

SEC Proposes New Advertising and Solicitation Rules for Investment Advisers and Private Fund Sponsors

The Bottom Line

- The SEC's proposed amendments, if adopted, would significantly change the rules applicable to marketing, advertising and solicitation disclosure by investment advisers and private fund sponsors. They are, therefore, important both for public companies and all marketing communications firms working with them.
- The SEC is now reviewing public comments on the proposed rules. It may propose a subsequent comment period, or revised rule proposals, prior to issuing final rules. It is likely, however, that the final rules will be the long-awaited update to broaden and modernize the scope of communication covered by the law.

The U.S. Securities and Exchange Commission (SEC) announced proposed amendments in late 2019 intended to modernize rules relating to client marketing and solicitation by investment advisers and private fund sponsors. The proposed amendments represent long-overdue updates to the SEC's existing rules. The public comment period for the proposed amendments concluded on January 3, 2020. The SEC is now reviewing comments and may propose a subsequent comment period, or revised rule proposals prior to issuing final rules (if they choose to do so at all).

The Advertising Rules

The SEC's current rules for investment adviser advertising and marketing were adopted in 1961, when the means of communicating and disseminating information were much more limited than today. The proposed rules (the "Proposed Advertising Amendments") broaden the scope of communications covered to include communications "by any means" (including digital communication, other digital media, social media, and traditional methods) that offer or promote advisory services or that seek to obtain or retain advisory clients, subject to limited exceptions.

Prohibited Advertising Practices

The SEC's current rules include four rigid prohibitions that bar:

1. Testimonials;
2. References to past profitable recommendations;
3. Representations regarding graphic or device-based buy/sell indicators; and
4. Misleading claims of free services.

The current rules also include a general prohibition on marketing communications that contain any untrue statements of material fact or are otherwise false or misleading.

The Proposed Changes

The Proposed Advertising Amendments would include three significant changes.

First, they would replace the current rigid prohibitions with more flexible principles intended to prohibit advertising and marketing that:

1. Contains untrue statements or omissions of facts necessary to make the statements made not misleading;
2. Contains unsubstantiated material claims;
3. Contains untrue or misleading implications or inferences;
4. Fails to disclose material risks or other limitations;
5. Selects or presents past performance or investment advice in a manner that is not fair and balanced; or
6. Is otherwise materially misleading.

Second, they would permit testimonials, endorsements and third-party ratings, as long as the advertisement discloses whether the applicable reviewer was compensated, together with certain other restrictions and conditions.

Third, they would provide tailored requirements for the presentation of performance results, based on an advertisement's intended audience. The rule would categorize investors as "retail" or "non-retail," with the latter consisting primarily of entities with \$25 million, or individuals with \$5 million, in investments. It establishes more prescriptive requirements for presenting performance results to retail investors than to non-retail investors.

Internal Review and Form ADV Reporting Requirements

The Proposed Advertising Amendments would impose new internal review and Form ADV reporting requirements on investment advisers. The internal review requirement would require that all marketing materials be reviewed by a designated employee for compliance with the advertising rules before dissemination.

Exceptions would apply to advertisements that are:

1. Sent to a single person or investor (although email communications based upon a template are excluded); or
2. Live broadcast oral communications.

The proposed reporting requirement would establish that every adviser must report additional information regarding its advertising practices on Form ADV, with special rules applicable to advertising performance results.

The Solicitation Rules

Scope of the Rules

The primary purpose of the solicitation rules is to require that clients of investment advisers receive disclosure about compensation payable to persons soliciting business for advisers. The proposed rules relating to solicitation (the Proposed Solicitation Amendments) would, most significantly, broaden the application of the solicitation rules to include:

1. Persons who solicit investors in private funds, as the current rules do not reach investors in private funds; and
2. All forms of compensation, rather than only cash compensation.

Written Agreement Requirement

Under the current SEC rules, solicitors and investment advisers must enter into written agreements containing certain required provisions. While this rule will largely be retained, the Proposed Solicitation Amendments would eliminate existing requirements that the written agreement include:

1. A provision requiring the solicitor to provide each client with the investment adviser's Form ADV; and
2. An undertaking by the solicitor to perform its solicitation activities in a manner consistent with the instructions of the investment adviser.

The Proposed Solicitation Amendments would also provide certain exemptions from the written agreement requirement.

Proposed Disclosure Requirements

The Proposed Solicitation Amendments would also amend the current rule that requires delivery of a disclosure document setting forth material information regarding the solicitation. As proposed to be amended, such disclosure:

1. Can now be delivered in any format, including audio, video or online, so long as true, accurate and current copies of the disclosures are retained;
2. Must include disclosure of potential conflicts of interest; and
3. May be delivered by either the solicitor or the investment adviser.

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