

# THIS MONTH IN COMPLIANCE

## Marketing Rule – Testimonials and Endorsements

### MONTHLY COMPLIANCE TASKS

Please be sure to check your SmartRIA CCO portal to keep up with your monthly Compliance tasks or utilize the CCO Scorecard included in our This Month in Compliance email. Please contact the following for:

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- **Task Related Questions:** Nancy Harry: [nharry@thecomplianceresource.com](mailto:nharry@thecomplianceresource.com)  
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CRP continues to unpack the SEC's sweeping and complex new Marketing Rule. This month we highlight Testimonials and Endorsements (Solicitors Rule). This section is one of the most significant changes reflected in the new rule and we believe the biggest deviation from the existing advertising rule.

### MARKETING RULE – TESTIMONIALS AND ENDORSEMENTS

The new Marketing Rule merges the Solicitation Rule into the Advertising Rule, addressing solicitation activities under the definitions of “endorsement” and “testimonial,” which both include statements that directly or indirectly solicit any investor to be the adviser’s client or private fund investor. Let us look at how these terms are defined in the new Rule:

**Endorsement** - any statement by a person *other than a current client* advised by the investment adviser that:

- (i) **Indicates approval, support, or recommendation** of the investment adviser or its supervised persons or describes that person’s experience with the investment adviser or its supervised persons.
- (ii) **Directly or indirectly solicits any current or prospective client** or investor to be a client of, or an investor in a private fund advised by, the investment adviser; or
- (iii) **Refers any current or prospective client or investor to be a client** of, or an investor in a private fund advised by, the investment adviser.

**Testimonial** - any statement *by a current client* advised by the investment adviser:

- (i) **About the client or investor’s experience** with the investment adviser or its supervised persons.
- (ii) **That directly or indirectly solicits any current or prospective client** to be a client of the investment adviser; or
- (iii) **That refers any current or prospective client or investor to be a client of** the investment adviser.

The Adopting Release states that a person providing an endorsement or testimonial under the Marketing Rule could be a firm (such as a broker-dealer or a bank) or its representative that solicits for an adviser, or an unaffiliated fund-of-funds or a feeder fund that solicits investors in an underlying fund or a master fund, respectively.

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## Marketing Rule – Testimonials and Endorsements

### Cash and Non-Cash Compensation

The Marketing Rule prohibits a firm from directly or indirectly compensating a person for an endorsement or testimonial unless the adviser complies with the conditions in the rule discussed below. This restriction on compensation for endorsements and testimonials applies to both cash and non-cash compensation. The form of compensation under the Marketing Rule will include fees based on:

- a percentage of assets under management or amounts invested,
- flat fees,
- retainers,
- hourly fees,
- reduced advisory fees,
- fee waivers, and
- any other cash compensation methods, as well as cash or non-cash rewards that advisers provide for endorsements and testimonials, including referral and solicitation activities.

Compensation also includes, sales awards or other prizes, gifts and entertainment, such as outings, tours, or other forms of entertainment that a firm provides as compensation for testimonials and endorsements.

### Conditions Applicable to Testimonials and Endorsements, Including Solicitations

An advertisement may not include any testimonial or endorsement, and a firm may not provide compensation, directly or indirectly, for a testimonial or endorsement, unless the adviser complies with certain disclosure, oversight, and disqualification provisions, subject to certain exceptions:

**Disclosure Requirements-** The Firm must disclose, or reasonably believe that the person giving the testimonial or endorsement discloses, clearly and prominently the following items: (In order to be “clear and prominent,” the disclosure must be in the advertisement itself and must be at least as prominent as the testimonial or endorsement; hyperlinked disclosure will not suffice!)

- ✓ The testimonial or endorsement is **provided by a client or investor or a person other than a client or investor**;
- ✓ **Cash or non-cash compensation was provided** for the testimonial or endorsement; and
- ✓ **Brief statement of any material conflicts** on the part of the person giving the testimonial or endorsement resulting from the firm’s relationship with such person. In addition, disclosing any compensation arrangement and describing the material conflicts (“supplemental disclosure requirement”).
  - Material terms include:
    - Whether the adviser will be paid a specific cash amount or a percentage of total advisory fees over a period of time, the value of any non-cash compensation if that value is readily ascertainable.
    - Any condition to the payment, i.e., a requirement that the client continue or renew the advisory relationship, and
    - Whether compensation is payable upon dissemination, deferred, contingent, or trailing.

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

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of interest arising from the promoter's relationship with the firm. These disclosures must be provided at the time the testimonial or endorsement is disseminated. The SEC has not provided guidance on the manner of delivering the disclosure

### Oversight and Compliance.

- Firm must have reasonable basis for believing that the testimonial or endorsement complies with the requirements of the rule.
- Firms should consider contractually obligating the promoter to fulfill the disclosure obligation and describe the scope of the agreed-upon activities and the terms of compensation.
- Firms should consider requiring compliance to preview all testimonials and endorsements and place limits on deviations from approved content and formats.
- The new Rule does not prescribe the type or frequency of due diligence an adviser must conduct in order to have a reasonable belief about a promoter's eligibility to receive compensation. However, since eligibility is measured at the time the testimonial or endorsement is disseminated, firms will need to establish some form of ongoing monitoring if a promoter's compensated testimonials or endorsements occur over a period of time.

### Disqualification.

The Rule prohibits a firm from compensating a person for a testimonial or endorsement if the firm knows that the person giving the testimonial or endorsement is subject to certain disqualifying events.

### Partial Exemptions

- **De Minimis Compensation.** Persons giving a testimonial or endorsement *that receives no compensation or total compensation of \$1,000 or less (or the equivalent value in non-cash compensation)* for 12 months are exempt from the written agreement requirement.
- **Advisory Affiliates.** Affiliates, partners, directors, officers, and adviser's employees are exempt from the written agreement requirement.
- **Broker-Dealers.** Registered broker-dealers exempt provided that they are not subject to statutory disqualification under the Securities Exchange Act of 1934.
- **Rule 506(d) Covered Persons.** Persons covered by rule 506(d) of the Securities Act of 1933 with respect to a rule 506 securities offering.

## MARKETING RULE – COMPLIANCE WITH THE NEW MARKETING RULE

On March 18, 2021 – the SEC issued a new FAQ concerning the adoption of the Marketing Rule:

**Q: I understand that an adviser must comply with the amended adviser marketing rule with respect to its advertising and solicitation activities by the compliance date (November 4th, 2022), which is 18 months after the effective date of the rule. May an adviser choose to comply with some of the marketing rule requirements before the compliance date, but not comply with others?**

*A: No. An adviser may choose to comply with the amended marketing rule in its entirety any time starting on the effective date, May 4th, 2021. Until an adviser transitions to the amended marketing rule, the adviser would continue to comply with the previous advertising and cash solicitation rules*

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*and look to the staff's positions under those rules. The staff believes an adviser may not cease complying with the previous advertising rule and instead comply with the amended marketing rule but still rely on the previous cash solicitation rule. Advisers are reminded that they should review their compliance policies and procedures in light of regulatory developments, including the adoption of the amended marketing rule. In addition, the staff believes that when advisers transition to the amended marketing rule, they will need to implement any revisions to the written compliance policies and procedures necessary so that they are reasonably designed to prevent violations of the amended marketing rule. Advisers are also reminded that they are required to maintain a copy of all compliance policies and procedures in effect at any time within the previous five years, and that it should be clear when those policies and procedures were in effect.*