.

478 NASAA Comment Letter.

After considering comments, we believe a partial exemption is necessary because it could be overly burdensome for advisers and persons providing testimonials or endorsements for *de minimis* compensation to comply with the rule's disqualification provisions. We do not believe the same level of incentive or risk to defraud investors exists when a *de minimis* fee is involved.[479] In supporting our proposed *de minimis* exemption, commenters agreed that a solicitor's incentives are reduced significantly when receiving *de minimis* compensation and that the need for heightened safeguards is likewise reduced.[480] We also believe that many solicitation and referral programs would benefit from this exemption. Commenters confirmed our observation that there is a recent trend towards the use of programs that involve *de minimis* compensation, such as refer-a-friend programs.[481]

However, we agree with commenters to both the proposed advertising rule and solicitation rule who expressed concern that minimal compensation may still create conflicts.[482] We believe disclosure of any conflicts is paramount to mitigate the risks that an investor would mistakenly view the promoter as unbiased and rely on a testimonial or endorsement more than the investor otherwise would have if the investor knew of any incentive or conflict. Even when there is no compensation involved, we believe these conflicts of interest create an incentive or bias on the part of the promoter. For instance, if the adviser and the promoter are participants in a referral network, it is important that these investors fully understand that the provider expects

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479 We stated in our proposal that we recognize that the solicitor disqualification may pose major challenges, especially for smaller advisers. *See* 2019 Proposing Release, *supra* footnote 7, at section II.B.7.

480 *See, e.g.*, IAA Comment Letter ("This will help alleviate the compliance burden on investment advisers where incentives are inherently limited, and thus risks to prospective clients are low."); Mercer Comment Letter.

481 *See, e.g.*, MarketCounsel Comment Letter; SIFMA AMG Comment Letter I.

482 *See* NASAA Comment Letter (arguing against the proposed *de minimis* exemption under the solicitation rule); Prof. Jacobson Comment Letter (supporting no *de minimis* exemption for testimonials and endorsements from the proposed advertising rule's disclosure requirements).

to benefit from its endorsement of or testimonial about the adviser. Although this will create some burden for promoters who are not already subject to the existing cash solicitation rule, we believe that the benefits of fully informing and protecting investors justify any such burden. Moreover, with respect to advisers, providing such disclosures is consistent with an adviser's duty to disclose all conflicts of interest and thus will not be unduly burdensome for advisers. In addition, we believe that subjecting testimonials and endorsements that are for no or *de minimis* compensation to the adviser oversight requirement is a reasonable benefit that justifies any burdens. Accordingly, unlike the proposed *de minimis* exemption under the solicitation rule, the final marketing rule will subject testimonials and endorsements for zero or *de minimis* compensation to the required disclosure and adviser oversight provisions and exempt such testimonials and endorsements only from the disqualification provisions.[483]

We also believe the exemption from the disqualification provisions will help ease the burden of compliance in many situations where the testimonials or endorsements are limited in scope, such as in refer-a-friend programs. To illustrate, if the disqualification provisions were to apply, one commenter stated that firms with "thousands of retail clients," not knowing who will participate in the refer-a-friend programs, would have to inquire into each client's disciplinary history.[484] We agree that such an undertaking would be a major compliance challenge that is disproportionate to the limited scope and magnitude of such non-professional refer-a-friend

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483 *See* final rule 206(4)-1(b)(4)(i). However, testimonials and endorsements for zero or *de minimis* compensation will not be required to have a written agreement under the adviser oversight provision. *See id*. *See also* section II.C.3. (discussing the written agreement requirement under the adviser oversight and compliance provision).

484 IAA Comment Letter.

programs. We accordingly believe that our approach appropriately balances the need for protections of the final rule with the burdens placed on the advisers complying with the rule.

After considering comments and various thresholds, however, we are increasing the proposed *de minimis* threshold amount to $1,000.[485] Accordingly, the disqualification provisions will not apply if an investment adviser provides compensation to a promoter of a total of $1,000 or less (or the equivalent value in non-cash compensation) during the preceding twelve months. We consider $1,000 to more appropriately capture referrals from both professional and non-professional types of testimonials and endorsements than the $100 amount we proposed. We also continue to believe that adopting an aggregate limit over a trailing 12-month period is consistent with our goal of providing an exception for small or nominal payments.[486] One commenter supported our approach in requiring a trailing period, agreeing that it would not overly burden advisers because adviser should be keeping records of such payments.[487]

c. *Registered Broker-Dealers*

Under the final rule, we are providing an exemption from the rule's disqualification provisions for promoters that are brokers or dealers registered with the Commission in accordance with section 15(b) of the Exchange Act, provided they are not subject to statutory disqualification under the Exchange Act.[488] In addition, we are providing an exemption from the rule's disclosure provisions when a broker-dealer is providing a testimonial or endorsement to a

485 Final rule 206(4)-1(e)(2).

486 We would measure the initial date of the 12-month period to begin at the time that a promoter's testimonial or endorsement is initially disseminated.

487 MarketCounsel Comment Letter.

488 Final rule 206(4)-1(b)(4)(iii)(C).

retail customer that is a recommendation subject to Regulation BI.[489] Finally, we are providing an exemption from certain disclosure requirements when a broker-dealer provides a testimonial or endorsement to an investor who is not a retail customer as defined in Regulation BI.[490]

While the proposed amendments to the solicitation rule would have applied the rule to all broker-dealer solicitations, we had contemplated whether to exempt certain advertisements or solicitation activities in some fashion from each of the proposed rules because we recognized some overlap in requirements applicable to broker-dealers.[491] We received several comments suggesting that we eliminate the application of the proposed advertising rule to advertisements related to potential investors in pooled investment vehicles, and that we exempt registered broker-dealers that solicit private fund investors from the proposed solicitation rule.[492] These commenters expressed concern that the proposed amendments would result in unnecessary and overlapping layers of regulation, including with respect to disclosures provided to investors, when a registered broker-dealer is involved in the sale of interests in a pooled investment vehicle.[493] One commenter also stated that broker-dealers already are subject to the statutory disqualifications in section 3(a)(39) of the Exchange Act.[494]

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489 Final rule 206(4)-1(b)(4)(iii)(A).

490 Final rule 206(4)-1(b)(4)(iii)(B).

491 2019 Proposing Release, *supra* footnote 7, at 38 and 211. We also considered the recently proposed exemption for certain "finders" involved in exempt offerings. *See* Notice of Proposed Exemptive Order Granting Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Finders, Release No. 34-90112 (Oct. 7, 2020) [85 FR 64542 (Oct. 13, 2020)].

492 *See, e.g.*, Wellington Comment Letter; Fidelity Comment Letter; MFA/AIMA Comment Letter I; IAA Comment Letter; Credit Suisse Comment Letter: SIFMA AMG Comment Letter I.

493 *Id*.

494 IAA Comment Letter.

We continue to believe that certain provisions of the final rule, such as the general prohibitions and performance provisions, should apply to all advertisements, regardless of whether the advertisement is provided to potential clients of an investment adviser or potential investors in a private fund.[495] However, we recognize that regulatory overlap would yield little benefit. Specifically, we agree with commenters that certain statutory or regulatory requirements applicable to registered broker-dealers will satisfy the policy goals of some of the conditions.[496] Broker-dealers are subject to disqualification for a variety of misconduct under the Exchange Act, many of which we believe are sufficiently similar to the misconduct that would trigger a disqualification under the marketing rule, but the Exchange Act is particularized to broker-dealer activity.[497] We are confident these disqualification provisions will serve the same policy goal as the disqualification provisions under this rule.[498] As a result, the final rule will exempt from the disqualification provisions any testimonial or endorsement by a broker-dealer registered with the

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495 As stated in the proposal, we recognize that there may be some overlap between the prohibition in rule 206(4)-8 and the final rule. However, the final rule provides more specificity regarding what we believe to be false or misleading statements that advisers to private funds must avoid in their advertisements. We also continue to believe that any additional costs to advisers to private funds as a result of potential overlap between the final rule and rule 206(4)-8 with respect to advertisements will be minimal, as an advertisement that would raise issues under rule 206(4)-8 might also raise issues under a specific provision of the final rule as well as other anti-fraud provisions of the Federal securities laws. *See* 2019 Proposing Release, *supra* footnote 7, at 35-36.

496 *See, e.g.*, MFA/AIMA Comment Letter I; Sidley Austin Comment Letter; SIFMA Comment Letter I.

497 *See* section 3(a)(39) of the Exchange Act. Among other things, a person is subject to "statutory disqualification" under the Exchange Act if such person (i) is subject to an order of the Commission denying, suspending for a period not exceeding 12 months, or revoking the person's registration as a broker or dealer or barring or suspending for a period not exceeding 12 months the person's being associated with a broker or dealer; (ii) is subject to an order of the CFTC denying, suspending, or revoking his registration under the Commodity Exchange Act; and (iii) has been convicted of any specified offense or other felony within 10 years of the date of filing of an application for membership of a self-regulatory organization. *See also* final rule 206(4)-1(e)(4).

498 In this case, we agree with commenters that certain statutory or regulatory requirements applicable to registered broker-dealers will satisfy the policy goals of some of the conditions. *See, e.g.*, MFA/AIMA Comment Letter I; Sidley Austin Comment Letter; SIFMA AMG Comment Letter I.

Commission under section 15(b) of the Exchange Act, if the broker-dealer is not subject to statutory disqualification under section 3(a)(39) of the Exchange Act.[499]

Likewise, we recognize that the requirements under Regulation BI include conflicts of interest and compensation disclosures.[500] For instance, under the Regulation BI Disclosure Obligation, when making a recommendation to a retail customer, a broker-dealer must disclose all material facts about the scope and terms of its relationship with the retail customer, such as the material fees and costs the customer will incur, as well as all material facts relating to its conflicts of interest associated with the recommendation, including third-party payments and compensation arrangements.[501] In addition, all of the other Regulation BI obligations would apply when the broker-dealer is making a recommendation to a retail customer. Accordingly, we believe that the robust, protective framework of Regulation BI renders the disclosure requirements of the final marketing rule unnecessary when a broker-dealer provides a testimonial or endorsement to a retail customer that is a recommendation subject to Regulation BI.[502]

In addition, we are providing a partial exemption in cases where a registered broker-dealer provides a testimonial or endorsement to an investor who is not a retail customer as

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499 Final rule 206(4)-1(b)(4)(iii)(C). *See also supra* section II.C.4.f. (discussing grandfathering for broker-dealers and covered persons with respect to the disqualification provisions). Advisers must have a reasonable basis for believing that the broker-dealer is not subject to such statutory disqualification, consistent with the adviser oversight and compliance provision applicable to testimonials and endorsements. Final rule 206(4)-1(b)(2)(i).

500 Although Regulation BI does not explicitly require disclosure related to whether or not the broker-dealer is a current client or investor of the adviser, the Disclosure Obligation under Regulation BI requires the broker-dealer firm or representative to disclose that it is acting in a broker-dealer capacity, which we believe investors will generally understand to imply that the broker-dealer is not a client or investor of the adviser. Given this, we do not believe we need to separately require such a broker-dealer to disclose its status as a client or non-client.

501 *See* Regulation Best Interest Release, *supra* footnote 146, at 14. Regulation BI applies when a broker-dealer makes a recommendation to a "retail customer." *See id*.

502 Final rule 206(4)-1(b)(4)(iii)(A).

defined in Regulation BI.[503] Specifically, under the final rule, a broker-dealer that provides a testimonial or endorsement to such an investor will not be required to disclose the material terms of any compensation arrangement or a description of any material conflicts of interest.[504] We believe that the clear and prominent disclosures such a broker-dealer will be required to provide under our final rule are sufficient to alert an investor that is not a retail customer that a testimonial or endorsement is a paid solicitation.[505] We also believe that these investors will be able to request from the broker-dealer other information about the solicitation.

Aside from this partial exemption from the disclosure provisions, the disclosure obligations of the final marketing rule will apply when a broker-dealer provides a testimonial or endorsement that is not a recommendation subject to Regulation BI. While registered broker-dealers may be subject to other disclosure obligations in these circumstances, these obligations generally do not align with the disclosure obligations for testimonials and endorsements under our final rule.[506] In addition, although broker-dealers must comply with FINRA rule 2210, we do not believe that FINRA rule 2210 requires the same substantive disclosures that we require under the final rule.[507] Moreover, communications for purposes of FINRA rule 2210 are "written"

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503 Final rule 206(4)-1(b)(4)(iii)(B).

504 *Id*. However, the broker-dealer must clearly and prominently disclose: (A) that the testimonial was given by a current client or investor, or the endorsement was given by a person other than a current client or investor; (B) that cash or non-cash compensation was provided for the testimonial or endorsement, if applicable; and (C) a brief statement of any material conflicts of interest on the part of the person giving the testimonial or endorsement resulting from the investment adviser's relationship with such person. *See* final rule 206(4)-1(b)(1)(i).

505 *See* final rule 206(4)-1(b)(1)(i).

506 *See, e.g.*, Exchange Act section 10(b) and rules 10b-5, 10b-10(a)(2), 12b-20, 15c1-5, and 15c1-6 as well as FINRA rules 2010, 2020, 2262, 2269, and 5123.

507 *See, e.g.*, FINRA rule 2210(d)(6).

communications, whereas our final rule would apply to written *and* oral advertisements.[508] Accordingly, absent any exemption under the final rule, the rule will require the disclosures of compensation arrangements and material conflicts of interest associated with a testimonial or endorsement.[509]

The final rule does not provide an exemption for registered broker-dealers from the adviser oversight and compliance condition applicable to testimonials and endorsements, including the written agreement requirement. We continue to believe that advisers should reasonably ensure that a registered broker-dealer providing a testimonial or endorsement for the adviser is complying with the rule's applicable conditions. We believe that many advisers would already have an incentive to oversee any broker-dealers operating as their promoters and accordingly believe that this provision will provide an additional benefit to investors without being unduly burdensome. As noted above, in the context of private placements of private fund shares, we believe that a written private placement agreement would meet the final rule's written agreement requirement, further reducing the compliance burdens associated with this aspect of the rule.[510]

d. *"Covered Persons"*

Under the final rule, similar to the partial exemption for registered broker-dealers, we are providing an exemption from the rule's disqualification provisions for "covered persons" under rule 506(d) of Regulation D with respect to a rule 506 securities offering, provided the person's

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508 *See* FINRA rule 2210(a)(1). Although FINRA rule 2210(f) separately covers public appearances, "communications" consist of "correspondence, retail communications, and institutional communications," all of which are defined as written communications. *See* FINRA rule 2210(a)(2), (3), and (5).

509 *See* final rule 206(4)-1(b)(1).

510 *See supra* footnote 361 and accompanying text.

involvement would not disqualify the offering under that rule.[511] With respect to rule 506 of Regulation D, "covered persons" include the issuer, its predecessors and affiliated issuers; directors, general partners, and managing members of the issuer; executive officers of the issuer, and other officers of the issuer that participate in the offering; beneficial owners of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power; promoters connected to the issuer in any capacity at the time of sale; for pooled investment fund issuers, the fund's investment manager and any general partner, managing member, director, executive officer or other officer participating in the offering of any such investment manager; and persons compensated for soliciting investors, including any general partner, managing member, director, executive officer or other officer participating in the offering of any such solicitor.[512]

Commenters expressed concern that issuers and solicitors conducting private fund offerings in reliance on Regulation D would face increased compliance burdens in observing two sets of overlapping disqualification regulations.[513] Stating that a majority of private placements are carried out under rule 506, these commenters suggested we conform the rule's disqualification provisions to the provisions under rule 506 of Regulation D for solicitors of investors in private funds who would be newly subject to the solicitation rule, or that we provide an exemption from the final rule's disqualification provisions for persons that are subject to rule 506 of Regulation D.[514]

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511 *See* final rule 206(4)-1(b)(4)(iv).

512 *See* rule 506(d)(1) under the Securities Act.

513 *See, e.g.*, Credit Suisse Comment Letter; SIFMA AMG Comment Letter I; MMI Comment Letter.

514 *Id*.

We agree with commenters that having one set of disqualifying events for promoters with respect to offerings conducted in reliance on rule 506 of Regulation D would streamline compliance processes and reduce the burden for such promoters. Additionally, similar to the statutory disqualification provisions under the Exchange Act, we believe that the disqualification provisions, or "bad actor" provisions, under Regulation D will serve the same policy goal as our final rule's disqualification provisions.[515] While we recognize that the two sets of disqualification provisions are not identical and that there are certain categories of disqualifying events that do not overlap, we do not believe that the differences justify having more than one set of disqualification provisions for compliance. Moreover, this exemption is narrowly limited to testimonials and endorsements that are in connection with a sale of securities under rule 506 of the Securities Act. Accordingly, in cases where a covered person's activity with respect to a rule 506 securities offering would be considered a testimonial or endorsement under our final rule, such covered person will not be subject to the disqualification provisions under our final rule so long as his or her involvement would not disqualify the offering under rule 506(d) under the Securities Act.[516]

Given that Regulation D does not have any similar provisions that are sufficient to replace our final rule's disclosure or adviser oversight and compliance provisions, covered persons under rule 506(d) of Regulation D will not be exempt from our rule's disclosure and adviser oversight and compliance obligations for testimonials and endorsements. Accordingly,

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515 We believe that the two sets of provisions are sufficiently similar to help realize our policy goal of reducing the risk that certain ineligible persons should not be acting as promoters. For example, an offering is disqualified under rule 506(d) if a covered person is subject to any order of the Commission entered within five years before such sale that, at the time of such sale, orders the person to cease and desist from committing or causing a violation or future violation of: (i) any scienter-based anti-fraud provision of the Federal securities laws; or (ii) section 5 of the Securities Act. *See* section 506(d)(1)(v) of the Securities Act. *See also* final rule 206(4)-1(e)(4)(v).

516 Final rule 206(4)-1(b)(4)(iv).

similar to the exemption for registered broker-dealers, persons covered by rule 506(d) of Regulation D with respect to a rule 506 offering will still be subject to all other provisions of the final rule, to the extent that their activity falls within the scope of the rule, including the general prohibitions, performance provisions, and conditions applicable to testimonials and endorsements except the disqualification provisions.

e. *No Exemptions for Impersonal Investment Advice and Nonprofit Programs*

i. Impersonal investment advice

The proposed solicitation rule would have provided a partial exemption for solicitation activities for investment advisory services that do not purport to meet the objectives or needs of specific individuals or accounts.[517] The proposed advertising rule did not provide any similar exemption. As a result of the merger of the two rules, the final rule will not have an exemption for promoters that refer investors for the provision of impersonal investment advice.[518]

One commenter supported our proposal to retain and modify the current exemption under the solicitation rule for solicitation activities related to the provision of impersonal investment advice.[519] This commenter stated that the exemption is a "long-standing feature of the regime covering solicitation," and that our proposed modifications such as removing the requirement to enter into a written agreement would improve aspects of the exemption. However, in the context of advertising, and testimonials and endorsements in particular, we do not believe that there

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517 Proposed rule 206(4)-3(b)(1). Specifically, such solicitors would not have had to enter into a written agreement and provide the solicitor disclosure and would not have been subject to the adviser oversight and compliance provision. However, such solicitors would have been subject to the disqualification provisions under the proposed rule.

518 Final rule 206(4)-1(b).

519 SIFMA AMG Comment Letter I.

should be any distinction made between personal and impersonal investment advice.[520] Many testimonials and endorsements, by their nature, will be used to promote and advertise an adviser's services, without taking into account a particular investor's objectives or needs. Accordingly, in such cases, we believe that investors should be afforded all protections of the final rule. A testimonial or endorsement serving as an advertisement for an adviser should not be exempt from providing disclosures when there is a material conflict of interest simply because the advertisement is related to the provision of impersonal investment advice instead of personal investment advice.

We stated in the proposal that the current and proposed solicitation rule provided a partial exemption for impersonal advisory services because we understood that "prospective clients normally would be aware that a person selling such services was a salesman who was paid to do so." However, with respect to the proposed advertising rule, one commenter argued against regulations built on any underlying assumption that consumers are skilled at evaluating testimonials.[521] Other commenters argued against permitting testimonials and endorsements, raising concerns about investor confusion and inadvertent investor harm.[522] Although we continue to recognize that a potential investor may be aware of a promoter's incentive to sell, after considering comments, we believe that any use of testimonials or endorsements, subject to the final exemptions, needs certain protections. Accordingly, notwithstanding the fact that an adviser may offer impersonalized services, if an adviser's advertisement includes a testimonial or endorsement, then such advertisement will be subject to the final rule's provisions.

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520 *See* current rule 206(4)-1. The current advertising rule does not have any exemptions for advertisements related to impersonal investment advice.

521 *See* TINA Comment Letter.

522 *See* Mercer Comment Letter; NAPFA Comment Letter.

ii. Nonprofit programs exemption

The proposed solicitation rule would have exempted certain types of nonprofit programs from the substantive requirements of the rule, codifying the positions taken in previous staff no-action letters.[523] The proposed advertising rule provided no such exemption for testimonials or endorsements. The final marketing rule will not have an exemption for nonprofit programs.[524]

We proposed this exemption because we believed that the potential for the solicitor to demonstrate bias towards one adviser or another when there is no profit motive made the protections of the solicitation rule unnecessary.[525] One commenter supported the proposed exemption and suggested that the same type of approach could be helpful for for-profit entities that provide matching of investors and advisers based on objective criteria.[526] However, given the merger of the advertising and solicitation rules and our final rule's requirements, we no longer believe that an exemption for nonprofit programs would be appropriate or necessary. Instead, we believe the requirements of the final rule are important for investors even when the advertisement take the form of a testimonial or endorsement by a nonprofit program.

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523 Some solicitors have, from time to time, requested that the staff not recommend enforcement action under the cash solicitation rule for referral programs with some, or all, of these features. *See* National Football League Players Association, SEC Staff No-Action Letter (Jan. 25, 2002) ("NFLPA Letter"); Excellence in Advertising, Limited, SEC Staff No-Action Letter (Nov. 13, 1986) ("EIA Letter"); International Association for Financial Planning, SEC Staff No-Action Letter (June 1, 1998) ("IAFP Letter"). These staff no-action letters will be nullified following the rescission of the solicitation rule.

524 *See* final rule 206(4)-1(b). The proposed solicitation rule would not have applied to an adviser's participation in a program when the adviser had a reasonable basis for believing that the solicitor is a nonprofit program, participating advisers compensated the solicitor only for the costs reasonably incurred in operating the program, and the solicitor provided clients a list, based on non-qualitative criteria, of at least two advisers. *See* proposed rule 206(4)-3(b)(4). There is no special exception made for nonprofit programs under the current advertising rule.

525 2019 Proposing Release, *supra* footnote 7, at section II.B.7.

526 SIFMA AMG Comment Letter I.

Among other things, our proposed solicitation rule would have required a separate solicitor disclosure that provided investors with certain information including the terms of compensation, and a written agreement between the adviser and solicitor describing the solicitation activities and requiring solicitor compliance with section 206 of the Act.[527] The proposed nonprofit programs exemption would have exempted advisers and solicitors from the requirements of the proposed solicitation rule including the written agreement and disclosure requirements, provided that the adviser and solicitor still met a number of conditions including some advisory oversight and different disclosures.[528]

Under the final rule, though we are not providing an exemption for nonprofit programs *per se*, we took into account that, if there is no or minimal compensation involved, the nonprofit program would fall under the *de minimis* exemption. As a result, many nonprofit programs may effectively be subject to the required disclosures and a part of the adviser oversight provision under the final rule, similar to the proposed exemption under the solicitation rule.[529] Under the final rule, the nonprofit program would need to disclose that it is not a current client of the adviser, the material terms of compensation, which, if any, would be similar to the disclosure

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527 *See* proposed rule 206(4)-3(a)(1).

528 *See* proposed rule 206(4)-3(b)(4), which would have required that: (i) the adviser have a "reasonable basis for believing" that among other things, the solicitor is a nonprofit program and that the solicitor (or adviser) "prominently discloses to the client, at the time of any solicitation activities," certain information; and (ii) solicitor or adviser disclose: (1) the criteria for inclusion on the list of investment advisers; and (2) that investment advisers reimburse the solicitor for the costs reasonably incurred in operating the program.

529 *See* final rule 206(4)-1(b)(4)(i). The proposed nonprofit program exemption would have required that the client receive certain disclosures. *See* proposed rule 206(4)-3(b)(4)(ii). The exemption would have also had a "reasonable basis" standard for the adviser's reliance on the exemption. *See* proposed rule 206(4)-3(b)(4)(i). As with the *de minimis* exemption, nonprofit programs would not have been subject to the disqualification provisions under the proposed rule. *See* proposed rule 206(4)-3(b)(4). Since a person or program would be unlikely to demonstrate bias in referring one adviser over another when neither adviser provides compensation based on the number of referrals made or any other indicator of the potential to earn the adviser profit, we believed, and continue to believe, that an exemption from the disqualification provisions in such cases is appropriate.

under the proposed exemption,[530] and any material conflicts of interest. With respect to the adviser oversight provision, if the nonprofit program falls under the *de minimis* exemption,[531] advisers would only need to have a reasonable basis for believing that the nonprofit program complies with the final rule, rather than a number of specific items as proposed under the solicitation rule.[532]

We believe that the disclosure and advisory oversight requirements under the final rule are more appropriate than, and preferable to, the more tailored disclosures and conditions that were proposed under the nonprofit program exemption. Accordingly, we believe eliminating the proposed nonprofit program exemption is appropriate, and the final rule will subject advisers participating in any referral program, whether nonprofit or for profit, to the rule in order to provide investors with sufficient and necessary information when presented with a testimonial or endorsement of an adviser by such a program. Absent the *de minimis* or other exemption, the rule will subject all referral programs that provide testimonials or endorsements to the required disclosures, adviser oversight and disqualification provisions.

D. Third Party Ratings

As proposed, the final rule will prohibit including third-party ratings in an advertisement, unless they comply with the rule's general prohibitions and additional conditions. An investment adviser may not include a third-party rating in its advertisement unless the adviser has a reasonable basis for believing that any questionnaire or survey used in the preparation of the

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530 The proposed exemption would have required that the solicitor or adviser disclose to the client that investment advisers reimburse the solicitor for the costs reasonably incurred in operating the client. Proposed rule 206(4)-3(b)(4)(ii)(B).

531 Such a program within the *de minimis* exemption will not be subject to the written agreement requirement under the adviser oversight and compliance provision. Final rule 206(4)-1(b)(2)(ii) and (b)(4)(i).

532 *See* proposed rule 206(4)-3(b)(4)(i).

third-party rating meets certain criteria and provides certain disclosures. Several commenters supported the proposed rule's approach of expressly permitting the inclusion of third-party ratings in advertisements.[533] However, one commenter requested that we prohibit third-party ratings in retail advertisements, arguing that advisers will be incentivized to purchase only positive third-party ratings and aggressively market them to mislead investors.[534] We believe that the final rule's conditions for including third-party ratings in an advertisement, discussed in more detail below, in conjunction with the rule's general prohibitions, mitigate any such incentives and safeguard investors from misleading third-party ratings.

The final rule will, as proposed, define "third-party rating" as a "rating or ranking of an investment adviser provided by a person who is not a *related person* (as defined in the Form ADV Glossary of Terms), and such person provides such ratings or rankings in the ordinary course of its business."[535] This definition is intended to permit advisers to use third-party ratings, subject to conditions, when the ratings are conducted in the ordinary course of business. We continue to believe that the ordinary course of business requirement would largely correspond to persons with the experience to develop and promote ratings based on relevant criteria. It would also distinguish third-party ratings from testimonials and endorsements that resemble third-party ratings, but that are not made by persons who are in the business of providing ratings or rankings. The requirement that the provider not be an adviser's related person will avoid the risk that certain affiliations could result in a biased rating.

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533 *See, e.g.*, Blackrock Comment Letter; IAA Comment Letter.

534 *See* NASAA Comment Letter.

535 Rule 206(4)-1(e)(17). An adviser's "related person" is defined in Form ADV's Glossary of Terms as "[a]ny *advisory affiliate* and any *person* that is under common *control* with your firm." Italicized terms are defined in the Form ADV Glossary. We believe that a rating by a person under common control with the adviser could present the same bias towards the adviser as a rating by an adviser's other advisory affiliates.

The final rule also will subject advertisements that include third-party ratings to additional tailored conditions, as proposed. For such advertisements, the final rule will require that the investment adviser have a reasonable basis to believe that any questionnaire or survey used in the preparation of the third-party rating is structured to make it equally easy for a participant to provide favorable and unfavorable responses, and is not designed or prepared to produce any predetermined result (the "due diligence requirement").[536] The final rule also will require that an investment adviser clearly and prominently disclose, or the investment adviser reasonably believes that the third-party rating clearly and prominently discloses: (i) the date on which the rating was given and the period of time upon which the rating was based; (ii) the identity of the third-party that created and tabulated the rating; and (iii) if applicable, that compensation has been provided directly or indirectly by the adviser in connection with obtaining or using the third-party rating (the "disclosure requirement").[537] In order to be clear and prominent, the disclosure must be at least as prominent as the third-party rating.[538] While we are adopting the conditions required for including any third-party rating in an advertisement largely as proposed, we are providing additional clarification on how advisers can comply with such conditions.

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536 *See* final rule 206(4)-1(c).

537 *See id*.

538 Commenters claimed that a "clearly and prominently" disclosure standard would pose challenges for certain advertisements, including advertisements on certain social media or internet platforms, if hyperlinking is not permitted. *See, e.g.*, Fidelity Comment Letter; LinkedIn Comment Letter; MMI Comment Letter. As discussed above, we continue to believe that it would not be consistent with the clear and prominent standard to use a hyperlink to include the disclosures required under the final rule. *See supra* section II.C.2.a. Instead, such required disclosures should be included within the advertisement.

Several commenters requested guidance on how an adviser can satisfy the due diligence requirement.[539] We continue to believe that an adviser could satisfy the requirement by accessing the questionnaire or survey that was used in the preparation of the rating. We are persuaded by commenters' concerns, however, that third-party rating agencies may be reluctant to share proprietary survey or questionnaire information to advisers, such as their calculation methodology.[540] Accordingly, we are clarifying that obtaining the questionnaire or survey used in the preparation of the rating is not the only means to satisfy this requirement. We also do not believe that this condition requires an adviser to obtain complete information about how the third-party rating agency collects underlying data or calculates a rating, as one commenter suggested.[541] Nevertheless, we continue to believe that an adviser relying solely on the results of a survey or questionnaire – *i.e.*, the rating itself – without conducting some due diligence into the underlying methodology and structure, could give rise to advertisements that include misleading ratings. To satisfy the due diligence requirement, an adviser could seek representations from the third-party rating agency regarding general aspects of how the survey or questionnaire is designed, structured, and administered. Alternatively, a third party rating provider may publicly disclose similar information about its survey or questionnaire methodology. In either case, the adviser could obtain sufficient information to formulate a reasonable belief as required by the due diligence requirement without obtaining proprietary data of third-party rating agencies.

The first provision of the disclosure requirement – the date on which the rating was given and the period of time upon which the rating was based – will assist investors in evaluating the

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539 *See, e.g.*, Blackrock Comment Letter (suggesting that firms might not be willing to provide proprietary survey methodology information to advisers); MFA/AIMA Comment Letter I; IAA Comment Letter; AIC Comment Letter.

540 *See, e.g.*, Blackrock Comment Letter; AIC Comment Letter.

541 *See* IAA Comment Letter.

relevance of the rating. Ratings from an earlier date, or that are based on information from an earlier period, may not reflect the current state of an investment adviser's business. An advertisement that includes an older rating would be misleading without clear and prominent disclosure of the rating's date.[542]

The second provision of the disclosure requirement – the identity of the third party that created the rating – is important because it will provide investors with the opportunity to assess the qualifications and credibility of the rating provider. Investors can look up a third party by name and find relevant information, if available, about the third party's qualifications and can form their own opinions about credibility.

The final provision of the disclosure requirement – that compensation has been provided directly or indirectly by the adviser in connection with obtaining or using the third-party rating – provides consumers with important context for weighing the relevance of the statement in light of the compensation incentive.[543] Although the final rule uses the term "compensation," this term continues to refer to cash and non-cash compensation, as proposed. Similarly, the final rule replaces the phrase "by or on behalf" with "directly or indirectly." As discussed above, this reflects a non-substantive change to use a phrase that we believe is commonly understood in the industry.[544]

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542 In addition, an adviser would be required to provide contextual disclosures of subsequent, less-favorable performance in the rating, if applicable. *See* final rule 206(4)-1(a).

543 In many cases, third-party ratings are developed by relying significantly on questionnaires or client surveys and involve different compensation models. For example, some investment advisers compensate the third-party ratings firm for the right to include the ratings or rankings that are calculated as a result of the survey in their advertisements. Other investment advisers compensate the third-party ratings firm to be included in the initial pool of advisers from which the rating or ranking is determined.

544 *See supra* section II.A.

While the final rule explicitly requires these three disclosures, they would not cure a rating that could otherwise be false or misleading under the final rule's general prohibitions or under the general anti-fraud provisions of the Federal securities laws. For example, where an adviser's advertisement references a recent rating and discloses the date, but the rating is based upon on an aspect of the adviser's business that has since materially changed, the advertisement would be misleading. Likewise, an adviser's advertisement would be misleading if it indicates that the adviser is rated highly without disclosing that the rating is based solely on a criterion, such as assets under management, that may not relate to the quality of the investment advice.

E. Performance Advertising

The final rule's general prohibitions apply to advertisements that include performance results ("performance advertising"), as proposed. We are adopting specific requirements and restrictions for performance advertising, with some changes from the proposal as described below. We continue to believe that performance advertising raises special concerns that warrant additional requirements and restrictions under the final marketing rule.[545] In particular, the presentation of performance could lead reasonable investors to unwarranted assumptions and thus would result in a misleading advertisement.[546] Some commenters objected to the proposed rule's specific performance advertising provisions, favoring relying only on the rule's general prohibitions for non-retail investors.[547] However, commenters generally did not advocate for the removal of the performance advertising provisions as a whole. After considering comments, we

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545 *See* 2019 Proposing Release, *supra* footnote 7, at text accompanying n. 181.

546 For example, investors may rely particularly heavily on advertised performance results in choosing whether to hire or retain an investment adviser or invest in a private fund managed by the adviser. This reliance may be misplaced to the extent that an investor considers past performance achieved by an investment adviser to be predictive of the results that the investment adviser will achieve for the investor.

547 *See, e.g.,* MFA/AIMA Comment Letter I; AIC Comment Letter I.

remain convinced that additional protections should apply to advertisements that include performance results.

We proposed several requirements for all advertisements that include performance advertising. Specifically, under our proposal, an advertisement could not: (i) include gross performance, unless the advertisement provided or offered to provide a schedule of fees and expenses deducted to calculate net performance (the "proposed schedule of fees requirement"); (ii) contain any statement that the performance results have been approved or reviewed by the Commission (the "Commission approval requirement"); and (iii) provide related, extracted, or hypothetical performance without meeting specific conditions.[548] For Retail Advertisements,[549] our proposal also would have required that: (i) any presentation of gross performance also include net performance, subject to conditions (the "net performance requirement"); and (ii) any performance results of a portfolio or composite aggregation of related portfolios include performance results for one-, five-, and ten-year periods, subject to conditions (the "time period requirement").[550] As discussed in more detail below, the final rule substantially adopts the proposed rule's requirements, and applies them to all advertisements that include performance advertising. Unlike the proposed rule, the final rule does not provide separate requirements for performance advertising in Retail Advertisements and Non-Retail Advertisements and will not include the proposed schedule of fees requirement.

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548 Proposed rule 206(4)-1(c)(1).

549 We proposed to define clients and investors that are "qualified purchasers" or "knowledgeable employees" as "Non-Retail Persons" and to define all other clients and investors as "Retail Persons." *See* proposed rule 206(4)-1(e)(8) and (14). Similarly, the proposed rule distinguished between advertisements for which an adviser has adopted and implemented policies and procedures reasonably designed to ensure that the advertisements are disseminated solely to Non-Retail Persons as "Non-Retail Advertisements" and all other advertisements as "Retail Advertisements." *See* proposed rule 206(4)-1(e)(7) and (13).

550 Proposed rule 206(4)-1(c)(2).

1. Net Performance Requirement; Elimination of Proposed Schedule of Fees Requirement

The final rule will prohibit any presentation of gross performance in an advertisement unless the advertisement also presents net performance (i) with at least equal prominence to, and in a format designed to facilitate comparison with, the gross performance; and (ii) calculated over the same time period, and using the same type of return and methodology as, the gross performance.[551] The final rule applies the net performance requirement to *all* advertisements, not only to Retail Advertisements and, in turn, eliminates the proposed schedule of fees requirement.[552] We discuss below the benefits of expanding the net performance requirement to all performance advertisements in light of the removal of the proposed schedule of fees requirement, and the anticipated effects on advisers.

Some commenters supported our proposal to require advisers that present gross performance in Retail Advertisements to present net performance.[553] They agreed that presentations of net performance help demonstrate the effect that fees and expenses will have on future performance. One commenter also stated that providing net performance information to Non-Retail Persons alerts them to the fact that fees and expenses may significantly reduce performance.[554]

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551 Final rule 206(4)-1(d)(1).

552 *Id*.

553 *See* Consumer Federation Comment Letter; CFA Institute Comment Letter; Proskauer Comment Letter. The majority of commenters who responded via the Investor Feedback Flyer marked net performance results as "Very Important."

554 *See* NYC Bar Comment Letter (expressing this idea in the context of its overall argument that the rule should not require an adviser to provide (or offer to provide) a schedule of fees and expenses to Non-Retail Persons when also presenting net performance).

Some commenters also supported our proposal to allow advisers to exclude net performance in Non-Retail Advertisements, stating that Non-Retail Persons are often not at risk of being misled by gross performance.[555] However, another commenter stated that many Non-Retail Persons investing in private funds prefer to receive both net and gross performance results in advertisements because it provides an opportunity to cross check the investors' net performance calculations against advisers' calculations.[556]

In addition, while some commenters supported permitting different performance presentations in Retail and Non-Retail Advertisements,[557] other commenters stated that it could create operational, administrative, and compliance burdens for advisers, and significant potential for errors.[558] Some commenters stated that advisers would face difficulties in controlling the distribution of Non-Retail Advertisements pursuant to policies and procedures that would be required under the proposal.[559] A few commenters also raised concerns that in some cases Retail and Non-Retail Persons may invest in the same fund, but may receive different types or levels of information because of the proposed rule's bifurcated approach.[560]

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555 *See, e.g.*, IAA Comment Letter; Proskauer Comment Letter (stating that for Non-Retail Persons, disclosure that gross performance is gross and not net is sufficient); CFA Institute Comment Letter; MFA/AIMA Comment Letter I; Blackrock Comment Letter.

556 *See* ILPA Comment Letter.

557 *See, e.g.,* CFA Institute Comment Letter; Consumer Federation Comment Letter.

558 *See, e.g.*, NYC Bar Comment Letter; NSCP Comment Letter; AIC Comment Letter I; NAPFA Comment Letter; ACG Comment Letter.

559 *See, e.g.*, NSCP Comment Letter; IAA Comment Letter (stating that prospective investors typically do not provide information about their retail or non-retail status at the marketing stage, and stating that in the case of non-U.S. investors, this information is generally not gathered at any stage).

560 *See* Ropes & Gray Comment Letter; Association for Corporate Growth Comment Letter. For example, a private fund that relies on section 3(c)(1) of the Investment Company Act may have investors that qualify as Retail and Non-Retail Persons under the proposed amendments to the advertising rule. Retail Persons would receive different disclosures under the proposal, raising the possibility of unequal treatment and potential questions about fair disclosure. *See* proposed rule 206(4)-1(c)(1) and (2).

After considering comments, we believe that the net performance requirement is reasonably designed to prevent all types of prospective clients and private fund investors from being misled by the presentation of gross performance in an advertisement. Presenting gross performance alone in this context may imply that investors received the full amount of the presented returns, when the fees and expenses paid in connection with the investment adviser's investment advisory services would reduce the returns to investors. Presenting gross performance alone also may be misleading to the extent that amounts paid in fees and expenses are not deducted and thus not compounded in calculating the returns. In addition, we believe that presenting net performance in all advertisements will help illustrate for investors the effect of fees and expenses on the advertised performance results and allow all investors to compare the adviser's performance presentation with their own calculations, if applicable. We do not believe the burden will be considerable given that many advisers already present net performance.[561]

Given the operational complexity and challenges that commenters noted, as well as changes we are making to the final rule to streamline the performance presentation requirements for all advisers, we are persuaded that the rule should no longer provide different flexibility for advertisements to Non-Retail Persons. Accordingly, the final rule implements changes from the proposed rule that we believe, when viewed as a whole, simplify the rule's compliance for all advisers, while preserving and promoting protection for all investors. In particular, we are eliminating the proposed schedule of fees requirement. Commenters stated that this requirement could be overly burdensome for advisers and may not provide relevant information to

561 *See* CFA Institute Comment Letter.

investors.[562] Some commenters also stated that Non-Retail Persons are in a position to negotiate for appropriately tailored disclosures based on their particular needs.[563] While one commenter disagreed, arguing that investors in private funds (including Non-Retail Persons) sometimes have difficulty obtaining information regarding fees and expenses for complex products,[564] we believe requiring net performance for all advertisements with appropriate disclosures will alert investors to the effect of fees on an adviser's performance results.

As proposed, the final rule will not prescribe disclosure requirements for net and gross performance presentations. Instead, an adviser would need to comply with the final rule's general prohibitions. Comments were mixed on this aspect of the proposal.[565] We continue to believe, however, that advisers should evaluate the particular facts and circumstances that may be relevant to investors, including the assumptions, factors, and conditions that contributed to the performance, and include appropriate disclosures or other information such that the advertisement does not violate the prohibitions in paragraph (a) of the final rule or other applicable law. Depending on the facts and circumstances, disclosures may include: (1) the material conditions, objectives, and investment strategies used to obtain the results portrayed; (2) whether and to what extent the results portrayed reflect the reinvestment of dividends and other earnings; (3) the effect of material market or economic conditions on the results portrayed; (4)

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562 *See, e.g.*, MFA/AIMA Comment Letter I; IAA Comment Letter; CFA Institute Comment Letter (stating that they do not believe it is feasible for an adviser that presents gross returns to provide the proposed fee schedule, but that advisers should disclose certain information about fees a client will pay).

563 *See* MFA/AIMA Comment Letter I; NYC Bar Comment Letter.

564 *See* ILPA Comment Letter.

565 *See, e.g.,* NAPFA Comment Letter (opposing additional disclosure requirements); NRS Comment Letter (supporting additional disclosure requirements). *See also* ILPA Comment Letter (requesting that the Commission incorporate specific disclosures for non-retail investors reviewing private equity fund performance advertising).

the possibility of loss; and (5) the material facts relevant to any comparison made to the results of an index or other benchmark.[566]

a. *Definition of Gross Performance*

Similar to the proposal, both "gross performance" and "net performance" will be defined by reference to a "portfolio," which is defined as "a group of investments managed by the investment adviser" and can include "an account or private fund."[567] Under the final rule, "gross performance" is defined to mean the performance results of a portfolio (or portions of a portfolio that are included in extracted performance, if applicable) before the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant portfolio.[568] We are adopting the definition of gross performance as proposed, with one change to require, as a commenter requested, that advisers that show extracted performance in accordance with the final marketing rule must show net and gross performance for the applicable subset of investments extracted from a portfolio.[569] This change clarifies that gross performance applies not only to an entire portfolio but also to a portion of a portfolio that is included in extracted performance.

Gross performance does not show the impact of all fees and expenses that the adviser's existing investors have borne or that prospective investors would bear, which can be relevant to an evaluation of the investment experience of the adviser's advisory clients and/or investors in private funds advised by the investment adviser.[570] While commenters generally supported the

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566 *See* 2019 Proposing Release, *supra* footnote 7, at nn.191-195.

567 Final rule 206(4)-1(e)(11). *See also* proposed rule 206(4)-1(e)(10).

568 Final rule 206(4)-1(e)(7).

569 *See* CFA Institute Comment Letter. *See infra* section II.E.5 (discussing extracted performance).

570 *See* 2019 Proposing Release, *supra* footnote 7, at text accompanying nn.235-236.

proposed definition of gross performance, some requested that we clarify the types of fees and expenses advisers must deduct in calculating gross performance.[571] For example, some commenters requested we specify that gross returns should reflect the deduction of transaction costs, if any exist.[572] One of these commenters also requested that we add a definition for "pure gross returns" (*i.e.*, returns that do not reflect the deduction of any transaction costs), and require advisers to make additional disclosures when presenting pure gross returns in advertisements.[573] The same commenter requested that we clarify that advisory fees paid to underlying investment vehicles must be deducted from gross performance.

Like the proposed rule, the final rule does not prescribe any particular calculation of gross performance. For example, many private funds use money-weighted returns instead of time-weighted returns.[574] Under the final rule, advisers may use the type of returns appropriate for their strategies provided that the usage does not violate the rule's general prohibitions, and, if applicable, subject to the requirements discussed below.[575] We continue to believe that, because of the variation among types of advisers and investments, prescribing the calculation could unduly limit the ability of advisers to present performance information that they believe would be most relevant and useful to an advertisement's audience. However, if an investment adviser calculates the performance of a portfolio in part by deducting transaction fees and expenses, but

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571 *See, e.g.*, IAA Comment Letter; CFA Institute Comment Letter.

572 *See* IAA Comment Letter (recommending for all cases where an investment adviser has discretion and is responsible for the execution of client transactions); CFA Institute Comment Letter (recommending for all presentations of gross returns other than those the adviser describes as "pure gross returns").

573 CFA Institute Comment Letter ("Pure gross returns are commonly used when transaction costs are bundled with investment management fees, such as in a wrap fee arrangement."). This commenter also requested that we clarify whether returns of accounts that pay zero commissions are gross returns or pure gross returns.

574 *See, e.g.*, CFA Institute Comment Letter.

575 *See, e.g., supra* section II.B; *infra* section II.E.

deducts no other fees or expenses, then such performance would be "gross performance." If an investment adviser's calculation of performance reflects the deduction of advisory fees paid to an underlying investment vehicle before the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant portfolio, then such performance would be "gross performance."

It would be misleading to present gross performance information without providing appropriate disclosure about gross performance, taking into account the particular facts and circumstances of the advertised performance. Advisers generally should describe the type of performance return presented in the advertisement. For example, an advertisement may or may not present the performance of a portfolio using a return that accounts for the cash flows into and out of the portfolio. In either case, under the final rule, an adviser generally should disclose what elements are included in the return presented so that the audience can understand, for example, how it reflects cash flow and other relevant factors. Similarly, if an adviser's presentation of gross performance does not reflect the deduction of transaction fees and expenses, an adviser should disclose that fact to avoid being misleading, if it would not be clear to the investor from the context of the advertisement.[576]

b. *Definition of Net Performance*

We are adopting the definition of net performance as proposed, with some modifications. First, as with gross performance and for the same reasons, the final rule provides that net performance applies not only to an entire portfolio but also to a portion of a portfolio that is included in extracted performance. Second, we are specifying when advisers may exclude

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576 Even though we are not adopting a definition of "pure gross performance," as one commenter suggested, we believe that any adviser that presents such performance results in addition to gross performance and net performance should identify pure gross returns and disclose that pure gross returns do not reflect the deduction of transaction costs, to avoid misleading recipients of the advertisement.

certain custodian fees paid to third parties. Third, we are prescribing some aspects of the calculation of net performance using model fees.

The final rule defines "net performance" to mean, in part, the performance results of a portfolio (or portions of a portfolio that are included in extracted performance, if applicable) after the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant portfolio.[577] Once an adviser establishes the "portfolio" for which performance results are presented, the adviser must determine the fees and expenses borne by the owner of the portfolio and then deduct those to establish the "net performance."

The final rule includes a non-exhaustive list of the types of fees and expenses to be considered in preparing net performance that is identical to the proposal.[578] This list includes, if applicable, advisory fees, advisory fees paid to underlying investment vehicles, and payments by the investment adviser for which the client or investor reimburses the investment adviser. It illustrates fees and expenses that clients or investors bear in connection with the services they receive. In addition, "net performance" may exclude custodian fees paid to a bank or other third-party organization for safekeeping funds and securities. Finally, the final rule permits the use of a model fee in calculating net performance in an advertisement, subject to conditions.

A few commenters supported the proposed definition of net performance.[579] Some commenters, however, requested we prescribe additional requirements for net performance

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577 Final rule 206(4)-1(e)(10).

578 *See* proposed rule 206(4)-1(e)(6).

579 *See* IAA Comment Letter; MFA/AIMA Comment Letter I; NRS Comment Letter.

calculations, including specific requirements for certain private funds.[580] For example, one commenter recommended that, when clients cannot "opt out" of custody or other administrative costs, the rule should expressly require the adviser to deduct these fees and costs when presenting net returns of a specific pooled investment vehicle.[581] This commenter requested that we clarify that when presenting net performance of a specific pooled fund, advisers must deduct administrative fees, as required when complying with the CFA Institute's Global Investment Performance Standards ("GIPS standards"). Some commenters supported our proposal not to prescribe specific calculations, stating that there is no single correct way to calculate returns.[582] Some of these commenters also requested we clarify that net performance calculations in advertisements must reflect the deduction of any transaction costs and investment advisory fees (including any performance-based fees or carried interest). One commenter requested clarification that net performance fees exclude taxes on gains generated in a portfolio.[583]

As proposed, the final rule does not prescribe any particular calculation of net performance. We believe that prescribing the calculation of net performance could unduly limit the ability of advisers to present performance information that they believe would be most relevant and useful to an advertisement's audience. Therefore, the final rule's definition continues to include a non-exhaustive list of the types of fees and expenses to be considered in preparing net performance. We decline, however, to enumerate all potential private fund fees

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580 *See* Consumer Federation Comment Letter (stating that the Commission should require advisers to comply with a uniform set of principles when calculating performance). *See also* CFA Institute Comment Letter; ILPA Comment Letter (both letters discussing particular concerns regarding private equity funds).

581 *See* CFA Institute Comment Letter.

582 *See, e.g.,* IAA Comment Letter; NRS Comment Letter.

583 *See* Resolute Comment Letter.

and expenses, as one commenter suggested.[584] Instead, the final rule's definition of net performance requires the deduction of private fund fees and expenses that the investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant fund.

However, we are clarifying in response to some commenters that any adviser that deducts applicable transaction fees and expenses, or advisory fees paid to an underlying investment vehicle, when calculating gross performance should also do so for net performance. We are also clarifying that, under the final rule's definition of net performance, advisory fees include performance-based fees and performance allocations that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant portfolio. With respect to administrative fees and expenses that a commenter raised, whether a client or investor pays them in connection with the investment adviser's advisory services (and therefore they must be deducted) depends on the facts and circumstances. For example, if an adviser agrees to bear certain administrative fees as a result of negotiations with investors in the private fund, or if an investor agrees to directly bear them, we do not believe that those fees should be included in the calculation of net performance. In response to a commenter discussed above, we believe that capital gains taxes paid outside of the portfolio are not fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services (and are therefore not required to be deducted in the calculation of net performance).[585]

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584 *See* ILPA Comment Letter.

585 *See* Resolute Comment Letter.

In addition, as proposed, the definition of net performance refers to the deduction of all fees that an investor "has paid or would have paid" in connection with the services provided. That is, where hypothetical performance is permissibly advertised under the final rule, net performance should reflect the fees and expenses that "would have" been paid if the hypothetical performance had been achieved by an actual portfolio.[586]

c. *Deduction of Custodian Fees Paid to a Bank or Other Third-Party Organization*

Under the final rule, presentation of "net performance" in an advertisement may exclude custodian fees paid to a bank or other third-party organization for safekeeping funds and securities, as proposed.[587] We understand that advisory clients commonly select and directly pay custodians, and in such cases, advisers may not have knowledge of the amount of such custodian fees to deduct for purposes of establishing net performance.

One commenter supported this treatment for non-pooled investment vehicles, stating that the rule should not require an adviser to reflect the deduction of custodian fees when clients select their custodians.[588] However, this commenter also recommended that the rule expressly require custody fee deduction if a client cannot "opt-out" of paying those fees.

After considering comments, we continue to believe that the final rule should allow an adviser to exclude custodian fees paid to third parties given a client may control custodian selection (and accompanying fees). We believe that this approach is appropriate even where advisers know the amount of custodian fees – *e.g.*, where the adviser recommended the custodian. However, to the extent a client or investor pays an adviser, rather than a third party,

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586 Final rule 206(4)-1(e)(10).

587 Final rule 206(4)-1(e)(10)(i). *See* proposed rule 206(4)-1(e)(6)(iii).

588 *See* CFA Institute Comment Letter. *See also* IAA Comment Letter (supporting permitting the exclusion of custodian fees, generally).

for custodial services, then the adviser must deduct the custodial fee in calculating net performance for purposes of the advertisement. This will be the case, for example, when an adviser provides custodial services with respect to funds or securities for which the performance is presented and charges a separate fee for those services, or when custodial fees are included in a single fee paid to the adviser, such as if they are included in wrap fee programs. This would also be the case when a client or investor reimburses the investment adviser for third-party custodian fees.

d. *Deduction of Model Fees*

Under the final rule, presentation of "net performance" in advertisements may reflect the deduction of a model fee when doing so would result in performance figures that are no higher than if the actual fee had been deducted, as proposed.[589] This will result in performance that is no higher than if the adviser deducted actual fees. For example, in a private fund with multiple series or classes where each series or class has different fees, an adviser may display the performance of the highest fee class. We did not receive any comments on this aspect of the proposal. Advisers may choose this modification to ease calculating net performance. When an adviser advertises net performance that is no higher than if deducting actual fees, there appears to be little chance of misleading the audience into believing that investors received better returns than they actually did.[590]

The rule also will allow net performance to reflect the deduction of a model fee that is equal to the highest fee charged to the intended audience to whom the advertisement is

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589 Final rule 206(4)-1(e)(10)(ii)(A).

590 If the fee to be charged to the intended audience is anticipated to be higher than the actual fees charged, the adviser must use a model fee that reflects the anticipated fee to be charged in order not to violate the rule's general prohibitions. *See id*. *See also* final rule 206(4)-1(a).

disseminated, similar to as proposed.[591] We continue to believe that allowing advisers to present net performance that reflects the deduction of this type of model fee may be useful for advisers who manage a particular strategy for different types of investors. For example, under the final rule, an adviser managing several accounts, each using the same investment strategy, could present in an advertisement the gross and net performance of all such accounts. For net performance, the adviser may deduct a model fee equal to the highest fee charged to retail investors (assuming an intended retail audience). This provision of the definition of net performance does not permit net performance that reflects a model fee that is not available to the intended audience. One commenter requested that we permit advisers to deduct model fees that reflect either the highest fee that was charged historically or the highest potential fee that it will charge the investors or clients receiving the particular advertisement, provided the performance is accompanied by appropriate disclosure.[592] Under the final rule, an adviser does not have discretion to choose the model fee to use in calculating net performance – it must use the higher of these two model fees.[593]

Another commenter supported this provision, but stated that where an adviser has not yet managed an actual account for clients or investors similar to the relevant audience, the rule

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591 Final rule 206(4)-1(e)(10)(ii)(B). The final rule reflects one change from the proposal, in response to a commenter that requested that we conform the phrase "relevant audience" in the proposed rule's model fee provision, to other parts of the rule. *See* CFA Institute Comment Letter. We agree, and have revised the provision to refer to the "intended audience to whom the advertisement is disseminated."

592 *See* MMI Comment Letter.

593 *See supra* footnote 590 (discussing the final rule's first model fee provision and the general prohibitions). As discussed above, net performance that reflects a model fee that is not available to the intended audience is not permitted under the final rule's second model fee provision.

should permit the adviser to deduct a model fee that is equal to the highest fee to be charged to relevant audience.[594] We agree, and the final rule requires the use of such a model fee.[595]

Another commenter expressed concern that the proposed rule would require an adviser to overstate its normal fee, when deducting a model fee, because the adviser had previously charged a client a higher fee for unique relationship servicing requirements.[596] If an adviser charged a higher fee for unique services that it does not intend to provide in the future to the intended audience for the advertisement, the portfolio may be outside of the scope of the adviser's performance calculation. For example, it may not meet the criteria for a related portfolio and, in that case, should not be included in the calculation of related performance.

Similarly, one commenter stated that the rule should not require an adviser to deduct a model fee when presenting performance of a portfolio of a non-fee paying client.[597] This commenter requested that we instead permit such adviser to calculate net performance returns using actual investment management fees (*i.e.*, zero fees) and disclose the percentage of assets under management represented by non-fee paying portfolios. Further, this commenter stated that the GIPS standards do not require the application of a model fee to non-fee-paying portfolios to calculate net returns, and that requiring it in the final rule may result in many advisers being required to restate historical performance. We believe this presentation could mislead investors to believe that they could receive returns as high as non-fee paying clients, even with the

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594 *See* CFA Institute Comment Letter.

595 *See* final rule 206(4)-1(e)(10) (referring, in the definition of net performance, to the deduction of all fees and expenses that a client or investor "would have paid"). An adviser could use such a model fee pursuant to the second model fee provision. Final rule 206(4)-1(e)(10)(ii)(B).

596 *See* Wellington Comment Letter.

597 *See* CFA Institute Comment Letter.

commenter's proposed disclosure. In the 2019 Proposing Release, we expressed similar concerns with presenting related performance of accounts with fee waivers or reduced rates unavailable to unaffiliated clients of the adviser.[598] Accordingly, to satisfy the final rule's general prohibitions, an adviser generally should apply a model fee that reflects either the highest fee that was charged historically or the highest potential fee that it will charge the investors or clients receiving the particular advertisement.

One commenter requested clarification that model fees also may exclude custodian fees that would be paid to a bank or other third-party organization.[599] We agree that an adviser that uses a model fee in accordance with the final rule may also exclude custodian fees if otherwise permitted under the final rule.

e. *Conditions for Presentation*

As proposed, the final rule will require that net performance be presented in the advertisement 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.[600] These conditions are designed to help ensure that net performance effectively conveys to the audience information about the effect of fees and expenses on the relevant performance. A calculation of net performance over a different time period or using a different type of return or methodology would not necessarily provide information about the effect of fees and expenses. Only one commenter discussed this condition and recommended that the Commission encourage advisers

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598 *See* 2019 Proposing Release, *supra* footnote 7, at text following footnote 288.

599 *See* IAA Comment Letter.

600 Final rule 206(4)-1(d)(1)(i) and (ii).

to be certain that the layout of the information presented is not misleading.[601] As described above, advertisements containing any performance presentation will be subject to the rule's general prohibitions.

2. Prescribed Time Periods

Our final rule also adopts the proposed one-, five-, and ten-year time period requirement for the presentation of performance results in an advertisement, with some modifications from the proposed rule. First, the final rule applies the time period requirement to all advertisements (with a new exception for private funds), rather than only to Retail Advertisements, as proposed.[602] Second, prescribed time periods must end on a date that is no less recent than the most recent calendar year-end, rather than the most recent practicable date, as proposed.[603] As proposed, this time period requirement will apply to all performance results, including gross and net performance, and including any composite aggregation of related portfolios. Also, as proposed, if the relevant portfolio did not exist for a particular prescribed period, then an adviser must present performance information for the life of the portfolio.[604] For example, if a portfolio has been in existence for seven years, then the adviser must show performance results for one- and five-year periods, as well as for the seven-year period. An investment adviser is free to include performance results for other periods as long as the advertisement also presents results for the prescribed time periods, and otherwise complies with the requirements of the final rule.[605]

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601 *See* CFA Institute Comment Letter.

602 Final rule 206(4)-1(d)(2). *See* proposed rule 206(4)-1(c)(2)(ii).

603 *See id*.

604 *See id*.

605 For example, an adviser may present performance results for three-year periods, which is a requirement for advisers that claim compliance with the GIPS standards. *See, e.g.*, CFA Institute Comment Letter. We are not requiring a three-year period, however, because we believe the time periods required under the final rule already provide investors with sufficient information regarding performance over varying time periods.

The final rule also adopts the proposed requirement that the prescribed time periods be presented with equal prominence in the advertisement, so that an investor can observe the history of the adviser's performance on a short-term and long-term basis.[606] An adviser may not highlight the single one-, five-, or ten-year period that shows the best performance, instead of showing them in relation to each other.

We believe this standardized presentation provides the audience with insight into the experience of the investment adviser over set periods that are likely to reflect how the advertised portfolio(s) performed during different market or economic conditions. For portfolios in existence for at least ten years, performance for that period could provide investors with more complete information than only performance over the most recent year. That performance may prompt investors to seek additional information from advisers regarding the causes of significant changes in performance over longer periods. Some commenters supported this aspect of the proposal for this reason.[607] These commenters also stated that this information would aid investors in comparing different performance advertisements and reduce the risk that advisers would present performance based on cherry-picked periods.

Several commenters stated that the proposed time period requirement for closed-end private funds, however, would be inappropriate and confusing for investors, in part, because such performance (especially five- and ten-year periods) may not exist for the fund advertised, since private funds are often advertised to investors at early stages.[608] In addition, commenters stated that the performance of private equity funds can vary substantially over the term of the fund

606 Final rule 206(4)-1(d)(2).

607 *See* Consumer Federation Comment Letter; CFA Institute Comment Letter; Fried Frank Comment Letter.

608 *See* AIC Comment Letter I; Fried Frank Comment Letter; MFA/AIMA Comment Letter I; IAA Comment Letter; Ropes & Gray Comment Letter; NYC Bar Comment Letter.

(with early years often negatively affected by organizational expenses of the "J-curve"), and that the presentation of performance over prescribed time periods is therefore not useful to investors.[609] Similarly, commenters noted that the presentation of performance using an internal rate of return, as is typical with private equity funds, is often not meaningful in the early years of the fund because the fund is not fully invested, no investments have been harvested, and the new investments likely have not changed in value.[610]

In light of our decision not to distinguish the treatment of Retail and Non-Retail Advertisements, and after considering comments, we agree that requiring advisers to provide performance results of private funds over one-, five-, and ten-year periods in advertisements will not provide investors with useful insight into how the advertised portfolio(s) performed during different market or economic conditions. Our final rule therefore applies the time period requirement to all performance advertisements, except for performance of a private fund.[611] An adviser may rely on this exception when displaying performance advertising of *any* type of private fund, rather than only when displaying performance advertising of private equity funds or other closed-end private funds. We believe that it is appropriate to except any private fund because there may be additional types of private funds than those identified by commenters for which displaying this information could be misleading. We decline to allow only certain defined types of private funds to rely on this exception, given the varied limitations that private funds may place on redemptions now and in the future. We also do not believe the benefit of having advisers parse the rule's requirements based on specific fund types would justify the complexity.

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609 *See, e.g.*, AIC Comment Letter; Fried Frank Comment Letter; Ropes & Gray Comment Letter; IAA Comment Letter.

610 *See* Fried Frank Comment Letter; MFA/AIMA Comment Letter I.

611 Final rule 206(4)-1(d)(2). *See also* final rule 206(4)-1(e)(13) (defining private fund).

Further, although we are not mandating presentation of performance for any specific time periods for these funds, presentations of private fund performance are subject to the general anti-fraud provisions of the Federal securities laws and the general prohibitions in the final rule, including the prohibition of including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced.[612]

Other commenters stated that our proposal would create operational difficulties for advisers that present annual returns as of the most recent calendar year-end.[613] A commenter stated that, for these advisers, the proposal's requirement to present one-, five-, and ten-year returns as of the "most recent practicable date" would require that they continuously update their performance presentations throughout the year.[614] This commenter requested we permit annual returns presented through the most recent calendar year-end. This commenter also requested that the final rule align with the GIPS standards by allowing advisers to present annual returns for the past ten years (or since inception if the track record exists for less than ten years) as of the most recent calendar year end, instead of one-, five-, and ten-year annualized returns.

We understand that, for some advisers, the most recent calendar year-end may be the most recent practicable date. Our final rule therefore requires that the prescribed time period end on a date that is no less recent than the most recent calendar year-end. In selecting time periods for purposes of an advertisement, an adviser may not select the periods that show only the most

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612 *See* Fried Frank Comment Letter; Ropes & Gray Comment Letter (discussing that when not using time-based performance, there is a potential for investment advisers to cherry-pick only recent performance results or strong performance years, or otherwise mislead investors by using "not meaningful" to show performance information).

613 *See* CFA Institute Comment Letter; IAA Comment Letter.

614 CFA Institute Comment Letter. *Cf.* MMI Comment Letter (requesting that our final rule permit advisers to present quarterly performance results).

favorable performance – *e.g.,* presenting a five-year period ending on a particular date because that five-year period showed growth while presenting a ten-year period ending on a different date because that ten-year period showed growth. Depending on the facts and circumstances, an adviser may be required to present performance results as of a more recent date than the most recent calendar year-end to comply with the rule's general prohibitions.[615] For example, it could be misleading for an adviser to present performance returns as of the most recent calendar year-end if more timely quarter-end performance is available and events have occurred since that time that would have a significant negative effect on the adviser's performance. If more recent quarter-end performance data is not available, the adviser should include appropriate disclosure about the performance presented in the advertisement.

We are also clarifying that, for an adviser that provides performance results in advertisements for periods other than one, five, and ten years, the adviser is free to include such results as long as the advertisement presents results for the final rule's required time periods. Thus, an adviser that complies with the GIPS standards may present annual returns for the past ten years (or since inception if the track record exists for less than ten years) as of the most recent calendar year end, in addition to performance results for the final rule's required periods.

3. Statements about Commission Approval

As proposed, the final rule prohibits any statement, express or implied, that the calculation or presentation of performance results in the advertisement has been approved or reviewed by the Commission in any advertisement containing performance results.[616] This

615 *See, e.g.,* final rule 206(4)-1(a)(6) (an advertisement may not include or exclude performance results, or present performance time periods, in a manner that is not fair and balanced).

616 Final rule 206(4)-1(d)(3).

approval prohibition is intended to prevent advisers from representing that the Commission has approved or reviewed the performance results, even when the adviser is presenting performance results in accordance with the rule. Furthermore, the final rule's general prohibitions have the effect of prohibiting an adviser from stating or implying that *any* part of an advertisement, and the advertisement as a whole, has been approved or reviewed by the Commission.[617] Our final rule prescribes this condition specifically for advertisements containing performance results because of the particular weight an investor would likely give to performance results that it believes the Commission has reviewed or vetted.

We received few comments on this aspect of the proposed rule, with one commenter supporting it and the other requesting clarification as to whether this provision would prohibit advertisements that combine performance results with summary information about an adviser's recent SEC examination.[618] We continue to believe that performance results may lead to a heightened risk of creating unrealistic expectations in an advertisement's audience. An express or implied statement that the Commission has reviewed or approved the performance results could advance such unrealistic expectations. For example, while potentially true, a statement that "performance results are prepared in compliance with the Commission's requirements on performance presentations in advertisements" may mislead an investor into thinking that the Commission has approved the results portrayed.[619] Such a statement could also be misleading to the extent it suggests that the Commission has reviewed or approved more generally the

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617 Final rule 206(4)-1(a)(3).

618 *See, e.g.,* Mercer Comment Letter (supporting this aspect of the proposed rule).

619 Similarly, section 208(a) of the Act, states that it is unlawful for a registered investment adviser to represent or imply in any manner whatsoever that it has been sponsored, recommended, or approved, or that his abilities or qualifications have in any respect been passed upon by the United States or any agency or any officer thereof.

investment adviser, its services, its personnel, its competence or experience, or its investment strategies and methods. Therefore, under the final rule, advisers may not represent that the Commission has approved or reviewed the performance results.[620]

4. Related Performance

The final rule will condition the use of "related performance" in adviser advertisements, on the inclusion of all "related portfolios."[621] Under the final rule, however, an adviser may exclude related portfolios if the advertised performance results are not materially higher than if all related portfolios had been included, and the exclusion does not alter the presentation of any applicable prescribed time period. The final rule defines "related performance" as "the performance results of one or more related portfolios, either on a portfolio-by-portfolio basis or as a composite aggregation of all portfolios falling within stated criteria."[622] It defines "portfolio" as "a group of investments managed by the investment adviser," and includes in the definition that "[a] portfolio may be an account or a private fund."[623] It defines "related portfolio" as "a portfolio with substantially similar investment policies, objectives, and strategies as those of the services being offered in the advertisement."[624] The final rule's treatment of related performance, including the conditions and definitions, is largely the same as the proposal. We discuss the few differences from the proposal below.

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620 *See also* section 208(a) of the Act.

621 Final rule 206(4)-1(d)(4). The presentation must also comply with the rule's general prohibitions. *See* final rule 206(4)-1(a).

622 Final rule 206(4)-1(e)(14).

623 Final rule 206(4)-1(e)(11). A portfolio also includes, but is not limited to, a portfolio for the account of the investment adviser or its *advisory affiliate* (as defined in the Form ADV Glossary of Terms). *See id*.

624 Final rule 206(4)-1(e)(15).

Commenters broadly supported allowing advisers to present related performance in adviser advertisements.[625] They generally agreed that related performance can be a valuable tool to assist an investor in evaluating a particular investment adviser or investment strategy, and that its use is consistent with industry practice. A few commenters also generally supported the proposed rule's conditions for the presentation of related performance.[626] Others, however, described the proposed conditions as overly prescriptive and stated that we should address cherry-picking related portfolios solely through the rule's general prohibitions, such as the "fair and balanced" provision.[627] Another commenter stated that we should remove the conditions and permit advisers to identify (and document) objective criteria that they can apply on a consistent basis to exclude certain types of accounts.[628] Conversely, one commenter said we should require composite performance without *any* exclusions of related portfolios because allowing exclusions from composites would be different from the GIPS standards that require composites to include all portfolios that are managed in the composite's strategy.[629]

We continue to believe that conditioning the presentation of related performance in advertisements on the presentation of all related portfolios (with limited exceptions) is necessary to prevent investment advisers from including only related portfolios that have favorable performance results or otherwise "cherry-picking." We believe our approach will provide advisers some flexibility in presenting related portfolios, without permitting exclusion because of

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625 *See, e.g.*, MFA/AIMA Comment Letter I; Proskauer Comment Letter; Comment Letter of Loan Syndications and Trading Association (Feb. 10, 2020) ("LSTA Comment Letter"); MMI Comment Letter.

626 *See* MFA/AIMA Comment Letter I (supporting the conditions generally, but requesting that we also permit advisers to present representative accounts that would not meet the proposed rule's conditions); LSTA Comment Letter.

627 *See* IAA Comment Letter; SIFMA AMG Comment Letter II; Ropes & Gray Comment Letter.

628 *See* SIFMA AMG Comment Letter II.

629 *See* CFA Institute Comment Letter.

poor performance. We believe this approach strikes the right balance between commenters that advocated for relying solely on the rule's general prohibition (and/or an adviser's own objective criteria), on the one hand, and requiring advisers to present all related performance, on the other hand. Under the final rule, although we are permitting an adviser to exclude related portfolios subject to conditions in the final rule, an adviser may nonetheless present performance without the exclusion of any related portfolios to comply with both the GIPS standards and the final marketing rule.

In a change from the proposed rule, the final rule will allow an investment adviser to exclude from the presentation of related performance in the advertisement one or more related portfolios so long as the advertised performance results are "not materially higher than" – rather than "no higher than" – if all related portfolios had been included. One commenter recommended this change, stating that it will not necessarily be clear whether performance is "no higher" because performance results may vary based on the time period presented.[630] Another commenter cautioned that, even with such conditions, an adviser would have difficulty demonstrating compliance for each period in its track record.[631] Furthermore, this commenter stated that an adviser would incur the burden of calculating performance including all related portfolios in order to show that the performance presented was "no higher than" or "not materially higher than" if all related portfolios had been included.

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630 *See* IAA Comment Letter ("A firm may seek to exclude an account that has a superior five-year return, but a poor one-year return, or present the performance of a representative account that has a superior one-year return, but a poor five-year return. In this scenario, the advertised performance over five and ten years would be lower, but the 1-year return would be higher. This practice may be prohibited by the proposed rule because the 1-year return does not satisfy the rule's requirements, even though the longer term returns do satisfy the rule's requirements."). *See also* CFA Institute Comment Letter (noting the same issue but making a different recommendation).

631 *See* CFA Institute Comment Letter.

We understand that an adviser will likely be required to calculate the performance of all related portfolios to ensure that the exclusion of certain portfolios from the advertisement meets the rule's conditions. Because of the special concerns that performance advertising raises, however, we believe that this burden is warranted to prevent related performance advertising from misleading investors. We believe that the modified condition we are adopting will achieve the same policy goal as our proposed rule, but give advisers additional flexibility to present related performance when there may be immaterial differences in performance results depending on the methods of calculation of returns or as between the different prescribed time periods.[632] Under the final rule, an adviser may meet this condition if the results for one prescribed time period are no higher than if all related portfolios had been included for that time period, and the results for another prescribed time period are higher, but not materially higher, than if all related portfolios had been included for that time period. It may also meet this condition if the results for any and all prescribed time periods are not materially higher than if all related portfolios had been included for each time period.

As proposed, the exclusion for related portfolios is also subject to the final rule's time period requirement for the presentation of performance in advertisements.[633] We did not receive any comments on this condition. Related performance therefore cannot exclude any related portfolio if doing so would alter the presentation of the proposed rule's prescribed time periods.

Some commenters recommended that we permit advisers to advertise one "representative account," such as a flagship fund, without any prescribed conditions or in addition to providing

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632 We are not prescribing a specific numerical or percentage threshold for materiality or immateriality as part of this requirement. Instead, based on the facts and circumstances, if the results of excluding the related portfolio would be material to a reasonable client or investor, the portfolio should not be excluded.

633 *See* final rule 206(4)-1(d)(4)(ii).

the performance results of all related portfolios.[634] Commenters generally describe representative accounts as those that most closely resemble, or are most representative of, the advertised portfolio's specific strategy.[635] A few commenters stated that permitting representative accounts would provide flexibility to advisers that manage separate accounts and may not maintain composites that cover all portfolios managed to a specific strategy, and to smaller advisers that do not have the resources to calculate the performance of a composite that includes all those portfolios.[636] One such commenter stated that smaller advisers would therefore face challenges under the proposed rule in demonstrating that the performance of a representative account is no higher than if all related portfolios had been included.[637] Others stated that permitting representative accounts would provide investors with more pertinent information than under our proposed rule, because they believe that prospective fund investors are generally less interested in the results of the ancillary funds around that flagship fund, and could find the additional information to be confusing.[638]

We are not convinced that the benefits of an adviser presenting in an advertisement a single representative account that is not subject to prescribed conditions would justify the risks of cherry-picking related portfolios with higher-than-usual returns.[639] We also believe the

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634 *See, e.g.*, IAA Comment Letter; Wellington Comment Letter; MFA/AIMA Comment Letter I; CFA Institute Comment Letter.

635 *See* Wellington Comment Letter; CFA Institute Comment Letter. *See also* MFA/AIMA Comment Letter I (discussing their view that "investment advisers need some flexibility to recognize a 'flagship' fund for a given strategy and to treat that 'flagship' fund as the sole related portfolio in many instances.").

636 *See* IAA Comment Letter; CFA Institute Comment Letter.

637 *See* IAA Comment Letter.

638 *See* MFA/AIMA Comment Letter I; Wellington Comment Letter; SIFMA AMG Comment Letter II.

639 Under our final rule, advisers may include performance returns of a single portfolio (without also providing the performance of other related portfolios) if the performance is not materially higher than if all related portfolios had been included, and the performance does not violate the rule's general prohibitions.

materiality standard we are adopting helps to alleviate the burden on advisers to present all related performance (subject to a conditional exception). We therefore decline to make this suggested change to the rule.

An adviser, however, may present the results of a single representative account (such as a flagship fund) or a subset of related portfolios alongside the required related performance so long as the advertisement would otherwise comply with the general prohibitions.[640] In these circumstances, where the required related performance is also presented in the advertisement, we believe the concerns regarding cherry-picking a particular portfolio are mitigated. In addition, as proposed, advisers may present related performance on a portfolio-by-portfolio basis under the final rule. Advisers that manage a small number of related portfolios may find a portfolio-by-portfolio presentation to be the clearest way of demonstrating related performance in their advertisements. Presenting related performance on a portfolio-by-portfolio basis may illustrate for the audience the differences in performance achieved by the investment adviser in managing portfolios having substantially similar investment policies, objectives, and strategies. A portfolio-by-portfolio presentation also may best illustrate the differences in performance between a flagship fund and other related portfolios in some cases.

As in the proposal, presenting related performance on a portfolio-by-portfolio basis will be subject to the general prohibitions, including the prohibition on omitting material facts necessary to make the presentation, in light of the circumstances under which it was made, not misleading. For example, an advertisement presenting related performance on a portfolio-by-portfolio basis could be potentially misleading if it does not disclose the size of the portfolios and the basis on which the adviser selected the portfolios. The alternative for presenting related

640 *See* Wellington Comment Letter.

performance, also as proposed, is as a composite aggregation of all portfolios falling within stated criteria, which we discuss below.

a. ***Related Portfolio***

Regarding presentations of related portfolios in advertisements, the final rule is similar to the proposal in that it does not identify or prescribe particular requirements for determining whether portfolios are "related" beyond whether there are "substantially similar" investment policies, objectives, and strategies as those of the services being offered in the advertisement. Some commenters also requested clarification that "related portfolio" does not include the performance results of the separately managed account or pooled investment vehicle being offered.[641] We agree that the offered portfolio is not included in the definition of "related portfolio."[642]

One commenter requested that we permit advisers to present performance results of a private fund both with and without the effect of any side pockets.[643] Whether a side pocket should be considered part of a portfolio or a separate portfolio and/or a related portfolio subject to the final rule's conditions for presenting related performance will be subject to the final rule's conditions for the presentation of performance and the rule's general prohibitions.[644]

A commenter also requested that we permit an adviser to exclude a separately managed account that has similar investment policies, objectives, and strategies to a private fund that the

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641 *See* SIFMA AMG Comment Letter II; AIC Comment Letter; CFA Institute Comment Letter.

642 A portfolio with substantially similar investment policies, objectives, and strategies as those of the services being offered in the advertisement is a related portfolio. *See* final rule 206(4)-1(e)(15). Any performance presented in the advertisement, whether or not related, must not violate the final rule's general prohibitions, and the applicable requirements for the presentation of performance. *See* final rule 206(4)-1(a) and (d).

643 *See* CFA Institute Comment Letter.

644 *See* final rule 206(4)-1(a).

investment adviser is offering, but is customized to reflect a client's investment objectives and desired restrictions, and has fees and expenses that may not be comparable to the private fund.[645] Another commenter, however, noted that each adviser should determine for itself whether portfolios having client-specific constraints are "substantially similar."[646]

Whether a portfolio is a "related portfolio" under the rule requires a facts and circumstances analysis. An adviser may determine that a portfolio with material client constraints or other material differences, for example, does not have substantially similar investment policies, objectives, and strategies and should not be included as a related portfolio. On the other hand, different fees and expenses alone would not allow an adviser to exclude a portfolio that has a substantially similar investment policy, objective, and strategy as those of the services offered.

Two commenters also requested that the rule permit an adviser that has advised multiple private funds over time to exclude earlier private funds that the adviser determines are no longer relevant to investors, even if these funds have substantially similar investment policies, objectives, and strategies (and are therefore related portfolios).[647] They stated that the performance of prior funds may not be relevant because the successor fund is larger than previous funds and capable of different types of investments, and that there may have been changed market conditions and/or investment professional turnover. Under the final rule, if the relevant financial markets or investment advisory personnel have changed over time such that the investment policies, objectives, and strategies of an adviser's earlier private funds are no

645 *See* AIC Comment Letter I.

646 *See* Consumer Federation Comment Letter.

647 *See* AIC Comment Letter I; Ropes & Gray Comment Letter.

longer substantially similar to those of the fund being marketed, the adviser would not be required to include the earlier private funds in its related performance.

In a change from the proposal, the final rule refers to presentation of related performance as "a composite aggregation" – rather than "one or more composite aggregations" – "of all portfolios within stated criteria."[648] An adviser may use the same criteria to construct any composites to meet the GIPS standards in order to satisfy the "substantially similar" requirement of the final rule's definition of "related portfolio."[649] However, in response to a comment from the organization that developed and administers the GIPS standards, our final rule clarifies that an adviser may only have one composite aggregation for each stated set of criteria. We agree with this commenter that the rule should not permit advisers to create more than one composite aggregation of all portfolios falling within a stated set of criteria.[650] In addition, similar to the proposal, the final rule does not prescribe specific criteria to define the relevant portfolios but requires that once the criteria are established, all related portfolios meeting the criteria are included in the composite.

As with the presentation of related performance on a portfolio-by-portfolio basis in an advertisement, any presentation as a composite is subject to the general prohibitions, including the prohibition on omitting material facts necessary to make the presentation, in light of the circumstances under which it was made, not misleading. For example, an advertisement presenting related performance in a composite would be false or misleading where the composite

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648 One commenter requested that we add a definition of "composite" that matches a commonly accepted industry term. *See* CFA Institute Comment Letter. The final rule does not include a definition for composite, because we understand that many investment advisers already have criteria governing their creation and presentation of composites.

649 *See* 2019 Proposing Release, *supra* footnote 7, at n.280 (discussing that, for GIPS purposes, a composite is an aggregation of portfolios managed according to a similar investment mandate, objective, or strategy).

650 *See* CFA Institute Comment Letter.

is represented as including all portfolios in the strategy being advertised but excludes some portfolios falling within the stated criteria or is otherwise manipulated by the adviser. We also believe that omitting the criteria the adviser used in defining the related portfolios and crafting the composite could result in an advertisement presenting related performance that is misleading.

Finally, the final rule's definition of "portfolio" includes a portfolio for the account of the investment adviser or its advisory affiliate. This is substantially the same as the proposed definition.[651] The only commenter that addressed this aspect of "related performance" generally agreed with our proposed approach.[652]

5. Extracted Performance

The final rule prohibits an adviser from presenting extracted performance in an advertisement unless the advertisement provides, or offers to provide promptly, the performance results of the total portfolio from which the performance was extracted.[653] "Extracted performance" means "the performance results of a subset of investments extracted from a portfolio."[654] We are adopting this provision substantially as proposed, though we are requiring the adviser provide, or offer to provide, the results of the "total portfolio," instead of the results of "all investments in the portfolio," at the request of a commenter that recommended we clarify an adviser does not have to highlight individual positions.[655]

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651 To simplify the definitions, the final rule includes this wording within the definition of "portfolio," rather than within the definition of "related portfolio," as proposed.

652 *See* CFA Institute Comment Letter.

653 Final rule 206(4)-1(d)(5).

654 Final rule 206(4)-1(e)(6).

655 *See* MFA/AIMA Comment Letter II. Final rule 206(4)-1(d)(5).

Commenters supported permitting extracted performance in advertisements, although they differed on what constitutes extracted performance.[656] Some commenters agreed that an adviser's extracted performance can provide useful information to investors, who often request such information to assist them in evaluating a particular investment adviser or investment strategy.[657] They noted that this is especially true for new or modified investment strategies, or new investment vehicles using a new or modified investment strategy.

However, two commenters requested clarification about the definition of extracted performance and objected to the proposed conditions.[658] One questioned whether the proposed definition includes composites of performance extracted from multiple portfolios, stating that the proposed conditions would be onerous in this case.[659] This commenter recommended eliminating the conditions and instead relying on the general prohibitions to ensure advertisements with extracted performance are fair and balanced and not misleading. The other stated that the final rule should distinguish between performance that is extracted from a single portfolio (*e.g.*, such as segment returns), and a standalone strategy presented as a composite of extracts from multiple portfolios.[660] This commenter stated that advisers typically present standalone composites and the final rule should permit them, subject to similar conditions as

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656 *See* MFA/AIMA Comment Letter I; LSTA Comment Letter; Proskauer Comment Letter; IAA Comment Letter; CFA Institute Comment Letter.

657 *See* MFA/AIMA Comment Letter I; LSTA Comment Letter. These commenters did not object to the proposed rule's conditions for presenting extracted performance.

658 *See* IAA Comment Letter; CFA Institute Comment Letter.

659 *See* IAA Comment Letter (stating that advisers that present composite performance that includes extracted performance would need to present the performance of each of the total portfolios from which the carve-out segments were extracted under the proposed rule).

660 *See* CFA Institute Comment Letter.

under the GIPS standards.[661] This commenter further agreed with the proposed requirement to provide, or offer to provide promptly, the performance results of the entire portfolio along with the extract when extracted performance is not advertised as a standalone strategy.

Like the proposed rule, our final rule's provision for extracted performance addresses the performance results of a subset of investments extracted from a single portfolio. For example, an investment adviser seeking to manage a new portfolio of only fixed-income investments may wish to advertise its performance results from managing fixed-income investments within a multi-strategy portfolio. If a prospective investor already has investments in fixed-income assets, it may want to use the extracted performance to consider the effect of an additional fixed-income investment on the prospective investor's overall portfolio. The prospective investor may also use the presentation of extracted performance from several investment advisers as a means of comparing investment advisers' management capabilities in that specific strategy.

We continue to believe that extracted performance can provide important information to investors about performance actually achieved within a portfolio. It can also provide investors with information about performance attribution within a portfolio.[662] Moreover, we expect that conditioning the presentation of extracted performance on presenting (or offering to provide promptly) the performance results of the entire portfolio from which the performance was extracted will prevent investment advisers from cherry-picking certain performance results and provide investors necessary context for evaluating the extract.[663] Requiring advisers to provide

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661 *See* CFA Institute Comment Letter. CFA Institute agreed that for advisers presenting segment returns, or attribution, of a total portfolio, the condition to present performance of the total portfolio would be relevant.

662 *See* CFA Institute Comment Letter (requesting guidance on whether the proposed rule's "extracted performance" covers attribution).

663 This context should include any particular differences in performance results between the entire portfolio and the extract. It may include assumptions underlying the extracted performance if necessary to prevent the performance results from being misleading. We received no comments on the "or offer to provide"

(or offer to provide promptly) this information mitigates the risk of extracted performance misleading investors. Furthermore, any differences between the performance of the entire portfolio and the extracted performance might be a basis for additional discussions between the investor and the adviser, which would assist the investor in deciding whether to hire or retain the adviser.

On the other hand, performance that is extracted from a composite from multiple portfolios is not extracted performance as defined in the final rule because it is not a subset of investments extracted from a portfolio. We believe that such a performance presentation carries a greater risk of misleading investors than an extract from a single portfolio because an adviser could cherry-pick holdings from across the composite and deem those holdings part of a particular strategy. In addition, similar to hypothetical performance, this type of composite performance presentation may not reflect the holdings of any actual investor. As a result, the final rule does not prohibit an adviser from presenting a composite of extracts in an advertisement, including composite performance that complies with the GIPS standards, but this performance information is subject to the additional protections that apply to advertisements containing hypothetical performance, as discussed below. While these additional protections may result in additional burdens for advisers that typically present extracted performance from multiple portfolios as a composite, we believe that the investor protection gained from applying the hypothetical performance restrictions to the presentation of this type of performance, which reflects a hypothetical portfolio, justifies such burden.[664]

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aspect of the proposal's provision to permit an adviser to *provide, or offer to promptly provide* the performance results of the entire portfolio from which the extract was extracted (italics added). Therefore, we adopted this aspect of the proposed rule.

664 The general prohibitions also will apply to any presentation of extracted performance. For example, we view it as misleading for an adviser to present extracted performance without disclosing that it represents a

One commenter recommended that we provide advisers with the option to either disclose assumptions underlying extracted performance, or provide them upon request, stating that detailed information about the selection criteria and assumptions used by the adviser could be overwhelming for a retail audience.[665] The final rule does not require an adviser to provide detailed information regarding the selection criteria and assumptions underlying extracted performance unless the absence of such disclosures, based on the facts and circumstances, would result in performance information that is misleading or otherwise violates one of the general prohibitions. As discussed above, an adviser should take into account the audience for the extracted performance in crafting disclosures.

Finally, as proposed, the final rule does not prescribe any particular treatment for a cash allocation with respect to extracted performance. One commenter recommended that we require such an allocation when presenting extracted performance advertised as a standalone strategy.[666] This commenter also stated that including an allocation of cash is not necessary when showing a segment of a strategy that is not used to advertise a standalone strategy. We believe that, depending on the facts and circumstances, presenting extracted performance without accounting for the allocation of cash could imply that the allocation of cash had no effect on the extracted performance and would be misleading.[667] In other cases, however, allocating cash to extracted

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subset of a portfolio's investments (an omission of a material fact). Similarly, we would view it as misleading to include or exclude performance results, or present performance time periods, in a manner that is not fair and balanced, and able to be substantiated in accordance with the general prohibitions. In addition, an extract would likely be false or misleading where it excludes investments that fall within the represented selection criteria.

665 *See* CFA Institute Comment Letter (discussing presentations of performance for standalone strategies).

666 *See* CFA Institute Comment Letter.

667 For example, it would be misleading to present extracted performance without allocating cash when the allocation of cash was part of the portfolio management for the subset of investments extracted from a portfolio, and such allocation would have materially reduced the extracted performance returns.

performance may not be appropriate, such as when cash allocation decisions were made separately from the management of the extracted investments and the extracted performance is not presented as a standalone strategy. We, therefore, believe that it is appropriate to provide advisers with flexibility here since the appropriateness of allocating cash will be based on the facts and circumstances. Regardless, we would view it as misleading under the final rule to present extracted performance in an advertisement without disclosing whether it reflects an allocation of the cash held by the entire portfolio and the effect of such cash allocation, or of the absence of such an allocation, on the results portrayed.

6. Hypothetical Performance

The final rule will prohibit an adviser from providing hypothetical performance in an advertisement, unless the adviser takes certain steps to address its potentially misleading nature. Largely as proposed, the final rule will condition the presentation of hypothetical performance in advertisements on the adviser adopting policies and procedures reasonably designed to ensure that the hypothetical performance information is relevant to the likely financial situation and investment objectives of the advertisement's intended audience. We intend for advertisements including hypothetical performance information to only be distributed to investors who have access to the resources to independently analyze this information and who have the financial expertise to understand the risks and limitations of these types of presentations (referred to herein collectively as "investors who have the resources and financial expertise").[668] An adviser also must provide additional information about the hypothetical performance that is tailored to the

668 We would not view the mere fact that an investor would be interested in high returns as satisfying the requirement that the hypothetical performance is relevant to the likely financial situation and investment objectives of the intended audience.

audience receiving the advertisement, such that the intended audience has sufficient information to understand the criteria, assumptions, risks, and limitations.

While commenters requested additional flexibility with regard to some of the conditions, they generally supported our proposed treatment of hypothetical performance.[669] However, one commenter stated that we should not allow the presentation of hypothetical performance in advertisements.[670]

We are adopting the hypothetical performance provisions of the rule largely as proposed because we believe that such presentations in advertisements pose a high risk of misleading investors since, in many cases, they may be readily optimized through hindsight. Moreover, the absence of an actual investor or, in some cases, actual money underlying hypothetical performance raises the risk of a misleading advertisement, because such performance does not reflect actual losses or other real-world consequences if an adviser makes a bad investment or takes on excessive risk. However, we understand that other information that may demonstrate the adviser's investment process as well as hypothetical performance may be useful to prospective investors who have the resources and financial expertise. When subjected to this analysis, the information may allow an investor to evaluate an adviser's investment process over a wide range of periods and market environments or form reasonable expectations about how the investment process might perform under different conditions. We believe the three conditions discussed below, as well as our changes to the definition of "hypothetical performance," will make it more likely that the dissemination of advertisements containing hypothetical

669 *See, e.g.,* Wellington Comment Letter; Comment Letter of Withers Bergman LLP (Feb. 10, 2020) ("Withers Bergman Comment Letter"); MMI Comment Letter; NAPFA Comment Letter.

670 *See* Mercer Comment Letter (stating that the restrictions imposed on hypothetical performance by the proposed general prohibitions would not be sufficient to prevent advisers from displaying hypothetical performance in a materially misleading manner).

performance information will be limited to investors who have the resources and financial expertise to appropriately consider such information.

Certain commenters suggested that we only allow advisers to present hypothetical performance to Non-Retail Persons,[671] while others advocated for a more nuanced approach (rather than categorical exclusions) that would allow the dissemination of hypothetical performance based on facts and circumstances.[672] As noted above, the final rule will not include different provisions for Retail and Non-Retail Persons and we believe that the rule is sufficiently flexible to facilitate the application of the hypothetical performance conditions based on facts and circumstances.

Like the proposed rule, the final rule applies to communications containing hypothetical performance that otherwise fall within the definition of "advertisement" because we believe that there is a significant risk that such performance could mislead investors.[673] Some commenters stated that we should not impose the hypothetical performance conditions to one-on-one communications as such an approach would inhibit communications between an adviser and prospective or current investors.[674] As discussed above, communications are excluded from the scope of the final rule as long as they are provided in response to unsolicited investor requests;

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671 *See, e.g.,* NASAA Comment Letter; Prof. Jacobson Comment Letter; Mercer Comment Letter.

672 *See, e.g.,* MFA/AIMA Comment Letter I.

673 *See* proposed rule 206(4)-1(e)(1). The proposed rule included one-on-one communications in the definition of advertisement. While the proposed rule excluded responses to unsolicited requests from the definition of advertisement, the exclusion did not cover hypothetical performance even if such performance was included in a one-on-one communication. As a result, under our proposed rule, hypothetical performance would have been subject to the specific conditions of the proposed rule (subsection (c)).

674 *See, e.g.,* MFA/AIMA Comment Letter I; IAA Comment Letter.

provided to a private fund investor in a one-on-one communication; or occur extemporaneously, live, and orally.[675]

While the final rule allows advisers to provide certain performance presentations in advertisements that would otherwise be considered hypothetical performance (*i.e.*, interactive tools and educational materials), we believe there are adequate protections to address this risk in part because the anti-fraud provisions of the Advisers Act would apply.[676]

We also made the following changes to the treatment of hypothetical performance advertising under the rule in response to commenters' concerns: (1) added more flexibility to the policies and procedures requirement of the final rule to allow advisers to consider the *likely* financial situation and investment objectives of the *intended audience*; (2) added more flexibility to allow advisers to consider each of the three hypothetical performance conditions with respect to the *intended audience* of the advertisement (as opposed to the specific person receiving the advertisement containing hypothetical performance information); (3) broadened the requirement for advisers to provide sufficient information to *all* investors (and not only Retail Persons) to enable them to understand the risks and limitations of using hypothetical performance advertising, except for private fund investors; and (4) revised the definition of hypothetical performance by: (a) broadening the types of model portfolios whose performance is considered hypothetical performance; (b) excluding the performance of proprietary portfolios and seed capital portfolios; (c) including data from prior periods (and not just "market data" as proposed) for certain backtested performance; and (d) excluding interactive analysis tools and predecessor

675 *See* final rule 206(4)-1(e)(1)(i)(A) and (C). The conditions also will not apply if hypothetical performance is included in a regulatory notice. Final rule 206(4)-1(e)(1)(i)(B).

676 In connection with the marketing of private funds, the anti-fraud provisions of the Securities Act and Exchange Act would also apply.

performance. The final rule also makes clear that an adviser need not comply with certain conditions on the presentation of performance in advertisements, namely the requirements to present specific time periods, and the particular conditions applicable to presenting related or extracted performance.[677]

a. *Types of Hypothetical Performance*

The final rule defines "hypothetical performance" as "performance results that were not actually achieved by any portfolio of the investment adviser" and explicitly includes, but is not limited to, model performance, backtested performance, and targeted or projected performance returns.[678] The proposed definition of hypothetical performance would have included "performance results that were not actually achieved by any portfolio *of any client* of the investment adviser" (emphasis added).[679] In response to one commenter's concerns,[680] we removed the "of any client" qualifier in order to clarify that the actual performance of the adviser's proprietary portfolios and seed capital portfolios is not hypothetical performance. However, advisers should not invest a nominal amount of assets in a portfolio in an effort to avoid the "hypothetical performance" designation. Instead, to show that the results are those of an actual portfolio, an adviser must invest an amount of seed capital that is sufficient to demonstrate that the adviser is not attempting to do indirectly what it is prohibited from doing directly,[681] or otherwise be able to demonstrate that the strategy is reasonably intended to be offered to investors.

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677 *See* final rule 206(4)-1(d)(6)(iii).

678 Final rule 206(4)-1(e)(8).

679 *See* proposed rule 206(4)-1(e)(5).

680 *See, e.g.,* CFA Institute Comment Letter.

681 *See* section 208(d) of the Act.

In a change from the proposal, we also narrowed the definition of hypothetical performance under the rule to exclude interactive analysis tools and predecessor performance. While we proposed to exclude certain financial tools from the hypothetical performance provisions, below we clarify the treatment of such tools in response to commenters' concerns. We excluded predecessor performance because we are adopting specific rule text on the presentation of predecessor performance.

We discuss each type of hypothetical performance in the following sections.

Model Performance. The proposal referred to, but did not define, "representative performance" and discussed model performance as a type of representative performance.[682] In response to commenters' concerns,[683] we are no longer using the term "representative performance" and are treating all "model performance" as hypothetical performance.[684] We did not intend to limit the definition of hypothetical performance to only performance generated by the models described in the Clover no-action letter. Rather, we proposed this definition to make clear that the rule would apply in the context of a common industry practice that has evolved around prior staff letters.[685] But, as one commenter noted, the discussion of model portfolios in

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682 *See* 2019 Proposing Release, *supra* footnote 7, at section II.A.5 (describing representative performance as *including* performance generated by models that adhered to the same investment strategy as that used by the adviser for actual clients).

683 *See, e.g.*, CFA Institute Comment Letter; IAA Comment Letter.

684 *See* final rule 206(4)-1(e)(8)(i). Model performance would include, among other things, the type of "model performance" described in the Clover Letter: performance results generated by a "model" portfolio managed with the same investment philosophy used by the adviser for actual client accounts and "consist[ing] of the same securities" recommended by the adviser to its clients during the same time period, "with variances in specific client objectives being addressed via the asset allocation process (*i.e.*, the relative weighting of stocks, bonds, and cash equivalents in each account)." *See* Clover Letter. The rule will treat this as hypothetical performance because, although the "model" consists of the same securities held by several portfolios, the asset allocation process would result in performance results that were not actually achieved by any portfolio.

685 *See* Clover Letter.

staff letters reflects only the specific circumstances of the adviser seeking a staff letter, and advisers currently employ model portfolios in a variety of circumstances.[686] Instead of limiting the discussion of model portfolios to those managed *alongside* portfolios managed for actual investors,[687] the final rule will broaden the definition. Model performance will include, but not be limited to, performance generated by the following types of models: (i) those described in the Clover no-action letter where the adviser applies the same investment strategy to actual investor accounts, but where the adviser makes slight adjustments to the model (*e.g.*, allocation and weighting) to accommodate different investor investment objectives; (ii) computer generated models; and (iii) those the adviser creates or purchases from model providers that are not used for actual investors. After considering comments, we believe it is appropriate for the final rule to accommodate the use of these variations while ensuring that advisers consider whether this information is relevant to the intended audience.[688]

One commenter supported treating model performance as hypothetical performance,[689] while some commenters objected because model performance could reflect the actual performance of a strategy that is managed in real time.[690] We understand that model portfolios can be (but are not always) managed alongside portfolios with investor or adviser assets and that many investors find model performance helpful. For instance, model performance may present a nuanced view of how an adviser would construct a portfolio without the impact of certain

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686 *See* SIFMA AMG Comment Letter II; IAA Comment Letter (discussing "other types of 'model' performance that do not reflect investment advice actually provided to clients").

687 *See* proposed rule 206(4)-1(e)(5).

688 *See, e.g.,* SIFMA AMG Comment Letter II (suggesting that the Commission recognize that model portfolios are not limited to the type discussed in the Clover Letter); IAA Comment Letter.

689 *See* CFA Institute Comment Letter (stating that "paper portfolios" should be treated as hypothetical performance).

690 *See, e.g.,* SIFMA AMG Comment Letter II; MMI Comment Letter.

factors, such as the timing of cash flows or investor-specific restrictions, which may not be relevant to the particular investor. Model performance also can help an investor assess the adviser's investment style for new strategies that have not yet been widely adopted (or adopted at all) by the adviser's investors.

However, we believe that model performance is appropriately treated as hypothetical performance because such performance was not achieved by the actual performance of a portfolio and could mislead investors. For example, advances in computer technologies have enabled an adviser to generate hundreds or thousands of potential model portfolios in addition to the ones it actually offers or manages. An adviser that generates a large number of model portfolios has an incentive to advertise only the results of the highest performing models and ignore others. The adviser could run numerous variations of its investment strategy, select the most attractive results, and then present those results as evidence of how well the strategy would have performed under prior market conditions. Even in cases where an adviser generates only a single model portfolio, neither investor nor sufficient adviser assets are at risk, so the adviser can manage that portfolio in a significantly different manner than if such risk existed. For these reasons, we believe it is more likely for an investor to be misled where the investor does not have the resources to scrutinize such performance and the underlying assumptions used to generate model portfolio performance. We believe treating model performance as hypothetical performance under the rule guards against the investor protection concerns addressed above.

Some commenters suggested that we consider more flexible treatment of model performance given that performance generated by certain types of model portfolios would be less

likely to mislead investors.[691] We believe that the conditions described below are sufficiently flexible to allow advisers to tailor their approach based on the intended audience of the advertisement *and* the type of hypothetical performance, including performance generated for different types of model portfolios. For example, if an adviser believes that model performance is less likely to mislead the intended audience, the adviser may decide that less-stringent policies and procedures are required under the first condition, and that the required disclosures may differ and be more limited than those required for backtested performance. In contrast, if an adviser believes that model performance is highly likely to mislead a particular audience (*e.g.*, it is difficult to provide disclosure that is sufficiently specific but also understandable), the adviser could adopt policies and procedures that eliminate the presentation of that type of model performance to this investor type in its advertisements or modify the presentation to satisfy the requirements of the final rule. An adviser would need to consider the intended audience of the advertisement and the type of hypothetical performance in order to satisfy the conditions.

Commenters suggested that we consider the impact of this characterization of hypothetical performance on model providers to wrap fee accounts and advisers that provide models to other, end-user advisers for implementation.[692] We understand that model providers may not have access to the actual performance data generated after the end-user adviser implements the model and that the performance data they have access to may reflect another

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691 *See, e.g.,* NYC Bar Comment Letter; NRS Comment Letter; MFA/AIMA Comment Letter I (stating that "the Commission should modify the Proposed Advertising Rule to allow investment advisers to scale the scope of disclosures to the risk profile of the type of 'hypothetical performance' information.").

692 *See, e.g.,* SIFMA AMG Comment Letter II; MMI Comment Letter (stating that model performance is not hypothetical because it "reflects actual performance of an investment strategy in real-time"); IAA Comment Letter (stating that "[m]any advisers serve as model providers to wrap accounts and other advisers. Such model providers would not necessarily have the data on the actual performance of the accounts managed to their models, as they are not acting directly as advisers to the underlying accounts."); NYC Bar Comment Letter.

adviser's fees or adjustments. Even if model providers had access to such actual performance data, we believe they would still be subject to the hypothetical performance provisions because the performance generated would be the performance of a portfolio managed by the end-user adviser, not the model provider. However, we believe that model providers would not have difficulty satisfying the three hypothetical performance provisions. For example, we anticipate the intended audience for model provider advertisements often will be end-user advisers or wrap fee program sponsors. Model providers therefore could adopt simple policies and procedures because the model provider reasonably believes that the intended audience is sophisticated and should have the analytical resources and tools necessary to interpret this type of hypothetical performance. The model provider could similarly satisfy the rule's disclosure requirements for hypothetical performance based on the end-user's profile since the model providers would know that the end-user adviser is a well-informed investor with analytical tools at his/her disposal.

Backtested Performance. As proposed, the final rule will treat backtested performance as a type of hypothetical performance. We proposed to include "[p]erformance that is backtested by the application of a strategy to market data from prior periods when the strategy was not actually used during those periods."[693]

One commenter supported broadening the types of backtested performance that would be subject to the hypothetical performance provisions.[694] Other commenters said that we should not treat backtested performance as a type of hypothetical performance.[695]

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693 *See* 2019 Proposing Release, *supra* footnote 7, at section II.A.5.c.iv.

694 *See* CFA Institute Comment Letter (stating that proposed definition of backtested performance would not include "strategies that take data from other portfolios managed by the Adviser or someone else and backtest an asset allocation strategy.").

695 *See, e.g.,* NYC Bar Comment Letter (stating "backtested returns are a conditional analysis of prior data" and advisers use this information to stress test investment methodologies that the advisers intend to use in the future); MMI Comment Letter (stating "backtested performance figures are not purely hypothetical, but

We acknowledge that backtested performance may help investors understand how an investment strategy may have performed in the past if the strategy had existed or had been applied at that time. In addition, this type of performance information may demonstrate how the adviser adjusted its model to reflect new or changed data sources. While we understand the potential value of such data to investors, backtested performance information also has the potential to mislead investors. Because this performance is calculated after the end of the relevant period, it allows an adviser to claim credit for investment decisions that may have been optimized through hindsight, rather than on a forward-looking application of stated investment methods or criteria and with investment decisions made in real time and with actual financial risk. For example, an investment adviser is able to modify its investment strategy or choice of parameters and assumptions until it can generate attractive results and then present those as evidence of how its strategy would have performed in the past.[696]

We believe that backtested performance included in an advertisement is more likely to be misleading to the extent that the intended audience does not have the resources and financial expertise to assess the hypothetical performance presentation. The conditions that the final rule will impose on displays of hypothetical performance in advertisements are designed to ensure that advisers present backtested performance in a manner that is appropriate for the advertisement's intended audience.

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rather reflect an analysis of actual investment performance based on certain assumptions" and that such illustrations "analyze historical data").

696 *See, e.g.,* David H. Bailey, Jonathan M. Borwein, Marcos López de Prado, and Qiji Jim Zhu, *Pseudo-Mathematics and Financial Charlatanism: The Effects of Backtest Overfitting on Out-of-Sample Performance*, 61(5) NOTICES OF THE AM. MATHEMATICAL SOCIETY, 458, 466 (May 2014), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2308659 (describing the potential to overfit an investment strategy so that it performs well in-sample (the simulation over the sample used in the design of the strategy) but performs poorly out-of-sample (the simulation over a sample not used in the design of the strategy)).

In response to a commenter's suggestion,[697] the final rule will apply to advertisements including presentations of performance that is backtested by the application of a strategy to data from prior time periods when the strategy was not actually used during those time periods, instead of applying only to application of the strategy to "market" data from a prior time period. Accordingly, the hypothetical performance provisions will apply to presentations of both market and non-market data in advertisements. This change will account for scenarios where an adviser could backtest performance based on non-market data (*e.g.*, data from other portfolios managed by the adviser). We are otherwise adopting this provision as proposed.

Another commenter asked that we address which disclosures must accompany specific displays of backtested performance.[698] In the spirit of our principles-based approach, we decline to prescribe the exact disclosure language that should accompany displays of backtested performance in advertisements.

Targets and Projections. As proposed, the final rule will treat presentations of targeted and projected returns in advertisements as presentations of hypothetical performance. Targeted returns reflect an investment adviser's aspirational performance goals. Projected returns reflect an investment adviser's performance estimate, which is often based on historical data and assumptions. Projected returns are commonly established through mathematical modeling.[699]

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697 *See* CFA Institute Comment Letter.

698 *See* NRS Comment Letter.

699 The final rule does not define "targeted return" or "projected return." We believe that these terms have commonly understood meanings, and we do not intend to narrow or expand inadvertently the wide variety of returns that may be considered targets or projections. We generally would consider a target or projection to be any type of performance that an advertisement presents as results that could be achieved, are likely to be achieved, or may be achieved in the future by the investment adviser with respect to an investor.

Most commenters that addressed this topic opposed the characterization of targeted returns as hypothetical performance on the grounds that targeted returns indicate expectations about how a product or strategy is intended to perform (*e.g.*, how aggressively a strategy will be managed) as opposed to predictions of performance.[700] Several of these commenters agreed that the Commission should continue to treat projected returns as hypothetical performance.[701]

Targets and projections could potentially be presented in such a manner to raise unrealistic expectations of an advertisement's audience and thus be misleading, particularly if they use assumptions that are not reasonably achievable. For example, an advertisement may present unwarranted claims based on assumptions that are virtually impossible to occur, such as an assumption that three or four specific industries will experience decades of uninterrupted growth.

We recognize, however, that there are some differences between targeted and projected returns. Targeted returns are aspirational and may be used as a benchmark or to describe an investment strategy or objective to measure the success of the strategy.[702] Projected returns, on the other hand, use historical data and assumptions to predict a likely return.[703] Therefore, targeted returns may not involve all (or any) of the assumptions and criteria applied to generate a projection. Still, we do not believe that the difference between targeted and projected returns is always readily apparent to recipients of an advertisement. We believe that the presentation of

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700 *See, e.g.*, Wellington Comment Letter (agreeing that projected returns have a heightened ability to mislead investors, but stating that targeted returns can provide useful information about the risk profile of an investment strategy); Fidelity Comment Letter; MMI Comment Letter (stating that targeted returns "are performance goals that an adviser seeks to achieve with a particular strategy or product" while hypothetical returns "represent a projection of what returns will or could be based on a series of assumptions").

701 *See, e.g.*, CFA Institute Comment Letter; AIC Comment Letter.

702 *See, e.g.*, CFA Institute Comment Letter

703 *Id.*

targeted returns in such context could result in unrealistic expectations. We continue to believe, therefore, that the presentation of targets and projections in advertisements should be subject to the rule's hypothetical performance conditions. The conditions we are adopting with respect to the use of hypothetical performance are principles-based, allowing the adviser to tailor the disclosure to the type of performance used in the advertisement. For example, in the case of an advertisement that presents targeted returns, which are generally aspirational in nature and not necessarily based on "criteria and assumptions," to meet this disclosure requirement an adviser's disclosure could state that criteria and assumptions were not used.

We believe that providing hypothetical performance in advertisements only to those investors with the resources and financial expertise to assess targets or projections will help avoid scenarios where an investor might be misled into thinking that such performance is guaranteed. We recognize that some investors want to consider targeted returns and projected returns (along with these underlying assumptions) when evaluating investment products, strategies, and services. For example, based on our staff's outreach and experience, we understand that financially sophisticated investors in particular may have specific return targets that they seek to achieve, and their planning processes may necessarily include reviewing and analyzing the targets advertised by investment advisers and the information underlying those targets. Specifically, an analysis of these targets or projections can inform an investor about an adviser's risk tolerance when managing a particular strategy. We understand that information about an adviser's targets or projections also can be useful to an investor when assessing how the adviser's strategy fits within the investor's overall portfolio, but advisers must consider the intended audience when making such presentations in advertisements.

The rule will apply only to targeted or projected performance returns "with respect to any portfolio or to the investment advisory services with regard to securities offered in the advertisement."[704] This means that projections of general market performance or economic conditions in an advertisement are not targeted or projected performance returns subject to the provision on presentation of hypothetical performance.

We did not propose to exclude from the definition of "hypothetical performance" the performance generated by interactive analysis tools. However, in the proposal, we noted that FINRA permits investment analysis tools as a limited exception from FINRA's general prohibition of projections of performance, subject to certain conditions and disclosures, and we requested comment on whether we should consider FINRA's approach.[705] Commenters generally supported an exclusion for such tools and for adopting FINRA's approach.[706]

As a result, the final rule will exclude the performance generated by investment analysis tools from the definition of hypothetical performance and will import a definition of "investment analysis tool" from FINRA Rule 2214 with slight modifications.[707] FINRA Rule 2214 defines an "investment analysis tool" as "an interactive technological tool that produces simulations and statistical analyses that present the likelihood of various investment outcomes if certain investments are made or certain investment strategies or styles are undertaken, thereby serving as

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704 Final rule 206(4)-1(e)(8)(iii).

705 *See* 2019 Proposing Release, *supra* footnote 7, at section II.A.5.c.iv.

706 *See, e.g.*, SIFMA AMG Comment Letter II (stating that "[i]n the retail setting it is common to use projections that are based on statistically valid methodologies (*e.g.*, Monte Carlo simulations) to assist clients and investors in understanding whether the investment of their current assets will allow them to meet future goals"); BlackRock Comment Letter (stating that the rule should provide a safe harbor from the hypothetical performance provisions for investment analysis tools that comply with FINRA rule 2214); IAA Comment Letter; T. Rowe Price Comment Letter.

707 FINRA rule 2214 provides a limited exception from FINRA rule 2210's prohibition on communications that predict or project performance. While FINRA rule 2210 applies differently to communications directed to retail versus institutional investors, our final rule does not have such a bifurcated approach.

an additional resource to investors in the evaluation of the potential risks and returns of investment choices." We will adopt this definition, but will require that a current or prospective investor must use the tool (*i.e.*, input information into the tool or provide information to the adviser to input into the tool).

Despite the fact that an investment analysis tool is often a computer-generated model that does not reflect the results of an actual account, the rule will allow an adviser to present these tools in advertisements without complying with the conditions applicable to hypothetical performance.[708] We do not view these tools as presenting the same investor risks that model portfolios do because they typically present information about various investment outcomes based on the investor's situation and require the investor to interface directly with the tool. In providing an interactive analysis tool, an adviser should consider which disclosures are necessary in order to comply with the general prohibitions of the final marketing rule. For example, to comply with the first general prohibition, the adviser should neither imply nor state that the interactive tool, alone, can determine which securities to buy or sell.

The final rule will allow advisers to use interactive analysis tools, provided that the investment adviser: (1) provides a description of the criteria and methodology used, including the investment analysis tool's limitations and key assumptions; (2) explains that the results may

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[708] Under the final rule, general educational communications that rely on public information and do not reference specific advisory products or services offered by the adviser would not qualify as advertisements. *See supra* section II.A.2.a.v. Educational presentations of performance that reflect an allocation of assets by type or class, which we understand investment advisers may use to inform investors and to educate them about historical trends regarding asset classes would not be treated as advertisements and would not be subject to the rule's conditions on the use of hypothetical performance. For example, the following would not be considered hypothetical performance under the final rule: a presentation of performance that illustrates how a portfolio allocated 60% to equities and 40% to bonds would have performed over the past 50 years as compared to a portfolio composed of 40% equities and 60% bonds. Our approach regarding educational presentations of performance would apply even if the investment adviser used one of the allocations in managing a strategy being advertised or illustrated such allocations by reference to relevant indices or other benchmarks.

vary with each use and over time; (3) if applicable, describes the universe of investments considered in the analysis, explains how the tool determines which investments to select, discloses if the tool favors certain investments and, if so, explains the reason for the selectivity, and states that other investments not considered may have characteristics similar or superior to those being analyzed; and (4) discloses that the tool generates outcomes that are hypothetical in nature.[709] The fact that an interactive tool uses the same underlying assumptions does not mean that outputs the tool generates are advertisements (because the adviser or investor inputs investor-specific information). We believe that there are adequate investor protection guardrails in place to allow advisers to provide interactive analysis tools.[710]

Commenters suggested that we clarify the treatment of broad market or index-based performance data.[711] We agree that the use of index-based data can be informative to investors as a benchmarking tool.[712] For example, in a scenario where an actual portfolio tracks an index, information regarding the index's performance can provide useful information regarding tracking error, sector allocation, and performance attribution. Accordingly, we believe that an index used

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709 *See* final rule 206(4)-1(e)(8)(iv)(A)(*4*). Such disclosure could state, for example: "IMPORTANT: The projections or other information generated by [name of investment analysis tool] regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results."

710 *See* section 206 of the Advisers Act. *See also* section 17(a) of the Securities Act, section 10(b) of the Exchange Act (and rule 10b-5 thereunder), and rule 206(4)-8 under the Advisers Act.

711 *See* IAA Comment Letter; CFA Institute Comment Letter (stating that "indexes created by the Adviser should be considered hypothetical performance when the Adviser backtests the index to see how it would have performed. Other than this case, we do not believe that benchmarks should be considered hypothetical performance.").

712 *See e.g.*, IAA Comment Letter; CFA Institute Comment Letter.

as a performance benchmark in an advertisement would not be hypothetical performance, unless it is presented as performance that could be achieved by a portfolio.[713]

b. *Conditions on Presentation of Hypothetical Performance*

Largely as proposed, the final rule will prohibit the presentation of hypothetical performance in advertisements except under certain conditions designed to address the potential for hypothetical performance to mislead investors. First, the adviser must adopt and implement policies and procedures reasonably designed to ensure that the hypothetical performance information is relevant to the likely financial situation and investment objectives of the intended audience of the advertisement. Second, the adviser must provide sufficient information to enable the intended audience to understand the criteria used and assumptions made in calculating such hypothetical performance (the "criteria and assumptions"). Third, the adviser must provide (or, if the intended audience is a private fund investor, provide, or offer to provide promptly) sufficient information to enable the intended audience to understand the risks and limitations of using hypothetical performance in making investment decisions (the "risk information").[714] For purposes of this discussion, we refer to the criteria and assumptions and the risk information collectively as the "underlying information." Finally, the final rule does not require an investment adviser to comply with several conditions applicable to the presentation of

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713 *See* final rule 206(4)-1(e)(8) (defining "hypothetical performance" as "performance results that were not actually achieved by any *portfolio* of the investment adviser"). Although we would not expect an adviser to comply with the conditions applicable to hypothetical performance, we *would* expect the adviser to comply with the general prohibitions, for instance, by disclosing that the volatility of the index is materially different from that of the model or actual performance results with which the index is compared. Most of the other provisions of the rule would be irrelevant. For instance, although the conditions on the presentation of performance would apply, the requirement to show net performance would be inapplicable because there are no fees or expenses to deduct from an index. Index information that is provided for general educational purposes and not, for instance, as a comparison to the adviser's performance presentation, would not be considered an advertisement. *See supra* section II.A.2.a.v.

714 *See* final rule 206(4)-1(d)(6)(iii).

performance information in advertisements, specifically the requirement to present specific time periods, and the requirements related to the presentation of related performance, and extracted performance.[715]

Policies and Procedures. In a modification from the proposal, under the first condition for displaying hypothetical performance information in advertisements, advisers must adopt and implement 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*.[716] The proposed condition would have required a higher degree of certainty of the financial situation and investment objectives of the person to whom the advertisement is disseminated. Under the final rule, reasonably designed policies and procedures need not address each recipient's particular circumstances; rather, the adviser must make a reasonable judgement about the likely investment objectives and financial situation of the advertisement's intended audience.

The final rule will not prescribe the ways in which an adviser may seek to satisfy the policies and procedures requirement, including how the adviser will establish that the policies and procedures are reasonably designed to ensure that the hypothetical performance is relevant to the likely financial situation and investment objectives of the intended audience. We have previously used policies and procedures to establish a defined audience.[717] We believe that this

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715 *See id*.

716 Final rule 206(4)-1(d)(6)(i).

717 We have defined "retail money market fund" to mean "a money market fund that has policies and procedures reasonably designed to limit all beneficial owners of the fund to natural persons." *See* 17 CFR 270.2a-7(a)(21); *see also Money Market Fund Reform; Amendments to Form PF*, Release No. IA-3879 (July 23, 2014) [79 FR 47736 (Aug. 14, 2014)], at nn.715- 716 and accompanying text.

approach will provide investment advisers with the flexibility to develop policies and procedures that best suit their investor base and operations.

While one commenter supported the proposed condition,[718] several commenters suggested that we eliminate it because it is too subjective and difficult to implement.[719] One commenter suggested that the condition not apply to institutional investors,[720] while another commenter stated that the condition imposes a standard so high that an adviser could not satisfy the standard for retail investors.[721] Another commenter suggested that we clarify that the proposed condition would not require an adviser to have knowledge of the specific individual circumstances or financial condition of *each* investor receiving hypothetical performance from the adviser.[722]

We continue to believe that this condition, as modified, will ensure that advisers provide advertisements containing relevant hypothetical performance to the appropriate audience without creating unnecessary compliance burdens. In response to commenters' concerns, however, the final rule will specify that the policies and procedures must be reasonably designed to ensure that hypothetical performance is relevant to the *likely* financial situation and investment objectives of the *intended audience*. We added the qualifier "likely" to clarify that an adviser is not required to know the actual financial situation or investment objectives of each investor that receives

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718 *See* Consumer Federation Comment Letter.

719 *See, e.g.,* MMI Comment Letter (stating this condition would be difficult, if not impossible, to satisfy for an advertisement that would be disseminated to a large number of people); SIFMA AMG Comment Letter II; Wellington Comment Letter.

720 *See* Credit Suisse Comment Letter.

721 *See* CFA Institute Comment Letter.

722 *See* Comment Letter of Flexible Plan Investments, Ltd. on proposed advertising rule (Feb. 10, 2020) ("Flexible Plan Investments Comment Letter II") (noting that the relevancy requirement would be difficult to administer because "[i]t will be dependent on knowing in many cases the exact person to whom the use of (sic) hypothetical performance is being delivered.").

hypothetical performance. We also replaced the word "person" with "intended audience" to clarify that advisers can comply with this condition, as well as the other conditions related to hypothetical performance, by grouping investors into categories or types, and to emphasize that an investor might not be a natural person. We believe that these changes will ease the compliance burdens commenters identified.

This condition is designed to help ensure that an adviser provides advertisements containing hypothetical performance information only to those investors with the resources and financial expertise. Hypothetical performance may not be relevant to the likely financial situation and investment objectives of and may be misleading for investors that do not have the resources and financial expertise. For example, analysis of hypothetical performance may require tools and/or other data to assess the impact of assumptions driving hypothetical performance, such as factor or other performance attribution, fee compounding, or the probability of various outcomes. Without being able to subject hypothetical performance to additional analysis, this information could tell an investor little about an investment adviser's process or other information relevant to a decision to hire the adviser. Instead, providing hypothetical performance to an investor that does not have access to the resources and financial expertise needed to assess the hypothetical performance and underlying information could mislead the investor to believe something about the adviser's experience or ability that is unwarranted. We believe that advisers generally would not be able to include hypothetical performance in advertisements directed to a mass audience or intended for general circulation. In that case, because the advertisement would be available to mass audiences, an adviser generally could not form any expectations about their financial situation or investment objectives.

The adviser's past experiences with particular types of investors should lead the adviser to design reasonable policies and procedures that distinguish among investor types and whether hypothetical performance is relevant to the likely financial situation and investment objectives of an audience composed of that type. Such policies and procedures could distinguish investor types on the basis of criteria, such as previous investments with the adviser, net worth or investing experience if that information is available to the adviser, certain regulatory defined categories (*e.g.,* qualified purchasers or qualified clients), or whether the intended audience includes only natural persons or only institutions.

An adviser could determine that certain hypothetical performance presentations are relevant to the likely financial situation and investment objectives of certain types of investors based on routine requests from those types of investors in the past. For example, an adviser, based on its past experience, might be able to reasonably conclude that hypothetical performance would be relevant to investors who meet certain financial sophistication standards such as qualified client[723] or qualified purchaser.[724] The adviser could explain in its policies and procedures why it believes that hypothetical performance is relevant for this intended audience. In addition, an adviser's policies and procedures should address how the adviser's dissemination of the advertisement would seek to be limited to that audience. As discussed above, hypothetical performance directed to mass audiences generally will not be able to meet this standard.

One commenter expressed concerns that this condition would pose a compliance challenge for advisers to private funds because they do not have insight into potential investors,

723 *See* rule 205-3(d)(1) under the Act.

724 *See* section 2(a)(51) of the Investment Company Act.

especially prior to the time when subscription documents are disseminated.[725] Because an adviser's policies and procedures should be informed by its prior experience with certain investor types, an adviser that plans to advise a private fund can develop policies and procedures that take into account its experience advising a prior private fund for which it raised money from investors. That experience might indicate that investors in the vehicle valued a particular type of hypothetical performance because, for example, the investors used it to assess the adviser's strategy and investment process. Similarly, an adviser could determine, based on its experience, that hypothetical performance is not relevant to the likely financial situation and investment objectives of certain investors and reflect such determination in its policies and procedures. New advisers that do not have prior client experiences to inform their determination of the intended audience can rely on other resources, including information they have gathered from potential investors (*e.g.*, questionnaires, surveys, or conversations) and academic research, to help identify the intended audience in connection with the three hypothetical performance conditions.[726]

One commenter expressed concern that this condition would effectively restrict hypothetical performance only to a sub-set of investors with the financial and analytical resources to analyze such performance even if an investor outside of this sub-set specifically requested the information.[727] As noted above, we believe that it is appropriate to apply the

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725 *See* Ropes & Gray Comment Letter.

726 Advisers may already be required to comply with similar provisions under other regulatory regimes that also require advisers to consider the recipient when disseminating communications. *See, e.g.*, FINRA rule 2210(d)(1)(E) ("Members must consider the nature of the audience to which the communication will be directed and must provide details and explanations appropriate to the audience."); Global Investment Performance Standards (GIPS) for Firms (2020), Provision 1.A.11; GIPS Standards Handbook for Firms (Nov. 2020), Discussion of Provision 1.A.11.

727 *See* CFA Institute Comment Letter (suggesting that "an [a]dviser could consider hypothetical performance to be relevant to the financial situation and investment objectives of the person if the person has expressed interest in the strategy or the [a]dviser has determined it is an appropriate strategy for the investor based on their (sic) investment needs").

hypothetical performance conditions to communications that otherwise meet the definition of advertisement, even if they take place in one-on-one settings due to the potential for such information to mislead investors. However, advisers would still be able to provide investors with interactive financial analysis tools without subjecting those tools to the hypothetical performance conditions.

Criteria and Assumptions. The second condition for the presentation of hypothetical performance will require the adviser to provide sufficient information to enable the intended audience to understand the criteria used and assumptions made in calculating the hypothetical performance.[728] The rule does not prescribe any particular methodology or calculation for the different categories of hypothetical performance, just as it does not prescribe methodologies or calculations for actual performance. Instead, advisers must provide the information about criteria and assumptions so that the intended audience can understand how the hypothetical performance was calculated. We are adopting the second condition largely as proposed, except that we are replacing the phrase "such person" with "the intended audience" for consistency with the first condition, as discussed above. In addition, and in response to one commenter's concerns,[729] we are clarifying that the adviser is responsible for providing sufficient information as we agree that it would not be workable to require advisers to have a precise understanding of exactly what each investor needs in order to allow that investor to understand the calculations and assumptions underlying the hypothetical performance.[730]

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728 *See* final rule 206(4)-1(d)(6)(ii). We would consider any calculation information provided alongside the hypothetical performance to be a part of the advertisement and therefore subject to the books and records rule. *See infra* section II.I.

729 *See* Flexible Plan Investments Comment Letter II.

730 This obligation would be similar to an adviser's obligation to provide full and fair disclosure to its clients of all material facts relating to the advisory relationship and of conflicts of interest. *See* Fiduciary Interpretation, *supra* footnote 8888, at n.70 (stating that institutional clients, as compared to retail clients,

Several commenters expressed concern that this condition would require advisers to disclose proprietary or confidential information[731] due to the statement in the proposal that this condition may require advisers to provide the "methodology used in calculating and generating the hypothetical performance."[732] To clarify, we do not expect advisers to disclose proprietary or confidential information to satisfy this condition. We expect that a general description of the methodology used would be sufficient information for an investor to understand how it was generated.

Under the final rule, the condition will not require an adviser to provide information that would be necessary to allow the intended audience to replicate the performance (*e.g.*, information that is confidential or proprietary). With respect to assumptions, investment advisers should provide information that includes any assumptions on which the hypothetical performance rests – *e.g.,* in the case of targeted or projected returns, the adviser's view of the likelihood of a given event occurring.

Commenters suggested that we not require advisers to disclose the extent to which hypothetical performance is based on the likelihood of an event occurring because this would require advisers to make speculative statements.[733] Yet, commenters agreed that an adviser should disclose the assumptions it has made.[734]

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generally have a greater capacity and more resources to analyze and understand complex conflicts and their ramifications).

731 *See, e.g.,* Withers Bergman Comment Letter; MFA/AIMA Comment Letter I; Resolute Comment Letter.

732 *See* 2019 Proposing Release, *supra* footnote 7, at section II.A.5.c.iv.

733 *See, e.g.,* NYC Bar Comment Letter; AIC Comment Letter.

734 *See, e.g.,* NYC Bar Comment Letter; AIC Comment Letter (stating that the requirements of the second condition are "consistent with market practice" but that advisers should not be required to state the likelihood that a given event would occur).

It is our view that assumptions underlying hypothetical performance should be interpreted to include assumptions that future events will occur. We believe that hypothetical performance, by its nature, contains a speculative element; therefore, requiring advisers to disclose the assumptions that informed a model aligns with the types of restrictions we seek to place on performance presentation that have a high potential to mislead investors. We believe advisers should provide this information so that the intended audience is able to determine, in part, how much value to attribute to the hypothetical performance. Without information regarding criteria and assumptions, we believe that such performance would be misleading even to an investor with the resources and financial expertise to evaluate it.

Risk Information. The final rule will require the adviser to provide – or, if the intended audience is a private fund investor, to provide, or offer to provide promptly – sufficient information to enable the intended audience to understand the risks and limitations of using the hypothetical performance in the advertisement in making investment decisions.[735]

Commenters generally supported this condition.[736] However, one commenter suggested that we add a reasonableness component in order to provide more flexibility, requiring advisers to provide *reasonably* sufficient information.[737] We do not believe this change is necessary as we believe that advisers' consideration of the intended audience will provide advisers with flexibility and alleviate some of the burdens imposed by these conditions. In a change from the proposal, we replaced "Non-Retail Person" with "an investor in a private fund" in order to align with broader changes to the rule (*i.e.*, to dispense with the distinction between Retail and Non-

735 *See* final rule 206(4)-1(d)(6)(iii).

736 *See* CFA Institute Comment Letter; Withers Bergman Comment Letter.

737 *See* Flexible Plan Investments Comment Letter II.

Retail Persons).[738] As explained above, we also replaced references to "such person" with "the intended audience." After considering comments,[739] the final rule will not require advisers to provide private fund investors with information on the risks and limitations of using the advertised hypothetical performance. Instead, advisers can merely offer to promptly provide such information.

With respect to risks and limitations, investment advisers should provide information that would apply to both hypothetical performance generally and to the specific hypothetical performance presented – *e.g.,* if applicable, that hypothetical performance reflects certain assumptions but that the adviser generated dozens of other, varying performance results applying different assumptions. Risk information should also include any known reasons why the hypothetical performance might differ from actual performance of a portfolio – *e.g.*, that the hypothetical performance does not reflect cash flows into or out of the portfolio. This risk information will, in part, enable the intended audience to understand how much value to attribute to the hypothetical performance in deciding whether to hire or retain the investment adviser or invest in a private fund managed by the adviser. An adviser should tailor its risk information to its intended audience.

In addition, any communication that is an advertisement under the first prong of the definition of advertisement, and that includes hypothetical performance, will be required to comply with the general prohibitions.[740] As a result, the rule will prohibit advisers from

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738 *See* proposed rule 206(4)-1(c)(1)(v)(C) (requiring an adviser to "[p]rovide[] (or, if such person is a *non-retail person*, provide[] or offer[] to provide promptly) sufficient information to enable such person to understand the risks and limitations of using such *hypothetical performance* in making investment decisions.").

739 *See, e.g.,* Ropes & Gray Comment Letter; IAA Comment Letter; AIC Comment Letter.

740 *See supra* section II.B.

presenting hypothetical performance in such advertisements in a materially misleading way. For example, we would view an advertisement as including an untrue statement of material fact if the advertised hypothetical performance reflected the application of rules, criteria, assumptions, or general methodologies that were materially different from those stated or applied in the underlying information of such hypothetical performance. Also, we would view it as materially misleading for an advertisement to present hypothetical performance that discusses any potential benefits resulting from the adviser's methods of operation without providing fair and balanced discussion of any associated material risks or material limitations associated with the potential benefits.[741] Similarly, an adviser can meets its obligation with respect to an advertisement presenting hypothetical performance that includes an offer to promptly provide risk information to a private fund investor if the adviser makes reasonable efforts to promptly provide such information upon the investor's request.

F. Portability of Performance, Testimonials, Endorsements, Third-Party Ratings, and Specific Investment Advice

Among the performance results that an investment adviser may seek to advertise are those of groups of investments or accounts for which the adviser, its personnel, or its predecessor investment adviser firms have provided investment advice in the past as or at a different entity. In some cases, an investment adviser may seek to advertise the performance results of portfolios managed by the investment adviser before it was spun out from another adviser. Alternatively, an adviser may seek to advertise performance achieved by its investment personnel when they were employed by another investment adviser. This may occur, for example, when a portfolio management team leaves one advisory firm and joins another advisory firm or begins its own

741 *See* final rule 206(4)-1(a)(4).

firm. Predecessor performance results may be directly relevant to an audience when the advertisement offers services to be provided by the personnel responsible for the predecessor performance, even when the personnel did not work for the adviser disseminating the advertisement (the "advertising adviser") during the period for which performance is being advertised.[742]

We believe that the presentation of predecessor performance can mislead investors, especially, for example, when: (i) the team that was primarily responsible for the predecessor performance is different from the team whose advisory services are being offered in the advertisement, (ii) an individual who played a significant part in achieving the predecessor performance is not a member of the advertising adviser's investment team,[743] (iii) the adviser that generated the performance underwent a restructuring, reorganization, or sale,[744] or (iv) an advertising adviser does not clearly disclose that the performance was achieved at a different entity.

We have previously identified characteristics of a restructuring, sale, or reorganization (collectively, "reorganization") that likely support a finding that an adviser's business continued to exist where: there was a substantial and direct business nexus between the successor and predecessor advisers; the reorganization was not designed to eliminate substantial liabilities

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742 The term "predecessor performance" is defined in final rule 206(4)-1(e) and refers to all situations where an investment adviser presents investment performance achieved by a group of investments consisting of an account or a private fund that was not advised by the investment adviser at all times during the period shown.

743 *See, e.g.,* Fiduciary Management Associates, Inc., SEC Staff No-Action Letter (Feb. 2, 1984) ("Fiduciary Management Letter").

744 *See, e.g.,* South State Bank, SEC Staff No-Action Letter (May 8, 2018) ("South State Bank Letter") (the staff stated that it would not recommend enforcement action based on representations designed to ensure advisory clients would not be misled if clients attributed the predecessor adviser's performance to the advertising adviser, including, for example, that it would operate in the same manner and under the same brand name as the predecessor adviser).

and/or spin off personnel; and, if applicable, the successor adviser assumed substantially all of the assets and liabilities of the predecessor adviser.[745] Under the final rule, we would consider similar factors when analyzing the extent to which an advertising adviser must treat a predecessor adviser's performance as predecessor performance. For example, we do not believe that a change of brand name, without additional differences between the advisory entity before and after the restructuring, would render its past performance as "predecessor performance." Likewise, a mere change in the form of legal organization (*e.g.*, from a corporation to limited liability company) or a change in ownership of the adviser would likely not raise the concerns described in this section.

In the proposal, we considered whether applying the rule's general prohibitions and the more specific performance advertising restrictions would sufficiently alleviate our concerns,[746] or whether specific rule provisions would more appropriately address those concerns.[747] For example, we questioned whether the untrue or misleading implication general prohibition would prevent the display of predecessor performance containing an untrue or misleading implication about a material fact relating to the advertising adviser. As another example, we stated that, depending on the circumstances, predecessor performance results that exclude accounts managed in a substantially similar manner at the predecessor firm may be misleading and implicate the proposed general prohibitions in the rule. We stated that such presentations could result in the inclusion or exclusion of performance results in a manner that is neither accurate nor fair and balanced. Accordingly, we requested comment on whether the advertising rule should include

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745 *See* Registration of Successors to Broker-Dealers and Investment Advisers, Release No. IA-1357 (Dec. 28, 1992) [58 FR 7-01 (Jan. 4, 1993)].

746 *See* proposed rule 206(4)-1(a) and (c).

747 For the discussion that follows, *see generally* 2019 Proposing Release, *supra* footnote 7, at section II.A.6.

additional provisions on the presentation of predecessor performance results, and we specifically asked about the approach our staff has taken in providing guidance on this issue under the current rule.[748]

Some commenters supported the addition of a provision on this topic, urging us to address predecessor performance in the final rule.[749] Two commenters supported the approach our staff took in its no-action letters and suggested we adopt a rule that would draw from those requirements, with minor modifications.[750] In light of these comments, we believe that placing explicit guardrails on displays of predecessor performance will increase investor protection, in addition to the general prohibitions. Moreover, we expect that clarifying our views on positions taken by our staff over the years will promote consistency of practices among advisory firms and thereby level the playing field.

Investments advisers will be prohibited from displaying predecessor performance in an advertisement, unless the following requirements are satisfied:

(A) the person or persons who were primarily responsible for achieving the prior performance results manage accounts at the advertising adviser;

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748 *See* Horizon Asset Management, LLC, SEC Staff No-Action Letter (Sept. 13, 1996) ("Horizon Letter"); Great Lakes Advisers, Inc., SEC Staff No-Action Letter (Apr. 3, 1992) ("Great Lakes Letter"); Fiduciary Management Letter; South State Bank Letter. We requested comment on a number of the issues raised by predecessor performance. *See* 2019 Proposing Release, *supra* footnote 7, at section II.A.6.

749 *See* IAA Comment Letter; CFA Institute Comment Letter (supporting specific provisions on predecessor performance, but suggesting compliance with GIPS standards); Fried Frank Comment Letter (stating that the final rule should explicitly address predecessor performance and supporting a "principles-based, disclosure-driven approach" that has a similar framework as the proposed approach to hypothetical performance); Comment Letter of SIFMA (Supplemental) (June 5, 2020) ("SIFMA Supplemental Comment Letter").

750 *See* IAA Comment Letter; SIFMA Supplemental Comment Letter.

(B) the accounts managed at the predecessor investment adviser are sufficiently similar to the accounts managed at the advertising adviser that the performance results would provide relevant information to investors;

(C) all accounts that were managed in a substantially similar manner are advertised unless the exclusion of any such account would not result in materially higher performance and the exclusion of any account does not alter the presentation of any prescribed time periods; and

(D) the advertisement clearly and prominently includes all relevant disclosures, including that the performance results were from accounts managed at another entity.[751]

In addition to applying these specific provisions, advisers should consider the extent to which other provisions of the advertising rule, such as the general prohibitions (including those pertaining to the fair and balanced presentation of information), apply to any display of predecessor performance.

Primarily Responsible. In order to present predecessor performance in an advertisement, the person or persons who were primarily responsible for achieving the prior performance results while employed at the predecessor firm must manage accounts at the advertising adviser.[752] We believe that the "primarily responsible" requirement will help place critical guardrails on the use of predecessor performance and will require advisers to focus on the role that the individual played in producing the performance (*e.g.*, the extent of the person's decision-making authority or influence). Advisers should consider the substantive responsibilities of those who are

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751 *See* final rule 206(4)-1(d)(7)(iv); *see also* 2019 Proposing Release, *supra* footnote 7, at sections II.A.5.c.ii and II.A.6.

752 *See* final rule 206(4)-1(d)(7)(i). Our staff has applied a similar principle when considering the presentation of predecessor performance. *See* Horizon Letter (stating that the staff would not find a display of predecessor performance to be in and of itself misleading based on several representations, including that "the person or persons who manage accounts at the adviser were also those primarily responsible for achieving the prior performance results").

responsible for generating the performance at issue and, where more than one individual is primarily responsible for making investment decisions, whether a substantial identity of the group responsible for achieving the prior performance have moved over to the advertising adviser. We anticipate that this principles-based approach will address scenarios where a committee makes the investment decisions and where a single person is responsible for investment decisions. Where a committee managed the group of investments at the predecessor firm, a committee comprising a substantial identity of the membership must manage the portfolios at the advertising adviser.[753]

A person or group of persons is "primarily responsible" for achieving prior performance results if the person makes or the group makes investment decisions.[754] Where more than one person is involved in making investment decisions, advisers should consider the authority and influence that each person has in making investment decisions.[755]

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753 Our staff applied a similar principle when considering investment teams or committees. *See* Great Lakes Letter, at n.4 (staff declined to take a no-action position where only one person from a three-person committee transferred from the predecessor adviser to the advertising adviser and where the other two individuals played a significant role stating that, "at a minimum, there would have to be a substantial identity of personnel among the predecessor's and successor's committees."); Horizon Letter (staff stated that it would not recommend enforcement action under rule 206(4)-1 where one individual was primarily responsible for achieving performance results at the predecessor firm and, upon joining the advertising adviser, would be a member of a three-person committee. The individual would still have final decision-making authority and the other committee members would only advise the sole decision-maker.).

754 Commenters generally supported applying guardrails to displays of predecessor performance based on existing staff no-action letters and industry best practices. *See* IAA Comment Letter (citing Horizon Letter, South State Bank Letter, Great Lakes Letter, Fiduciary Management Letter, and Conway Asset Management, Inc., SEC Staff No-Action Letter (Jan. 27, 1989)); Fried Frank Comment Letter; SIFMA Supplemental Comment Letter.

755 *See* 2019 Proposing Release, *supra* footnote 7, at section II.A.6. (stating that it may be difficult to attach relative significance to the role played by each group member where an adviser selects portfolio securities by consensus or committee decision-making). *See also* Great Lakes Letter; Horizon Letter. Commenters generally supported the positon our staff has taken in no-action letters on predecessor performance where a committee makes investment decisions. *See, e.g.,* IAA Comment Letter (suggesting that the final rule require that "substantially all of the investment decision-makers who manage accounts at the adviser are those primarily responsible for achieving the prior performance results").

Sufficiently similar accounts. Under the final rule, an advertising adviser may not present predecessor performance in an advertisement unless the accounts managed at the predecessor and advertising advisers are "sufficiently similar" in order to ensure the investor receives relevant information.[756] Prior staff letters took no-action positions with accounts that were "so similar" to the advertised accounts.[757] We believe that the language in the final rule provides advisers appropriate flexibility in displaying predecessor performance and would not result in investor confusion.

Managed in a substantially similar manner. Under the final rule, an investment adviser using predecessor performance in an advertisement will be required to display all accounts that were managed in a "substantially similar manner" at the predecessor adviser, unless excluding any account would not result in materially higher performance and the exclusion of any account does not alter the presentation of any applicable time periods required by the rule.[758] This condition mirrors the related performance provisions of the final rule, which requires investment advisers to include all related portfolios and only permits an adviser to exclude a related portfolio if performance would not be materially higher and if the exclusion of any related portfolio does

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[756] *See* final rule 206(4)-1(d)(7)(ii). Our staff applied a similar principle when considering whether displays of predecessor performance would be relevant to investors. *See* Horizon Letter (stating that the staff would not find a display of predecessor performance to be in and of itself misleading based on several representations, including that "the accounts managed at the predecessor entity are so similar to the accounts currently under management that the performance results would provide relevant information to prospective clients").

[757] *See* IAA Comment Letter (suggesting that the Commission require the accounts to be "sufficiently similar" instead of "so similar").

[758] *See* final rule 206(4)-1(d)(7)(iii). Our staff applied a similar principle when considering whether displays of predecessor performance would be relevant to investors. *See* Horizon Letter (stating that the staff would not find a display of predecessor performance to be in and of itself misleading based on several representations, including that "all accounts that were managed in a substantially similar manner are advertised unless the exclusion of any such account would not result in materially higher performance"); IAA Comment Letter (supporting this provision).

not alter the presentation of any applicable time periods required by the rule.[759] Accounts that are managed in a substantially similar manner are those with substantially similar investment policies, objectives, and strategies.[760] As a result, advisers can use the same approach for determining the scope of the accounts that are managed in a substantially similar manner as they use to determine which accounts are related portfolios for purposes of displaying related performance.

An adviser that chooses to display predecessor performance information in an advertisement must consider the related performance requirements of the final rule. For example, if an adviser includes predecessor performance and the advertising adviser manages accounts that are related portfolios to those groups of investments depicted in the predecessor performance, then the advertising adviser must include these related portfolios in its performance display.[761]

Relevant disclosures. The final rule will require an adviser to clearly and prominently include all relevant disclosures and indicate that the performance results were from accounts managed at another entity.[762] While what disclosures are "relevant" will depend on the facts and

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759 *See* final rule 206(4)-1(d)(4); 2019 Proposing Release, *supra* footnote 7, at section II.A.5.c.ii, n.279.

760 *See* final rule 206(4)-1(e)(15). Our staff has stated that it would not recommend enforcement action if advisers present predecessor performance where the adviser presents the composite performance of all of the predecessor firm's accounts that had the same investment objectives and were managed using the same investment strategies that the adviser will manage at the new firm. *See* Horizon Letter.

761 In presenting such performance, advisers should also consider the general prohibitions and other performance advertising provisions of the final rule.

762 *See* final rule 206(4)-1(d)(7)(iv). Our staff applied a similar principle when considering whether displays of predecessor performance would be relevant to investors. *See* Horizon Letter (stating that the staff would not find a display of predecessor performance to be in and of itself misleading based on several representations, including that "the advertisement includes all relevant disclosures, including that the performance results were from accounts managed at another entity."). Disclosures that are subject to a clear and prominent standard under final rule 206(4)-1 should be included within the advertisement. *See supra* footnote 286.

circumstances, we agree with a commenter's suggestion that the fact that the performance was generated from accounts managed at another entity will always be relevant. Accordingly, the final rule will explicitly require this disclosure.[763] Additionally, advisers should consider what disclosures would be appropriate to comply with the other provisions of the final rule, such as the general prohibitions.

Our amendments to the books and records rule will require an adviser to retain records to support the performance presented.[764] We believe that, in order to avoid misleading presentations of predecessor performance, an adviser must have access to the books and records underlying the performance.[765] We have applied this concept more generally under the final rule, which will also require that an adviser have a reasonable basis for believing that it will be able to substantiate (upon demand by the Commission) all material statements of fact contained in an advertisement.[766]

Certain commenters that addressed this aspect of the proposal requested that we preserve flexibility for the types of records that support predecessor performance,[767] while another

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763 *See* IAA Comment Letter (suggesting the addition of "including that the performance results were from accounts managed at another entity" to the rule text).

764 *See* final rule 204-2(a)(16). *See also* Great Lakes Letter (stating that rule 204-2(a)(16) applies to a successor's use of a predecessor's performance data).

765 Our staff took this approach in stating that it would not recommend enforcement action under section 206 of the Advisers Act or the current advertising rule if an advertising adviser presents performance results achieved at another firm based on several representations, including that the advertising adviser would keep the books and records of the predecessor firm that are necessary to substantiate the performance results in accordance with rule 204-2(a)(16). *See* Horizon Letter; *see also* Great Lakes Letter, at n.3 (stating that rule 204-2(a)(16) "applies also to a successor's use of a predecessor's performance data"). We understand that investment advisers who consider this staff no-action letter currently keep copies of all advertisements containing performance data and all documents necessary to form the basis of those calculations.

766 *See* final rule 206(4)-1(a)(2).

767 *See* SIFMA AMG Comment Letter II; IAA Comment Letter (stating that an adviser should be permitted to substantiate performance using publicly available information and audit or verification statements); MarketCounsel Comment Letter (noting that the books and records of the predecessor firm are often unavailable due to contractual or privacy restrictions and suggesting that the Commission permit

commenter disagreed that flexibility was appropriate and suggested permitting predecessor performance only where the records required under rule 204-2 were available.[768] Without supporting information, we are concerned about the accuracy of such performance displays and that such information could be misleading. We do not believe that an advertising adviser could recreate performance based on a sampling of investor statements and/or display performance from a prior firm because we are concerned that such an approach has a heightened risk of cherry picking performance. Allowing a sampling of information to support performance displays is inconsistent with our general approach to require advisers to display all applicable performance (*e.g.*, related performance) to mitigate these cherry-picking concerns.

Because the final rule addresses the portability of adviser performance, our staff will withdraw several no-action letters our staff has issued on this topic.[769] However, other related letters will not be withdrawn in connection with this rulemaking since they address different activity than the activity covered by our final rule text on predecessor performance. Those letters address topics including an adviser's use of performance generated by predecessor accounts (*e.g.*, separate accounts or private funds) in RIC advertisements and filings[770] and the establishment of pools in order to generate performance track records.[771] These letters generally

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advertising advisers to recreate performance based on a sampling of client statements and/or display performance from a prior firm in a scenario where the advertising adviser has a copy of the advertisement and where the prior firm was subject to the books and records rule).

768 *See* CFA Institute Comment Letter (stating that alternative books and records requirements should not be an option for predecessor performance because verification reports will not satisfy the books and records requirements in most cases, nor would performance information that has been subject to a financial statement audit).

769 *See infra* section II.J.

770 *See, e.g.,* MassMutual Institutional Funds, SEC Staff No-Action Letter (Sept. 28, 1995); Nicholas-Applegate, SEC Staff No-Action Letter (Aug. 6, 1996); Growth Stock Outlook Trust Inc., SEC Staff No-Action Letter (Apr. 15, 1986).

771 *See* Dr. William Greene, SEC Staff No-Action Letter (Feb. 3, 1997).

address the use of performance from *predecessor accounts* (*i.e.*, where the same adviser uses performance generated by one investment vehicle in an advertisement for another product) rather than performance of a predecessor advisory firm.[772]

Although we requested comment on the portability of testimonials, endorsements, third-party ratings, and specific investment advice,[773] commenters did not address these topics. To the extent that testimonials, endorsements, third-party ratings, and specific investment advice contain performance from a predecessor firm, the general prohibitions apply to such testimonials, endorsements, and third-party ratings. We do not believe we need to address their portability specifically as the general prohibitions, depending on the facts and circumstances, will have the effect of prohibiting advisers from presenting misleading information to investors by using outdated testimonials, endorsements, and third-party ratings.

G. Review and Approval of Advertisements

The final rule will not require investment advisers to review and approve their advertisements prior to dissemination, unlike the proposal. The proposed advertising rule would have required an adviser to have an advertisement reviewed and approved for consistency with the requirements of the proposed rule by a designated employee before disseminating the advertisement, except in certain circumstances.[774] We proposed this requirement because we believed it might reduce the likelihood of advisers violating the proposed rule. We believed it was important that investment advisers implement a process designed to promote compliance with the proposed rule's requirements. We also proposed to require that advisers create and

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772 *See, e.g.,* Salomon Brothers Asset Management Inc., SEC Staff No-Action Letter (July 23, 1999). *See also*, Jennison Associates LLC, SEC Staff No-Action Letter (July 6, 2000).

773 *See* 2019 Proposing Release, *supra* footnote 7, at section II.A.6.

774 *See* proposed rule 206(4)-1(d).

maintain a written record of the review and approval of the advertisement, which would have allowed our examination staff to better review adviser compliance with the rule.

Many commenters opposed this requirement or suggested modifications to it. Commenters expressed concern that it would impose a significant compliance burden on advisers, especially smaller firms.[775] Many commenters also argued that such a requirement would be duplicative of the compliance rule, pointing out that most advisers already have implemented policies and procedures to review advertisements for accuracy prior to dissemination.[776] Other commenters stated that an inflexible review and approval requirement covering nearly all advertisements would impair an adviser's ability to communicate timely with clients, resulting in poor client service or slow responses during periods of market volatility.[777] Commenters claimed that the proposal, which did not exclude one-on-one communications from the definition of advertisement, would effectively require advisers to screen *all* communications to assess whether a communication would constitute an advertisement subject to the review and approval requirement, or met one of the requirement's exceptions.[778] Consequently, some of these commenters suggested that if we adopt this requirement, the final rule should expand the exceptions to include, for example, responses to questions that contain pre-approved template language, advertisements to Non-Retail Persons, and interactive social media content.[779]

After considering these comments, we are not adopting the proposed internal review and approval requirement. Instead, we believe an adviser's existing obligations under the

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775 *See, e.g.*, FPA Comment Letter; MFA/AIMA Comment Letter I.

776 *See, e.g.*, SBIA Commenter Letter; SIFMA AMG Comment Letter I.

777 *See, e.g.*, Commonwealth Comment Letter.

778 *See, e.g.*, NSCP Comment Letter; SIFMA AMG Comment Letter I.

779 *See, e.g.*, MFA/AIMA Comment Letter I; MMI Comment Letter; ICE Comment Letter.

compliance rule will allow an adviser to tailor its compliance program to its own advertising practices to prevent violations from occurring, detect violations that have occurred, and correct promptly any violations that have occurred.[780] In adopting the compliance rule, the Commission stated that investment advisers should adopt policies and procedures that address ". . . the accuracy of disclosures made to investors, clients, and regulators, including account statements and advertisements."[781] We believe for these compliance policies and procedures to be effective, they should include objective and testable means reasonably designed to prevent violations of the final rule in the advertisements the adviser disseminates.

Advisers can establish such an objective and testable compliance policies and procedures through a variety of tools. For example, internal pre-review and approval of advertisements could serve as an effective component of an adviser's compliance program. Other effective methods to prevent issues could include reviewing a sample of advertisements based on risk or pre-approving templates. Effective methods to detect and correct promptly violations and adjust practices to prevent future violations might include spot-checking advertisements and periodic reviews.[782] Commenters confirmed our understanding that the internal policies and procedures of many advisers currently require some level of review for advertisements, although not pre-

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780 *See* Compliance Program Adopting Release, *supra* footnote 371, at 74716. Rule 206(4)-7 makes it unlawful for an investment adviser to provide investment advice unless the adviser has adopted and implemented written policies and procedures reasonably designed to prevent violations of the Advisers Act and rules that the Commission has adopted under the Act, which will include final rule 206(4)-1 and its specific requirements. *See* rule 206(4)-7(a). Rule 206(4)-7 also requires investment advisers to review, no less than annually, the adequacy of the policies and procedures and the effectiveness of their implementation, and to designate who is responsible for administering the policies and procedures adopted under the rule. *See id.* at (b)-(c).

781 *See* Compliance Program Adopting Release, *supra* footnote 371, at 74716.

782 *See* Compliance Program Adopting Release, *supra* footnote 371, at 74716. If advisers indirectly market or solicit through third parties, they should consider how to tailor policies and procedures according to the risks posed by those third parties making statements that constitute advertisements under the rule. *See supra* section II.C.3.

review of every advertisement.[783] Advisers should also consider the extent to which reasonably designed policies and procedures should involve training on the requirements and prohibitions of the advertising rule for any employee(s) involved in the creation, review, or dissemination of adviser advertisements.

In addition, consistent with the Commission's examination authority, upon request, advisers must promptly provide information about their compliance policies and procedures and any records that document implementation of those policies and procedures to us and our staff.[784] The Commission's ability to collect information in a timely fashion through its examination authority, and evaluate such information for compliance with the Federal securities laws, is essential to our mission of protecting investors and our securities markets.[785] Indeed, the prompt production of records to the Commission is central to our mission of protecting investors, and is imperative to an effective and efficient examination program.[786]

In connection with the proposed review and approval requirement, we also proposed to require investment advisers to maintain a copy of all written approvals of advertisements by

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783 *See, e.g.*, SBIA Comment Letter; SIFMA AMG Comment Letter I (stating that advisers' compliances programs currently include upfront reviews of templates, spot-checking or sampling advertisements after dissemination, or a risk-based approach depending on the type of advertisement).

784 *See* 15 U.S.C. 80b-4 (section 204 of the Investment Advisers Act) (providing the Commission with examination authority over "all records" of an investment adviser); *see* rule 204-2(g)(2) (requiring prompt production of records); *see* rule 204-2(a)(17) (requiring investment advisers to make and keep records of their policies and procedures formulated pursuant to rule 206(4)-7).

785 *See, e.g.*, 15 U.S.C. 80b-4 (section 204 of the Investment Advisers Act) (providing the Commission with examination authority); *see also* 17 CFR 275.204-2 (rule 204-2 under the Investment Advisers Act) (Commission books and records rules).

786 *See, e.g.,* Electronic Recordkeeping by Investment Companies and Investment Advisers, Release No. IA-1945 (May 24, 2001) [66 FR 29224 (May 30, 2001)] (explaining that the "continuing accessibility and integrity of fund and adviser records are critical to the fulfillment of our oversight responsibilities," and noting the Commission's expectation that a fund or adviser would be permitted to delay furnishing electronically stored records for more than 24 hours only in "unusual circumstances.").

designated employees.[787] As we are not adopting the proposed pre-use approval requirement, we are also not adopting this associated recordkeeping requirement.

H. Amendments to Form ADV

We are adopting, largely as proposed, amendments to Item 5 of Form ADV Part 1A to improve information available to the Commission and the public about advisers' marketing practices. Item 5 currently requires an adviser to provide information about its advisory business.[788] We proposed to add a subsection L ("Marketing Activities") to require information about an adviser's use in its advertisements of performance results, testimonials, endorsements, third-party ratings, and references to its specific investment advice.

Several commenters supported the proposed additions to Form ADV,[789] while others questioned their usefulness.[790] Some commenters suggested removing the question regarding whether an adviser's performance results were verified, arguing that it could disadvantage smaller advisers or could provide investors with a false assurance of accuracy.[791] Other commenters suggested that we include questions about an adviser's use of other types of performance, such as predecessor performance,[792] or specific types of hypothetical performance.[793] One commenter opposed including questions regarding the amount or range of

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787 *See* proposed rule 204-2(a)(11)(iii).

788 Exempt reporting advisers (that are not also registering with any state securities authority) are not required to complete Item 5 of Part 1A. Accordingly, subsection L of Item 5 of Part 1A will not be required for such advisers. *See, e.g.*, Instruction 3 to Form ADV: General Instructions ("How is Form ADV organized"). Exempt reporting advisers will not be subject to the final rule. *See supra* footnote 21.

789 *See* CFA Institute Comment Letter; NRS Comment Letter; NAPFA Comment Letter.

790 *See, e.g.*, SIFMA AMG Comment Letter I.

791 *See, e.g.*, JG Advisory Comment Letter; Pickard Djinis Comment Letter.

792 *See* CFA Institute Comment Letter.

793 *See* NRS Comment Letter (suggesting that Form ADV specifically request that an adviser disclose whether its advertisements include backtested performance or projected or targeted returns).

compensation paid for testimonials, endorsements, or third-party ratings, arguing that this could be commercially sensitive information.[794] Others suggested technical improvements to the proposed section. For example, one commenter requested that we clarify how frequently advisers must update responses to Item 5.L.[795] Another commenter requested that we define advertisement and other relevant terms of Item 5.L in the Form ADV Glossary.[796]

After considering the comments, we are adopting new subsection L to Item 5 of Form ADV with slight modifications to the ordering and content of the subsection versus the proposal. We are also amending the Form ADV Glossary to incorporate the final rule's definitions for "advertisement," "endorsement," "hypothetical performance," "testimonial," "third-party rating," and "predecessor performance." Because new subsection L is included under Item 5 of Form ADV, advisers will be required to update responses to these questions in their annual updating amendment only.[797] We continue to believe that this new information will be useful for staff in reviewing an adviser's compliance with the final rule, including the restrictions and conditions on advisers' use in advertisements of performance presentations and third-party statements.

First, we are combining several proposed questions into Item 5.L(1), which will require an adviser to state whether any of its advertisements include performance results, a reference to specific investment advice, testimonials, endorsements, or third-party ratings.[798] Unlike under the proposal, this item will require an adviser to address separately whether its advertisements include testimonials, endorsements, and third-party ratings. We believe that requiring advisers to

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794 *See* SIFMA AMG Comment Letter I.

795 *See* NRS Comment Letter.

796 *See* Pickard Djinis Comment Letter.

797 *See* Instruction 4 to Form ADV: General Instructions ("When am I required to update my Form ADV?").

798 The question will exclude testimonials and endorsements given by certain affiliated persons of the adviser that satisfy rule 206(4)-1(b)(4)(ii).

address each separately will provide more specific and useful information to our staff regarding whether an adviser engages in these marketing practices. We are not including the proposed related question that would have asked whether the performance results in Item 5.L(1) were reviewed or verified, as proposed. We agree with commenters that "verification" may inappropriately suggest an assurance of accuracy to investors, and disadvantage smaller advisers that may not obtain third-party reviews of their performance results.[799]

As proposed, we are requiring an adviser to state whether the adviser pays or otherwise provides cash or non-cash compensation, directly or indirectly, in connection with the use of testimonials, endorsements, or third-party ratings.[800] This question will only require 'yes' or 'no' responses, and will not require additional information about the amount or range of compensation provided to avoid the disclosure of potentially sensitive information as suggested by one commenter.[801]

Third, unlike under our proposal, we are adding items requiring an adviser to state whether any of its advertisements include hypothetical performance and predecessor performance, respectively. We agree with commenters' suggestions that this information could be useful for our staff preparing for examinations, especially considering that hypothetical performance can pose a heightened risk of misleading investors.[802] Additionally, as explained above, the final rule specifically addresses when advisers can include predecessor performance

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799 *See* JG Advisory Comment Letter; CFA Institute Comment Letter.

800 This question will appear in Item 5.L(2), but had been proposed as Item 5.L(4).

801 *See* SIFMA AMG Comment Letter I.

802 *See, e.g.*, CFA Institute Comment Letter; NRS Comment Letter.

in advertisements.[803] Responses regarding predecessor performance will enable our examination staff to better assess compliance with this new provision of the rule.

I. Recordkeeping

We are adopting amendments to the books and records rule, largely as proposed, to reflect the final rule and to help further the Commission's inspection and enforcement capabilities. Investment advisers must make and keep records of all advertisements they disseminate, and certain alternative methods for complying with this provision are available for oral advertisements, including oral testimonials and oral endorsements.[804] If an adviser provides an advertisement orally, the adviser may, instead of recording and retaining the advertisement, retain a copy of any written or recorded materials used by the adviser in connection with the oral advertisement.[805] If an adviser's advertisement includes a compensated oral testimonial or endorsement, the adviser may, instead of recording and retaining the advertisement, make and keep a record of the disclosures provided to investors.[806] Further, if an adviser's disclosures with respect to a testimonial or endorsement are not included in the advertisement, then the adviser must retain copies of such disclosures provided to investors.[807]

Commenters generally disagreed with this expansion of the books and records rule, which currently only requires advisers to retain advertisements sent to ten or more persons. According to commenters, advisory firms of all sizes would face compliance challenges,

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803 *See supra* section II.F.

804 *See* final rule 204-2(a)(11)(i)(A).

805 *See* final rule 204-2(a)(11)(i)(A)(*1*).

806 *See* final rule 204-2(a)(11)(i)(A)(*2*).

807 *See* final rule 204-2(a)(11)(i)(A) and (15)(i).

especially smaller advisers, if required to maintain all advertisements.[808] We believe, however, that this change is necessary to conform the books and records rule to the definition of advertisement and is designed to ensure advisers comply with the requirements in the final rule.[809] Our decision to narrow the proposed definition of advertisement by excluding one-on-one communications from the first prong of the definition (other than most communications that include hypothetical performance) will lessen any burden imposed by the associated recordkeeping obligations.

One commenter asked us to clarify that electronic mail ("e-mail") archives are an acceptable method of maintaining records of advertisements that are disseminated to investors, and we agree.[810] The final rule does not prescribe or prohibit any particular method of maintaining records. Rather, it requires the adviser to maintain and preserve these records "in an easily accessible place for a period of not less than five years, the first two years in an appropriate office of the investment adviser, from the end of the fiscal year during which the investment adviser last published or otherwise disseminated, directly or indirectly, the…advertisement."[811] We believe it would be permissible for an adviser to store records using e-mail archives (including in cloud storage or with a third-party vendor), provided that the

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808 *See* JG Advisory Comment Letter; NAPFA Comment Letter; FPA Comment Letter.

809 *See also* NRS Comment Letter (stating that "most advisers have developed procedures requiring the retention of all written communications, so that individuals within the firm do not have the discretion to determine whether or not a particular communication is required under rule 204-2(a)(7)."). As proposed, we are not changing the requirement that advisers keep a record of communications other than advertisements (*e.g.*, notices, circulars, newspaper articles, investment letters, and bulletins) that the investment adviser disseminates, directly or indirectly, to ten or more persons.

810 *See* JG Advisory Comment Letter.

811 Final rule 204-2(e)(3)(i). This provision has not been amended from the current rule.

adviser can promptly produce records in accordance with the recordkeeping rule[812] and statements of the Commission.[813]

The current recordkeeping rule requires advisers to retain originals of all written communications received and copies sent by the adviser relating to the performance or rate of return of any or all managed accounts or securities recommendations.[814] As proposed, the final rule will amend the current rule to also require advisers to maintain written communications relating to the performance or rate of return of any portfolios (as defined in the final marketing rule).[815]

The current recordkeeping rule requires advisers to retain all 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 or all managed accounts or securities recommendations in any advertisement.[816] As proposed, the final rule will amend the current rule to also require advisers to maintain 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 (as defined in the final marketing rule).[817] In addition, the supporting records of investment advisers that display hypothetical performance must include

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812 *See* final rule 204-2(g)(2)(ii). This provision has not been amended from the current rule.

813 *See* Amendments to the Timing Requirements for Filing Reports on Form N-PORT, Release No. IC-33384 (Feb. 27, 2019) [84 FR 7980 (Mar. 6, 2019)] (interim final rule), at n.44. *See also* JG Advisory Comment Letter (suggesting that the Commission clarify that e-mail archives are an acceptable method of recordkeeping in certain contexts).

814 *See* current rule 204-2(a)(7)(iv).

815 *See* final rule 204-2(a)(7)(iv).

816 *See* current rule 204-2(a)(16).

817 *See* final rule 204-2(a)(16). *See also* Recordkeeping by Investment Advisers, Release No. IA-1135 (Aug. 17, 1988) [53 FR 32033 (Aug. 23, 1988)] (describing as "supporting records" the documents necessary to form the basis for performance information in advertisements that are required under rule 204-2(a)(16)).

copies of all information provided or offered pursuant to the hypothetical performance provisions of the final rule.[818] These changes are designed to help to facilitate the Commission's inspection and enforcement capabilities.

In a change from the proposal, the final rule will require advisers to maintain documentation of communications relating to predecessor performance.[819] This change complements the predecessor performance provisions of the final rule and will help ensure that advertising advisers retain appropriate documentation to substantiate displays of predecessor performance. One commenter noted that advisers often have difficulty complying with the books and records requirements in connection with predecessor performance.[820] For the reasons discussed above, we decline to provide additional flexibility.[821]

In a change from the proposal, we will require advisers to make and keep a record of who the "intended audience" is pursuant to the hypothetical performance and model fee provisions of the final marketing rule.[822] Our examination staff may choose to review the adviser's policies and procedures (for displaying hypothetical performance) against the records retained in connection with this new recordkeeping provision when determining whether the adviser

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818 *See* final rule 206(4)-1(d)(6), which will prohibit hypothetical performance in an advertisement except under certain conditions, including a requirement that the investment adviser provides (or offers to provide promptly to a recipient that is a private fund investor) sufficient information to enable the intended audience to understand the risks and limitations of using such hypothetical performance in making investment decisions. Any such supplemental information that is required by final rule 206(4)-1 to be a part of the advertisement is subject to the books and records rule. *See* final rule 204-2(a)(16).

819 *See* proposed rule 204-2(a)(7)(iv). *See also* 2019 Proposing Release, *supra* footnote 7, at sections II.A.6. and II.C. (requesting comment about whether to amend the books and records rule to address the substantiation of performance results from a predecessor firm and whether the Commission should amend the rule to address specifically other provisions of the proposed advertising rule).

820 *See* SIFMA AMG Comment Letter II.

821 *See supra* section I.F.

822 *See* final rule 204-2(a)(19). *See also* final rule 206(4)-1(d)(6) and (e)(10)(ii)(B).

satisfied the hypothetical performance policies and procedures condition. Also, we believe this additional requirement will assist our examination staff in confirming that advisers are appropriately considering the target audience when preparing and disseminating net performance and hypothetical performance.

We proposed to require investment advisers to maintain a copy of all written approvals of advertisements by designated employees in order to track a corresponding proposed provision of the advertising rule relating to a review and approval process.[823] Since we are not adopting the provision of the proposed advertising rule relating to review and approval, we are not adopting the corresponding proposed recordkeeping requirement. As discussed above, we are persuaded by commenters who asserted that an adviser's own policies and procedures would provide an effective compliance mechanism.[824]

The combination of the current solicitation rule and current advertising rule into a single marketing rule resulted in additional changes to the books and records rule. We are adopting, as proposed, changes to the books and records rule in order to correspond to the marketing rule's provisions that address testimonials and endorsements. The rule will require investment advisers to make and keep any communication or other document related to the investment adviser's determination that it has a reasonable basis for believing that a testimonial or endorsement complies with rule 206(4)-1 and that a third-party rating complies with rule 206(4)-1(c)(1).[825] We are not adopting amendments to the books and records rule that would specifically reference

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823 *See* proposed rule 204-2(a)(11)(iii).

824 *See, e.g.*, NRS Comment Letter.

825 *See* final rule 204-2(a)(15)(ii).

the adviser's obligation to retain the written agreements with promoters[826] because such a provision would be duplicative of the current books and records rule.[827]

We did not receive any comments on the proposed amendments to the recordkeeping rule provisions that corresponded to the proposed amendments to the solicitation rule. For the reasons discussed in the proposal regarding amendments to the solicitation rule, we are retaining the current recordkeeping rule's requirement for investment advisers to keep a record of the disclosures delivered to investors, which now apply to testimonials, endorsements, and third-party ratings. However, we are adjusting the wording to correspond to changes to the final marketing rule that permit either the investment adviser or the promoter to provide the disclosure. Further, in a change from the current solicitation rule, the final marketing rule will not require a promoter to provide an investor with the adviser's brochure. Accordingly, as proposed, we will remove the corresponding books and records requirement as no longer relevant or necessary.

As discussed above, in a change from the proposed amendments to the solicitation rule, the final rule contains a partial exemption (from the disclosure requirements associated with testimonials and endorsements in the final rule) for an adviser's affiliated personnel. The amended recordkeeping rule will now contain a corresponding requirement for advisers that rely on the exemption to keep a record of the names of all affiliated personnel and document their affiliates' status at the time the investment adviser disseminates the testimonial or endorsement.[828]

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826 *See* final rule 206(4)-1(b)(2)(ii).

827 Advisers are already required to retain the written agreement pursuant to current rule 204-2(a)(10).

828 *See* final rule 204-2(a)(15)(iii).

Finally, we are adopting, as proposed, the requirement that an adviser retain a copy of any questionnaire or survey used in the preparation of a third-party rating included or appearing in any advertisement.[829] Commenters expressed concerns about not being able to obtain a copy of the questionnaire or survey.[830] As discussed above, we recognize this concern and the rule will require an adviser to retain a copy of this material only in the event the adviser obtains a copy of the questionnaire or survey (*i.e.*, an adviser would not be *required* to obtain a copy of the questionnaire or survey in order to comply with rule 206(4)-1 or rule 204-2)).

J. Existing Staff No-Action Letters

Staff in the Division of Investment Management reviewed certain of our staff's no-action letters that addresses the application of the advertising and solicitation rules to determine whether any such letters should be withdrawn in connection with the adoption of the marketing rule. Because we are rescinding the solicitation rule, the staff no-action letters that address that rule will be nullified.[831] Additionally, pursuant to the staff's review, the staff will be withdrawing the staff's remaining no-action letters and other staff guidance, or portions thereof, as of the compliance date of the final rules.[832] A few commenters supported this approach, suggesting that the final rule should either supersede or incorporate every letter.[833] Other commenters requested that certain no-action letters not be withdrawn that were issued to

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829 *See* final rule 204-2(a)(11)(ii).

830 *See, e.g.*, Blackrock Comment Letter; AIC Comment Letter.

831 The order granting exemptive relief under rule 206(4)-3 is also terminated. *See* In the Matter of Blackrock, Investment Advisers Release Nos. 2971 (Jan. 4, 2010) [75 FR 1421 (Jan. 11, 2010)] (application) and 2988 (Feb. 26, 2010) (order) (stating that "the Applicant will rely on the Order only for so long as the Cash Solicitation Rule in effect as of the date of the Order is operative.").

832 A list of the letters to be withdrawn will be available on the Commission's website.

833 IAA Comment Letter; Mercer Comment Letter.

solicitors who would otherwise be subject to the rule's disqualification provisions.[834] These commenters alternatively requested that the Commission grandfather such solicitation arrangements if these letters are withdrawn.

Based on the staff's review, we understand that some solicitors may continue to conduct solicitation activity consistent with the conditions stated in certain of the solicitor disqualification letters identified below.[835] The majority of these letters, however, pertain to events that occurred more than ten years prior to the effective date of the marketing rule and thus would not be disqualifying events under the marketing rule.[836] The nullification of these solicitation disqualification letters will not have an impact on the relevant solicitor's eligibility under the rule. For the minority of the solicitor disqualification letters that involve events that occurred within the rule's ten-year lookback period, however, nullification of these letters could trigger disqualification under the marketing rule for that underlying event. To avoid this result, we understand that the staff will take a no-action position with respect to the events in those letters to prevent those solicitors from being deemed disqualified under the marketing rule. This position is designed primarily to assist the phase-out of these letters as of the compliance date of the final rule.[837]

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834 *See, e.g.*, SIFMA AMG Comment Letter II; Mercer Comment Letter; Stansberry Comment Letter.

835 *See also*, Stansberry Comment Letter.

836 *See* final rule 206(4)-1(e)(4).

837 We believe that the need for this position will likely be temporary since the events covered by these letters, over time, will fall outside the ten-year lookback period for purposes of disqualification under the rule.

K. Transition Period and Compliance Date

The final rule will provide an eighteen-month transition period between the effective date of the rule and the compliance date. While we had proposed a one-year transition period, two commenters requested a longer transition period to prepare for the new rule's requirements.[838] One of these commenters argued that a two-year transition period would be more appropriate given the compliance burden of implementing the proposed review and approval requirement.[839] We did not adopt the proposed pre-review and approval requirement; nevertheless, we appreciate commenters' concerns. Accordingly, the compliance date will be eighteen months following the effective date of the rules. Any advertisements disseminated on or after the compliance date by advisers registered or required to be registered with the Commission would be subject to the new marketing rule.

The compliance date for the amended recordkeeping rule will also provide an eighteen-month transition date from the effective date of the rule. Advisers filing Form ADV after a similar eighteen-month transition period from the effective date of the rule will be required to complete the amended form. Importantly, Form ADV does not require an adviser to update responses to Item 5 promptly by filing an other-than-annual amendment, and if an adviser submits an other-than-annual amendment, the adviser is not required to update its response to Item 5 even if the response has become inaccurate.[840] Therefore, each adviser is only responsible for filing an amended form that includes responses to the amended questions in Item 5 in its next annual updating amendment that is filed after the eighteen-month transition period.

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838 *See* FPA Comment Letter; MFA/AIMA Comment Letter I.

839 *See* MFA/AIMA Comment Letter I.

840 *See* Form ADV General Instruction 4.

L. Other Matters

Pursuant to the Congressional Review Act,[841] the Office of Information and Regulatory Affairs has designated this rule a "major rule" as defined by 5 U.S.C. § 804(2). If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

III. ECONOMIC ANALYSIS

A. Introduction

We are mindful of the costs imposed by, and the benefits obtained from, our rules. Whenever we engage in rulemaking and are required to consider or determine whether an action is necessary or appropriate in the public interest, section 202(c) of the Advisers Act requires the Commission to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. The following analysis considers, in detail, the potential economic effects that may result from the final rule, including the benefits and costs to market participants as well as the broader implications of the final rule for efficiency, competition, and capital formation. Where possible, the Commission quantifies the likely economic effects of the final rule; however, the Commission is unable to quantify certain economic effects because it lacks the information necessary to provide estimates or ranges. In some cases, quantification is particularly challenging due to the number of assumptions that would be required to forecast how investment advisers would respond to the new conditions of the final rule, and how those responses would in turn affect the broader market for investment advice and the investors' participation in this market. Nevertheless, as described more fully

841 5 U.S.C. § 801 *et seq*.

below, the Commission is providing both a qualitative assessment and, where feasible, a quantified estimate of the economic effects.

In large part, the scope of these costs and benefits is determined by the scope of the rule's definition of advertisement. The final rule's definition includes many of the types of communications subject to the current advertising rule. The final rule, however, will expressly apply the protections of the rule to investors in private funds, and advisers will now incur costs related to these communications, to the extent that their current practices differ from the final rule. In addition, the definition's scope has been expanded to include communications made by promoters, including cash-compensated promoters, who were previously subject to the cash solicitation rule, and non-cash-compensated promoters who were not. Some of these affected promoters whose communications will be newly defined as advertisements may also be registered broker-dealers whose communications may be subject to other regulatory requirements governing communications and advertisements, including those under the Exchange Act, the rules promulgated thereunder (including Regulation BI), and FINRA rules (including FINRA rule 2210). The final rule's application to promoters that are registered broker-dealers relating to endorsements to private fund investors may create some overlap in regulation to the extent regulatory requirements under the Exchange Act and FINRA rules apply to their promotional activities. This may create burdens on these promoters to the extent their compliance with these other regulatory requirements does not fully satisfy the final rule. However, both the costs and benefits of the testimonial and endorsement requirements will be mitigated by the exclusions from the endorsement requirements that will apply to these registered broker-dealers.

Other aspects of the final rule will also yield costs and benefits, such as the final rule's general prohibitions on certain marketing practices. The impact of these changes are generally limited to the extent that communications are subject to similar restrictions under the current advertising rule, the current solicitation rule, and the general anti-fraud provisions of the securities laws, and the extent to which the final rule's prohibitions conform to current market practices. The impact is more pronounced with respect to communications newly subject to the definition of an advertisement and not previously subject to the solicitation rule—particularly to communications by solicitors who are not cash-compensated. In addition, the rules and rescission of existing no-action letters may increase certainty because advisers who choose to advertise will be able to follow the requirements of the final rules rather than various no-action letters, which could ultimately reduce compliance costs. Conversely, to the extent that the specificity of the rules prompts some advisers to devote greater resources to ensure compliance obligations under the final rules, the requirements of the rules may impose greater costs on such funds and advisers. Changes in costs of compliance for advisers ultimately could affect investors to the extent that any changes in costs would be passed down to them in the form of changed fund operating expenses or higher advisory fees.

In addition, the rule will (i) permit investment advisers to use certain features in an advertisement, such as testimonials and endorsements, subject to certain conditions, such as disclosing information that would help investors evaluate the advertisement, and (ii) prohibit third-party ratings and investment adviser performance in advertisements unless they comply with certain conditions. The ability to use testimonials and endorsements will likely have a less pronounced impact on advisers that are currently complying with the solicitation rule because this aspect of the marketing rule is drawn from the current solicitation rule. The impact of

restrictions in the marketing rule related to the use of performance advertising is likely similar on advisers currently subject to the advertising or solicitation rule because this aspect of the final rule permits certain activity that is not permissible under either current rule. If an adviser that is subject to the current advertising rule is implementing practices similar to those of the recipients of staff letters with respect to performance advertising, the impact of this new aspect of the final rule may be less pronounced for these advisers as compared to the impact on other advisers to the extent that there are some similarities between the final rule and the staff letters.

The Commission is also adopting amendments to Form ADV that are designed to provide additional information regarding advisers' marketing practices, and amendments to the Advisers Act books and records rule to correspond to the features of the marketing rule. The final rule reflects market developments since 1961 and 1979, when rules 206(4)-1 and 206(4)-3, respectively, were adopted, as well as practices addressed in staff no-action letters. These market developments include advances in communication technology and marketing practices that did not exist at the time the rules were adopted and may fall outside of the scope of the current rules.

B. Broad Economic Considerations

While we discuss investment advisers' many diverse marketing methods and practices in detail later, here we discuss the broad economic considerations that frame our economic analysis of the final rule and describe the relevant structural features of the market for investment advice and its relationship to marketing of advisory services and private funds. Key to this framework is the problem that investors face when searching for an investment adviser; specifically the lack of information that investors may have about the ability and potential fit of an investment adviser for the investor's preferences. By setting up this economic framework, we can see how the

characteristics of the market for investment advice and its participants can influence the costs and benefits of the final rule and its impact on efficiency, competition, and capital formation.

Information Usefulness

The usefulness of the information in investment adviser advertisements is an important factor in determining how investors decide with which investment advisers to engage. For the purposes of the final rule, we use the term "ability" to refer to the usefulness of advice an investment adviser provides. The "potential fit" of an investment adviser refers to attributes that investors may have specific preferences for, such as communication style, investment style, or risk preference. For example, some investors would prefer an investment adviser that does not proactively provide advice or suggest investments, while others might prefer a more active communication and management style.

While the effectiveness and usefulness of an investment adviser's advertisements can have direct effects on the quality of the matches that investors make with investment advisers – in terms of both fit and better returns from the investment – there may be important indirect effects as well. If the final rule provides additional methods for investment advisers to credibly and truthfully advertise their ability and potential fit with investors, investment advisers may have a greater marginal incentive to invest more in the quality of their services, because advisers would have additional methods to communicate their ability and potential fit through advertisements. Additionally, because investors might be able to better observe the relative qualities of competing investment advisers, the final rule may also enhance competition among investment advisers. In summary, to the extent that the final rule improves the effectiveness and usefulness of investment adviser advertisements, the final rule could also have a secondary effect

of increasing competition among investment advisers, and encourage investment in the quality of services.

Information Access

Investors generally have access to a variety of sources of information on the ability and potential fit of an investment adviser. Advertisements, word of mouth referrals, and independent research are all ways in which investors acquire information about investment advisers as they search for them. During this search, investors trade off the benefits of finding a better investment adviser (in terms of ability and potential fit) against the costs of searching for and obtaining information about one. If the cost of searching is too high, investors may contract with lower quality investment advisers on average, because they cannot spend the resources to conduct a search that would yield an investment adviser with higher ability or better fit, or they might not be able to evaluate the quality of the investment adviser they have found. Thus, higher search costs can result in inefficiencies because the same expected quality of match requires an investor to incur higher search costs. Similarly, for a fixed amount of spending on a search, an investor is less able to find information about investment advisers, and finds a lower expected quality of match.

Marketing can potentially mitigate inefficiencies associated with the costs of searching for good products or suitable services. To the extent that marketing provides accurate and useful information to investors about investment advisers at little or no cost to investors, marketing can reduce the search costs that investors bear to acquire information and improve the ability of investors to identify high quality investment advisers. Investors have a variety of preferences regarding investment adviser characteristics such as investment strategies or communication styles. Marketing can help communicate information about an investment adviser's ability, and

that may aid an investor in selecting an investment adviser who is a good "fit" for the investor's preferences.

While marketing by or on behalf of investment advisers may reduce search costs for potential investors, investment advisers' or promoters' incentives may not necessarily be aligned with those of potential investors. Such a misalignment could undercut the potential gains to efficiency. For example, investment advisers have incentives to structure their advertisements to gain potential investors, regardless of whether their advertisements accurately reflect their ability and indicate whether they offer a potential fit with an investor's preferences. One commenter suggested, for instance, that advisers may be incentivized to purchase positive testimonials or endorsements, or otherwise curate content. [842]

In addition, advertisements might make claims that are costly for investors to verify or are inherently unverifiable. For example, evaluating a claim that an investment adviser's strategy generates "alpha" or returns in excess of priced risk factors generally requires information about the strategy's returns and permitted holdings, as well as a model that attributes returns to risk factors. While some investors may have ready access to these resources or information, other investors may not. In some cases, an investor may be unable to assess the plausibility of an investment adviser's claims. An investment adviser might also state facts but omit the contextual details that an investor would need to properly evaluate these facts.

Several economic models suggest that the ability to control or influence an investor's access to information can hamper the investor's ability to process information in an unbiased

842 *See* NASAA Comment Letter.

manner, even if the specific facts or information communicated to an investor are not false.[843] For example, this type of control or influence on information can be as explicit as deletion or removal of unfavorable ratings or reviews,[844] or as implicit as a reordering of the ratings or a suggestion of which ratings or reviews to read.[845] Similarly, promoters may overstate the quality of the investment adviser they are promoting or their familiarity with the advisers' services, or hide negative details that would have aided an investor when choosing an investment adviser or private fund, given promoters' financial incentive to recommend the adviser to the investor.

Information Evaluation

There are considerable differences among investors and potential investors in their ability to process and evaluate information communicated by investment advisers. Many investors and prospective investors may lack the financial literacy needed to evaluate and interpret the types of financial information contained in investment adviser advertisements. In 2010, the Dodd-Frank Act required the Commission to study the financial literacy among retail investors, including methods and efforts that could increase financial literacy among investors.[846] The Commission contracted with the Federal Research Division at the Library of Congress to conduct a review of

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843 Luis Rayo and Ilya Segal, *Optimal Information Disclosure*, 118 J. POL. ECON. 949 (2010); Emir Kamenica and Matthew Gentzkow, *Bayesian Persuasion*, 101 AM. ECON. REV. 2590 (2011); Pak Hung Au and King King Li, *Bayesian Persuasion and Reciprocity: Theory and Experiment,* SSRN (June 5, 2018), *available at* https://ssrn.com/abstract=3191203; Jacob Glazer and Ariel Rubinstein, *On Optimal Rules of Persuasion*, 72 ECONOMETRICA 1715 (2004) ("Glazer").

844 *See id.* for Segal and Rayo 2010, Kamenica and Gentzkow 2011, Au Li 2018.

845 *See* Glazer, *supra* footnote 843.

846 U.S. Securities and Exchange Commission, *Study Regarding Financial Literacy Among Investors As Required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Aug. 2012), *available at* https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf. ("Financial Literacy Study").

the quantitative studies on the financial literacy of retail investors in the United States.[847] According to the Library of Congress Report, studies show consistently that many American retail investors[848] lack important elements of financial literacy. For example, studies have found that many investors do not understand certain financial concepts, such as compound interest and inflation. Studies have also found that many investors do not understand other key financial concepts, such as diversification or the differences between stocks and bonds, and are not fully aware of investment costs and their impact on investment returns.[849] A 2016 FINRA survey found that 56 percent of respondents correctly answered less than half of a set of financial literacy questions, and yet 65 percent of respondents assessed their own knowledge about investing as high (between five and seven on a seven-point scale).[850] Moreover, the general lack of financial literacy among some investors makes it difficult for those investors to evaluate claims about financial services made in advertisements, which increases the risk that such investors are unable to effectively use the information in advertisements to find an investment adviser that has high ability and is a good fit.[851]

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847 *See id.* Although the report does not link American investors specifically to those who would become clients of SEC-registered investment advisers or investors in private funds, we believe that the study may be indicative of the level of financial literacy for prospective investors.

848 The financial literacy studies in the Library of Congress Report (2011) fall into three categories, depending on the population or special topic under investigation. Most studies survey the general population. For example, the FINRA Investor Education Foundation's 2009 National Financial Capability study, which was included in the Library of Congress Report, consisted of a national sample of 1488 respondents. Other research included in the report focus on particular subgroups, such as women, or specific age groups or minority groups. A third type of study deals specifically with investment fraud. These studies do not differentiate between qualified purchasers, knowledgeable employees, and other investors. Results from studies conducted on general populations may not apply to private fund investors.

849 *See* Financial Literacy Study, *supra* footnote 846.

850 FINRA Investor Education Foundation, Investors in the United States (2016).

851 Annamaria Lusardi and Olivia S. Mitchell, *The Economic Importance of Financial Literacy: Theory and Evidence*, 52 J. ECON. LITERATURE 5 (2014).

C. Baseline

1. Market for Investment Advisers for the Advertising Rule

a. *Current Regulation*

The current rule 206(4)-1 imposes four broadly drawn limitations on the content of advertisements that are "directly or indirectly" published, circulated, or distributed by investment advisers. In addition to these specific prohibitions, the current rule prohibits any advertisement that contains any untrue statement of a material fact, or which is otherwise false or misleading. This prohibition operates more generally than the specific prohibitions to address advertisements that do not violate any of the specific prohibition but still may be fraudulent, deceptive, or manipulative and, accordingly, may risk misleading investors.

For purposes of the advertising rule, the Commission currently defines "advertisement" to be "any notice, circular, letter or written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities."

Investment advisers owe a fiduciary duty under the Advisers Act, which is enforceable under the Act's anti-fraud provisions in section 206.[852] Section 206 of the Advisers Act prohibits

[852] *See* Fiduciary Interpretation, *supra* footnote 88, at 6-7.

misstatements or misleading omissions of material facts and other fraudulent acts and practices in connection with the conduct of an investment advisory business.[853]

b. *Market Practice*

In addition to section 206 and rule 206(4)-1, investment advisers have considered staff no-action letters in their advertising practices. For example, the staff has issued no-action letters under rule 206(4)-1(b), stating that, in general, the staff would not view a written communication by an adviser to an existing client or investor about the performance of the securities in the investor's account as an "offer" of investment advisory services but instead would view it as part of the adviser's advisory services (unless the context in which the performance or past specific recommendations are provided suggests otherwise), and that the staff would not view communications by an adviser in response to an unsolicited request by an investor, prospective client, or consultant for specified information as an advertisement.[854]

The staff has also stated that it would not recommend enforcement action under section 206(4) and rule 206(4)-1 on issues relating to third-party ratings and testimonials. Specifically, the staff has stated that it would not recommend enforcement action if certain circumstances were present regarding the use of ratings or testimonials, such as: (i) references to independent third-party ratings that are developed by relying significantly on client surveys or clients' experiences more generally;[855] (ii) the use of "social plug-ins" such as the "like" feature on an

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853 *See also* section 17(a) of the Securities Act, section 10(b) of the Exchange Act and rule 10b-5 thereunder, and rule 206(4)-8 under the Advisers Act.

854 *See* ICAA letter, *supra* footnote 95.

855 *See* Investment Adviser Association, SEC Staff No-Action Letter (Dec. 2, 2005) (not recommending enforcement action if in determining whether a third-party rating is a testimonial, the adviser considers the criteria used by the third party when formulating the rating and the significance to the ratings formulation of criteria related to client evaluations of the adviser); DALBAR, Inc., SEC Staff No-Action Letter (Mar. 24, 1998) (not recommending enforcement action if an adviser used references to third-party ratings that reflect client experiences, based on certain representations and certain disclosures made, both of which

investment adviser's social media site;[856] and (iii) references regarding, for example, an adviser's religious affiliation or moral character, trustworthiness, diligence or judgement, in addition to more typical testimonials that reference an adviser's technical competence or performance track record.[857] The Commission has also stated that an investment adviser should consider the application of rule 206(4)-1, including the prohibition on testimonials, before including hyperlinks to third-party websites on its website or in its electronic communications.[858] For example, staff has stated that it would not recommend enforcement action, under certain circumstances, when an adviser provided: (i) full and partial client lists;[859] and (ii) references to unbiased third-party articles concerning the investment adviser's performance.[860]

Staff no-action letters have also stated that the staff would not recommend enforcement action under rule 206(4)-1 for references to specific investment advice in an advertisement, notwithstanding the rule's general prohibition of the use of past specific recommendations. An

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designed to ensure the that rating is developed in a fair and unbiased manner and that disclosures provide investors with sufficient context to make informed decisions).

856 *See, e.g.,* National Examination Risk Alert, Office of Compliance, Inspections and Examinations (Jan. 4, 2012).

857 *See* Gallagher and Associates, Ltd., SEC Staff No-Action Letter (July 10, 1995) (where the staff reiterated its view that rule 206(4)-1 prohibits testimonials of any kind concerning the investment adviser); *see also* IM Guidance Update No. 2014-04, at n.12 and accompanying text, in which staff partially withdrew its Gallagher position.

858 *See* Interpretive Guidance on the Use of Company Web Sites, Release No. IC-28351 (Aug. 1, 2008); *see also* Guidance on the Testimonial Rule and Social Media, IM Guidance Update No. 2014-04, at n.19 and accompanying text.

859 *See, e.g.,* Cambiar Investors, Inc., SEC Staff No-Action Letter (Aug. 28, 1997) (stating it would not recommend enforcement action when the adviser proposed to use partial client lists that do no more than identify certain clients of the adviser, the Commission staff stated its view that partial client lists would not be testimonials because they do not include statements of a client's experience with, or endorsement of, an investment adviser); *see also* Denver Investment Advisors, Inc., SEC Staff No-Action Letter (July 30, 1993) (stating that partial client lists can be, but are not necessarily, considered false and misleading under 206(4)-1(a)(5)).

860 *See* New York Investors Group, Inc., SEC Staff No-Action Letter (Sept. 7, 1982) (stating that in the staff's view an unbiased third-party article concerning an adviser's performance is not a testimonial unless the content includes a statement of a customer's experience with or endorsement of the adviser).

adviser that acts consistently with a staff no-action letter may include past specific recommendations in an advertisement provided the recommendations were selected using performance-based or objective, non-performance-based criteria, and in either case, the adviser's practices are consistent with a number of specific representations articulated in the no-action letters.[861] For example, the staff stated that it would not recommend enforcement action if an adviser included in an advertisement a partial list of recommendations provided that, in general, the list: (i) includes an equal number (at least five) of best and worst-performing holdings; (ii) takes into account consistently the weighting of each holding within the portfolio (or representative account) that contributed to the performance during the measurement period; (iii) is presented consistently from measurement period to measurement period; and (iv) discloses how to obtain the calculation methodology and an analysis showing every included holding's contribution to the portfolio's (or representative account's) overall performance.[862]

The staff has also stated that it would not recommend enforcement action if an adviser includes in an advertisement a partial list of recommendations selected using objective, non-performance-based criteria, provided that, in general: (i) the same selection criteria are used consistently from measurement period to measurement period; (ii) there is no discussion of the

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861 *See, e.g.,* Scientific Market Analysis, SEC Staff No-Action Letter (Mar. 24, 1976) (the staff would not recommend enforcement action when an investment adviser offers a list of past specific recommendations, provided that the adviser offers to provide the list free of charge); and Kurtz Capital Management, SEC Staff No-Action Letter (Jan. 18, 1988) (the staff would not recommend enforcement action relating to an adviser's distribution of past specific recommendations contained in third-party reports, provided that the adviser sends only bona-fide unbiased articles).

862 *See* The TCW Letter (not recommending enforcement action based on certain representations such as presenting best and worst-performing holdings on the same page with equal prominence; disclosing that the holdings identified do not represent all of the securities purchased, sold or recommended for the adviser's clients and that past performance does not guarantee future results; and maintaining certain records, including, for example, evidence supporting the selection criteria used and supporting data necessary to demonstrate the calculation of the chart or list's contribution analysis).

profits or losses (realized or unrealized) of any specific securities; and (iii) the adviser maintains certain records, including, for example, records that evidence a complete list of securities recommended by the adviser in the preceding year for the specific investment category covered by the advertisement and the criteria used to select the specific securities listed in the advertisement.[863]

Finally, the Commission has brought enforcement actions related to the presentation of performance results in advertisements. For example, we have alleged in settled enforcement actions that the performance information that certain advisers included in their advertisements failed to disclose all material facts, and thus created unwarranted implications or inferences.[864] Our staff has also expressed its views as to the types of disclosures that would be necessary in order to make the presentation of certain performance information in advertisements not misleading.[865] Our staff has taken the position that the failure to disclose how material market conditions, advisory fee expenses, brokerage commissions, and the reinvestment of dividends

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863 *See* Franklin Letter (not recommending enforcement action based on certain representations including that the adviser would disclose in the advertisement that the specific securities identified and described do not represent all of the securities purchased, sold, or recommended for advisory clients, and that the investor not assume that investments in the securities identified and discussed were or will be profitable); *see also supra* footnote 204 (citing Clover Letter, Stalker Letter, and Eberstadt Letter regarding untrue or misleading implications).

864 *See, e.g.,* In the Matter of Van Kampen Investment Advisory Corp., Release No. IA-1819 (Sept. 8, 1999) (settled order); In the Matter of Seaboard Investment Advisers, Inc., Release No. IA-1431 (Aug. 3, 1994) (settled order).

865 *See, e.g.,* Clover Letter (not recommending enforcement action provided that certain disclosures about included performance results are made). Regarding mutual funds, our staff has stated that it would not recommend enforcement action if an advertisement included performance data from private accounts that are substantially similar in size and investment strategy to the fund in the fund's prospectus or sales literature if the prospectuses or advertisements: (i) disclose that the performance results are not those of the fund and should be considered a substitute for such performance; (ii) include the fund's performance results if such results exist and; (iii) disclose all material differences between the institutional accounts and the fund. *See* Nicholas-Applegate Mutual Funds, SEC Staff No-Action Letter (Aug. 6, 1996); GE Funds, SEC Staff No-Action Letter (Feb. 7, 1997); ITT Hartford Mutual Funds, SEC Staff No-Action Letter (Feb. 7, 1997).

affect the performance results would be misleading.[866] Our staff has also considered materially misleading the suggestion of potential profits without disclosure of the possibility of losses.[867]

Our staff has taken the position that prior performance results of accounts managed by a predecessor entity may be used so long as: (i) the person responsible for such results is still the adviser; (ii) the prior account and the present account are similar enough that the performance results would provide relevant information; (iii) all prior accounts that are being managed in a substantially similar fashion to the present account are being factored into the calculation; and (iv) the advertisement includes all relevant disclosures.[868] More recently, our staff has taken the position that, based on certain representations, a surviving investment adviser following an internal restructuring may continue to use the performance track record of a predecessor advisory affiliate to the same extent as if the restructuring had not occurred.[869]

In addition, the Commission believes that many advisers currently prepare and present GIPS standard-compliant performance information, and also that many advisers currently

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866 *See* Clover Letter (not recommending enforcement action provided that if an adviser compares performance to that of an index, it would disclose all material factors affecting the comparison) *See also* Investment Company Institute, SEC Staff No-Action Letter (May 5, 1988); Association for Investment Management and Research, SEC Staff No-Action Letter (Dec. 18, 1996) (not recommending enforcement action provided that gross performance results may be provided to clients so long as this information is presented on a one-on-one basis or alongside net performance with appropriate disclosure.) *See Also* Securities Industry Association, SEC Staff No-Action Letter (Nov. 27, 1989) (not recommending enforcement action provided that an adviser that advertises historical net performance using a model fee makes certain disclosures).

867 *See* Clover Letter (stating staff's view that an adviser's advertisement that suggests or makes claims about the potential for profit without also disclosing the possibility of loss may be misleading for purposes of rule 206(4)-1(a)(5)).

868 *See* Horizon Letter; *see also* Great Lakes Letter (not recommending enforcement action if a successor adviser, composed of less than 100 percent of the predecessor's committee, used the preceding performance information in their calculation when there was a substantial identification of personnel, and noting that without substantial identification of personnel in such a committee, use of the data would be misleading even with appropriate disclosure).

869 *See* South State Bank Letter (the staff stated that it would not recommend enforcement action on representations including, for example, that the successor adviser would operate in the same manner and under the same brand name as the predecessor adviser).

prepare annual performance information for investors. The GIPS standards require advisers to provide certain reports to prospective clients at a specific time, and the standards provide guidance on how advisers can determine whether a potential investor qualifies as a "prospective client."[870]

Regarding the use of model performance results, the staff has taken the position that such results are misleading under rule 206(4)-1(a)(5) if the investment adviser does not make certain disclosures.[871] The Commission has also taken the position that the use of backtested performance data may be misleading unless accompanied by disclosure detailing the inherent limitations of data derived from the retroactive application of a model developed with the benefit of hindsight.[872] Moreover, staff have taken the position that the rule 204-2(a)(16) requirement to

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870 Global Investment Performance Standards (GIPS) for Firms (2020), Provision 1.A.11. (requiring the firm to "make every reasonable effort to provide a GIPS Composite Report to all Prospective Clients when they initially become Prospective Clients"), and GIPS Standards Handbook for Firms (Nov. 2020), Discussion of Provision 1.A.11. (stating that "[i]t is up to the firm to establish policies and procedures for determining who is considered to be a prospective client. These include policies and procedures for determining when an interested party becomes a prospective client. An interested party becomes a prospective client when two tests are met. First, the interested party must have expressed interest in a specific composite strategy or strategies. Second, the firm must have determined that the interested party qualifies to invest in the respective composite strategy").

871 *Id. See also* In the Matter of LBS Capital Mgmt. Inc., Release No. IA-1644 (July 18, 1997) (settled order) (The Commission brought an enforcement action and stated its view that the marketing materials were misleading and that the Commission looks at "investment sophistication or acumen" of the recipients of an advertisement will look into the identity of the intended recipient of advertisement when determining if the results were misleading.).

872 *See* In the Matter of Market Timing Systems, Inc., *et al.,* Release No. IA-2047 (Aug. 28, 2002) (settled order) (The Commission brought an enforcement action against, among others, a registered investment adviser, asserting that its advertising was misleading because it failed to disclose that performance results advertised were hypothetical and generated by the retroactive application of a model, and in other cases failed to disclose the relevant limitations inherent in hypothetical results and the reasons why actual results would differ); *see also* In the Matter of Leeb Investment Advisers, *et al.,* Release No. IA-1545 (Jan. 16, 1996) (settled order) (The Commission brought an enforcement action against, among others, a registered investment adviser, asserting that advertising mutual fund performance using a market-timing program based on backtested performance was misleading because the program changed during the measurement period and certain trading strategies were not available at the beginning of the measurement period.). *See also* In the Matter of Schield Mgmt. Co., *et al.,* Release No. IA-1872 (May 31, 2000) (settled order) (The Commission brought an enforcement action against, among others, a registered investment adviser, asserting that advertisements presenting backtested results were misleading in violation of section 206(2) and rule 206(4)-1 because, among other things, they failed to disclose or inadequately disclosed that the

keep records of documents necessary to form the basis for performance data provided in advertisements also applies to a successor's use of a predecessor's performance data.[873]

Certain investment advisers that must comply with the final rule are also subject to other regulatory regimes that govern communications and advertisements. For example, investment advisers that are also registered as broker-dealers must comply with FINRA's rules.[874] FINRA rule 2210 governs broker-dealers' communications with the public, including communications with retail and institutional investors, and provides standards for the content, approval, recordkeeping, and filing of communications with FINRA. In particular, FINRA's rule 2210(d)(6) requires any retail communication or correspondence providing any testimonial concerning the investment advice or investment performance of a member or its products to prominently disclose: (i) the fact that the testimonial may not be representative of the experiences of other customers; (ii) the fact that the testimonial is no guarantee of future performance or success; and (iii) if more that $100 is paid for the testimonial, the fact that it is a paid testimonial. FINRA rule 2210(d)(6) also requires that if a testimonial in any type of communication concerns a technical aspect of investing, the person making the testimonial must have the knowledge and experience to form a valid opinion. Regulation BI also applies to testimonials or endorsements by promoters that are registered broker-dealers to the extent such testimonials or endorsements are recommendations to retail customers under that regulation.

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performance was backtested, and stating that labeling backtested returns "hypothetical" did not fully convey the limitations of the performance.).

873 Rule 204-2(a)(16); *See* Great Lakes Letter (not recommending enforcement action and stating the staff's view that the requirement in rule 204-2(a)(16) applies to a successor's use of a predecessor's performance data.)

874 Similarly, investment advisers registered with the Commission may also be registered with the National Futures Association and may be subject to additional compliance rules on sales practices and promotional material. *See* NFA Compliance Rules 2-29 and 2-36. *See also* Municipal Securities Rulemaking Board rules G-21(a) and G-40.

Additionally, communications to investors in private funds are subject to various statutory and regulatory anti-fraud provisions, such as rule 206(4)-8 under the Advisers Act, section 17(a) of the Securities Act, section 10(b) of the Exchange Act and rule 10b-5 thereunder.

c. *Data on Investment Advisers*

Based on Form ADV filings, as of August 1, 2020, 13,724 investment advisers were registered with the Commission. Of these registered investment advisers ("RIAs"), 11,653 reported that they were "large advisory firms," with regulatory assets under management ("RAUM") of at least $90 million. 512 reported that they were "mid-sized advisory firms," with RAUM of between $25 million and $100 million, and 1,561 did not report as either, which implies that they have regulatory assets under management of under $25 million.[875]

Form ADV disclosures show $97.05 trillion in RAUM for all RIAs, with an average of $7.07 billion and a median of $350 million. These values show that the distribution of RAUM is skewed, with more RIAs managing assets below the average, than above. The majority of RIAs report that they provide portfolio management services for individuals and small businesses.[876] In aggregate, RIAs have over $97 trillion in RAUM. A substantial percentage of RAUM at investment advisers is held by institutional investors, such as investment companies, pooled

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875 From Form ADV: a "Large advisory firm" either: (a) has regulatory assets under management of $100 million or more or (b) has regulatory assets under management of $90 million or more at the time of filing its most recent annual updating amendment and is registered with the SEC; a "mid-sized advisory firm" has regulatory assets under management of $25 million or more but less than $100 million and either: (a) not required to be registered as an adviser with the state securities authority of the state where they maintain their principal office and place of business or (b) not subject to examination by the state securities authority of the state where they maintain their principal office and place of business.

876 Of the 13,724 RIAs, 8,795 (64 percent) report in Item 5.G.(2) of Form ADV that they provide portfolio management services for individuals and/or small businesses. In addition, there are approximately 17,932 state-registered investment advisers. Approximately 14,851 state-registered investment advisers are retail facing (*see* Item 5.D. of Form ADV).

investment vehicles, and pension or profit-sharing plans.[877] Based on staff analysis of Form ADV data, 8,134 (59 percent) of RIAs have some portion of their business dedicated to individual clients, including both high net worth and non-high net worth individual clients.[878] In total, firms that have some portion of their business dedicated to high net worth clients have approximately $44 trillion of RAUM,[879] of which $12 trillion is attributable to individual clients, including both non-high net worth and high net worth clients. Approximately 7,115 RIAs (52 percent) serve 35.4 million non-high net worth individual clients and have approximately $5.2 trillion in RAUM attributable to the non-high net worth clients, while nearly 7,694 RIAs (56 percent) serve approximately 4.9 million high net worth individual clients with $7.5 trillion in RAUM attributable to the high-net worth clients. In addition, there are 3,517 broker dealers registered with FINRA, 442 identify themselves as dually registered broker-dealers, and 2,394 investment advisers (17%) report an affiliate that is a broker-dealer.

2. Market for Solicitation Activity

a. *Current Regulations*

The current solicitation rule makes paying a cash fee for referrals of advisory clients unlawful unless the solicitor and the adviser enter into a written agreement. A solicitor's written

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877 *See* Table 1.

878 We use the responses to Items 5(D)(a)(1), 5(D)(a)(3), 5(D)(b)(1), and 5(D)(b)(3) of Part 1A of Form ADV. If at least one of these responses was filled out as greater than 0, the firm is considered as providing business to retail investors. Form ADV Part 1A. Of the 8,134 investment advisers serving individual clients, 356 are also registered as broker-dealers. By high net worth (HNW) individual, we are referring to an individual who is a "qualified client" as defined in rule 205-3 under the Advisers Act. Generally, this means a natural person with at least $1,000,000 in assets under the management of an adviser, or whose net worth exceeds $2,100,000 (excluding the value of his or her primary residence). *See* rule 205-3(d)(1); Order Approving Adjustment for Inflation of the Dollar Amount Tests in Rule 205-3 under the Investment Advisers Act of 1940, Release No. IA-4421 (June 14, 2016).

879 The aggregate RAUM reported for these investment advisers that have retail investors includes both retail RAUM as well as any institutional RAUM also held at these advisers.

agreement with an advisor must also contain an undertaking by the solicitor to perform its duties under the agreement in a manner consistent with the instructions of the investment adviser and the provisions of the Advisers Act and the rules thereunder. In addition, among other provisions, it requires the solicitor to provide the client with a current copy of the investment adviser's Form ADV brochure and a separate written solicitor disclosure document at the time of solicitation.[880] The solicitor disclosure must contain information highlighting the solicitor's financial interest in the investor's choice of an investment adviser.[881] Further, advisers are required to have a reasonable belief that solicitors are complying with these contractual requirements.

In addition, the solicitation rule prescribes certain methods of compliance, such as requiring an adviser to receive a signed and dated acknowledgment of receipt of the required disclosures.[882] The solicitation rule also prohibits advisers who have engaged in certain misconduct from acting as solicitors.[883]

b. *Data on Solicitors*

Given that there is no current registration requirement for solicitors of investment advisers based on their solicitation activity, our view on solicitation practices is through the disclosures made by RIAs in Form ADV. As of August 1, 2020, 27 percent of RIAs reported compensating any person besides an employee for client referrals.[884] As shown in Figure [1], the share of RIAs that reported this type of arrangement has declined since 2009. However, this figure does not capture employees of an investment adviser that are compensated for client

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880 *See* rule 206(4)-3(a)(1)(ii).

881 *See* rule 206(4)-3(b).

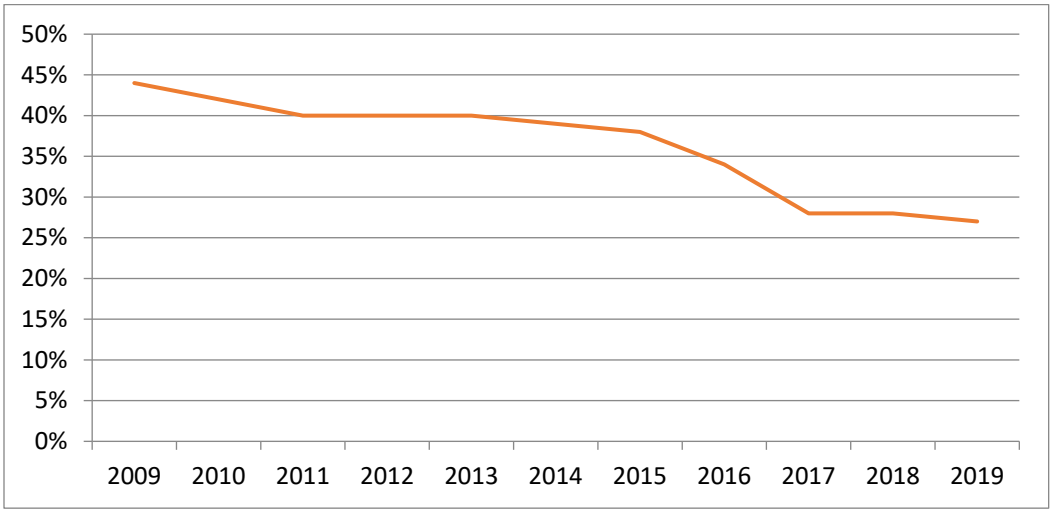
882 *See* rule 206(4)-3(a)(2)(iii)(B).

883 *See* rule 206(4)-3(a)(1)(ii).

884 Response to Item 8(h)(1) of Part 1A of Form ADV.

referrals, who are solicitors under the solicitation rule. The downward trend in Figure [1] may suggest that the use of solicitors is declining through an overall decline in client referral activity. Alternatively, the data presented in the figure is also consistent with employers shifting their solicitation activities in-house.

Figure [1] Percentage of RIAs that Compensate Persons besides Employees for Client Referrals[885]



c. *RIAs to Private Funds*

Based on Form ADV data from August 1, 2020, 4,925 RIAs report that they are advisers to private funds, and 54 of these RIAs report that they are a small entity.[886] Of the RIAs that advise private funds, 1,641 RIAs report that they use the services of solicitors that are not their employees or themselves ("related marketers" in Form ADV). Among the RIAs that hire solicitors, each RIA uses 3 solicitors on average, while the median number of solicitors reported is 1, and the maximum is 67. There are 343 RIAs that indicate that they have at least one related

885 Based on responses to Item 8(h)(1) of Part 1A of Form ADV.

886 Form ADV Item 5.F.2 and Item 12.A.

marketer, and 206 of them indicate that they only rely on related marketers. Among RIAs that report using a related marketer, the average number of related marketers reported is 1.5, while the median reported is 1 and the maximum is 24. 1,315 RIAs indicate that they have at least one marketer that is registered with the SEC: the average number of marketers, registered with the SEC as either IAs or BDs, employed by these RIAs is 3.1, while the median number reported is 2 and the maximum is 67. Finally, 570 RIAs indicate that they have at least one non-US marketer: the average number of non-US marketers reported among these RIAs is 3.1, while the median is 1 and the maximum is 60.[887]

3. RIA Clients

RIAs are required to report their specific number of clients in 13 different categories and a catch-all "Other" category.[888] Based on Form ADV data collected as of August 1, 2020, RIAs report having a total of approximately 42 million clients, and $97 trillion in RAUM. Individual investors constitute the majority (95 percent) of the RIA client base. Columns 2 and 3 of Table 1 present the breakdown of the RIA client base, and column 4 shows the total RAUM from each investor category as of August 2020.

Non-high net worth (HNW) individuals comprise the largest group of advisory clients by client number – 83 percent of total clients. The number of HNW individuals is only 12 percent of advisory clients, but RAUM from HNW individuals makes up almost 8 percent of the industry-wide RAUM ($97 trillion) in 2018, while RAUM from non-HNW individuals accounts makes up about 5.4 percent.

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887 Data on solicitors (marketers) hired by RIAs to private funds are collected from Form ADV Section 7.B(1) (28).

888 Form ADV Item 5.D. of Part 1A.

Table 1: Investor Categories by Clients, RAUM, and Advisers[889]

Investor Categories	Clients	Clients (%)	RAUM (Billions)	RAUM (%)	Advisers
Non-HNW individuals	35,433,736	83.451%	$5,228.92	5.39%	7115
HNW individuals	4,916,781	11.580%	$7,465.29	7.69%	7694
Other investment advisers	863,785	2.034%	$1,250.71	1.29%	548
Corporations or other businesses	321,471	0.757%	$2,674.23	2.76%	3320
Pension and profit sharing plans	386,897	0.911%	$6,504.54	6.70%	3933
Other	279,025	0.657%	$970.50	1.00%	951
Pooled Investment Vehicles (PIVs)- Other	83,942	0.198%	$25,883.53	26.68%	5354
State/municipal entities	24,761	0.058%	$3,565.01	3.67%	970
Charities	99,968	0.235%	$1,189.66	1.23%	3302
Banking or thrift institutions	9,833	0.023%	$992.93	1.02%	281
Insurance companies	12,070	0.028%	$6,257.69	6.45%	711
PIVs – Investment companies	26,520	0.062%	$33,362.03	34.39%	1583
Sovereign Wealth Funds and Foreign official institutions	1,643	0.004%	$1,544.11	1.59%	213
PIVs – Business development companies	159	0.0004%	$132.15	0.14%	87

A number of surveys show that individuals[890] predominantly find their current financial firm or financial professional from personal referrals by family, friends, or colleagues, rather than through advertisements.[891] For instance, a 2008 study conducted by RAND reported that 46 percent of survey respondents indicated that they located a financial professional from personal referral, although this percentage varied depending on the type of service provided (*e.g.*, only 35 percent of survey participants used personal referrals for brokerage services). After personal referrals, RAND 2008 survey participants ranked professional referrals (31 percent), print

889 Data taken from Form ADV data.

890 The surveys generally use "retail investors" to refer to individuals that invest for their own personal accounts.

891 *See* Angela A. Hung, *et al.*, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers,* RAND Institute for Civil Justice Technical Report (2008), *available at* https://www.rand.org/content/dam/rand/pubs/technical_reports/2008/RAND_TR556.pdf ("RAND 2008"), which discusses a shift from transaction-based to fee-based brokerage accounts prior to certain regulatory changes at the time; *see also* Financial Literacy Study, *supra* footnote 846.

advertisements (4 percent), direct mailings (3 percent), online advertisements (2 percent), and television advertisements (1 percent), as their source of locating individual professionals. The RAND 2008 study separately inquired about locating a financial firm,[892] in which a smaller group of respondents reported selecting a financial firm (of any type) based on: referral from family or friends (29 percent), professional referral (18 percent), print advertisement (11 percent), online advertisements (8 percent), television advertisements (6 percent), direct mailings (2 percent), with a general "other" category (36 percent).

The Commission's 2012 Financial Literacy Study provides similar responses, although it allowed survey respondents to identify multiple sources from which they obtained information that facilitated the selection of the current financial firm or financial professional.[893] In the 2012 Financial Literacy Study,[894] 51 percent of survey participants received a referral from family, friends, or colleagues. Other sources of information or referrals came from: referral from another financial professional (23 percent), online search (14 percent), attendance at a financial professional-hosted investment seminar (13 percent), advertisement (*e.g.*, television or newspaper) (11.5 percent), other (8 percent), while approximately 4 percent did not know or could not remember how they selected their financial firm or financial professional. Twenty-five percent of survey respondents indicated that the "name or reputation of the financial firm or financial professional" affected the selection decision.

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892 Only one-third of the survey respondents that responded to "method to locate individual professionals" also provided information regarding locating the financial firm.

893 *See* Financial Literacy Study, *supra* footnote 846.

894 The data used in the 917 Financial Literacy Study comes from the Siegel & Gale, Investor Research Report (July 26, 2012), *available at* https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part3.pdf.

D. Costs and Benefits of the Final Rule and Form Amendments

The Commission is adopting a final combined marketing rule by amending rule 206(4)-1, which is related to advertisements, and eliminating rule 206(4)-3, which deals with solicitation. The final rule changes the definition of advertisement and generally expands the set of permitted advertisements. It includes general prohibitions of certain advertising practices, and will (i) impose requirements of or restrictions on investment adviser performance in advertisements, and (ii) permit investment advisers to use certain features in an advertisement, such as testimonials, endorsements, and third-party ratings, subject to certain conditions, such as disclosing information that would help investors evaluate the advertisement.

The marketing rule, among other things, also applies disclosure, oversight, and disqualification requirements to compensated testimonials or endorsements, including those directed at prospective investors in private funds. The Commission is also adopting amendments to Form ADV that are designed to provide additional information regarding advisers' marketing practices and amendments to the Advisers Act books and records rule to correspond to the features of the marketing rule. The final rule reflects market developments since 1961 and 1979, when rules 206(4)-1 and 206(4)-3, respectively, were adopted, as well as practices addressed in staff no-action letters. These market developments include advances in communication technology and marketing practices that did not exist at the time the rules were adopted and may fall outside of the scope of the current rules. As a result, the current rule is less effective at mitigating some information and search problems investors face when searching for investment advisers than when it was initially written.[895]

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[895] *See infra* section III.B.

Advertisements falling in the two categories of communications defined as advertisements in the final rule are currently subject to different regulatory baselines and market practices. We discuss the costs and benefits of specific provisions of the final rule, taking care to note whether a cost or benefit applies to the first or the second prong of advertisement, or both.

1. Quantitative Estimates of Costs and Benefits

The economic effects of the final rule are generally difficult to quantify for several reasons. First, there is little to no direct data suggesting how investment advisers and promoters might alter their marketing practices as a result of the final rule or mitigate the compliance burdens related to the final rule, and commenters did not provide any. It is difficult to quantify the impact that specific provisions of the final rule will have on adviser behavior because the final rule may influence adviser behavior in opposing directions. For example, it might motivate advisers to provide more information to potential investors that helps such investors more accurately evaluate those advisers' abilities and potential fit with such investors' preferences. Alternatively, the rule may introduce compliance burdens that disincentivize the creation of communications that fall within the definition of advertisement. This could reduce the amount of information that advisers provide to potential investors through advertisements.

Second, it is difficult to quantify the impact that the specific provisions of the final rule will have on investor behavior because the final rule may influence investor behavior in opposing directions. Disclosures might provide additional context for investors to make better decisions when choosing investment advisers; alternatively, they might not be used by investors, or might make them overconfident when making decisions.[896] Without knowing the magnitude

[896] *See infra* section III.B.

of these opposing effects, it is not possible to quantify the effects of specific provisions of the final rule.

Finally, it is difficult to quantify the extent to which certain changes in adviser, promoter, and investor behavior enhance or diminish the welfare of specific market participants. For example, if investors increased the amount of advisers' RAUM as a result of the final rule, it is not clear to what extent investor welfare would have improved, without knowing the extent to which the final rule also affected the quality of investment advisers with whom investors chose to invest. Further, if RAUM increased as advisers increased their marketing and incurred higher marketing expenditures, a portion of these expenditures could be transferred to investors through fees offsetting, in part, any increase in investor welfare.

Some commenters directly addressed the cost estimates in the proposal.[897] Two of these commenters stated that the proposal underestimated the number of advertisements that investment advisers use under the current rule.[898] One commenter stated that heavy advertisers would be expected to create new advertisements 50 times per year, and update their advertisements 250 times per year.[899] One commenter broadly criticized the cost estimates as too low, and also specifically criticized the proposal's estimates of the number of advertisements that advisers would distribute.[900] In response to commenters, we have adjusted our estimates of the annual number of advertisements that investment advisers will create.[901]

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897 *See* Fidelity, IAA, MFA/AIMA Comment Letters.

898 *See* Fidelity, IAA Comment Letters.

899 *See* Fidelity Comment Letter

900 *See* IAA Letter Comment Letter.

901 *See infra* section IV.B.

One commenter made several critiques of the cost estimates.[902] The commenter separated its expected costs into three categories –implementation costs, ongoing costs, and management resource drain, arguing that the proposal failed to recognize whole types of costs. The commenter broadly criticized many of the quantitative estimates in the proposal as significantly underestimating the cost burden on investment advisers. The commenter specifically criticized the cost estimates for third-party rankings, hypothetical performance, and Form ADV changes, but did not provide additional estimates or data to use. Many of the quantitative estimates in the proposal were for the Paperwork Reduction Act ("PRA"), which are a subset of the total economic costs of the rule. Many of these total costs are difficult to quantify, for reasons mentioned above. However, given the commenter's feedback on the categories and types of costs that the rules will impose on investment advisers, we have updated our analysis of the costs of the rule, as well as our PRA-related quantitative cost estimates.

In the following sections, we have quantified some elements of the overall cost of the general anti-fraud prohibitions as part of the Commission's Paperwork Reduction Act obligations. These are costs associated with the collection of information that are generated by the final rule, but do not represent the entire cost of each provision.

2. Definition of Advertisement

The final rule's definition of advertisement contains two prongs. The first prong generally captures traditional advertising, and changes the scope of communications that fall within the scope of the final rule. The first prong includes, among other communications, communications made to investors and potential investors in private funds advised by the adviser. The second prong generally includes the cash-compensated solicitation activity that

902 *See* MFA/AIMA Comment Letter.

occurs currently under rule 206(4)-3. In addition, the second prong will include non-cash compensated communications made by promoters and compensated solicitation activity for private fund investors.

This definition of "advertisement" determines the scope of communications affected by the final rule, which determines, in part, the costs and benefits of the regulatory program set forth by the other components of the final rule (the "programmatic effects"). For example, if the definition of "advertisement" is not sufficiently broad and excludes communications that could serve as a substitute for advertisements and that raise similar investor protection concerns, investment advisers might use these alternative communications to avoid the costs associated with complying with the final rule. This would reduce the effect of changes to the substantive provisions to the advertising rule that would regulate advertisements. Conversely, if the scope of communications captured by the final rule is too broad and captures communications that do not aim to attract clients, the amendments may impose costs on investment advisers while yielding insubstantial benefits.

In response to the final rule's definition of advertisement, investment advisers and promoters might modify their communication strategies in an effort to reduce the amount of communication that could be deemed to fall within the definition of "advertisement." These strategic responses could, in turn, impose costs on some clients or investors, to the extent that they currently rely on communications by investment advisers or promoters that are advertisements to inform their decisions.[903] If investment advisers or promoters respond by

[903] To the extent that broker-dealers and other third parties disseminate communications that are defined as advertisements under the final rule, including with respect to private funds, they may incur compliance costs associated with the final rule. These compliance obligations generally will be separate from any compliance obligations incurred under the requirements of the Exchange Act, the rules promulgated thereunder, and FINRA rules.

reducing the amount of such communications, both prospective and existing investors may need to search more intensively for information about investment advisers than they currently do or, alternatively, base their choice of financial professional on less information. This could result, for example, in inefficiencies to the extent that an existing client of an investment adviser is unaware of the breadth of services the investment adviser provided and incurs costs to open a new account with another investment adviser to obtain certain services. Similarly, a prospective client that receives less information from investment advisers and promoters might ultimately choose an investment adviser that is a poorer match for them or might be discouraged from seeking investment advice. These potential costs to investors depend on the extent to which the final rules cause investment advisers and promoters to reduce their advertisements.

As discussed above, some of the affected parties whose communications will be newly defined as advertisements under the final rule may also be registered broker-dealers whose communications are subject to other regulatory regimes that govern communications and advertisements, including those under FINRA rules and, in some cases, Regulation BI. As a result, these parties will incur new compliance obligations with respect to communications subject to the final rule, and may incur incremental costs similar to other parties whose communications are also newly-subject to the rule. In general, however, to the extent that these parties may leverage existing compliance methods similar to those that they currently use, the programmatic effects of including these communications within the final rule's definition of advertisement may be mitigated.

Below, we address the costs and benefits associated with determining the scope of communications affected by the final rule through specific elements of the final rule's definition

of an advertisement.[904] We address the costs and benefits of the two prongs of the definition separately.

a. Communications Other than Compensated Testimonials or Endorsements

The first prong includes within the definition of an advertisement 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 information, and that offers the investment adviser's investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the investment adviser or offers new investment advisory services with regard to securities to current clients or investors in a private fund advised by the investment adviser. It also excludes (a) extemporaneous, live, oral communications, regardless of whether they are broadcast; (b) any 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; and (c) a communication that includes hypothetical performance that is provided: (i) in response to an unsolicited investor request or (ii) to a private fund investor in a one-on-one communication.

i. Any direct or indirect communication an investment adviser makes

The first prong includes communications directly or indirectly made by the adviser, regardless of whether they are prepared and disseminated by the adviser or by a third party. Prong one includes communications disseminated by an adviser that incorporate statements or

[904] The specific costs and benefits of the rule's changes to the substantive prohibitions and conditions applicable to advertisements are discussed in later sections. *See infra* section II.D.3-8.

content prepared by a third party, such as positive reviews from clients selectively picked by an adviser to be posted or attributed, materials an adviser helps draft to be distributed by third-party promoters, and endorsements organized by an adviser on social media. This provision (the phrase "directly or indirectly") does not differ from the current rule, and we therefore do not anticipate any significant costs or benefits to be generated directly by this provision.

The first prong defines advertisements as communications made to more than one person, or to any number of persons if the communication includes hypothetical performance information that is not provided in response to an unsolicited investor request or to a private fund investor in a one-on-one communication. Because the definition's limitation to communications to more than one person does not differ from the current rule, we generally do not anticipate any significant costs or benefits to be generated directly by this part of the rule.[905] However, the inclusion of one-on-one communications with hypothetical performance information (except for hypothetical performance information that is provided in response to an unsolicited investor request or to a private fund investor) in the definition of advertisement represents a change from the current rule.[906] We expect that this change could produce costs and benefits with respect to these one-on-one communications that are similar to those described below that are associated with prong one's inclusion of communications that offer investment advisory services to prospective investors, including for review and monitoring of communications.

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905 The final rule does contain a related compliance and recordkeeping requirement that requires investment advisers to retain records of communications addressed to more than one person, which we discuss in further detail later. *See infra* section III.D.8.

906 The rule excludes from the first prong of the advertisement definition a communication that includes hypothetical performance that is provided in response to an unsolicited investor request for such information or to a private fund investor in a one-on-one communication. *See* rule 206(4)-1(e)(1)(i)(C). Because the current advertising rule excludes one-on-one communications from the definition of advertisement, we do not anticipate that this exclusion will result in significant costs or cost savings for advisers.

While the current definition of advertisement includes communications directly or indirectly made by the adviser, it only explicitly covers written, radio, or television advertisements. As a result, the first prong of the definition could cover additional communications with prospective clients as compared to the current definition. This change will further extend the investor protection and benefits of the final rule.[907] Investment advisers will also incur costs directly as a result of this change, which may include dedicating personnel time, or conducting training for personnel to determine the extent to which the substantive content of one of these newly-covered types of communication subjects it to the final rule.[908]

These costs may be mitigated to the extent that investment advisers may be able to leverage existing oversight methods similar to those that they currently use, including those used by dual-registrant advisers or promoters who are also broker-dealers in connection with compliance with FINRA's rules,[909] for example, in communicating with prospective clients through intermediaries. Additionally, investment advisers might reduce certain types of communications to avoid having to bear these costs of complying with the final rule, which may mitigate the benefits of additional information in advertisements available to investors.[910]

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907 *See, e.g., infra* sections III.D.3; III.D.4; III.D.5.

908 *See supra* section III.D.1 and footnote 902.

909 *See supra* section II.A.2.b.i.

910 The final rule contains a related compliance and recordkeeping requirement that requires investment advisers to retain records of communications addressed to more than one person, which we discuss in further detail later. *See infra* section III.D.8.

ii. Offers the investment adviser's investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the investment adviser

Prong one also includes communications that offer the investment adviser's investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the investment adviser. This prong will expressly apply to communications to prospective investors in private funds. By including communications that offer the adviser's investment advisory services with regard to securities to private fund investors, the final rule will provide more specificity (and certainty) regarding what we believe to be untrue or misleading statements that advisers must avoid in their advertisements, which may reduce compliance costs for some investment advisers. On the other hand, to the extent that an adviser's current practices differ from the final rule, an investment adviser may incur some increased costs to review and monitor its communications with potential investors for general compliance purposes. An investment adviser may respond by reducing the number of these advertisements or the amount of information it distributes to potential investors. This could, in turn, reduce the amount of information available to potential investors in these private funds. An investment adviser to a private fund also may respond by not seeking potential investors likely to have less money to invest in the private fund, reducing investment opportunities for these investors.

iii. Offers new investment advisory services with regard to securities to current clients or investors in a private fund advised by the investment adviser

The final definition of advertisement under the first prong also includes communications that offer new investment advisory services with regard to securities to existing clients or investors in a private fund advised by the investment adviser. Investment advisers will incur

costs similar to those described above that are associated with prong one's inclusion of communications that offer investment advisory services to prospective investors, including for review and monitoring of communications. However, to the extent that an adviser uses a single set of communications aimed at both new and existing clients, these costs may be mitigated because the adviser may incur only a single set of costs for both prospective and existing investors.

b. Compensated Testimonials and Endorsements

The second prong of the final definition of advertisement includes testimonials or endorsements for which compensation is provided, excluding any 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. The baseline for these advertisements is generally shaped by the current solicitation rule, which obligates advisers to enter into written agreements with solicitors to require them to act in a manner consistent with the Advisers Act and rules, including the current advertising rule.[911] Under the current solicitation rule, investment advisers must have a reasonable belief that solicitors are complying with this written agreement. Furthermore, solicitations of private fund investors are not subject to the current solicitation rule.

Prong two will scope in non-cash compensated testimonials and endorsements and compensated testimonials and endorsements to private fund investors, including communications from solicitors for impersonal advisory services, and, as a result, will extend the investor protection benefits of the final rule to the investors who receive these communications.

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911 Under the cash solicitation rule, certain affiliated advisers are not required to satisfy all of the elements of the written agreement. See rule 206(4)-3(a)(2)(ii) and (iii).

Similarly, it will impose certain costs on advisers and persons who are solicitors under the current rule, including costs associated with oversight of these communications not currently subject to the rule, including endorsements to private fund investors.[912] Advisers may respond by reducing the number of these advertisements or the amount of information they distribute to potential investors. Similarly, advisers to private funds also may respond by not seeking potential investors likely to have less money to invest in the private fund, reducing investment opportunities for these investors.

Prong two does not contain the same exclusion for one-on-one communications as prong one. Oversight of one-on-one communications will likely involve greater costs for investment advisers compared to those addressed to more than one person because one-on-one communications have the potential for more variety and volume in their content. However, one-on-one solicitations are subject to the current solicitation rule. Therefore, there will likely be incrementally greater costs for advisers overseeing promoters under the final rule. Of these incremental costs, the increase in costs is attributable less to the inclusion of one-on-one communications and more to the expansion in compensation type (from cash to non-cash) and the expanded types of persons who would be promoters under the final rule as compared to solicitors under the current solicitation rule.

Extending the scope of the rule to communications made by solicitors who receive non-cash compensation may have further benefits for investors. Because solicitations provided in connection with non-cash compensation that solicitors might receive generate nearly identical conflicts of interest to solicitations provided in connection with cash compensation, prong two may reduce the risk that investors might be unaware of such conflicts for a larger set of

[912] *See infra* sections III.D.3-8 for discussion of the direct costs and benefits of the requirements of the rule.

communications. For example, many advisers use brokerage - a form of non-cash compensation - to reward brokers that refer them to investors. This practice presents advisers with conflicts of interest as the brokers' interests may not be aligned with investors' interests. Including non-cash compensated testimonials and endorsements in the definition of advertisement would also give cash and non-cash compensation more equal regulatory treatment for these purposes, which will enhance competition between promoters that accept non-cash compensation and those that accept cash compensation. Additionally, to the extent that investment advisers currently direct order flow to broker-dealers with lower execution quality, the final rule's inclusion of non-cash compensation into the definition of advertisement could potentially affect quality of execution. If the final rule's requirements for non-cash compensation impose regulatory burdens that reduce the usage of directed brokerage towards brokers with lower quality of execution, these investment advisers might instead choose brokers with higher execution quality, which could result in a benefit for their investors.

The extent of additional benefits and costs attributed to prong two of the definition will be mitigated to the extent that solicitors previously entered into written agreements obliging them to act in a manner consistent with the Advisers Act and its rules, including the current advertising rule. As a result of such agreements, the additional costs and benefits of the final rule's substantive provisions for these solicitors will generally be limited to changes in the programmatic effects of the final rule as compared to the current advertising rule. Any solicitors making communications subject to the final rule who did not previously enter into such a contract will, however, incur these costs fully and also incur costs associated with the creation of written agreements. The benefits and costs attributed to prong two may also be mitigated to the extent that advisers and promoters were previously complying with the current solicitation rule

with respect to endorsements to private fund investors and to the extent that some aspects of the final rule overlap with the scope of rule 206(4)-8 under the Advisers Act, section 17(a) of the Securities Act, or section 10(b) and rule 10b-5 under the Exchange Act.

c. Exclusions from the Definition of Advertisement

The first prong of the definition of an advertisement excludes extemporaneous, live, oral communications. The current rule does not, however, include these communications unless they are broadcast by radio or television. As a result, to the extent that some extemporaneous, live, oral communications were previously transmitted by radio or television or otherwise subject to the current advertising rule, the first prong of the definition could cover fewer of these communications with investors than the current definition. While this change could reduce investor protection and benefits of the final rule to investors with respect to these communications, it may also reduce the costs associated with the fact that advisers might avoid making any extemporaneous communications because of the difficulties in ensuring that they comply with the requirements of the rule.

Both prongs of the definition of advertisement contain an exception for any statutorily or regulatory required notice, filing, or communication, provided that such information is reasonably designed to satisfy the requirements of such notice, filing, or other required communication. These exceptions are designed to reduce the likelihood that the final rule imposes costs or burdens on communications unrelated to advertising, or adds costs or burdens for communications already regulated by the Commission. The current advertising rule does not exclude statutory or regulatory notices, so the final rule will entail a reduction in costs for investment advisers to the extent they currently bear costs to comply with the advertising rule for

their statutory or regulatory notices. Advisers will, however, continue to incur potential liability for these statements under applicable anti-fraud provisions.

3. General Prohibitions

The final rule generally prohibits certain marketing practices as a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts. In general, we anticipate that the introduction of these general prohibitions will generate new interpretive questions regarding whether a particular communication is prohibited, which will impose compliance costs on investment advisers, including costs of legal advice and managerial resources, on an initial and ongoing basis. In addition, promoters for investment advisers will bear similar compliance costs, such as for legal advice and managerial resources.[913]

Below, we analyze the costs and benefits of these general prohibitions.[914] The baseline for analyzing different types of advertisements may, however, be different. While advertisements as defined under the final rule will be subject to a single set of prohibitions and requirements, under the baseline, the same advertisements as defined by the final rule may be subject to different regulatory requirements. For example, solicitors that receive cash compensation are currently subject to the solicitation rule and, because they have entered into written agreements that oblige them to act in a manner consistent with the Advisers Act and its rules, the advertising rule. However, some communications that meet the definition of an advertisement do not currently fall under the solicitation rule or the advertising rule. For

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913 *See supra* section III.D.1 and footnote 902.

914 In addition to the general prohibitions discussed below, the final rule specifically prohibits (i) any untrue statement of a material fact, or omission to state a material fact necessary in order to make the statement made, in the light of the circumstances under which it was made, not misleading and (ii) otherwise materially misleading statements. These provisions prohibit statements that would be prohibited by the current advertising rule and rule 206(4)-8, for example, and as a result, we do not believe that these provisions will generate significant costs or benefits.

example, non-cash compensated promoters, and promoters for an adviser's impersonal advisory services currently are not subject to the requirements of rule 206(4)-3, while under the final rule certain of their communications would be defined as advertisements and subject to the general prohibitions. Further, communications to prospective and current investors in private funds are currently subject to rule 206(4)-8, section 17(a) of the Securities Act, section 10(b) of the Exchange Act, and rule 10b-5 thereunder.

We have quantified a subset of the costs associated with the general anti-fraud prohibition, specifically, the burden of information collection costs estimated for the purposes of the Paperwork Reduction Act. The general anti-fraud prohibitions do not create any collection of information burdens, with one exception. The prohibition on unsubstantiated statements of material fact might cause investment advisers to create records to substantiate statements either contemporaneously or after the fact, and we estimate the costs of this collection. We estimate these costs to be $657 for each investment adviser per year, for a total cost of $9,016,668 per year.[915]

a. Unsubstantiated Material Statements of Fact

The final rule contains a prohibition on material statements of fact that an investment adviser does not have a reasonable basis for believing that it will be able to provide substantiation on demand by the Commission. Investment advisers would need to gather materials needed to substantiate the material statements of fact made in advertisements only if requested by the Commission. Currently, there is no express prohibition of making statements in advertisements that the adviser does not have a reasonable basis for believing it will be able to substantiate on demand, in the current rule or the general anti-fraud provisions.

915 *See infra* section IV.B.1.

This prohibition will benefit current and prospective investors by reducing the likelihood that advisers will make material statements of fact in advertisements that are not able to be substantiated, a practice which could potentially mislead investors. Additionally, the prohibition could incentivize investment advisers to invest additional resources to substantiate material statements of fact. Some commenters noted that a substantiation requirement would be burdensome, [916] and we recognize that there will be costs associated with this requirement for advisers. We note, however, that commenters raised these concerns about the proposed requirement, which was not limited to material statements of *fact*. Nonetheless, there may, for example, be costs to determine whether a statement is a material statement of fact, whether the adviser has a reasonable basis to believe that it will be able to substantiate the statement upon demand, or how statements or facts would be substantiated on demand. These costs could include, among other things, personnel time for review and documentation, as well as direct costs when demanded by the Commission, which might entail personnel time to prepare materials for the Commission. Further, while an adviser may choose to substantiate the material fact after it has received the demand from the Commission, we recognize that some advisers may choose to create such records contemporaneously with the advertisement for sake of efficiency or to manage their compliance risk, which will cause them to incur compliance costs.

Compliance costs may, however, be mitigated to the extent that advisers currently retain records that effectively substantiate performance advertising[917] and, upon inquiry by the staff or the Commission, demonstrate that the adviser's statements are not untrue statements of material fact, consistent with the Advisers Act and its rules. These costs may be further mitigated to the

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916 *See, e.g.*, MFA/AIMA Comment Letter I; FPA Comment Letter; NVCA Comment Letter; Fried Frank Comment Letter.

917 *See supra* footnote 221.

extent that advisers believe there are external sources that support the material statements of fact they make in advertisements, which they also believe will be available at the time of any subsequent demand by Commission staff. We expect that this may be the case for some of the material facts, and costs may be further mitigated to the extent that advisers do not prepare this support in advance of such demand.

We recognize that the costs associated with substantiation might induce some investment advisers to avoid making material statements of fact that are too costly to substantiate. This could yield benefits for clients or investors, to the extent that any such advertisement not made has an increased risk of being misleading. These decisions could, however, have costs to clients or investors to the extent that they would receive less information about an adviser, and costs to advisers to the extent that they forgo some communications to clients or investors.

b. Untrue or Misleading Implications or Inferences

The final rule contains a prohibition on 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. There is no provision in the current advertising rule that expressly prohibits this type of information, though in staff no-action letters, the staff has stated its view that in some circumstances an advertisement may be false or misleading if it implies, or a reader would infer from it, something false.[918] Further, the current advertising rule and rule 206(4)-8 each generally prohibit misleading statements.

To the extent that advisers or promoters do not already omit information that would reasonably be likely to cause an untrue or misleading implication or inference, this prohibition to be drawn concerning a material fact relating to the investment adviser will benefit current and

[918] *See supra* section II.B.2; III.C.1.b.

prospective investors by removing this type of information from advertisements, which has the potential to mislead investors and impair their ability to find an investment adviser. In addition, because this prohibition will generally require the adviser to consider the context and totality of information presented such that it would not reasonably be likely to cause any misleading implication or inference to be drawn concerning a material fact relating to the investment adviser, the prohibition will entail compliance costs to investment advisers and promoters, including those related to interpretation of the application of the new rule. We expect, however, that the costs and benefits of the prohibition will likely be mitigated, to the extent that advisers and promoters currently exclude from their communications this type of information.

c. Failure to Provide Fair and Balanced Treatment of Material Risks or Other Limitations

The final rule contains a prohibition on advertisements which 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 associated material risks or other limitations associated with the potential benefits. Currently, while Form ADV requires disclosure of certain material risks, there is no provision in the current advertising rule, rule 206(4)-8, the other rules under the Advisers Act, or in the Advisers Act itself that explicitly requires such treatment.

This prohibition will benefit current and prospective investors by requiring material risks and other limitations to be presented in a fair and balanced manner included in advertisements. This could provide such investors with additional, higher quality, information about investment advisers and additional context for the claims they make in their advertisements. This information would allow investors to find better matches with investment advisers, and would reduce the costs associated with the search for investment advisers.

This prohibition, however, may cause advisers and promoters to incur costs associated with changes to compliance processes, and investment advisers might incur costs to adjust their advertising materials to discuss material risks and limitations in a fair and balanced manner, including changes in formatting and tailoring disclosures based on the form of the communication. To the extent that investment advisers already prepare similar disclosure in existing communications with investors or in connection with the preparation of Form ADV Part 2, we expect the costs of compliance to be mitigated.

One commenter expressed concern that this prohibition would expand the amount of required disclosures and overwhelmingly lengthen advertisements.[919] We recognize that this prohibition will have costs associated with changes to the formatting of advertisements associated with the additional information, including with respect to communications made to prospective and current investors in private funds advised by the investment adviser. Further, we recognize that the associated costs might induce some investment advisers and promoters to avoid making some types of claims to the extent that they will require extensive discussion of the associated material risks or other limitations. This could have costs to investors to the extent that they would receive less information about an adviser, and costs to advisers to the extent that they forgo some communications to investors. This could, however, yield benefits for investors, to the extent that any such advertisement not made has an increased risk of being misleading.

d. Anti-Cherry Picking Provisions: References to Specific Investment Advice and Presentation of Performance Results

[919] *See* MFA/AIMA Comment Letter I.

The final rule contains two other provisions designed to address concerns about investment advisers presenting potentially cherry-picked information to investors in advertisements.

The first prohibits reference to specific investment advice where such advice is not presented in a manner that is fair and balanced. Currently, there is a *per se* prohibition against past specific recommendations in the advertising rule, though the current rule allows reference to past specific recommendations in an advertisement where the advertisement offers to furnish a list of all recommendations made by such investment adviser in the last year. Further, the staff has indicated that it would not recommend enforcement action under rule 206(4)-1 under certain circumstances.[920]

The first provision replaces the current advertising rule's *per se* prohibition of past specific recommendations with a principles-based prohibition on presentations of specific investment advice that is not presented in a manner that is "fair and balanced." We believe that this change will provide benefits to advisers and promoters by providing additional clarity on which market practices are prohibited. Further, it will provide benefits to current and prospective investors related to potentially expanding the circumstances under which advisers may provide information regarding past specific advice to investors. In addition, investors may be able to better evaluate presentations of past or current specific advice because of the rule's requirement for fair and balanced presentation. This shift in approach might impose costs on investment advisers and promoters related to compliance, who will need to devote personnel time to evaluate whether a potential presentation of specific investment advice is fair and

920 *See infra* section II.C.1.b.

balanced.[921] These compliance costs may be mitigated to the extent that advisers currently present past or current specific recommendations in a "fair and balanced" manner. Further, these costs may also be mitigated to the extent that an adviser currently complies with FINRA's rule 2210, which requires that broker communications be "fair and balanced."[922]

The second anti-cherry-picking provision prohibits presentations of performance results, or performance time periods that are not presented in a fair and balanced manner. Currently, there is no express provision in the advertising rule requiring presentation of performance results in this manner, though the staff has stated views regarding certain circumstances in which the staff may view a presentation of performance results as misleading, including, for example, where an adviser failed to disclose how material market conditions, advisory fee expenses, brokerage commissions, and reinvestment of dividends affect the performance results.[923]

This provision may yield benefits to current and prospective investors by reducing the likelihood that they are misled by advertisements, and requiring the provision of information to evaluate an investment adviser that is presented in a fair and balanced manner. We recognize, however, that the standard in this rule will impose costs on advisers and promoters. Two commenters, for example, indicated that the "fair and balanced" standard may be difficult in application.[924] We recognize that this "fair and balanced" component for the second provision also represents a shift towards a principles-based approach, which could impose compliance

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921 *See supra* section III.D.1 and note 902.

922 *See supra* section II.B.5.a.

923 *See supra* section III.C.1.b

924 Consumer Federation Comment Letter; NASAA Comment Letter.

costs on investment advisers, who might need to devote personnel time to update compliance processes.[925]

These costs and benefits may be mitigated, however, to the extent that advisers already ensure that their advertisements are fair and balanced in presentation of performance results in order to ensure that they are not misleading under the current advertising rule or other applicable anti-fraud provisions.

These costs might, however, induce some investment advisers to avoid presenting performance results altogether. This could have costs to investors to the extent that they would receive less information about an adviser's performance, and may make finding an investment adviser more difficult or costly for some investors. Additionally, this could impose costs on advisers to the extent that they forgo some communications to investors. This reduction in performance advertising, however, could yield benefits for investors, to the extent that any such advertisement not made has an increased risk of misleading investors.

4. Conditions Applicable to Testimonials and Endorsements, Including Solicitations

The final rule prohibits the use of testimonials and endorsements unless they comply with certain disclosure, oversight, and disqualification requirements, substantially as originally proposed for solicitors. The costs and benefits of this provision of the final rule differ depending on whether the testimonial or endorsement is compensated or uncompensated.

To clarify the change from the baseline for each type of advertisement, we analyze the costs and benefits of imposing these conditions on testimonials and endorsements that are not compensated. We then separately analyze the costs and benefits of these conditions for testimonials and endorsements that are compensated. As described above, the baseline for each

925 *See supra* section III.D.1 and *infra* section IV.A.

type of advertisement is different, making the extent of the effects of the changes effected by the rule different for advisers, depending on whether they are complying with the current advertising rule and the current solicitation rule.[926]

We have quantified a subset of the costs associated with requirements for testimonials and endorsements, specifically, the burden of information collection costs estimated for the purposes of the Paperwork Reduction Act.[927] The disclosure and oversight provisions of the requirements for testimonials and endorsements will entail information collection costs, and investment advisers will incur initial implementation costs. We estimate that investment advisers will incur an initial implementation cost of $1,060 for each adviser, or $7,273,720 in total.[928] We estimate that investment advisers will incur an ongoing internal cost of $5,729 per year per adviser, $500 external cost for those advisers that deliver disclosures by postal service, and $39,998,598 in total.[929] We therefore estimate a total industry cost in the first year of $47,272,318.[930]

a. Communications Other than Compensated Testimonials or Endorsements

The current advertising rule prohibits, but does not define, testimonials and does not address endorsements. In contrast to the current advertising rule, the final rule prohibits advisers from using, or compensating promoters for testimonials and endorsements, unless certain

926 *See supra* section III.D.3.

927 *See infra* section IV.B.2.

928 Initial cost burden estimate of $1,060 from section IV.B.2. 13,724 x ½ =6,862 affected investment advisers. $1,060 x 6,862 = $7,273,720.

929 Ongoing cost estimate includes disclosure, oversight, and annual costs from section IV.B.2. $5,679 x 6,862 + $500 external cost x 6,862 advisers x 20% mail use = $39,998,598.

930 This number is based on the following calculation: $7,273,720 + $39,998,598= $47,272,318.

requirements are met, and distinguishes statements made by investors from those made by non-investors.

In general, we believe that the ability of advisers to advertise testimonials and endorsements will give investors additional information about the views of clients and non-clients with an investment adviser, which could improve the matches between investors and investment advisers. Additionally, the ability to use testimonials and endorsements in advertisements might incentivize investment advisers to further improve the quality of the services they provide, because investment advisers will be better able to advertise any improvements in their services. We discuss the costs and benefits of the requirements that must be met in order to include a testimonial or endorsement in an advertisement below.

i. Disclosures

The final rules impose disclosure requirements on investment advisers that make use of testimonials and endorsements and on persons giving testimonials and endorsements, unless subject to an exemption.[931] Under the final rule, an investment adviser must disclose, or reasonably believe that the person giving the testimonial or endorsement discloses, (i) clearly and prominently, (A) whether the person giving the testimonial or endorsement is a client or a non-client, as applicable, (B) that cash or non-cash compensation was provided for the testimonial or endorsement, if applicable, and (C) a brief statement of any material conflicts of interests; (ii) the material terms of the person's compensation arrangement, if any, including a description of the compensation provided or to be provided to the person for the testimonial or endorsement; and (iii) a description of any material conflicts of interest the person may have that result from the

931 *See supr*a section II.C.5 (discussing partial exemptions from disclosure requirements).

investment adviser's relationship with such person and/or any compensation arrangement. These disclosures must be delivered at the time the testimonial or endorsement is disseminated.

These disclosures can aid investors by providing information and context with which to evaluate a promoter's claims. Investors may benefit from receiving information about the experiences of other investors or other people. In addition, the requirement that the advertisement clearly and prominently disclose the client status of the promoter, the fact of compensation, and a brief statement of material conflicts of interests will increase the salience of these disclosures, and increase the likelihood that they are incorporated into an investor's decisions. Testimonials and endorsements may benefit investment advisers by allowing them to show satisfied clients or other persons willing to support the investment adviser.

However, the positivity of a testimonial or endorsement may not always reflect the investment adviser's ability or the adviser's potential "fit" for investors. The final rule may, therefore, lead investment advisers, regardless of ability, to inefficiently increase spending on testimonials or endorsements in advertisements to attract clients. In this case, the fees that result from higher advertising spending could mitigate the benefits that the additional information in testimonials and endorsements might provide to investors. Additionally, to the extent that market practices have developed in such a way that, under circumstances described in staff no-action letters, market participants already include information in advertisements that would be a testimonial under the final rule, the costs and benefits of the final rule's testimonials and endorsements provision will be decreased in magnitude relative to the baseline.

The final rule's requirement for disclosure of client or non-client status of the promoter, material terms of compensation, and material conflicts of interest, will provide useful information to prospective clients about the potential credibility and incentives of the provider of

the testimonial or endorsement. This provision might also yield benefits for investors if investment advisers or their promoters are incentivized to mitigate their conflicts of interest or otherwise improve the quality of their services as a result of the disclosures. This might improve the efficiency of the investment adviser search process by improving the quality of the matches between investors and investment advisers, both because of the additional information about promoters' incentives and because it may lead investment advisers to alter their arrangements to mitigate conflicts of interest.

However, conflict of interest disclosures may not necessarily lead to optimal decisions by investors. For example, the Commission's Financial Literacy Study surveyed investors about their understanding of fees as disclosed in a typical brochure, finding that many respondents had difficulty interpreting certain disclosures that are relevant to evaluating conflicts of interest.[932] These findings are consistent with academic literature that describes investors' difficulty in understanding financial disclosure. For example, one study shows that, in an experimental setting, even when subjects were told of the bias of persons who were giving them advice, participants did not fully adjust their behavior to reflect the disclosed bias.[933] In addition, these papers and others[934] find that mandating disclosure from biased persons may have the unintended

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932 "For instance, they had difficulty calculating hourly fees and fees based on the value of their assets under management. They also had difficulty answering comprehension questions about investment adviser compensation involving the purchase of a mutual fund and identifying and computing different layers of fees based on the amount of assets under management. Moreover, many of the online survey respondents on the point-of-sale panel had similar difficulties identifying and understanding fee and compensation information described in a hypothetical point-of-sale disclosure and account statement that would be provided to them by broker-dealers." *See* Financial Literacy Study, *supra* footnote 846.

933 *See* Daylian M.Cain, *et al.*, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*, 34 J. L. STUD. 1 (2005); George Loewenstein, *et al.*, *The Limits of Transparency: Pitfalls and Potential of Disclosing Conflicts of Interest*, 101 AM. ECON. REV. 423 (2011).

934 *See e.g.,* Steven Pearson, *et al.*, *A Trial of Disclosing Physicians' Financial Incentives to Patients*, 166 ARCHIVES OF INTERNAL MEDICINE 623 (2006); Sunita Sah, George Loewenstein & Daylian M. Cain, *The Burden of Disclosure: Increased Compliance With Distrusted Advice*, 104 J. PERSONALITY & SOC. PSYCHOL. 289 (2013).

consequence of making these persons appear honest and increase trust in them. While the context of these studies is not specific to investment advisers, promoters, or in certain cases, of financial advice generally, they provide evidence that suggests that disclosures might not fully mitigate the incentive problems generated by conflicts of interest. Additionally, advisers or their promoters may incur legal and compliance costs in connection with reviewing existing disclosures and drafting new disclosures to comply with the final rule.

ii. Oversight and Compliance

The final rule has an oversight and compliance provision that requires the investment adviser to have a reasonable basis for believing that a testimonial or endorsement complies with the rule.[935] This provision is designed to help ensure that communications made by promoters comply with the provisions of the final rule. This requirement will entail costs for both advisers and their promoters to devote staff and managerial resources, enter into new written agreements or amend existing written agreements, and update their processes to the extent necessary for oversight and compliance of testimonials and endorsements under the final rule.

b. Compensated Testimonials or Endorsements

The current solicitation rule prohibits advisers from providing solicitors with cash compensation, unless certain requirements are satisfied. Among these requirements is a requirement that the adviser enter into a written agreement requiring the solicitor to act in a manner consistent with the Advisers Act and its rules. Non cash-compensated solicitations are

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935 In addition, the final rule requires that an investment adviser have "a written agreement with any person giving a compensated testimonial or endorsement that describes the scope of the agreed-upon activities and the terms of the compensation for those activities." However, the rule does not contain this requirement in the case of uncompensated testimonials and endorsements or where *de minimis* compensation is provided to the promoter. For example, promoters providing testimonials or endorsements in refer-a-friend programs might not be subject to these requirements depending on the amount of compensation provided in such programs.

not subject to the solicitation rule, however. To the extent that non-cash compensated testimonials and endorsements are viewed as advertisements made directly or indirectly by an adviser, they may be subject to the current advertising rule, including its general prohibition on testimonials if applicable. Solicitations of private fund investors are not subject to the current solicitation rule, though they are subject to rule 206(4)-8 and are likely subject to restrictions applicable to private placements under the Federal securities laws. Persons who would be promoters under the final rule that are registered broker-dealers and FINRA members, such as those who transact in privately issued securities, are also subject to FINRA rules applicable to communications, including restrictions on the use of compensated testimonials, and may be subject to Regulation BI.

We believe that the costs and benefits of the conditions on the use of testimonials and endorsements in an advertisement will have similar costs and benefits to those described above,[936] though these effects will be mitigated to the extent that the adviser was complying with the current solicitation rule. To some extent these effects will also be mitigated to the extent the promoter is a registered broker-dealer and FINRA member; such a promoter could adapt existing compliance systems, for instance, but will need to modify for any differences under the two regulatory constructs.

i. Disclosures

We expect similar costs and benefits of the disclosure requirements for compensated testimonials and endorsements as described above for non-compensated testimonials and endorsements. For example, we expect investors to benefit from new disclosures, as mitigated to

[936] *See supra* section III.D.4.a.

the extent that, for example, conflict of interest disclosures may not necessarily lead to optimal decisions by investors. Further, disclosures may impose compliance costs on advisers and promoters similar to those described above, including costs to draft new disclosures in connection with, for example, advertisements by non-cash compensated promoters and in connection with compensated testimonials or endorsements made to prospective or current investors in private funds advised by the adviser.

However, these costs and benefits may be mitigated with respect to compensated testimonials or endorsements for four reasons. First, these costs may be mitigated for communications made by cash-compensated solicitors, given the disclosure requirements under the current solicitation rule. Currently, cash compensated solicitors must provide disclosures to clients pursuant to rule 206(4)-3(b), as well as provide the investment adviser's Form ADV brochure and their disclosure statement to potential investors. As a result, we expect that these costs will be mitigated to the extent that this type of information is already known and accessible to the investment adviser and promoter, and to the extent that similar information is already provided under the current solicitation rule. Further, the final rule's requirement to provide disclosure at the time the testimonial or endorsement is disseminated is similar to the current solicitation rule's requirement to deliver disclosure at the time of any solicitation activities. Second, the final rule exempts from these disclosure requirements certain affiliates of the adviser, provided that the affiliation is readily apparent or disclosed to the client or investors at the time the testimonial or endorsement is disseminated.

Third, the costs and benefits of this provision may be mitigated because the final rule includes exemptions from these disclosure requirements. First, there is an exemption from these requirements when a broker-dealer provides a testimonial or endorsement to a retail customer

that is a recommendation subject to Regulation BI. Second, when a broker-dealer provides a testimonial or endorsement to an investor that is not a retail customer as defined by Regulation BI, there is an exemption from the requirements to disclose the material terms of any compensation arrangement and a description of any material conflicts of interest. As a result, the extent of the effects of this exemption on investors will vary. Where the testimonial or endorsement is a recommendation to a retail customer subject to Regulation BI, broker-dealers, including those that are also registered as investment advisers,acc will have to comply with the Disclosure Obligation under Regulation BI and will not also be subject to disclosure requirements under the final rule. Although these investors will not receive the investor protection benefits of the marketing rule disclosures, the recommendation will be subject to Regulation BI requirements under the baseline. With respect to testimonials or endorsements by a broker-dealer to investors that are not retail customers (as defined by Regulation BI), although we believe such investors will be able to request from the broker-dealer other information about the solicitation, some may not. These exemptions may, therefore, result in a reduction of costs and benefits of the disclosure provisions for testimonials and endorsements to these investors.

These exemptions might also make advisers more likely to compensate a broker-dealer as a promoter rather than promoters that are not broker-dealers, which would give these broker-dealers a competitive advantage. Further, with respect to communications made by broker-dealers that are not so exempted, costs for promoters who are broker-dealers may also be mitigated to the extent that broker-dealers are already preparing similar disclosures in order to comply with other disclosure obligations.[937]

[937] *See supra* section II.C.2.

Finally, because there is no Form ADV brochure delivery requirement under the final rule, as compared to the current solicitation rule, we anticipate a reduction in costs associated with cash-compensated promoters no longer being subject to this requirement. We expect that this will not result in a loss of benefits to clients, however, because they will still receive the brochure from advisers as a result of advisers' delivery obligations. We recognize, however, that investment advisers and persons who are currently cash-compensated solicitors will bear costs as a result of the replacement of the current rule's disclosure requirements with the final rule's disclosure requirements.

ii. *Oversight and Compliance*

Investment advisers must have a reasonable belief that the solicitors comply with the provisions of the Advisers Act and rules under the current solicitation rule, and we therefore expect the magnitude of the costs and benefits from the application of the testimonials and endorsements requirements related to oversight and compliance to be relatively small for advisers complying with the current rule and for promoters that are cash solicitors under the current solicitation rule.

Under the current solicitation rule, investment advisers must make a bona fide effort to ascertain whether the cash-compensated solicitor has complied with the provisions of its written agreement with the adviser and must have a reasonable basis for so believing. As described above, the final rule has an oversight and compliance provision that requires the investment adviser to have a reasonable basis for believing that a testimonial or endorsement complies with the rule, and as applicable here, the adviser must also have a written agreement with the person giving a testimonial or endorsement that describes the scope of the agreed upon activities when making payments for compensated testimonials and endorsements that are above the *de minimis*

threshold. This provision will help ensure that communications made by promoters comply with the provisions of the final rule. Further, this requirement would entail costs for both advisers and their promoters to devote personnel time and managerial resources to enter into written agreements and update the processes necessary for oversight and compliance of testimonials and endorsements.

These benefits and costs may, however, be mitigated for several reasons. First, to the extent that advisers with cash-compensated solicitors are already substantially performing this oversight in connection with their compliance with rule 206(4)-3's oversight requirements, the rule will not have these full effects. Second, for private placements of private fund shares, the written private placement agreement could meet the written agreement requirement. Third, the final rule includes certain exemptions from the requirement to enter into a written agreement with the adviser. The first such exemption applies where *de minimis* compensation is provided to the promoter. For example, promoters providing testimonials or endorsements in refer-a-friend programs will likely be eligible for this exemption. The second such exemption applies to certain affiliates of the adviser, provided that the affiliation is readily apparent or disclosed to the client or investors at the time the testimonial or endorsement is disseminated.

iii. Disqualification

The final rule contains disqualification provisions which prohibit an adviser from compensating a person, directly or indirectly, for any testimonial or endorsement if the adviser knows, or, in the exercise of reasonable care, should have known, that the person is an ineligible person at the time the testimonial or endorsement is disseminated. The rule defines an "ineligible person" to mean a person, who is subject to a disqualifying Commission action or disqualifying event, and certain of that person's employees and other persons associated with an

ineligible person. The definition further encompasses, as appropriate, all general partners or all elected managers of an ineligible person.

Ineligible Persons and Disqualifying Events

Currently, the solicitation rule categorically bars advisers from making cash payments to certain disqualified persons. The final rule's disqualification provisions generally expand the set of ineligible persons by including certain disciplinary actions that are not part of the current solicitation rule. For example, under the final rule a disqualifying event is expanded to also include generally actions of the CFTC and self-regulatory organizations. It also newly includes Commission cease and desist orders from committing or causing a violation or future violation of any scienter-based anti-fraud provision of the Federal securities laws, and Section 5 of the Securities Act.

The final rule's prohibition on compensating such ineligible persons could yield benefits for investors by prohibiting investment advisers from hiring promoters most likely to abuse investors' trust – that is, promoters who have been subject to certain Commission opinions or orders, other regulatory actions, civil actions, or convictions for certain conduct. This prohibition could, however, also yield costs for advisers. For example, an adviser may not be able to hire a solicitor that the adviser otherwise feels to be best able to promote its service. This may reduce the number of persons available to advisers to serve as promoters, increase the cost of obtaining referrals for investment advisers, and impose costs on those promoters who are disqualified. The application of the final rule's definition of ineligible person could also impose additional compliance and search costs on investment advisers. For example, investment advisers will need to check that a promoter is not an ineligible person. In addition, to the extent the disqualification provisions under the new rule result in an increase in the number of

disqualified persons as compared to the current rule, the number of available potential promoters would fall, which could increase the difficulty of finding a promoter for an adviser.

We expect that the benefits and costs of this provision may be mitigated for a number of reasons. First, to the extent a solicitor is currently cash-compensated and currently subject to the solicitation rule, the final disqualification provisions are not entirely new, and only those changes from the solicitation rule's disqualification provisions, including new bars on persons subject to CFTC and self-regulatory organization orders, will have any economic effects.

Second, the final rule includes certain exemptions from this requirement. The first such exemption is available for promoters who receive *de minimis* compensation. The second exemption is available for promoters that are brokers or dealers registered with the Commission in accordance with section 15(b) of the Exchange Act, provided they are not subject to statutory disqualification under the Exchange Act. Broker-dealers currently have similar provisions that protect investors by disqualifying certain individuals from acting as a broker-dealer. This exemption may further have the effect of making it more likely that an adviser will compensate a broker-dealer as a promoter. In addition, persons that are covered by rule 506(d) of Regulation D under the Securities Act with respect to a rule 506 securities offering and whose involvement would not disqualify the offering under that rule (such as persons acting as placement agents for a private fund) will also not be disqualified under this disqualification provision of the final rule, which could similarly encourage the use of such agents in connection with marketing activities for private funds.

Finally, the final rule's disqualification provisions will not disqualify any promoter for any matter(s) that occurred prior to the effective date of the rule, if such matter would not have disqualified the promoter under rule 206(4)-3, as in effect prior to the effective date of the rule.

We expect this will reduce the costs and benefits of the disqualification provisions when the rule initially goes into effect.

The final rule also provides a conditional carve-out from the definition of disqualifying event, with respect to a person that is subject to certain Commission opinions or orders, provided certain requirements are met. The provisions of this conditional carve-out are similar to statements in staff no-action letters in which the staff stated that it would not recommend enforcement action to the Commission under section 206(4) and rule 206(4)-3 if the solicitor's practices were consistent with certain representations made in connection with those letters.

Diligence Standards

In addition to changing what promoters are ineligible to be compensated by an adviser, the final rule changes the diligence standards of investment advisers when hiring promoters. It establishes a knowledge or reasonable care standard for the disqualification provisions, which replaces the current solicitation rule's absolute bar on paying cash for solicitation activities to a person with any disciplinary history enumerated in the rule.

In general, we believe that the requirement to exercise reasonable care at the time of dissemination will yield indirect benefits for investors, because it will require advisers to help ensure that the protections of the rule's disqualification provisions are realized for investors. This standard will also generally impose costs on advisers related to the necessary investigation of the promoter and to ensuring that they remain in compliance.

We expect that the benefits and costs of this provision may be mitigated to the extent a solicitor is cash-compensated and previously subject to the solicitation rule. The required diligence standard in the final rule is formally less burdensome than was required under the current solicitation rule, which could lower compliance costs for advisers, including by reducing the likelihood that advisers will inadvertently violate the provision due to disqualifying events

that they would not, even in the exercise of reasonable care, have known existed. We do not, however, believe that this standard will significantly affect the client and investor protections of the disqualification provisions, because we do not believe that investigation beyond what is reasonable under the circumstances would yield substantial benefits. Under the final rule, an adviser will need to inquire into the relevant facts of an engagement, with the method or level of due diligence or other inquiry varying depending on the circumstances of the compensated promoter and its arrangement with the adviser.[938] To the extent that an engagement presents greater risk, greater screening and compliance mechanisms would be required under the rule, which we believe would preserve these benefits. For example, to the extent that there are indicators suggesting bad actor involvement, increased levels of due diligence will be required. Further, we believe that advisers will generally use many of the same mechanisms that they use today to determine whether a disqualified person is an ineligible person under the final rule. To the extent that the mechanisms currently in use already resemble or satisfy the final rule's diligence standard, the cost burden of the new standard may be mitigated.

5. Third-Party Ratings

The final rule will also restrict the use of third-party ratings in advertisements, subject to certain requirements about the structure of the rating, and clear and prominent disclosures about the date of the rating, the identity of the third party, and compensation provided for obtaining or using the rating. We analyze the costs and benefits of imposing restrictions on the use of third-party ratings on communications subject to these restrictions below.

While the current advertising rule does not mention third-party ratings, it prohibits an advertisement that contains a third-party rating if it contains an untrue statement or a material

938 *See supra* section II.C.4.a.

fact or is otherwise false or misleading. Further, the current solicitation rule, like the current advertising rule, does not expressly mention third-party ratings.

The staff has taken the position that certain ratings may constitute testimonials and stated it would not recommend enforcement action under the prohibition of testimonials if an adviser made references in an advertisement to third-party ratings that reflect client experiences, based on certain representations.[939] Specifically, no-action letters have stated the staff would consider the following when not recommending an enforcement action for potentially false or misleading ratings in an advertisement: whether the advertisement disclosed the criteria on which the rating was based, whether favorable ratings were selectively disclosed, whether there were any untrue implications of being a top-rated adviser, the identity of who created and conducted the rating, and whether investors can expect similar performance in the future from the investment adviser.[940]

The disclosure requirements of the final rule will provide investors more information to judge the context of a third-party rating, which might reduce the likelihood that investors will be misled by an investment adviser's ratings.[941] Additionally, the final rule requires that the adviser have a reasonable basis for believing that any questionnaire or survey used in the preparation of a third-party rating be structured to make it equally easy for a participant to provide favorable and unfavorable responses, and not designed or prepared to produce any predetermined result, which might also reduce the likelihood that investors will be misled. Investors will benefit from the disclosure requirements for third-party ratings, not only because the disclosures provide investors

939 *See* DALBAR, Inc., SEC Staff No-Action Letter (Mar. 24, 1998).

940 *See id.*; *see* Investment Adviser Association, SEC Staff No-Action Letter (Dec. 2, 2005)

941 *See* supra section III.B.

with additional context to evaluate the information provided in ratings, but also because the required disclosures may dissuade advisers from including misleading third-party ratings.

The disclosures required by the final rule might reduce the incentives of investment advisers to include third-party ratings that might be stale or otherwise misleading. The requirement to create these disclosures could impose costs on advisers, including compliance costs related to drafting these disclosures and ensuring that they comply with the requirements of the final rule. In addition, the final rule requires that investment advisers make certain disclosures or reasonably believe that such disclosures have been made, which will impose additional costs on investment advisers. Investment advisers and the associated personnel that use third-party ratings in their advertisements will bear costs associated with compliance with this aspect of the final rule.[942] These costs could entail the dedication of personnel time and managerial resources to draft disclosures and to satisfy due diligence requirements.

However, these costs and benefits may be mitigated because the third-party rating requirements of the final rule are similar to the representations made in staff letters in which it has previously stated that it would not recommend enforcement under section 206(4) and rule 206(4)-1. As a result, advisers may only bear the incremental costs of modifying compliance systems to account for the differences of the final rule requirements, though these advisers would also bear the costs of evaluating those differences.

We have quantified a subset of the costs associated with requirements for the use of third-party ratings in advertisements, specifically, the burden of information collection costs estimated

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[942] Although the investment advisers bear the legal burden of complying with third-party ratings requirement, we expect that the costs of this requirement will be partially borne by other parties, such as persons communicating on behalf of an investment adviser.

for the purposes of the Paperwork Reduction Act.[943] The disclosure provisions of the requirements for testimonials and endorsements will entail information collection costs, and investment advisers will incur initial implementation costs. We estimate that investment advisers will incur an initial implementation cost of $1,011 for each adviser, or $6,937,482 in total.[944] We estimate that investment advisers will incur an ongoing cost of $252.74 per year per adviser, or $1,734,301.88 total ongoing cost per year. We therefore estimate a total industry cost in the first year of $8,671,783.88.[945]

6. Performance Advertising

The final rule includes provisions that impose specific requirements and prohibitions on the inclusion of performance information in advertisements. These provisions include net performance requirements, prescribed time period requirements, prohibitions of statements expressing or implying Commission approval or review of the calculation or presentation of performance results in the advertisement, and requirements for related performance, extracted performance, hypothetical performance, and predecessor performance. We analyze the costs and benefits of imposing these specific requirements on the use of performance advertising in communications below.

We have quantified a subset of the costs associated with the restrictions on the use of performance advertising in advertisements, specifically, the burden of information collection costs estimated for purposes of the Paperwork Reduction Act.[946] The provisions of the

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943 *See infra* section IV.B.3.

944 Initial cost burden estimate of $1,011 from section IV.B.3. 13,724 x ½ =6,862 affected investment advisers. $1,011 x 6,862 = $$6,937,482.

945 Ongoing cost estimate includes disclosure, oversight, and annual costs from section IV.B.3. $252.74 x 6,862 = $1,734,301.88. For the total first year cost, $6,937,482 + $1,734,301.88 =$8,671,783.88.

946 *See infra* section IV.B.4.

requirements for performance advertising will entail information collection costs and modification of the presentation of performance. These collection of information costs primarily entail an initial cost to update performance calculations, and an ongoing annual cost for investment advisers. We estimate that investment advisers will incur a total initial

implementation cost $394,998,740[947] and a total ongoing cost of $273,772,232 per year.[948] We therefore estimate the total cost in the first year to be $672,544,972.[949]

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947 These total cost estimates differ from those in section IV.B.4, because the estimates in those sections amortize the initial implementation costs over three years, while the cost estimates in this section do not. However, both estimates make identical assumptions about the resources required to comply with the rule. The initial burden associated with net performance is based on 15 hours x $337 (compliance manager and compliance attorney, split evenly) = $5,055 for each of the 13,038 investment advisers expected to be affected, implying an initial cost of $65,907,090. The initial burden associated with performance time periods is based on 35 hours x $337 (compliance manager and compliance attorney, split evenly) = $11,795 for each of the 13,038 investment advisers expected to be affected, implying an initial cost of $153,783,210. The initial burden associated with related performance is based on 30 hours x $337 (compliance manager and compliance attorney, split evenly) = $10,110 for each of the 10,979 investment advisers expected to be affected, implying an initial cost of $110,997,690. The initial burden associated with extracted performance is based on 10 hours x $337 (compliance manager and compliance attorney, split evenly) = $3,370 for each of the 686 investment advisers expected to be affected, implying an initial cost of $2,311,820. The initial burden associated with hypothetical performance is based on 15 hours x $337 (compliance manager and compliance attorney, split evenly) +7 hours x $530 (compliance officer) = $8,765 for each of the 6,862 investment advisers expected to be affected, implying an initial cost of $60,145,430. The initial burden associated with predecessor performance is based on 20 hours x $337 (compliance manager and compliance attorney, split evenly) = $6,740 for each of the 275 investment advisers expected to be affected, implying an initial cost of $1,853,500. Therefore, the total initial industry burden associated with the final rule is $197,721,270 + $153,783,210 + $110,997,690 + $2,311,820 + $60,145,430 + $1,853,500 = $394,998,740. *See infra* section II.B.4

948 The ongoing burden associated with net performance is based on 10.5 hours x $337 (compliance manager and compliance attorney, split evenly) = $3,538.50 for each of the 13,038 investment advisers expected to be affected, implying an ongoing cost of $46,134,963. The ongoing burden associated with performance time periods is based on 28 hours x $337 (compliance manager and compliance attorney, split evenly) = $9,436 for each of the 13,038 investment advisers expected to be affected, implying an ongoing cost of $123,026,568. The ongoing burden associated with related performance is based on 17.5 hours x $337 (compliance manager and compliance attorney, split evenly) = $5,897.50 for each of the 10,979 investment advisers expected to be affected, implying an ongoing cost of $64,748,652.50. The ongoing burden associated with extracted performance is based on 7 hours x $337 (compliance manager and compliance attorney, split evenly) = $2,359 for each of the 686 investment advisers expected to be affected, implying an ongoing cost of $1,618,274. The ongoing burden associated with hypothetical performance is based on 10.5 hours x $337 (compliance manager and compliance attorney, split evenly) + 3.75 hours x $530 (compliance officer) = $5,526 for each of the 6,862 investment advisers expected to be affected, implying an ongoing cost of $37,919,412. The ongoing burden associated with predecessor performance is based on 3.5 hours x $337 (compliance manager and compliance attorney, split evenly) = $1,179.50 for each of the 275 investment advisers expected to be affected, implying an initial cost of $324,362.50. Therefore, the total initial industry burden associated with the final rule is $138,404,889 + $123,026,568 + $64,748,652.50 + $1,618,274 + $37,919,412 + $324,362.50= $273,772,232. *See infra* section II.B.4

949 $394,998,740 (total initial cost) + $273,772,232 (total ongoing cost) + $3,774,000 (external cost) = $672,544,972 (total first year cost).

a. Net Performance Requirement

The final rule will prohibit any presentation of gross performance unless the advertisement also presents net performance with at least equal prominence to the presentation of gross performance. In addition, the net performance must be calculated over the same time period, and using the same type of return and methodology as, the gross performance. While the current advertising rule does not mention performance advertising, it prohibits any untrue statement of a material fact and statements that are otherwise false or misleading, which includes statements made in the context of performance advertising. The staff has stated its views about the types of circumstances in which it may view the presentation of performance results as misleading, including, for example, where an adviser did not disclose how advisory fee expenses, commissions, and reinvestment of dividends affect the performance results.[950]

This provision will likely benefit investors by providing them with additional information about the performance generated by an investment adviser, including the effect of fees and expenses on that performance, and reducing the chance that they are misled by presentations of gross performance. To the extent that investment advisers' current practices differ from the requirements of this provision, these requirements may impose costs on advisers, including advisers that serve private funds, to compute and include net performance in their marketing communications, to the extent that advisers do not currently compute and include net performance. These costs could involve devoting personnel time, modifying marketing materials, and devoting managerial resources. In addition, some investors may be better able to make their own risk adjusted return assessments, and these investors may similarly derive fewer benefits from this requirement.

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950 *See supra* section III.C.1.b.

However, these costs and benefits may be mitigated to the extent that this requirement is similar to the circumstances under which the staff has previously stated that it would not recommend enforcement under section 206(4) and rule 206(4)-1. Given that many investment advisers already provide this information in light of staff no-action letters, there are not likely to be significant costs or benefits to this provision.

b. Prescribed Time Periods

The final rule prohibits the presentation of performance results of any portfolio or any composite aggregation of related portfolios, other than any private fund, in advertisements unless the results for one, five, and ten year periods are presented as well. Each of the required time periods must be presented with equal prominence and end on a date that is no less recent than the most recent calendar-year end.[951] If the portfolio was not in existence for the full duration of any of these three periods, the lifetime of the portfolio can be substituted. Under the baseline for current advertisements, there is no such Commission requirement relating to performance advertising.

Requiring advertisements to include one, five, and ten year period performance will benefit investors other than private fund investors by giving them standardized information about the performance and limiting the potential that an investor could be unintentionally misled about an investment adviser's performance through the investment adviser's selection of performance periods. The requirement will impose costs on investment advisers, who will need to compute the performance for the prescribed time periods, update their advertising materials, and devote personnel time to ensure compliance with the final rule. These costs may disincentivize the

951 *See supra* section II.E.2.

presentation of performance results of any portfolio or any composite aggregation of related portfolios.

However, these benefits and costs may be mitigated to the extent that this requirement is similar to information currently collected and provided to clients in order to comply with GIPS standards to present performance information. In addition, to the extent that advisers already present, for example, performance information for these time periods, these costs and benefits may also be mitigated.

c. Statements of Commission Approval or Review

The final rule prohibits any advertisement that includes a statement, whether express or implied, that the calculation or presentation of performance results has been reviewed or approved by the Commission. This prohibition will benefit investors by preventing misleading advertisements that could lead investors to draw false conclusions about the Commission's approval of a presentation or calculation of performance. Any such statement would be false, as the Commission does not review or approve of calculations or presentations of performance. The prohibition may likely impose costs associated with legal review of performance presentation, but these costs are likely to remain small. Further, such costs may be mitigated to the extent that advisers currently have procedures to ensure compliance with section 208(a), which contains a similar prohibition from representing or implying that an adviser's abilities or qualifications have been passed upon by the United States or any agency thereof.

d. Related Performance

The final rule will condition the presentation of "related performance" in all advertisements on the inclusion of all related portfolios. However, the final rule will allow related performance to exclude related portfolios as long as the advertised performance results are not materially higher than if all related portfolios had been included. This exclusion will be

subject to the rule's requirement that the presentation of performance results of any portfolio include results for one-, five-, and ten-year periods. The final rule will allow related performance to be presented either on a portfolio-by-portfolio basis or as a composite of all related portfolios. The inclusion of related performance in advertisements may give investment advisers flexibility in how they choose to advertise their performance, such as which aspects of their performance they can advertise, and might give investors additional information about how an investment adviser managed portfolios having substantially similar investment policies, objectives and strategies.

The requirements for related performance may, however, impose costs on investment advisers related to the creation of composites to the extent that they do not currently create composites or create composites using the final rule's criteria for related portfolios. For example, the "not materially higher than" requirement for excluding related portfolios may generate an additional need to recalculate performance to verify that the related performance satisfies the requirement. Further, as discussed above, we understand that an adviser will likely be required to calculate the performance of all related portfolios to ensure that any exclusion of certain portfolios meets the rule's conditions, which may be burdensome on advisers, particularly smaller advisers.[952]

However, we expect investment advisers to incur these calculation costs only if they expect sufficient benefits from inclusion of related performance. Further, we expect that these costs and benefits may be mitigated to the extent that advisers currently include related

[952] *See* IAA Comment Letter.

performance presentations in their advertisements that comply with the current rule.[953] Commenters generally described the related performance definition that was originally proposed as being similar to industry practice.[954] In addition, advisers that comply with GIPS standards are permitted to show related performance in advertisements, and presentations that meet the GIPS standard requirements to show all related performance will also satisfy the requirements of this provision to show all related performance.

e. Extracted Performance

The final rule will condition the presentation of extracted performance in all advertisements on the advertisement providing, or offering to provide promptly, the performance results of the total portfolio from which the performance was extracted. "Extracted performance" means "the performance results of a subset of investments extracted from a portfolio."[955] While the current advertising rule does not mention extracted performance, it prohibits any untrue statement of a material fact and statements that are otherwise false or misleading, which includes statements made in the context of advertising extracted performance.

The use of extracted performance in advertisements will benefit investors by giving them information about performance results applicable to a particular subset of the adviser's investments, and the accompanying disclosures could help investors contextualize the claims of an investment adviser about its extracted performance, thereby reducing the risk that investors might be misled by such extracted performance.

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953 The use by investment advisers that are also broker-dealers of certain forms of related performance in advertisements may be viewed by FINRA as inconsistent with the content standards in FINRA rule 2210.

954 *See* MFA Comment Letter I; Proskauer Comment Letter.

955 Final rule 206(4)-1(e)(6).

Investment advisers who use extracted performance in their advertisements will likely incur costs to prepare the performance results of the total portfolio from which the performance was extracted, to the extent that they do not do this already. The final rule does not prohibit an adviser from presenting a composite of extracts, including composite performance that complies with GIPS standards. However, any presentation of a composite of extracts is subject to the additional protections that apply to hypothetical performance, as discussed below, and as a result, these additional protections may result in additional burdens for advisers that typically present extracted performance from multiple portfolios as a composite, and potentially limit these types of presentations of performance to institutional investors.

However, these benefits and costs may be mitigated to the extent that the restrictions imposed by this provision are similar to the manner in which advisers currently present extracted performance, including under GIPS standard requirements applicable to similar presentations of extracted performance, or other requirements.

f. Hypothetical Performance

The rule also prohibits the use of hypothetical performance in advertisements unless (i) the investment 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; (ii) provides sufficient information to enable the intended audience to understand the criteria used and assumptions made in calculating such hypothetical performance; and (iii) provides, or if the intended audience is an investor in a private fund provides, or offers to provide promptly, sufficient information to enable the intended audience to understand the risks and limitations of using such hypothetical performance in making investment decisions. The rule defines several types of hypothetical performance - model performance, performance derived from model portfolios; backtested

performance, performance that is backtested by the application of a strategy to data from prior time periods when the strategy was not actually used during those periods; and targeted or projected performance returns with respect to any portfolio or to the investment services offered in the advertisement.

The current advertising rule does not explicitly address hypothetical performance. The Commission has, however, brought enforcement actions alleging that the presentation of performance results that were not actually achieved would be misleading where certain disclosures were not made, including disclosure that the performance results were hypothetical or disclosure of the relevant limitations inherent in hypothetical results and the reasons why actual results would differ.[956]

The final rule's imposes minimum standards for the presentation of hypothetical performance in advertisements, which could potentially increase the willingness of investment advisers to use hypothetical performance. If investment advisers increase their use of hypothetical performance in advertising, investors may benefit from the additional information provided by hypothetical performance advertising, together with information and context that may help investors to better understand it. This additional information could aid an investor in the choice of an investment adviser by helping investors find a better match or reducing costs associated with finding an investment adviser.

To the extent that these requirements will help ensure that hypothetical performance is disseminated to the specific investors who have access to the resources to independently analyze this information and who have the financial expertise to understand the risks and limitations of these types of presentations, these requirements on the presentation of hypothetical performance

956 *See supra* section III.C.1.b.

will benefit investors. Although investors will not face any direct costs from the inclusion of hypothetical performance, they may face indirect costs associated with processing and interpreting this new information if investment advisers increase their use of hypothetical performance. Even if investors are provided with sufficient information to contextualize hypothetical performance, they may need time and expertise to interpret that contextual information. Some, investors might have difficulty interpreting the context of hypothetical performance because of a lack of resources of financial expertise, which could lead to poorer matches with investment advisers. However, the final rule requires disclosures and contextual information for hypothetical performance that are sufficient for the intended audience, which should mitigate these costs to investors.

Advisers may incur costs associated with complying with the three conditions described above, such as consulting with in-house counsel, time to draft these policies and procedures and disclosures, and requiring firms to pay outside counsel or consultants to draft or review these policies and procedures and disclosures. These requirements could also entail costs such as training of staff to comply with the policies and procedures, and demands on personnel time and counsel to draft and review advertisements and disclosures to ensure compliance with the policies and procedures and the rule's requirements. We recognize that investment advisers will need to evaluate their intended audiences, as well as ensure that the advertisement is tailored to the audience receiving it, which will cause advisers to incur costs. An adviser may make such evaluations based on past experiences with investor types, including, for example, routine requests from those types of investors in the past, or based on information they have gathered from potential investors (*e.g.*, questionnaires, surveys, or conversations) or academic research.[957]

[957] See *supra* section II.E.6.b.

Investment advisers are, however, unlikely to incur these costs if they do not expect the benefits of hypothetical performance advertising to exceed the costs associated with screening.

The costs and benefits associated with these restrictions may, however, be mitigated to the extent that advisers currently present information that meets the final rule's definition of "hypothetical performance" in circumstances consistent with the representations made in staff no-action letters. Additionally, to the extent that some investment advisers already maintain policies and procedures to screen prospective clients in order to comply with the GIPS standards, the net costs and benefits associated evaluating an "intended audience" for purposes of complying with this requirement may be mitigated. Under these circumstances, advisers may only bear the incremental costs of modifying compliance systems and disclosures to account for the differences of the final rule's requirements, though these advisers would also bear the costs of evaluating those differences.

g. Predecessor performance

The final rule subjects the presentation of predecessor performance to several requirements: (i) the person or persons who were primarily responsible for achieving the prior performance results manage accounts at the advertising adviser; (ii) the accounts managed at the predecessor investment adviser are sufficiently similar to the accounts managed at the advertising investment adviser that the performance results would provide relevant information to clients or investors; (iii) all accounts that were managed in a substantially similar manner are advertised unless the exclusion of any such account would not result in materially higher performance and the exclusion of any account does not alter the presentation of any applicable time periods required by the final rule; and (iv) the advertisement includes, clearly and

prominently, all relevant disclosures, including that the performance results were from accounts managed at another entity.

Under the current advertising rule, predecessor performance is not explicitly addressed; however, the staff has stated in no-action letters that it would not view advertisements that include predecessor performance as misleading under certain circumstances.[958] These circumstances are similar to the requirements of the final rule, and costs and benefits may flow from the extent to which the rule imposes requirements for use of predecessor performance.

To the extent that the final rule's provisions permit the use of predecessor performance in advertisements, predecessor performance has the potential to provide additional information and context for investors. This information could improve investor decisions and reduce the costs associated with searching for an investment adviser. However, the rule has requirements that will impose costs on investment advisers that present predecessor performance. Determining the extent to which the personnel and the portfolios of a predecessor adviser are sufficiently similar under the rule can require resources, especially when portfolios are managed by multiple people, or have long or complicated performance histories. Additionally, investment advisers may bear additional costs to analyze any intellectual property issues or non-compete agreements between portfolio management personnel and their previous firms.

7. Amendments to Form ADV

Under the final rule, Form ADV will include additional questions about investment advisers' advertising practices, including performance advertising, the use of testimonials and endorsements, and compensation for promoters. Current Form ADV does not contain any questions about advertising practices, and the changes to Form ADV will support the

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958 *See* Horizon Letter.

Commission's compliance oversight efforts, thus helping the Commission monitor market practices and the effects of its rules. For example, the changes to Form ADV will allow the Commission to understand the relative popularity of certain advertising practices and compensation practices for promoters. To the extent that these amendments do facilitate compliance oversight, these changes may benefit clients. These investors may also derive benefits from the information provided in the Form ADV, as amended, which may help them make better decisions with respect to which advisers' services to utilize. Additionally, it will enable the Commission to evaluate the final rule's requirements, and their impact on how investment advisers choose to advertise. Investment advisers that use advertisements will likely incur additional costs associated with collecting information to answer these questions, as investment advisers will need to accurately track the types of content in their advertisements.

We have quantified a subset of the costs associated with changes to Form ADV, specifically the burden of information collection costs estimated for the purposes the Paperwork Reduction Act. The amendments to Form ADV will impose additional ongoing costs for investment advisers. We estimate the marginal increase in the aggregate cost burden of these changes to Form ADV will be $4,355,288 per year for RIAs not obligated to prepare and file relationship summaries, $3,429,942 per year for RIAs obligated to prepare and file relationship summaries, and $171,881 per year for exempt reporting advisers.[959] We therefore estimate the total annual cost increase for all advisers to be $7,957,111 per year.[960] However, we note that

[959] The total cost increase for exempt reporting advisers reflects an increase in the number of exempt reporting advisers rather than a per adviser cost increase generated by the final rule.

[960] *See infra* section IV.E. Cost estimates were calculated by subtracting current Form ADV cost burdens from the new Form ADV cost burdens.

some portion of the increase in costs is due to an increase in the number of RIAs that will bear these costs, and not entirely due to an increase in the cost burden for an individual RIA.

8. Recordkeeping

The amendments to the recordkeeping rule will require investment advisers to make and keep records of all advertisements they disseminate. Generally, the amended recordkeeping rule will require additional retention of written or distributed communications of an investment adviser, including certain oral communications. For example, the current recordkeeping rule requires the retention of advertisements disseminated to ten or more individuals. In contrast, the amendments require that advisers retain all advertisements, with the two exceptions. First, for oral advertisements, the adviser may, instead of recording and retaining the advertisement, retain a copy of any written or recorded materials used by the adviser in connection with the oral advertisement.[961] Second, if an adviser's advertisement includes a compensated oral testimonial or endorsement, the adviser may, instead of recording and retaining the advertisement, make and keep a record of the disclosures provided to investors.[962] In addition, if the required disclosures with respect to a testimonial or endorsement are not included in the advertisement, then the adviser must retain copies of such disclosures provided to investors.[963] The recordkeeping rule will continue to require that advisers keep a record of communications other than advertisements (for example, notices, circulars, newspaper articles, investment letters, and bulletins) that the investment adviser disseminates, directly or indirectly, to ten or more persons. Additionally, there are some types of newly required records that can be particularly costly to retain. For example, creating and retaining records of orally delivered disclosures will impose extra costs on

961 *See* final rule 204-2(a)(11)(i)(A)(*1*).

962 *See* final rule 204-2(a)(11)(i)(A)(*2*).

963 *See* final rule 204-2(a)(11)(i)(A) and (15)(i).

investment advisers and promoters. These requirements may result in costs on investment advisers, such as dedicating personnel time to capture and retain these records.

The amendments to the recordkeeping rule will also require investment advisers to make and keep: (i) documentation of communications relating to predecessor performance; (ii) documentation to support performance calculations; (iii) copies of any questionnaire or survey used in preparation of a third-party rating (in the event the adviser obtains a copy of the questionnaire or survey); (iv) if not included in an advertisement, a record of disclosures provided to the client; (v) documentation substantiating the adviser's reasonable basis for believing that a testimonial, endorsement, or third-party rating complies with the applicable tailored requirements of the marketing rule and copies of any written agreement made with promoters; (vi) a record of certain affiliated personnel of the adviser; and (vii) a record of who the "intended audience" is.

These requirements will impose compliance costs on advisers related to the creation and retention of these records. These costs will be associated with additional personnel time to capture or retain these communications. Notably, retaining documents that form the basis of a calculation could be more expensive due to the requirement that advisers retain calculation information for portfolios (and not only for managed accounts and securities recommendations). However, we believe that there is overlap between accounts included in "portfolios" and those "managed accounts" already captured by the current recordkeeping rule. Retaining these documents might require an investment adviser to evaluate which documents are relevant for a performance calculation, which could potentially generate costs for the investment adviser. Similarly, advisers will incur costs related to required records that are not communications, including a record of who an advertisement's "intended audience" is, for example. Creation of

these records might involve research and collection of information about an investment adviser's intended audience. Furthermore, the recordkeeping rule requires advisers to retain documents that support the inclusion of predecessor performance in an advertisement, including a requirement to make and keep originals of all written communications received and copies of all written communications sent by an investment adviser relating to predecessor performance and the performance or rate of return of any portfolios. In contrast, this provision in the current recordkeeping rule only requires advisers to make and keep originals of all written communications received and copies of all written communications sent by an investment adviser relating to the performance or rate of return of any or all managed accounts or securities recommendations. The recordkeeping rule also requires that a list of certain affiliated personnel be retained, to parallel the exemption for certain affiliated personnel from the compensated testimonials and endorsements requirements. This requirement may generate costs for the investment adviser to retain and update this list. Some of these costs may ultimately be passed on to clients or investors through higher fees.

These costs may, however, be mitigated to the extent that advisers are already retaining similar records. Under the current recordkeeping rule, for example, advisers are required to retain originals of documentation supporting the calculation of performance or rate of return of all managed accounts or securities recommendations. The amendments to the recordkeeping rule, in contrast, will also require documentation supporting the calculation of performance or the rate of return for any or all portfolios. As a result, the total costs of compliance for advisers with respect to communications previously included in the definition of an advertisement will be mitigated somewhat. Further, the staff has, for example, taken the position that rule 204-2(a)(16)

also applies to a successor's use of a predecessor's performance data.[964] As a result, retention of some documentation and written communications required to be retained under the recordkeeping rule will impose relatively minor costs on investment advisers with respect to communications currently subject to the existing recordkeeping requirements.

Under the baseline, there are no recordkeeping requirements for the communications of solicitors, except for the disclosure documents that solicitors are required to provide to clients pursuant to the current solicitation rule. Investment advisers that currently use solicitors will incur additional costs associated with the substantive changes to the final recordkeeping requirements discussed in this section, as well as the expansion of the definition of advertisement to include testimonials and endorsements. In addition, given that the recordkeeping obligations fall upon investment advisers and not their promoters, we do not anticipate this provision will generate substantial costs or benefits for promoters.

We have quantified a subset of the costs associated with the recordkeeping provisions, specifically, the burden of information collection costs estimated for the purposes of the Paperwork Reduction Act. The amendments to the recordkeeping requirements will cause investment advisers to incur annual ongoing costs related to the creation and retention of records. We estimate these costs to have a total cost of $16,636,198 per year.[965]

E. Efficiency, Competition, Capital Formation

We believe the final amendments could have positive effects on efficiency, competition, and capital formation. As discussed below, we expect the amendments could improve efficiency

964 *See* rule 204-2(a)(16); *See* Great Lakes Letter (not recommending enforcement action and stating the staff's view that the requirement in rule 204-2(a)(16) applies to a successor's use of a predecessor's performance data.)

965 *See infra* section IV.D.

by improving the quantity and quality of information in advertisements. Further, if investors are thereby able to make more informed decisions about investment advisers and more easily learn about the ability and potential fit of investment advisers, investment advisers might have a stronger incentive to invest in the quality of their services, which could promote increased competition among investment advisers. However, if advertisements attract customers for investment advisers in a manner unrelated to the quality of their services, competition among investment advertisers could result in an inefficient "arms race." To the extent that the final rule results in improved matches in the market for investment advice, potential investors may be drawn to invest additional capital, which could promote capital formation.

1. Efficiency

The final rules have the potential to improve the information in investment adviser advertisements by improving the quantity and quality of information available to investors. This in turn could improve the efficiency of the market for investment advice in two ways.

First, the final rule could increase the overall amount of information in investment adviser advertisements by increasing the types of information that investment advisers include in their advertisements and prescribing requirements and restrictions on the presentation of certain kinds of information in adviser and private fund advertisements. This could either be directly through the provisions of the rule, or indirectly, through competition among investment advisers on how informative their advertisements are. For example, to the extent that the rules and rescission of existing no-action letters increase certainty for advisers and thereby reduce compliance costs, advisers may increase their use of the types of marketing activities covered by the final rules. This may increase investor access to information regarding the ability and potential fit of investment advisers, which may improve the quality of the matches that investors

make with investment advisers. In addition, advertisements can improve the efficiency of the investment adviser search process through the investor protections and disclosures that the final rule will provide. On the other hand, investment advisers, promoters, and related personnel may reduce the overall amount of information in these communications, because of the expanded definition of an advertisement and related costs imposed on communications newly brought within the definition, which could reduce the overall efficiency of an investor's investment adviser search.

The information from testimonials, endorsements, performance data, and third-party ratings presented in accordance with the provisions of the rule can potentially provide valuable information for investors. Better informed investors could improve the efficiency of the market for investment advice by improving the matches between investors and investment advisers and reducing search costs, as they may be better able to evaluate investment advisers based on the information in their advertisements.[966] To the extent that the rule improves the usefulness of the recommendations of non-cash compensated promoters, another programmatic benefit of the rule is that it may improve the efficiency of matches between investment advisers and investors.

Although the final rule requires additional disclosures when investment advisers include certain elements in their advertisements, the value of these disclosures to investors depends on the extent to which investors are able to utilize the disclosures to better understand the context of an adviser's claims. By providing information to investors in the required disclosures to aid their evaluation of an adviser's advertisements, these disclosures could mitigate the potential that advertisements mislead investors, and improve their ability to find the right investment adviser for their needs.

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966 *See supra* section III.B.

Second, the final rule could increase the overall quality of information about investment advisers. To the extent that the rules mitigate misleading or fraudulent advertising practices, investors may be more likely to believe the claims of investment adviser advertisements. Because information in advertisements is more likely to increase the number of investors interested in an investment adviser, advisers may include more information that will improve the choices of investors. One potential consequence of modifying the regulatory standards for advertisements provided by the final rule is that investment advisers may increase the amount of resources they allocate to advertising their services (including resources aimed to address compliance with the final rule). While additional spending on advertisements may facilitate matching between investment advisers and investors, under some circumstances, this additional spending may be inefficient if the benefits of better matches fall short of the resources required to facilitate better matches.

The final rule also merges certain solicitation activity into the definitions of testimonials and endorsements and expands the scope by covering all forms of compensation. The rule also includes persons providing testimonials or endorsements to investors in a private fund. In addition, the rule will continue to require disclosures to make salient the nature of the relationship between a promoter and the investment advisers. These provisions could improve the efficiency of the market for promoters and their investment advisers by ensuring that the provisions for testimonials and endorsements apply to all forms of potential conflicts of interest. If investors are aware of these conflicts of interest through disclosures, they may be better able to interpret testimonials and endorsements and choose an investment adviser that is of higher quality, or a better match.

2. Competition

As discussed earlier, the final rule might result in an increase in the efficiency of investment adviser advertisements, providing more useful information to investors about the abilities of an investment adviser than advertisements under the baseline, which would allow them to make better decisions about which investment advisers to choose.[967] In this case, if investors make more informed decisions about investment advisers based on the content of their advertisements, investment advisers might have a stronger incentive to invest in the quality of their services, as the final rule will permit them more flexibility to communicate the higher quality of their services by providing additional information about their services. This could promote competition among investment advisers based on the quality of their services, and result in a benefit for investors.

However, the final rule might instead provide investment advisers with a stronger incentive to invest in the quality of their advertisements rather than the quality of their services. If investment advisers increase spending on advertisements in a way that does not improve the information quality in advertisements, but still attracts investors, the competition could potentially be inefficient. Although the direct costs of advertisements would be borne by the investment adviser, it is possible that some portion of the costs of advertisement will be indirectly borne by investors.[968] As a result, investments in advertisements may result in higher fees for investors.

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967 *See supra* section III.B.

968 Firms that face a change in costs will bear some portion of these costs directly, but will also pass a portion of the cost to their consumers through the price. In a competitive market, the portion of these costs that firms are able to pass on to consumers depends on the relative elasticities of supply and demand. For example, if demand for investment adviser services is elastic relative to supply of investment adviser services, investment advisers will be limited in their ability to pass through costs. For more, *see* Mankiw, Gregory, *Principles of Economics* (2017).

The final rule has conditions that can affect market participants in different ways. For example, the final rule's restriction on the presentation of performance results unless results for one, five, and ten year periods are presented does not restrict the presentation of performance of private funds. This could give investment advisers that are able to advertise both private funds and general funds more options in how they advertise performance, and provide them a competitive advantage over investment advisers that only advertise non-fund performance. Further, to the extent that advisers increase their usage of compensated testimonials or endorsements as a result of the final rule, this could provide competitive advantages to advisers who are better able to pay fees for such testimonials or endorsements, or for larger firms who have larger audiences with which to leverage favorable testimonials and endorsements.[969] In addition, provisions for different types of performance advertising can have a disparate impact on newer investment advisers versus older ones. Generally, newer investment advisers have fewer performance advertising options and shorter performance histories than older investment advisers, and might prefer to rely on hypothetical or related performance advertising. To the extent that the final rule's provisions place different requirements on these types of performance, newer investment advisers could face competitive disadvantages relative to older investment advisers.

In addition, the final rule affects current solicitors by including non-cash compensation in the scope of the rule's requirements for testimonials and endorsements. The final rule could improve competition among investment advisers and solicitors by subjecting all forms of compensation for testimonials and endorsements to the same requirements, and not imposing a higher regulatory burden on solicitors compensated in cash and their respective investment

969 *See* NAPFA Comment Letter.

advisers do not receive a higher regulatory burden. Under the final rule, providers of testimonials or endorsements that prefer or accept cash compensation for their activities will not be subject to a higher burden relative to persons that prefer or accept non-cash compensation. In addition, non-cash compensated promoters will bear additional costs associated with being scoped into the marketing rule. We expect that some portion of these costs will be passed onto investors through higher fees.

Differences in the scope of disqualification between investment advisers subject to the disqualification provisions in this final rule, broker-dealers, and promoters of private funds under Regulation D may create competitive disparities in the personnel that are available to provide testimonials or endorsements. Investment advisers that operate as broker-dealers or advise private funds might have more flexibility to use personnel that might be disqualified from providing testimonials or endorsements under the final rule, but are not disqualified under section 3(a)(39) of the Exchange Act for broker-dealers or Regulation D for advisers of private funds. This flexibility could impose an uneven burden on investment advisers, as those that are also registered as broker-dealers or broker-dealer affiliates, or advise private funds, will potentially able to draw upon a larger pool of personnel to provide testimonials or endorsements.

3. Capital Formation

To the extent that the final rule results in improved matches in the market for investment advice, potential investors may be drawn to invest additional capital, which could promote capital formation, to the extent that the additional capital does not reduce other forms of capital formation. However, the final rule could induce some investment advisers to increase their advertising such that the additional expenses of advertising may offset any gains to the quality of

matches with investors.[970] In this case, any benefits to capital formation as a result of the final rule could be reduced or eliminated.

Similarly, if the costs associated with the disclosure, oversight, and recordkeeping requirements of the final rule result in a reduction of advertisements, the information available to investors might decrease. This could decrease the quality of matches between investors and investment advisers, leading investors to divert capital away from investment to other uses, hindering capital formation.

The final rule's expansion of the types of compensation subject to solicitor regulation for providers of testimonials or endorsements might improve the efficiency of the ultimate choice of investment adviser that investors make. Improving the efficiency of the investment adviser selection process could improve the efficiency of the investing overall for investors, which may lead them to devote more capital towards investment. In addition, the final rule expands the set of disqualifying events that would bar an adviser from compensating an individual to provide a testimonial or endorsement, which may improve an investor's confidence in a testimonial or endorsement's recommendation of an investment adviser, which, in turn, could lead investors to allocate more of their resources towards investment, thus promoting capital formation.

F. Reasonable Alternatives

1. Reduce or Eliminate Specific Limitations on Investment Adviser Advertisements

We could change the degree to which the marketing rule relies on specific limitations on investment adviser marketing. One alternative to the marketing rule would be reducing or eliminating specific limitations on investment adviser advertising, and instead relying on general

970 *See supra* sections III.E.1 and III.E.2.

prohibitions to achieve the programmatic benefits of the rule. For example, such an alternative might include reducing or eliminating the specific limitations on the different types of hypothetical performance or testimonials and endorsements. The specific prohibitions of the final rule are prophylactic in nature, and many of the advertising practices described in the specific prohibitions would also be prohibited under the general prohibition on fraud and deceit in section 206 of the Act, among other provisions.[971]

As a consequence, advisers might bear greater compliance costs in interpreting the rule or may otherwise restrict their advertising activities unnecessarily, and may reduce their advertising as a result. Alternatively, advisers may face lower compliance costs associated with the specific prohibitions. In addition, under such an approach, investors may also not obtain some of the benefits associated with the final rule. For example, in the absence of a specific advertising rule, investors would not necessarily obtain the benefits associated with the comparability of performance presentations provided in the proposed rule, or the requirement to provide performance over a variety of periods (except in private fund advertisements) so that an investor may sufficiently evaluate the adviser's performance. Investors would also not benefit from the specific protections against the potential for misleading hypothetical performance contained in the final rule, such as the requirement to have policies and procedures designed to ensure that such performance is relevant to the likely financial situation and investment objectives of the investor and includes sufficient disclosures to enable persons receiving it to understand how it is calculated and the risks and limitations of relying on it. Although some advisers might provide such information, even in the absence of the final specific requirements to help ensure that their

971 For anti-fraud provisions applicable to the marketing of private funds, *see* Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, rule 10b-5, and rule 206(4)-8 under the Advisers Act.

performance presentations comply with section 206 of the Act or other applicable anti-fraud provisions, others may not. As a consequence, this approach may benefit certain advisers by allowing them to avoid the costs of the specific requirements of the final rule, but investors would not receive the benefit of the other protections of the rule.

One variation of this alternative would be to eliminate the marketing rule and instead rely solely on the general prohibitions against fraud or deceit in section 206 of the Advisers Act and certain rules thereunder. Under such an approach, a rule specifically targeting adviser advertising practices might be unnecessary. In the absence of a marketing rule, however, an adviser might have not sufficient clarity and guidance on whether certain advertising practices would likely be fraudulent and deceptive. As a consequence, advisers may bear costs in obtaining such guidance or may otherwise restrict their advertising activities unnecessarily in the absence of such clarity and guidance that would be provided through a rule, and may reduce their advertising as a result.

Conversely, another alternative to the marketing rule would be to make the rule more prescriptive, prescribing certain specific and standardized disclosures in lieu of the principles-based approach of the final rule. On the one hand, such an approach may provide investors with disclosures that may be more comparable across advisers, and ease the costs associated with interpretation and compliance. However, standardized disclosures could both impose costs on investment advisers by requiring disclosures when they might not provide much investor protection benefit, and also not require disclosures when an investor might benefit from one. The broad framework of the final rule is designed to permit investment advisers to tailor their disclosures to their specific marketing practices, subject to certain specific requirements.

A related alternative to the final rule would be to align the marketing rule more closely with FINRA rule 2210 and related rules. FINRA rule 2210 governs broker-dealers' communications with the public, including communications with retail and institutional investors, and provides standards for the content, approval, recordkeeping, and filing of communications with FINRA.[972] To the extent that such an alternative resembles Rule 2210, this alternative might impose lower compliance cost burdens for dual-registrants who are subject to Rule 2210 and related rules than under the final rule. However, as discussed above, standardized disclosures for investment advisers could be over- or under-inclusive given the variety of investment advisory services and advertising practices associated with investment advisers, and we believe that the final rule's approach of providing advisers' with a broad framework within which to determine how best to present advertisements so they are not false and misleading is consistent with the features of the market for investment advice.[973] Further, because FINRA rule 2210 does not contain similar provisions to all of the requirements of the final rule, this alternative would not have offered the same investor protections of the final rule. For example, FINRA rule 2210 does not contain a similar provision to the final rule's requirement to disclose compensation for a solicitation or referral or for the conflict of interest that results.[974]

2. Bifurcate Some Requirements

One alternative to the final rule would be to separate requirements of the originally proposed rule that currently apply to all advertisements. For example, one alternative approach

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[972] *See supra* section III.C.1.b.

[973] *See supra* footnote 279 and accompanying text for a discussion of comments we received on this point.

[974] See *supra* section II.C.5.c.

to regulation that we considered is prohibiting hypothetical performance in advertisements to retail investors, but not others, provided that certain disclosures were made.

Evidence from academic research suggests that investors are highly segmented in their financial literacy and access to resources.[975] The fact that certain market segments are susceptible to misconduct suggests that the lack of financial literacy or access to resources may also leave them susceptible to false or misleading statements in advertisements or solicitations.

Tailoring requirements to suit the segmented nature of the market for investment advice may yield benefits to investor protection for investors with lower financial literacy or access to resources, as advertisements directed towards these specific market segments vulnerable to misleading statements would face additional requirements. Similarly, advertisements not directed towards those segments would benefit from additional flexibility and information contained in these advertisements. However, bifurcating the requirements in the final rule might also impose additional costs on investment advisers, who may need to expend additional resources to create advertisements that complied with two increasingly different sets of requirements.

3. Hypothetical Performance Alternatives

One alternative to the final rule's treatment of hypothetical performance would be to prohibit all forms of hypothetical performance in all advertisements. The Commission

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975 *See* Financial Literacy Study, *supra* footnote 846. *See also* Mark Egan, Gregor Matvos and Amit Seru, The Market for Financial Adviser Misconduct, 127 J. POL. ECON. 233 (2019). The paper uses the term "financial advisors," to refer to broker-dealer representatives. The authors argue that broker-dealer representatives target different groups of investors and that this segmentation permits firms with high tolerance for misconduct on the part of their associated persons to coexist with firms maintaining clean records in the current market. They find that misconduct is more common among firms that advise retail investors, and in counties with low education, elderly populations and high incomes (when controlling for other characteristics).

considered this alternative because it believes hypothetical performance generally presents a high risk of misleading investors. This alternative would eliminate the possibility that investors are misled by hypothetical performance, but also eliminates the possibility that investors might gain useful information from some types of hypothetical information. This additional information might have been useful for improving the quality of the matches that investors make with investment advisers. While a prohibition on hypothetical performance might improve the efficiency of investment adviser advertising by reducing the chance that investors are misled by advertisements, efficiency can also be reduced if investors are less able to receive relevant information about the investment adviser.

Conversely, another alternative would be to permit all hypothetical performance in all advertisements, without any additional requirements. This could increase the relevant hypothetical performance that reaches investors. While such statements would still be subject to the final rule's general prohibitions, we believe that this approach would still pose a high risk that hypothetical performance would mislead investors. This approach would lack the final rule's protections that are designed to help ensure that hypothetical performance is disseminated to investors who have access to the resources to independently analyze this information and who have the financial expertise to understand the risks and limitations of these types of presentations.

4. Alternatives to the Combined Marketing Rule

In the proposal, we also considered retaining separate advertising and solicitation rules and instead updating and clarifying each rule separately. However, in the proposal the advertising rule was expanded to permit advertisements containing testimonials and endorsements, subject to certain requirements, which had the potential to subject promoters and

solicitors to duplicative requirements from both the advertising and the solicitation rule. These duplicative requirements would have imposed additional costs to promoters and their investment advisers, and potentially decreased the usefulness of the disclosures made to investors.

We also considered the alternative of not applying the final amended merged marketing rule to the solicitation of existing and prospective private fund investors. Under this alternative, the rule would apply only to the adviser's clients (including prospective clients), which, in the case of funds, are the private funds themselves, and would not apply to investors in private funds. However, while investors in private funds may often be financially sophisticated, they may not be aware that the person engaging in the solicitation activity may be compensated by the adviser or aware of the other disclosure items that we are requiring, and we believe investors in such funds should be informed of that fact, those disclosure items and the related conflicts. In addition, we believe that the application of the final merged marketing rule to investors in private funds is consistent with the portions of the rule that concern investment adviser advertising. This consistency could avoid any competitive disparities between investment advisers that advise private funds and those that do not, and reduce the costs that investment advisers bear, by potentially removing costs associated with identifying whether the target of a communication is a private fund investor or not. We believe that harmonizing the scope of the merged rule with the advertising portions of the rule to the extent possible should ease compliance burdens.

5. Alternatives to Disqualification Provisions

We also considered an alternative to current rule 206(4)-3 wherein the disqualification provisions of the rule would not apply if the solicitor has performed solicitation activities for the investment adviser during the preceding twelve months and the investment adviser's compensation payable to the solicitor for those solicitation activities was $1,000 or less (or the

equivalent value in non-cash compensation). We considered the alternative of not having any *de minimis* exemption in the proposal, which would expand the set of individuals for whom the investment adviser would need to assess for disqualification, potentially extending the costs and benefits of the proposed solicitation rule to these solicitation activities, we believe the solicitor's incentives to defraud an investor are significantly reduced when receiving *de minimis* compensation, and that the need for heightened safeguards is likewise reduced.

Conversely, we also considered the alternative of adopting a higher threshold for a *de minimis* exemption. However, we believe that an aggregate $1,000 *de minimis* amount over a trailing year period is consistent with our goal of providing an exception for small or nominal payments. Regarding the trailing period, we understand that a very engaged solicitor who is paid even a small amount per referral could potentially receive a significant amount of compensation from an adviser over time even if the solicitor receives less than $1,000 per year. Over multiple years, such an investment adviser's compensation could accumulate to a more significant amount. In such a case we believe that investors should be informed of the conflict of interest and gain the benefit of the other provisions of the rule.

IV. PAPERWORK REDUCTION ACT ANALYSIS

A. Introduction

Certain provisions of our rule amendments will result in new "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[976] The rule amendments will have an impact on the current collection of information burdens of rule 204-2 under the Investment Advisers Act ("the Act") and Form ADV. The title of the new collection of information we are proposing is "Rule 206(4)-1 under the Investment Advisers Act." The

[976] 44 U.S.C. 3501 et seq.

Office of Management and Budget ("OMB") has not yet assigned a control number for "Rule 206(4)-1 under the Investment Advisers Act." The titles for the existing collections of information that we are amending are: (i) "Rule 206(4)-3 under the Investment Advisers Act of 1940 (17 CFR 275.206(4)-3)" (OMB number 3235-0242); (ii) "Rule 204-2 under the Investment Advisers Act of 1940" (OMB control number 3235-0278); and (iii) "Form ADV" (OMB control number 3235-0049). The Commission is submitting these collections of information to OMB for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

We published notice soliciting comments on the collection of information requirements in the 2019 Proposing Release and submitted the proposed collections of information to OMB for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. Although we received no comments directly on the proposed collections of information burdens, we did receive three comments on aspects of the economic analysis that implicated estimates we used to calculate the collection of information burdens. Two commenters generally stated that advisers would disseminate new advertisements and update existing advertisements much more frequently than estimated in our proposal, due to the proposed expanded definition of advertisement.[977] Two other commenters suggested that our assumptions underestimated the amount of time and costs required to implement the proposed amendments to the advertising and solicitation rules.[978] We address these comments below.

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977 Fidelity Comment Letter; IAA Comment Letter.

978 MFA/AIMA Comment Letter I.

We discuss below the new collection of information burdens associated with the amendments to rule 206(4)-1, as well as the revised existing collection of information burdens associated with the amendments to rule 204-2 and Form ADV. There will no longer be a collection of information burden with respect to rule 206(4)-3 because we are rescinding this rule. Responses provided to the Commission in the context of its examination and oversight program concerning the amendments to rule 206(4)-1 and rule 204-2 will be kept confidential subject to the provisions of applicable law. However, because some of the information collection pursuant to rule 206(4)-1 requires disclosures to investors, these disclosures will not be kept confidential. Responses to the disclosure requirements of the amendments to Form ADV, which are filed with the Commission, are not kept confidential.

B. Rule 206(4)-1

The marketing rule states that, as a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts, practices, or courses of business within the meaning of section 206(4) of the Act, it is unlawful for any investment adviser registered or required to be registered under section 203 of the of the Act, directly or indirectly, to disseminate any advertisement that violates any of paragraphs (a) through (d) of the rule, which include the rule's general prohibitions, as well as conditions applicable to an adviser's use of testimonials, endorsements, third-party ratings, and performance information.[979]

Each requirement under the final rule that an adviser disclose information, offer to provide information, or adopt policies and procedures constitutes a "collection of information" requirement under the PRA. The respondents to these collections of information requirements

[979] Final rule 206(4)-1(b), (c).

will be investment advisers that are registered or required to be registered with the Commission. As of August 1, 2020, there were 13,724 investment advisers registered with the Commission.[980] Investment adviser marketing is not mandatory; however: (i) marketing is an essential part of retaining and attracting clients; (ii) marketing may be conducted easily through the internet and social media; and (iii) the definition of "advertisement" expands the scope of the advertising rule. Accordingly, we estimate that all investment advisers will disseminate at least one communication that meets the rule's definition of "advertisement" and therefore be subject to the requirements of the marketing rule.

While commenters claimed that our assumptions in the proposal significantly underestimated the scope of communications that would constitute an advertisement under the proposed amendment to the advertising rule, we made several modifications versus the proposal that will reduce the amount of communications subject to the rule to address commenters' concerns.[981] For example, the marketing rule will exclude certain one-on-one communications from the first prong of the definition and communications to current clients that do not offer new or additional advisory services. These changes from the proposal will significantly reduce the scope of communications subject to the marketing rule.

Because the use of testimonials, endorsements, third-party ratings, and performance results in advertisements is voluntary, the percentage of investment advisers that would include these items in an advertisement is uncertain. However, we have made certain estimates of this data, as discussed below, solely for the purpose of this PRA analysis.

1. General Prohibitions

980 *See supra* section III.C.1.c.

981 *See* MFA/AIMA Comment Letter I; Fidelity Comment Letter.

The general prohibitions under the rule do not create a collection of information and are, therefore, not discussed, with one exception. The final rule will prohibit advertisements that include a material statement of fact that the adviser does not have a reasonable basis for believing that it will be able to substantiate upon demand by the Commission. As discussed above, advisers would be able to demonstrate this reasonable belief in a number of ways.[982] For example, they could make a record contemporaneous with the advertisement demonstrating the basis for their belief. An adviser might also choose to implement policies and procedures to address how this requirement is met. This will create a collection of information burden within the meaning of the PRA.

As stated above, we estimate that all investment advisers will disseminate at least one communication that meets the rule's definition of "advertisement" and therefore be subject to the requirements of the marketing rule. We also estimate that such advertisements will include at least one statement of material fact that will be subject to this general prohibition, for which an adviser will create and/or maintain a record documenting its reasonable belief that it can substantiate the statement. This estimate reflects that many types of statements typically included in an advertisement (e.g. performance) can likely be substantiated by other records that an adviser will be required to create and maintain under the final rule.[983] Table 1 summarizes the final PRA estimates for the internal and external burdens associated with this requirement.

Table 1: General Prohibitions

	Internal Hour Burden		Wage Rate[1]	Internal Time Costs	Annual External Cost Burden
FINAL ESTIMATES FOR RULE 204-1 FOR GENERAL PROHIBITIONS					
Determine whether statements in an	0.5	×	$309 (compliance manager)	$156	

982 *See supra* section II.B.2.

983 *See supra* section II.B.2.

advertisement are material facts	0.5	×	$365 (compliance attorney)	$183
Creation and maintenance of records substantiating material facts in any advertisements	4	×	$62 (general clerk)	$248
	1	×	$70 (compliance clerk)	$70
Total burden per adviser	6			$657
Total number of affected advisers	× 13,724			× 13,724
Total burden for general prohibitions	**82,344 hours**			**$9,016,668**

Notes:
1. *See* SIFMA Report, *supra* footnotes 1041 & 1045.

2. Testimonials and Endorsements in Advertisements

Under the marketing rule, investment advisers are prohibited from including in any advertisement, or providing any compensation for, any testimonial or endorsement unless the adviser discloses, or the investment adviser reasonably believes that the person giving the testimonial or endorsement discloses: (i) clearly and prominently: (A) that the testimonial was given by a current client or investor, or the endorsement was given by a person other than a current client or investor; (B) that cash or non-cash compensation was provided for the testimonial or endorsement, if applicable; and (C) a brief statement of any material conflicts of interest on the part of the person giving the testimonial or endorsement resulting from the investment adviser's relationship with such person; (ii) the material terms of any compensation arrangement, including a description of the compensation provided or to be provided, directly or indirectly, to the person for the testimonial or endorsement; and (iii) a description of any material conflicts of interest on the part of the person giving the testimonial or endorsement resulting from the investment adviser's relationship with such person and/or any compensation arrangement.[984] The rule also imposes an oversight obligation that requires that an investment

[984] Final rule 206(4)-1(b)(1).

adviser have a reasonable basis to believe that the testimonial or endorsement complies with the marketing rule and have a written agreement with the person giving a testimonial or endorsement (except for certain affiliated persons of the adviser) that describes the scope of the agreed upon activities and the terms of the compensation for those activities when making payments for compensated testimonials and endorsements that are above the *de minimis* threshold.[985] This collection of information consists of two components: (i) the requirement to disclose certain information in connection with the testimonial and endorsement, and (ii) the requirement to oversee the testimonial or endorsement, including a written agreement with certain persons giving the testimonial or endorsement.

The final rule's definitions of testimonials and endorsements generally contain three elements: (i) statements about the client's/non-client's or investor's experience with the investment adviser or its supervised persons, (ii) statements that directly or indirectly solicit any prospective client or investor in a private fund for the investment adviser, or (iii) statements that refer any prospective client or investor in a private fund to the investment adviser. The first element is drawn from the definitions of these terms in our proposed advertising rule. The second and third elements are drawn from the scope of our proposed solicitation rule.[986] Accordingly, our PRA analysis will be drawn from our proposed estimates and discussion of both proposed rules in the 2019 Proposing Release.[987]

In our advertising rule proposal, from which the first element of these definitions is drawn, we estimated that 50 percent of advisers would include a testimonial or endorsement

985 *Id.*

986 *Id.*

987 *See* 2019 Proposing Release, *supra* footnote 7, at section IV.

under the proposed advertising rule. We also estimated in our advertising proposal that an investment adviser that includes testimonials or endorsements in advertisements would use approximately 5 testimonials or endorsements per year, and would create new advertisements with new or updated testimonials and endorsements approximately once per year. In the solicitation rule proposal, from which elements two and three of the definitions are drawn, we estimated that 47.8 percent of advisers would compensate a solicitor for solicitation activity under the proposed solicitation rule.[988] We also estimated in our proposal that for each registered investment adviser that would conduct solicitation activity, they would use approximately 30 referrals annually, distributed by an average of three solicitors. We did not receive comment on any of these estimates.

We are revising our estimates from the advertising rule proposal to account for the merger of solicitation concepts into the definitions of testimonial and endorsement. We continue to estimate that 50 percent of advisers will use a testimonial or endorsement; however, we are increasing our estimate of the amount of testimonials and estimates each adviser will use to reflect the definitions' inclusion of solicitation concepts.[989] Accordingly, we estimate that each adviser will use an average of five promoters and use 35 testimonials or endorsements annually, which includes testimonials and endorsements incorporated into an adviser's own advertisement and those communicated by promoters directly. This estimate also reflects the elimination of the proposed exemptions for solicitations for impersonal advisory services or by non-profit referral programs, as well as the addition of the final rule's exemptions for registered broker-dealers and "covered persons" under rule 506(d) of Regulation D.

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[988] *See* 2019 Proposing Release, *supra* footnote 7, at section IV.

Under the marketing rule, an adviser that uses a testimonial or endorsement will be required to disclose certain information at the time it is disseminated, which incorporates many of the disclosure elements required under the proposed solicitation rule. As such, we are drawing from the burden estimate we attributed to solicitation disclosures in the 2019 Proposing Release in developing the burden estimate for *all* testimonials and endorsements under the final rule, not just for the types of testimonials and endorsements that were drawn from the proposed rule. To address one commenter's contention that we underestimated this burden, and recognizing the changes from the proposal, we are revising this estimate upwards to 0.20 hours per disclosure.[990] We believe that advisers will incur this same burden each year, since each testimonial and/or endorsement used will likely be different and thus require updated disclosures. An investment adviser's in-house compliance managers and compliance attorneys will likely prepare disclosures, which will likely be included in the advertisement.[991]

Some of these third-party testimonials and endorsements will require delivery; thus, we estimate that 20 percent of the disclosures would be delivered by the U.S. Postal Service, with the remaining 80 percent delivered electronically or as part of another delivery of documents. For the 20% of advisers that will use physical mail, we estimate that the average annual costs associated with printing and mailing this information will be collectively $500 for all disclosure documents associated with a single registered investment adviser.[992]

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990 MFA/AIMA Comment Letter I.

991 We estimate the hourly wage rate for compliance manager is $309 and a compliance attorney is $337. The hourly wages used are from SIFMA's Management & Professional Earnings in the Securities Industry 2013 ("SIFMA Report"), modified by Commission staff to account for an 1800-hour work-year and inflation, and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

992 We do not have specific data regarding how the cost of printing and mailing the underlying information would differ, nor are we able to specifically identify how the cost of printing and mailing the underlying information might be affected by the rule. For these reasons, we estimate $500 per year to collectively print and mail, upon request, the underlying information associated with hypothetical performance for

We estimate the average burden hours each year per adviser to oversee testimonials and endorsements will be one hour for each promoter, or five hours in total for each adviser that is subject to this collection of information.[993] While the final rule provides flexibility as to how advisers conduct this oversight, we generally believe that this burden will include contacting solicited clients, pre-reviewing testimonials or endorsements, or other similar methods. Additionally, we estimate that each adviser will incur an average burden hour of one hour for each promoter, or five hours in total, to prepare the required written agreements. In-house compliance managers and compliance attorneys are likely to provide oversight of the third party testimonials and endorsements and prepare the written agreements.

Finally, in response to one commenter who argued that we did not account for upfront implementation costs for using testimonials and endorsements, we estimate that each adviser that uses a compensated testimonial or endorsement will incur an initial burden of two hours to modify its policies and procedures to reflect the adviser's oversight of testimonials and endorsements.[994] We believe that an adviser's chief compliance officer will complete this task.[995] Table 2 summarizes the final PRA estimates for the internal and external burdens associated with these requirements.

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purposes of our analysis. In addition, investors may also request to receive the underlying information electronically. We estimate that there would be negligible external costs associated with emailing electronic copies of the underlying information.

993 This estimate is based on the following calculation: 1 hour per each solicitor relationship x 5 promoter relationships. Although in our proposal we estimated that the oversight requirement would impose a burden of 2 hours per adviser, we believe that because the marketing rule does not require a written agreement, the burden to oversee the promoter relationship will be less than proposed.

994 MFA/AIMA Comment Letter I. Accordingly, the amortized average burden will be 0.67 hours for each of the first 3 years.

995 We estimate that the hourly wage for a chief compliance officer is $530. The hourly wage is from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800-hour work-year and inflation, and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

Table 2: Testimonials and Endorsements

	Internal Hour Burden		Wage Rate[1]	Internal Time Costs	Annual External Cost Burden
FINAL ESTIMATES FOR TESTIMONIALS AND ENDORSEMENTS					
Modify policies and procedures[2]	0.67 hours	×	$530 (chief compliance officer)	$355.10	
Revise and update each required disclosure	0.1 hours × 35 disclosures	×	$309 (compliance manager)	$1,081.50	--
	0.1 hours × 35 disclosures	×	$365 (compliance attorney)	$1,277.50	
Oversight of compensated testimonials and endorsements and preparation of written agreements	1 hours × 5 promoters	×	$309 (compliance manager)	$1,545	
	1 hours × 5 promoters	×	$365 (compliance attorney)	$1,825	
Total burden per adviser	17.67 hours			$6,084.1	$500
Total number of affected advisers	× 6,862			× 6,862	× 6,862 (× 20% of advisers that will use physical mail)
Total burden for testimonials and endorsements	**121,252 hours**			**$1,749,094**	**$686,200**

Notes:
1. See SIFMA Report, *supra* footnotes 1041 & 1045.
2. Amortized over a three year period.

3. Third-Party Ratings in Advertisements

As discussed above, rule 206(4)-1(c) will prohibit an investment adviser from including a third-party rating in an advertisement unless certain conditions are met, including that the adviser must clearly and prominently disclose (or reasonably believe that the third-party rating clearly and prominently discloses): (i) the date on which the rating was given and the period of time upon which the rating was based, (ii) the identity of the third-party that created and tabulated the rating, and (iii) if applicable, that cash or non-cash compensation has been provided directly or indirectly by the adviser in connection with obtaining or using the third-party rating.

As discussed in the advertising rule proposal, we continue to believe that approximately 50 percent of advisers will use third-party ratings in advertisements, and that they will typically use one third-party rating on an annual basis. We believe that advisers will incur an initial

internal burden of 3.0 hours to draft and finalize the required disclosures for third-party ratings, which we are adjusting upwards from 1.5 hours in the advertising rule proposal to address one commenter's concern that we underestimated this burden.[996] As discussed in the advertising rule proposal, because many of these ratings or rankings are done yearly *(e.g.,* 2018 Top Wealth Adviser), we continue to estimate that an adviser that continues to use a third-party rating will incur ongoing, annual costs of 0.75 burden hours to draft the third-party rating disclosure updates.[997] Table 3 summarizes the final PRA estimates for the internal and external burdens associated with these requirements.

Table 3: Third-Party Ratings

	Internal Hour Burden[1]		Wage Rate[2]	Internal Time Costs	Annual External Cost Burden
FINAL ESTIMATES FOR THIRD PARTY RATINGS					
Draft initial disclosures[1]	0.5 hours		$309 (compliance manager)	$154.50	
	0.5 hours		$365 (compliance attorney)	$182.50	
Update required disclosures	0.375 hours	×	$309 (compliance manager)	$115.88	
	0.375 hours	×	$365 (compliance attorney)	$136.88	
Total burden per adviser	1.75 hours			$589.76	
Total number of affected advisers	× 6,862			× 6,862	
Total burden for third-party ratings	**12,009 hours**			**$4,046,933**	

Notes:
1. Amortized over a three-year period.
2. See SIFMA Report, *supra* footnotes 1041 & 1045.

996 *See* MFA/AIMA Comment Letter I. Accordingly, we estimate that the amortized average burden will be 1 hour for each of the first 3 years for each investment adviser to comply with the conditions for including third-party ratings in an advertisement (3.0 hours / 3 years = 1 hour). We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager.

997 We believe that this burden will also be split evenly between an adviser's compliance attorney and compliance manager.

4. Performance Advertising

The marketing rule will impose certain conditions on the presentation of performance results in advertisements, as discussed above. Below we discuss the conditions that create "collection of information" requirements within the meaning of the PRA. First, the rule will prohibit any presentation of gross performance unless the advertisement also presents net performance that meets certain criteria.[998] Second, the rule will prohibit any presentation of performance results of any portfolio or any composite aggregation of related portfolios, other than any private fund, unless the advertisement includes performance results of the same portfolio or composite aggregation for one-, five-, and ten-year periods, except that if the relevant portfolio did not exist for a particular prescribed period, then the life of the portfolio must be substituted for that period.[999] Third, the rule will prohibit an advertisement from including related performance, unless it includes all related portfolios, subject to a conditional exception.[1000] Fourth, the rule will prohibit an advertisement from including extracted performance, unless the advertisement provides, or offers to provide promptly, the performance results of the total portfolio from which the performance was extracted.[1001] Fifth, the rule will also prohibit an advertisement from including predecessor performance, unless certain conditions are satisfied.[1002] Finally, the rule will require that an adviser that advertises hypothetical performance: (i) adopts and implements policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the likely financial situation and investment

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998 Final rule 206(4)-1(d).

999 *Id.* at (d)(2).

1000 *Id.* at (d)(4).

1001 *Id.* at (d)(5).

1002 *Id.* at (d)(7).

objectives of the intended audience of the advertisement; (ii) provide reasonably sufficient information to enable the intended audience to understand the criteria used and assumptions made in calculating such hypothetical performance; and (iii) provide (or, if the intended audience is an investor in a private fund provide, or offers to provide promptly) reasonably sufficient information to enable the intended audience to understand the risks and limitations of using such hypothetical performance in making investment decisions

We estimate that almost all advisers provide, or seek to provide, performance information to their clients. Based on staff experience, we estimate that 95 percent, or 13,038 advisers, provide performance information in their advertisements. The estimated numbers of burden hours and costs regarding performance results in advertisements may vary depending on, among other things, the complexity of the calculations, the type of performance and the risks that investors may not understand the limitations of the information, and whether preparation of the disclosures is performed by internal staff or outside counsel.

a. *Presentation of Net Performance in Advertisements*

We estimate that an investment adviser that elects to present gross performance in an advertisement will incur an initial burden of 15 hours in preparing net performance for each portfolio, including the time spent determining and deducting the relevant fees and expenses to apply in calculating the net performance and then actually running the calculations.[1003] We have adjusted this estimate upwards from the proposal to reflect one commenter's claim that we

[1003] Accordingly, we estimate that the amortized initial burden will be 5 hours for each of the first 3 years for each investment adviser to prepare net performance (15 hours / 3 years = 5 hours / year). We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager (2.5 hours each).

underestimated this burden in the proposal.[1004] Based on staff experience, we estimate that the average investment adviser will present performance for 3 portfolios over the course of a year, excluding any related portfolios that an adviser may need to include for purposes of presenting related performance.[1005] As noted above, we estimate that 95 percent, or 13,038 advisers, provide performance information in their advertisements and thus will be subject to this collection of information burden.

We expect that the calculation of net performance may be modified every time an adviser chooses to update the advertised performance. We estimate that after initially preparing net performance for each portfolio, investment advisers will incur a burden of 3 hours to update the net performance for each subsequent presentation. Again, we adjusted this estimate upwards from the proposal to reflect one commenter's claim that we underestimated this burden in the analysis.[1006] For purposes of this analysis, we estimate that advisers will update the relevant performance of each portfolio 3.5 times each year.[1007]

b. *Time Period Requirement in Advertisements*

We estimate that an investment adviser that elects to present performance results in an advertisement will incur an initial burden of 35 hours in preparing performance results of the same portfolio for one-, five-, and ten-year periods (excluding private funds), taking into account that these results must be prepared on a net basis (and may also be prepared and presented on a

1004 *See* MFA/AIMA Comment Letter I.

1005 The burden associated with calculating net performance in connection with presenting related performance is discussed in section IV.B.3.c. below.

1006 *See* MFA/AIMA Comment Letter I.

1007 We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager (3 hours x 3.5 times per year = 10.5 hours; 10.5 hours / 2 = 5.25 hours each).

gross basis).[1008] We estimate that after initially preparing one-, five-, and ten-year performance for each portfolio, investment advisers will incur a burden of 8 hours to update the performance for these time periods for each subsequent presentation. For purposes of this analysis, we estimate that advisers will update the relevant performance 3.5 times each year.[1009] We received no comments on these estimates and continue to believe they are appropriate.

c. *Related Performance*

We estimate that an investment adviser that elects to present related performance in an advertisement will incur an initial burden of 30 hours, with respect to each advertised portfolio or composite aggregation of portfolios, in preparing the relevant performance of all related portfolios.[1010] We have revised this estimate upwards to address one commenter's claim that we underestimated this time burden in the proposal.[1011] This time burden will include the adviser's time spent classifying which portfolios meet the rule's definition of "related portfolio" – *i.e.*, which portfolios have "substantially similar investment policies, objectives, and strategies as those of the services offered in the advertisement."[1012] This burden also will include time spent determining whether to exclude any related portfolios in accordance with the rule's provision

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1008 Accordingly, we estimate that the amortized initial burden will be 11.67 hours for each of the first 3 years for each investment adviser to prepare performance results that comply with this requirement (35 hours / 3 years = 11.67 hours / year). We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager (5.83 hours each).

1009 We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager (8 hours x 3.5 times per year = 28 hours; 28 hours / 2 = 14 hours each).

1010 Accordingly, we estimate that the amortized initial burden will be 10 hours for each of the first 3 years for each investment adviser to prepare related performance in connection with this requirement (30 hours / 3 years = 10 hours / year). We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager (5 hours each).

1011 *See* MFA/AIMA Comment Letter I.

1012 *See* final rule 206(4)-1(e)(16). Our estimate accounts for advisers that may already be familiar with any composites that meet the definition of "related portfolio."

allowing exclusion of one or more related portfolios if "the advertised performance results are not materially higher than if all related portfolios had been included" and "the exclusion of any related portfolio does not alter the presentation of the time periods prescribed by paragraph (d)(2)."[1013] Finally, this time burden will include the adviser's time calculating and presenting the net performance of any related performance presented.

We continue to estimate that 80 percent of advisers (or 10,979 advisers) will have other portfolios with substantially similar investment policies, objectives, and strategies as those offered in the advertisement and choose to include related performance. We estimate that after initially preparing related performance for each portfolio or composite aggregation of portfolios, investment advisers will incur a burden of 5 hours to update the performance for each subsequent presentation. Although we expect that advisers might update their performance fewer times per year than we had proposed because the final rule permits performance to be shown as of the most recent calendar year end, we continue to estimate that advisers will update the relevant related performance 3.5 times each year.[1014] We received no comments on these estimates and continue to believe they are appropriate.

d. *Extracted Performance*

As in the advertising rule proposal, we estimate that an investment adviser that elects to present extracted performance in an advertisement will incur an initial burden of 10 hours in preparing the performance results of the total portfolio from which the performance is extracted

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1013 *See* final rule 206(4)-1(d)(4).

1014 We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager (5 hours x 3.5 times per year = 17.5 hours; 17.5 hours / 2 = 8.75 hours each).

in order to provide or offer to provide such performance results to investors.[1015] For purposes of this analysis, we continue to assume 5 percent of advisers will include extracted performance. We estimate that after initially preparing the performance of the total portfolio from which extracted performance is extracted, investment advisers will incur a burden of 2 hours to update the performance for each subsequent presentation. For purposes of this analysis, we estimate that advisers will update the relevant total portfolio performance 3.5 times each year.[1016] We also estimate that registered investment advisers may incur external costs in connection with the requirement to provide performance results of a total portfolio from which extracted hypothetical performance is extracted. We estimate that the average annual costs associated with printing and mailing this information upon request will be collectively $500 for all documents associated with a single registered investment adviser. We received no comments on these estimates and continue to believe they are appropriate.

e. *Hypothetical Performance*

We estimate that an investment adviser that elects to present hypothetical performance in an advertisement will incur an initial burden of 7 hours in preparing and adopting 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

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1015 Accordingly, we estimate that the amortized initial burden will be 3.33 hours for each of the first 3 years for each investment adviser to prepare the performance of the total portfolio from which the presentation of extracted performance is extracted (10 hours / 3 years = 3.33 hours / year). We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager (1.67 hours each).

1016 We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager (2 hours x 3.5 times per year = 7 hours; 7 hours / 2 = 3.5 hours each).

advertisement.[1017] We have revised this estimate upwards from the advertising rule proposal to address one commenter's claim that we underestimated this time burden.[1018] For purposes of this analysis, we continue to estimate that 50 percent of advisers will include hypothetical performance in advertisements.

We continue to estimate that advisers that use hypothetical performance will disseminate advertisements containing hypothetical performance 20 times each year, including in certain one-on-one communications that meet the final rule's definition of advertisement. We estimate that after adopting appropriate policies and procedures, an adviser will incur a burden of 0.25 hours to categorize investors according to their likely financial situation and investment objectives pursuant to the adviser's policies and procedures.[1019]

Additionally, we estimate that an investment adviser that elects to present hypothetical performance in an advertisement will incur an initial burden of 20 hours in preparing the information sufficient to understand the criteria used and assumptions made in calculating, as well as risks and limitations in using, the hypothetical performance, in order to provide such information, which may in certain circumstances be upon request.[1020] We have also revised this estimate upwards from the proposal to address one commenter's claim that we underestimated

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1017 Accordingly, we estimate that the amortized initial burden will be 2.33 hours for each of the first 3 years for each investment adviser to comply with this requirement (7 hours / 3 years = 2.33 hours / year). We believe that an adviser's chief compliance officer will complete this task.

1018 *See* MFA/AIMA Comment Letter I.

1019 We believe that an adviser's chief compliance officer will complete this task (20 presentations per year x 0.25 hours each = 5 hours per year).

1020 Accordingly, we estimate that the amortized initial burden will be 6.67 hours for each of the first 3 years for each investment adviser to comply with this requirement (20 hours / 3 years = 6.67 hours / year). We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager (3.33 hours each). This estimate includes the time spent by an adviser in preparing the information. The time spent calculating the hypothetical performance that is based on such information is not accounted for in this estimate, as the rule does not require that an advertisement present hypothetical performance.

this time burden.[1021] We estimate that after initially preparing the underlying information, investment advisers will incur a burden of 3 hours to update the information for each subsequent presentation. For purposes of this analysis, we estimate that advisers will update their hypothetical performance, and thus the underlying information, 3.5 times each year.[1022]

We estimate that registered investment advisers may incur external costs in connection with the requirement to provide this underlying information upon the request of an investor or prospective investor in a private fund. We estimate that the average annual costs associated with printing and mailing this underlying information upon request will be collectively $500 for all documents associated with a single registered investment adviser.[1023]

f. *Predecessor Performance*

The final rule will impose conditions on an adviser's use of predecessor performance. We estimate that an investment adviser that elects to present predecessor performance in an advertisement will incur an initial burden of 10 hours in preparing the relevant performance results and associated disclosures.[1024] This time burden will include the adviser's time spent classifying which performance results are eligible to be ported – i.e., to determine whether accounts at a predecessor adviser are "sufficiently similar" and the persons are "primarily responsible" for the performance, or that the relevant algorithm was responsible for achieving the

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1021 *See* MFA/AIMA Comment Letter I.

1022 We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager (3 hours x 3.5 times per year = 10.5 hours; 10.5 hours / 2 = 5.25 hours each).

1023 *See supra* footnote 992 for a discussion of estimated mailing costs.

1024 Accordingly, we estimate that the amortized initial burden will be 3.33 hours for each of the first 3 years for each investment adviser to prepare predecessor performance in connection with this requirement (10 hours / 3 years = 3.33 hours / year). We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager (1.67 hours each).

prior performance results.[1025] This burden also will include time spent determining whether to exclude any account in accordance with the rule's provision allowing exclusion of one or more accounts if the advertised performance results "would not result in materially higher performance." Finally, this time burden will include the adviser's time calculating and presenting the net performance and appropriate time periods of any predecessor performance presented.

We estimate that 2% of advisers (or 275 advisers) will include predecessor performance in an advertisement. We estimate that after initially preparing predecessor performance, investment advisers will incur a burden of 1 hour to update the relevant disclosures and performance information for each subsequent presentation. For purposes of this analysis, we estimate that advisers will update the relevant disclosures 3.5 times each year.[1026] Table 4 summarizes the final PRA estimates for the internal and external burdens associated with these requirements.

Table 4: Performance

	Internal Hour Burden		Wage Rate[2]	Internal Time Costs	Annual External Cost Burden
FINAL ESTIMATES FOR NET PERFORMANCE					
Initial performance calculations[1]	2.5	×	$309 (compliance manager)	$772.5	
	2.5	×	$365 (compliance attorney)	$912.5	
Updating performance	5.25	×	$309 (compliance manager)	$1,622.25	
	5.25	×	$365 (compliance attorney)	$1,916.25	
Total burden per adviser	15.5			$5,223.50	
Total number of affected advisers	× 13,038			× 13,038	
Sub-total burden	**202,089 hours**			**$68,103,993**	

1025 Final rule 206(4)-1(d)(7)(i)-(ii).

1026 We believe that this burden will be split evenly between an adviser's compliance attorney and compliance manager (1 hour x 3.5 times per year = 3.5 hours; 3.5 hours / 2 = 1.75 hours each).

FINAL ESTIMATES FOR PERFORMANCE TIME PERIOD REQUIREMENT					
Initial performance calculations[1]	5.83	×	$309 (compliance manager)	$1,801.47	
	5.83	×	$365 (compliance attorney)	$2,127.95	
Updating performance	14	×	$309 (compliance manager)	$4,326	
	14	×	$365 (compliance attorney)	$5,110	
Total burden per adviser	39.7			$13,365.42	
Total number of affected advisers	× 13,038			× 13,038	
Sub-total burden	**517,608.6 hours**			**$174,258,346**	
FINAL ESTIMATES FOR RELATED PERFORMANCE					
Preparing initial performance for all related portfolios[1]	5	×	$309 (compliance manager)	$1,545	
	5	×	$365 (compliance attorney)	$1,825	
Updating performance for all related portfolios	8.75	×	$309 (compliance manager)	$2,703.75	
	8.75	×	$365 (compliance attorney)	$3,139.75	
Total burden per adviser	27.5			$9,267.50	
Total number of affected advisers	× 10,979			× 10,979	
Sub-total burden	**301,922.5 hours**			**$101,747,882.50**	
FINAL ESTIMATES FOR EXTRACTED PERFORMANCE					
Initial performance calculations[1]	1.67	×	$309 (compliance manager)	$516.03	
	1.67	×	$365 (compliance attorney)	$609.55	
Updating performance	3.5	×	$309 (compliance manager)	$1,081.50	
	3.5	×	$365 (compliance attorney)	$1,277.50	
Total burden per adviser	10.3			$3,484.58	$500
Total number of affected advisers	× 686			× 686	× 686
Sub-total burden	**7,065.8 hours**			**$2,390,421.90**	$343,000
FINAL ESTIMATES FOR HYPOTHETICAL PERFORMANCE					
Initially adopting and implementing policies and procedures[1]	2.33	×	$530 (chief compliance officer)	$1,234.90	
Updating policies and procedures	5	×	$530 (chief compliance officer)	$2,650	
Initially preparing disclosures and underlying information[1]	3.33	×	$309 (compliance manager)	$1,028.97	
	3.33	×	$365 (compliance attorney)	$1,215.45	
Updating disclosures and underlying information	5.25	×	$309 (compliance manager)	$1,622.25	
	5.25	×	$365 (compliance attorney)	$1,916.25	

Total burden per adviser	24.5			$9,667.82	$500
Total number of affected advisers	× 6,862			× 6,862	X 6,862
Sub-total burden	**168,119 hours**			**$66,340,581**	$3,431,000
FINAL ESTIMATES FOR PREDECESSOR PERFORMANCE					
Initially determining performance that is eligible to be ported, draft disclosures, and calculate performance[1]	1.67	×	$309 (compliance manager)	$516.03	
	1.67	×	$365 (compliance attorney)	$609.55	
Updating disclosures and performance	1.75	×	$309 (compliance manager)	$540.75	
	1.75	×	$365 (compliance attorney)	$638.75	
Total burden per adviser	6.84			$2,305.08	
Total number of affected advisers	× 275			× 275	
Sub-total burden	**1,881 hours**			**$633,897**	
TOTAL ESTIMATED TIME BURDEN FOR PERFORMANCE REQUIREMENTS					
	1,198,686 hours			**$413,475,121**	**$3,774,000**

Notes:
1. Amortized over a three-year period.
2. *See* SIFMA Report, *supra* footnotes 1041 & 1045.

5. Total Hour Burden Associated with Rule 206(4)-1

Accordingly, we estimate the total annual hour burden for investment advisers registered or required to be registered with the Commission under proposed rule 206(4)-1 to prepare testimonials and endorsements, third-party ratings, and performance results disclosures will be 1,414,291 hours, at a time cost of $468,287,816. The total external burden costs would be $4,460,200. The following chart summarizes the various components of the total annual burden for investment advisers.

	Internal hour burden	**Internal burden time cost**	**External cost burden**
General Prohibitions	**82,344 hours**	**$9,016,668**	
Testimonials and Endorsements	**121,252** hours	$**41,749,094**	$**686,200**
Third-Party Ratings	**12,009** hours	$**4,046,933**	-
Performance	1,198,686 hours	$413,475,121	$3,774,000
Total annual burden	**1,414,291 hours**	**$468,287,121**	**$4,460,200**

C. Rule 206(4)-3

Rule 206(4)-3 (OMB number 3235-0242) currently prohibits investment advisers from paying cash fees to solicitors for client referrals unless certain conditions are met. As discussed above, we are rescinding rule 206(4)-3 and merging some of its components into the combined marketing rule. The collection of information burden associated with the requirements of rule 206(4)-3 has been incorporated into the collection of information burden for rule 206(4)-1. There will no longer be a collection of information burden associated with rule 206(4)-3.

D. Rule 204-2

Under section 204 of the Advisers Act, investment advisers registered or required to register with the Commission under section 203 of the Advisers Act must make and keep for prescribed periods such records (as defined in section 3(a)(37) of the Exchange Act), furnish copies thereof, and make and disseminate such reports as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. Rule 204-2 sets forth the requirements for maintaining and preserving specified books and records. This collection of information is found at 17 CFR 275.204-2 and is mandatory. The Commission staff uses the collection of information in its examination and oversight program. As noted above, responses provided to the Commission in the context of its examination and oversight program concerning the amendments to rule 204-2 will be kept confidential subject to the provisions of applicable law.

We are amending rule 204-2 to require investment advisers to retain copies of all advertisements.[1027] The current rule requires investment advisers to retain copies of

[1027] *See* final rule 204-2(a)(11); *see also supra* section II.I (discussing the amendments to the books and records rule).

advertisements to 10 or more persons.[1028] For oral advertisements, amended rule 204-2 provides that an adviser may instead retain a copy of any written or recorded materials used by the adviser in connection with the oral advertisement.[1029] For compensated oral testimonials and endorsements, the adviser may instead make and keep a record of the disclosures provided to clients or investors required by the final rule.[1030] We are also amending the rule to require investment advisers to retain: (i) documentation of communications relating to predecessor performance; (ii) copies of all information provided or offered pursuant to the marketing rule's conditions on advertising hypothetical performance; and (iii) records of who the "intended audience" relating to the conditions of hypothetical performance. The amendments will not require an adviser to maintain copies of written approvals of advertisements, since we are not adopting the proposed requirement that an adviser review and approve advertisements before dissemination.

Amended rule 204-2 will require registered investment advisers to maintain a copy of any questionnaire or survey used in preparation of the third-party rating. Advisers must also make and retain: (i) a record of the disclosures provided to clients or investors pursuant to the marketing rule, if not included in the advertisement, (ii) documentation related to the adviser's determination that it has a reasonable basis for believing that a testimonial, endorsement, or third-party rating complies with the applicable conditions of the marketing rule, and (iii) a record of all affiliated personnel of the adviser.[1031] Each of these records will be required to be maintained in the same manner, and for the same period of time, as other books and records

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1028 Rule 204-2(a)(11).

1029 *See* final rule 204-2(a)(11)(i)(A)(*1*).

1030 *See id.*

1031 *See* final rule 204-2(a)(15)(i)–(ii).

required to be maintained under rule 204-2(a). Specifically, investment advisers will be required to maintain and preserve these records in an easily accessible place for not less than 5 years from the end of the fiscal year during which the last entry was made on such record, the first 2 years in an appropriate office of the investment adviser. Requiring maintenance of these records will facilitate the Commission's ability to inspect and enforce compliance with the marketing rule.[1032] The information generally is kept confidential subject to the applicable law.[1033]

The respondents to this collection of information are investment advisers registered or required to be registered with the Commission. The use of advertisements is not mandatory, but as discussed above, we estimate that 100 percent of investment advisers will disseminate at least one communication meeting the rule's definition of "advertisement" (including oral advertisements) and therefore be subject to the requirements of the rule. The Commission therefore estimates that, based on Form ADV filings as of August 1, 2020, approximately 13,724 investment advisers will be subject to the proposed amendments to rule 204-2 under the Advisers Act.

Based on staff experience, we estimate that 95 percent of advisers (or 13,038 advisers) provide, or seek to provide, performance information to their clients.[1034] The amendments to the recordkeeping rule will require advisers to maintain communications to clients or investors that contain performance calculations of portfolios, in addition to those that reference performance of managed accounts and securities recommendations as currently required. We believe based on staff experience that advisers already have recordkeeping processes in place to maintain client communications; however, this amendment will expand the types of communications subject to

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1032 *Id.*

1033 *See* section 210(b) of the Advisers Act (15 U.S.C. 80b-10(b)).

1034 *See* 2016 Form ADV Amendments Release, *supra* footnote 249 at 149.

the recordkeeping rule and thus increase this collection of information burden.

The amendments will require advisers to maintain copies of any documents provided or offered to clients or investors explaining the assumptions and criteria underlying the hypothetical performance calculation and the risks and limitations in using hypothetical performance. In addition, the amendments will require advisers to create and maintain a record of who the "intended audience" is in connection with its advertisements that include hypothetical performance. We estimate that approximately 50 percent of advisers (or 6,862 advisers) will use hypothetical performance in an advertisement and therefore be subject to the expanded recordkeeping obligations relating to the retention of documents that support those performance calculations. The recordkeeping rule will also require advisers that present predecessor performance to maintain sufficient records to support the performance results provided. As discussed above, we estimate that 2% of advisers (or 275 advisers) will present predecessor performance thus be subject to this collection of information burden.

The rule will require advisers that use a testimonial or endorsement to create and maintain a record of the names of all affiliated personnel of the adviser and documentation substantiating the adviser's reasonable basis for believing that the testimonial or endorsement complies with the specific conditions of the marketing rule. As discussed above, we estimate that 50 percent of advisers (or 6,862 advisers) will use a testimonial or endorsement.

In addition, we estimate that approximately 50 percent of advisers (or 6,862 advisers) will use third-party ratings in advertisements, and will therefore also be subject to the recordkeeping amendments corresponding to the rule's conditions relating to the use of third-party ratings. These amendments require that an adviser: (i) retain a copy of any questionnaire or survey used in the preparation of a third-party rating included or appearing in any

advertisement, and (ii) make and retain documentation substantiating the investment adviser's reasonable basis for believing that the third-party rating complies with the specific conditions of the marketing rule.[1035] In a change from the proposal, the marketing rule does not require advisers to obtain the questionnaire or survey to satisfy the specific conditions for third-party ratings; instead, advisers can comply with the conditions for third-party ratings by other means (which will not trigger a recordkeeping obligation). Accordingly, we estimate that approximately 50 percent of the investment advisers that will use a third-party rating, or 3,431 advisers, will comply with the third-party ratings conditions of the rule by obtaining the underlying questionnaire or survey.

For the recordkeeping amendments relating to testimonials and endorsements, we estimate that the amendments will result in a collection of information burden estimate of 5 hours for each of the estimated 6,862 advisers that will use a testimonial or endorsement. We are revising this estimate upwards versus the proposal to reflect the additional recordkeeping obligations we are adopting, such as the requirement to create documentation of the adviser's reasonable belief that the testimonial or endorsement complies with the specific conditions of the marketing rule.

We also estimate the amendments will result in a collection of information burden of 3 hours for the 50 percent of advisers (or 6,862 advisers) that we estimate will use third-party ratings. Again, we have revised this estimate upwards from the proposal to reflect the additional obligations imposed by the amended recordkeeping rule, such as the requirement to create documentation of the adviser's reasonable belief that the third-party rating complies with the specific conditions of the marketing rule. Table 5 summarizes the final PRA estimates for the

[1035] *See supra* section III.B.2.

internal and external burdens associated with these requirements.

Table 5: Rule 204-2

	Internal Hour Burden		Wage Rate[1]	Internal Time Costs	Annual External Cost Burden
FINAL ESTIMATES FOR RULE 204-2 FOR ADVERTISING RETENTION AND PERFORMANCE					
Retention of advertisements	8	×	$62 (general clerk)	$496	
	2	×	$70 (compliance clerk)	$140	
Total burden per adviser	10			$636	
Total number of affected advisers	× 13,724			× 13,724	
Sub-total burden	**137,240 hours**			**$8,728,464**	
Retention of communications containing performance results	**2**	×	$62 (general clerk)	$124	
	1	×	$70 (compliance clerk)	$70	
Total burden per adviser	3			$194	
Total number of affected advisers	× 13,038			× 13,038	
Sub-total burden	**39,114 hours**			**$2,529,372**	
Retention of documentation relating to hypothetical performance and record of intended audience	**2**	×	$62 (general clerk)	$124	
	1	×	$70 (compliance clerk)	$70	
Total burden per adviser	3			$194	
Total number of affected advisers	× 6,862			× 6,862	
Sub-total burden	**20,586 hours**			**$1,331,228**	
Retention of documentation relating to predecessor performance	**2**	×	$62 (general clerk)	$124	
	1	×	$70 (compliance clerk)	$70	
Total burden per adviser	3			$194	
Total number of affected advisers	× 275			× 275	
Sub-total burden	**825 hours**			**$53,350**	
FINAL ESTIMATES FOR RULE 204-2 FOR TESTIMONIALS AND ENDORSEMENTS					
Creation and retention of records documenting adviser's reasonable belief, disclosures not included in an advertisement, and list of affiliates	4	×	$62 (general clerk)	$248	
	1	×	$70 (compliance clerk)	$70	
Total burden per adviser	5			$318	
Total number of affected advisers	× 6,862			× 6,862	

Sub-total burden	**34,310 hours**			**$2,182,216**
FINAL ESTIMATES FOR RULE 204-2 FOR THIRD-PARTY RATINGS				
Creation and retention of records documenting adviser's reasonable belief and list of affiliates	2	×	$62 (general clerk)	$124
	1	×	$70 (compliance clerk)	$140
Total burden per adviser	3			$264
Total number of affected advisers	× 6,862			× 6,862
Sub-total burden	**20,586 hours**			**$1,811,568**
TOTAL ESTIMATED FINAL BURDEN FOR RULE 204-2				
Total burden	**252,661 hours**			**$16,636,198**

Notes:
1. *See* SIFMA Report, *supra* footnotes 1041 & 1045.

As noted above, the approved annual aggregate burden for rule 204-2 is currently 2,435,364 hours, based on an estimate of 13,299 registered advisers, or 183 hours per registered adviser, with a total monetized costs of $154,304,664.[1036] We therefore estimate that the amendments to the recordkeeping rule will result in an aggregate increase in the collection of information burden estimate by 18.44 hours for each of the estimated 13,724 registered advisers, resulting in a total of 201.44 hours per adviser.[1037] This would yield an annual estimated aggregate burden of 2,764,563 hours under amended rule 204-2 for all registered advisers,[1038] for a monetized cost of $175,980,426.[1039] This represents in an increase of 329,199[1040] annual aggregate hours in the hour burden and an annual increase of $21,675,762 from the currently approved total aggregate monetized cost for rule 204-2.[1041] These increases are attributable to a

1036 2,435,364 hours / 13,299 registered advisers = 183 hours per adviser.

1037 10 hours (advertising retention) + 3 hours (performance retention) x 95% + 3 hours (hypothetical performance) x 50% + 3 hours (predecessor performance) x 2% + 5 hours (testimonials and endorsements) x 50% + 3 hours (third-party ratings) x 50% = 18.44 hours.

1038 13,724 registered investment advisers x 201.44 hours = 2,764,563 hours.

1039 $16,636,198 / 252,661 hours = $65.84/ hour for these amendments; $65.84 / hour x 329,199 hours = $21,675,762. $21,675,762 + $154,304,664 = $175,980,426.

1040 2,764,563 hours – 2,435,364 hours = 329,199 hours.

1041 $175,980,426- $154,304,664 = $21,675,762.

larger registered investment adviser population since the most recent approval and adjustments for inflation, as well as the rule 204-2 amendments relating to the new marketing rule. The following chart shows the differences from the approved annual hourly burden for the current books and records rule.

Requirement	Estimated Burden Increase or Decrease	Brief Explanation
All collections of information under rule 204-2 (including new requirements).	**18.44 hour increase.** The overall hour burden per adviser would increase from 183 hours to 201.44 hours.	The currently approved burden reflects the current rule's requirement that investment advisers retain copies of advertisements to 10 or more persons. The amended rule will require that they retain copies of all advertisements, as well as copies of any questionnaires or surveys obtained in connection with third-party ratings in advertisements. The amended rule will also require that advisers that use testimonials, endorsements, or third-party ratings make and retain a record documenting that the adviser has a reasonable belief that these items comply with the applicable conditions of the marketing rule.

E. Form ADV

Form ADV (OMB Control No. 3235-0049) is the investment adviser registration form under the Advisers Act. Rule 203-1 under the Advisers Act requires every person applying for investment adviser registration with the Commission to file Form ADV. Rule 204-4 under the Advisers Act requires certain investment advisers exempt from registration with the Commission ("exempt reporting advisers") to file reports with the Commission by completing a limited number of items on Form ADV. Rule 204-1 under the Advisers Act requires each registered and exempt reporting adviser to file amendments to Form ADV at least annually, and requires advisers to submit electronic filings through IARD. On June 5, 2019, the Commission adopted amendments to Form ADV and related rules under the Act to add new Form ADV Part 3: Form

CRS (relationship summary) requiring certain registered investment advisers to prepare and file a relationship summary for retail investors.

The paperwork burdens associated with rules 203-1, 204-1, and 204-4 are included in the approved annual burden associated with Form ADV and thus do not entail separate collections of information. These collections of information are found at 17 CFR 275.203-1, 275.204-1, 275.204-4 and 279.1 (Form ADV itself) and are mandatory. Responses are not kept confidential. We are adopting amendments to Form ADV to add a subsection L to Item 5 of Part 1A ("Marketing Activities") to require information about an adviser's use in its advertisements of testimonials, endorsements, third-party ratings, and previous investment advice. Specifically, we will require an adviser to state whether any of its advertisements include performance results, hypothetical performance, or predecessor performance. We will also require an adviser to state whether any of its advertisements includes testimonials, endorsements, or a third-party rating, and if so, whether the adviser pays or otherwise provides cash or non-cash compensation, directly or indirectly, in connection with their use. Finally, we will require an adviser to state whether any of its advertisements includes a reference to specific investment advice provided by the adviser.

The collection of information is necessary to improve information available to us and to the general public about advisers' advertising practices. Our staff will use this information to help prepare for examinations of investment advisers. This information will be particularly useful for staff in reviewing an adviser's compliance with the marketing rule, including the restrictions and conditions on advisers' use in advertisements of performance presentations and third-party statements. We are not proposing amendments to Form ADV Parts 2 or 3.

1. Respondents

The respondents to current Form ADV are investment advisers registered with the Commission or applying for registration with the Commission and exempt reporting advisers.[1042] Based on the IARD system data as of August 1, 2020, approximately 13,724 investment advisers were registered with the Commission, and 4,455 exempt reporting advisers file reports with the Commission. The amendments to Form ADV will increase the information requested in Form ADV Part 1A for registered investment advisers. Because exempt reporting advisers are required to complete a limited number of items in Part 1A of Form ADV, which excludes Item 5, they will not be subject to these amendments and will therefore not be subject to this collection of information.[1043] However, these exempt reporting advisers are included in the PRA for purposes of updating the overall Form ADV information collection. In addition, as noted above, in 2019 the Commission adopted amendments to Form ADV to add a new Part 3, requiring registered investment advisers that offer services to retail investors to prepare and file with the Commission, post to the adviser's website (if it has one), and deliver to retail investors a relationship summary.[1044] The burdens associated with completing Part 3 are included in the PRA for purposes of updating the overall Form ADV information collection.[1045]

1042 An exempt reporting adviser is an investment adviser that relies on the exemption from investment adviser registration provided in either section 203(l) of the Advisers Act because it is an adviser solely to one or more venture capital funds or 203(m) of the Advisers Act because it is an adviser solely to private funds and has assets under management in the United States of less than $150 million.

1043 An exempt reporting adviser is not a registered investment adviser and therefore will not be subject to the amendments to Item 5 of Form ADV Part 1A. Exempt reporting advisers are required to complete a limited number of items in Form ADV Part 1A (consisting of Items 1, 2.B., 3, 6, 7, 10, 11 and corresponding schedules), and are not required to complete Part 2.

1044 *See* Form CRS Relationship Summary; Amendments to Form ADV, Release No. IA-5247 (June 5, 2019) [84 FR 33492 (Jul. 12, 2019)].

1045 *See* Updated Supporting Statement for PRA Submission for Amendments to Form ADV Under the Investment Advisers Act of 1940 (the "Approved Form ADV PRA").

The currently approved burdens for Form ADV are set forth below:[1046]

	RIAs not obligated to prepare and file relationship summaries	RIAs obligated to prepare and file relationship summaries	Exempt reporting advisers	All advisers
Number of advisers included in the currently approved burden	5,064 + 571 expected newly registered RIAs annually	8,235 + 656 expected newly registered RIAs annually	4,280 + 441 expected new ERAs annually	17,597 advisers + 1,740 expected new RIAs and ERAs annually
Currently approved total annual hour estimate per adviser	29.22 hours	37.47 hours	3.60 hours	29.28 annual blended average hours per adviser
Currently approved aggregate annual hour burden	164,655 hours	333,146 hours	16,996 hours	514,797 hours
Currently approved aggregate monetized cost	$44,950,816	$90,978,858	$4,639,908	$140,569,582

Based on updated IARD system data as of August 1, 2020, we estimate that the number of registered investment advisers that are required to complete, amend, and file Form ADV (Part 1 and Part 2) with the Commission, but who are not obligated to prepare and file relationship summaries as of the applicable compliance date for Form ADV Part 3, is 5,506, and we also continue to believe, based on IARD system data, that that 1,227 new advisers will register with us annually, 571 of which will not be required to prepare a relationship summary.[1047] Based on updated IARD system data as of August 1, 2020, we estimate that the number of registered investment advisers that are required to complete, amend, and file Form ADV (Part 1 and Part 2)

1046 The information in the following table is from the Approved Form ADV PRA, *id*.

1047 As of August 1, 2020, there are 13,724 registered investment advisers, 8,218 of which file a Form CRS. *See also* Approved Form ADV PRA, *id*., at text accompanying nn.55-56 ("[W]e estimate that 1,227 new advisers will register with us annually, 656 of which will be required to prepare a relationship summary.")

and prepare and file relationship summaries is 8,218, and we continue to believe, based on IARD system data, that that 1,227 new advisers will register with us annually, 656 of which will be required to prepare a relationship summary.[1048] Based on updated IARD system data as of August 1, 2020, we estimate that the number of exempt reporting advisers is 4,455; however, we continue to believe that, based on IARD system data, there would be 441 new exempt reporting advisers annually.[1049]

2. Estimated new annual hour burden for advisers

As a result of the proposed amendments to Form ADV Part 1A discussed above, we estimate that the average total annual collection of information burden for registered investment advisers that are not obligated to prepare and file relationship summaries will increase 0.5 hours to 29.72 hours per registered investment adviser per year for Form ADV. We estimate that the average total annual collection of information burden for registered investment advisers who *are* obligated to prepare and file relationship summaries will increase 0.5 hour to 38.97 hours per registered investment adviser per year for Form ADV. We do not expect that the amendments will increase or decrease the currently approved total burden estimate of 3.60 per exempt reporting adviser completing Form ADV. We are not modifying our estimates from the proposal. Although one commenter claimed that we underestimated the Form ADV burden, this commenter mischaracterized our statements in the proposal.[1050] We stated in the proposal that the Form ADV amendments would not increase the time required to complete the form for

1048 *See id*.

1049 *Id*., at n.42.

1050 In the proposal, we estimated that the amendments would not change the burden for exempt reporting advisers because they will not be required to complete the new portion of Form ADV.

exempt reporting advisers (not registered investment advisers), which we continue to believe is the case.

The currently approved annual aggregate burden for Form ADV for all registered advisers and exempt reporting advisers is 514,797 hours, for a monetized cost of $140,569,582.[1051] This is an annual blended average per adviser burden for Form ADV of 29.28 hours, and $7,996 per adviser.[1052] Factoring in the new questions on Part 1 of Form ADV that will be required for all registered investment advisers (but not for exempt reporting advisers), and increases due to increased number in RIAs since the burden estimate was last approved (but a decreased number in ERAs), the revised annual aggregate burden hours for Form ADV (Parts 1, 2 and 3) for all registered advisers and exempt reporting advisers will be 544,053 hours per year, with a monetized value of $148,526,578.[1053] This will be an aggregate increase of 29,256 hours, or $7,956,996 in the monetized value of the hour burden, from the currently approved annual aggregate burden estimates, increases which are attributed to the factors described above.

Estimated new annual hour burden for advisers:

	RIAs not obligated to prepare and file relationship summaries	RIAs obligated to prepare and file relationship summaries	Exempt reporting advisers	All advisers
Number of advisers to be	5,506 + 571 expected newly	8,218 + 656 expected newly	4,455 + 441 expected new ERAs annually	

1051 *Id*., at nn.44-45 and accompanying text,

1052 *Id*., at nn.46-47 and accompanying text.

1053 544,053.4 aggregate annual hour burden is the sum of: ((i) 29.72 hours x (5,506 RIAs + 571 expected newly registered RIAs annually) = 180,608 total aggregate annual hour burden for RIAs not obligated to prepare and file relationship summaries; (ii) 38.97 hours x (8,218 + 656 expected newly registered RIAs annually) = 345,819.8 total aggregate annual hour burden for RIAs not obligated to prepare and file relationship summaries; (iii) 3.60 hours x (4,455 + 441 expected new ERAs annually) = 17,625.6 total aggregate annual hour burden for ERAs). We believe that performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the SIFMA Management and Professional Earnings Report suggest that costs for these positions are $237 and $309 per hour, respectively, with a blended rate of $273. Therefore: 544,053.4 hours x $273 = $148,526,578.

included in the final burden	registered RIAs annually	registered RIAs annually		
Final total annual hour estimate per adviser	29.72	38.97	3.60 hours	
Final aggregate burden hours	180,608 hours	345,819.8 hours	17,625.6 hours	544,053.4 hours
Final aggregate monetized cost	$49,306,104	$94,408,800	$4,811,789	$148,526,578

V. FINAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Final Regulatory Flexibility Analysis ("FRFA") in accordance with section 4(a) of the Regulatory Flexibility Act ("RFA").[1054] It relates to: (i) final amendments to rule 206(4)-1 under the Investment Advisers Act; (ii) final amendments to rule 204-2, and (iii) final amendments to Form ADV Part 1A.

A. Reason for and Objectives of the Final Amendments

1. Final rule 206(4)-1

We are adopting amendments to rule 206(4)-1 (now known as the "marketing rule"), which we adopted in 1961 to target advertising practices that the Commission believed were likely to be misleading. We are also incorporating into rule 206(4)-1 certain aspects of rule 206(4)-3 (previously referred to as the "cash solicitation rule"), which we adopted in 1979 to help ensure clients are aware that paid solicitors who refer them to advisers have a conflict of interest. We are accordingly eliminating rule 206(4)-3.

As discussed above, we are adopting amendments to rule 206(4)-1 to impose: (i) general prohibitions of certain advertising practices applicable to all advertisements; (ii) tailored restrictions or conditions on specific practices applicable to testimonials, endorsements, and

[1054] 5 U.S.C. 603(a).

third-party ratings; and (iii) tailored requirements for the presentation of performance results, including predecessor performance. The final rule is designed to restrict or place conditions on specific practices we believe may cause investors to be misled without appropriate conditions or limitations. The final rule will also include a new definition of "advertisement" that is intended to be flexible enough to remain relevant and effective in the face of advances in technology and evolving industry practices. The reasons for, and objectives of, the final amendments are discussed in more detail in sections I and II, above. The burdens of these requirements on small advisers are discussed below as well as above in sections III and IV, which discuss the burdens on all advisers. The professional skills required to meet these specific burdens are also discussed in section IV.

We believe that our final amendments are appropriate and in the public interest and will improve investor protection. We are adopting amendments to the current rule because while we believe that the concerns that motivated the Commission to adopt rule 206(4)-1 and 206(4)-3 still exist today, we also believe that we can achieve our regulatory goals in a more tailored manner. We believe that our final amendments will update the rule's coverage to reflect regulatory changes and evolution of industry practices, improve the quality of disclosures to investors, and streamline elements of the rules our 40 years of experience has suggested may no longer be necessary for investor protection.

2. Final rule 204-2

We are also adopting related amendments to rule 204-2, the books and records rule, which sets forth requirements for maintaining, making, and retaining advertisements. We are amending the rule to require investment advisers to make and keep records of all advertisements they disseminate. In addition, we are adopting the provisions to the books and records rule that will explicitly require investment advisers: (i) that use third-party ratings in an advertisement to

record and keep a copy of any questionnaire or survey used in the preparation of the third-party rating; and (ii) to maintain documentation of communications relating to predecessor performance and to support performance calculations. We are also adopting the recordkeeping requirement that corresponds to the amendments related to testimonials, endorsements, and third-party ratings under the final rule such that advisers must retain: (i) if not included in the advertisement, a record of the disclosures provided to clients or investors pursuant to final rule 206(4)-1; (ii) documentation substantiating the adviser's reasonable basis for believing that the testimonial or endorsement complies with the final rule and that the third-party rating complies with the final rule 206(4)-1(c)(1); and (iii) a record of the names of all persons who are an investment adviser's partners, officers, directors, or employees, or a person that controls, is controlled by, or is under common control with the investment adviser, or is a partner, officer, director or employee of such a person.

As discussed above, we are adopting these amendments to rule 204-2 to: (i) conform the books and records rule to the final rule; (ii) help ensure that an investment adviser retains records of all its advertisements; and (iii) facilitate the Commission's inspection and enforcement capabilities. The reasons for and objectives of, the final amendments to the books and records rule are discussed in more detail in section II.I above. The burdens of these requirements on small advisers are discussed below as well as above in our Economic Analysis and Paperwork Reduction Act Analysis, which discuss the burdens on all advisers. The professional skills required to meet these specific burdens are also discussed in Section IV.

3. Final Amendments to Form ADV

We are also adopting amendments to Item 5 of Part 1A of Form ADV to improve information available to us and to the general public about advisers' advertising practices. We

will be adding a subsection L ("Marketing Activities") to require information about an adviser's use in its advertisements of performance results, its previous investment advice, testimonials, endorsements, and third-party ratings.

Specifically, we will require an adviser to state whether any of its advertisements includes testimonials, endorsements, or a third-party rating, and if so, whether the adviser pays cash or non-cash compensation, directly or indirectly, in connection with their use. We will also require an adviser to state whether any of its advertisements includes performance results or a reference to specific investment advice provided by the adviser. Finally, we will require an adviser to state whether any of its advertisements include hypothetical or predecessor performance. Our staff will use this information to help prepare for examinations of investment advisers. This information will be particularly useful for staff in reviewing an adviser's compliance with the final rule, including the restrictions and conditions on advisers' use in advertisements of performance presentations, testimonials and endorsements, and third-party ratings. The reasons for and objectives of, the final amendments to Form ADV are discussed in more detail in section II.A.8 above. The burdens of these requirements on small advisers are discussed below as well as above in our Economic Analysis and Paperwork Reduction Act Analysis, which discuss the burdens on all advisers. The professional skills required to meet these specific burdens are also discussed in Section IV.

B. Significant Issues Raised by Public Comments

In the 2019 Proposing Release, we requested comment on the matters discussed in the IRFA, including the number of small entities subject to the proposed amendments to rules 206(4)-1, 206(4)-3, and 204-2, and Form ADV, as well as the potential impacts discussed in this analysis; and whether the proposal could have an effect on small entities that has not been

considered. We requested that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact. In addition, we included in the proposal a "Feedback Flyer" as Appendix C thereto. The "Feedback Flyer" solicited feedback from smaller advisers on the effects on small entities subject to our proposal, and the estimated compliance burdens of our proposal and how they would affect small entities.

After consideration of the comments we received on the proposed rules and amendments, we are adopting the amendments with several modifications that are designed to reduce certain operational challenges that commenters identified, while maintaining protections for investors and providing investors with useful and important disclosures. However, none of the modifications was significant to the small-entity cost burden estimates discussed below. Revisions to the estimates are instead based on updated figures regarding the number of small entities affected by the new rule and amendments and updated estimated wage rates.

C. Legal Basis

The Commission is adopting amendments to rule 206(4)-1 under the Advisers Act under the authority set forth in sections 203(d), 206(4), 211(a) and 211(h) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(d), 10b-6(4) and 80b-11(a) and (h)]. The Commission is adopting amendments to rule 204-2 under the Advisers Act under the authority set forth in sections 204 and 211 of the Investment Advisers Act of 1940 [15 U.S.C. 80b-4 and 80b-11]. The Commission is adopting amendments to Form ADV under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and 28(e)(2) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a) and 78bb(e)(2)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 7sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 80a-37(a)], and

sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)].

D. Small Entities Subject to the Rule and Rule Amendments

In developing these amendments, we have considered their potential impact on small entities that would be subject to the final amendments. The final amendments will affect many, but not all, investment advisers registered with the Commission, including some small entities.

Under Commission rules, for the purposes of the Advisers Act and the RFA, an investment adviser generally is a small entity if it: (1) has assets under management having a total value of less than $25 million; (2) did not have total assets of $5 million or more on the last day of the most recent fiscal year; and (3) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.[1055] Our final amendments will not affect most investment advisers that are small entities ("small advisers") because they are generally registered with one or more state securities authorities and not with the Commission. Under section 203A of the Advisers Act, most small advisers are prohibited from registering with the Commission and are regulated by state regulators. Based on IARD data, we estimate that as of August 1, 2020, approximately 545 SEC-registered advisers are small entities under the RFA.[1056]

1055 Advisers Act rule 0-7(a).

1056 Based on SEC-registered investment adviser responses to Items 5.F. and 12 of Form ADV. Only SEC-registered investment advisers with RAUM of less than $25 million, as indicated in Form ADV Item 5.F.(2)(c) are required to respond to Form ADV Item 12. For purposes of this analysis, a registered investment adviser is classified as a "small business" or "small organization" if they respond "No" to Form ADV Item 12.A., 12.B.(1), 12.B.(2), 12.C.(1), and 12.C.(2). These responses indicate that the registered investment adviser had RAUM of less than $25 million, did not have total assets of $5 million or more on the last day of the most recent fiscal year; and does not control, is not controlled by, and is not under common control with another investment adviser that has RAUM of $25 million or more, or any person

1. Small Entities Subject to Amendments to Marketing Rule

As discussed above in section III. (the Economic Analysis), the Commission estimates that based on IARD data as of August 1, 2020, approximately 13,724 investment advisers would be subject to the final amendments to rule 206(4)-1 under the Advisers Act and the related final amendments to rule 204-2 under the Advisers Act.[1057]

All of the approximately 545 SEC-registered advisers that are small entities under the RFA will be subject to the amended rule 206(4)-1 and corresponding amendments to rule 204-2. This is because, as discussed above in the PRA, we estimate that all investment advisers will disseminate at least one communication meeting the final rule's definition of "advertisement" and therefore be subject to the requirements of the final rule.[1058] Furthermore, the rule's additional conditions and restrictions on testimonials, endorsements, and third-party ratings, as well as certain presentations of performance, will apply to many advertisements under the rule.[1059]

2. Small Entities Subject to Amendments to the Books and Records Rule 204-2

As discussed above, there are approximately 545 small advisers currently registered with us, and we estimate that 100 percent of advisers registered with us will be subject to amendments to the books and records rule.

(other than a natural person) that had total assets of $5 million or more on the last day of the most recent fiscal year, consistent with the definition of a small entity under the Advisers Act for purposes of the RFA.

1057 *See supra* footnote 1038 and accompanying text.

1058 *See* PRA discussion, above, at sections IV.A and B.

1059 As discussed above, the use of testimonials, endorsements, and third-party ratings in advertisements is voluntary but we estimate that approximately 50% of registered investment advisers would use testimonials or endorsements in advertisements, and approximately 50% of registered investment advisers would use third-party ratings in advertisements. *See* PRA discussion, above, at sections IV.A and B.

3. Small Entities Subject to Amendments to Form ADV

As discussed above, there are approximately 545 small advisers currently registered with us, and we estimate that 100 percent of advisers registered with us will be subject to amendments to Form ADV.

E. Projected Reporting, Recordkeeping and Other Compliance Requirements

1. Final Rule 206(4)-1

Final rule 206(4)-1 will impose certain reporting and compliance requirements on certain investment advisers, including those that are small entities. All registered investment advisers that distribute advertisements under the rule, which we estimate to be all advisers, will be required to comply with the final rule's general prohibition of fraudulent or misleading advertisements. In addition, all advisers that use testimonials, endorsements, and third-party ratings will be required to include disclosures and comply with other conditions. Small entity advisers will be required to comply with restrictions and other conditions related to the presentation of certain performance results in advertisements. The final amendments, including compliance and recordkeeping requirements, are summarized in this FRFA (section V.A., above). All of these final requirements are also discussed in detail, above, in sections I and II, and these requirements and the burdens on respondents, including those that are small entities, are discussed above in sections III and IV (the Economic Analysis and Paperwork Reduction Act Analysis, respectively) and below. The professional skills required to meet these specific burdens are also discussed in section IV.

As discussed above, there are approximately 545 small advisers currently registered with us, and we estimate that 100 percent of advisers registered with us will be subject to amendments to the marketing rule. As discussed above in our Paperwork Reduction Act Analysis in section III above, we estimate that the final amendments to rule 206(4)-1 under the Advisers Act, which

will require advisers to prepare disclosures for testimonials and endorsements, third-party ratings, and performance results, will create a new annual burden of approximately 98 hours per adviser, or 56,135 hours in aggregate for small advisers.[1060] We therefore expect the annual monetized aggregate cost to small advisers associated with our final amendments to be $18,596,390.[1061]

2. Final Amendments to Rule 204-2

The final amendments to rule 204-2 will require investment advisers to retain records of all advertisements they disseminate.[1062] We are also requiring investment advisers that use a third-party rating in an advertisement to retain a copy of any questionnaire or survey used in preparation of the third-party rating, as well as documentation of communications relating to predecessor performance and supporting performance calculations.[1063] To correspond to the provisions with respect to testimonials, endorsements, and third-party ratings, we are amending the books and records rule to require investment advisers to make and keep records of: (i) if not included in the advertisement, a record of the disclosures provided to clients or investors pursuant to the final rule 206(4)-1; (ii) documentation substantiating the adviser's reasonable basis for believing that the testimonial or endorsement complies with the final rule and that the third-party rating complies with rule 206(4)-1(c)(1); and (iii) a record of the names of all persons who are an investment adviser's partners, officers, directors, or employees, or a person that controls, is controlled by, or is under common control with the investment adviser, or is a

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1060 1,414,291 hours / 13,724 advisers = 103 hours per adviser. 103 hours x 545 small advisers = 56,135 hours.

1061 $468,287,816 total cost x (545 small advisers / 13,724 advisers) = $18,596,390.

1062 *See* final rule 204-2(a)(11)(i)(A).

1063 *See* final rule 204-2(a)(7)(iv), (11)(ii), and (16).

partner, officer, director or employee of such a person, pursuant to the final rule 206(4)-1(b)(4)(ii).[1064] Each of these records will be required to be maintained in the same manner, and for the same period of time, as other books and records required to be maintained under rule 204-2(a).

As discussed above, there are approximately 545 small advisers currently registered with us, and we estimate that 100 percent of advisers registered with us will be subject to amendments to the books and records rule. As discussed above in our Paperwork Reduction Act Analysis in section IV.D above, the amendments to rule 204-2 under the Advisers Act will increase the annual burden by approximately 18.44 hours per adviser, or 10,049.8 hours in aggregate for small advisers.[1065] We therefore believe the annual monetized aggregate cost to small advisers associated with our amendments will be $6,960,596.[1066]

3. Final Amendments to Form ADV

Final amendments to Form ADV will impose certain reporting and compliance requirements on certain investment advisers, including those that are small entities, requiring them to provide information about their use in its advertisements of performance results, previous investment advice, testimonials, endorsements, and third-party ratings. The final amendments, including recordkeeping requirements, are summarized above in this FRFA (section V.A). All of these final requirements are also discussed in detail, above, in section II.I, and these requirements and the burdens on respondents, including those that are small entities, are discussed above in sections III and IV (the Economic Analysis and Paperwork Reduction Act

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1064 *See* final rule 204-2(a)(15)(i) through (ii).

1065 18.44 hour x 545 small advisers = 10,049.8 hours.

1066 545 registered investment advisers x 201.44 hours = 109,784.8 hours. (17% x 109,784.8 hours x $70) + (83% x 109,784.8 hours x $62) = $6,960,596.

Analysis) and below. The professional skills required to meet these specific burdens are also discussed in section IV.

Our Economic Analysis, discussed in section III above, discusses these costs and burdens for respondents, which include small advisers. As discussed above in our Paperwork Reduction Act Analysis in section IV.E above, the final amendments to Form ADV will increase the annual burden for advisers (other than exempt reporting advisers, who will not be required to respond to the new Form ADV questions) by approximately 0.5 hours per adviser, or 272.5 hours in aggregate for small advisers (other than exempt reporting advisers).[1067] We therefore expect the annual monetized aggregate cost to small advisers (other than exempt reporting advisers, for whom there will be no additional cost) associated with our final amendments will be $74,392.50.[1068]

F. Duplicative, Overlapping, or Conflicting Federal Rules

1. Final Rule 206(4)-1

Other than existing rule 206(4)-1 and the prohibitions contained in section 208(a)-(c) of the Act, investment advisers do not have obligations under the Act specifically for adviser advertisements. As discussed above in section II.A.4., we recognize that advisers to private funds, who would be included in the scope of the final rule 206(4)-1, are prohibited from making misstatements or materially misleading statements to investors under rule 206(4)-8.[1069] Although the final marketing rule may overlap with the prohibitions in rule 206(4)-8 in certain circumstances, just as it overlaps with section 206 with respect to an adviser's clients and

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1067 38.97 hour x 545 small advisers = 21,238.6 hours.

1068 272.5 hours x $273 = $74,392.50. *See supra* footnote 1053 for a discussion of who we believe would perform this function, and the applicable blended rate.

1069 There may be other legal protections of investors from fraud. *See, e.g.,* section 17(a) of the Securities Act, as well as section 10(b) of the Exchange Act and rule 10b-5 thereunder.

prospective clients, we believe it is important from an investor protection standpoint to delineate these obligations to all investors in the advertising context and provide a framework for an adviser's advertisements to comply with these obligations. We also understand that many private fund advisers already consider the current staff positions related to the current advertising rule when preparing their marketing communications. As a result, we believe that our application of the final rule to advertisements to private fund investors would result in limited additional regulatory or compliance costs for many of these advisers.

We also recognize that advisers have other compliance oversight obligations under the Federal securities laws, including the Act. For example, advisers are subject to the Act's compliance rule, which we adopted in 2003.[1070] Therefore, when an adviser utilizes a promoter as part of its business, the adviser must have in place under the Act's compliance rule policies and procedures that address this relationship and are reasonably designed to ensure that the adviser is in compliance with the final rule. We believe the final rule's adviser oversight and compliance provision applicable to testimonials and endorsements will work well with the Act's compliance rule, as both are principles-based and will allow advisers to tailor their compliance with the final rule as appropriate for each adviser. There are no duplicative, overlapping, or conflicting Federal rules with respect to the final amendments to rule 204-2.

With respect to testimonials and endorsements, our amendments to rule 206(4)-1 will eliminate some regulatory duplication. For example, rule 206(4)-3 has had a duplicative requirement that a solicitor deliver to clients the adviser's Form ADV brochure, even though advisers are already required to deliver their ADV brochures to their clients under rule 204-3.

[1070] *See supra* footnote 371 and accompanying text. The compliance rule contains principles based requirements for advisers to adopt compliance policies and procedures that are tailored to their businesses. *Id*.

To the extent that both advisers and solicitors currently deliver the adviser's Form ADV brochure, the final rule will reduce the redundancy of disclosures. In addition, as discussed above, the final rule's disqualification provisions will apply to situations in which an adviser compensates a person, directly or indirectly, for a testimonial or endorsement. This includes persons who provide testimonials or endorsements to private fund investors such as broker-dealers. Such broker-dealers may also be subject to the statutory disqualification provisions under the Exchange Act. To the extent that a person is subject to both disqualification provisions, there would be some overlapping categories of disqualifying events (*i.e.*, certain bad acts would disqualify a person under both provisions). For instance, certain types of final orders of certain Federal and foreign regulators would be disqualifying events under both provisions. Accordingly, as discussed above, we are providing an exemption from the disqualification provisions for registered broker-dealers that are subject to and complying with the statutory disqualification provisions under the Exchange Act.

We understand that some promoters will also be subject to the "bad actor" disqualification requirements, which disqualify securities offerings from reliance on exemptions if the issuer or other relevant persons (such as underwriters, placement agents and the directors, officers and significant shareholders of the issuer) have been convicted of, or are subject to court or administrative sanctions for, securities fraud or other violations of specified laws.[1071] Some types of bad acts could disqualify a person from engaging in certain capacities in a securities offering under Rule 506 of Regulation D under the Securities Act, as well as from engaging as a promoter under the final rule. Accordingly, as discussed above, we are providing an exemption

[1071] *See* Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings, Release No. 33-9414 (July 10, 2013) [78 Fed. Reg. 44729 (July 24, 2013).

from the disqualification provisions for covered persons that are subject to and not disqualified under Rule 506 of Regulation D under the Securities Act.

As discussed above, the final rule's required disclosures provisions will apply to all testimonials and endorsements, including those that are provided by registered broker-dealers in certain circumstances. Such broker-dealers may also be subject to other regulatory disclosure provisions such as under Regulation Best Interest. To the extent that a broker-dealer's testimonial or endorsement is a recommendation subject to Regulation BI, then there would be some overlapping requirements with our final rule (*i.e.*, disclosing compensation arrangements and material conflicts of interest under both provisions). For instance, under the Regulation BI disclosure obligations, when making a recommendation to a retail customer, a broker-dealer must disclose all material facts about the scope and terms of its relationship with a retail customer, such as the material fees and costs the customer will incur as well as all material facts relating to its conflicts of interest associated with the recommendation, including third-party payments and compensation arrangements.[1072] Similarly, under the final rule, when soliciting for an adviser, the broker-dealer would have to disclose any material conflicts of interest on his or her part resulting from their relationship and/or any compensation arrangement with the adviser.[1073] Accordingly, as discussed above, we are providing an exemption from the final rule's required disclosures provisions for testimonials and endorsements that are disseminated by registered broker-dealers to the extent that such testimonials or endorsements are recommendations subject to Regulation BI in order to help eliminate regulatory duplication.

1072 *See* Regulation Best Interest Release, *supra* footnote 146, at 14.

1073 *See* final rule 206(4)-1(b)(1)(iii).

In addition to testimonials and endorsements that are recommendations subject to Regulation BI, we are providing a partial exemption from certain disclosure requirements where a broker-dealer provides a testimonial or endorsement to an investor that is not a retail customer as defined in Regulation BI. As discussed above in section II.C.5.c., we believe that the clear and prominent disclosures such a broker-dealer will be required to provide under our final rule are sufficient to alert an investor that is not a retail customer that a testimonial or endorsement is a paid solicitation. In addition, we believe that these investors will be able to request from the broker-dealer other information about the solicitation.

2. Final Amendments to Form ADV

Our new subsection L ("Marketing Activities") to Item 5 of Part 1A of Form ADV will require information about an adviser's use in its advertisements of performance results, testimonials, endorsements, third-party ratings and its previous investment advice. These final requirements will not be duplicative of, or overlap with, other information advisers are required to provide on Form ADV.

G. Significant Alternatives

1. Final Rule 206(4)-1

The RFA directs the Commission to consider significant alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. We considered the following alternatives for small entities in relation to the final rule and the corresponding amendments to rule 204-2 under the Advisers Act and to Form ADV: (i) differing compliance or reporting requirements that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the final rule for such small entities; (iii) the use of performance rather than

design standards; and (iv) an exemption from coverage of the final rule, or any part thereof, for such small entities.

Regarding the first and fourth alternatives, the Commission believes that establishing different compliance or reporting requirements for small advisers, or exempting small advisers from the final rule, or any part thereof, would be inappropriate under these circumstances.[1074] Because the protections of the Advisers Act are intended to apply equally to clients of both large and small firms, it would be inconsistent with the purposes of the Advisers Act to specify differences for small entities under the final rule and corresponding changes to rule 204-2 and Form ADV. However, we are adopting an exemption for *de minimis* compensation with respect to the use of testimonials and endorsements, which we expect will apply to some small entities that offer *de minimis* compensation to promoters.[1075] Although, as discussed above, we believe heightened safeguards would generally be appropriate for an adviser's use of testimonials or endorsements, a promoter's incentives are significantly reduced when receiving *de minimis* compensation. We believe the need for heightened safeguards for *de minimis* compensation is likewise reduced.

1074 For example, one commenter stated that smaller advisers would face challenges under the proposed rule in demonstrating that the performance of a representative account is no higher than if all related portfolios had been included. *See* IAA Comment Letter. *See also* proposed rule 206(4)-1(c)(1)(iii)(A). However, we do not believe that providing smaller advisers with the benefit of presenting a single representative account that is not subject to prescribed conditions would justify the risks of cherry-picking related portfolios with higher-than-usual returns. As a result, we are not adopting different compliance requirements or exemptions for smaller advisers. Instead, we have modified our final rule to allow all advisers to include performance returns of a single portfolio if they can demonstrate that the performance is not *materially* higher than if all related portfolios had been included, and the performance meets the rule's general prohibitions. *See* final rule 206(4)-1(d)(4)(i). *See also* section II.E.4. (discussing related performance).

1075 Specifically, the disqualification provisions of the rule related to testimonials and endorsements will not apply if the person has provided testimonials or endorsements for the investment adviser during the preceding twelve months and the investment adviser's compensation payable to such person for those testimonials or endorsements is $1,000 or less (or the equivalent value in non-cash compensation).

As discussed above, we believe that the final rule will result in multiple benefits to clients. For example, the final rule's disclosure requirements and other conditions applicable to the use of advertisements will provide investors with information they need to assess the adviser's advertising claims (for performance results) and third-party claims about the adviser (for testimonials, endorsements, and third-party ratings). In particular, the disclosures related to testimonials and endorsements will: (i) help to ensure that investors are aware that promoters have a conflict of interest in referring them to advisers that compensate them for the referral; (ii) extend the current solicitation rule's investor protection to investors whose advisers compensate their promoters with non-cash compensation; (iii) extend the rule to private fund investors; and (iv) eliminate duplicative disclosures. We believe that these benefits should apply to clients of smaller firms as well as larger firms.

We also believe that the rule's disqualification provisions with respect to testimonials and endorsements will result in transparency and consistency for advisory clients, promoters, and advisers, as the provisions will generally eliminate the need for advisers to seek separate relief from the rule. In addition, as discussed above, we believe that our final rule's placing guardrails on displays of performance will increase investor protection and the utility of the information provided and decrease the likelihood that it is misleading. Establishing different promoter disqualification provisions or performance provisions for large and small advisers would negate these benefits. Also, as discussed above, our staff will use the corresponding information that advisers report on the amended Form ADV to help prepare for examinations of investment advisers. Establishing different conditions for large and small advisers that advertise their services to investors would negate these benefits.

Regarding the second alternative, we believe the final rule is clear and that further clarification, consolidation, or simplification of the compliance requirements is not necessary. As discussed above, the final rule will provide general anti-fraud principles applicable to all advertisements under the rule; will provide further restrictions and conditions on certain specific types of presentations, such as testimonials and endorsements; and will provide additional conditions for advertisements containing certain performance information. These provisions will address a number of common advertising practices that have not been explicitly addressed or broadly restricted (*e.g.*, the current advertising rule prohibits testimonials concerning the investment adviser or its services, and direct or indirect references to specific profitable recommendations that the investment adviser has made in the past). The proposed provisions will clarify and modernize the advertising regime, which has come to depend on a large number of no-action letters over the years to fill the gaps.

Regarding the third alternative, we determined to use a combination of performance and design standards. The general prohibitions will be principles-based and will give advisers a broad framework within which to determine how best to present advertisements so they are not false or misleading. There will also be the principles-based requirement that an adviser must have a reasonable basis for believing that a person providing a testimonial or endorsement has complied with the final rule. We believe that providing advisers with the flexibility to determine how to implement the requirements of the rule allows them the opportunity to tailor these obligations to the facts and circumstances of their particular arrangements. The final rule will also contain design standards, as it contains additional conditions for certain third-party statements, and certain restrictions and conditions on performance claims. These restrictions and conditions are narrowly tailored to prevent certain types of advertisements that are not a

fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Act from misleading investors. The corresponding changes to rule 204-2 and Form ADV are also narrowly tailored to reflect the final rule.

We also considered an alternative that would not have included design standards, and that would have relied entirely on performance standards. In this alternative, as discussed in the Economic Analysis at section III above, we would reduce the limitations on investment adviser advertising, and rely on the general prohibitions to achieve the programmatic costs and benefits of the rule. As discussed in the Economic Analysis, we believe that many of the types of advertisements that would be prohibited by the final rule's limitations have the potential to be fraudulent or misleading. We do not believe that removal of the limitations on advertisements we are adopting would, in comparison with the final rule, permit advertisements that would not be inherently fraudulent or misleading. In addition, we believe that the removal of limitations may create uncertainty about what types of advertisements would fall under the general prohibitions.

STATUTORY AUTHORITY

The Commission is adopting amendments to rule 206(4)-1 under the Advisers Act under the authority set forth in sections 203(d), 206(4), 211(a), and 211(h) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(d), 10b-6(4) and 80b-11(a) and (h)]. The Commission is rescinding rule 206(4)-3 under the Advisers Act under the authority set forth in sections 203(d), 206(4), 211(a), and 211(h) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-2(d), 80b-6(4), and 80b-11(a) and (h)]. The Commission is adopting amendments to rule 204-2 under the Advisers Act under the authority set forth in sections 204 and 211 of the Investment Advisers Act of 1940 [15 U.S.C. 80b-4 and 80b-11]. The Commission is adopting amendments to Form ADV under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and

28(e)(2) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a) and 78bb(e)(2)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 7sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 80a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)].

List of Subjects in 17 CFR Parts 275 and 279

Reporting and recordkeeping requirements; Securities.

TEXT OF AMENDMENTS

For the reasons set out in the preamble, title 17, chapter II of the Code of Federal Regulations is amended as follows:

PART 275 – RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for part 275 continues to read in part as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(11)(H), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

* * * * *

Section 275.204-2 is also issued under 15 U.S.C 80b-6.

* * * * *

2. Amend § 275.204-2 by

a. Revising paragraphs (a)(7)(iv), (a)(11), (15), and (16); and

b. Adding paragraph (a)(19).

The revisions and addition to read as follows:

§ 275.204-2 Books and records to be maintained by investment advisers

(a) * * *

(7) * * *

(iv) *Predecessor performance* (as defined in § 275.206(4)-1(e)(12) of this chapter) and the performance or rate of return of any or all managed accounts, *portfolios* (as defined in § 275.206(4)-1(e)(11) of this chapter), or securities recommendations; Provided, however:

(A) That the investment adviser shall not be required to keep any unsolicited market letters and other similar communications of general public distribution not prepared by or for the investment adviser; and

(B) That if the investment adviser sends any notice, circular, or other *advertisement* (as defined in § 275.206(4)-1(e)(1) of this chapter) offering any report, analysis, publication or other investment advisory service to more than ten persons, the investment adviser shall not be required to keep a record of the names and addresses of the persons to whom it was sent; except that if such notice, circular, or *advertisement* is distributed to persons named on any list, the investment adviser shall retain with the copy of such notice, circular, or *advertisement* a memorandum describing the list and the source thereof.

* * * * *

(11) (i) A copy of each

(A) *Advertisement* (as defined in § 275.206(4)-1(e)(1) of this chapter) that the investment adviser disseminates, directly or indirectly, except:

(*1*) For oral *advertisements,* the adviser may instead retain a copy of any written or recorded materials used by the adviser in connection with the oral *advertisement*; and

(*2*) For compensated oral *testimonials* and *endorsements* (as defined in § 275.206(4)-1(e)(17) and (5) of this chapter), the adviser may instead make and keep a record of the disclosures provided to clients or investors pursuant to § 275.206(4)-1(b)(1) of this chapter; and

(B) Notice, circular, newspaper article, investment letter, bulletin, or other communication that the investment adviser disseminates, directly or indirectly, to ten or more persons (other than persons associated with such investment adviser); and

(C) If such notice, circular, *advertisement*, newspaper article, investment letter, bulletin, or other communication recommends the purchase or sale of a specific security and does not state the reasons for such recommendation, a memorandum of the investment adviser indicating the reasons therefor; and

(ii) A copy of any questionnaire or survey used in the preparation of a *third-party rating* included or appearing in any *advertisement* in the event the adviser obtains a copy of the questionnaire or survey.

* * * * *

(15) (i) If not included in the *advertisement*, a record of the disclosures provided to clients or investors pursuant to § 275.206(4)-1(b)(1)(ii) and (iii) of this chapter;

(ii) Documentation substantiating the adviser's reasonable basis for believing that a *testimonial* or *endorsement* (as defined in § 275.206(4)-1(e)(17) and (5) of this chapter) complies with § 275.206(4)-1 and that the *third-party rating* (as defined in § 275.206(4)-1(e)(18) of this chapter) complies with § 275.206(4)-1(c)(1) of this chapter.

(iii) A record of the names of all persons who are an investment adviser's partners, officers, directors, or employees, or a person that controls, is controlled by, or is under common control with the investment adviser, or is a partner, officer, director or employee of such a person pursuant to § 275.206(4)-1(b)(4)(ii) of this chapter.

(16) All accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of any performance or rate

of return of any or all managed accounts, *portfolios* (as defined in § 275.206(4)-1(e)(11) of this chapter), or securities recommendations presented in any notice, circular, *advertisement* (as defined in § 275.206(4)-1(e)(1) of this chapter), newspaper article, investment letter, bulletin, or other communication that the investment adviser disseminates, directly or indirectly, to any person (other than persons associated with such investment adviser), including copies of all information provided or offered pursuant to § 275.206(4)-1(d)(6) of this chapter; provided, however, that, with respect to the performance of managed accounts, the retention of all account statements, if they reflect all debits, credits, and other transactions in a client's or investor's account for the period of the statement, and all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts shall be deemed to satisfy the requirements of this paragraph.

* * * * *

(19) A record of who the "intended audience" is pursuant to § 275.206(4)-1(d)(6) and(e)(10)(ii)(B) of this chapter.

* * * * *

3. Revise § 275.206(4)-1 to read as follows:

§ 275.206(4)-1 Investment Adviser Marketing.

As a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts, practices, or courses of business within the meaning of section 206(4) of the Act (15 U.S.C. 80b-6(4)), it is unlawful for any investment adviser registered or required to be registered under section 203 of the Act (15 U.S.C. 80b-3), directly or indirectly, to disseminate any *advertisement* that violates any of paragraphs (a) through (d) of this section.

(a) *General prohibitions*. An *advertisement* 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 the 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 by the Commission;

(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.

(b) *Testimonials and endorsements*. An *advertisement* may not include any *testimonial* or *endorsement*, and an adviser may not provide compensation, directly or indirectly, for a *testimonial* or *endorsement*, unless the investment adviser complies with the conditions in paragraphs (b)(1) through (3) of this section, subject to the exemptions in paragraph (b)(4) of this section.

(1) *Required disclosures*. The investment adviser discloses, or reasonably believes that the person giving the *testimonial* or *endorsement* discloses, the following at the time the *testimonial* or *endorsement* is disseminated:

(i) Clearly and prominently:

(A) That the *testimonial* was given by a current client or investor, and the *endorsement* was given by a person other than a current client or investor, as applicable;

(B) That cash or non-cash compensation was provided for the *testimonial* or *endorsement*, if applicable; and

(C) A brief statement of any material conflicts of interest on the part of the person giving the *testimonial* or *endorsement* resulting from the investment adviser's relationship with such person;

(ii) The material terms of any compensation arrangement, including a description of the compensation provided or to be provided, directly or indirectly, to the person for the *testimonial* or *endorsement*; and

(iii) A description of any material conflicts of interest on the part of the person giving the *testimonial* or *endorsement* resulting from the investment adviser's relationship with such person and/or any compensation arrangement.

(2) *Adviser oversight and compliance*. The investment adviser must have:

(i) A reasonable basis for believing that the *testimonial* or *endorsement* complies with the requirements of this section, and

(ii) A written agreement with any person giving a *testimonial* or *endorsement* that describes the scope of the agreed-upon activities and the terms of compensation for those activities.

(3) *Disqualification*. An investment adviser may not compensate a person, directly or indirectly, for a *testimonial* or *endorsement* if the adviser knows, or in the exercise of reasonable care should know, that the person giving the *testimonial* or *endorsement* is an *ineligible person* at the time the *testimonial* or *endorsement* is disseminated. This paragraph shall not disqualify any person for any matter(s) that occurred prior to May 4, 2021, if such matter(s) would not have disqualified such person under § 275.206(4)-3(a)(1)(ii) of this chapter, as in effect prior to May 4, 2021.

(4) *Exemptions*. (i) A *testimonial* or *endorsement* disseminated for no compensation or *de minimis compensation* is not required to comply with paragraphs (b)(2)(ii) and (3) of this section;

(ii) A *testimonial* or *endorsement* by the investment adviser's partners, officers, directors, or employees, or a person that controls, is controlled by, or is under common control with the investment adviser, or is a partner, officer, director or employee of such a person is not required to comply with paragraphs (b)(1) and (2)(ii) of this section, provided that the affiliation between the investment adviser and such person is readily apparent to or is disclosed to the client or investor at the time the *testimonial* or *endorsement* is disseminated and the investment adviser documents such person's status at the time the *testimonial* or *endorsement* is disseminated;

(iii) A *testimonial* or *endorsement* by a broker or dealer registered with the Commission under section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(a)) is not required to comply with:

(A) Paragraph (b)(1) of this section if the *testimonial* or *endorsement* is a recommendation subject to § 240.15l-1 of this chapter (Regulation Best Interest) under that Act;

(B) Paragraphs (b)(1)(ii) and (iii) of this section if the *testimonial* or *endorsement* is provided to a person that is not a retail customer (as that term is defined in § 240.15l-1 of this

chapter (Regulation Best Interest) under the Securities Exchange Act of 1934 (15 U.S.C. 78o(a)); and

(C) Paragraph (b)(3) of this section if the broker or dealer is not subject to statutory disqualification, as defined under section 3(a)(39) of that Act; and

(iv) A *testimonial* or *endorsement* by a person that is covered by rule 506(d) of Regulation D under the Securities Act of 1933 (§ 230.506(d) of this chapter) with respect to a rule 506 securities offering under the Securities Act of 1933 (§ 230.506 of this chapter) and whose involvement would not disqualify the offering under that rule is not required to comply with paragraph (b)(3) of this section.

(c) *Third-party ratings.* An *advertisement* may not include any *third-party rating*, unless the investment adviser:

(1) Has a reasonable basis for believing that any questionnaire or survey used in the preparation of the *third-party rating* is structured to make it equally easy for a participant to provide favorable and unfavorable responses, and is not designed or prepared to produce any predetermined result; and

(2) Clearly and prominently discloses, or the investment adviser reasonably believes that the *third-party rating* clearly and prominently discloses:

(i) The date on which the rating was given and the period of time upon which the rating was based;

(ii) The identity of the third party that created and tabulated the rating; and

(iii) If applicable, that compensation has been provided directly or indirectly by the adviser in connection with obtaining or using the *third-party rating*.

(d) *Performance*. An investment adviser may not include in any *advertisement*:

(1) Any presentation of *gross performance*, unless the *advertisement* also presents *net performance*:

(i) With at least equal prominence to, and in a format designed to facilitate comparison with, the *gross performance*; and

(ii) Calculated over the same time period, and using the same type of return and methodology, as the *gross performance*.

(2) Any performance results, of any portfolio or any composite aggregation of *related portfolios*, in each case other than any *private fund*, unless the *advertisement* includes performance results of the same *portfolio* or composite aggregation for one-, five-, and ten-year periods, each presented with equal prominence and ending on a date that is no less recent than the most recent calendar year-end; except that if the relevant *portfolio* did not exist for a particular prescribed period, then the life of the *portfolio* must be substituted for that period.

(3) Any statement, express or implied, that the calculation or presentation of performance results in the *advertisement* has been approved or reviewed by the Commission.

(4) Any *related performance*, unless it includes all *related portfolios*; provided that *related performance* may exclude any *related portfolios* if:

(i) The advertised performance results are not materially higher than if all *related portfolios* had been included; and

(ii) The exclusion of any *related portfolio* does not alter the presentation of any applicable time periods prescribed by paragraph (d)(2) of this section.

(5) Any *extracted performance*, unless the *advertisement* provides, or offers to provide promptly, the performance results of the total *portfolio* from which the performance was extracted.

(6) Any *hypothetical performance* unless the investment adviser:

(i) 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*;

(ii) Provides sufficient information to enable the intended audience to understand the criteria used and assumptions made in calculating such *hypothetical performance*; and

(iii) Provides (or, if the intended audience is an investor in a *private fund*, provides, or offers to provide promptly) sufficient information to enable the intended audience to understand the risks and limitations of using such *hypothetical performance* in making investment decisions; Provided that the investment adviser need not comply with the other conditions on performance in paragraphs (d)(2), (4), and (5) of this section.

(7) Any *predecessor performance* unless:

(i) The person or persons who were primarily responsible for achieving the prior performance results manage accounts at the advertising adviser;

(ii) The accounts managed at the predecessor investment adviser are sufficiently similar to the accounts managed at the advertising investment adviser that the performance results would provide relevant information to clients or investors;

(iii) All accounts that were managed in a substantially similar manner are advertised unless the exclusion of any such account would not result in materially higher performance and the exclusion of any account does not alter the presentation of any applicable time periods prescribed in paragraph (d)(2) of this section; and

(iv) The *advertisement* clearly and prominently includes all relevant disclosures, including that the performance results were from accounts managed at another entity.

(e) *Definitions*. For purposes of this section:

(1) *Advertisement* means:

(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*, that offers the investment adviser's investment advisory services with regard to securities to prospective clients or investors in a *private fund* advised by the investment adviser or offers new investment advisory services with regard to securities to current clients or investors in a *private fund* advised by the investment adviser, but does not include:

(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 other required communication; or

(C) A communication that includes *hypothetical performance* that is provided:

(1) 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

(2) To a prospective or current investor in a *private fund* advised by the investment adviser in a one-on-one communication; and

(ii) Any *endorsement* or *testimonial* for which an investment adviser provides compensation, directly or indirectly, but does not include any 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.

(2) *De minimis compensation* means compensation paid to a person for providing a *testimonial* or *endorsement* of a total of $1,000 or less (or the equivalent value in non-cash compensation) during the preceding 12 months.

(3) A *disqualifying Commission action* means a Commission opinion or order barring, suspending, or prohibiting the person from acting in any capacity under the Federal securities laws.

(4) A *disqualifying event* is any of the following events that occurred within ten years prior to the person disseminating an *endorsement* or *testimonial*:

(i) A conviction by a court of competent jurisdiction within the United States of any felony or misdemeanor involving conduct described in paragraph (2)(A) through (D) of section 203(e) of the Act;

(ii) A conviction by a court of competent jurisdiction within the United States of engaging in, any of the conduct specified in paragraphs (1), (5), or (6) of section 203(e) of the Act;

(iii) The entry of any final order by any entity described in paragraph (9) of section 203(e) of the Act, or by the U.S. Commodity Futures Trading Commission or a self-regulatory organization (as defined in the Form ADV Glossary of Terms)), of the type described in paragraph (9) of section 203(e) of the Act;

(iv) The entry of an order, judgment or decree described in paragraph (4) of section 203(e) of the Act, and still in effect, by any court of competent jurisdiction within the United States; and

(v) A Commission order that a person cease and desist from committing or causing a violation or future violation of:

(A) Any scienter-based anti-fraud provision of the Federal securities laws, including without limitation section 17(a)(1) of the Securities Act of 1933 (15 U.S.C. 77q(a)(1)), section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)) and § 240.10b-5 of this chapter, section 15(c)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(c)(1)), and section 206(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-6(1)), or any other rule or regulation thereunder; or

(B) Section 5 of the Securities Act of 1933 (15 U.S.C. 77e);

(vi) A *disqualifying event* does not include an event described in paragraphs (e)(4)(i) through (v) of this section with respect to a person that is also subject to:

(A) An order pursuant to section 9(c) of the Investment Company Act of 1940 (15 U.S.C. 80a-9) with respect to such event; or

(B) A Commission opinion or order with respect to such event that is not a *disqualifying Commission action*; provided that for each applicable type of order or opinion described in paragraphs (e)(4)(vi)(A) and (B) of this section:

(*1*) The person is in compliance with the terms of the order or opinion, including, but not limited to, the payment of disgorgement, prejudgment interest, civil or administrative penalties, and fines; and

(*2*) For a period of ten years following the date of each order or opinion, the *advertisement* containing the *testimonial* or *endorsement* must include a statement that the person providing the *testimonial* or *endorsement* is subject to a Commission order or opinion regarding one or more disciplinary action(s), and include the order or opinion or a link to the order or opinion on the Commission's website.

(5) *Endorsement* means any statement by a person other than a current client or investor in a *private fund* advised by the investment adviser that:

(i) Indicates approval, support, or recommendation of the investment adviser or its *supervised persons* or describes that person's experience with the investment adviser or its *supervised persons*;

(ii) Directly or indirectly solicits any current or prospective client or investor to be a client of, or an investor in a *private fund* advised by, the investment adviser; or

(iii) Refers any current or prospective client or investor to be a client of, or an investor in a *private fund* advised by, the investment adviser.

(6) *Extracted performance* means the performance results of a subset of investments extracted from a *portfolio*.

(7) *Gross performance* means the performance results of a *portfolio* (or portions of a *portfolio* that are included in *extracted performance*, if applicable) before the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant *portfolio*.

(8) *Hypothetical performance* means performance results that were not actually achieved by any *portfolio* of the investment adviser.

(i) *Hypothetical performance* includes, but is not limited to:

(A) Performance derived from model *portfolios*;

(B) Performance that is backtested by the application of a strategy to data from prior time periods when the strategy was not actually used during those time periods; and

(C) Targeted or projected performance returns with respect to any *portfolio* or to the investment advisory services with regard to securities offered in the *advertisement*, however:

(ii) *Hypothetical performance* does not include:

(A) An interactive analysis tool where a client or investor, or prospective client, or investor, uses the tool to produce simulations and statistical analyses that present the likelihood of various investment outcomes if certain investments are made or certain investment strategies or styles are undertaken, thereby serving as an additional resource to investors in the evaluation of the potential risks and returns of investment choices; provided that the investment adviser:

(1) Provides a description of the criteria and methodology used, including the investment analysis tool's limitations and key assumptions;

(2) Explains that the results may vary with each use and over time;

(3) If applicable, describes the universe of investments considered in the analysis, explains how the tool determines which investments to select, discloses if the tool favors certain investments and, if so, explains the reason for the selectivity, and states that other investments not considered may have characteristics similar or superior to those being analyzed; and

(4) Discloses that the tool generates outcomes that are hypothetical in nature; or

(B) *Predecessor performance* that is displayed in compliance with paragraph (d)(7) of this section.

(9) *Ineligible person* means a person who is subject to a *disqualifying Commission action* or is subject to any *disqualifying event,* and the following persons with respect to the *ineligible person*:

(i) Any employee, officer, or director of the *ineligible person* and any other individuals with similar status or functions within the scope of association with the *ineligible person*;

(ii) If the *ineligible person* is a partnership, all general partners; and

(iii) If the *ineligible person* is a limited liability company managed by elected managers, all elected managers.

(10) *Net performance* means the performance results of a *portfolio* (or portions of a *portfolio* that are included in *extracted performance*, if applicable) after the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant *portfolio*, including, if applicable, advisory fees, advisory fees paid to underlying investment vehicles, and payments by the investment adviser for which the client or investor reimburses the investment adviser. For purposes of this rule, *net performance*:

(i) May reflect the exclusion of custodian fees paid to a bank or other third-party organization for safekeeping funds and securities; and/or

(ii) If using a model fee, must reflect one of the following:

(A) The deduction of a model fee when doing so would result in performance figures that are no higher than if the actual fee had been deducted; or

(B) The deduction of a model fee that is equal to the highest fee charged to the intended audience to whom the *advertisement* is disseminated.

(11) *Portfolio* means a group of investments managed by the investment adviser. A *portfolio* may be an account or a *private fund* and includes, but is not limited to, a *portfolio* for the account of the investment adviser or its *advisory affiliate* (as defined in the Form ADV Glossary of Terms).

(12) *Predecessor performance* means investment performance achieved by a group of investments consisting of an account or a *private fund* that was not advised at all times during the period shown by the investment adviser advertising the performance.

(13) *Private fund* has the same meaning as in section 202(a)(29) of the Act.

(14) *Related performance* means the performance results of one or more *related portfolios*, either on a *portfolio*-by-*portfolio* basis or as a composite aggregation of all *portfolios* falling within stated criteria.

(15) *Related portfolio* means a *portfolio* with substantially similar investment policies, objectives, and strategies as those of the services being offered in the *advertisement*.

(16) *Supervised person* has the same meaning as in section 202(a)(25) of the Act.

(17) *Testimonial* means any statement by a current client or investor in a *private fund* advised by the investment adviser:

(i) About the client or investor's experience with the investment adviser or its *supervised persons*;

(ii) That directly or indirectly solicits any current or prospective client or investor to be a client of, or an investor in a *private fund* advised by, the investment adviser; or

(iii) That refers any current or prospective client or investor to be a client of, or an investor in a *private fund* advised by, the investment adviser.

(18) *Third-party rating* means a rating or ranking of an investment adviser provided by a person who is not a *related person* (as defined in the Form ADV Glossary of Terms), and such person provides such ratings or rankings in the ordinary course of its business.

§ 275.206(4)-3 [Removed and reserved]

4. Remove and reserve § 275.206(4)-3.

PART 279 – FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

5. The authority citation for part 279 continues to read as follows:

Authority: The Investment Advisers Act of 1940, 15 U.S.C. 80b-1, *et seq.*, Pub. L.111-203, 124 Stat. 1376.

6. Amend Form ADV (referenced in § 279.1) by:

a. Adding Item 5.L to Part 1A;

b. Revising the instructions to the form, in the section entitled "Form ADV: Glossary of Terms;"

c. Revising the instructions to the form, in the section entitled "Part 2A of Form ADV: Firm *Brochure*," by removing the phrase "SEC rule 206(4)-3" in the Note in Item 14.B. and adding, in its place, "SEC rule 206(4)-1."

The addition and revision read as follows:

NOTE: The text of Form ADV does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM ADV (Paper Version)

• UNIFORM APPLICATION FOR INVESTMENT ADVISER

REGISTRATION

AND

• REPORT BY EXEMPT REPORTING ADVISERS

PART lA

* * * * *

Item 5: Information About Your Advisory Business
ADVISORY ACTIVITIES

L. Marketing Activities

(1) Do any of your *advertisements* include:

a. Performance results?

Y N

b. A reference to specific investment advice provided by you (as that phrase is used in rule 206(4)-1(a)(5))?

Y N

c. *Testimonials* (other than those that satisfy rule 206(4)-1(b)(4)(ii))?

Y N

d. *Endorsements* (other than those that satisfy rule 206(4)-1(b)(4)(ii))?

Y N

e. *Third-party ratings*?

Y N

(2) If you answer "yes" to L(1)(c), (d), or (e) above, do you pay or otherwise provide cash or non-cash compensation, directly or indirectly, in connection with the use of *testimonials, endorsements,* or *third-party ratings*?

Y N

(3) Do any of your *advertisements* include *hypothetical performance*?

Y N

(4) Do any of your *advertisements* include *predecessor performance*?

Y N

* * * * *

APPENDIX B: FORM ADV GLOSSARY OF TERMS

GLOSSARY OF TERMS

1. **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***, that offers the investment adviser's investment advisory services with regard to securities to prospective ***clients*** or investors in a ***private fund*** advised by the investment adviser or offers new investment advisory services with regard to securities to current ***clients***

or investors in a ***private fund*** advised by the investment adviser, but does not include: (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 other required communication; or (C) a communication that includes ***hypothetical performance*** that is provided: (1) 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 (2) to a prospective or current investor in a ***private fund*** advised by the investment adviser in a one-on-one communication; and (ii) any ***endorsement*** or ***testimonial*** for which an investment adviser provides compensation, directly or indirectly, but does not include any 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. *[Used in: Part 1A, Item 5]*

2. **Advisory Affiliate:** Your advisory affiliates are (1) all of your officers, partners, or directors (or any ***person*** performing similar functions); (2) all ***persons*** directly or indirectly ***controlling*** or ***controlled*** by you; and (3) all of your current ***employees*** (other than ***employees*** performing only clerical, administrative, support or similar functions).

   If you are a "separately identifiable department or division" (SID) of a bank, your ***advisory affiliates*** are: (1) all of your bank's ***employees*** who perform your investment advisory activities (other than clerical or administrative ***employees***); (2) all ***persons*** designated by your bank's board of directors as responsible for the day-to-day conduct of your investment advisory activities (including supervising the ***employees*** who perform investment advisory activities); (3) all ***persons*** who directly or indirectly ***control*** your bank, and all ***persons*** whom you ***control*** in connection with your investment advisory activities; and (4) all other ***persons*** who directly manage any of your investment advisory activities (including directing, supervising or performing your advisory activities), all ***persons*** who directly or indirectly ***control*** those management functions, and all ***persons*** whom you ***control*** in connection with those management functions. *[Used in: Part 1A, Items 7, 11, DRPs; Part 1B, Item 2]*

3. **Annual Updating Amendment:** Within 90 days after your firm's fiscal year end, your firm must file an "annual updating amendment," which is an amendment to your firm's Form ADV that reaffirms the eligibility information contained in Item 2 of Part 1A and updates the responses to any other item for which the information is no longer accurate. *[Used in: General Instructions; Part 1A, Instructions, Introductory Text, Item 2; Part 2A, Instructions, Appendix 1 Instructions; Part 2B, Instructions]*

4. **Borrowings:** Borrowings include secured borrowings and unsecured borrowings, collectively. Secured borrowings are obligations for borrowed money in respect of which the borrower has posted collateral or other credit support and should include any reverse repos (i.e., any sale of securities coupled with an agreement to repurchase the same (or similar) securities at a later date at an agreed price). Unsecured borrowings are obligations for borrowed money in respect of which the borrower has not posted collateral or other credit support. *[Used in: Part 1A, Instructions, Item 5, Schedule D]*

5. **Brochure:** A written disclosure statement that you must provide to ***clients*** and prospective ***clients***. See SEC rule 204-3; Form ADV, Part 2A. *[Used in: General Instructions; Used throughout Part 2]*

6. **Brochure Supplement:** A written disclosure statement containing information about certain of your ***supervised persons*** that your firm is required by Part 2B of Form ADV to provide to ***clients*** and prospective ***clients***. See SEC rule 204-3; Form ADV, Part 2B. *[Used in: General Instructions; Used throughout Part 2]*

7. **Charged:** Being accused of a crime in a formal complaint, information, or indictment (or equivalent formal charge). *[Used in: Part 1A, Item 11; DRPs]*

8. **Client:** Any of your firm's investment advisory clients. This term includes clients from which your firm receives no compensation, such as family members of your ***supervised persons***. If your firm also provides other services (e.g., accounting services), this term does not include clients that are not investment advisory clients. *[Used throughout Form ADV and Form ADV-W]*

9. **Commodity Derivative:** Exposures to commodities that you do not hold physically, whether held synthetically or through derivatives (whether cash or physically settled). *[Used in: Part 1A, Schedule D]*

10. **Control:** The power, directly or indirectly, to direct the management or policies of a ***person***, whether through ownership of securities, by contract, or otherwise.

    - Each of your firm's officers, partners, or directors exercising executive responsibility (or ***persons*** having similar status or functions) is presumed to control your firm.

    - A ***person*** is presumed to control a corporation if the ***person***: (i) directly or indirectly has the right to vote 25 percent or more of a class of the corporation's voting securities; or (ii) has the power to sell or direct the sale of 25 percent or more of a class of the corporation's voting securities.

    - A ***person*** is presumed to control a partnership if the ***person*** has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the partnership.

    - A ***person*** is presumed to control a limited liability company ("LLC") if the ***person***: (i) directly or indirectly has the right to vote 25 percent or more of a class of the interests of the LLC; (ii) has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the LLC; or (iii) is an elected manager of the LLC.

    - A ***person*** is presumed to control a trust if the ***person*** is a trustee or ***managing agent*** of the trust.

    [Used in: General Instructions; Part 1A, Instructions, Items 2, 7, 10, 11, 12, Schedules A, B, C, D, R; DRPs]

11. **Credit Derivative:** Single name credit default swap, including loan credit default swap, credit default swap referencing a standardized basket of credit entities, including credit default swap indices and indices referencing leveraged loans, and credit default swap referencing bespoke basket or tranche of collateralized debt obligations and collateralized loan obligations (including cash flow and synthetic) other than mortgage backed securities. *[Used in: Part 1A, Schedule D]*

12. **Custody:** Holding, directly or indirectly, ***client*** funds or securities, or having any authority to obtain possession of them. You have custody if a ***related person*** holds, directly or indirectly, ***client*** funds or securities, or has any authority to obtain possession of them, in connection with advisory services you provide to ***clients***. Custody includes:

    - Possession of ***client*** funds or securities (but not of checks drawn by ***clients*** and made payable to third parties) unless you receive them inadvertently and you return them to the sender promptly, but in any case within three business days of receiving them;

    - Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw ***client*** funds or securities maintained with a custodian upon your instruction to the custodian; and

    - Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives you or your ***supervised person*** legal ownership of or access to ***client*** funds or securities.

    [Used in: Part 1A, Item 9; Part 1B, Instructions, Item 2; Part 2A, Items 15, 18]

13. **Discretionary Authority or Discretionary Basis:** Your firm has discretionary authority or manages assets on a discretionary basis if it has the authority to decide which securities to purchase and sell for the ***client***. Your firm also has discretionary authority if it has the authority to decide which investment advisers to retain on behalf of the ***client***. *[Used in: Part 1A, Instructions, Item 8; Part 1B, Instructions; Part 2A, Items 4, 16, 18; Part 2B, Instructions]*

14. **Employee:** This term includes an independent contractor who performs advisory functions on your behalf. *[Used in: Part 1A, Instructions, Items 1, 5, 11; Part 2B, Instructions]*

15. **Endorsement:** Any statement by a person other than a current ***client*** or investor in a ***private fund*** advised by the investment adviser that: (i) indicates approval, support, or recommendation of the investment adviser or its ***supervised persons*** or describes that person's experience with the investment adviser or its ***supervised persons***; (ii) directly or indirectly solicits any current or prospective ***client*** or investor to be a ***client*** of, or an investor in a ***private fund*** advised by, the investment adviser; or (iii) refers any current or prospective ***client*** of, or an investor in a ***private fund*** advised by, the investment adviser. *[Used in: Part 1A, Item 5]*

16. **Enjoined:** This term includes being subject to a mandatory injunction, prohibitory injunction, preliminary injunction, or a temporary restraining ***order***. *[Used in: Part 1A, Item 11; DRPs]*

17. **Equity Derivative:** Includes both listed equity derivative and derivative exposure to unlisted securities. Listed equity derivative includes all synthetic or derivative exposure to equities, including preferred equities, listed on a regulated exchange. Listed equity derivative also includes a single stock future, equity index future, dividend swap, total return swap (contract for difference), warrant and right. Derivative exposure to unlisted equities includes all synthetic or derivative exposure to equities, including preferred equities, that are not listed on a regulated exchange. Derivative exposure to unlisted securities also includes a single stock future, equity index future, dividend swap, total return swap (contract for difference), warrant and right. *[Used in: Part 1A, Schedule D]*

18. **Exempt Reporting Adviser:** An investment adviser that qualifies for the exemption from registration under section 203(l) of the Advisers Act because it is an adviser solely to one or more venture capital funds, or under rule 203(m)-1 of the Advisers Act because it is an adviser solely to ***private funds*** and has assets under management in the United States of less than $150 million. *[Used in: Throughout Part 1A; General Instructions; Form ADV-H; Form ADV-NR]*

19. **Felony:** For jurisdictions that do not differentiate between a felony and a ***misdemeanor***, a felony is an offense punishable by a sentence of at least one year imprisonment and/or a fine of at least $1,000. The term also includes a general court martial. *[Used in: Part 1A, Item 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

20. **Filing Adviser:** An investment adviser eligible to register with the SEC that files (and amends) a single ***umbrella registration*** on behalf of itself and each of its ***relying advisers***. *[Used in: General Instructions; Part 1A, Items 1, 2, 3, 10 and 11; Schedule R]*

21. **FINRA CRD** or **CRD:** The Web Central Registration Depository ("CRD") system operated by FINRA for the registration of broker-dealers and broker-dealer representatives. *[Used in: General Instructions; Part 1A, Item 1, Schedules A, B, C, D, R, DRPs; Form ADV-W, Item 1]*

22. **Foreign Exchange Derivative:** Any derivative whose underlying asset is a currency other than U.S. dollars or is an exchange rate. Cross-currency interest rate swaps should be included in foreign exchange derivatives and excluded from ***interest rate derivatives***. *[Used in: Part 1A, Schedule D]*

23. **Foreign Financial Regulatory Authority:** This term includes (1) a foreign securities authority; (2) another governmental body or foreign equivalent of a ***self-regulatory organization*** empowered by a foreign government to administer or enforce its laws relating to the regulation of ***investment-related*** activities; and (3) a foreign membership organization, a function of which is to regulate the participation of its members in the activities listed above. *[Used in: Part 1A, Items 1, 11, DRPs; Part 2A, Item 9; Part 2B, Item 3]*

24. **Found:** This term includes adverse final actions, including consent decrees in which the respondent has neither admitted nor denied the findings, but does not include agreements, deficiency letters, examination reports, memoranda of understanding, letters of caution, admonishments, and similar informal resolutions of matters. *[Used in: Part 1A, Item 11; Part 1B, Item 2; Part 2A, Item 9; Part 2B, Item 3]*

25. **Government Entity:** Any state or political subdivision of a state, including (i) any agency, authority, or instrumentality of the state or political subdivision; (ii) a plan or pool of assets ***controlled*** by the state or political subdivision or any agency, authority, or instrumentality thereof; and (iii) any officer, agent, or employee of the state or political subdivision or any agency, authority, or instrumentality thereof, acting in their official capacity. *[Used in: Part 1A, Item 5]*

26. **Gross Notional Value:** The gross nominal or notional value of all transactions that have been entered into but not yet settled as of the reporting date. For contracts with variable nominal or notional principal amounts, the basis for reporting is the nominal or notional principal amounts as of the reporting date. For options, use delta adjusted notional value. *[Used in: Part 1A, Schedule D]*

27. **High Net Worth Individual:** An individual who is a ***qualified client*** or who is a "qualified purchaser" as defined in section 2(a)(51)(A) of the Investment Company Act of 1940. *[Used in: Part 1A, Item 5]*

28. **Home State:** If your firm is registered with a ***state securities authority***, your firm's "home state" is the state where it maintains its ***principal office and place of business***. *[Used in: Part 1B, Instructions]*

29. **Hypothetical Performance:** Performance results that were not actually achieved by any portfolio of the investment adviser. (i) ***Hypothetical performance*** includes, but is not limited to: (A) performance derived from model portfolios; (B) performance that is backtested by the application of a strategy to data from prior time periods when the strategy was not actually used during those time periods; and (C) targeted or projected performance returns with respect to any portfolio or to the investment services offered in the ***advertisement***; however: (ii) ***Hypothetical performance*** does not include: (A) an interactive analysis tool where a ***client*** or investor, or prospective ***client***, or investor, uses the tool to produce simulations and statistical analyses that present the likelihood of various investment outcomes if certain investments are made or certain investment strategies or styles are undertaken, thereby serving as an additional resource to investors in the evaluation of the potential risks and returns of investment choices; provided that the investment adviser: (1) provides a description of the criteria and methodology used, including the investment analysis tool's limitations and key assumptions; (2) explains that the results may vary with each use and over time; (3) if applicable, describes the universe of investments considered in the analysis, explains how the tool determines which investments to select, discloses if the tool favors certain investments and, if so, explains the reason for the selectivity, and states that other investments not considered may have characteristics similar or superior to those being

analyzed; and (4) discloses that the tool generates outcomes that are hypothetical in nature; or (B) ***predecessor performance*** that is displayed in compliance with rule 206(4)-1(d)(7). *[Used in: Part 1A, Item 5]*

30. **Impersonal Investment Advice:** Investment advisory services that do not purport to meet the objectives or needs of specific individuals or accounts. *[Used in: Part 1A, Instructions; Part 2A, Instructions; Part 2B, Instructions]*

31. **Independent Public Accountant:** A public accountant that meets the standards of independence described in rule 2-01(b) and (c) of Regulation S-X (17 CFR 210.2-01(b) and (c)). *[Used in: Part 1A, Item 9; Schedule D]*

32. **Interest Rate Derivative:** Any derivative whose underlying asset is the obligation to pay or the right to receive a given amount of money accruing interest at a given rate. Cross-currency interest rate swaps should be included in ***foreign exchange derivatives*** and excluded from interest rate derivatives. This information must be presented in terms of 10-year bond equivalents. *[Used in: Part 1A, Schedule D]*

33. **Investment Adviser Representative:** Any of your firm's ***supervised persons*** (*except* those that provide only ***impersonal investment advice***) is an investment adviser representative, if --

    - the ***supervised person*** regularly solicits, meets with, or otherwise communicates with your firm's ***clients***,

    - the ***supervised person*** has more than five ***clients*** who are natural persons and not ***high net worth individuals***, and

    - more than ten percent of the ***supervised person's clients*** are natural persons and not ***high net worth individuals***.

NOTE: If your firm is registered with the ***state securities authorities*** and not the SEC, your firm may be subject to a different state definition of "investment adviser representative." Investment adviser representatives of SEC-registered advisers may be required to register in each state in which they have a place of business.

[Used in: General Instructions; Part 1A, Item 5; Part 2B, Item 1]

34. **Investment-Related:** Activities that pertain to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with an investment adviser, broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, futures sponsor, bank, or savings association). *[Used in: Part 1A, Items 7, 11, Schedule D, DRPs; Part 1B, Item 2; Part 2A, Items 9 and 19; Part 2B, Items 3, 4 and 7]*

35. **Involved:** Engaging in any act or omission, aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act. *[Used in: Part 1A, Item 11; Part 2A, Items 9 and 10; Part 2B, Items 3 and 7]*

36. **Legal Entity Identifier:** A "legal entity identifier" assigned by a utility endorsed by the Global LEI Regulatory Oversight Committee (ROC) or accredited by the Global LEI Foundation (GLEIF). *[Used in: Part 1A, Item 1, Schedules D and R]*

37. **Management Persons:** Anyone with the power to exercise, directly or indirectly, a ***controlling*** influence over your firm's management or policies, or to determine the general investment advice given to the ***clients*** of your firm.

    Generally, all of the following are management persons:

    - Your firm's principal executive officers, such as your chief executive officer, chief financial officer, chief operations officer, chief legal officer, and chief compliance officer; your directors, general partners, or trustees; and other individuals with similar status or performing similar functions;

    - The members of your firm's investment committee or group that determines general investment advice to be given to ***clients***; and

    - If your firm does not have an investment committee or group, the individuals who determine general investment advice provided to ***clients*** (if there are more than five people, you may limit your firm's response to their supervisors).

[Used in: Part 1B, Item 2; Part 2A, Items 9, 10 and 19]

38. **Managing Agent:** A managing agent of an investment adviser is any ***person***, including a trustee, who directs or manages (or who participates in directing or managing) the affairs of any unincorporated organization or association that is not a partnership. *[Used in: General Instructions; Form ADV-NR; Form ADV-W, Item 8]*

39. **Minor Rule Violation:** A violation of a ***self-regulatory organization*** rule that has been designated as "minor" pursuant to a plan approved by the SEC. A rule violation may be designated as "minor" under a plan if the sanction imposed consists of a fine of $2,500 or less, and if the sanctioned ***person*** does not contest the fine. (Check with the appropriate ***self-regulatory organization*** to determine if a particular rule violation has been designated as "minor" for these purposes.) *[Used in: Part 1A, Item 11]*

40. **Misdemeanor:** For jurisdictions that do not differentiate between a ***felony*** and a misdemeanor, a misdemeanor is an offense punishable by a sentence of less than one year imprisonment and/or a fine of less than $1,000. The term also includes a special court martial. *[Used in: Part 1A, Item 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

41. **Non-Resident:** (a) an individual who resides in any place not subject to the jurisdiction of the United States; (b) a corporation incorporated in or that has its ***principal office and place of business*** in any place not subject to the jurisdiction of the United States; and (c) a partnership or other unincorporated organization or association that is formed in or has its ***principal office and place of business*** in any place not subject to the jurisdiction of the United States. *[Used in: General Instructions; Form ADV-NR]*

42. **Notice Filing:** SEC-registered advisers may have to provide ***state securities authorities*** with copies of documents that are filed with the SEC. These filings are referred to as "notice filings." *[Used in: General Instructions; Part 1A, Item 2; Execution Page(s); Form ADV-W]*

43. **Order:** A written directive issued pursuant to statutory authority and procedures, including an order of denial, exemption, suspension, or revocation. Unless included in an order, this term does not include special stipulations, undertakings, or agreements relating to payments, limitations on activity or other restrictions. *[Used in: Part 1A, Items 2 and 11, Schedules D and R; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

44. **Other Derivative:** Any derivative that is not a ***commodity derivative***, ***credit derivative***, ***equity derivative***, ***foreign exchange derivative*** or ***interest rate derivative***. *[Used in: Part 1A, Schedule D]*

45. **Parallel Managed Account:** With respect to any registered investment company or series thereof or business development company, a parallel managed account is any managed account or other pool of assets that you advise and that pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as the identified investment company or series thereof or business development company that you advise. *[Used in: Part 1A, Schedule D]*

46. **Performance-Based Fee:** An investment advisory fee based on a share of capital gains on, or capital appreciation of, ***client*** assets. A fee that is based upon a percentage of assets that you manage is not a performance-based fee. *[Used in: Part 1A, Item 5; Part 2A, Items 6 and 19]*

47. **Person:** A natural person (an individual) or a company. A company includes any partnership, corporation, trust, limited liability company ("LLC"), limited liability partnership ("LLP"), sole proprietorship, or other organization. *[Used throughout Form ADV and Form ADV-W]*

48. **Predecessor Performance:** Investment performance achieved by a group of investments consisting of an account or a ***private fund*** that was not advised at all times during the period shown by the investment adviser advertising the performance. *[Used in: Part 1A, Item 5]*

49. **Principal Office and Place of Business:** Your firm's executive office from which your firm's officers, partners, or managers direct, ***control***, and coordinate the activities of your

firm. *[Used in: Part 1A, Instructions, Items 1 and 2; Schedules D and R; Form ADV-W, Item 1]*

50. **Private Fund:** An issuer that would be an investment company as defined in section 3 of the Investment Company Act of 1940 but for section 3(c)(1) or 3(c)(7) of that Act. *[Used in: General Instructions; Part 1A, Instructions, Items 2, 5, 7, and 9; Part 1A, Schedule D]*

51. **Proceeding:** This term includes a formal administrative or civil action initiated by a governmental agency, ***self-regulatory organization*** or ***foreign financial regulatory authority***; a ***felony*** criminal indictment or information (or equivalent formal charge); or a ***misdemeanor*** criminal information (or equivalent formal charge). This term does not include other civil litigation, investigations, or arrests or similar charges effected in the absence of a formal criminal indictment or information (or equivalent formal charge). *[Used in: Part 1A, Item 11, DRPs; Part 1B, Item 2; Part 2A, Item 9; Part 2B, Item 3]*

52. **Qualified Client:** A ***client*** that satisfies the definition of qualified client in SEC rule 205-3. *[Used in: General Instructions; Part 1A, Schedule D]*

53. **Related Person:** Any ***advisory affiliate*** and any ***person*** that is under common ***control*** with your firm. *[Used in: Part 1A, Items 7, 8 and 9; Schedule D; Form ADV-W, Item 3; Part 2A, Items 10, 11, 12 and 14; Part 2A, Appendix 1, Item 6]*

54. **Relying Adviser:** An investment adviser eligible to register with the SEC that relies on a ***filing adviser*** to file (and amend) a single ***umbrella registration*** on its behalf. *[Used in: General Instructions; Part 1A, Items 1, 7 and 11; Schedules D and R]*

55. **Self-Regulatory Organization** or **SRO:** Any national securities or commodities exchange, registered securities association, or registered clearing agency. For example, the Chicago Board of Trade ("CBOT"), FINRA and New York Stock Exchange ("NYSE") are self-regulatory organizations. *[Used in: Part 1A, Item 11; DRPs; Part 1B, Item 2; Part 2A, Items 9 and 19; Part 2B, Items 3 and 7]*

56. **Sovereign Bonds:** Any notes, bonds and debentures issued by a national government (including central government, other governments and central banks but excluding U.S. state and local governments), whether denominated in a local or foreign currency. *[Used in: Part 1A, Schedule D]*

57. **Sponsor:** A sponsor of a ***wrap fee program*** sponsors, organizes, or administers the program or selects, or provides advice to ***clients*** regarding the selection of, other investment advisers in the program. *[Used in: Part 1A, Item 5, Schedule D; Part 2A, Instructions, Appendix 1 Instructions]*

58. **State Securities Authority:** The securities commissioner or commission (or any agency, office or officer performing like functions) of any state of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. *[Used throughout Form ADV]*

59. **Supervised Person:** Any of your officers, partners, directors (or other ***persons*** occupying a similar status or performing similar functions), or ***employees***, or any other ***person*** who provides investment advice on your behalf and is subject to your supervision or ***control***. *[Used throughout Part 2]*

60. **Testimonial**: Any statement by a current ***client*** or investor in a ***private fund*** advised by the investment adviser: (i) about the ***client*** or investor's experience with the investment adviser or its ***supervised persons*** (ii) that directly or indirectly solicits any current or prospective ***client*** or investor to be a client of, or an investor in a ***private fund*** advised by, the investment adviser; or (iii) that refers any current or prospective ***client*** or investor to be a ***client*** of, or an investor in a ***private fund*** advised by, the investment adviser. *[Used in: Part 1A, Item 5]*

61. **Third-party Rating**: A rating or ranking of an investment adviser provided by a ***person*** who is not a ***related person*** and such ***person*** provides such ratings or rankings in the ordinary course of its business. *[Used in: Part 1A, Item 5]*

62. **Umbrella Registration:** A single registration by a ***filing adviser*** and one or more ***relying advisers*** who collectively conduct a single advisory business and that meet the conditions set forth in General Instruction 5. *[Used in: General Instructions; Part 1A, Items 1, 2, 3, 7, 10 and 11, Schedules D and R]*

63. **United States person:** This term has the same meaning as in rule 203(m)-1 under the Advisers Act, which includes any natural person that is resident in the United States. *[Used in: Part 1A, Instructions, Item 5; Schedule D]*

64. **Wrap Brochure or Wrap Fee Program Brochure:** The written disclosure statement that ***sponsors*** of ***wrap fee programs*** must provide to each of their ***wrap fee program clients***. *[Used in: Part 2, General Instructions; Used throughout Part 2A, Appendix 1]*

65 **Wrap Fee Program:** Any advisory program under which a specified fee or fees not based directly upon transactions in a ***client's*** account is charged for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and the execution of ***client*** transactions. [*Used in: Part 1, Item 5; Schedule D; Part 2A, Instructions, Item 4, used throughout Appendix 1; Part 2B, Instructions]*

By the Commission.

Dated: December 22, 2020.

Vanessa A. Countryman,

Secretary.