

SEC's New Marketing Rule  
(2nd Session – Testimonials)  
Presented by Bryan Hill  
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## Today's Presenter

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## Today's Agenda

- Background
- Effective/Compliance Date
- Definitions
- General Prohibitions
- Testimonial/Endorsement Requirements
- Exemptions
- ADV Disclosures & Record Keeping

*Please refer to last week's webinar regarding the SEC's Marketing Rule on Traditional Advertising Including Performance Advertising, Hypothetical or Predecessor Advertising, 3<sup>rd</sup> Party Ratings and Use of Social Media.*

## Section 206 of IAA'40

- Even If A Communication Isn't Defined as Advertising under SEC's Marketing Rule, An Investment Adviser & Its Communication Is Subject to the Anti-Fraud Provision of Investment Advisers Act of 1940:

*It shall be unlawful for any investment adviser by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly— ...  
(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client ....*

## Background

- SEC's New Marketing Rule Merged Old Advertisement Rule from 1961 and Old Solicitor Rule from 1979
- Allows Client Testimonials if Requirements Met
- With Respect to Solicitations, New Marketing Rule Expands Coverage to
  - All Forms of Compensation Rather Than Merely Cash Compensation
  - Also Include Current & Prospective Investors in Fund
  - Eliminates Certain Requirements

## Effective/Compliance Date

- Passed by SEC Commissioners on 12/22/20
- Rule Isn't Effective Until 60 Days from Publication in Federal Register ("Effective Date")
- As of 3:30 p.m. Central Wednesday, February 3, 2021, the SEC's New Marketing Rule Hasn't Been Published in the Federal Register
- Marketing Rule Includes an Extended, 18-Month Transition Period after the Effective Date
  - "Compliance Date" Is 18 Months After Effective Date
- Advertising Is Required to Comply with New Marketing Rule After Compliance Date
- Risk that New Majority of Commissioners Pulls Back for Reconsideration



## Definition of Advertisement - Second Prong

- Covers **compensated** testimonials and endorsements, which will include a similar scope of activity as traditional solicitations under the current solicitation rule.
- Includes **oral** communications and **one-on-one** communications to capture traditional one-on-one solicitation activity, in addition to solicitations for **non-cash compensation**.
- Excludes certain information contained in a statutory or regulatory notice, filing, or other required communication

## Cash Compensation

- Includes fees based on a percentage of assets under management or amounts invested, flat fees, retainers, hourly fees, reduced advisory fees, fee waivers, and any other methods of cash compensation.
- Also includes directed brokerage that compensates brokers for soliciting/referring

## Non-Cash Compensation

- Non-cash compensation incentivizes persons to provide a positive statement about an adviser, or make a referral or solicitation on an adviser's behalf and thus must be disclosed
  - Entertainment, tours, outings, sales awards and gifts are examples of non-cash compensation
  - Attendance at training/education meeting will not be non-cash compensation provide attendance not provided in exchange for solicitation activities

## For Compensation – Facts & Circumstances

- Timing of compensation relative to an endorsement or testimonial is relevant in determining whether an adviser is providing compensation for the testimonial or endorsement.
- There will be a mutual understanding of a quid pro quo, whether explicit or inferred based on facts and circumstances, for most compensated endorsements or testimonials.
- However, SEC declines to draw bright lines around either the timing of the compensation or the establishment of a mutual understanding.

## Definition of Testimonial

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

- (i) **About** the client or investor’s experience with the **investment adviser** or its **supervised persons**;*
- (ii) 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***
- (iii) 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 Testimonial

- 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

## 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:*

- (i) 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;*
- (ii) 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*
- (iii) 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

- 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



## Promoter Giving Testimonials or Endorsements

- May be acting as an investment adviser depending upon facts and circumstances and require registration under federal or state securities laws
- Similarly, may be acting as a broker-dealer requiring registration
  - For example, when soliciting investors for, or referring investors to, an adviser or a private fund advised by the adviser.

## SEC's New Marketing Rule - 206(4)-1

*“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. 80b6(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.”*

# Advertising Prohibitions

- **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;**
- 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;
- **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;**
- Discussing any potential benefits without providing fair and balanced treatment of any associated material risks or limitations;
- Referencing specific investment advice provided by the adviser that is not presented in a fair and balanced manner;
- Including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced; and
- **Including information that is otherwise materially misleading.**

## Examples of Applying General Prohibitions to Testimonials/Endorsements

- *“[I]t would be misleading for an adviser to compensate a person to refer investors to the adviser by stating that the person had a “positive experience” with the adviser when such person is not a client or private fund investor of the adviser for its advisory services. To avoid making such a statement misleading, the adviser could disclose that the experience does not relate to any advisory services.”*
- *“[A]n adviser may not provide a testimonial on its website where a client falsely claims that the client has worked with the adviser for over 20 years when the adviser has only been in business for five years.”*

## Need Equal Number of Negative Testimonials?

*“We do not believe that the general prohibition requires an adviser to present an equal number of negative testimonials alongside positive testimonials in an advertisement, or balance endorsements with negative statements in order to avoid giving rise to a misleading inference, ascertain commenters suggested. Rather, the general prohibition requires the adviser to consider the context and totality of information presented such that it would not reasonably be likely to cause any misleading implication or inference. **General disclaimer language (e.g., “these results may not be typical of all investors”) would not be sufficient to overcome this general prohibition.** However, one approach that we believe would generally be consistent with the general prohibitions would be for an adviser to **include a disclaimer that the testimonial provided was not representative, and then provide a link to, or other means of accessing (such as oral directions to go to the relevant parts of an adviser’s website), all or a representative sample of the testimonials about the adviser.**”*

## Testimonial or Endorsement Prohibited Rule 206(4)-1(b)

*“An **advertisement** may **not** include any **testimonial** or **endorsement**, and an adviser may **not** provide compensation, directly or indirectly, for a testimonial or endorsement, **unless** the investment adviser complies with the conditions in paragraphs (b)(1) through (3) of this section, subject to the exemptions in paragraph (b)(4) of this section.”*

## Required Disclosures for Testimonial or Endorsement Clearly & Prominently

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;
- (B) That cash or non-cash compensation was provided for the testimonial or endorsement, if applicable; 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;



## Clear and Prominent Standard

- Disclosures be 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.

## Timing of Disclosures

*“The required disclosures with respect to testimonials and endorsements must be delivered **at the time the testimonial or endorsement is disseminated...** We continue to believe the timing of disclosures is important. If the disclosures are not provided at the time the testimonial or endorsement is disseminated, many of the disclosures may not have the same impact on investors.”*

## No Separate Disclosure Required

- Not Requiring a Separate Disclosure
  - Clear & Prominent Disclosure Will Be Within Testimonial & Endorsement
  - Other Disclosures Can Be Delivered via Paper, Electronically or Orally
- Need to Have a Record of the Disclosures
  - If Delivered Orally Will Need a Recording

## Delivery of Form ADV Part 2A

Promoter Making the Testimonial or Endorsement Is Not Required to Deliver the Investment Adviser's Form ADV Part 2A Disclosure Brochure at Time of Testimonial or Endorsement

## Adviser Oversight & Compliance

The investment adviser must have the following:

- A reasonable basis for believing that the testimonial or endorsement complies with the requirements of this section, and
- 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.

## Disqualification

An investment adviser may not compensate a person, directly or indirectly, for a testimonial or endorsement if the adviser knows, or in the exercise of reasonable care should know, that the person giving the testimonial or endorsement is an ineligible person at the time the testimonial or endorsement is disseminated.

## Disqualification

A disqualifying event is any of the following events that occurred within 10 years prior to the person disseminating an endorsement or testimonial:

- A conviction by a court of competent jurisdiction within the United States of any felony or misdemeanor involving conduct described in paragraph (2)(A) through (D) of section 203(e) of the Investment Advisers Act;
- A conviction by a court of competent jurisdiction within the United States of engaging in, any of the conduct specified in paragraphs (1), (5), or (6) of section 203(e) of the Investment Advisers Act;
- The entry of any final order by any entity described in paragraph (9) of section 203(e) of the Act, or by the U.S. Commodity Futures Trading Commission or a self-regulatory organization (as defined in the Form ADV Glossary of Terms)), of the type described in paragraph (9) of section 203(e) of the Act;



## Disqualification Doesn't Include

A disqualifying event does not include an event described above with respect to a person that is also subject to

- (A) An order pursuant to section 9(c) of the Investment Company Act of 1940 (15 U.S.C. 80a-3) with respect to such event; or
- A SEC opinion or order with respect to such event that is not a disqualifying SEC action; provided that for each applicable type of order or opinion:
  - The person is in compliance with the terms of the order or opinion, including, but not limited to, the payment of disgorgement, prejudgment interest, civil or administrative penalties, and fines; and
  - For a period of 10 years following the date of each order or opinion, the advertisement containing the testimonial or endorsement must include a statement that the person providing the testimonial or endorsement is subject to a Commission order or opinion regarding one or more disciplinary action(s), and include the order or opinion or a link to the order or opinion on the Commission's website.

## Disqualification (Continued)

- The entry of an order, judgment or decree described in paragraph (4) of section 203(e) of the Act, and still in effect, by any court of competent jurisdiction within the United States; and
- A Commission order that a person cease and desist from committing or causing a violation or future violation of:
  - (A) Any scienter-based anti-fraud provision of the Federal securities laws, including without limitation section 17(a)(1) of the Securities Act of 1933 (15 U.S.C. 77q(a)(1)), section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)) and 17 CFR 240.10b-5, section 15(c)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(c)(1)), and section 206(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-6(1)), or any other rule or regulation thereunder; or
  - (B) Section 5 of the Securities Act of 1933 (15 U.S.C. 77e)

## Partial Exemption – De Minimis Compensation

- A testimonial or endorsement disseminated for **no compensation** or **de minimis compensation** is **not** required to comply with the **written agreement** and/or **disqualification** requirements.
  - De minimis compensation means compensation paid to a person for providing a testimonial or endorsement of a total of **\$1,000 or less** (or the equivalent value in non-cash compensation) **during the preceding 12 months**

## Partial Exemption – Related Persons

- A testimonial or endorsement by the investment adviser's partners, officers, directors, or employees, or a person that controls, is controlled by, or is under common control with the investment adviser, or is a partner, officer, director or employee of such a person is **not** required to comply with **disclosure and agreement requirements**, provided that **the affiliation** between the investment adviser and such person
  - is **readily apparent** to or
  - is **disclosed** to the client or investor at the time the testimonial or endorsement is disseminated and the investment adviser documents such person's status at the time the testimonial or endorsement is disseminated

## No Non-Profit Exemption

- Unlike the Proposed Rule, There's No Exemption for Non-Profit Per Se From the Disclosure and Oversight Requirements

## 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

## Record Keeping - Retention

- Requires the adviser to maintain and preserve these records “in an easily accessible place for a period of not less than five years, the first two years in an appropriate office of the investment adviser, from the end of the fiscal year during which the investment adviser last published or otherwise disseminated, directly or indirectly, the...advertisement.

## Record Keeping

- An investment adviser is required to keep a copy of the advertisement (as defined in Rule 206(4)-1(e)(1)) that the investment adviser disseminates, directly or indirectly, except:
  - For compensated **oral testimonials and endorsements** (as defined in Rule 206(4)-1(e)(17) and (5)), the adviser may instead make and keep a record of the disclosures provided to clients or investors pursuant to Rule 206(4)-1(b)(1) of this chapter;



## Record Keeping

- If not included in the advertisement, a record of the required testimonial and endorsement disclosures provided to clients or investors
- Documentation substantiating the adviser's reasonable basis for believing that a testimonial or endorsement complies with Rule 206(4)-1

## Record Keeping

- A record of the names of all persons who are an investment adviser's partners, officers, directors, or employees, or a person that controls, is controlled by, or is under common control with the investment adviser, or is a partner, officer, director or employee of such a person pursuant to Rule 206(4)-1 (i.e., endorsement by a related person)

## Resources

- **SEC Final Rule Release:**

<https://www.sec.gov/rules/final/2020/ia-5653.pdf> (Actual Marketing Rule starts on approximately page 405.)

- **RCC's Marketing Rule FAQs:**

[https://www.ria-compliance-consultants.com/https-www-ria-faqs\\_sec\\_marketing\\_rule\\_for\\_investment\\_advisers/](https://www.ria-compliance-consultants.com/https-www-ria-faqs_sec_marketing_rule_for_investment_advisers/)

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