



# Proposed Revisions to the Advertising and Cash Solicitation Rules – Comment Letters

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# Introduction



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# Introduction

- On November 4, 2019, in a 507 page proposed rule release, the Securities & Exchange Commission proposed revisions to the existing rules on Investment Adviser Advertisements and Compensation for Solicitations. Release No. IA-5407.
- Comments on these Proposed Rules were due by February 10, 2020.
- We reviewed 23 comment letters submitted to the SEC by leading industry groups, registered investment advisers, law firms, and other interested parties (see below for a list of commenters). The letters address a variety of issues, but as expected, on balance, the letters focus primarily on narrowing the application and impact of the rules.
  - American Investment Council (AIC), Baillie Gifford, Blackrock, CFA Institute (CFA), City Bar of New York, Council of Institutional Investors, Credit Suisse, Fidelity Investments, Fried, Frank, Harris, Shriver & Jacobson, LLP, Institutional Limited Partners Association (ILPA), Managed Funds Association and Alternative Investment Management Association (MFA and AIMA), LinkedIn, Proskauer Rose LLP, Investment Adviser Association (IAA), Investment Company Institute (ICI), Seward & Kissel LLP, Sidley Austin LLP, SIFMA, Ropes & Gray LLP, Wealthfront Corporation, Wellington Management, Winston & Strawn LLP

# Summary of Advertising Rules Revisions

- Principles-Based Approach
- Definition of “Advertising”
- General Prohibitions
- Retail / Non-Retail Persons
- Performance Advertising
- Hypothetical and Related Performance
- Past Specific Recommendations, Predecessor Performance, and Extracted Performance
- Compliance Review & Form ADV Amendments

# Principles-Based Approach

- The Proposed Rule was described by the SEC as a move away from specific prohibitions to a new principles-based approach. It replaces five per se prohibitions in the existing Advertising Rule with seven general prohibitions.
- A majority of the commenters support the Proposed Rule's principles-based approach to regulating advertising by investment advisers and, in the words of the Investment Advisers Association, a move away from “a complex web of existing SEC no action guidance”. None of the commenters raised issues with this change to a principles-based approach; rather, commenters have been quick to point out aspects of the Proposed Rule where they believe specific guidelines should be replaced with a principles-based approach.
- Examples of commenters urging a further adoption of a principles-based approach include (i) the distinction in the Proposed Rule between retail and non-retail investors (SIFMA), (ii) the required designated employee review of advertisements (SIFMA, Blackrock), and (iii) the requirement to “clearly and prominently” disclose risks (Ropes).

# Definition of Advertising

- All of the comment letters we reviewed provide feedback on the revised definition of “Advertising,” with the vast majority recommending to narrow the definition in a variety of ways.
- The Proposed Rule would expand the definition of “advertisement” to include any communication, disseminated by any means, by or on behalf of an investment adviser, that offers or promotes investment advisory services or that seeks to obtain or retain advisory clients or investors in any pooled investment vehicle advised by the adviser.
- However, it excludes four categories of communications:
  - live oral communications that are not broadcast;
  - responses to certain unsolicited requests for specified information (excluding communications containing hypothetical performance and communications to Retail Persons that contain performance);
  - advertisements, other sales material, or sales literature that is about a registered investment company or a business development company and is within the scope of other Commission rules; and
  - information required to be contained in a statutory or regulatory notice, filing, or other communication.

# Definition of Advertising

## Summary of Comments on Definition of Advertising



# Highlights from Comments on Definition of Advertising

- A common theme in the comments on advertising is a focus on reducing the scope and breadth of the definition of “advertising” under the Proposed Rule.
- The Proposed Rule only exempts responses to unsolicited requests from the definition of “advertising”; however, the majority of the comments we reviewed, including those from SIFMA, agree that any ancillary information provided as part of such response should also be excluded if it reasonably relates to the request. IAA also makes the point that due diligence data provided to non-retail investors should be excepted, and several commenters go further to say that even responses containing performance information should be excluded if it is requested or, in certain cases, reasonably related to the request.
- Several commenters seek clarification as to whether advisers will be permitted to provide information to consultant databases under the exclusion for responses to unsolicited requests.
- Several commenters argue that all marketing materials related to private fund offerings should be excluded from the requirements of the Proposed Rule on the basis that they are used to solicit investors rather than advisory clients and that these investors are typically sophisticated, and therefore do not require the same level of disclosures as retail investors.
- CFA would have a spectrum of types of advertisements, with more prescriptive rules applied to more broadly disseminated information and less with respect to presentations for sophisticated investors.



# General Prohibitions

- The Proposed Rule replaces the five current per se prohibitions on advertisements with seven general prohibitions.

Proposed Rule	Current Rule
<p>(1) making an untrue statement of a material fact, or omission of a material fact necessary to make the statement made, in light of the circumstances under which it was made, not misleading;</p> <p>(2) making a material claim or statement that is <u>unsubstantiated</u>;</p> <p>(3) making an untrue or misleading implication about, or being reasonably likely to cause an untrue or misleading inference to be drawn concerning, a material fact relating to the investment adviser;</p> <p>(4) discussing or implying any potential benefits without clear and prominent discussion of associated material risks or other limitations;</p> <p>(5) referring to <u>specific investment advice</u> provided by the adviser that is not presented in a <u>fair and balanced</u> manner;</p> <p>(6) including or excluding performance results, or presenting performance time periods, in a manner that is not <u>fair and balanced</u>;</p> <p>(7) being otherwise materially misleading.</p> <p>Proposed rule 206(4)-1(a)(1)-(7).</p>	<p>(1) testimonials,</p> <p>(2) past specific recommendations,</p> <p>(3) charts/formulas that are offered to assist a person in making investment decisions without prominently disclosing the limitations,</p> <p>(4) a statement that a service or report is free of charge if it is not in fact free of charge, and</p> <p>(5) any untrue statement of material fact or which is otherwise false or misleading.</p> <p>Rule 206(4)-1.</p>

# General Prohibitions

- There are a variety of comments on the seven general prohibitions.

## Comments on Specific Prohibitions

SUPPORTS USE OF HYPERLINKS AND/OR SEPARATE  
DISCLOSURE TO MEET CLEAR AND PROMINENT  
DISCLOSURE OF RISKS

7

SUPPORTS REMOVAL OF PER SE PROHIBITION ON  
TESTIMONIALS/ENDORSEMENTS

7

WOULD MODIFY OR REMOVE REQUIREMENTS  
AROUND EVALUATING METHODOLOGY BEHIND  
THIRD PARTY RANKINGS

4

OPPOSES THE PROHIBITION ON  
UNSUBSTANTIATED MATERIAL CLAIMS AND/OR  
UNTRUE OR MISLEADING IMPLICATIONS ABOUT  
MATERIAL FACTS

3

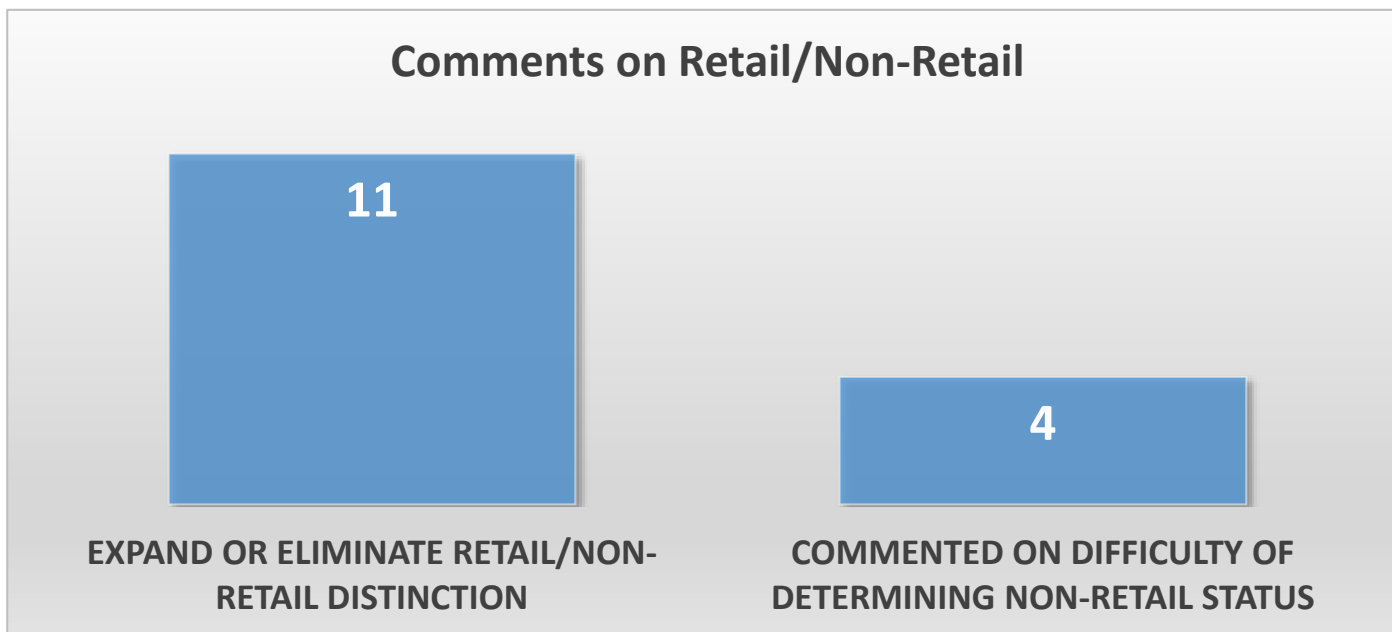
# General Prohibitions

Other comments include:

- MFA and AIMA would permit compensation for third party ratings so long as the compensation does not effect the outcome.
- SIFMA would only regulate testimonials and endorsements that explicitly relate to the advisory services or capabilities of the adviser under the Advertising Rule. It would not subject other statements or opinions about the adviser, such as those relating to the adviser's soft skills, to the requirements of the Advertising Rule. IAA is concerned that as drafted, the rule requires that an adviser present negative testimonials on a side by side basis with positive testimonials.
- Not unexpectedly, LinkedIn supports the rule clarification that “likes” and “shares” on social media are not testimonials or endorsements.
- ILPA and CFA would revise disclosures to be more specifically tailored to the information presented.

# Retail / Non-Retail Persons

- The proposed rules regarding the use of performance have different requirements for advertisements directed solely at “Non-Retail Investors,” as opposed to “Retail Investors”.
- Non-Retail Persons are persons who are “qualified purchasers” or “knowledgeable employees” under the Investment Company Act.
- Retail Persons are all other persons.
- A majority of the letters take issue with the Retail / Non-Retail dichotomy created in the proposed rules, with 11 of the commentators specifically calling for it to be removed or, at a minimum, expanding the definition of Non-Retail to cover accredited investors.



# Performance Advertising

- The Proposed Rule requires advertisements that are not solely disseminated to Non-Retail Persons to include: (1) the presentation of net performance alongside any presentation of gross performance, and (2) generally, the presentation of the performance results of any portfolio or certain composite aggregations across 1-, 5-, and 10-year periods.
  - There are six commenters who suggest removal of the 1-, 5- and 10-year periods, particularly highlighting the fact that they have no relevance in the private equity fund context.
- Additionally, in a departure from the current rules, the Proposed Rule permits disclosure of gross performance results in advertising provided solely to “Non-Retail Persons” so long as the adviser provides (or offers to provide promptly) a schedule of fees and expenses deducted to calculate net performance. Advertisements provided to Retail Investors are required to show net performance, with at least equal prominence, alongside any presentation of gross performance.
  - Seven commenters agree that the requirement to provide a list of fees and expenses should be removed from the final rule. City Bar of NY, for example, notes that a schedule of fees and expenses would not provide meaningful protection to sophisticated investors who are already aware of the effect fees and expenses have on returns, and they posit that providing hypothetical fees and expenses could be misleading.
  - ILPA argues that the schedule of fees requirement should be revised to require more specific disclosures around methodologies, such as the impact of sublines and specific carried interest calculations.

# Performance Advertising

## Performance Advertising Comments

WOULD REMOVE OR TAILOR REQUIREMENT  
FOR SCHEDULE OF FEES AND EXPENSES

7

REQUESTS REMOVAL OF TIME BASED  
REPORTING ACROSS 1-, 5-AND 10-YEAR  
PERIODS FOR RETAIL ADVERTISEMENTS FOR  
ALL/CERTAIN PRIVATE FUNDS

6

REQUESTS TO LIMIT/SCALE REQUIRED  
DISCLOSURES

3

SUPPORTS NOT REQUIRING NET PERFORMANCE  
ALONGSIDE GROSS FOR NON-  
RETAIL/SOPHISTICATED

2

# Hypothetical and Related Performance

- In a departure from the current rule (but building off of relevant no action letters), the Proposed Rule specifically provides that hypothetical and model performance (including “target performance” and “projected returns”) can be included in advertising subject to certain requirements, including that the performance is relevant to the investor and the sponsors adequately disclose the risks and limitations of the performance.
  - There are a number of comments here focused on excluding target returns and, in certain cases, projected returns from the definition of hypothetical performance.
  - SIFMA specifically expresses concerns about prohibiting the use of hypothetical performance in retail performance because, in their view, advisers routinely rely on such performance when offering service to retail investors.
- The Proposed Rule requires that if an adviser is showing performance results, it must show performance results from all of its portfolios with substantially similar investment policies, objectives, and strategies as those being offered or promoted in the advertisement, with limited exceptions, either on a portfolio by portfolio basis or as a composite of all portfolios falling within the criteria.
  - Showing related performance is a hot topic as there is uncertainty about what that means in practice and how relevant that information is for investors. Ropes & Gray suggests that the requirement be removed entirely, while others like AIC request that separately managed accounts and prior funds be excluded. SIFMA and IAA argue that whether related performance must be included should be driven by the general prohibitions rather than prescribed rules.

# Hypothetical / Related Performance

## Comments on Hypothetical/Related Performance

WOULD EXCLUDE TARGET RETURNS FROM  
DEFINITION OF HYPOTHETICAL PERFORMANCE

8

COMMENTS ON RELATED PERFORMANCE

7

COMMENTS ON PREDECESSOR PERFORMANCE

5

COMMENTS ON PAST SPECIFIC  
RECOMMENDATIONS

5

REQUESTS TO REMOVE RELEVANCE STANDARD  
FOR USE OF HYPOTHETICAL, RELATED AND  
EXTRACTED

3

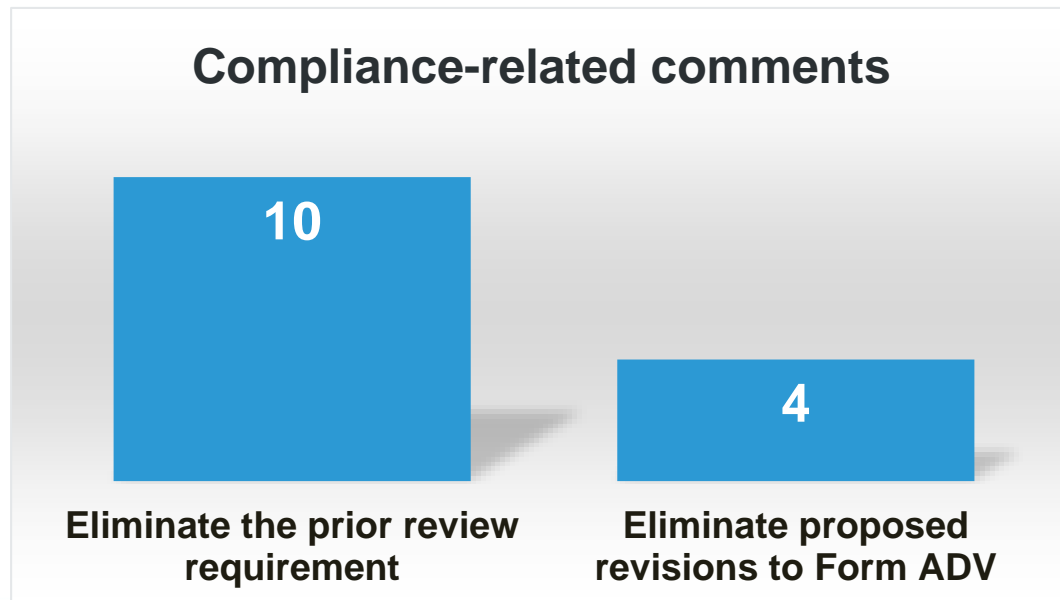


# Past Specific Recommendations, Predecessor Performance, and Extracted Performance

- The Proposed Rule prohibits (a) referring to specific investment advice provided by the adviser that is not presented in a fair and balanced manner, or (b) including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced.
- The Proposed Rule would permit showing the performance results of a subset of investments extracted from a portfolio, provided that it provides or offers to provide promptly the performance results of the entire portfolio.
- There are a number of varied comments on these rules but no specific theme across comments other than excluding target performance from the definition of hypothetical performance.
  - CFA suggests imposing higher requirements on extracted performance advertised as a standalone strategy, such as a fundamental belief that the strategy could be managed as a standalone portfolio. CFA also recommends using GIPS standards for prior performance.
  - Another commenter requests to add actual performance of the portfolio.
  - SIFMA reiterates its earlier comment about wanting to rely on general prohibitions instead of specific rules.
  - IAA requests specific standards that mirror existing no action guidance.
  - Ropes, Credit Suisse, and Wellington request to remove the relevance standard for hypothetical, related and extracted performance.

# Compliance Review and Form ADV Amendments

- The proposed amendments would require advertisements (as well as updates to advertisements) to be reviewed and approved in writing by a designated employee before dissemination, except for advertisements that are (1) communications disseminated only to a single person or household or to a single investor in a pooled investment vehicle, or (2) live oral communications broadcast on radio, television, the internet, or any other similar medium. The proposed changes to the recordkeeping rule would also require that investment advisers keep a copy of all designated employee approvals. The proposal would amend Form ADV to require additional information regarding advisers' advertising practices to help facilitate the Commission's inspection and enforcement capabilities.
- There were many letters in opposition to the prior review requirement, on the basis that each adviser should have the flexibility to determine the specifics of their own compliance practices rather than having those proscribed by regulation. Several commentators also opposed the related revisions to Form ADV.



# Summary of Proposed Cash Solicitation Rule Revisions

- **Definition of Solicitation**
- **Compensation**
- **Solicitor Disclosure**
- **Written Agreement**
- **Oversight and Compliance**
- **Exemptions**
- **Disqualification**

# Proposed Cash Solicitation Rule Revisions

- **Definition of Solicitor**: Generally maintains the current definition, however, and most significantly, the proposed rule would revise the existing rule to cover people who solicit existing and prospective investors in private funds. Therefore private funds and their advisers would no longer be outside the scope of this rule.
- **Compensation**: Under the proposed rule, both cash and non-cash compensation and direct and indirect payments would be covered, such that all forms of compensation would be prohibited unless the adviser complies with the rule.
- **Solicitor Disclosure**: The proposed rule requires that the solicitor and adviser agree in writing to provide specified disclosures to investors, including the terms of any compensation arrangement and any material conflicts of interest that may arise from the arrangement.

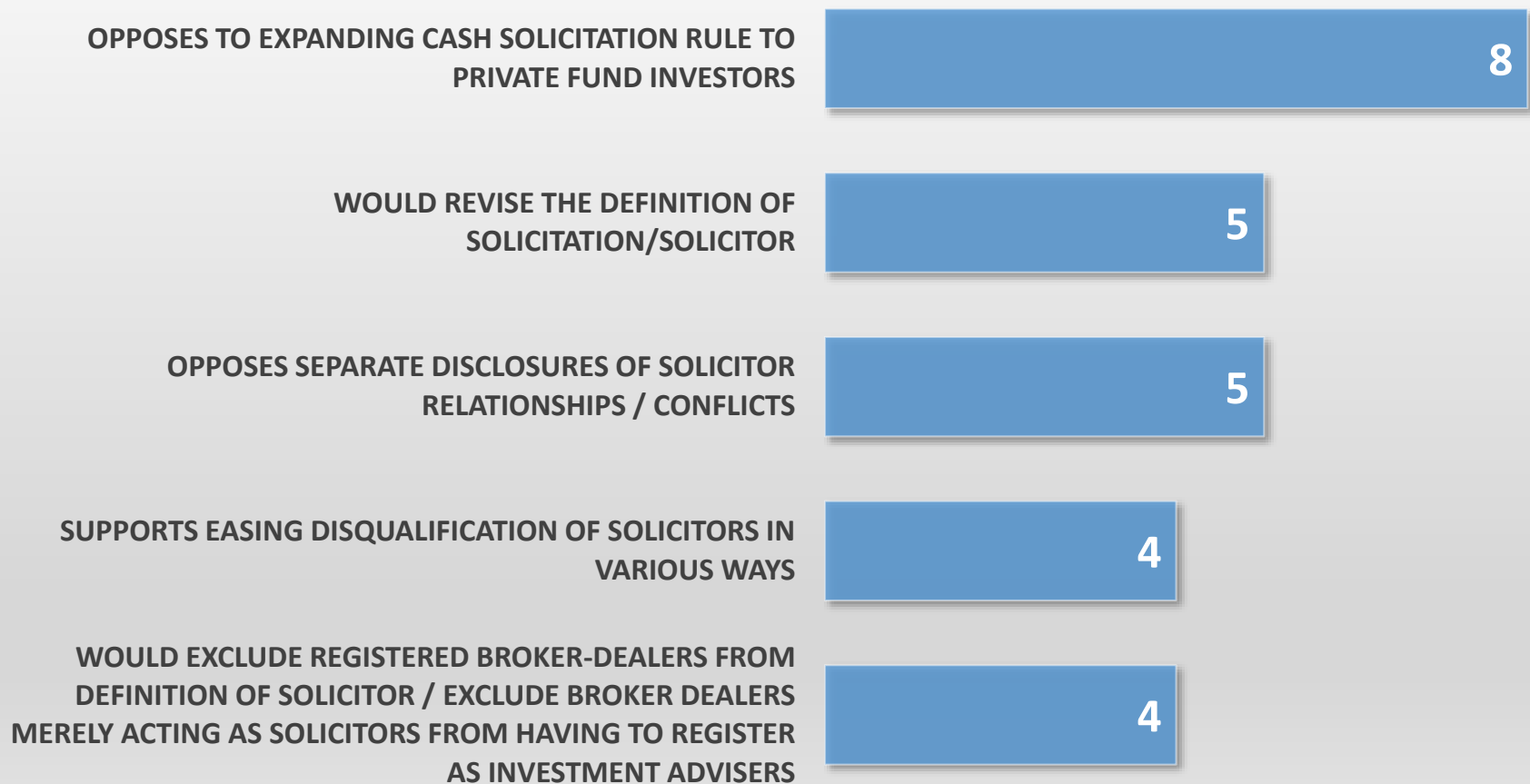
# Cash Solicitation Rule Revisions

- **Written Agreement**: Consistent with the current rule, the adviser's compensation arrangement with any solicitor must be pursuant to a written agreement, with exceptions for in house personnel and certain affiliates.
- **Oversight and Compliance**: Under the proposed rule, the adviser would need to have a reasonable basis for believing that the solicitor complied with the terms of the solicitation agreement.
- **Exemptions from the rule**: (i) solicitation that is solely for impersonal investment advice, and (ii) solicitation by an adviser's in-house solicitors and other affiliated solicitors. In-house and affiliated solicitors would still be required to disclose their affiliation with the adviser if for any reason it is unclear to the investor or the investor is otherwise unaware.
- **Disqualification**: The proposed rule makes certain revisions to the existing rule's disqualification provision by expanding the list of events for which a person can be disqualified from acting as a solicitor.

# Proposed Cash Solicitation Rule Revisions

- There are several comments on the proposed Cash Solicitation Rule amendments, most of which relate to its proposed application to private fund investors. In all, the comments seek to scale back the revisions.

## Comments on the Cash Solicitation Rule Amendments



# Conclusion



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