



MANAGED FUNDS  
ASSOCIATION



## MFA and AIMA Recommendations on the SEC's Proposed Advertising Rule May 8, 2020

MFA and AIMA support the Commission's goal of crafting a principles-based rule that facilitates robust communication between advisers and investors, while ensuring that investors are protected from false and misleading statements. However, we have significant concerns with the proposed modernization of the advertising rule.<sup>1</sup> We believe that, in its totality, the proposed advertising rule would impair drastically the useful flow of information to investors. Thus, it would harm investors by reducing transparency that is critical to their ability to evaluate and monitor their investments and the investment advisers overseeing them.

We submitted a detailed comment letter outlining with specificity our concerns, the rationale for those concerns, and our recommended solutions.<sup>2</sup> In general, our comments and recommendations rely heavily on two overarching principles. First, that principles-based definitions and substantive requirements should be favored over-prescriptive rules. Second, that advisers should be held accountable for designing and implementing a robust compliance program based on the risk profile of their activities, rather than being required to comply with a one-sized-fits all regulatory scheme.

To be a constructive resource to the Commission, we have summarized our key recommendations below and in Appendix A provided a mark-up of the text of the proposed rule.

### Key Recommendations

#### (1) Definition of "Advertisement"<sup>3</sup>

**Issue:** The definition of "advertisement" is overly broad and the exclusions very narrow, such that it would significantly reduce the flow of information to investors, and unduly complicate ordinary-course interactions with third parties (*e.g.*, investment consultants and the press).

#### **Recommendation:**

- Exclude communications addressed to a single person, or in the alternative, adopt a *de minimis* standard that is consistent with the FINRA (*i.e.*, only applies to any communication disseminated to 25 or more retail investors) or NFA approaches (*i.e.*, effectively exempts routine day-to-day communications with customers);

---

<sup>1</sup> File Number S7-21-19.

<sup>2</sup> MFA and AIMA comment letter, dated February 10, 2020, available here: <https://www.managedfunds.org/letters/mfa-aima-letter-on-sec-advertising-and-solicitation-rules/> ("Comment Letter").

<sup>3</sup> See Comment Letter, section 2.1, at 8-16.

- Eliminate the phrase “by or on behalf of”, or in the alternative, adopt a standard similar to FINRA’s “entanglement” standard (*i.e.*, looking at whether the FINRA member through its conduct adopted or endorsed the third party’s statement). We understand that the intent of the Commission in proposing this provision was to adopt a standard similar to that of the FINRA “entanglement” standard. If the Commission adopts FINRA’s standard, we recommend that the Commission provide safe harbors for ordinary course activities with third parties (*e.g.*, confirming that an investment adviser providing limited information that a third party later distributes or incorporates into third-party materials would not: (i) result in those materials being “by or on behalf of” the investment adviser; or (ii) by itself, constitute endorsement by the investment advisers of the third party’s later materials).
- Eliminate the term “promote”, or in the alternative, clarify that it does not expand the definition of “advertisement” beyond its meaning under the current advertising rule;
- Exclude an investment adviser’s response to all unsolicited investor requests, including a response that contains actual or hypothetical performance and/or information that the investment adviser determines in good faith is reasonably related to the unsolicited request. In the alternative, clarify in the final rule release that an investment adviser’s response to an unsolicited request that contains performance information fits within the exclusion; and
- Carve out the following important investment adviser communications: (i) communications that contain market commentary; (ii) communications sent solely to an investment adviser’s existing clients or investors or to prospective clients and investors upon their request (*e.g.*, risk reports, portfolio updates, and client or investor newsletters); (iii) general announcements relating to an investment adviser’s personnel, philanthropic activities, firm awards, or general business developments; (iv) prospectuses, private placement memoranda, and similar offering documents; and (v) interviews or firm profiles conducted by a third-party media publication that are not focused on offering an investment adviser’s products or services.

## (2) Definitions of “Retail Person”/“Non-Retail Person”<sup>4</sup>

**Issue:** Existing Commission rules already significantly limit the types of investors that can invest in private funds. As a result, we are concerned that the Commission’s proposed distinction between a “retail person” and “non-retail person” captures certain investors who are considered sophisticated under current practice within the definition of “retail person” (*e.g.*, an “accredited investor” or “qualified client”). This approach is inconsistent with the Commission’s recent private offering concept release and the proposed updates to the “accredited investor” definition.

### **Recommendation:**<sup>5</sup>

- Include “qualified clients” and “accredited investors” in the “non-retail person” definition;

---

<sup>4</sup> See Comment Letter, section 2.2, at 16-21.

<sup>5</sup> Please note that our remaining recommendations are premised on the Commission incorporating our recommended changes to the definitions of “retail person” and “non-retail person”. To the extent the Commission does not incorporate these changes, we would have additional comments on the proposed rule.

- Allow investment advisers to classify a non-U.S. person as a “retail person” or “non-retail person” based on existing practices, so long as the adviser makes its determination in “good faith”; and
- Add a grandfathering provision for current non-U.S. investors, given that, at the time of their original investment, no “retail person”/“non-retail person” distinction was even considered.

### (3) Pre-Use Review and Approval Mandate<sup>6</sup>

**Issue:** Combined with the broad definition of “advertisement”, this requirement would substantially and unnecessarily complicate investment advisers’ compliance obligations.

**Recommendation:** Eliminate the proposed pre-use review and approval mandate, and allow an investment adviser to reasonably design its policies and procedures to maintain compliance with the rule. In the alternative, retain the requirement but: (i) exclude ministerial communications, communications to a single investor (to the extent such communications are not already excluded from the definition of “advertisement”), and correspondence that is incidental and summarizes already reviewed content; and (ii) clarify that investment advisers are permitted to re-use previously reviewed and approved communications where the same substantive response is being sent to several different clients or investor, or the only changes are to update figures or dates.

### (4) Use of “Hypothetical Performance” Information<sup>7</sup>

**Issue:** The proposal defines “hypothetical performance” broadly, includes different types of performance information that have disparate uses, risk profiles, and complexities (*e.g.*, backtested, model, target, and projected performance), and then imposes the same disclosure requirements on each. To comply with the related disclosure requirements, investment advisers would have to disclose highly confidential and proprietary information about their investment processes, which could prevent investment advisers from making useful performance presentations.

#### **Recommendation:**

- The Commission should adopt a more flexible approach that would allow investment advisers to scale the scope and specific language of required disclosures to the risk profile of the type of “hypothetical performance” information used, and should remove targeted performance from the definition of “hypothetical performance”.
- The Commission should remove targeted performance from the definition of “hypothetical performance”. Targeted performance is a forward-looking projection and, as such, carries a different and significantly lower risk profile than “hypothetical performance” presentations that involve, for example, simulated track records that comprise back-tested information.
- The Commission should remove the prescriptive, suitability procedures in the case of advertisements containing hypothetical performance provided to non-retail persons.

---

<sup>6</sup> See Comment Letter, section 2.7, at 30-32.

<sup>7</sup> See Comment Letter, section 2.6.3, at 27-30.

## (5) General Prohibitions<sup>8</sup>

**Issue:** The proposed “general prohibitions” are overly prescriptive requirements and contain seven variations on the otherwise straightforward concept that an “advertisement” should not be misleading. This prescriptive approach risks confusion in application and unintended consequences.

**Recommendation:** Eliminate the proposed prescriptive approach in favor of continued reliance on the simpler and clearer anti-fraud standard from the current advertising rule, which would create a true principles-based approach. In the alternative, if the Commission is concerned that a single anti-fraud standard is not sufficiently protective of “retail persons”, we recommend that the Commission develop prohibitions specifically designed to their level of sophistication.

## (6) Prescribed Performance Periods in a “Retail Advertisement”<sup>9</sup>

**Issue:** While sensible for mutual funds, the requirement to prescribe one-, five-, and ten-year performance presentation periods in a “retail advertisement” is unworkable for private funds because they are varied in nature and cannot be as easily subjected to one-size-fits-all requirements, and for some private funds, the investment adviser cannot present the actual performance results until the end of life of the fund.

**Recommendation:** Eliminate the standardized timeframe requirement.

## (7) Testimonials, Endorsements, and Third-Party Ratings<sup>10</sup>

**Issue:** The requirement to disclose non-cash compensation presents the same ambiguities as for the solicitation rule, and adds significant ambiguity to the scope of the disclosure requirement. Also, the requirement that investment advisers conduct diligence on the rating process for third-party ratings would create significant challenges.

**Recommendation:**

- Require only disclosure of cash compensation and only where such cash compensation was provided “in exchange for” the testimonial, endorsement or third-party rating.
- Eliminate the investment adviser due diligence requirement.

## (8) Past Specific Recommendations/Specific Investment Advice<sup>11</sup>

**Issue:** We are concerned with the discussion and positive statements in the proposed rule release regarding the existing staff no-action letters in this area, which are narrow and of limited utility in many circumstances.

---

<sup>8</sup> See Comment Letter, Section 2.3, at 21-22.

<sup>9</sup> See Comment Letter, section 2.2.4, at 20-21.

<sup>10</sup> See Comment Letter, Section 2.4, at 23-24.

<sup>11</sup> See Comment Letter, section 2.5, at 24-25.

**Recommendation:**

- We recommend that the Commission clarify in the final rule release that these letters are only examples of safe harbors, and not the sole circumstances in which an investment adviser’s presentation of past specific recommendations would be appropriate and permissible. We believe that in cases where an investment adviser discloses total portfolio performance (*e.g.*, advertisements relating to funds), such disclosure is itself a sufficient measure to address the potential for investor confusion otherwise associated with highlighting individual positions or position results.
- We recommend that the Commission clarify in the final rule release that the discussion about specific investment advice does not apply to statements regarding current investments. Such statements are not performance information because they do not convey information about buy/sell pairs and associated pricing levels. Accordingly, we believe they are appropriately regulated by existing anti-fraud and manipulation provisions, and should not be considered “specific investment advice”.

**(9) Form ADV Supplemental Questions<sup>12</sup>**

**Issue:** The questions would not provide the Commission with accurate insight into investment advisers’ actual advertising practices as advisers would answer all questions in the affirmative, and they would not benefit investors who would already know about the adviser’s practices.

**Recommendation:** Eliminate the supplemental questions.

\* \* \* \* \*

We thank you for considering our recommendations, and we welcome the opportunity to discuss our views with you in greater detail. Please do not hesitate to contact Carlotta D. King of MFA at 202-730-2600 or Jiří Król of AIMA at 202-919-4940 with any questions that you might have regarding this summary.

---

<sup>12</sup> See Comment Letter, section 2.8, at 32-33.

## APPENDIX A

### Proposed Mark-Up of Text

#### **275.206(4)–1 Advertisements by investment advisers.**

As a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts, practices, or courses of business within the meaning of section 206(4) of the Act [15 U.S.C. 80b– 6(4)], it is unlawful for any investment adviser registered or required to be registered under section 203 of the Act [15 U.S.C. 80b–3], directly or indirectly, to disseminate any *advertisement* that violates any of paragraphs (a) through (d) of this section.

(a) *General prohibitions.* An *advertisement* may not:

~~(1) Include any untrue statement of a material fact, or omit to state 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 claim or statement that is unsubstantiated;~~

~~(3) Include an untrue or misleading implication about, or reasonably be likely to cause an untrue or misleading inference to be drawn concerning, a material fact relating to the investment adviser;~~

~~(4) Discuss or imply any potential benefits to clients or investors connected with or resulting from the investment adviser's services or methods of operation without clearly and prominently discussing any associated material risks or other limitations associated with the potential benefits;~~

~~(5) Include a reference to specific investment advice provided by the investment adviser where such investment advice is not presented in a manner that is fair and balanced;~~

~~(6) Include or exclude performance results, or present performance time periods, in a manner that is not fair and balanced; or~~

~~(7) Otherwise be materially misleading.~~

(b) *Testimonials, endorsements, and third-party ratings.* An *advertisement* may not include any *testimonial*, *endorsement*, or *third-party rating*, unless:

(1) For a *testimonial* or *endorsement*, the investment adviser clearly and prominently discloses, or the investment adviser reasonably believes that the *testimonial* or *endorsement* clearly and prominently discloses, that:

~~(i) The *testimonial* was given by a client or investor, and the *endorsement* was given by a non-client or non-investor, as applicable; and~~

(ii) If applicable, cash ~~or non-cash~~ compensation has been provided by or on behalf of the adviser in ~~connection with~~ exchange for the adviser obtaining or using the *testimonial* or *endorsement*;

(2) For a *third-party rating*, ~~the investment adviser reasonably believes that any questionnaire or survey used in the preparation of the *third-party rating* 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~~ the investment adviser clearly and prominently discloses, or the investment adviser reasonably believes that the *third-party rating* ~~clearly and prominently~~ discloses:

(i) The date on which the rating was given and, ~~if applicable,~~ 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 cash ~~or non-cash~~ compensation has been provided by or on behalf of the adviser in ~~connection with~~ exchange for obtaining or using the *third-party rating*.

(c) *Performance*. An investment adviser may not include:

(1) In any *advertisement*:

(i) Any presentation of *gross performance*, unless the *advertisement* provides or offers to provide promptly ~~a schedule of the specific fees and expenses (presented in percentage terms) deducted to calculate net performance;~~

(ii) Any statement, express or implied, that the calculation or presentation of performance results in the *advertisement* has been approved or reviewed by the Commission;

(iii) Any *related performance*, unless it includes all *related portfolios*; provided that *related performance* may exclude any *related portfolios* if:

(A) The advertised performance results are no higher than if all *related portfolios* had been included; ~~and~~

~~(B) The exclusion of any *related portfolio* does not alter the presentation of the time periods prescribed by paragraph (c)(2)(ii) of this section;~~

(iv) Any *extracted performance*, unless the *advertisement* provides or offers to provide promptly the performance results of ~~all investments in~~ the total portfolio from which the performance was extracted; or

(v) Any *hypothetical performance* unless the investment adviser:

(A) For any retail advertisement, aAdopts and implements policies and procedures reasonably designed to ensure that the *hypothetical performance* is relevant to the financial situation and investment objectives of the person to whom the *advertisement* is disseminated;

(B) Provides sufficient disclosures that accompany such *hypothetical performance* and that the investment adviser reasonably determines are scaled appropriately to the risk profile of the type of *hypothetical performance* being provided and reasonably explain the *hypothetical performance* shown;~~Provides sufficient information to enable such person to understand the criteria used and assumptions made in calculating such *hypothetical performance*;~~ and

(C) Provides (or, if such person is a *non-retail person*, provides or offers to provide promptly) sufficient information to enable such person to understand the risks and limitations of using such *hypothetical performance* in making investment decisions.

(2) In any *retail advertisement*:

(i) Any presentation of *gross performance*, unless the *advertisement* also presents *net performance*:

(A) With at least equal prominence to, and in a format designed to facilitate comparison with, the *gross performance*; and

(B) Calculated over the same time period, and using the same type of return and methodology as, the *gross performance*; ~~and~~

~~(ii) Any performance results of any *portfolio* or any composite aggregation of *related portfolios*, unless the *advertisement* includes performance results of the same *portfolio* or composite aggregation for one-, five-, and ten-year periods, each presented with equal prominence and ending on the most recent practicable date; except that if the relevant *portfolio* did not exist for a particular prescribed period, then the life of the *portfolio* must be substituted for that period.~~

~~(d) *Review and approval*. An investment adviser may not, directly or indirectly, disseminate an *advertisement* unless the *advertisement* has been previously reviewed and approved as being consistent with the requirements of this section by a designated employee, except for *advertisements* that are:~~

~~(1) Communications that are disseminated only to a single person or household or to a single investor in a *pooled investment vehicle*; and~~

~~(2) Live oral communications that are broadcast on radio, television, the internet, or any other similar medium.~~

(e) *Definitions*. For purposes of this section:

(1) *Advertisement* means any communication, disseminated by any means, ~~to more than one investment advisory client or investor 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.

*Advertisement* does not include:

(i) Live oral communications that are not broadcast on radio, television, the internet, or any other similar medium;<sup>13</sup>

---

<sup>13</sup> We do not have any comments on the proposed language. However, the discussion around this exclusion in the proposed rule release created number of concerns. We recommend that the Commission clarify the following in the final rule release that: (1) storyboards, outlines, notes, and any other written material used by investment advisers to prepare for or conduct a client or investor presentation are within the proposed exclusion; provided that the investment adviser does not show or disseminate these materials to the client or investor; (2) what constitutes a "live" communication is to be understood flexibly in light of both the present context and the continued evolution of the media and technology involved; and (3) a quarterly conference call for client and investors (i.e., not open to the general public) organized by a chief investment officer or a portfolio manager would be considered a live oral communication that fits within the exclusion.

(ii) A communication by an investment adviser that does no more than respond to an unsolicited request for information specified in such request about the investment adviser or its services, including any information that the investment adviser determines in good faith is reasonably related to the unsolicited request, other than:

~~(A) Any communication to a retail person that includes performance results; or~~

~~(B) Any communication that includes hypothetical performance;~~

(iii) A communication that contains market commentary;

(iv) A communication sent solely to one existing or prospective investment advisory client or investor;

(v) A communication relating to the announcement of an investment adviser's personnel, philanthropic activities, firm awards, or general business developments;

(vi) A fund prospectus, private placement memoranda, or similar offering document;

(vii) A communication containing an interview or profile of an investment adviser that is conducted by a third-party media publication and does not offer an investment adviser's products or services;

(viii) An advertisement, other sales material, or sales literature that is about an investment company registered under the Investment Company Act of 1940 or about a business development company and that is within the scope of rule 482 or rule 156 under the Securities Act; or

~~(ix)~~ Any information required to be contained in a statutory or regulatory notice, filing, or other communication.

(2) *Endorsement* means any statement by a person other than a client or investor indicating approval, support, or recommendation of the investment adviser or its *advisory affiliates*, as defined in the Form ADV Glossary of Terms.

(3) *Extracted performance* means the performance results of a subset of investments extracted from a *portfolio*.

(4) *Gross performance* means the performance results of a *portfolio* before the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant *portfolio*.

(5) *Hypothetical performance* means performance results that were not actually achieved by any *portfolio* of any client of the investment adviser. *Hypothetical performance* includes, but is not limited to:

(i) Performance derived from representative model *portfolios* that are managed contemporaneously alongside *portfolios* managed for actual clients; and

(ii) Performance that is backtested by the application of a strategy to market data from prior periods when the strategy was not actually used during those periods; and

~~(iii) Targeted or projected performance returns with respect to any portfolio or to the investment services offered or promoted in the advertisement.~~

(6) *Net performance* means the performance results of a *portfolio* after the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant *portfolio*, including, if applicable, advisory fees, advisory fees paid to underlying investment vehicles, and payments by the investment adviser for which the client or investor reimburses the investment adviser. For purposes of this rule, *net performance* may reflect one or more of the following:

(i) The deduction of a model fee when doing so would result in performance figures that are no higher than if the actual fee had been deducted;

(ii) The deduction of a model fee that is equal to the highest fee charged to the relevant audience of the *advertisement*; and

(iii) The exclusion of custodian fees paid to a bank or other third-party organization for safekeeping funds and securities.

(7) *Non-retail advertisement* means any *advertisement* for which an investment adviser has adopted and implemented policies and procedures reasonably designed to ensure that the *advertisement* is disseminated solely to *non-retail persons*.

(8) *Non-retail person* means one or more of the following:

(i) A "qualified purchaser," as defined in section 2(a)(51) of the Investment Company Act of 1940 and taking into account rule 2a51-1 under the Investment Company Act;

~~(ii) A "qualified client," as defined in Rule 205-3 of the Investment Advisers Act of 1940;~~

~~(iii) An "accredited investor," as defined in Rule 501 of the Securities Act of 1933; and~~

~~(iv) A "knowledgeable employee," as defined in rule 3c-5 under the Investment Company Act of 1940, with respect to a company that would be an investment company but for the exclusion provided by section 3(c)(7) of the Investment Company Act and that is advised by the investment adviser; and~~

~~(v) A person or entity that is not a "U.S. person" as defined in Regulation S of the Securities Act of 1933, and that:~~

~~(A) An investment adviser acting in good faith and in consideration of any applicable regulations of the non-U.S. jurisdiction that determine which clients or investors are non-retail clients or investors; or~~

~~(B) Is an existing investor in a pooled investment vehicle.~~

(9) *Pooled investment vehicle* means any pooled investment vehicle as defined in Rule 206(4)-8(b).

(10) *Portfolio* means a group of investments managed by the investment adviser. A *portfolio* may be an account or a *pooled investment vehicle*.

(11) *Related performance* means the performance results of one or more *related portfolios*, either on a *portfolio-by-portfolio* basis or as one or more composite aggregations of all *portfolios* falling within stated criteria.

(12) *Related portfolio* means a *portfolio* with substantially similar investment policies, objectives, and strategies as those of the services being offered or promoted in the *advertisement*. *Related portfolio* includes, but is not limited to, a *portfolio* for the account of the investment adviser or its *advisory affiliate*, as defined in the Form ADV Glossary of Terms.

(13) *Retail advertisement* means any *advertisement* other than a *non-retail advertisement*.

(14) *Retail person* means any person other than a *non-retail person*.

(15) *Testimonial* means any statement of a client's or investor's experience with the investment adviser or its *advisory affiliates*, as defined in the Form ADV Glossary of Terms.

(16) *Third-party rating* means a rating or ranking of an investment adviser provided by a person who is not a *related person*, as defined in the Form ADV Glossary of Terms, and such person provides such ratings or rankings in the ordinary course of its business.

**~~PART 279—FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940~~**

~~■ 5. The authority citation for part 279 continues to read as follows:~~

~~**Authority:** The Investment Advisers Act of 1940, 15 U.S.C. 80b-1, *et seq.*, Pub. L. 111-203, 124 Stat. 1376.~~

**~~{§ 279.1 Amended}~~**

~~■ 6. Amend § 279.1 by revising Form ADV, Part 1A. The revised section of Form ADV, Part 1A—the addition of Item 5.L—is attached as Appendix A.~~

\*\*\*\*\*