The SEC Marketing Rule: 14 Things to Know and Choices to Make

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The best way to get your "arms around this rule" is to begin with your policies and procedures.[1] Here are fourteen things you need to know and choices to make to assist you in drafting your firm's marketing policies and procedures.

At the end of this article, we will present six case studies to illustrate practical examples of the implementation of the Rule.

1. **When do you plan to implement the new policies and procedures?**
   The Marketing Rule will become effective on May 4, 2021, and mandatory compliance will be required by November 4, 2022. There is an 18-month period where firms can comply with the old Rule or adopt the new Rule, however, the SEC FAQ Question #1 (3/18/21) has stated that adoption of the new Rule is "all or nothing."

   A firm might consider implementing early to take advantage of new marketing opportunities. Wayne Gretzky was once asked "how do you skate so fast?" Gretzky's response was, "I don't skate to where the puck is, I skate to where the puck is going." Heeding Gretzky's example, don't plan for where the Marketing Rule is today, plan for where the Marketing Rule is headed. Social media is revolutionizing society and our industry is no exception. Customer reviews (testimonials) are an integral part of social media and will become more important for financial services firms. Firms may want to proactively cultivate reviews on services such as Google My Business to show positive ratings and improve search engine optimization (SEO). This is just one example of why a firm might consider implementing early.

2. **How will you consolidate your policies and procedures?**
   The advertising and solicitor's sections of compliance manuals will need to be consolidated to reflect the SEC's decision to consolidate 206(4)-1 and 206(4)-3. Many firms have separate sections of their manual addressing electronic communications and social media, which firms should consider consolidating.

   Marketing is typically addressed in many contexts and interspersed throughout a policies and procedures manual. There are some sections where you may decide not to consolidate such as marketing to seniors, and email marketing. This is a good opportunity to review your manual and consolidate sections for better organization.

3. **To pre-review or not to pre-review, that is the question.**
   Amended Rule 206(4)-1 does not require pre-review, however, most firms already require pre-review and will likely require pre-review under the new Rule.

   The choice to require pre-review is complex and can be challenging in some instances. Consider a pre-review policy when working with an influencer on YouTube. The influencer is most likely not familiar with your firm' policies and procedures and some of their material may not be pre-planned. Another example is activities of a private fund placement agent would be challenging to pre-review. The downside of a pre-review policy is once disseminated oral and written marketing communications are subject to the Rule and could create violations of the pre-review policy. This must be balanced against the risk of unreviewed marketing communications that violate the content provisions of the firm's marketing policies. This is a complex decision and there is no easy answer.

4. **How will you define "marketing materials" subject to your policies?**
   Many firms will adopt a broader definition of "marketing materials" than the Rule to minimize staff from having to make the determination of what is, and what is not, subject to the Rule.

1. NSCP *Currents* will publish a Special Edition on the Marketing Rule, including sample policies and procedures. Please stay tuned...

For example, the SEC stated that client newsletters that do not contain an offer of new services are not considered marketing materials subject to the Rule, however, most firms already require client newsletters to be approved and will likely continue to do so under the new Rule.

5. **How will you comply with general prohibition #2 and substantiate material statements of fact?**
   The SEC adopting release stated "the staff will presume than an investment adviser that is unable to substantiate material claims of fact upon demand did not have a reasonable basis to believe it could do so" (See General Prohibition #2.) *This may be one of the most challenging requirements for marketing review*. In many cases the substantiation will need to be footnoted in the marketing piece or the substantiation will need to be submitted as supplemental material for approval. Consider the challenge with oral marketing or video. So, the way you review IA marketing materials will likely change due to this provision in the amended Rule.

6. **The adopting release indicates the sophistication of the target audience must be considered when applying the general prohibitions. How will your review process identify the target audience and what policies, if any, will the firm implement regarding the sophistication of the target audience?**
   Most firms utilize some form of a "Marketing Review Cover Sheet" and these may need to be amended to include the target audience. Going forward approvals may have to specify the target audience such as approved for "institutional," "retail" or "all." A good example would be marketing pieces that include hypothetical performance. These might be approved "institutional only."

7. **What are your policies regarding social media and participation in blogs, chatrooms (ex. r/WallStreetBets) etc.?**
   Consider the case of "Roaring Kitty" who was a registered representative of a BD and actively posted on Reddit regarding GameStop stock and others. What if Roaring Kitty was an IAR? How would this activity have been interpreted under your policies and procedures? When reading about cases such as Roaring Kitty it is a good practice to ask if this could have happened at your firm. Then ponder the efficacy of your policies and procedures. Firms that obtain Annual Certifications from associated persons should consider adding an admonition such as "I certify that I am aware of and have complied with the XYZ's policies regarding social media."

8. **What are layered disclosures?**
   The amended Rule adopting release went into detail regarding layered disclosures to satisfy the "clear and prominent disclosure" requirement. As opposed to disclosures included at the end of a marketing piece or event, layered disclosures are sprinkled throughout the piece or event such that relevant disclosures are proximate to the material requiring disclosure. These disclosure may then be "layered" with more comprehensive disclosures later in the piece or event. Clear and prominent disclosures are required when using testimonials, endorsements, third-party ratings and predecessor performance. It is not explicitly required when advertising hypothetical performance but layered disclosures should be considered.

   The amended Rule is agnostic to the medium of communication whereas the old Rule was specific to written advertisements. *Most Compliance Officers have been conditioned to rely exclusively on written disclosures; however, this will no longer be possible in some cases*. Compliance Officers need to understand the various forms of communication and adapt disclosures accordingly. In many cases, layered disclosures will be indicated.

9. **How will your policies contemplate the use of influencers or bloggers?**
   Influencers and bloggers are considered "promoters" and subject to the testimonials and endorsement section of the Marketing Rule. Your firm is required to document the influencer is not subject to disqualification and there must be a written agreement stipulating the terms of the compensation. Finally, there are required clear and prominent disclosures. Case study #1 illustrates how your policies and procedures should contemplate the use of an influencer.

10. **How will the policies contemplate the use of rating services such as Google My Business?**
    Customer reviews are extremely popular on the internet and it is likely they will be popular in the financial services industry. *This could be the new frontier of the new Marketing Rule*. You need to train your staff on "adoption and entanglement" which is defined in the template policies and procedures. Basically, adoption and entanglement can be summed up in the saying, "you touch it, you own it." Case Study #6 illustrates considerations for accommodating the use of customer review services such as Google My Business.

11. **How will your policies and procedures contemplate the use of third-party ratings and awards?**
    Third-party ratings may not be used unless:

    > *"The firm 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."*

    The bottom line is ratings and awards must be bona fide. Thus, many ratings/awards that were previously allowed may no longer be used. Many ratings and awards were simply paid (false) advertisements.

    Although not explicitly covered under the Rule, an analogous circumstance may be applied to professional certifications. They should be bona fide as well.

12. **Considerations for policies surrounding performance advertising:**
    The prior Rule does not address performance advertising, instead performance advertising is defined by a plethora of no-action letters and enforcement precedents. The SEC will be withdrawing some no-action relief, but they have not yet announced which ones.

    Generally, the amended Rule does not bring major changes in the area of performance advertising. Any marketing piece that includes hypothetical performance is subject to the Rule, even in one-on-one presentations. A welcome change is performance time frames are now standardized.

    > *"The advertisement must include 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."*

13. **When do templates cross the line from one-on-one communications to become marketing materials subject to your firm's policies?**
    The adopting release clarified that this exclusion applies to communications with multiple natural persons representing a single entity or account. The adopting release identified

certain types of communications that will not meet the requirements of the one-on-one exclusion.

- Bulk emails or algorithm-based messages that are nominally directed at or "addressed to" only one person but are in fact widely disseminated to numerous investors do not meet the one-on-one requirements and are considered advertisements under the Marketing Rule.
- Customizing a template presentation or mass mailing by filling in the name of an investor and/or including other basic information about the investor would not constitute a one-on-one communication.
- A bona fide one-on-one communication that includes hypothetical information will also be subject to the Marketing Rule unless the hypothetical information is included specifically in response to an unsolicited investor request or provided to a private fund investor.

14. **Considerations for Advisers to private funds:**
Investors in private funds are not "clients" of the fund Adviser and 206(4)-1 historically did not apply to private fund investors. The caveat is even though not expressly included, it is common for the SEC to review private fund marketing material during an exam and there is an expectation that the materials will meet certain requirements. The amended Rule provides clarity since the amended Rule explicitly includes marketing to private fund investors.

The prohibition on general solicitation under Reg D, Rule 506 still applies to 506(b) offerings, however, 506(c) allows general solicitation under prescribed conditions. Since this is under Reg D and not 206(4)-1, most policies and procedure manuals include a section for "Private Funds" and the prohibition on general solicitation is covered in this chapter. Although marketing related, many firms may choose not to consolidate this section of their manual with amended Rule 206(4)-1.

Advisers are responsible for compliance with the Rule with regard to fund interests distributed by placement agents or other intermediaries. There will be a learning process with these third-parties and firms will need to not only understand the Rule and have good policies and procedures, they will need to be able to effectively train their own personnel and third-parties such as placement agents.

Although one-on-one communications to a private fund investor, even if they contain hypothetical performance, are exempt, they are subject to the Rule if delivered through a paid endorsement or testimonial. Thus, the activities of paid finders, promoters, etc., are subject to the Rule. Performance projections (hypothetical performance) included with or in the private placement memorandum ("PPM") should be considered subject to the provisions of the Marketing Rule. Material terms in the PPM regarding material terms, objectives, risks and other required elements are not subject to the Rule.

Once you have tailored your new marketing policies and procedures, consider using your policies and procedures as the basis for training. The policies and procedures can be converted to a Power Point presentation, distributed as an attachment to a compliance memo or utilized in the way you see best for your firm.

Case Studies:

These case studies are meant to provide insights into the practical application of the new Marketing Rule, but they also highlight some of the changes and challenges.

Case Study #1 (Influencer)

Scenario:
Consider a hypothetical where an influencer interviews a member of your firm on their YouTube Channel and is compensated more than $1,000 for the event.

Analysis:

A. Rule implication.
   1. This is a paid endorsement which meets the second prong of the definition of an advertisement subject to the Rule and the firm's policies and procedures.

B. Requirements.
   1. Verify and document the influencer is not subject to disqualification. Maintain printouts from BrokerCheck and IAPD.
   2. There must be a written agreement stipulating the terms of the compensation.
   3. Disclosure requirements.
      a) To satisfy the clear and prominent disclosure requirement, the influencer should be given a script to read prior to speaking with or about the firm (see template policies and procedures for template language).
      b) There should be more detailed disclosures which can be read or displayed at the end of the YouTube video.

C. Additional Procedures.
   1. The influencer should be given a copy of the firm's policies and procedures and specifically educated on the seven general prohibitions.
   2. Since these are paid leads, they need to be sourced so the influencer can be paid. A belt and suspenders approach would be to create a written disclosure given to the prospect when they contact your firm. This can be incorporated into a piece that describes the relationship with the influencer and includes some complimentary language so it does not seem like a legal disclosure, and it can create some goodwill with the influencer.

Case Study #2 (Sphere of Influence)

Scenario:
One of your advisers has a strong network including a CPA and estate attorney, both of whom are clients of the firm. She wants to pay them for referrals and anticipates the payments will total over $1,000.

Analysis:

A. Rule implication.
   1. This is a paid testimonial which meets the second prong of the definition of an advertisement subject to the Rule and the firm's policies and procedures.

B. Requirements.
   1. Verify and document the sphere of influence is not subject to disqualification. Maintain printouts from BrokerCheck and IAPD.
   2. There must be a written agreement stipulating the terms of the compensation.
   3. Disclosure requirements.
      a) To satisfy the clear and prominent disclosure requirement, the sphere of influence

should be given a script to read prior to speaking with or about the firm.

b) Since these are paid leads, they need to be sourced so the sphere of influence can be paid. A belt and suspenders approach would be to create a written disclosure given to the prospect when they contact your firm. This can be incorporated into a piece that describes the relationship with the sphere of influence and includes some complimentary language so it does not seem like a legal disclosure, and it can create some goodwill with the sphere of influence.

C. Additional Procedures.
   1. The sphere of influence should be given a copy of the firm's policies and procedures and specifically educated on the seven general prohibitions.

Case Study #3 (Ratings and Awards)

Scenario:
One of your advisers is ranked as a top independent financial advisory firm in Barron's as well as a top US Registered Investment Adviser in Financial Times. She wants to advertise these awards/rankings in her email signature.

Analysis:
A. Rule implication.
   1. Third-party ratings and awards are covered in the Rule explicitly in the negative (what you can't do).
   2. Third-party ratings may not be used unless the firm "…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."

B. Requirements.
   1. Clear and prominent disclosure of:
      a) The date on which the rating was given and the period of time upon which the rating was based;
      b) The identity of the third party that created and tabulated the rating; and
      c) If applicable, that compensation has been provided directly or indirectly by the adviser in connection with obtaining or using the third-party rating.
   2. The disclosures should be added directly beneath the ratings/awards in the email signature but to be clear and prominent, should not be obscured in fine print.

C. Additional Procedures.
   1. When approving the use of third-party ratings or awards the firm must determine they are bona fide.
   2. The firm should review the Advertising Log for any prior approvals of third-party ratings/awards and scrub any which do not meet the requirements of the amended Rule.

D. References. (Note – These may be subject to possible withdrawal)
   1. DALBAR No-Action Letter (March 24, 1998)
   2. IAA No-Action Letter (December 5, 2005)

Case Study #4 (Partial Client List)

Scenario:
Your firm's senior management would like to include the logos of several high-profile companies that are clients of the firm on your website.

Analysis:

A. Rule implication.
   1. Prior regulatory guidance focused primarily on whether client lists would be deemed prohibited testimonials. Cambiar Investors No-Action Letter (August 28, 1997) clarified that if the list does nothing more than identify clients, it is not a testimonial.
   2. The Denver Investment Advisers No-Action Letter (July 30, 1993) stipulated:
      a) The Adviser must not use performance-based criteria in deciding whether or not to include clients on the list.
      b) There must be a disclaimer indicating it is unknown if these clients approved of the adviser or the services provided.
      c) The list must include a statement disclosing the objective criteria used to determine which clients to include on the list.
   3. Since testimonials are now allowed the firm needs to determine what type of disclosures are required.

B. Requirements.
   1. Include the following disclosure, "Please note that this list represents a cross-section of our clients. It is not known whether the listed clients approve or disapprove of the firm and all of the advisory services provided. The criteria for selection on the list is subjective, but generally favored clients with name-recognition."
   2. The firm should obtain the permission of each client included on the list.

Case Study #5 (Past Specific Recommendations)

Scenario:
Your firm's Marketing Director would like to include past specific recommendations in an advertising campaign.

Analysis:

A. Rule implication.
   1. Old Rule 206(4)-1(a)(2) prohibited advertising past specific recommendations unless the advertisement included or offered to provide a list of all past recommendations during the immediately preceding period of not less than one year.
   2. Further the list must include:
      a) The name of each security recommended, including the date and nature of each recommendation (buy, sell, hold).
      b) The market price of the security at the time of the recommendation.
      c) The market price at the most recent date prior to running the advertisement or releasing the list.
   3. Past specific recommendations are not explicitly addressed in the new Rule and will thus be subject to the General Prohibitions and any No-Action letters that are not withdrawn.

B. Requirements.
   1. The firm should be cognizant and careful to present past specific recommendations in a balanced manner without cherry-picking the best recommendations.
   2. The firm should adhere to the old Rule and provide disclosures.

C. References.
   1. Franklin Management No-Action Letter (December 10, 1998)

2. Investment Counsel of America No-Action Letter (March 1, 2004)
3. TCW Group No-Action Letter (November 7, 2008)
4. SEC OCIE Risk Alert – "The Most Frequent Advertising Rule Compliance Issues Identified in OCIE Examinations of Investment Advisers" (September 14, 2017)

Case Study #6 (Google My Business)

Scenario:
Your Marketing Director wants to add Google My Business links to everyone's email signature with a request to review the firm. The Marketing Director also wants to create an email campaign encouraging clients to review the firm on Google My Business.

[If you are not familiar with Google My Business, do an internet search on your firm. The search results are presented on the left and on the right you should see the Google My Business listing. On the listing you may see the business location, profile, maps, a link to the website, and customer reviews. In all likelihood, you have probably seen these before but didn't know they are Google My Business.]

Analysis:
A. Rule implication.
   1. Unclear.
   2. If the firm did not solicit ratings, it would not adopt or be entangled in Google My Business. Thus, it would not be subject to the Rule.
   3. However, the solicitation of reviews is entanglement but is this sufficient to deem the reviews a testimonial? We will likely need to wait for regulatory guidance and hopefully this will be addressed in an FAQ.
   4. If the firm responds to reviews or requests that certain reviews be removed this will be entanglement and subject the reviews to the Rule.
B. Requirements.
   1. How will the firm meet the clear and prominent disclosure requirements for testimonials?
   2. Most sites do not have the functionality to add clear and prominent disclosures.
   3. Disclosures could be added to the company profile, but the Google My Business company profile is limited to 750 characters and would not meet the requirement for clear and prominent.
C. "Between a rock and a hard place"
   1. If the firm cannot determine if the Rule applies, and even if it does, how would it comply with the requirements, it is best to steer clear for now.
   2. It is likely this will be addressed in a forthcoming FAQ.

Case Study #7 (LinkedIn Endorsements)

Scenario:
Your Director of Marketing would like to have staff take advantage of the endorsement features on LinkedIn by updating their profiles. Under the old Rules the endorsement features were prohibited.

Analysis:
A. Rule implication.
   1. LinkedIn ("LI") does not have endorsements per se. The two features which could implicate the Marketing Rule are "Skills" and "Recommendations."
      a) In the LI profile skills can be listed or turned off. If listed, another LI user can endorse the skill with a single click. If the other user is a client or investor in your private fund

this could be deemed a testimonial.

b) In the LI profile, recommendations can be listed or turned off. A recommendation is a written statement that would clearly be an endorsement/testimonial subject to the Rule.

2. Since skills and recommendations can be turned off, allowing them to be visible would likely constitute entanglement and implicate the Marketing Rule.

B. Requirements.

1. LI skills and recommendations required clear and prominent disclosures.
2. The best way to display LI disclosures is via the "Featured" section of the profile.
   a) https://www.socialmediaexaminer.com/how-to-use-linkedin-featured-section-on-your-profile/
   b) You should create a disclosure page of your website where you will link the disclosures in the Featured section.
   c) You can create a written disclosure that should satisfy the requirement to be clear and prominent.
3. Recommendations can be selectively displayed or hidden. Moreover, before being displayed the recipient of the recommendation has the opportunity to request edits. This raises the potential for the recommendations to be misleading as specifically indicated in the Marketing Rule adopting release. Your firm's policies should require all recommendations to be displayed and edits by the recipient should be prohibited. ■