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The SEC's New Marketing Rule – Practically Speaking: General Prohibitions

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In December 2020, the Securities and Exchange Commission (SEC) finalized amendments to its advertising and solicitation rules under the Investment Advisers Act of 1940, as amended. Those finalized amendments merged the Advisers Act's current advertising rule (Rule 206(4)-1) with the cash solicitation rule (Rule 206(4)-3) under a new rule: Rule 206(4)-1, the Investment Adviser Marketing rule.

SEC-registered investment advisers (RIAs) must comply with the new marketing rule by November 4, 2022.

Commentary going back to December 2020 has explained what the new marketing rule says. But considerably less commentary has explained what, practically speaking, RIAs should be doing to ensure their marketing efforts, documents, systems, and procedures comply with the new marketing rule.

This is one of five “Practically Speaking” alerts providing succinct and practical high-level guidance from our attorneys regarding five aspects of the new marketing rule that we see as most impactful on RIAs’ marketing efforts.

General Prohibitions

Overview

The new marketing rule establishes seven principles-based general prohibitions for all advertisements disseminated by RIAs, in addition to the rule’s provisions regarding particular aspects of advertisements.

Under the rule, an advertisement may not:

1. Include an untrue statement of a material fact, or 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;
2. Include a material statement of fact that the RIA does not have a reasonable basis for believing it will be able to substantiate upon demand by the SEC;
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 RIA;
4. Discuss any potential benefits to clients or investors connected with or resulting from the RIA’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. Reference specific investment advice provided by the RIA, where such investment advice is not presented in a fair and balanced manner;
6. Include or exclude performance results, or present performance time periods, in a manner that is not fair and balanced; or
7. Be otherwise materially misleading.

Practically Speaking, What Now?

While similar to the prohibitions against fraudulent and misleading statements applicable under pre-November 4, 2022 rules, the “seven prohibitions” expand the scope of SEC review when advertisements are examined.

Legal, compliance, and marketing personnel at RIAs who have not yet adopted the new rule should keep the following pointers in mind when reviewing (and revising) their pre-November 4, 2022 marketing materials for continued use in a compliant manner under the rule, and/or when creating new compliant materials:

1. RIAs will need to evaluate the particular facts and circumstances of each advertisement to ensure it does not run afoul of these seven prohibitions. For certain marketing practices, the SEC noted the nature of the audience to which the advertisement is directed is a key factor for determining how the general prohibitions should be applied.

Therefore, RIAs should more closely scrutinize whether an advertisement abides by all of the prohibitions in light of the intended audience.

2. Material claims will need to be substantiated, but opinions will not. Thus, when deciding how to convey a particular message in an advertisement, RIAs will need to determine whether they can substantiate a fact underpinning that message. The best way to do that may be with contemporaneous books and records. While the rule does not require contemporaneous substantiation for non-performance information – it requires a reasonable belief that the non-performance information can be substantiated – doing so would be an industry best practice. For performance information, the backup records necessary to demonstrate calculation of performance has to exist in books and records maintained by the RIA at the time the performance information is used. Opinions should be clearly labelled as such. Superlatives and self-proclaimed accolades, like “best in class” or “superior returns,” are low-hanging fruit for regulators, and often cannot be substantiated on their face.
3. On a related note, given the need for facts to be substantiated, RIAs may want to adopt a process for logging substantiated factual statements in a central and easily accessible location, such as a shared spreadsheet, that contains both factual statements that appear in advertisements, and hyperlinks to, or excerpts from, source material that substantiates those statements. Additionally, RIAs will likely want to establish access controls for any centralized document, and determine who will be responsible for maintaining it, such as the chief compliance officer or the person tasked with reviewing advertisements for compliance with the rule.

Should the SEC ever request such information, this kind of document could save countless hours—and headaches. Additionally, the SEC explained in its adopting release for the new rule that if an RIA cannot produce information that substantiates certain factual statements in advertisements, it will presume the RIA did not have a reasonable basis for believing it could do so.

4. Because certain kinds of information must be presented in a “fair and balanced” manner, RIAs will need to decide what is “fair and balanced”, and how to craft advertisements that fit that bill, in light of the SEC’s guidance in the new marketing rule.

Take, for example, how and where to present disclaimers and risk disclosures. In some formats, such as a printed brochure, the placement would be straightforward. But when it comes to others, such as social media or podcast advertisements, more thought will need to be given to how and where to present this information. For example, some RIAs include hyperlinks on their social media profiles to disclaimer language hosted on their websites.

As another example, the SEC stated that, with regard to case studies, it would not be fair and balanced for an RIA to present case studies only reflecting profitable investments when there are similar unprofitable investments. In the SEC's view, the disclosure of the overall performance of the relevant investment strategy or private fund for at least the relevant period covered by the list of investments would render the presentation of information fair and balanced.

The upshot, both as to these two examples and more generally, is that for the foreseeable future, knowing how to provide the context necessary for information in advertisements to be fair and balanced will be a judgment call for legal, compliance, and marketing staff at RIAs.

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