## CCO TASK SUPPORT

Please be sure to check your SmartRIA CCO portal to keep up with your monthly Compliance tasks.
Please contact the following for:

- **Task Related Questions:** Nancy Harry: nharry@thecomplianceresource.com
  Stacie Craddock: scraddock@thecomplianceresource.com
  Sara Sparks: ssparks@thecomplianceresource.com
- **Login & Portal Requests:** Sara Sparks: ssparks@thecomplianceresource.com

## CCO TOOLS INCLUDED THIS MONTH:

- **CCO Checklist** – Complete the attached CCO Checklist for the month of June 2022.
- **Risk Matrix 2022** – During June, July, August – the Risk Matrix review will be part of the CCO Tasks.
- **Sample "Promotor" Agreement** to update all existing Solicitor Agreements.

## CRP SCHEDULE TO IMPLEMENT THE INVESTMENT ADVISER MARKETING RULE

- ☑ Reviewing the definition and prohibitions of the New Marketing Rule under the act *(highlighted in May 2022 TMIC)*
- ☑ Adopting, replacing, and implementing new requirements of using Third-Party Ratings and Performance Information *(highlighted in May 2022 TMR)*
- ☑ **Adopting, replacing, and implementing new requirements of using Testimonials, and Endorsements *(highlighted this month)***
- ☐ Amendments to firm's books and records, implementation, and adoption of policies and procedures
- ☐ CCO training and firm risk assessment

## TESTIMONIALS AND ENDORSEMENTS

An "Advertisement" includes any *endorsement* or *testimonial* for which an investment adviser provides compensation, directly or indirectly.

**Testimonial** – A statement (written or oral) from a CURRENT client:

- About the client or investor's *experience with the investment adviser* or its supervised persons.
- That directly or indirectly *solicits any current or prospective client* to be a client of the investment adviser.
- That *refers any current or prospective* client or investor to be a client of the investment adviser.

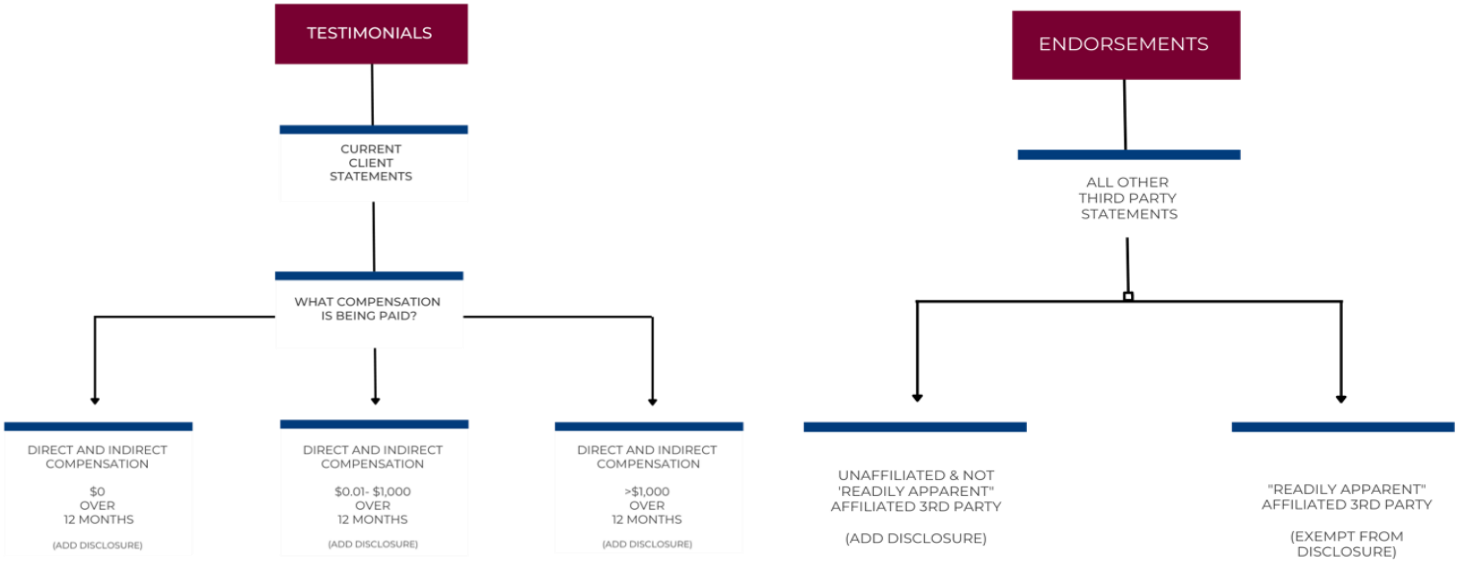
**Endorsement –** A statement (written or oral) from ALL OTHER THIRD PARTIES:

- *Indicates approval, support, or recommendation* of the firm and/or IAR and describes that person's experience
- Directly or indirectly *solicits any current or prospective client*
- *Refers any current or prospective client to be a client* of firm

Under SEC Rule 206(4)-1 testimonials and endorsements are permitted as long as they adhere to certain guidelines including satisfying ***certain disclosure, oversight, and disqualification provisions***. Any testimonials/endorsements must still abide by general advertising regulations in that ***they cannot be misleading, untrue, or fictitious, and use of performance information*** in testimonials/ endorsements is prohibited.

- Examples of activities **LIKELY TO BE DEEMED AN ENDORSEMENT OR TESTIMONIAL** include the following:
  - Websites of lead-generating firms or Adviser referral networks (endorsement).
  - A blogger's website review of an Adviser's services (endorsement or testimonial).
  - A professional or other service provider that refers an investor to an Adviser, even infrequently (endorsement or testimonial).
  - Solicitor arrangements (previously made under Advisers act rule 206(4)-3, the "cash payments for client solicitations rule").

- Examples that are likely **NOT DEEMED TO BE AN ENDORSEMENT OR TESTIMONIAL** include the following:
  - A third-party marketing service or news publication that prepares content for the adviser or disseminates content (such as an adviser newsletter); or,
  - A company that provides a list containing the names and contact information of prospective investors.




Testimonials and endorsements also **include solicitation and referral activities**, including statements that directly or indirectly solicit any investor to be the Firm's client, or refers any investor to be the Firm's client and lead-generation Firms and adviser referral networks.

**COMPENSATED TESTIMONIALS AND ENDORSEMENTS**

The Firm may provide cash or non-cash compensation to a person providing a testimonial or endorsement (a "promoter"), provided the following conditions are met: **1) REASONABLE BASIS, 2) WRITTEN AGREEMENT, 3) DISQUALIFICATION.**

**1) REASONABLE BASIS**

**Q. What level of diligence will be required to satisfy the requirement that an investment adviser have a reasonable basis for believing that a testimonial or endorsement complies with the requirements of the Marketing Rule?**

**A.** In the Adopting Release, the SEC stated that in the context of solicitation or referral activity, a "reasonable basis" could involve periodically making inquiries of a sample of investors solicited or referred. The Adopting Release makes no reference to the SEC staff's 2008 Mayer Brown no-action letter, which expressly provides that the solicitation rule does not apply to an adviser's engagement of placements agents or other persons that solicit investors in funds

managed by the adviser. See Mayer Brown LLP, SEC Staff No-Action Letter (July 15, 2008). Presumptively, this letter will be withdrawn in connection with the Marketing Rule's implementation. by the promoter in order to assess whether that promoter's statements comply with the rule. In addition, an adviser could implement policies and procedures to form a reasonable basis for believing the testimonial or endorsement complies with the rule; for endorsements by "influencers" or other public statements, this could involve a direct sampling of a promoter's statements. An adviser could also include representations, warranties, and other terms in its written agreement with the solicitor or promoter to help form such a reasonable belief. Such agreements could provide mechanisms, for example, to enable advisers to pre-review testimonials or endorsements or otherwise impose limitations on the content of those statements.

**2) WRITTEN AGREEMENT**

**Q. What terms and conditions will be required in an investment adviser's agreement with a promoter? Will current solicitation agreements need to be amended?**

**A.** The Marketing Rule requires the written agreement between an adviser and a promoter to (i) describe the scope of the agreed-upon activities and (ii) set forth the terms of compensation for those activities, including non-cash compensation that could be construed as indirect compensation under the Marketing Rule. In addition, agreements should be drafted to facilitate the adviser's forming a reasonable basis for believing that any endorsement by the promoter complies with the requirements of the Marketing Rule. To that end, advisers should consider specifying the respective roles and responsibilities of the adviser and the promoter regarding creation, review, and delivery of required disclosures to prospective investors and documenting any circumstances that may allow endorsements by the solicitor to qualify for the exemptions set forth in the Marketing Rule. Consistent with the adviser's oversight obligation under the Marketing Rule, advisers should also consider representations, warranties, and covenants requiring the promoter to periodically provide, or provide upon request, sample endorsements and related disclosures for the adviser's review and requiring notification of a change in eligibility status or other material terms of the promoter's compliance with the agreement.

**3) DISQUALIFICATION**

**Q. What level of diligence will be required in order for an investment adviser to determine that a person is not disqualified from acting as a solicitor or promoter?**

**A.** The Firm may not compensate an individual who would otherwise be deemed an ineligible person with a disqualifying action or event under federal securities laws. Disqualifying actions and events include but are not limited to an SEC opinion or order barring, suspending, or prohibiting the person from acting in any capacity under the federal securities laws and certain convictions, orders, and legal proceedings described in Section 203(e) of the Advisers Act. The Marketing Rule does not require an adviser to monitor the eligibility of promoters on a continuous basis to satisfy the "reasonable care" standard set forth in the rule. The SEC stated in the Adopting Release that the frequency with which an adviser must monitor eligibility and the steps an adviser must take in making this assessment will vary depending on the facts and circumstances. The SEC noted in the Adopting Release that advisers could likely take a similar approach to monitoring promoters as that used to monitor their own supervised persons, though advisers may assess the eligibility of their supervised persons more frequently in light of their obligations to report promptly certain disciplinary events on Form ADV.

The litany of disqualifying triggers is broader in the new rule than the old; certain carve-outs are provided; and all triggers other than an SEC opinion or order barring, suspending, or prohibiting a person from acting in any capacity under the federal securities laws (which the rule calls a *disqualifying Commission action)* are subject to a 10-year lookback.

**CCO REMINDER: Unlike the current requirement under the cash solicitation rule, the paid promoter under the new marketing rule is not obliged to deliver the adviser's Form ADV brochure. Nor is the promoter required either to deliver a specific disclosure document or obtain the client's written acknowledgement of receipt of required disclosures.**

**Q. Will current "solicitors" under the solicitation rule be considered "promoters" under the Marketing Rule?**

**A.** The requirements of the Marketing Rule reach the activities of current "solicitors" under the solicitation rule, as well as a new, broad group of other "promoters." Notably, the SEC also expanded the application of the Marketing Rule to cover the solicitation of private fund investors (rather than just advisory clients). Investment advisers will need to examine their relationships with these parties to determine whether compensation is paid directly or indirectly (e.g., through gifts, entertainment, awards, or directed brokerage) for their services, whether amendments to existing agreements are necessary, and how to exercise sufficient oversight over these promoters.

## CLEAR AND PROMINENT DISCLOSURE REQUIREMENT

**Q. What does the term "clear and prominent" mean with respect to the required disclosures?**

**A.** In the Adopting Release, the SEC clarified that an adviser must include disclosures within the testimonial or endorsement to meet the "clear and prominent" standard. In the case of an oral testimonial or endorsement, these disclosures must be provided contemporaneously.

**Q. Can investment advisers use hyperlinks to the prominent disclosures required by the Marketing Rule?**

**A.** The Adopting Release explains that these disclosures should be read at the same time as the associated statement and that hyperlinking "clear and prominent" disclosures is prohibited. The disclosure should state that the promoter, due to the compensation received, has an incentive to recommend the adviser, resulting in a material conflict of interest, and any other material conflicts of interest arising from the promoter's relationship with the Firm.

**Q. How does our Firm determine what disclosure should be used?**

**A.** Consider the following:

- Was the testimonial was given by a current client, or the endorsement was given by someone other than a current client?
- Was there cash or non-cash compensation provided for the testimonial or endorsement?
- Are there any material conflicts of interest on the part of the person giving the testimonial or endorsement resulting from the person's relationship with the adviser? Requires a brief statement.

## DE MINIMIS EXEMPTION

If the cash or non-cash compensation is valued at less than $1,000 per 12-month period, **a written agreement is not required**. In order to determine whether the de minimis exemption has been exceeded (at least $1,000 in any 12-month period), *the Adviser must maintain records of any amount of compensation paid to a promoter, including the value of non-cash compensation.*

## REGISTRATION REQUIREMENTS

Notwithstanding the above, some state rules and regulations require persons receiving compensation for client referrals to be registered as investment advisers or Investment Adviser Representatives (IARs). *The Adviser will ensure that any person (individual or entity) acting as a solicitor is properly registered as an IAR of the Adviser or investment adviser prior to receiving compensation for client referrals, if required.*

## THIRD-PARTY ATTRIBUTION

In addition to "advertisements", the adviser shall also be responsible for "advertisements" directed by a third-party if the Adviser (or a related person) participates in the communication. Whether information posted or published by third parties is attributable to an adviser requires an analysis of the facts and circumstances to determine (i) whether the adviser has

explicitly or implicitly endorsed or approved the information after its publication (adoption) or (ii) the extent to which the adviser has involved itself in the preparation of the information (entanglement).

At a minimum, the following factors should be considered when assessing whether it has participated in a third-party "advertisement":

- Was the Adviser involved in creating or disseminating the advertisement (entanglement)?
- Did the Adviser authorize the communication?
- Did the Adviser provide the material to third-party for dissemination?
- Did the Adviser endorse the material after publication (adoption)?
- Are the materials collaborative (ex. fund of funds, 3rd party models)?
- Did the Adviser selectively delete, alter, or endorse comments on a third parties' content on their own social media platform(s)?

## EXEMPTIONS

**Q. Are there any exemptions from the Disclosure Requirements?**

**A.** Yes. There are three exemptions from the Disclosure Requirements:

- **AFFILIATES.** Testimonials and endorsements by certain affiliates of an adviser are exempt from the Disclosure Requirements if (a) the affiliation between the adviser and the affiliate is "readily apparent" to or is disclosed to the client or investor at the time of solicitation, and (b) the adviser documents the affiliate's status at the time of solicitation.
- **RECOMMENDATIONS SUBJECT TO REGULATION BEST INTEREST.** If an SEC-registered broker-dealer provides a testimonial or endorsement that is a recommendation subject to Regulation Best Interest ("Regulation BI"), the testimonial or endorsement is exempt from all the Disclosure Requirements. This is because Regulation BI imposes its own disclosure obligations, which are like the Marketing Rule's Disclosure Requirements.
- **PERSONS WHO ARE NOT "RETAIL CUSTOMERS".** If an SEC-registered broker-dealer provides a testimonial or endorsement to a person that is not a "retail customer", the testimonial or endorsement is exempt from two of the Disclosure Requirements: (a) material terms of any compensation arrangement and (b) material conflicts of interest. Such broker-dealer is still required to make the disclosures that are subject to the "clear and prominent" standard.

## REFERRAL NETWORKS/LEAD GENERATION FIRM FAQ

**Q. Do lead-generation firms or adviser referral networks (collectively, "operators") fall into the scope of the rule?**

**A.** Lead generation firms are operated by 'non-investors' where an Adviser compensates an operator to solicit investors for, or refer investors to, the RIA. These types of 'operators' make third-party advisory services (such as model portfolio providers) accessible to investors and stated that the operators do not promote or recommend particular services or products accessible on the platform. In both examples, the operator's website likely meets the final marketing rule's definition of endorsement. An operator may tout the advisers included in its network, and/or guarantee that the advisers meet the network's eligibility criteria. In addition, because operators typically offer to "match" an investor with one or more advisers compensating it to participate in the service, operators typically engage in solicitation or referral activities. Similarly, a blogger's website review of an adviser's advisory service would be a testimonial or an endorsement under the final marketing rule because it indicates approval, support, or a recommendation of the investment adviser, or because it describes its experience with the adviser. If the adviser directly or indirectly compensates the blogger for its review, for example by paying the blogger based on the amount of assets deposited in new accounts from client referrals or the number of accounts opened, the testimonial or endorsement will be an advertisement under the definition's second prong. Depending on the facts and circumstances, a lawyer or other service provider that refers an investor to an adviser, even infrequently, may also meet the rule's definition of testimonial or endorsement. On the other hand, where an adviser pays a third-party marketing service or news publication to prepare content for and/or disseminate a communication, we generally

would not treat this communication as an endorsement under the second prong of the definition of "advertisement." Similarly, 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.

**Advisors have until November 4, 2022, to comply, so use the time wisely.**

**LET'S RECAP THE "TO-DO" LIST REGARDING TESTIMONIALS AND ENDORSEMENTS:**

- ☐ **Does your firm have any current solicitor agreements?**
  If so, document the list of current agreements and review the relationships for the following:
  - Review the "Promoter' for any disqualifying events
  - Is the Promotor properly registered per the State rules, (if necessary)?
  - Does the relationship trigger direct compensation more than the di minimis per the new Rule?
  - Is the payment to be paid a specific cash amount or a percentage of total advisory fees over a period of time?
  - Disclose the value of any non-cash compensation if that value is readily ascertainable.
  - Is there any condition to the payment, i.e., a requirement that the client continue or renew the advisory relationship, and is the compensation payable upon dissemination, deferred, contingent, or trailing?

- ☐ **Execute a "Promoter Agreements" by all your existing relationships.**
  **(REFER TO ATTACHED SAMPLE FOR TAILORING TO YOUR FIRM)**

- ☐ **Does your Firm use Lead Generation Firms?**
  If so:
  - Work with CRP on updating ADV Part 2A and Part 1 to reflect disclosure of the relationship.

  Remember – these relationships will trigger the new Marketing Rule requirements.

- ☐ **Will your Firm use Testimonials by current clients in their advertisements?**
  If so, let's:
  - Review the requirements for disclosure on advertising materials
  - Amend the P&P, ADV Part 1 and Part 2A Brochure documents

- ☐ **Review website for disclosure language –** (Disclosure language must be at least as prominent as the testimonial or endorsement and is required to be shown in the same font size as the rest of the language, DO NOT list any personal identifying information of a client without their consent. Client initials or first names and last initial may be used provided the promoter has given permission to include, Include what type of compensation was provided in the form of (insert details regarding compensation), If any conflicts of interest exist due to the relationship between the person providing the testimonial/endorsement and the advisor (Briefly describe the conflict of interest/ relationship)

- ☐ **Adopt policies "reasonably designed" to adhere to the new Rule regarding use of testimonials and/or endorsements.** ***(Stay tuned for CRP's Template Policies and Procedures beginning June 15th, 2022)***

**JUNE 15, 2022: TMR – AMENDMENTS TO FIRMS BOOKS AND RECORDS, AMENDMENTS TO ADV DISCLOSURE DOCUMENTS, IMPLEMENTATION, AND ADOPTION OF POLICIES AND PROCEDURES**

Finally, the Commission adopted related amendments to the investment adviser registration form and the books and records rule. In addition, the Commission amended Form ADV to require advisers to provide additional information regarding their marketing practices to help facilitate the Commission's inspection and enforcement capabilities.