

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:

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CCO TOOLS INCLUDED THIS MONTH:

- **CCO Checklist** – Complete the attached CCO Checklist for the month of May 2022.

CRP SCHEDULE TO IMPLEMENT THE INVESTMENT ADVISER MARKETING RULE

In late December 2020, the SEC Commission announced it had finalized reforms to modernize rules that govern investment adviser advertisements and compensation to solicitors under the Investment Advisers Act of 1940. Neither rule had been amended significantly since its adoption over forty years ago.

“The marketing rule reflects important updates to the traditional advertising and solicitation regimes, which have not been amended for decades, despite our evolving financial markets and technology,” said Chairman Jay Clayton. “This comprehensive framework for regulating advisers’ marketing communications recognizes the increasing use of electronic media and mobile communications and will serve to improve the quality of information available to investors. The new rule provides for an extended compliance period intended to provide advisers with a sufficient transition period, including to enable consultation with the Commission’s expert staff.”

Since the new Rule is complex and has several new items and disclosures to comply with, CRP will break it down over several educational resources, including May, June, and July TMIC and TMR. In the following educational pieces, we will assist firms through the process of:

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

REVIEWING THE DEFINITION AND PROHIBITIONS OF THE NEW MARKETING RULE UNDER THE ACT

Definition of Advertisement. The amended definition of “advertisement” contains two prongs: one that captures *communications traditionally covered by the advertising rule* (advertisements) and another that governs solicitation activities previously covered by the cash solicitation rule (testimonials & promoters).

FIRST PRONG – ADVERTISEMENTS:

First, the definition includes any direct or indirect communication an investment adviser makes that: (i) offers the investment adviser's investment advisory services with regard to securities to prospective clients or private fund investors, or (ii) offers new investment advisory services with regard to securities to current clients or private fund investors. The first prong of the definition excludes most one-on-one communications and contains certain other exclusions. Certain specific categories of communications receive special treatment under the first prong of the definition of "advertisement."

- **Extemporaneous, Live, Oral Communications.** Extemporaneous, live, oral communications are excluded from the definition of advertisement, regardless of whether they are broadcast. However, prepared remarks and speeches, such as those delivered from scripts, as well as slides or other written materials distributed to an audience in connection with a presentation, would not be excluded to the extent they otherwise meet the definition of an advertisement.
- **Notices and Filings.** Information contained in required statutory or regulatory notices and filings will not be considered an advertisement, provided such information is reasonably designed to satisfy the requirements of the notice or filing. For example, information reasonably designed to satisfy the requirements of Form ADV Part 2, or Form CRS, will not be an advertisement. Information included in a regulatory filing that is not reasonably designed to satisfy the adviser's obligations under the filing and that otherwise meets the definition of advertisement would remain subject to the Marketing Rule.
- **Hypothetical Performance.** Presentation of hypothetical performance is excluded from the definition of advertisement *only if* the communication is:
 - in response to an unsolicited client request; or
 - to a private fund investor in a one-on-one communication;
 - *Hypothetical performance included in all other communications that offer investment advisory services, including one-on-one communications to prospective advisory clients, is subject to the new Rule.*

SECOND PRONG - COMPENSATED TESTIMONIALS AND ENDORSEMENTS:

The definition generally includes any endorsement or testimonial for which an adviser provides cash and non-cash compensation directly or indirectly (e.g., directed brokerage, awards, or other prizes, and reduced advisory fees).

- **"Testimonial"** is defined to include statements by current clients or private fund investors about their experience with the adviser.
- **"Endorsement"** is defined to include statements by a person other than a current client or private fund investor that indicate approval, support, or a recommendation of the adviser or describes the person's experience with the adviser.

Communications considered to be a testimonial or endorsement include statements regarding an adviser's investment advisory expertise or capabilities, as well as the adviser's qualities, expertise, or capabilities in other contexts where it is suggested that such qualities, expertise, or capabilities are relevant to the adviser's investment advisory services.

Whether an adviser provides direct or indirect compensation depends on a circumstance determination. The term may include, for example, gifts and entertainment, fee rebates, and other forms of indirect benefits, provided that these benefits are designed to incentivize the recipient to make a positive statement about an adviser, although an employee's regular

salary and bonus for investment advisory activities or clerical, administrative, support, or similar functions would not be considered compensation in exchange for a testimonial or endorsement.

In the Adopting Release, the SEC specifically declined to define what may or may not be considered indirect compensation, and therefore, the term will be subject to broad interpretation.

GENERAL PROHIBITIONS. The Marketing Rule replaces the four “prescriptive” prohibitions contained in the current advertising rule with seven principles-based prohibitions as a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts.

- making an **untrue statement** of a material fact, or omitting a material fact necessary to make the statement made, in light of the circumstances under which it was made, not **misleading**;
- making a material statement of fact that the adviser **does not have a reasonable basis for believing it will be able to substantiate** upon demand by the Commission;
- including information that would reasonably be likely to cause an **untrue or misleading implication or inference** to be drawn concerning a material fact relating to the adviser;
- discussing any potential benefits **without providing fair and balanced treatment** of any associated material risks or limitations;
- 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**; and
- including information that is **otherwise materially misleading**.

MARKETING RULE ROLLOUT FOR MAY, JUNE, JULY 2022

As noted above, the new rule is complex and has several components. CRP will provide education and implementation per the following schedule:

MAY 15, 2022 – THIS MONTH’S RESOURCE (“TMR”)

UNDERSTANDING THE REQUIREMENTS OF THE NEW MARKETING RULE: INVESTMENT PERFORMANCE INFORMATION AND THIRD-PARTY RATINGS

CRP will review the requirement advisers need to implement to standardize components of investment performance presentation in marketing materials. This is aimed to help investors evaluate and compare investment opportunities. CRP will also provide guidance and sample disclosures for advertisements including third-party ratings.

JUNE 1, 2022 - THIS MONTH IN COMPLIANCE ("TMIC")

UNDERSTANDING THE REQUIREMENTS OF THE NEW MARKETING RULE: TESTIMONIALS AND ENDORSEMENTS

CRP will review the requirement advisers will need to implement to permit the use of testimonials and endorsements, which include traditional referral and solicitation activity, subject to certain conditions.

- Sample Promotor (aka Solicitor) Agreement Template- adopt for firms intending to use paid testimonials and endorsements or promotors.
- Disclosures for testimonials and endorsements

JUNE 15, 2022 – THIS MONTH’S RESOURCE ("TMR")

AMENDMENTS TO FIRMS BOOKS AND RECORDS, IMPLEMENTATION, AND ADOPTION OF POLICIES AND PROCEDURES

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.

- Review amendments to the books and records Rule and Form ADV
- Review, tailor, and implement new policies and procedures

JULY 1, 2022 - THIS MONTH IN COMPLIANCE ("TMIC")

CCO TRAINING AND FIRM RISK ASSESSMENT

- Sample Training for IARs – including policies and procedures
- Begin completion of CRP Risk Matrix checklist
- Sample disclosures that include new items under the advertising Rule

WHAT’S NEXT? WITHDRAWAL OF STAFF GUIDANCE.

Our team at CRP has been concerned with the lack of guidance and FAQs from the SEC regarding this sweeping rule change. We have heard rumblings of a New Marketing Rule outreach program, as well as additional FAQs and other public releases regarding it, are in the works. The outreach will likely be later this summer, but hopefully not too close to November. CRP will keep firms updated on any exceptions we are observing in exams being conducted.

The staff of the Division of Investment Management will withdraw no-action letters and other guidance addressing the application of the advertising and cash solicitation rules as those positions are either incorporated into the final rule or will no longer apply. A list of the letters will be available on the Commission’s website at SEC.gov.