



# SPOTLIGHT ON

## Regulation of Advisor Advertising and Marketing

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Advisors face a range of restrictions on their advertising and marketing efforts.

Advisors can generally advertise the firm and their advisory services, but are barred from using certain types of advertisements or including certain things in those ads. Also, advisors must include standard disclaimers and make certain disclosures in their ads.

This document is designed to provide a general overview of the rules governing advertising by advisors. It summarizes the prohibited forms of advertising and highlights common areas regulators focus on, like ads concerning the advisor's performance or use of social media.

### What is advertising?

Advertising is defined broadly under federal and state rules. Rule 206(4)-1 of the Investment Advisers Act (the "Act"), defines advertising as:

“any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities.”

In short, advertising includes communications in writing or electronic form designed to get new clients or retain current clients, such as ads placed online, in magazines, newspapers, on TV or radio; client newsletters; marketing brochures; and firm websites.

## What is advertising? (cont.)

But advisor “advertising” does not include:

- In-person, telephone or other one-on-one conversations;
- Written responses to unsolicited requests for specific information;
- Regular account statements or reports sent to existing clients that do not solicit new business; and
- Academic articles not offering advisory services.

## What types of ads are prohibited?

Advisors cannot use advertisements that:

- Include or refer to testimonials about a client’s experience with, or endorsement of, an advisor.
  - However, advisors may use:
    - Lists identifying selected clients of the advisor if the advisor includes disclaimers and disclosures, and objective criteria used to select the clients;
    - Objective, numerical third-party ratings of advisors based on statistically valid client samples and unbiased questionnaires; and
    - Unbiased third-party articles regarding the advisor’s performance that do not include inferences about client experiences or the advisor’s competence.
- Refer or allude to specific recommendations made by the advisor that were or would have been profitable.
  - The advisor may list all recommendations made during at least the preceding year if it includes the following information: the name of each security recommended, the date and nature of each recommendation, the market price at the time, the price at which the recommendation was to be acted upon, the market price as of the most recent practicable date, and a legend on the first page in as large as print as the largest print used in the body stating: “it shall not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list.”
- Directly or indirectly represent that any graph, chart, formula, or other device can in and of itself be used to determine which securities to buy or sell, or when to buy or sell securities, without prominently disclosing the limitations and difficulties of their use;

## What types of ads are prohibited (cont.)

- Represent that any report, analysis, or service will be provided free of charge unless it will be furnished entirely free, and without any condition; or
- Contain any untrue statement of a material fact or are otherwise false or misleading. Regulators may take into account the form and content of the ads, the advisor's ability to perform advertised acts, the implications and inferences arising from the ads, and the sophistication of the client or prospective client targeted by the ads when deciding whether an ad is misleading.

## How advisors can advertise performance information.

Advisors often try to attract new clients by presenting their investment record to prospective clients, either by showing the performance of some (or all) actual portfolios the advisor manages or by showing how a "model portfolio" performed.

This is referred to as "performance advertising" and regulators impose specific restrictions on it and heavily scrutinize these ads. We summarize these basic requirements below.

**Treatment of fees.** Any performance information must be net of advisory fees, brokerage or other commissions, and any other applicable charges, including any fees and charges paid to the advisor's affiliate and all transaction costs unless: (a) it also includes net performance information in an equally prominent, easy to compare, manner; (b) custodial fees are included; or (c) the ad is communicated to a sophisticated client, i.e., one able to negotiate his or her fees, on one-on-one, confidential and private, basis, and includes certain written disclosures about the impact of fees and expenses. (In some fact-specific situations the SEC has allowed advisors to present net-of-fees performance information reflecting the deduction of model fees.)

**Required disclosures.** Advisors must include narrative disclosures in their performance advertising, including discussions about:

- The effect of material market or economic conditions on the results portrayed;
- Any dividend and other earning reinvestment reflected in the results portrayed;
- The probability of loss any time an advisor makes claims about the potential for profit;
- All material facts relevant to any index comparisons; and
- All material conditions, objectives, or investment strategies used to obtain the results portrayed.

## How advisors can advertise performance information (cont.)

Advertising concerning the performance of a model portfolio must also include disclosures discussing:

- Any limitations inherent in the model results including that the results are not based on actual trading;
- The effect of any intervening material changes in conditions, objectives, or investment strategies on the results portrayed in the model;
- Whether any of the securities or investment strategies in the model portfolio do not or only partially relate to the type of services offered by the advisor; and
- Whether the advisor's clients had investment results materially different from results portrayed in the model.

**Selection of accounts included in actual performance ads.** Advertisements concerning actual performance information may be based on all accounts under management, or select accounts if excluding certain accounts does not make the results misleading and the advisor discloses the basis for the selection, the material effect of the selection on the results portrayed, and other material facts.

**Portability of performance information.** Newly registered investment advisors may be interested to know that performance is portable, meaning that they may reference the historical performance record of a predecessor firm or the advisor's portfolio managers while at another firm if:

- The same person managing the accounts was primarily responsible for the prior performance results;
- The results of the accounts that became accounts of the portfolio manager at the new firm were not materially different from the performance of the accounts that did not follow him to the new firm;
- The accounts were of similar types and composition to the advisor's current accounts so the performance information is relevant to prospective clients;
- All accounts were managed in a substantially similar manner as the advisor advertises now;
- The ad discloses that the results were from accounts managed at a different entity; and
- The successor firm fully complies with the record-keeping requirements regarding performance data from the predecessor firm.

## How advisors can advertise performance information (cont.)

**Use of backtested results.** Advisors must provide additional disclosures when presenting hypothetical “backtested” information, i.e., hypothetical performance based on how an advisor’s strategy would have performed in the past. Advisors can only provide backtested results to “sophisticated” clients, and must make the following disclosures in connection with hypothetical backtested results:

- The backtested performance was derived from the retroactive application of a trading model developed with the benefit of hindsight;
- The limitations inherent in backdated data due to the benefit of hindsight and why actual results may vary;
- Whether trading strategies retroactively applied were not available during those time periods;
- Whether actual performance of client accounts was materially worse than the advertised hypothetical results for that time period;
- The material economic and market factors that may have affected the advisor’s decision-making if he had used the model to actually manage client funds;
- Whether the performance numbers are net of advisory fees, brokerage or other commissions or other expenses the client would have paid;
- Any material facts relevant to comparisons between the backtested performance and the benchmark; and
- The potential for loss.

**Requirements for advertising GIPS Compliance.** Advisors may choose to comply with the Global Investment Performance Standards (“GIPS”), industry-accepted standards for calculating and presenting investment performance results to prospective clients. But once an advisor claims compliance with GIPS, it must comply with these performance presentation standards at all times on a firm-wide basis. (SEC and State examiners may review this during examinations.) Additionally, advisors that advertise their GIPS compliance in an advertisement must adhere to either the GIPS Advertising Guidelines or the full GIPS standards.

## How advisors can use social media.

Advisors may be eager to use social media tools to advertise themselves or their services. Regulators scrutinize these advertisements, however, for the same rules discussed above concerning other forms of advertising. The regulators also require advisors to set up procedures and controls distinct from those required for other forms of advertising since social media is a different and harder to control than static print or news advertising. The regulators continue to issue guidance on this subject, including the March 2014 Guidance Update from the SEC's Division of Investment Management, which is available at <http://www.sec.gov/investment/im-guidance-2014-04.pdf>.

Specifically, advisors must follow certain rules if they re-publish, circulate, or reference content written by others, including commentary on social media sites. Among other things:

- The advisor cannot change or affect which commentary is included or how it is presented;
- The commentators' ability to include their opinions on the site cannot be restricted;
- The site must allow readers to view all public commentary and update new commentary on a real-time basis;
- The content must be independent from the advisor, i.e., it cannot be directly or indirectly written by the advisor and the advisor cannot compensate the commentator;
- The advisor must publish all of the unedited comments appearing on the site regarding the advisor; and
- The advisor cannot highlight or give prominence to certain types of testimonials, and must publish all commentary in a content-neutral manner such as in chronological or alphabetical order.

Advisors may also reference the independent social media side in non-social media ads to signal to clients or prospective clients that they may research public commentary about the advisor.

Advisors are expected to adopt and periodically review policies and procedures relating to social media usage, including usage guidelines, content standards, and monitoring of firm and third-party social media sites, and pre-approval or content.

## Advisors' use of acronyms.

Generally, registered advisors may not use acronyms such as "RIA." Rather, regulators prefer that advisors spell that term out in their advertising because some may think that the acronym refers to an educational or professional designation (like a CPA, CFA, MD, etc.), or that the firm is sponsored, approved, or recommended by the SEC. Advisors may of course indicate that they are registered advisors, without suggesting that registration carries some official approval or indicating the advisor has attained a particular level of skill or ability.

## Other obligations concerning advertisements.

SEC-registered advisors must maintain records related to any advertisements and documents substantiating any performance claims made in advertisements circulated (directly or indirectly) to 10 or more persons for a period of five years.

If an advisor sends an advertisement to more than 10 persons and uses a list to do so, the advisor must keep a copy of the advertisement as well as the list and a memorandum describing the list and its source. (Otherwise, the advisor does not need to keep a record of recipients' names and addresses.)

When an advertisement recommends the purchase or sale of a specific security without discussing the rationale for the recommendation, the advisor must retain both the advertisement and a memorandum stating the basis for the recommendation.

Advisors may satisfy the recordkeeping requirements regarding performance advertising by retaining relevant internally generated documents, any third-party records such as custodial and brokerage statements confirming the accuracy of the advisor's account statements and performance-related records, and any independent auditor reports verifying performance information.

For additional information on advisors' record-keeping obligations, please review our brochure, [Spotlight on Advisors' Recordkeeping Obligations](#).

Advisors must also ensure that they adopt and implement written compliance policies and procedures reasonably designed to prevent violations of Rule 206(4)-1. This includes having internal processes to review advertisements before they are disseminated, review material discrepancies between composites and benchmarks, and using a secondary independent pricing service to periodically verify prices supplied by the primary pricing service. The ads should be reviewed by one or more firm staff involved in marketing, analyzing performance, and trading.

## **Additional state obligations may apply.**

Advisors should also keep in mind that many states follow the SEC's rules but other states may impose additional, stricter, rules on advertising by registered investment advisors than those imposed by the SEC. For instance, some states require registered advisors to submit their advertisements for review by state securities regulators before use.

Compliance with the rules governing advertising by registered advisors requires fact-intensive analysis of advertising content. Before advertising, advisors should obtain legal advice from attorneys knowledgeable about the applicable regulations and guidance in this area, including relevant SEC no-action letters and any recent guidance on social media usage.

### **About Greenwich Compliance**

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