

The background of the slide is a close-up, slightly out-of-focus photograph of numerous colorful wooden blocks. The blocks are in various colors including yellow, pink, light green, blue, purple, and orange. They are stacked and arranged in a way that creates a sense of depth and texture. The lighting is soft, highlighting the edges of the blocks.

**Baker
McKenzie.**

The New Framework for Investment Adviser Marketing

North America Financial Regulation & Enforcement Practice | January 27, 2021



Agenda

1 Overview of the New Marketing Rule

2 Expanded Definition of Advertisement

3 Advertisements

4 Solicitation and Referral Arrangements

5 Focus on Private Funds

6 Other Considerations: Form ADV, Books and Records

7 Approach to Implementation

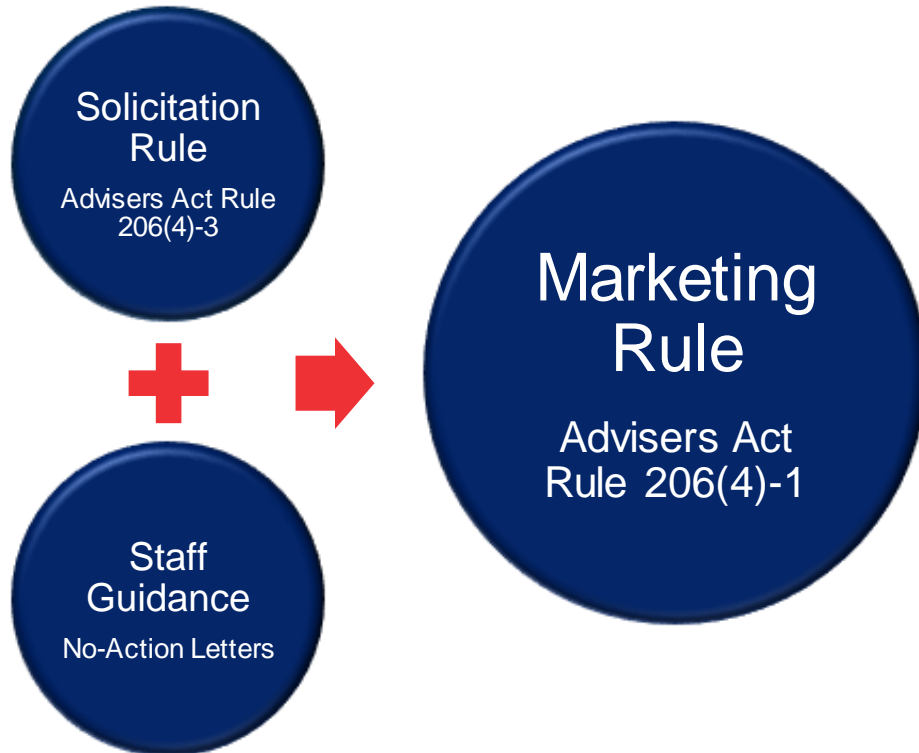
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Overview of the New Marketing Rule

Overview of New Marketing Rule

Key changes from existing rules



Key Developments

- Media neutral definition
- Principles-based approach – no per se prohibitions
- No requirement for prior review and approval
- No explicit distinction between retail and institutional communications
- Incorporates solicitation rule concepts and prior no-action guidance
- Introduces “promoter” concept
- Covers cash and non-cash compensation
- Expands disqualification provisions for promoters

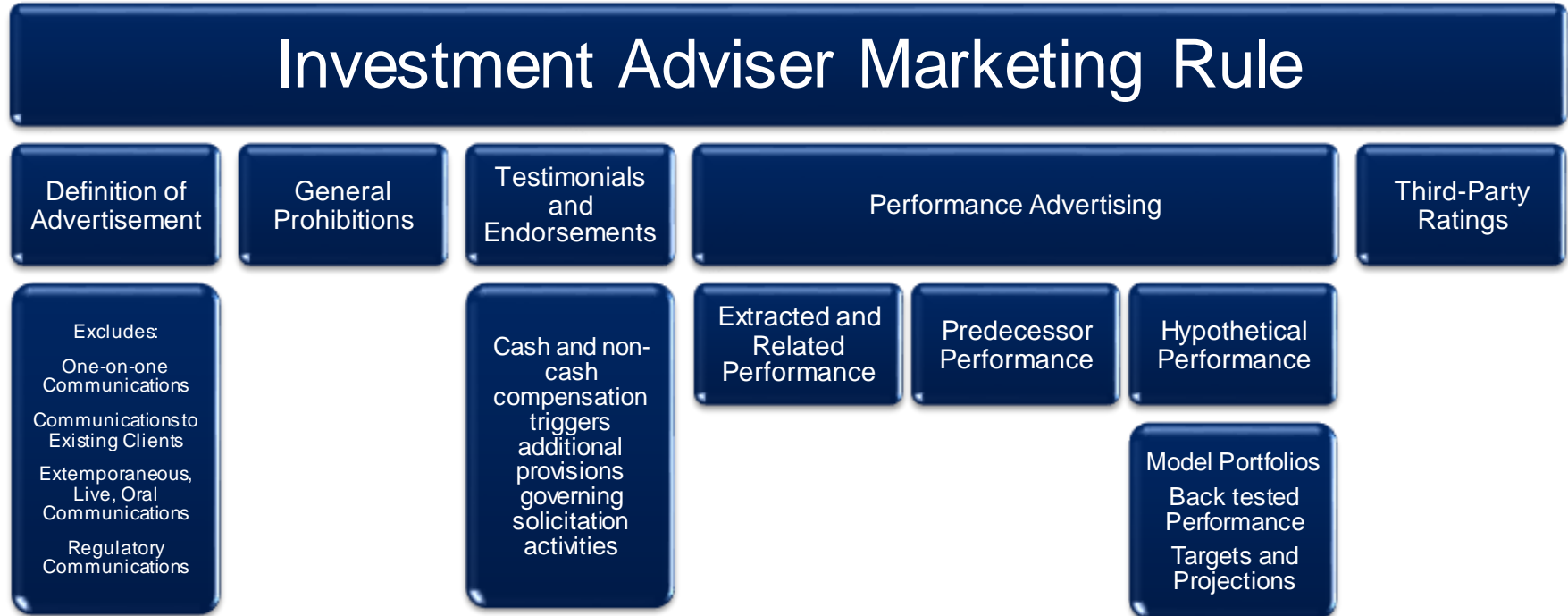
Overview of New Marketing Rule

Timing and transition considerations

- Transition
 - Adopted: December 22, 2020
 - Effective date: 60 days after publication in the Federal Register
 - Compliance date: 18 months after the effective date
- Impact of change in administration
- Implications for future SEC examinations and enforcement

Overview of New Marketing Rule

Structure of the new rule



The background of the slide features a collection of colorful wooden blocks, similar to building blocks or Tetris pieces, arranged in a staggered, overlapping pattern. The colors include shades of yellow, pink, light green, blue, purple, and orange. The lighting is soft, creating subtle shadows and highlights on the blocks' surfaces.

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Expanded Definition of Advertisement

Expanded Definition of Advertisement

Refined approach contains two parts

Advertisement is defined as:

- Any *direct or indirect communication* an investment adviser makes to *more than one person* . . . that offers the investment adviser's investment advisory services with regard to securities to *prospective clients or investors* in a private fund advised by the investment adviser or offers *new investment advisory services* with regard to securities to *current clients or investors* in a private fund advised by the investment adviser; and
- Any endorsement or testimonial for which an investment adviser provides *compensation*, directly or indirectly.

Expanded Definition of Advertisement

Refined approach in relation to proposed amendments

- Covers direct and indirect communications
 - Content distributed by third-parties
 - Third-party hyperlinks
 - Third-party posts on social media sites
 - Personal social media posts by employees
- Expressly includes communications to investors in private funds advised by the adviser
- Focuses on services offered to prospective clients/investors and new or additional advisory services offered to existing clients/investors
- Applies to investment advisory services with respect to securities

Expanded Definition of Advertisement

Retained and expanded certain exclusions

The definition of an advertisement excludes:

- **Communications to one “person”**
 - Hypothetical performance is only excluded if it is provided in response to an unsolicited client request or to a private fund investor
- **Brand communications, general educational information, and market commentary**
- **Extemporaneous, live, oral communications**
- **Information contained in regulatory filings**
 - Information must be “reasonably designed” to satisfy the requirements of such regulatory filings

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Advertisements

General Prohibitions

Designed to provide greater clarity around misleading practices

An advertisement may not:

- 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
- 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
 - Statements of facts, as opposed to opinions, should be verifiable
 - Not required to maintain a file of substantiating materials for every advertisement, but need controls
- Include information that would reasonably be likely to cause an untrue or misleading implication or inference to be drawn concerning a material fact relating to the adviser
 - Addresses situations where statements are literally true, but where the overall effect may create an untrue or misleading inference or implication about the adviser
 - Requires consideration of the context and totality of the information presented

General Prohibitions

Designed to provide greater clarity around misleading practices

- Discuss any potential benefits to clients or investors connected with or resulting from the investment adviser's services or methods of operation without providing fair and balanced treatment of any material risks or material limitations associated with the potential benefits
 - Removed requirement to "clearly and prominently" provide material risk disclosure
 - No need to discuss every potential risk or limitation in detail, but must discuss material risks and limitations associated with the benefits in a fair and balanced manner
 - Permits layered disclosure, so long as layered disclosure or hyperlinks do not obscure important information
- 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
 - Eliminates per se prohibition on past specific recommendations and replaces it with "specific investment advice," but same policy to eliminate "cherry-picking"
 - Not bound by prior no-action letters to satisfy fair and balanced standard
 - "Fair and balanced" concept in FINRA Rule 2210(d)(1)(A) is relevant, but not controlling or authoritative

General Prohibitions

Designed to provide greater clarity around misleading practices

- **Include or exclude performance results, or present performance time periods, in a manner that is not fair and balanced**
 - Designed to prevent an adviser from “cherry-picking” time periods (e.g., very short time periods or inconsistent time periods) that are not reflective of general results
 - Requires disclosure of market conditions, unusual circumstances, other material factors that contributed to performance
- **Otherwise be materially misleading**
 - Catch-all provision

Testimonials and Endorsements

Definitions focus on the relationship of the speaker

- Testimonial means any statement by a **current client or investor** about the client or investor's experience with the investment adviser or its supervised persons
- Endorsement means any statement by a person **other than a current client or investor** that indicates approval, support, or recommendation of the investment adviser or its supervised persons or describes that person's experience with the investment adviser or its supervised persons

Third-Party Ratings

Marketing rule expressly addresses third-party ratings

Third-party rating is a rating or ranking of an investment adviser provided by a person who is *not a related person*, and who provides such ratings or rankings *in the ordinary course of its business*

- Designed to distinguish from testimonials and endorsements that resemble ratings, but are not made by persons with the appropriate experience
- Related person is defined in Form ADV
- Limitation on related persons is designed to avoid risk of affiliations resulting in a biased rating

Third-Party Ratings

Subject to due diligence and disclosure requirements

- **Due diligence requirement**
 - Adviser must have a reasonable basis to believe that any questionnaire or survey makes it equally easy for a participant to provide favorable and unfavorable responses, and is not designed to produce predetermined results
- **How to satisfy due diligence requirement**
 - Obtain a copy of the questionnaire or survey
 - Seek representations from the third-party about the general aspects of how survey or questionnaire is designed, structured, and administered
 - Rely on public disclosure about survey or questionnaire methodology

Third-Party Ratings

Subject to due diligence and disclosure requirements

- **Disclosure requirement**
 - Adviser must clearly and prominently disclose, or the adviser reasonably believes that the rating clearly and prominently discloses:
 - Date on which the rating was given
 - Period of time on which the rating was based
 - Identity of the third-party that created and tabulated the rating
 - If applicable, that compensation has been provided directly or indirectly by the adviser in connection with obtaining or using the rating
- **Clear and prominent means disclosure is at least as prominent as the rating**
- **Compensation refers to cash and non-cash compensation**

Performance Advertising

Guidelines applicable to performance presentations

Net Performance

- Performance of a portfolio after the deduction of all fees and expenses that a client or investor has paid or would pay in connection with the investment advisory services to the relevant portfolio
- May exclude custodian fees
- May reflect the deduction of a model fee equal to the highest fee charged to the intended audience, or that would result in performance that is no higher than if the actual fee had been deducted

Gross Performance

- Performance 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 advisory services to the relevant portfolio

Performance Advertising

Guidelines applicable to actual performance

- **Net and Gross Side-by-side**
 - Equal prominence in a format designed to facilitate comparison
 - Calculated over the same time period using the same type of return methodology
- **Prescribed time periods**
 - Performance returns must be shown for one-, five-, and 10-year time periods (or since inception)
 - As of a date that is no less recent than the most recent calendar year-end
 - Prescribed time periods must be shown with equal prominence
 - Private funds are **not** subject to this requirement

Performance Advertising

Guidelines applicable to actual performance

Related performance

- Performance of portfolios with substantially similar investment policies, objectives and strategies as those of the services being offered in the advertisement
- Must include all related accounts – unless the exclusion of a particular account would not result in materially higher performance results and does not alter the presentation of any applicable time periods

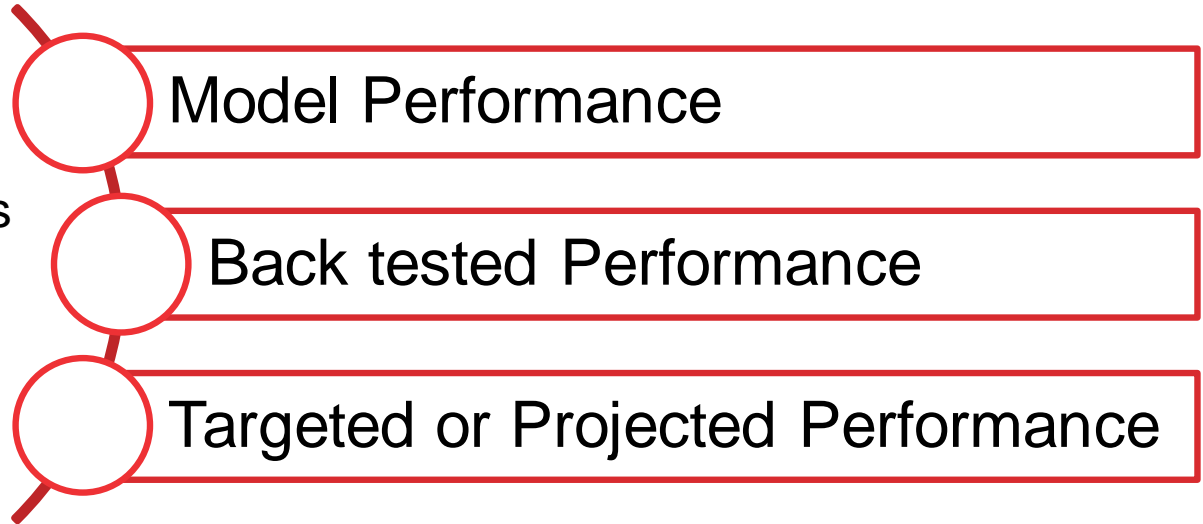
Extracted performance

- Performance of a subset of investments from a single account or fund
- Must be accompanied by the results of the portfolio from which the performance was extracted

Hypothetical Performance

Definition of hypothetical performance

Hypothetical performance refers to any performance results that were not actually achieved by any portfolio of the investment adviser



Hypothetical Performance

Definition excludes investment analysis tools

- Hypothetical performance does not include performance generated by an “investment analysis tool” under FINRA Rule 2214 – so long as the client or investor uses the tool (directly or through an adviser) and subject to disclosure that:
 - Describes the criteria and methodology used, including limitations and key assumptions
 - Explains that the results may vary with each use and over time
 - Describes the universe of investments, explains how the tool selects investments, discloses if tool favors certain investments and explains the reason for the selectivity, states that other investments not considered may have similar or superior characteristics
 - States that the tool generates hypothetical outcomes

Hypothetical Performance

Conditions for the use of hypothetical performance

- **Policies and Procedures**
 - Adviser must adopt and implement policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the *likely* financial situation and investment objectives of the *intended audience*
 - No requirement to know the actual financial situation or investment objectives of each investor that receives hypothetical performance
 - Intended audience means adviser can group investors into categories or types
 - Advertisements directed to a mass audience or intended for general circulation present problems
- **Disclosure of criteria and assumptions**
- **Disclosure of risks and limitations of relying on hypothetical performance to investment decisions**

Predecessor Performance

Approach generally codifies existing no-action guidance

- Refers to performance of accounts or private funds that were not advised at all times during the period shown by the adviser advertising the performance
- Predecessor performance cannot be used unless:
 - The person or persons who were primarily responsible for achieving the prior performance results manage accounts at the advertising adviser
 - The accounts managed at the predecessor adviser are sufficiently similar such that the performance results would provide relevant information to clients or investors
 - All accounts that were managed in a substantially similar manner are advertised unless the exclusion of any such account would not result in materially higher performance or alter the presentation of any applicable time periods
 - The advertisement clearly and prominently includes all relevant disclosures, including that the performance results were from accounts managed at another entity



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Solicitation and Referral Arrangements

Testimonials and Endorsements

Solicitation and referral concepts are incorporated into definitions

- Testimonial means any statement by a **current client or investor** about the client or investor's experience with the investment adviser or its supervised persons
- Endorsement means any statement by a person **other than a current client or investor** that indicates approval, support, or recommendation of the investment adviser or its supervised persons or describes that person's experience with the investment adviser or its supervised persons
- Both definitions also include a statement that directly or indirectly **solicits or refers** any current or prospective client or investor
- **Compensated** testimonials and endorsements trigger specific conditions but **uncompensated** testimonials and endorsements must still comply with general prohibitions, disclosure requirements and adviser oversight requirements

Testimonials and Endorsements

General requirements for use of testimonials and endorsements

- **Compensation**
 - Direct and indirect
 - Cash and non-cash
- **De minimis**
 - \$1,000 or less (or equivalent value)
 - During prior 12 months
- **Advisory affiliate**
- **Regulatory status of promoters**
- **Clear and prominent disclosure**
 - Status as client or non-client
 - Whether cash or non-cash compensation was provided
 - Material terms of compensation arrangement, including amount
 - Material conflicts of person giving testimonial or endorsement
- **Adviser oversight**
- **Written agreement**
- **Disqualification provisions**

Compensation for Testimonials and Endorsements

Both cash and non-cash compensation trigger conditions

- **Cash compensation** includes fees based on a percentage of assets under management or amount of assets invested, flat fees, retainers, hourly fees, reduced advisory fees, fee waivers or other methods of cash compensation
- **Non-cash compensation** includes directed brokerage, sales awards or other prizes, gifts and entertainment (e.g. outings, tours) provided by adviser for testimonials and endorsements
 - Attendance at training and education meetings is **not** non-cash compensation, **provided that** attendance at such events is **not provided in exchange** for solicitation / promoter activities
 - No exemption for broker-dealer sales awards or contests for dual registrants
- Compensation also includes **cash and non-cash rewards** advisers provide for endorsements and testimonials, including referrals

Direct and Indirect Compensation and Referrals

Facts and circumstances analysis provides parameters to assess compensation and referral activity

- Factors to consider regarding compensation – though no bright lines exist – include:
 - Timing of compensation
 - Mutual understanding of *quid pro quo*
 - No exclusion for one-on-one communications
- Factors to consider to evaluate referral activity include:
 - Assessing existing relationships that provide referrals
 - Assessing lead-generation or referral networks
 - Objective criteria set out by investors

Regulatory Status of Promoters

SEC withdraws long-standing position, thus triggering investment advisers and broker-dealer status questions for promoters

- Adopted the proposal to withdraw SEC's 1979 position where a solicitor was an associated person and therefore not required to register individually under the Advisers Act, (note: in contrast, majority of state securities regulators require solicitor registration)
- No similar associated person position adopted for promoters as part of the Marketing Rule
- Downstream impact:
 - Promoters should analyze broker dealer and/or investment adviser status based on facts and circumstances
 - State securities regulations may be amended as a result of the elimination of SEC Rule 206(4)-3 and/or this new SEC position regarding regulatory status

Partial Exemption: De Minimis Compensation

Exemption gives relief from disqualification provisions

- The Marketing Rule includes a de minimis exemption for compensated testimonials or endorsements when a promoter receives a \$1,000 threshold amount
 - Disqualification provisions will not apply if an adviser compensates a promoter with a total of \$1,000 or less (or equivalent value in non-cash compensation) within the preceding 12 months
 - Threshold increased from \$100 in the proposal
- Disclosure and adviser oversight and compliance requirements still apply
- No exemptions for impersonal investment advice or nonprofit programs

Partial Exemption: Affiliated Person of the Adviser

Exemption gives relief from disclosure and written agreement

- The Marketing Rule includes a partial exemption for a promoter who is an affiliated person of the adviser:
 - Relationship must be **readily apparent** to an investor **or disclosed** at the time the testimonial or endorsement is disseminated
 - Adviser must document advisory affiliate's status as affiliated at the time the testimonial or endorsement is disseminated
 - **No written agreement** required
- Additional existing provisions continue to apply:
 - Disqualification requirements
 - Adviser oversight

Disclosures for Testimonials and Endorsements

Required at time testimonial or endorsement disseminated

- Adviser must clearly and prominently disclose, or reasonably believe that the promoter makes required disclosures:
 - That testimonial is given by a current client or private fund investor and the endorsement by a person other than client or investor
 - That cash or non-cash compensation was provided, if applicable
 - A brief statement of any **material conflicts of interest** by the person giving the testimonial or endorsement resulting from relationship with adviser, including material terms of compensation arrangement
- Clear and prominent means disclosure is at least as prominent as the testimonial or endorsement to ensure that:
 - Disclosure is provided **within** the testimonial or endorsement
 - Disclosure should appear **close** such that testimonial or endorsement and disclosure **can be read at the same time**

Disclosures: Additional Considerations

Requirements regarding material terms of compensation are broad

- Material terms of compensation arrangement:
 - Description of compensation provided or to be provided, directly or indirectly
 - Includes disclosure of **payment of third-party expenses**, if such payment is part of the compensation arrangement
 - Should help convey **nature and magnitude of the promoter's incentive** to refer the investor to the adviser
 - If arrangement includes a **directed brokerage arrangement**, disclosure should include this information and the commissions clients will pay
- There is no requirement to disclose the name of promoter, but the disclosure should include only information about the relevant compensation arrangement between adviser and specific name of promoter
- Limited exemption allowing Reg BI disclosure to satisfy Marketing Rule disclosure requirement when Reg BI applies to a broker-dealer's activity as a promoter or when a broker-dealer makes a testimonial or endorsement to a non-retail customer

Disqualification Requirements

Applies solely to compensated testimonials and endorsements

- Provisions are greatly expanded compared to Rule 206(4)-3 disqualification provisions and are based on the concept of an **ineligible person**
- An **ineligible person** means a person (**including an entity**) who is subject to a **disqualifying SEC action** or to any **disqualifying event**.
 - When the promoter is an entity, it can become an ineligible person if any of the following became subject to a disqualifying event:
 - Any employee, officer, or director of the promoter firm and any other individuals with similar status or functions within the scope of association with the promoter firm
 - If the promoter entity is a partnership, all general partners of the promoter
 - If the promoter entity is a limited liability company managed by elected managers, all elected managers of the promoter.
 - Disqualification provisions do not apply to a disqualified person's "control affiliates" but do apply when a promoter is an affiliated person of the adviser

Exemptions from Disqualification Requirements

Several partial exemptions exclude disqualification requirements

- **De minimis exemption**
 - Disqualification provisions not applicable
- **Partial exemptions:**
 - Persons acting as compensated promoters that are broker-dealers registered with the SEC pursuant to Section 15(b) of the Exchange Act, provided they are not subject to Exchange Act disqualification provisions
 - Persons covered by Regulation D Rule 506(d) with respect to rule 506 offerings, provided the person's involvement would not disqualify the offering under rule 506

Adviser Oversight and Written Agreement

Solicitation and referral concepts are incorporated into definitions

- **Structure of adviser oversight:**
 - All testimonials and endorsements – including uncompensated testimonials and endorsements – are subject to adviser oversight, even if other exemptions apply
 - Adviser must have a reasonable basis for believing that a testimonial or endorsement complies with the Marketing Rule
 - Adviser oversight requirement focuses on specific restrictions and requirements of the Marketing Rule, not broader anti-fraud provisions
- **Written agreement:**
 - Remains a requirement but separate disclosure document and related delivery requirements have been withdrawn
 - Could provide mechanisms to enable advisers to pre-review testimonials or endorsements, or otherwise impose limitations on the content of those statements
 - Does not apply to de minimis solicitor arrangements or when promoters are affiliated persons of the adviser

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Focus: Impact on Private Funds

Marketing to Private Fund Investors in Scope

Both prongs of the definition of advertisement expressly include marketing communications to private fund investors, incorporating a *look through* approach

Advertisement is defined as:

- Any direct or indirect communication an investment adviser makes to more than one person . . . that offers the investment adviser's investment advisory services with regard to securities to prospective clients or *investors in a private fund* advised by the investment adviser or offers new investment advisory services with regard to securities to current clients or *investors in a private fund* advised by the investment adviser; and
- Any endorsement or testimonial for which an investment adviser provides *compensation*, directly or indirectly
 - Both definitions of endorsement and testimonials also include a statement that directly or indirectly *solicits or refers* any current or prospective clients or *investors in a private fund*

Marketing Rule Approach to Private Funds

Application of Marketing Rule to private funds focuses on offerings that are not covered by other requirements under the securities laws

- **Marketing Rule expressly refers to 3(c)(1) and 3(c)(7) funds**
 - In contrast, aspects of the proposal had included a broader approach to pooled investment vehicles
 - RICs and BDCs are, as expected, not within the scope of the rule
- **Final rule includes communications to new investors in private funds, or offers of new or additional funds to existing private fund investors**
 - *Mayer Brown 2008 No-Action Letter* no longer applicable (No-action relief had stated that Rule 206(4)-3 does not apply to an adviser's cash payment to a person solely to compensate that person by soliciting investors to invest in a fund or other pooled investment vehicle)
 - Marketing Rule includes endorsement, solicitation and referrals to private fund investors
 - Advertising compliance for private funds will require both Marketing Rule considerations and FINRA advertising rule considerations

Limited Exceptions for Private Funds

Advertising prong of the definition of advertisement provides certain limited exceptions from Marketing Rule for private fund marketing

- **Communications with hypothetical performance to private fund investors do qualify for the one-on-one exception**
 - Based on concept that investors will have the opportunity to ask questions and assess the limitations of this information during a one-on-one interaction
 - In contrast, for other advisory services, communications containing hypothetical performance do not qualify for the one-on-one exceptions
 - Must offer to provide promptly sufficient information to enable intended audience to understand risks and limitations of using hypothetical performance in making decisions
- **Advertisement to private funds not subject to prescribed time periods for performance returns**
 - Private funds not required to show performance returns for one-, five- and 10-year time periods (or since inception)

Certain Existing Private Fund Communications are Advertisements

Facts and circumstances analysis applies

- Certain contents of private placement memoranda (PPMs) could be excluded
 - Facts and circumstances analysis applies to information in a PPM to determine whether information constitutes an advertisement
 - PPM information about **material terms, objectives and risks** of a fund offering is not an advertisement but related performance information of other managed accounts could be
 - Based on a facts and circumstances analysis, **pitch books or other materials** provided with the PPM could also fall within the definition of advertisement
- Contents of due diligence rooms could qualify as an advertisement
 - Some of the information in due diligence rooms could qualify as an advertisement if the materials satisfy requirement of the definition
 - Due diligence rooms are not advertisements themselves

Testimonials and Endorsement Requirements Can Apply to Broker-Dealers

Broker-dealers can benefit from partial exemptions for testimonials and endorsements and other guidance to comply with the Marketing Rule if broker-dealer activity constitutes an endorsement

- **Clear and prominent disclosure**
 - Limited exemption allows Reg BI disclosure to satisfy Marketing Rule disclosure requirement when Reg BI applies to a broker-dealer's activity as a promoter or when a broker-dealer makes a testimonial or endorsement to a non-retail customer
- **Adviser oversight**
- **Written agreement**
 - Written private placement agreement that describes the scope of agreed upon activities and the terms of the compensation for those activities could be used to meet the written agreement requirement
- **Disqualification provisions contains partial exemptions for rule 506 offerings and for broker-dealers:**
 - Persons acting as compensated promoters that are broker-dealers registered with the SEC pursuant to Section 15(b) of the Exchange Act, provided they are not subject to Exchange Act disqualification provisions
 - Persons covered by Regulation D Rule 506(d) with respect to rule 506 offerings, provided the person's involvement would not disqualify the offering under rule 506

Cross-Border Application of Marketing Rule for Private Funds

Past guidance reiterated

- Substantive provisions of the Advisers Act do not apply to offshore advisers with respect to offshore clients
 - Release reiterates past guidance
- Onshore advisers subject to Advisers Act and rules for both U.S. and non-U.S. clients
 - Onshore advisers have principal office and place of business in the United States

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Other Considerations

Review and Approval of Advertisements

Additional focus on compliance policies and procedures

- **No requirement for prior review and approval**
 - Final rule relies on adviser's existing obligations under the Compliance Rule, which allows advisers to tailor their compliance program based on firm's advertising practices
- **“Objective and testable” compliance policies and procedures**
 - Internal pre-review and approval
 - Risk-based sampling before (or after) dissemination
 - Pre-approving templates
- **Prompt production of records that document implementation of compliance policies and procedures**

Form ADV

New Form ADV disclosure around marketing practices

- **New Item 5.L (Marketing Practices) in Form ADV, Part 1A**
- **Yes/No questions about whether:**
 - Advertisements include hypothetical performance, predecessor performance, specific investment advice, testimonials, endorsements, third-party ratings, hypothetical performance
 - The adviser pays cash or non-cash compensation in connection with testimonials, endorsements, or third-party ratings
- **Only required to update responses during annual amendment**

Books and records

Conforming changes to books and records requirements

- References to managed accounts and securities recommendations expanded to add “portfolios”
- Additional books and records
 - Written communications received or sent relating to predecessor performance
 - Copy of each advertisement the adviser disseminates, directly or indirectly, with accommodations for oral advertisements
 - Documents necessary to substantiate the calculation hypothetical performance, and copies of disclosure about the assumptions, risks, and limitations of the use of hypothetical performance
 - Records relating to adviser’s determination that it has a reasonable basis for believing that testimonials, endorsements, and third-party ratings comply with the Marketing Rule
 - Copy of any questionnaire or survey used in the preparation of a third-party rating in any advertisement, if the adviser receives a copy
 - Record of the “intended audience” for hypothetical performance and model fee provisions
 - List of affiliated promoters
- Rule does not prescribe or prohibit any particular method of maintaining records (email archives, cloud storage, third-party vendors are all permissible)

Preparing for implementation

Next steps to consider impact of Marketing Rule

- Existing solicitation arrangements
- Online advertising and social media influencers
- Distribution through broker-dealers, including placement agent agreements
- Training
- Policies and procedures
- Performance calculations
- Existing advertisements

Meet the Team



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Partner and Co-Chair,
Financial Regulation &
Enforcement Practice



Jennifer Klass
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Jonathan Hoffman
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Questions

Baker McKenzie.

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