

# MARKETING RULE CHECKLIST

Section 206 of the Advisers Act generally prohibits an investment adviser from engaging in fraudulent, deceptive, or manipulative activities. On December 22, 2020, the SEC adopted amendments to Rule 206(4)-1 (the “Marketing Rule”) under the Investment Advisers Act of 1940. The Marketing Rule imposes a set of seven principles-based general prohibitions that apply to all advertisements, in addition to specific conditions that apply to advertisements that contain performance, testimonials, endorsements, and third-party ratings. The Marketing Rule’s definition of “advertisement” includes traditional communications disseminated by the investment adviser, as well as communications to investors in a private fund advised by the investment adviser and certain third-party communications. The compliance date for the Marketing Rule is November 4, 2022<sup>1</sup>. This checklist is designed to assist a registered investment adviser in developing advertisements that comply with the Marketing Rule and implementing appropriate policies and procedures.

## Definition of Advertisement

- ✓ *Rule 206(4)-1 contains an expanded definition of “advertisement” that, among other things, rescinds the prohibition on the use of testimonials and endorsements in advertisements.*

An **advertisement** includes:

- (i) Any direct or indirect communication an 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, or 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

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<sup>1</sup> Concurrent with the amendments to existing Rule 206(4)-1, the SEC rescinded Rule 206(4)-3 and incorporated substantive provisions related to solicitation of investment advisory clients and investors in private funds managed by an investment adviser into Rule 206(4)-1. An investment adviser must continue to comply with Rules 206(4)-1 and 206(4)-3, as in effect prior to May 4, 2021, until such time as it has implemented the necessary policies and procedures to ensure compliance with the new Rule.

- (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.

## General Prohibitions

- ✓ *Rule 206(4)-1 contains a number of principles-based general prohibitions that should be considered in connection with all advertisements intended for clients or investors (or potential investors) in private-funds sponsored by the investment adviser. An investment adviser should ensure that all advertisements, including fund PPMs and related materials, are drafted in a manner consistent with these general prohibitions.*

In any advertisement, an investment adviser may not:

- (i) 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;
- (ii) 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;
- (iii) 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;
- (iv) 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;
- (v) 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;
- (vi) Include or exclude performance results, or present performance time periods, in a manner that is not fair and balanced; or
- (vii) Otherwise be materially misleading.

## Testimonials and Endorsements

- ✓ *Under Rule 206(4)-1, an investment adviser can utilize testimonials and endorsements in its advertisements.*

**Testimonials** – 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.

**Endorsements** – 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.

- ✓ *In general, an advertisement that includes testimonials or endorsements of any kind must be*

accompanied by the following **required disclosures**<sup>2</sup> (in the case of clear and prominent disclosures, the disclosure must be included in the advertisement).

- (i) The advertisement must clearly and prominently disclose:
    - A. that the testimonial was given by a current client or private fund investor or 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 (as 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 advertisement must disclose 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) The advertisement must provide 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.
- ✓ *An investment adviser must have a written agreement with any person giving a compensated testimonial or endorsement. The written agreement must describe the scope of the agreed-upon activities and the terms of the compensation to be paid if compensation received by the promoter in the preceding 12 months was more than \$1,000.*
- ✓ *An investment adviser may not compensate a person, directly or indirectly, for a testimonial or endorsement if it 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.*

**Ineligible Persons** – a person who is subject to a disqualifying Commission action or to any disqualifying event or certain of that persons' employees and associates, provided that (i) registered broker-dealers that are not subject to statutory disqualification under the Securities Exchange Act and (ii) any person covered by Rule 506(d) of Reg. D with respect to a private offering of securities under Rule 506 who would not disqualify the private offering under Rule 506(d), will be exempt from the disqualification provisions.

**Disqualifying Commission Action** – any Commission opinion or order barring, suspending, or prohibiting a person from acting in any capacity under the Federal securities laws.

**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:

- (i) 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 Advisers Act;
- (ii) 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 Advisers Act;
- (iii) entry of any final order by any entity described in paragraph (9) section 203(e) of the Advisers Act, or by the U.S. Commodity Futures Trading Commission or a self-regulatory organization, of the type described in paragraph (9) of section 203(e) of the Advisers Act;
- (iv) the entry of an order, judgment, or decree that is described in paragraph (4) of section 203(e) of the Advisers Act, and that is in effect at the time of dissemination of the testimonial or endorsement, by any court of competent jurisdiction within the United States; and

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<sup>2</sup> In the case of an endorsement made by a promoter of the investment adviser, the investment adviser can comply with the disclosure requirement if it reasonably believes that the promoter discloses the information required by Rule 206(4)-1(b)(1) at the time the endorsement is disseminated.

- (v) 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 or any other rule or regulation thereunder or (ii) Section 5 of the Securities Act.

## Advertising Performance

- ✓ *An investment adviser will not include any presentation of gross performance in an advertisement unless that 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, using the same type of return and methodology as, the gross performance.*

**Gross performance** – 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.

**Net performance** – 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.

- In calculating net performance, an investment adviser should take into account, if applicable, advisory fees (including performance-based fees), advisory fees paid to underlying investment vehicles, and payments by the investment adviser for which the client or investor reimburses the investment adviser.
  - Net performance may exclude custodian fees paid to a bank or other third-party organizations for safekeeping funds and securities, and the Rule permits the use of a model fee in calculating net performance in an advertisement, when doing so would result in performance figures that are no higher than if the actual fee had been deducted.
- ✓ *In general, performance for accounts other than private funds should be presented for one-, five-, and ten-year (or since inception) time periods. Such time periods must end on a date that is no less recent than the most recent calendar year-end. Performance for each time period must be presented with equal prominence in the advertisement.*
  - ✓ *Private fund performance does not have to be presented for these prescribed time periods. Presentation of private fund performance is, however, subject to the general antifraud provisions of the Federal securities laws and the general prohibitions in Rule 206(4)-1 (as set forth above). Thus, an investment adviser may not include or exclude performance results, or present performance for any time periods, in a manner that is not fair and balanced.*
  - ✓ *In general, an advertisement may not include the use of related performance unless such related performance includes all related portfolios; provided, that performance of a related portfolio may be omitted if the advertised performance is not materially higher than if all related portfolios had been included and the exclusion does not alter the presentation of any prescribed time period.*

**Related performance** – 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.

**Related portfolio** – a portfolio with substantially similar investment policies, objectives, and strategies as those of the being offered in the advertisement.

- ✓ *If the relevant financial markets or portfolio management personnel have changed over time such that the investment policies, objectives, and strategies of earlier private funds are no longer substantially similar to those of a fund being marketed, such earlier private funds can be excluded from related performance (subject to disclosure of the rationale for such omission).*

- ✓ An investment adviser cannot present 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.

**Extracted Performance** – the performance results of a subset of investments extracted from a portfolio. Note that the Rule does not prescribe any particular treatment for a cash allocation with respect to extracted performance.

- ✓ Prior to using hypothetical performance in its advertisements, an investment adviser 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 of the advertisement**.
  - ✓ This obligation to consider the likely financial situation and intended audience of an advertisement is intended to help ensure that advertisements containing hypothetical performance information are provided only to those investors with the resources and financial expertise. Hypothetical performance may be misleading for investors that do not have the resources and financial expertise.
  - ✓ Accordingly, an investment adviser should not use hypothetical performance in advertisements that are directed to a mass audience or intended for general circulation.
- ✓ As noted above, a communication that includes hypothetical performance and that is provided: (i) 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 (ii) to a prospective or current investor in a private fund advised by the investment adviser in a one-on-one communication **is not an advertisement**.
- ✓ An advertisement may only include hypothetical performance if it: (i) includes sufficient information to enable the intended audience to understand the **criteria used and assumptions made** in calculating such hypothetical performance; and (ii) provides (or, if the intended audience is an investor in a private fund, either 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.
  - ✓ An investment adviser must provide the information about criteria and assumptions so that the intended audience can understand how the hypothetical performance was calculated. It is not necessary to disclose proprietary or confidential information to satisfy this condition. A general description of the methodology used will be sufficient.
  - ✓ With respect to risks and limitations, an investment adviser should provide information that would apply to both hypothetical performance generally and to the specific hypothetical performance presented. For example, if the specific hypothetical performance reflects certain assumptions but the investment adviser also generated varying performance results by applying different assumptions, that should be disclosed. 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.
- ✓ Hypothetical performance presented in an advertisement does not need to comply with the requirements for specific time periods, related performance, or extracted performance set forth above.
- ✓ An advertisement that includes hypothetical performance must comply with the general prohibitions set forth above.

**Hypothetical Performance** – is performance that was not actually achieved by any portfolio managed by the investment adviser. Hypothetical performance **includes**, but is not limited to: (i) model performance; (ii) backtested performance; and (iii) targeted or projected performance. Hypothetical performance **does not include** predecessor performance or performance generated by an interactive tool where an investor or potential investor can produce simulations and statistical analyses of various investment outcomes.

**Model Performance** – includes, but is not 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.

**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 time periods.

**Targeted Performance** – reflects an investment adviser’s aspirational performance goals.

**Projected Performance** – reflects an investment adviser’s performance estimate and is often based on historical data and assumptions. Projected returns are commonly established through mathematical modeling.

**Predecessor Performance** – is 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.

## Portability of Performance

- ✓ *An investment adviser is prohibited from displaying predecessor performance in an advertisement, unless the following requirements are satisfied:*
  - ✓ *the person or persons who were primarily responsible for achieving the prior performance results manage accounts at the advertising adviser;*
  - ✓ *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;*
  - ✓ *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*
  - ✓ *the advertisement clearly and prominently includes all relevant disclosures, including that the performance results were from accounts managed at another entity.*

**Predecessor Performance** – is 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.

**Primarily Responsible** – A person or group of persons is “primarily responsible” for achieving prior performance if the person makes or the group makes investment decisions. Where more than one person was involved in making investment decisions, an adviser should consider the authority and influence that each person has in making 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.

**Sufficiently Similar** – Accounts that are managed in a substantially similar manner are those with substantially similar investment policies, objectives, and strategies.

## Third-Party Ratings

- ✓ *An investment adviser may not include 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 investment adviser has 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 investment adviser clearly and prominently discloses, or 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.*

**Third-Party Rating** – 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) of the adviser, and such person provides such ratings or rankings in the ordinary course of its business.