

ADVERTISING REVIEW

CRP has been receiving many great questions around the topic of Advertising Review. We thought it would be helpful for our Compliance Teams to do a quick review of some commonly found deficiencies within our advertising review in exams. For the best guidance on advertising, we look back at an SEC Risk Alert published in September 2017. The Risk Alert focused on the Advertising Rule and compliance issues identified in deficiency letters sent to SEC registered investment advisers. Please take a moment to review the following areas as it will assist your firm when preparing for a State or SEC Exam, and your own firm's internal review process.

Advertisements, as defined in the Advertising Rule, can encompass a broad array of statements. The Advertising Rule states that an **"advertisement shall include any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers:**

- *any analysis, report, or publication concerning securities, or when used in making a determination as to when to buy or sell any security, or which security to buy or sell; or*
- *any graph, chart, formula, or other device to be used in making a determination as to when to buy or sell any security, or which security to buy or sell; or*
- *any other investment advisory service with regard to securities."*

Adviser statements made through electronic media, or other non-traditional styles of presentation may fall within the purview of the Advertising Rule. (Think Social Media folks!). This includes:

- *"re-posting" of third party information not created by a representative of your firm!*
- *Any article or posting that is "re-posted" must adhere to the same advertising rule as if your firm drafted it.*

MOST FREQUENT ADVERTISING RULE COMPLIANCE ISSUES

Below are the most frequent deficiencies that OCIE staff has identified in connection with failure to comply with the Advertising Rule:

- **Misleading Performance Results.** OCIE staff has observed advertisements that the staff believed to contain misleading performance results. For example, advisers that presented performance results without deducting advisory fees. Also, adviser advertisements that compared results to a benchmark, but did not include disclosures about the limitations inherent in such comparisons, including instances where, for example, an advertisement did not disclose that the advertised strategy materially differed from the composition of the benchmark to which it was compared. Additionally, adviser advertisements that contained hypothetical and back-tested performance results but did not explain how these returns were derived and did not include other potentially material information regarding the performance results. Remember to define a benchmark, particularly if a blended benchmark is being used.
- **Misleading One-on-One Presentations.** Advertisements the staff believes contain misleading one-on-one presentations. For example, advisers that advertised performance results (gross of fees) in certain one-on-one presentations but did not include potentially relevant disclosures, there are 4 required disclosures for this, consult your Compliance Manual for details. In addition, some one-on-one presentations (that are subject to the Advertising Rule) that advertised performance results did not reflect the deduction of advisory fees and that client returns would be diminished by such fees and other expenses.
- **Misleading Claim of Compliance with Voluntary Performance Standards.** Advertisements the staff believe contained misleading claims of compliance with voluntary performance standards, or lack of explanation and disclosure. For example, advisers claimed that their advertised performance results complied with a certain voluntary performance standard, when it was not clear to staff that the advertised performance results adhered to the performance standard's guidelines.
- **Cherry-Picked Profitable Stock Selections.** Advertisements the staff believe contain cherry-picked stock selections. For example, advisers that included only profitable stock selections or recommendations in presentations, client newsletters, or on their websites, without meeting the conditions set forth in Subsection (a)(2) of the Advertising Rule.
- **Misleading Selection of Recommendations.** Advertisements the staff believe contain misleading selections of investment recommendations. For example, advisers that disclosed past specific investment recommendations that may have been misleading because they included only a limited amount of recommendations, in order to illustrate a particular

THIS MONTH'S RESOURCE: ADVERTISING REVIEW

investment strategy, and they did not meet the conditions set forth in Subsection (a)(2) of the Advertising Rule.

- **Compliance Policies and Procedures.** Advisers that did not appear to have compliance policies and procedures reasonably designed to prevent deficient advertising practices. For example, advisers that did not have, or did not implement, policies and procedures pertaining to the following issues: the process for reviewing and approving advertising materials prior to their publication or dissemination; when using composites, determining the parameters for which accounts were included or excluded from performance calculations; and confirming the accuracy of performance results in compliance with the Advertising Rule.
- **Awards, Ranking Lists, Professional Designations.** OCIE launched the Touting Initiative in 2016 to examine the adequacy of disclosures that advisers provided to their clients when touting awards, promoting ranking lists, and/or identifying professional designations (collectively “accolades”) in their marketing materials. OCIE launched its Touting Initiative in response to the regularity with which staff encounters advisers that advertise these accolades without disclosing material facts about them.
- **Misleading Use of Third-Party Rankings or Awards.** Advertisements containing the potentially misleading use of third-party rankings or awards. Advisers that published potentially misleading advertisements containing references to awards or rankings conferred by third parties that failed to disclose facts, which staff believes were material under the circumstances, about such awards or rankings. For example:
 - Published marketing materials that referenced stale rankings or evaluation information, thus potentially misrepresenting the adviser’s current status. For example, advertisements that referred to advisers receiving high rankings in various publications, but those publications were issued several years prior, and the rankings were no longer applicable.
 - Published potentially misleading advertisements that did not disclose the relevant selection criteria for the awards or rankings, or who created and conducted the survey and the fact that advisers paid a fee to participate in or distribute survey results.
- **Misleading Use of Professional Designations.** Advertisements and disclosures made in advisers’ Form ADV Part 2B Brochure Supplements that contained potentially false or misleading references to employee professional designations, such as references to professional designations that have lapsed, or did not explain the minimum qualifications required to attain such designations.
 - See Item 2 of Form ADV Part 2B Brochure Supplement (Educational Background and Business Experience), which states that the adviser may list any professional designations held by a supervised person, but if the adviser does so, the adviser must provide a sufficient explanation of the minimum qualifications required for each designation to allow clients to understand the value of the designation.
- **Testimonials.** Advisers that had published statements of clients attesting to their services or otherwise endorsing the adviser that may be prohibited testimonials (e.g., client endorsements published in firm websites, social media pages, reprints of third party articles, or pitch books).

MORE TIPS TO WATCH FOR WHEN REVIEWING ADVERTISING

- **Superlative Statements.** The use of certain words or statements may be considered false and misleading to clients if the terms are not adequately defined or substantiated. Such statements may lead clients to infer something about the adviser’s capabilities which may be unwarranted or unsubstantiated. For example, a prospective client may conclude erroneously that comparable investment opportunities cannot be found elsewhere.
 - ❑ **CCO TIP:** Be on the lookout for words considered to be superlative - **unique, best in class, one-of-a-kind, expert, world-class, etc.**
 - ❑ **CCO Tip:** Avoid statements that cannot be substantiated.
- **Fiduciary Breach.** The adviser breached its fiduciary duty in violation of Section 206 when the adviser operated in a manner that resulted in clients incurring additional and unnecessary expenses, while the adviser and/or its IARs generated additional revenue, and transacted in investments that may have been unsuitable given stated client

THIS MONTH'S RESOURCE: ADVERTISING REVIEW

investment objectives and risk tolerances, while the adviser failed to disclose material information regarding these arrangements.

- CCO TIP:** Review all revenue sharing arrangements and/or outside business activities and verify all arrangements have been **fully disclosed on Part 1, Part 2A, Form CRS (if applicable), U4, and 2B**
- **Double Dipping.** The adviser represented that it was the adviser's intention not to charge investment advisory fees for the first three years on alternative investments for which it's IARs had previously earned a commission. However, the adviser engaged in such double-charging of fees.
 - CCO TIP: Was a commission previously earned on a product recently where advisory fees are also being deducted?** Reach out to CRP for a copy of the Double Dipping Form for use in these scenarios.
- **Conflicts of Interest Disclosure.** The adviser failed to disclose material information to clients and potential clients regarding the significant conflicts of interest it faced when recommending alternative investments to clients. Specifically, the adviser failed to disclose that many of the alternative investments for which clients paid commissions were available to be purchased without a commission. The adviser also failed to disclose fee billing practices with respect to alternative investments for which clients also paid commission charges. Furthermore, the adviser failed to disclose what, if any, steps it would take to mitigate the potential conflicts of interest associated with IARs' ability to receive both commissions and advisory fees on alternative investments.
 - CCO TIP:** A recent reviews of conflicts was conducted when drafting Form CRS. **Be on the look-out for potential conflicts and the requirement to disclose on both Part 2A and Form CRS going forward.** Work with CRP to amend accordingly.
- **Failure to Adhere to Client's Risk Tolerance.** The adviser appears to have managed certain clients' accounts in a manner inconsistent with the client's stated objectives and risk tolerance. Most of these client accounts had "moderate" risk tolerances, which appears inconsistent with large holdings in illiquid, alternative investments, suggesting the adviser may not be managing their client accounts consistent with its fiduciary duty.
 - CCO TIP:** Complete quarterly review of client accounts and ensure the stated risk tolerance aligns with the account objectives and risk tolerance. Firms may use CRP's template Annual Client Review Certification to assist in the review and ensure investment objectives, risk tolerance, and client profiles stay aligned up to date.
- **IAR Trustee Relationships and Supervision.** The staff inquires on trustee relationships and how the firm knows if an IAR is a trustee of an account. The staff needs policies in place to ensure IARs disclose any trustee relationships. Furthermore, the adviser then must have procedures in place to ensure the policy is followed.
 - CCO TIP:** Train your IARs on the Firm's Trustee policy - advisers are not allowed to be trustees on client accounts, except for prior personal relationships, i.e. family related accounts. Annual Compliance Certifications assist with this IAR attestation.
- **Rollovers.** When financial plans do not appear to include a comparison of fees and expenses between the existing plan in relation to the option recommended when an adviser provides recommendations to clients on both, in-service employer pension withdrawals and rollovers to individual retirement accounts that would be managed by adviser. Failure to provide full and fair disclosure on the benefits and consequences of these transactions raises concerns as to whether or not advisory clients has sufficient information to understand the recommendations and ensure its in the best interest of the client. The staff felt that by not including a comparison of fees and expenses the adviser's duty to act in the best interest of its clients was questioned.
 - CCO TIP:** Refer to CRP's rollover rationale form included in our latest TMIC September 2020 publication.
- **Use of "may" in the Form ADV, Part 2A.** The adviser states that **services** "may include...." The staff believes the term "may" is ambiguous and does not provide certainty as to what specific services a client could expect to receive.
 - CCO TIP:** Avoid use of "may" in all disclosure material.

REFER TO A SAMPLE ADVERTISING CHECKLIST INCLUDED IN TMR. BE SURE TO TAILOR TO YOUR FIRM!

NO FURTHER UPDATES FOR PROPOSED SEC RULES ON ADVERTISING...WE WILL KEEP YOU INFORMED WHEN ANY UPDATES ARE RELEASED.