

RIA Compliance Consultants



SEC's New Marketing Rule

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Today's Agenda

Background & Effective Date

Form ADV Part 1 Updates

Written Compliance Program Updates

General Advertising Prohibitions

Third-Party Rankings

Performance Advertising

Testimonials

Promoters (i.e. Solicitors)

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Combines SEC's Previous Advertising Rule (206(4)-1) and Solicitor Rule (206(4)-3)



New Marketing Rule Designed to Comprehensively Address Investment Adviser Marketing Communication



Passed by SEC Commissioners on 12/22/2020



Effective Date was May 4, 2021



Marketing Rule Includes an Extended, 18-Month
Transition Period after the Effective Date

“Compliance Date” Is 18 Months After Effective Date
(**November 4, 2022**)



Advertising Is Required to Comply with New Marketing Rule After Compliance Date

SEC's New Marketing Rule

Retired prior SEC no-action letters and related guidance

Adoption and Entanglement

Direct and Indirect Communication an investment adviser makes

Facts, Circumstances and Context

- *Brand Content, General Educational Material, and Market Commentary*

Specifically, now includes "investors in any pooled investment vehicle (i.e. private fund) advised by the investment adviser".

Definition of Advertisement under the Marketing Rule

The amended definition of “advertisement” includes two separate parts. The first part generally includes the kinds of communications traditionally covered by the advertising rule and the second generally includes the kinds of activities previously covered by the cash solicitation rule.

The **first part** includes any direct or indirect communication an investment adviser makes that: (i) offers the investment adviser’s investment advisory services with regard to **securities** to prospective clients or private fund investors, or (ii) offers new investment advisory services with regard to **securities** to current clients or private fund investors.

- The first part does not include one-on-one communications. However, hypothetical performance information does not qualify for this one-on-one exclusion unless provided in response to an unsolicited investor request or to a private fund investor.
- The first part also does not include extemporaneous, live, oral communications, and information contained in a statutory or regulatory notice, filing, or other required communication.

Definition of Advertisement under the Marketing Rule

The **second** part generally includes any endorsement or testimonial for which an adviser provides cash or non-cash compensation directly or indirectly (e.g., directed brokerage, awards or other prizes, and reduced advisory fees).

Definition of Advertisement under the Marketing Rule

Compliance point: *With Regard to Securities*

Otherwise, could result in overbroad application

However, general anti-fraud rule and provisions apply to essentially everything therefore covering an investment adviser's advertisements and other communications about its other non-securities related services.

Substantively, RCC recommends compliance professionals apply same standards to *everything*.

Form ADV Part 1

- Under Item 5, New Sub-Section L for Marketing Activities
 - An adviser will be required to state whether any of its advertisements include performance results, a reference to specific investment advice, testimonials, endorsements, or third-party ratings
 - An adviser will be required to state yes or no as to whether the adviser pays or otherwise provides cash or non-cash compensation, directly or indirectly, in connection with the use of testimonials, endorsements, or third-party ratings

Adviser Oversight & Compliance (Rule 206(4)-1(b)(2))



Testimonials - The new rule specifically states that investment advisers must have the following:

A reasonable basis for believing that the testimonial or endorsement complies with the requirements of this section, and
If being compensated, a written agreement with any person giving a testimonial or endorsement that describes the scope of the agreed-upon activities and the terms of compensation for those activities.

No SEC Requirement for Compliance to Review Advertisement Before Use

“[W]e are not adopting the proposed internal review and approval requirement. Instead, we believe an adviser’s existing obligations under the compliance rule will allow an adviser to tailor its compliance program to its own advertising practices to prevent violations from occurring, detect violations that have occurred, and correct promptly any violations that have occurred.... Advisers can establish such an objective and testable compliance policies and procedures through a variety of tools.”

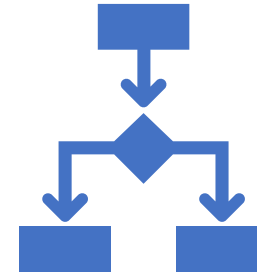
Review and Approval Procedures

- However, RCC-recommended best practice is to delegate the CCO or his/her designee to be responsible for reviewing/approving, in writing, all advertising and marketing materials.
- Determine process for pre-approval
- Determine process for periodic post-review
- Implement use of checklist and/or *Advertising Review/Approval Coversheet*.
- Design process to ensure advertisements are stored and archived with books and records. All records must be maintained for period of no less than five years from end of fiscal-year during which record was last used. Must maintain supporting data for performance of all periods reported.
- Retain proof of approval and intended audience.

Written Compliance Policies and Procedures



Review and update written policies and procedures designed to ensure compliance with the “*Adviser Oversight and Compliance*” requirement.



Update the *Advertising and Marketing* (or similar section) of written Compliance Policies and Procedures Manual

Explicitly state whether testimonials/endorsements are permitted and used.

Explicitly state whether third-party rankings are permitted.


Explicitly state whether firm uses performance in advertising.


Explicitly state firm’s policy on social media.


Memorialize who at the firm is responsible for or allowed to create and distribute advertisements.


Develop standards for reviewing and approving all advertising.


Written Compliance Policies and Procedures – Testimonials


 The compliance manual should specifically state whether the firm permits or prohibits paid testimonials and endorsements.


 Specifically explain and clarify the types of *paid* testimonials and endorsements permitted or prohibited.


 If *paid* testimonials and endorsements are allowed, the compliance policy should outline and detail the minimum requirements of new rule.

 The policy should outline the procedures designed to establish a reasonable basis that the firm and promoters are complying with the new rule (inquiries of solicited investors, inquiries with promoters, including specific terms in the written agreement).

 If testimonials and endorsements are allowed, develop due diligence for “approving” promoters.

 Memorialize if firm does or does not compensate for testimonials/endorsements.

 Procedures should explicitly cover required disclosures

 Designated the supervised person or persons responsible for implementing and monitoring the firm’s procedures for utilizing testimonials/endorsements.

Written Compliance Policies and Procedures – Advisory Personnel Training

Ensure supervised persons receive sufficient training regarding the SEC's new Marketing Rule.

Ensure supervised persons fully understand the firm's policy and procedures related to use or prohibition of testimonials and endorsements.

Facts and Circumstances. Firm's actual policies/procedures and training program need to be customized and specific to what the firm is *actually doing*. Off-the-shelf compliance manual sections and off-the-shelf training are good starting points, but alone are insufficient.

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Marketing Rule General Prohibitions

Untrue Statements

- Making an untrue statement of a material fact, or omitting a material fact necessary to make the statement made, in light of the circumstances under which it was made, not misleading;

Reasonable Basis

- Making 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 SEC;

Misleading Implication

- Including 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;

Risks and Limitations

- Discussing any potential benefits without providing fair and balanced treatment of any associated material risks or limitations;

Fair and Balanced

- Referencing specific investment advice provided by the adviser that is not presented in a fair and balanced manner;

Performance Not Done Properly

- Including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced; and

Materially Misleading

- Including information that is otherwise materially misleading.

Marketing Rule Prohibitions - Misleading Implications

“For instance, if an adviser were to state accurately in an advertisement that it has ‘more than a hundred clients that have stuck with me for more than ten years,’ we believe it may create a misleading implication if the adviser actually has a very high turnover rate of clients.”

See <https://www.sec.gov/rules/final/2020/ia-5653.pdf> at page 73.

Marketing Rule Prohibitions - Misleading Implications

“Additionally, this provision will prohibit an adviser from stating that all of its clients have seen profits, even if true, without providing appropriate disclosures if it only has two clients, as it may be reasonably likely to cause a misleading inference by potential clients that they would have a high chance of profit by hiring the adviser as well.”

See <https://www.sec.gov/rules/final/2020/ia-5653.pdf> at page 73.

Failure to Provide Fair and Balanced Treatment of Material Risks or Material Limitations

“For example, an advertisement could comply with this requirement by identifying one benefit of an adviser’s services, accompany the discussion of the benefit with fair and balanced treatment of material risks associated with that benefit within the four corners of that advertisement, and then include a hyperlink to additional content that discusses additional benefits and additional risks of the adviser’s services in a fair and balanced manner.”

Third-Party Ratings



An advertisement may not include any third-party rating, unless the investment adviser:



(1) Has a reasonable basis for believing 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



(2) Clearly and prominently discloses, or the investment adviser reasonably believes that the third-party rating clearly and prominently discloses:

- The date on which the rating was given and the period of time upon which the rating was based;
- The identity of the third party that created and tabulated the rating; and
- If applicable, that compensation has been provided directly or indirectly by the adviser in connection with obtaining or using the third-party rating.

Performance - Net of Fee Requirement

An investment adviser may not include in any advertisement:

Any presentation of **gross** performance in an advertisement is **prohibited** unless the advertisement also presents **net** performance

- (i) with **at least equal prominence to**, and in a format designed to facilitate comparison with, the gross performance, and
- (ii) calculated over the **same time period** and using the **same type of return and methodology** as the gross performance.

Performance – Prescribed Time Periods



An investment adviser may not include in any advertisement:



Any performance results, of any portfolio or any composite aggregation of related portfolios, in each case other than any private fund, 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 a date that is no less recent than the most recent calendar year-end**; 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.

Performance - No Statements of SEC Review/Approval



An investment adviser may not include in any advertisement:



Any statement, express or implied, that the calculation or presentation of performance results in the advertisement has been approved or reviewed by the Commission.

Performance – Related Performance



An investment adviser may not include in any advertisement:



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

- (i) The advertised performance results are not materially higher than if all related portfolios had been included; and
- (ii) The exclusion of any related portfolio does not alter the presentation of any applicable time periods prescribed by the Rule.

Performance – Related Performance



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



Related portfolio means a portfolio with substantially similar investment policies, objectives, and strategies as those of the services being offered in the advertisement.

Performance – Extracted Performance



An investment adviser may not include in any advertisement:



Any extracted performance, unless the advertisement provides, or offers to provide promptly, the performance results of the total portfolio from which the performance was extracted. **Extracted performance** means the performance results of a subset of investments extracted from a portfolio.

Hypothetical Performance

- Hypothetical Performance Is Generally Prohibited Subject to Certain Conditions
 - Adoption of policies & procedures reasonably designed to ensure that the hypothetical performance information is relevant to the likely financial situation and investment objectives of the advertisement's intended audience
 - Only be distributed to investors who have access to the resources to independently analyze info and who have the financial expertise to understand the risks and limitations of these types of presentations
 - Must provide additional information about the hypothetical performance that is tailored to the audience receiving the advertisement, such that the intended audience has sufficient information to understand the criteria, assumptions, risks, and limitations

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Definition of Hypothetical Performance



Performance results that were **not actually achieved** by any portfolio of the investment adviser



Explicitly includes, but is not limited to, model performance, back-tested performance, and targeted or projected performance returns



Does not include performance generated by interactive analysis tools

Hypothetical Performance

RCC believes that advisers generally would not be able to include hypothetical performance in advertisements directed to a mass audience or intended for general circulation.

Predecessor Performance



Predecessor Performance Is Prohibited unless the following requirements are satisfied:



(A) Person or persons who were primarily responsible for achieving prior performance results manage accounts at advertising adviser;



(B) Accounts managed at predecessor investment adviser are sufficiently similar to the accounts managed at advertising adviser that performance results would provide relevant information to investors;



(C) 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 and the exclusion of any account does not alter the presentation of any prescribed time periods; and



(D) Advertisement clearly and prominently includes all relevant disclosures, including that the performance results were from accounts managed at another entity

Predecessor Performance

Predecessor performance means investment performance achieved by a group of investments consisting of an account or a private fund that was not advised at all times during the period shown by the investment adviser advertising the performance.

Performance – Calculation Type

Not Required to Use a Particular Calculation Method (e.g., Money-Weighted Return, Time-Weighted Returns)

Should Describe Type of Investment Performance & What Elements Are Considered/Included

Performance Advertising Disclosure

Depending on the facts and circumstances, disclosures may include:

- Material conditions, objectives, and investment strategies used to obtain the results portrayed;
- Whether and to what extent the results portrayed reflect the reinvestment of dividends and other earnings;
- Effect of material market or economic conditions on the results portrayed;
- Possibility of loss; and
- Material facts relevant to any comparison made to index or benchmark.

Definition of Testimonial

*“Testimonial means any statement by a **current** client or investor in a private fund advised by the investment adviser:*

***About** the client or investor’s experience with the **investment adviser** or its **supervised persons**;*

*That directly or indirectly **solicits** any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser; **or***

*That **refers** any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser.”*

Definition of Endorsement

*“Endorsement means any statement by a **person other than** a current client or investor in a private fund advised by the investment adviser 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;

*Directly or indirectly **solicits** any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser; or*

***Refers** any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser.”*

Testimonial & Endorsement Examples

- Includes opinions or statements by persons about the investment advisory expertise or capabilities of the adviser or its supervised persons.
- Also includes statements in an advertisement about an adviser or its supervised person's qualities (e.g., trustworthiness, diligence, or judgment) or expertise or capabilities in other contexts, when the statements suggest that the qualities, capabilities, or expertise are relevant to the advertised investment advisory services.
- Includes any statements that solicits or refers

Testimonial & Endorsement Examples

- May include a lawyer or other service provider that refers an investor to an adviser, even infrequently, depending upon the facts and circumstances
- May include lead-generation firms and referral networks if tout adviser or match client with adviser and receives compensation from the adviser
- May include blogger website review because it indicates approval, support, or a recommendation of the adviser, or because it describes its experience with the adviser and receives compensation from the adviser
- However, hiring a third-party marketing service to prepare a communication generally wouldn't be an endorsement
- Likewise, a non-investor selling an adviser a list containing the names and contact information of prospective investors typically would not, without more, meet the definition of endorsement

Due Diligence of Promoters

- Determine promoter due diligence policy and procedures.
- Due diligence should be documented, in writing, and memorialized with the firm's compliance books and records.
- Due diligence should be performed initial and annually thereafter.
- Firms should develop minimum standards for selecting and hiring promoters.
- This is very important for *paid* testimonials and endorsements but don't overlook due diligence of accepting/promoting unpaid testimonials and endorsements

Required Disclosures for Testimonial or Endorsement Clearly & Prominently (Rule 206(4)-1(b)(1))

The investment adviser discloses, or reasonably believes that the person giving the testimonial or endorsement discloses, the following at the time the testimonial or endorsement is disseminated:

- (A) 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 (**Status as a Client or Non-Client**);
- (B) That cash or non-cash compensation was provided for the testimonial or endorsement, if applicable (**Fact of Compensation**); and
- (C) 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 (**Statement of Material Conflicts of Interest**).

Clear and Prominent Standard

Disclosures included within the testimonial or endorsement

- Disclosures should be close to the testimonial/endorsement statement such that the statement and disclosures are read at the same time
- Reader should not be referred somewhere else for the disclosures

In an oral testimonial or endorsement, disclosures provided at the same time

Conflicts of Interest Disclosure

There should be explicit disclosure that the promoter, due to such compensation, has an incentive to recommend the adviser, resulting in a material conflict of interest.

Additionally, a promoter could have other material conflicts of interest based on a relationship with the investment adviser that could affect the credibility of the testimonial or endorsement.

Other Required Disclosures for Testimonial or Endorsement Not Necessarily Clearly & Prominently – More Details

- 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.
- 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.

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Resources

- SEC Final Rule Release:
<https://www.sec.gov/rules/final/2020/ia-5653.pdf> (Actual Marketing Rule starts on approximately page 405).
- SEC's Marketing Compliance Frequently Asked Questions
<https://www.sec.gov/investment/marketing-faq>
- SEC's Small Entity Compliance Guide: Investment Adviser Marketing:
<https://www.sec.gov/investment/investment-adviser-marketing>
- RCC's Marketing Rule FAQs:
<https://www.ria-compliance-consultants.com/https-www-ria-faqs-sec-marketing-rule-for-investment-advisers/>

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