SEC Reminds Advisors of Marketing Rule Compliance Deadline

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There are many aspects of 2020 that we would love to purge from our memories. Quarantining at home while perhaps simultaneously homeschooling children, disinfecting groceries, and the promise of a two-week collective effort to flatten the curve (which was *slightly* extended). In light of what we've all been through, the SEC's December 2020 Marketing rule Release may not be among the highlights of what you remember about that year. Fortunately for us, the SEC has recently issued reminders to its registered advisors concerning the Marketing Rule. Although the rule became effective May 4, 2021, advisors were allowed to defer complying with the rule. However, the SEC took an all-or-none approach to compliance, and as such, many firms chose to wait-and-see what guidance may be released before fully adopting the rule (and the compliance requirements that would immediately spring into effect). On November 4, 2022, however, compliance with the new rule is mandatory. Advisors who have, as of today, not yet tackled updating their compliance manuals may still have lingering questions about what the rule entails, specifically as it pertains to endorsements and testimonials. This article focuses on a few (but not all) of the most-asked-about elements concerning the marketing rule.

Definition of Advertising

The definition of an advertisement includes two prongs:

1. any direct or indirect communication an investment advisor makes that: (i) offers the investment advisor's investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the investment advisor ("private fund investors"), or (ii) offers new investment advisory services with regard to securities to current clients or private fund investors. The SEC specifically excludes most one-on-one communications from this prong, with some exceptions.[1]
2. compensated testimonials and endorsements that include a similar scope of activity as traditional solicitations under the current solicitation rule. In fact, the SEC completely rescinded the former Cash Solicitation Rule 206(4)-3.

Testimonials and Endorsements

Most advisors will be familiar with the classic marketing requirements, such as the prohibition of misleading or deceptive statements in marketing materials. This has not changed. One of the biggest changes is that the new

marketing rule takes previously prohibited activities (testimonials and endorsements) and adds parameters concerning their acceptable use.

To use testimonials and endorsements, disclosure is required at the time it is disseminated. Disclosure must be clear and prominent and state whether the testimonial was given by a current client or investor, or someone other than a current client or investor. The disclosure must also state whether cash or non-cash compensation was provided for the testimonial or endorsement, if applicable; and must include a brief statement of any material conflicts of interest on the part of the person giving the testimonial or endorsement resulting from the advisor's relationship with that person. If there was a compensation arrangement, the material terms and description of the compensation provided or to be provided, directly or indirectly, must be disclosed. The compensation arrangement represents a conflict of interest on the part of the person giving the testimonial or endorsement, and such conflict must also be disclosed.[2]

Adoption and Entanglement

The above is straightforward as it relates to marketing material you generate and control. However, what happens when the testimonials or endorsements are generated and/or published by a third party? This is a common question that comes up in connection with determining whether an advisor has an obligation to provide disclosure as required under the Rule. In many cases, you cannot control what third parties do. But in some cases, advisors can become "entangled" in or "adopt" a third-party testimonial or endorsement. When addressing the analysis it would perform to determine whether an advisor is required to comply with the Marketing Rule (with respect to third-party content) the SEC refers to "entanglement" and "adoption." If the SEC determines, based on the specific facts and circumstances, that the advisor has adopted and/or entangled itself in the material, then the Rule applies to the advisor, disclosure is required, and the advisor will be liable for the content as if it produced the content itself. The following are examples of adoption and entanglement:

- **Adoption** – the advisor explicitly or implicitly endorses or approves the information. Hypothetical examples include an advisor who publishes third party reviews on its website or incorporates information received from a third party into its performance advertising.

- **Entanglement** – the advisor involves itself in the third party's preparation of the information (this requires a level of "pre-publication involvement," which would be weighed by the SEC). A few hypothetical examples would include a scenario where an advisor pays for a positive review, tells a client what to write in their review, and/or has the ability to "approve" a review before it's published, etc. The more involved the advisor is in what is being published, the more likely it will be seen to have "entangled" itself in the material, and the SEC would view the material as the advisor's.

Solicitor Arrangements

As previously mentioned, the new Marketing Rule also shut down the former Cash Solicitation Rule in its entirety. The new Rule effectively combined previous requirements of the Cash Solicitation Rule, such as prohibiting certain “bad actors” from being able to receive compensation for referrals, while adding a de minimis threshold of $1,000 over the prior 12 months before a written agreement is required. While a signed client acknowledgment is no longer required, it would be difficult to demonstrate disclosure of the conflict of interest without one. As such, obtaining a signed disclosure is strongly recommended. On the plus side, however, the solicitor is no longer required to provide the prospect with a copy of the advisor’s Form ADV Part 2A Disclosure Brochure. Note, however, that these changes in no way affect whether a state requires a solicitor to be licensed and registered.

Conclusion

Advisors are encouraged to evaluate their marketing and solicitor practices to understand how the marketing rule will impact them. Compliance is required as of November 4, 2022. While you still have some time to refresh your memory of the Marketing Rule specifics, the window will soon be closing.

[1] See Investment Advisers Act Rule 206(4)-1(e)(1)

[2] 206(4)-1(b)(1)