



PROGRAM MATERIALS

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The Proposed Advertising and Solicitation Rules - Game Changer for Advisers

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The Proposed Advertising and Solicitation Rules – Game Changer for Advisers

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Proposed Amendments to Advertising Rule

Advertising Rule Amendments

- On November 9, SEC released proposed amendments to the Advertising Rule – 206(4)-1
- Boon to adviser business? – headache for compliance
- Broadly expands definition of advertisement
 - Includes most communications with prospective and many with existing clients
- Withdrawing no-action letters and related guidance
 - 180 letters (100 of which related to bad actors under solicitation rule)
- Comments due 60 days after publishing in Fed. Register

Definition of Advertisement

- Any communication,
- Disseminated by any means,
- By or on behalf of an investment adviser,
- That offers or promotes the investment adviser's investment advisory services,
- Or that seeks to obtain or retain one or more investment advisory clients,
- Or investors in any pooled investment vehicle advised by the investment adviser

Expanded Scope of Advertisement

- Brings into its scope all online communications
 - i.e., social media
- Includes communications made by affiliates, consultants or employees
 - i.e., private fund info distributed by the private fund or others
 - If adviser takes affirmative steps with respect to content (draft, influence, edit, delete or compensates)
 - Unless not authorized
- Includes communications concerning private funds
 - In addition to 206(4)-8 (concerning fraud & manipulation)

4 Exclusions to Advertisement

- Non-broadcast live oral communications
- Responses to unsolicited requests for information
 - Cannot be solicited by adviser
 - Cannot include additional advertisements
 - 2 Exceptions:
 - Communications to retail persons including performance results
 - Communications that include hypothetical performance
- RIC and BDC advertisements
- Information required for regulatory filings

Similar Anti-Fraud Provisions

- No materially untrue statements, omissions or unsubstantiated claims
 - No guarantees of returns
 - Unsubstantiated claims about adviser or performance
- No cherry picking of specific investment results – must be “fair and balanced”
 - Facts and circumstances dependent
 - Allows for thought pieces
 - Allows to describe strategies in certain situations
 - But suggests using prior guidance
- Catch-all for materially misleading info
- As before, only need to show negligence - not scienter

Expanded Anti-Fraud Provisions

- No untrue or misleading implications
 - Implications cannot be untrue
 - Facts cannot be true, but stated in misleading way
 - E.g. inferences about adviser or performance
- Must disclose material risks and other limitations when advertising benefits of adviser's services
- Disclosures must be "clear and prominent"
 - Can vary based on medium
 - E.g. – okay to redirect a client to an online disclosure, but not to only hyperlink to the disclosure

Testimonials & Endorsements - Allowed

- Broad definitions
- Captures all advertisements containing any:
 - direct or indirect
 - approval, support, recommendation or experience
- Can be by clients or non-clients in connection with adviser's advisory services

How to Use Testimonials & Endorsements?

- Condition: Must disclose:
 - Who gave testimonial/endorsement
 - Whether they were compensated
- Cannot be misleading
 - Rearranging favorable reviews more prominently

Third Party Ratings - Allowed

- **Definition:**
 - ratings by non-related person who provides such ratings in ordinary course of business
- **Condition:** Must **disclose:**
 - Who is providing rating
 - Whether compensated
 - Date rating was made
 - Period of time rating was based on

Third Party Rating – Reasonableness Standard

- Adviser must reasonably believe that questionnaire/survey used makes it equally easy to provide positive and negative ratings
- Not designed to produce a pre-determined result

Testimonials, Endorsements & Ratings

- Generally okay. Examples:
 - Third party platform solicits users to post positive and negative reviews
 - Third party posting public commentary to adviser's website or social media site
 - Use of "like," "share" or "endorse" features on a third-party website or platform
- Unless adviser takes steps to influence reviewers or commentary

Testimonials, Endorsements & Ratings – “On Behalf”

- **Social media activity** would be considered “**by or on behalf of**” adviser, if adviser takes **affirmative steps** to **involve itself in content**
 - **Preparing** content
 - **Editing** or **prioritizing** content
 - **Paying** for content

Performance Info - Permitted

- Must include disclosures, so that not misleading
 - Must be tailored
 - Facts and circumstances dependent
- Also, two special disclosures required for “retail investors”
- Retail investor means:
 - Not a qualified purchaser or knowledgeable employee
 - Look-through pool to investor

Non-Retail Advertisements

- To use non-retail advertisements, must adopt procedures reasonably designed to ensure dissemination only to QPs and KEs
- Periodically review adequacy of policy

Performance – Disclosure Requirements

- 2 disclosure requirements for retail clients:
 - If including gross performance, must include net performance
 - What “has or would have been paid” – in the case of hypothetical performance
 - Ready to provide schedule of specific fees and expenses that were deducted to calculate net performance (promptly)
 - Present with at least equal prominence
 - Present in format that will aid comparison
 - No required calculation methodology for net performance, although non-exhaustive list of suggested fees and expenses is provided
 - Show each fee and expense as % of AUM
 - Include results across 1, 5 and 10-year periods (or since inception)
 - If 7 years, show 1, 5 and 7 year period
 - Each period must be shown with equal prominence

Net Performance Calculations

- 1) Deduct highest fee that could be charged to a portfolio (easiest); or
- 2) Deduct highest fee that could be charged to relevant audience of advertisement
- Can choose whether to exclude custodian fees paid to bank or other party to safe-keep the assets, unless:
 - Adviser provides custody and charges a separate fee; or
 - Part of single fee paid to adviser – such as a wrap program

Related Performance - Permitted

- Must be for “substantially similar” strategies
- Must include all related portfolios, unless advertised performance is no higher than if all related portfolios had been included
- Cannot exclude performance if such exclusion would alter the proposed rule’s prescribed time periods
- FINRA does not allow related performance for retail investors
- Can present on portfolio-by-portfolio basis or as composites

Extracted Performance - Permitted

- Allows advisers to extract performance from multi-strategy product to show only specific performance
- Must provide or offer to provide performance results of all investments in portfolio from which performance was extracted (promptly)

Hypothetical Performance - Permitted

- Includes:
 - Backtested performance
 - Excludes educational presentations about historical trends, etc.
 - Representative performance (model portfolios)
 - Target or projected performance
 - Prohibited by FINRA in most cases
 - Tools that review past information are not included as hypotheticals, unless they suggest or imply future returns

Hypothetical Performance – Permitted If....

- Adopts policies reasonably designed to ensure disseminated only to persons for which it is relevant to their:
 - financial situation and
 - investment objectives
 - Prevents general circulation
- Provide sufficient info to understand the: criteria and assumptions in calculating, and risks and limitations of using the info

Portability of Performance - Permitted

- Subject to general misleading prohibitions
- Plus, specific considerations
 - Must have disclosures about different personnel or firm achieved past performance
 - Must have been primarily responsible
 - Strategy must be substantially similar
 - Cannot exclude accounts traded in a substantially similar manner
 - Must include all disclosures so not misleading

Portability of Performance – Requirements (cont.)

- Must include all restrictions on past specific performance
 - May need to apply related and extracted considerations
- Still need books and records to substantiate underlying performance
 - In alternative, asking for comments if using publicly available information and verification/auditing

All – Ads -Review & Approval – Who?

- Requires advertisements be pre-reviewed and approved beforehand
 - By a designated employee to ensure complies with rules
 - Must be “knowledgeable and competent” in the rules
 - Can designate one or more employees
 - Generally part of legal or compliance
 - Not same person that prepared it (if possible)

Review & Approval

- Other requirements:
 - Updates to existing ads would require approval
 - Need to account for expanded definition of advertisement
 - Need to substantially revise policies

Review & Approval

- Does not apply to:
 - Live oral communications
 - If scripted, scripts and slides subject to advanced approval
 - If recorded, subject to approval before redistribution
 - Communications only to a single person or household or single investor in a pooled vehicle
 - Cannot customize a template presentation or mass mailing by filling in investor name or including other basic information about investor

ADV Amendments

- Proposing to amend Item 5 of Part 1A
- Add Section L – Advertising Activities to help prepare for exams:
 - Whether ads contain performance results and who reviewed
 - Whether ads contain testimonials, endorsements or thirty party ratings and if compensated
 - Whether ads contain past specific recommendations



Proposed Amendments to Cash Solicitation Rule

Amendments to Cash Solicitation Rule

- Applies to all cash and non-cash compensation
 - directed brokerage
 - sales awards
 - training
 - education
 - refer-a-friend rewards
 - revenue sharing discounted services
- Expands scope to cover solicitations of private fund investors, as opposed to only advisory clients
- Does not apply to RICs or BDCs

Solicitor Disclosure

- Either solicitor or adviser must provide clients with the solicitor disclosure (describes parties, relationship and compensation arrangement)
- Must now also include conflicts of interest
- No longer need confirmation of receipt by client
- No longer needs to be written
 - If not written, oral communication must be recorded

Written Agreement

- Still enter agreement describing solicitation activities and relationship
- Must now list who provides the solicitor disclosure to clients
- Solicitor must undertake to perform its duties consistent with Sections 201(1), (2) and (4) of the Advisers Act, as opposed to consistent with adviser's instructions

No ADV Brochure Delivery

- Solicitor no longer needs to deliver adviser's ADV brochure to clients
- Duplicative of adviser's duties
- Was a constant deficiency on exams

Solicitor Supervision

- Still required to oversee solicitor solicitation activities
- Still required to have reasonable basis for believing solicitor complied with written agreement
 - Making periodic client inquiries
 - Being copied on client emails

Disqualified Solicitors

- As before, cannot use a disqualified solicitor
- Provides expanded list of disciplinary actions and events

Exemptions

- Proposed rule maintains and creates following exemptions in connection with all or most of above requirements:
 - Solicitors that refer clients solely for impersonal investment advice (not many robo or internet advisers)
 - Solicitors that are an adviser's employees or other affiliates
 - Solicitors that receive de minimis compensation (\$100 or less, or equivalent)
 - Solicitors that are not-for-profit



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Nicole is an attorney at Stradley Ronon Stevens and Young LLP. Nicole represents securities, commodities and cryptocurrency professionals in a variety of regulatory, compliance and corporate matters. She has extensive experience with respect to hedge funds, commodity pools, private equity funds, venture capital funds, real estate funds, fund of funds, cryptocurrency funds and socially responsible investment (SRI) vehicles. Nicole provides legal and compliance guidance to registered and exempt investment advisers, commodity pool operators (CPOs), commodity trading advisers (CTAs), introducing brokers (IBs), forex (FX) firms, proprietary trading firms and broker-dealers (BDs). She also serves as counsel to boards, mutual funds and exchange-traded funds (ETFs). Nicole drafts and develops offering documents, compliance manuals, policies and procedures, corporate materials, contracts/investment agreements and advertising materials. She also provides legal and structuring guidance concerning master-feeder structures, domestic and foreign funds, international offerings and separately managed accounts. Nicole is a Founder of the Investment Network and the Digital Assets Working Group. Nicole is the Director of the Washington DC Compliance Round Table of the Chicago Region. Nicole was selected as a Super Lawyers Rising Star in 2016, 2017 and 2018.

Resources:

- Client Alert: SEC Proposes to Modernize the Advertising and Cash Solicitation Fee Rules for Investment Advisers