THE BASICS OF THE NEW SEC RULING

A Helpful Guide to Understanding the Modernized Marketing and Advertising World

On December 22nd, 2020, the SEC adopted amended Rule 206(4)-1 under the Investment Advisers Act of 1940. The effective date when new rules took effect was May 4th, 2021. SEC-registered investment advisers, subject to the new rules, are required to have their respective marketing practices and compliance updated by the SEC's November 4th, 2022 deadline.

Who is subject to the new rules?

Investment advisers required to be registered with the SEC. RIAs registered at the state level will still need to conform to their respective state's marketing rules, which may or may not incorporate the SEC's new rules going forward. FINRA-registered brokers are still subject to FINRA's own rules on advertising and communications.

What is required?

Advisors can choose to adopt the new rule as of May 4th, 2021 but must comply with it in its entirety upon adoption. November 4th, 2022 is the compliance deadline for which all SEC-registered investment advisors must comply with the new rules. Until advisers fully transition to the amended marketing and advertising rules, they need to remain compliant with previous advertising and cash solicitation rules in effect. Marketing and advertising practices, recordkeeping policies, and written compliance policies and procedures must be updated and filed with clear dates regarding when and where advisers are complying with the new rule.

What does it mean?

Financial advisers will now be able to proactively use testimonials from clients and endorsements from non-clients, while highlighting their respective ratings via third-party review sites. However, the new rules provide a series of general prohibitions that still apply to testimonials and endorsements, a series of specific requirements, and limitations on who/what can be a "promotor" for the adviser.

What is in the *Final Rule: Investment Adviser Marketing*?

A summary breakdown of the different rule components is provided below. *(See Complete Ruling Here: https://www.sec.gov/rules/final/2020/ia-5653.pdf)*

Current Advertising Definition

"Advertising" is said to include any direct or indirect communication an investment adviser makes that either:

- (1) offers the investment adviser's investment advisory services with regard to securities to prospective clients or private fund advisers, or
- (2) offers new investment advisory services with regard to securities to current clients or private fund investors.

Expanded Definition

"Advertising" now includes any endorsement or testimonial for which an investment adviser provides cash or non-cash compensation directly or indirectly. Performance results can be included if certain provisions are met, such as (but not limited to), performance results being presented in a fair and balanced manner, meaning gross and net performance must be presented with at least equal prominence, calculated over the same time period, using the same type of return and methodology, and other provisions related to portfolio size/policy, hypothetical performance, and predecessor performance.

General Prohibitions

"Marketing Rule" will prohibit the following advertising practices:

- Making an untrue statement of a material fact or omitting a material fact necessary to make the statement accurate.
- Including information that is otherwise materially misleading.
- Making a material statement of fact where the adviser does not have a reasonable basis for believing it.
- Including information that would reasonably be likely to cause an untrue or misleading implication or inference to be drawn relating to the adviser.
- Discussing any potential benefits without providing fair and balanced treatment of any associated material risks or limitation.

- 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.

Testimonials and Endorsements: Oversight and Compliance

"Disclosures" are required to have clear and prominent language associated with the person(s) providing the endorsement or testimonials.

- Are they a current client or not?
- How are they being compensated?
- Are there any material conflicts of interest within the relationship or compensation plan?
- What are the material terms of any compensation arrangement?
    - Including a description of the compensation provided or to be provided (indirectly or directly)

"Written Agreements" are required between the adviser and person(s) providing the endorsement or testimonial, with a reasonable basis for believing they're in compliance with the new rule.

- If the "promoter" is an affiliate of the adviser, or if they receive de minimis compensation (i.e. $1,000 or less, or the equivalent value in non-cash compensation, during the preceding twelve months), then a written agreement may not be required.

"Recordkeeping" for all advertisements must be made and kept by the adviser, no matter how many persons the advertisement is sent to.

- Additionally, advisers are required to provide information about their use of performance results, testimonials, endorsements, third-party ratings, and references to specific investment advice in advertisements on their Form ADV.

"Disqualification" is the rule prohibiting certain "bad actors" and those previously sanctioned under Federal securities laws from acting as promoters, subject to exceptions where other disqualification provisions apply.

Third-Party Ratings: Oversight and Compliance

"Conditions" must be met regarding any advertisements that seek to include third-party ratings under the new rules, including disclosures and satisfaction of certain criteria pertaining to the preparation of the rating.

- The provider may not be a related person (as defined in Form ADV) and must provide rankings or ratings in the ordinary course of business.
- The adviser must have a reasonable basis for believing that any survey or questionnaire used by provider is not designed to produce a pre-determined result.
- The rating must clearly and prominently disclose the time period covered and the date on which the rating was given, the identity of the provider, and whether provider was compensated.

What can advisers do after May 4th, 2021?

While advisers have until November 4th, 2022 to fully comply with the SEC's new marketing rule, those who wish to do so before then will need to update their Form ADV and other records/materials.

SEC-Registered Investment Advisers will be required to incorporate each specific instance within their Form ADV relating to advertisements that include: performance results, testimonials, endorsements, third-party ratings, and references to specific investment advice.

Advisers must indicate whether cash or non-cash compensation is offered in connection with the use of testimonials, endorsements, and/or third-party ratings. Furthermore, advisers are required to disclose whether any advertisements include hypothetical performance or predecessor performance.

SEC-Registered Investment Advisers will be required to make and keep records of all advertisements distributed in an accessible place for at least five years. Furthermore, advisers are required to maintain communications/data pertaining to the performance or rate of return, hypothetical performance, predecessor performance, testimonial/endorsement/third-party rating, disclosures delivered to investors, and questionnaire/survey used in third-party rating advertisements.

How can advisers begin, once fully compliant with the new rules, marketing and advertising via testimonials & endorsements?

The Ask

One way to collect testimonials is digitally. You can utilize a landing page with a short request form following a specific format or with a survey/questionnaire platform.

Drive clients to your page or survey via dedicated email blasts or within your eSignature. But remember, ask in a way that makes it objective so it cannot be seen as untrue or misleading or geared toward only a favorable experience.

Another way to collect testimonials is directly in-person or over the phone. Advisers can ask clients at an event, in an appointment, or in a catch-up conversation. This is a great opportunity to incorporate within an adviser's existing sales/review process.

The Format

The person(s) acting as the reviewer is required to write from their perspective, including their respective personal/unique experience with the adviser/firm.

All testimonials must include a disclosure, specific to compensation received and the relationship. When collecting the testimonial, it is important for this information to be organized.

Additionally, a disclosure is required stating that the respective testimonial is not representative of everyone's individual experience. Links to all available testimonies must be accessible for the person(s) viewing to see in-full.

How can advisers create and execute their plan?

Start by formulating a list of specific questions for the person(s) you're reaching out to. Remember, keep the questions objective in nature allowing for both the potential of favorable and unfavorable responses.

- Why did you choose us as your trusted financial professional?
- Has there been a time where we exceeded your expectations?

- During your most recent appointment, phone conversation, event attendance, etc. did you have the chance to ask and receive answers on all of your questions?
- Describe your experience with us. How would you rate, and why?

These questions can be used as a starting point for your in-person or over the phone conversations, within printed materials, or for a specific form that can live directly on your website.

Next, work with your marketing team to draft and implement a survey to your current client base. Remember, testimonials can only be used if they meet specific criteria, and they must not be used as a way to directly lead the person(s) to a more favorable/desirable result.

Surveys, data, and their corresponding marketing components must be a part of recordkeeping. If an altered response is desired, such as for the use of a quote, then the adviser is required to receive written approval from the person(s) prior to implementing.

Make an Intro for the Request

- State why you are writing to them, how their input can help, and what you might plan to do with their information if granted permission.
- Include all appropriate disclosures for your firm, including as it may relate to the new SEC rulings

Ask Your Questions

- Be sure to include a question regarding permission to share their respective insights and answers…and how they wish it to appear

Marketing Platforms: What Goes Where?

Leverage your client testimonials via your website, email marketing, broadcast (radio and television), social media, and third-party review sites. But, REMEMBER:

- Adviser may not deliver a story based on a client's experience. Further clarification from the SEC is pending regarding whether or not an adviser may directly read (i.e. Video or Radio or Television) a testimonial provided by a client.

- Clients may agree to appear on live or recorded video, radio, television, with an opportunity to share their personal experience. Direct quotes may be used as well, if consent is given and if appropriate disclosures are included.
- Public sites are now allowed to collect testimonials, such as Facebook, Google, or Yelp. Advisers now have the opportunity to link third-party review sites within their website and email communication. It is recommended that advisers keep a close eye on public sites so that responses can be made in a timely manner whether they are negative or positive.

Concluding Thoughts

Two of the most intriguing quotes that came out of the new SEC ruling were: "Truth is not a defense" and "Something could be deemed misleading even if it's factually correct."

Often, it is best to be more general and less specific to help get the most objective testimonial/endorsement possible.

In addition to compliance guidelines set forth in the new ruling, RIA's advertising must involve the adviser satisfying their due diligence requirement and the disclosure requirement.

A lot of the SEC's follow up interpretation of the new ruling has been left vague on purpose. The adopting release states "some due diligence" is required by advisers. Remember, this new rule and its components have never been monitored or acted-on by any adviser or by the SEC before.

Start small and start slow. If you're not ready to fully comply, then wait and prepare.

IMPORTANT DISCLAIMER

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SOURCES FOR ADDITIONAL INFORMATION:

- https://www.sec.gov/rules/final/2020/ia-5653.pdf
- https://www.sec.gov/investment/marketing-faq
- https://www.sec.gov/news/press-release/2020-334