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Managing Influence: Social Media for Investment Advisers under the SEC's New Marketing Rule

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Social media marketing has emerged as one of the primary channels through which businesses reach consumers; the investment advisory industry is no exception.[1] The Securities and Exchange Commission (SEC or Commission) recognized this evolution in connection with adopting amendments to its advertising rule (Advertising Rule) in December 2020.[2] The recently amended Marketing Rule (Marketing Rule), Rule 206(4)-1 under the Investment Advisers Act of 1940 (Advisers Act), expands investment advisers' ability to use social media platforms to meet consumers where they increasingly look for financial advice.[3] The Marketing Rule presents significant legal and regulatory challenges that investment advisers must navigate in order to use these platforms to engage with new and existing clients. This article explores various areas of concern for investment advisers that seek to use social media consistent with the requirements of the Marketing Rule and SEC guidance set forth in the Adopting Release, and practical steps investment advisers should consider taking prior to the Marketing Rule's November 4, 2022 compliance date.[4] Specifically, discussed are: (1) potential liability for third-party content; (2) disclosure issues on space-constrained social media platforms; (3) associated persons' use of personal social media; and (4) recordkeeping obligations.

The Marketing Rule's Impact on Social Media

The Advertising Rule was adopted by the SEC in 1961, well before the inception of social media. By contrast, the new Marketing Rule recognizes modern forms of communication; its two-prong definition of "advertisement" subjects a broad range of digital communications to the Rule, including emails, text messages, instant messages, electronic presentations, videos, films, podcasts, digital audio or video files, blogs, electronic billboards, and social media posts.[5] In a major policy shift, the definition of "advertisement" also includes compensated testimonials and endorsements by third parties, including those that are provided orally,[6] eliminating the prohibition that had been in place since the adoption of the Advertising Rule.[7] The Advertising Rule's express prohibition on the use of testimonials (which SEC Staff viewed as including endorsements)[8] in investment adviser advertising limited investment advisers' ability to use many features of popular social media platforms. Taken together, the Marketing Rule's definition of "advertisement" and the elimination of the prohibition on testimonials and endorsements will expand opportunities for investment advisers to take advantage of popular digital and social media marketing tools and trends, including the use of social media "influencers", podcasts, sponsored blogs, and

other referral networks. Nevertheless, the Marketing Rule imposes substantial controls and limitations on such uses.

All advertisements, including on digital and social media platforms, are subject to a set of seven principles-based general prohibitions that are designed to prevent fraudulent, deceptive, or manipulative advertising.[9] Moreover, compensated testimonials and endorsements are subject to additional conditions. First, advertisements that include a compensated testimonial or endorsement must clearly and prominently disclose: (i) the testimonial or endorsement was provided by a client or non-client, as applicable; (ii) compensation was provided for the testimonial or endorsement; and (iii) a brief statement of any material conflicts of interest.[10] Second, the investment adviser must have: (i) a reasonable basis for believing that any testimonial or endorsement complies with the requirements of the rule; and (ii) a written agreement with any person giving a compensated testimonial or endorsement that describes the scope of the agreed on activities and the terms of the compensation for those activities, if the investment adviser provides compensation to the person providing the testimonial or endorsement that exceeds the *de minimis* threshold.[11] Third, the Marketing Rule prohibits an investment adviser from compensating a person, directly or indirectly, for a testimonial or endorsement if the investment adviser 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.[12]

Liability for Third-Party Content

The Marketing Rule's two-prong definition of advertisement includes traditional advertisements that the investment adviser disseminates itself (prong 1 advertisements) and compensated endorsements or testimonials made by third parties (prong 2 advertisements).[13] Depending on the particular facts and circumstances, information disseminated by a third party may be attributable to an investment adviser as a prong 1 advertisement if an adviser has "adopted" the information or "entangled" itself with it.[14] For example, an investment adviser might adopt information posted by a third party on another website if the investment adviser reproduces such information on its own website or entangles itself with the content if it involves itself in the preparation of the information.[15] If an investment adviser adopts or entangles itself with third-party content, the Marketing Rule deems this content to be an advertisement of the investment adviser for which it is liable and must comply with the elements of the Marketing Rule. Similarly, investment advisers are also liable for third-party content that constitutes a compensated testimonial or endorsement under prong 2 of the definition of advertisement. In either case, investment advisers must consider how they will seek to limit their liability for third-party content under the Marketing Rule.

Prong 1 Advertisements—Traditional Online Marketing Adoption and Entanglement

An investment adviser may wish to restrict online and social media marketing to content the investment adviser itself disseminates to avoid the heightened compliance and legal risk of overseeing third parties that create and disseminate content on the investment adviser's behalf. Nevertheless, because most investment advisers do not maintain a marketing platform aside from their own websites, they may wish to publish advertisements on platforms hosted by third parties. For example, an investment adviser may wish to place a targeted advertisement on the webpage of a financial blog or publish an advertisement on a popular YouTube channel. In addition to the targeted advertisement being deemed a prong 1 advertisement, the presence of any compensation paid by the investment adviser creates a risk that any accompanying statements by the blogger or YouTube host, whether expressly sanctioned by the investment adviser or not, could

constitute compensated endorsements under the Marketing Rule.

The Marketing Rule's definition of advertisement includes endorsements for which an investment adviser provides compensation directly *or indirectly*, and the SEC noted in the Adopting Release that whether compensation provided by an investment adviser is for an endorsement depends on the facts and circumstances.[16] Thus, assuming the investment adviser has compensated the third-party to display its advertisement, any statement made by the third-party that refers, approves of, or recommends the investment adviser on the blog or YouTube channel could be deemed to be a *compensated* endorsement and trigger the additional disclosure, oversight, and disqualification conditions of the Marketing Rule.[17]

Similarly, even if the investment adviser is not using a third party to display an advertisement, but provides compensation to the third party for other services, any favorable statement by the third party, in light of such compensation, could give rise to a compensated endorsement under the Marketing Rule. In the Adopting Release, the Commission explained that whether an investment adviser's compensation is intended to be for an endorsement depends on the timing of the compensation relative to the endorsement and whether there is a mutual understanding of a *quid pro quo*, either explicit or inferred.[18] As such, investment advisers may wish to consider, among other things, the following when marketing on third-party platforms:

- When advertising on websites and social media platforms of third parties, how will the investment adviser create safeguards to avoid third-party statements being attributable to the investment adviser as a compensated endorsement?
- When compensating any third parties, what safeguards will an investment adviser implement to prevent statements by these third parties regarding the investment adviser from triggering a compensated endorsement?

Prong 1 Advertisements—Interactive Content

Many common social media platforms include interactive features that permit followers to comment, like, share, or otherwise express interest on a user's site or profile. In the Adopting Release, the Commission stated that such expressions on an investment adviser's social media page would not be attributable to the investment adviser if the investment adviser merely permits the use of these features and does not exercise any authority to modify, sort, edit, or otherwise involve itself in the presentation of those comments and expressions.[19] The Commission also explained that an investment adviser can make limited changes to third-party content and avoid it being attributed to the investment adviser, provided that the investment adviser makes these changes based on pre-established, objective criteria that are documented in the investment adviser's policies and procedures and that are not designed to favor or disfavor the investment adviser.[20] For example, an investment adviser may establish policies and procedures to correct factual errors and remove commentary that constitutes profanity, unlawful content, threatening language or spam.

Additionally, in the Adopting Release, the Commission cautioned that third-party content may be attributable to an investment adviser if it provides a hyperlink to that content on its own social media or website. For example, an investment adviser that "shares" content to its social media followers may be liable for such content.[21] As such, an investment adviser may wish to consider, among other things, the following when marketing on social media:

- How the investment adviser currently uses social media and whether the platforms it uses enable third parties to create content that is viewable by others on the site.
- Whether policies and procedures are in place that permit the investment adviser to modify content only for a non-biased purpose.

- Do policies and procedures provide training to the investment adviser's relevant employees regarding the requirement to prevent third-party statements on social media from being attributed to the investment adviser?
- What controls does the investment adviser have in place with respect to hyperlinking third-party information in an advertisement? How will the investment adviser confirm that hyperlinked third-party information is consistent with all aspects of the Marketing Rule, including that it does not include any misleading statements or cause an untrue or misleading implication or inference?

Prong 2 Advertisements—Compensated Endorsements

An investment adviser may opt to use the services of an endorser on social media, for example, by compensating third-party influencers or bloggers for referrals or sponsoring a podcast on which the podcast host makes periodic recommendations of the investment adviser. The Marketing Rule's conditions for compensated endorsements present special challenges for these types of arrangements. As noted above, the Marketing Rule requires that, when making use of compensated endorsements, investment advisers must: (1) include specific required disclosures; (2) have policies and procedures related to oversight and compliance, including a written agreement for certain promoters; and (3) ensure that promoters are not subject to disqualification.

Under the first condition, a compensated endorsement must disclose, or the investment adviser must reasonably believe that the person giving the endorsement discloses, certain information as described above.[22] An investment adviser may form a reasonable belief for purposes of the disclosure requirement if, for example, it provides a blogger or social media influencer the required disclosures and confirms that it has made such disclosures appropriately in their respective endorsements, or the investment adviser and endorser include a provision in a written agreement requiring the endorser to provide required disclosures.[23] These disclosures must be provided at the same time the endorsement is disseminated.[24] Thus, investment advisers must coordinate with endorsers to confirm that the appropriate disclosures are provided and that proper records are maintained. Second, the investment adviser must have policies and procedures in place to oversee the endorser, which could include mechanisms to enable the investment adviser to form a reasonable basis for believing that an endorsement complies with the Marketing Rule's specific conditions, and will generally have to enter into a written agreement that describes the scope of the agreed-upon activities and the terms of compensation for those activities.[25] Finally, the investment adviser cannot compensate any endorser if the investment adviser knows or reasonably should know that the endorser is subject to statutory disqualification.[26] Thus, the investment adviser must engage in front-end and ongoing due diligence when using an endorser. As such, an investment adviser may wish to consider, among other things, the following when using a compensated endorser:

- Whether the investment adviser will draft disclosures prior to the endorser's dissemination of the endorsement and provide them to the endorser to be included with the endorsement. Once drafted, the investment adviser should consider how the required disclosures will be delivered in connection with the endorsement.
- How the investment adviser will confirm that the required disclosures are provided in connection with an oral endorsement, such as on a podcast. How will the investment adviser confirm that it complies with applicable recordkeeping obligations?
- Does the investment adviser expect to pay more than *de minimis* compensation to an endorser

over a 12-month period? If so, a written agreement is required with such person. In addition to the terms required by the Marketing Rule, an investment adviser may wish to consider adding other protective provisions to the agreement, such as setting forth content restrictions, requiring pre-approval of endorsements, or detailing who is responsible for certain disclosures.

- Whether the investment adviser has appropriate policies and procedures in place to oversee the endorser, on both an initial and ongoing basis, and to assess whether the endorser is disqualified or becomes disqualified under the Marketing Rule.

Disclosure Limitations on Space-Constrained Social Media Platforms

Certain social media platforms limit the amount of content a user can include in a given post. For example, Twitter notably imposes a character limitation on its tweets. These limitations may pose challenges for investment advisers seeking to comply with the disclosure requirements of the Marketing Rule, which require disclosure of certain information to be made "clearly and prominently" in connection with a testimonial or endorsement.[27] The required information includes that the testimonial was given by a current client or investor, and the endorsement was given by a person other than a current client or investor, as applicable; that cash or non-cash compensation was provided for the testimonial or endorsement, if applicable; and 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.[28] These disclosures, in contrast to most other disclosures required by the Marketing Rule, must be included within the endorsement itself, that is, including the disclosures on a separate page accessible via a hyperlink is not permitted.[29]

In the Adopting Release, the Commission declined to modify the Marketing Rule's clear and prominent disclosure requirement to accommodate these character-constrained social media platforms.[30] However, the Commission noted that it believes the clear and prominent disclosures "can be provided succinctly within the testimonial or endorsement" such that investment advisers can use these platforms for testimonials and endorsements.[31]

Other disclosures required by the Marketing Rule that are not subject to the clear and prominent disclosure requirement can be provided outside of the advertisement and may be provided through hyperlinks in a separate disclosure document.[32] The Commission also indicated that investment advisers can use other technological tools, such as QR codes or mouse-over windows, to facilitate such layered disclosure.[33] Nevertheless, an investment adviser that layers its disclosures in connection with a testimonial or endorsement must still ensure that any discussion of benefits are balanced by a discussion of risks in a fair and balanced manner.[34] Additionally, the investment adviser must also be mindful of the general prohibitions and, for example, cannot use layered disclosure or hyperlinks to obscure important information.[35]

All disclosures required to be provided in connection with an endorsement must be provided at the time of the endorsement.[36] This can present a challenge for oral endorsements where the clear and prominent disclosures must be provided "within" the endorsement. For example, if an investment adviser compensates a podcast host to endorse the investment adviser on its podcast, the host would be required to provide these disclosures orally during the podcast at the same time as the endorsement.[37] As such, an investment adviser may wish to consider, among other things, the following when engaging in these practices:

- How to craft succinct disclosures in space-limited social media platforms that comply with the clear and prominent standard and the general

prohibitions, but that otherwise allow space for marketing content.
- How to create separate layers of disclosure that can be accessed through a hyperlink or other methods that contain the other disclosures required by the Marketing Rule to be provided in connection with a testimonial or endorsement.
- Whether to adopt policies and procedures to confirm that promoters that use these platforms are appropriately including required disclosures.

Associated Persons' Use of Social Media

Associated persons of an investment adviser that use social media outside of the investment adviser's managed social media accounts may create communications or content that is attributable to the investment adviser for purposes of the Marketing Rule. Even where an associated person uses social media in a personal capacity, the Commission noted that depending on the facts and circumstances, it could appear to investors that the communication is made on behalf of the investment adviser.[38] While the Commission has not provided direct guidance regarding these facts and circumstances, the risk that a statement is attributed to an investment adviser may be heightened when the associated person's affiliation with the investment adviser is apparent (for example, LinkedIn or other professional networking sites) or the associated person's communication discusses substance that is related to the investment adviser's services (for example, a blog regarding financial planning concepts). Nevertheless, the Commission stated that if an investment adviser adopts and implements policies and procedures reasonably designed to prevent (or prohibit altogether) the use of an associated person's social media accounts for marketing the investment adviser's advisory services, it generally would not view such communications as attributable to the investment adviser.[39] Such policies and procedures could include, for example, periodic training, attestations, and periodic reviews of publicly available content on associated persons' social media accounts.[40] It is important that investment advisers exercise reasonable care in adopting any policies and procedures that address this concept. The Commission suggested in the Adopting Release that it would consider the investment adviser's supervision and compliance efforts in determining whether an associated person's social media posts are attributable to the investment adviser.[41]

Although these policies and procedures would help insulate the investment adviser from liability for associated persons' personal social media content, they would not shield the associated person from liability for violating the Marketing Rule in a personal capacity.[42] Given the prevalence of personal social media use, investment advisers should consider:

- Whether to implement policies and procedures that limit associated persons' use of social media accounts in their personal capacity. If so, how should the investment adviser craft these policies and procedures such that they are practical, but also reasonably designed in the eyes of the Commission?
- How to provide effective training to help educate associated persons on the risks of violating the Marketing Rule with personal social media, even if the investment adviser has adopted the requisite policies and procedures itself.

Recordkeeping Issues

In connection with the Marketing Rule, the Commission also adopted changes to Rule 204-2 under the Advisers Act.[43] These amendments require investment advisers to make and keep records of all advertisements as defined under the Marketing Rule, including oral advertisements and oral testimonials and endorsements.[44] However, for compensated oral testimonials and endorsements, the investment adviser may instead make and keep a record of the disclosures provided as required by Rule 206(4)-1(b)(1).[45]

The investment adviser also must make and keep a record of any disclosures provided in connection with a testimonial or endorsement that is not included in the advertisement.[46]

These obligations pose challenges for investment advisers that market on social media platforms with messages or posts that disappear after being viewed by the user or after a short amount of time (for example, "live streams" or ephemeral messaging). For example, an investment adviser that compensates a promoter to endorse the investment adviser in a live stream that disappears once the stream has ended must consider how it will comply with its recordkeeping obligations.[47] Similarly, investment advisers that compensate a podcast host to provide an endorsement will need to consider how to confirm that proper records of the oral endorsement and oral disclosures are created and maintained.

Investment advisers should consider:

- For advertisements on social media platforms that disappear or expire, how will the investment adviser create a process for capturing records of such advertisements and the disclosures that must be included within such advertisements? For third-party endorsements on these platforms, how will the investment adviser involve the promoter in this process?
- For oral compensated endorsements, will the investment adviser attempt to create a record of the endorsement as a whole, or retain a record of the disclosures provided in connection with such endorsement? If so, how will the investment adviser involve the promoter in this process? Will the investment adviser's written agreement with the promoter address recordkeeping responsibilities?

Conclusion

Investment advisers must be mindful that every advertisement, whether distributed by the investment adviser itself or a third party, must comply with the Marketing Rule. This includes compliance with the Marketing Rule's general prohibitions and the specific conditions applicable to testimonials, endorsements, third-party ratings, and performance advertising. Additionally, any testimonial or endorsement that also refers to an investment adviser's performance or third-party rating must also comply with the Marketing Rule's specific conditions applicable to performance advertising and third-party ratings. Navigating the Marketing Rule's multiple layers of complexity, especially for social media and other digital platforms, can be challenging. Nevertheless, investment advisers that successfully navigate these challenges may be able to unlock social media and online marketing opportunities to engage with a new generation of clients.

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NOTES

1 *See* "US Digital Ad Spending Will Surpass Traditional in 2019," *eMarketer.com* (Feb. 19, 2019) (noting that in 2019 the US digital advertising budget will surpass the traditional advertising spend and estimating that it will exceed two-thirds of total media spending by the end of 2023). According to a 2019 Report by National Regulatory Service and the Investment Adviser Association, "[t]he number of investment advisers with at least one social media platform or website continued to increase, going from 11,070 in 2018 to 11,538 in 2019 . . . [and] advisers using more than one social media platform or multiple websites grew by 19 percent to nearly half (6,392 firms or 49.2 percent)." 2019 Evolution Revolution, Investment Advisers Association at National Regulatory Service (2019). The five most popular social media platforms used by registered

investment advisers included LinkedIn, Facebook, Twitter, YouTube, and Instagram. *Id.*

2 *See Investment Adviser Marketing*, Release No. IA-5653 (Dec. 22, 2020) (hereinafter Adopting Release).

3 *See* "Gen-Z Turns to TikTok, Instagram for Personal Finance Advice Despite Misleading Investment Tips," *USA TODAY* (Sept. 3, 2021).

4 For a comprehensive discussion of the new Marketing Rule, *see* "The SEC's Modernized Marketing Rule for Investment Advisers," *K&L Gates Asset Management and Investment Funds Alert* (Jan. 20, 2021) (K&L Gates Alert), available at *https://www.klgates.com/The-SECs-Modernized-Marketing-Rule-for-Investment-Advisers-1-20-2021*.

5 *See* Adopting Release, *supra* n.2 at 17.

6 Rule 206(4)-1(e)(1)(ii).

7 *See* Guidance on the Testimonial Rule and Social Media, IM Guidance Update No. 2014-04 (Mar. 2014). The Marketing Rule generally defines testimonials as statements by clients and endorsements as statements by non-clients. Rule 206(4)-1(e)(5), (17).

8 *See id*.

9 Rule 206(4)-1(a). *See* K&L Gates Alert, *supra* n.4, for an extensive discussion and frequently asked questions regarding the general prohibitions.

10 Rule 206(4)-1(b)(1). Advertisements that contain a compensated testimonial or endorsement must also disclose other items, such as the material terms of the compensation arrangement, including a description of the compensation provided, and a description of certain material conflicts of interest. However, these disclosures are not subject to the "clear and prominent" requirement and thus may be provided through hyperlinks, in a separate disclosure document or any other similar methods. A registered broker-dealer is exempt from the Rule's disclosure requirement if it provides a testimonial or endorsement that is a recommendation to a retail customer under Regulation BI, and exempt from the disclosures required by paragraphs (ii) and (iii) for testimonials or endorsements provided to a person that is not a retail customer under Regulation BI. *See* Rule 206(4)-1(b)(4)(iii). Certain affiliated persons of an investment adviser that provide a testimonial or endorsement are also exempt from the Rule's disclosure requirement and the requirement to enter into a written agreement. *See* Rule 206(4)-1(b)(4)(ii).

11 Rule 206(4)-1(b)(2). The *de minimis* threshold is $1,000 (or the equivalent value in non-cash compensation). Rule 206(4)-1(e)(2). Thus, if an investment adviser compensates a person providing a testimonial or endorsement less than $1,000 over the preceding 12 months, the investment adviser is not subject to the requirement to enter into a written agreement with such person. *Id.*

12 Rule 206(4)-1(b)(3). An "ineligible person" is a person who is subject either to a "disqualifying Commission action" or to any "disqualifying event" and certain of its employees or associated persons. *See* Rule 206(4)-1(e)(3), (4), and (9). Registered broker-dealers and persons covered by rule 506(d) of Regulation D are not subject to this disqualification provision if they are not otherwise disqualified by section 3(a)(39) of the Securities Exchange Act of 1934 or rule 506(d) of Regulation D, respectively. *See* Rule 206(4)-1(b)(4)(iii)-(iv).

13 Rule 206(4)-1(e)(1).

14 *See* Adopting Release, *supra* n.2 at 21.

15 *Id.* at 22.

16 Rule 206(4)-1(e)(1)(ii); *see* Adopting Release, *supra* n.2 at 50-51.

17 Rule 206(4)-1(b).

18 *See* Adopting Release, *supra* n.2 at 51.

19 *See* Adopting Release, *supra* n.2 at 23. The Adopting Release provided welcome clarity on this issue, which had not been clearly addressed in the SEC Staff's 2014 guidance. *See* Guidance on the Testimonial Rule and Social Media, IM Guidance Update No. 2014-04 (Mar. 2014).

20 *See* Adopting Release, *supra* n.2 at 22.

21 *Id.* at 22.

22 Rule 206(4)-1(b).

23 *See* Adopting Release, *supra* n.2 at 104.

24 Rule 206(4)-1(b)(1)(i).

[25] Rule 206(4)-1(b)(2). The written agreement requirement only applies if the investment adviser compensates the endorser more than $1,000 in the prior 12 months. Rule 206(4)-1(e)(2).

[26] Rule 206(4)-1(c).

[27] Rule 206(4)-1(b)(i).

[28] Rule 206(4)-1(b)(i).

[29] *See* Adopting Release, *supra* n.2 at 160 n. 538.

[30] *See* Adopting Release, *supra* n.2 at 92.

[31] *Id.*

[32] These disclosures include: (1) 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 (2) 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. Rule 206(4)-1(b)(1)(ii)-(iii).

[33] *Id.* at 76 n. 241.

[34] *Id.* at 76-77.

[35] *Id.* at 77.

[36] Rule 206(4)-1(b).

[37] *See* Adopting Release, *supra* n.2 at 106. Such disclosures are also subject to the recordkeeping rule. *See* Rule 204-2(a)(11)(i)(A)(2). If an investment adviser disseminates the required disclosures orally in connection with an oral testimonial or endorsement, the investment adviser may choose, consistent with applicable law, to record the oral disclosures either prior to or at the time of the dissemination of the testimonial or endorsement. *See* Adopting Release, *supra* n.2 at 108.

[38] *See* Adopting Release, *supra* n.2 at 24.

[39] *Id.*

[40] *Id.* at 24-25. Nevertheless, certain state laws may limit an employer's ability to police an employee's social media.

[41] *Id.* at 24.

[42] *Id.* at 24, n. 53.

[43] *See* Adopting Release, *supra* n.2 at 6.

[44] Rule 204-2(a)(11)(i)(A). For oral advertisements, the investment adviser may instead retain a copy of any written or recorded materials used by the investment adviser in connection with the oral advertisement. Rule 204-2(a)(11)(i)(A)(1). An investment adviser must retain a copy of any advertisement for a period of five years from the time the advertisement was last published or otherwise disseminated. Rule 204-2(e)(3)(i).

[45] Rule 204-2(a)(11)(i)(A)(2).

[46] Rule 204-2(a)(15)(i).

[47] Unlike the prong 1 definition of advertisement, the prong 2 definition of advertisement does not exclude extemporaneous, live, oral communications. Rule 206(4)-1(e)(1)(ii).