COMPLIANCE May 5, 2022

November SEC Advertising Rule Compliance Date Fast Approaching

Experts with the Wagner Law Group say complying with the marketing rule can be a significant process, and firms need to make sure they are on track for full compliance by early November.

By John Manganaro

In December 2020, the U.S. Securities and Exchange Commission voted to finalize key reforms under the Investment Advisers Act to modernize the rules that govern investment adviser advertisements and payments to solicitors.

The finalized amendments created a single rule to replace the previously distinct advertising and cash solicitation rules. According to the SEC's leadership, the final rule is designed to more "comprehensively and efficiently" regulate investment advisers' marketing communications. They say the reforms will allow advisers to provide investors with useful information as they choose investment advisers and advisory services, subject to conditions that are reasonably designed to prevent fraud.

With its vote to finalize the new marketing standards, the SEC set a final compliance date of Nov. 4, 2022. Since then, in anticipation of the compliance date, the SEC has withdrawn or modified a significant number of No-Action Letters published under the previous advertising rule and the cash solicitation rule.

In a new white paper assessing the state of the evolving adviser advertising landscape, Wagner Law Group Attorneys Seth Gadreau and Stephen Wilkes say the SEC's actions represent a "substantial overhaul" of the now-defunct advertising and cash solicitation rules. Based on a firm's current practices, they warn, compliance with the marketing rule can be a significant process. If firms have not done so already, they need to make sure they are on track for full compliance by Nov. 4.

"The technology used for communications has advanced, the expectations of investors seeking advisory services have changed and the profiles of the investment advisory industry have diversified," the attorneys write. "The new

marketing rule recognizes these changes and the SEC's experience administering the current rules."

As the Wagner attorneys explain, the framework taking effect in early November will expand the scope of communications that are considered "advertisements" for purposes of the rule. In this sense, while the rule permits more types of advertisements—including testimonials, endorsements, third-party ratings and hypothetical performance—these new strategies are subject to the marketing rule's new principles-based regime. In other words, the forthcoming framework is far from a marketing free-for-all, and it still demands significant planning and diligence on the part of registered firms.

The SEC also instituted related amendments to Form ADV, the investment adviser registration form, and Rule 204-2, the books and records rule. The Wagner attorneys point out that the marketing regulation is the first significant change to these rules and has important implications for all investment advisers—particularly with respect to presentation of performance and solicitation activities.

The Wagner white paper explains that, under the marketing rule, the definition of "advertisement" now has two prongs. The first includes any direct or indirect communication an investment adviser makes to more than one person —or to one or more persons if the communication includes hypothetical performance—that offers the adviser's investment advisory services regarding securities to prospective clients or investors in a private fund advised by the investment adviser. This same prong also defines an advertisement as any offer of new investment advisory services regarding securities to current clients or investors in a private fund advised by the investment adviser.

The second prong of the definition, as described in the white paper, generally includes any testimonial or endorsement for which an adviser provides compensation. Communications directed to only one person are included, the attorneys point out, as are oral communications. Compensation includes cash and non-cash compensation paid directly or indirectly by the adviser.

"A key to the SEC's view of compensation is whether it is the basis of some form of quid pro quo for the testimonial or endorsement," the attorneys say. "Attendance at training and education meetings, including company-sponsored

meetings such as annual conferences, is not considered compensation if it is not provided in exchange for the endorsement or testimonial. The SEC declined to offer a bright-line test."

Notably, for purposes of the marketing rule, the new advertisement definition does not differentiate between retail and non-retail investor communications and applies a uniform standard for both institutions and individuals.

The white paper points out that the marketing rule permits the use of testimonials and endorsements, subject to compliance with multiple conditions. The first pertains to disclosure: an adviser must clearly and prominently disclose, or reasonably believe that the person giving the testimonial or endorsement discloses, whether the "promoter" giving the testimonial or endorsement is a client of the investment adviser. Additionally, the adviser must disclose whether the promoter is being compensated, including both cash and non-cash compensation.

"Further disclosures are required for any material conflicts of interest on the part of the person giving the testimonial or endorsement resulting from the compensation arrangement and/or the adviser's relationship with the promoter," the attorneys warn.

Another condition requires that investment advisers enter into written agreements with promoters in connection with the use of a testimonial or endorsement. Investment advisers that use testimonials or endorsements in advertisements must also have policies and procedures to ensure compliance with the new marketing rule, the Wagner attorneys note.

Finally, an adviser will not be able to directly or indirectly compensate a person 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 ineligible under the marketing rule at that time. As the attorneys explain, certain "bad actors," as defined under Rule 506 of Regulation D, and other "ineligible persons" are prohibited from acting as promoters.

The Wagner attorneys emphasize that advisers will need to analyze the particular facts and circumstances of each advertisement when applying the general prohibitions of the marketing rule—including the nature of the audience to

which the advertisement is directed. They point out that the SEC has noted the requirements' similarity to FINRA Rule 2210's general standards regarding communication with the public.

Tagged: Advice, adviser advertising, FINRA, SEC