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**Addendum: for use with Series 65, 66, and 63 online courses per a regulatory update related to the new Investment Adviser Marketing Rule. According to NASAA, exam questions are expected to be updated to reflect these rule changes on April 1, 2022.**

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*The following are revisions and additions to supplement your existing text.*

Series 65 and 66: Laws, Regulations, and Guidelines, Including Prohibition on Unethical Business Practices

B. Ethical Practices and Fiduciary Obligations

1. Communications with Clients and Prospects

Series 63: Definitions

E. Ethical Practices and Fiduciary Obligations

1. Communications with Clients and Prospects

Correspondence and Advertising – *section renamed as “Investment Adviser Advertising”*

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## **Investment Adviser Advertising**

The Uniform Securities Act (USA) and the Investment Advisers Act of 1940 prohibit an investment adviser from engaging in activities that are fraudulent, manipulative and deceptive. This includes advertising that is untruthful or misleading.

Under the USA, investment adviser advertising that violates the Investment Advisers Act of 1940 is illegal. The SEC administers and enforces the Investment Advisers Act of 1940 and regulates investment adviser advertising under the anti-fraud provisions of the Advisers Act.

The new Marketing Rule, which went into effect May 4, 2021, with a compliance date of November 4, 2022, is designed to regulate investment adviser marketing communications. It is the culmination of a major effort on the part of the SEC to rework and combine the previous advertising and solicitation rules under the Investment Advisers Act of 1940, amending Rule 206(4)-1 and replacing Rule 206(4)-3. The new rule is intended to modernize the framework for investment adviser advertising, while incorporating the requirements for compensated solicitation activities.

## **Definitions**

The definition of an **advertisement** under the new marketing rule includes two parts:

1. Direct or indirect communications; and
2. Solicitation activities, including testimonials and endorsements.

Note that an advertisement must be addressed to *more than one person*.

**Direct or indirect communications** are investment adviser communications, in which the investment adviser offers:

- *Existing* securities-related investment advisory services to *prospective* clients or private fund investors; or
- *New* securities-related investment advisory services to *current* clients or private fund investors.

Indirect communications are those initiated by an investment adviser and disseminated through third parties, such as consultants, other investment advisers, and promoters.

Exclusions to the definition of an advertisement include:

1. One-on-one communications with *existing customers* if they do not pertain to *offering new advisory services*; or
2. Extemporaneous, live, and oral communications, regardless of whether they are broadcast or take place one-on-one.

**Solicitation activities, including testimonials and endorsements**, are activities for which an adviser provides cash and non-cash compensation, directly or indirectly (e.g., directed brokerage, sales awards, or other prizes, and reduced advisory fees), regardless of whether the communication is made orally or in writing, to one or more persons.

*Testimonials* include any statements by a *current client* or *private fund investor* about their experience with the investment adviser or its supervised persons.

*Endorsements* include any statements by a person, *other than a current client* or *private fund investor*, that describe that person's experience with or indicate approval, support, or recommendation of the investment adviser or its supervised persons.

## Requirements for Disclosure, Oversight, and Disqualification Provisions

Testimonials and endorsements are permitted in advertisements if the investment adviser adheres to the requirements for **disclosure, oversight, and disqualification provisions**.

**Disclosures**, whether disseminated to investors in writing or orally, must clearly and prominently disclose:

- Whether the person giving the testimonial or endorsement (the "promoter") is a client;
- Whether the promoter is compensated (cash or non-cash compensation);
- Material conflicts of interest on the part of the person giving the testimonial or endorsement; and
- Terms of the compensation arrangement.

The SEC does NOT require the investment adviser to disclose the name of the broker/dealer that will execute trades or the business background of the solicitor.

Note: The adviser is NOT required to obtain from each investor written acknowledgement of receipt of these disclosures.

**Oversight and Written Agreement:** An adviser that uses testimonials or endorsements in an advertisement must oversee compliance with the marketing rule. An adviser also must enter into a written agreement with promoters, except when the promoter is an *affiliate* of the adviser or the promoter *receives de minimis compensation* (i.e., \$1,000, or less, or the equivalent value in non-cash compensation, during the preceding 12 months).

**Disqualification:** The rule prohibits certain "bad actors" from acting as promoters, subject to exceptions where other disqualification provisions apply. A "bad actor" is an individual who is subject to an SEC action such as an order barring, suspending, or prohibiting the individual from participating in the securities industry.

**Timing of disclosures:** The required disclosures must be provided at the time the testimonial or endorsement is disseminated. Either the adviser or the solicitor may make the required disclosures. If the adviser does not make the disclosures, it must have a reasonable belief that the solicitor is doing so.

## General Prohibitions

The Marketing Rule prohibits the following practices in an advertisement:

- Omitting or making an untrue statement of a material fact;
- Making 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 SEC*;
- Discussing potential benefits without providing a fair and balanced treatment of the associated material risks or limitations;
- Referencing specific investment advice provided by the adviser that is not presented in a fair and balanced manner;
- Including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced; and
- Including information that is otherwise materially misleading.

### Examples:

1. In the use of graphs, formulas, or similar devices, the advertisement must disclose that these devices cannot, by themselves, determine which securities to buy or sell.
2. Advertisements may refer to past specific recommendations that were profitable provided the advertisement includes 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, during that time).
3. An advertisement cannot state that any report, analysis, or service will be furnished free of charge unless such product is provided free and without condition. This would be considered an untrue statement.

4. If an investment adviser produces an advertisement that makes the claim that the investment adviser is a "fee-only investment adviser" and their "fee" is based solely on performance, it would be prohibited to direct this advertisement to the general public since performance-based fees are only allowed for qualified clients.

## Third-Party Ratings

A third-party rating is a rating or ranking of an investment adviser provided by a person who is not a related person and who provides these ratings or rankings in the ordinary course of its business.

The inclusion of a third-party rating is prohibited *unless* the adviser provides disclosures in the advertisement, such as:

- The date on which the rating was given and the time frame upon which the rating was based;
- The identity of the third party that created the rating; and
- The fact that compensation was provided directly or indirectly by the adviser.

## Performance Advertising

Performance advertising is permitted provided the investment adviser adheres to the following requirements:

- If gross performance is presented, the advertisement must *also present net performance*, which includes the effect of fees and expenses on the investment return.
- Performance results must include specific time periods in which the results were realized.
- Any statement that the SEC has approved or reviewed any calculation or presentation of performance results is *prohibited*.
- The investment adviser is prohibited from "*cherry picking*" results. If the performance of one portfolio is presented, the investment adviser must present the results from all related portfolios with substantially similar investment policies or objectives.
- The investment adviser is also prohibited from "cherry picking" results from a subset of investments extracted from a portfolio, *unless the advertisement provides, or offers to provide promptly, the performance results of the total portfolio*.

*Hypothetical performance* is permitted if the adviser adopts and implements policies and procedures reasonably designed to ensure that the performance is relevant to the likely financial situation *and* investment objectives of the intended audience, and the adviser provides the underlying criteria and assumptions:

- Results that were *not actually achieved* by any portfolio of the investment adviser;
- 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 definition of advertisement*;
- The SEC does *not* consider performance results generated by an *investment analysis tool* (as defined by FINRA 2214) as hypothetical analysis, provided that the current or prospective investor proactively used the tool (i.e., input information into the tool or provided information to the adviser to input into the tool); and
- FINRA 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 an additional resource to investors in the evaluation of the potential risks and returns of investment choices."

**Predecessor performance** (investment results attained at a previous investment adviser) can be advertised if there is appropriate similarity between the personnel and accounts of the predecessor adviser and those of the advertising (current) adviser. In addition, the advertising adviser must include all relevant disclosures clearly and prominently in the advertisement.

## Review and Approval of Advertisements

Internal review and approval of advertisements by the investment adviser before they are disseminated to investors are *not* required. However, the adviser must have written policies and procedures to prevent violations of the marketing rule from occurring, and detect and promptly correct any violations that have occurred.

**Note:** Regardless of whether an individual is working with a federally-registered or state-registered advisory firm, the investment adviser representatives (IARs) who represent the firm must register with the state. Since the majority of states define any individual who solicits investment advisory services to be an Investment Adviser Representative (IAR), individuals soliciting for either type of firm are typically required to register as IARs of the firm at the state level.