

The logo for K&L GATES is displayed in white, bold, sans-serif capital letters within an orange rectangular box. The background of the slide features a blurred cityscape at night with bokeh light effects, overlaid with a digital grid and a world map composed of blue dots. A white line graph with data points and candlestick-style markers is also visible, with several data points labeled with values and percentage changes: 334 +7.09%, 56 +1.13%, 178 +3.28%, 206 +1.17%, 281 +1.07%, and 566 +2.08%.

K&L GATES

Marketing Rule Implementation: Updates and Challenges

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Background



BACKGROUND

- First substantive amendments to the Advertising and Solicitation rules since **1961** and **1979**, respectively
- **101+ no-action letters**; hundreds of enforcement actions
- Amendments initially proposed on November 4, 2019
- Over **90 comment letters** submitted on proposal
- In the adopting release, the Commission recognized:
 - Changes in technology and social media
 - Expectations of investors seeking advisory services
 - Evolution of industry practices
- Must comply with Marketing Rule's requirements by **November 4, 2022 (tomorrow!)**

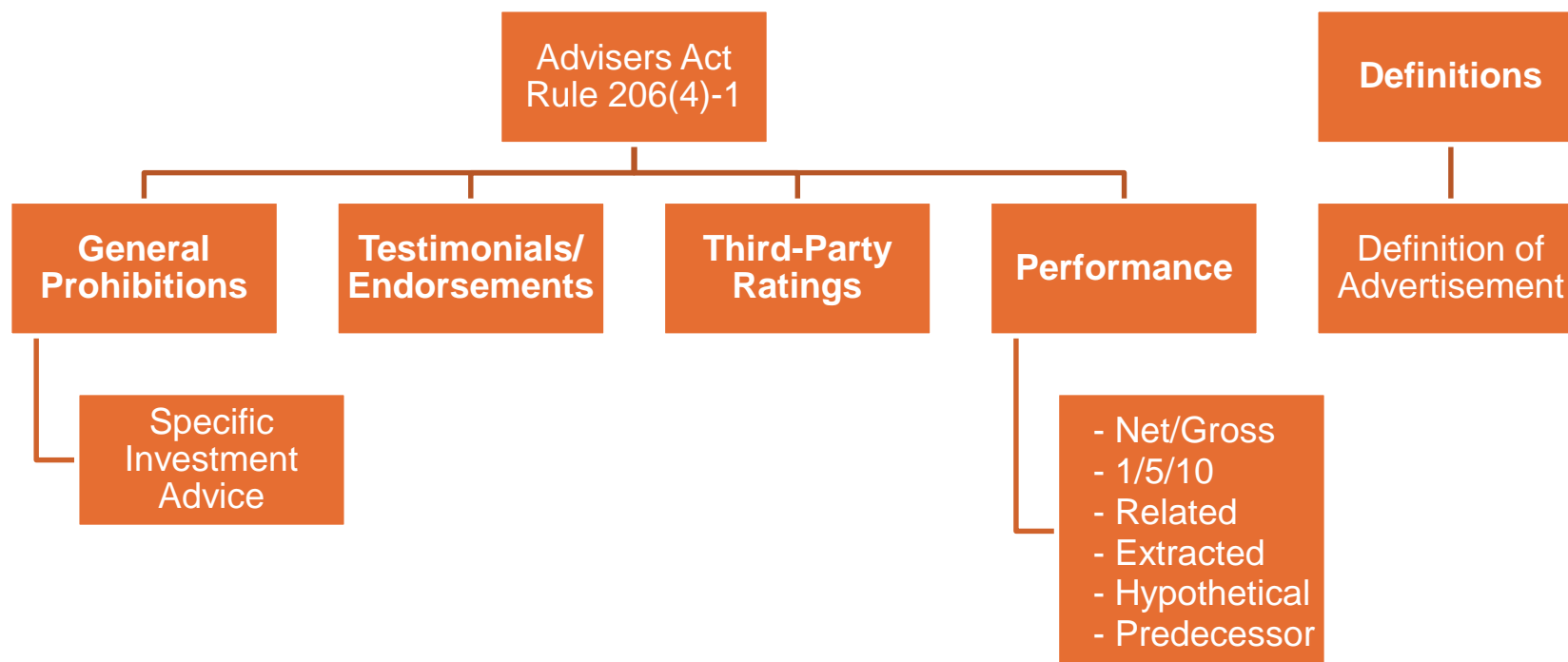


MARKETING RULE OVERVIEW

- Combines prior Advertising and Solicitation rules into a single “**Marketing Rule**”
- Extends the Marketing Rule to all “private funds”
- Replaces *per se* prohibitions with principles-based standards
- Expressly permits past specific recommendations, testimonials, and third-party ratings
- Guidance on social media, layered disclosures
- Standardized, rule-based framework for performance advertising
- Explicitly addresses performance portability and extracted performance



STRUCTURE OF MARKETING RULE





Timeline



MARKETING RULE TIMELINE

November 4, 2019

Initial Rule
Proposal

December 22, 2020

SEC Adoption

March 5, 2021

Publication
in Federal
Register

May 4, 2021

Effective
Date

November 4, 2022

Compliance
Date





Marketing Rule Challenges



SUBSTANTIATION OF MATERIAL FACTS

“An advertisement may not...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.”

- Applies to material statements of fact, not opinions
- Claims about performance would be statements of material facts
- No need to develop and maintain files of substantiating materials for every advertisement, provided that you can substantiate upon demand by the SEC staff
- Can (i) make contemporaneous records demonstrating basis for belief, or (ii) implement policies and procedures to address how this requirement is met



ARCHIVAL MATERIALS

How should we treat historical press releases, investor letters, and social media posts made before November 4? Do we need to remove or update them to comply?



IDENTIFICATION OF PROMOTERS

“An advertisement may not include any testimonial or endorsement, and an adviser may not provide compensation, directly or indirectly, for a testimonial or endorsement, unless the investment adviser [satisfies the Marketing Rule’s requirements.]”

- Cash solicitors
- Placement agents
- Model/wrap program sponsors
- Capital Introduction Groups
- Gifts and Entertainment



OVERSIGHT OF PROMOTERS

Adviser must have a ***reasonable basis*** for believing that a testimonial or endorsement complies with the Marketing Rule's requirements

“The question of what would constitute a reasonable basis for believing that the testimonial or endorsement complies with the requirement of the final rule would depend upon the facts and circumstances.”



AWARDS AND RANKINGS

Advertisements may ***not*** include third-party ratings unless the adviser:

1. has a reasonable basis for believing that any questionnaire or survey used in preparation 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***; and
2. 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.



CONSULTANT DATABASES

Is performance we provide to a consultant subject to the Marketing Rule?

*“We believe communications that investment advisers use to offer their advisory services have an equal potential to mislead—and should be subject to the rule—regardless of whether the adviser communicates directly **or indirectly** through a third party, such as a **consultant**, intermediary, or related person.”*

- SEC staff guidance in the form of FAQs may be forthcoming with respect to this practice



PERFORMANCE ATTRIBUTION

The treatment of performance attribution is *unclear* based on the plain text of the Marketing Rule and the adopting release

- Reasonable basis to take the position that certain types of performance attribution (other than attribution that is clearly extracted performance) may be shown gross-of-fees
- Advisers should document their approach and highlight calculation challenges
- Any such attribution should be presented in a manner that ensures the reader understands the effect of fees on the performance of the whole portfolio from which the attribution is derived



PERFORMANCE OF INDIVIDUAL HOLDINGS

It is *unclear* whether the performance of individual investments must be shown net-of-fees, or gross and net with equal prominence

- Strong argument that the performance of individual investments may be presented gross-of-fees in some circumstances
- “Gross performance” is defined in the Rule as the performance “of a portfolio (or portions of a portfolio that are included in extracted performance, if applicable).”
- As with performance attribution, advisers should document their approach, highlight calculation challenges, and ensure the reader understands the effect of fees on the performance of the whole portfolio



PREDECESSOR PERFORMANCE

Predecessor performance is prohibited in an advertisement unless:

- i. person(s) ***primarily responsible*** for achieving prior performance results continue to manage accounts at the advertising adviser;
- ii. accounts managed at predecessor adviser are ***sufficiently similar*** to accounts managed at advertising adviser;
- iii. all accounts ***managed in a substantially similar manner*** are advertised ***unless*** exclusion of any account would not result in materially higher performance or alter the presentation of any prescribed time periods; and
- iv. advertisement clearly and prominently includes ***all relevant disclosures*** and indicates performance results were from accounts managed at another entity



PREDECESSOR PERFORMANCE

But, the predecessor performance requirements do not apply to reorganizations where “the adviser’s business continued to exist”

Factors to consider:

- i. Substantial and direct business nexus between predecessor adviser and successor adviser
- ii. Reorganization not designed to eliminate substantial liabilities and/or spin off personnel
- iii. Successor adviser assumed substantially all of the assets and liabilities of the predecessor adviser



GOVERNANCE AND DOCUMENTATION

Certain policies will need to be updated

- Marketing review, social media, recordkeeping, promoters, indirect/noncash compensation, performance presentation, net performance calculation, related performance materiality, hypothetical performance

Must maintain and preserve **key records** of **all** advertisements disseminated

- Including records related to calculation of all performance, questionnaires used in third-party ratings, and intended audience of hypothetical performance/model fees





What Happens Next?



SEPTEMBER RISK ALERT

“The staff will conduct a number of specific national initiatives, as well as a ***broad review through the examination process*** for compliance with the Marketing Rule that will include, but will not be limited to, the following areas:

- Marketing Rule Policies and Procedures
- Substantiation Requirement
- Performance Advertising Requirements
- Books and Records”

