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Marketing Rule Charges for Testimonials and Endorsements, Third-party Ratings, and Substantiation

By Jeremy McCamic

On September 9, 2024, the Securities and Exchange Commission ("SEC") announced settled charges against nine registered investment advisers for violations of Rule 206(4)-1 under the Investment Advisers Act of 1940 (the "Marketing Rule").[1] These enforcement actions under the Marketing Rule are the first actions unrelated to hypothetical performance since the rule's adoption on November 4, 2022. Instead, these actions reveal how the SEC is interpreting two of the thorniest issues the new Marketing Rule presented: (1) third-party promotion, in the form of testimonials, endorsements, and third-party ratings, and (2) substantiation. In a rulemaking that was heavy on principles and light on guidance, compliance programs now have some answers of how to make use of third-party promotion and proper substantiation of material claims. While many have commented on the need for more transparency, these latest crackdowns may provide sobering, if not shocking, instructions for the industry.

1. Testimonials and Endorsements

Ratings, rankings, and awards have all been in use for years, but the Marketing Rule allowed the industry to present testimonials and endorsements for the first time. Testimonials and endorsements make up the second prong of the rule's definition of advertisement[2]. Also, as defined, this third-party promotion covers solicitation and referral activities that had previously fallen under the now repealed and replaced Cash Solicitation Rule, Rule 206(4)-3 under the Investment Advisers Act of 1940. The change comes with statements about the investment adviser that are not tied to solicitation or referral efforts. Testimonials include any statement by a current client or investor in a private fund advised by the investment adviser about the client or investor's experience with the investment adviser or its supervised persons.[3] Endorsements include any statement by a person other than a current client or investor in a private fund advised by the investment adviser that 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.[4]

Testimonials and endorsements were heralded as one of the positives of the Marketing Rule upon its release, however there is a catch: significant disclosure requirements.[5] First, advertisements containing testimonials and endorsements must "clearly and prominently" disclose that the person giving the statement is a current client or investor or is a person other than a current client or investor, that compensation was provided, and a brief statement of any material conflicts of interest resulting from the investment advisers relationship with such person.[6] Additionally, the investment adviser must disclose the material terms of any compensation arrangement and make further disclosure of any material conflicts of interest due to the investment adviser's relationship with the person and/or the compensation arrangement.[7]

The Official Wealth Manager of Notre Dame Athletics

The first settled orders were due to an investment adviser failing to provide the required disclosures for an endorsement.[8] The investment adviser was described publicly as the "Official Wealth Management Partner of Notre Dame Athletics."[9] The SEC order redacted the name of the university, but these statements are still public, and since Notre Dame is one of the most iconic brands in collegiate sports, with televised games, regular broadcasts and enormous ticket sales, the SEC may have chosen to bring an enforcement action about this endorsement because of its extremely wide reach. The SEC found that the statement "Official Wealth Management Partner" constituted an endorsement because it was made by a person other than a current client and indicates approval, support, or recommendation. It was an advertisement because the endorsement was compensated. As such, clear and prominent disclosures are required.

The endorsement was directly and indirectly disseminated by the investment adviser and Notre Dame athletics on public websites, social media platforms, online videos, on physical objects like bags, and flags, and even on the jumbotron during games. To be compliant, disclosures of Notre Dame's non-client status, their compensation, and a brief statement of any conflicts of interest from the relationship with Notre Dame would need to be present on the jumbotron, the physical objects like bags and flags, and in all of the videos, social media posts and webpages. These disclosures were not present on many of the advertisements, and the investment adviser was ordered to pay a monetary penalty.

The investment adviser's website also contained a "Testimonials" page that contained quotes expressing positive views of the firm. One such statement was actually made by a former client, making it an endorsement under the rule. All of the statements on the webpage lacked clear and prominent disclosures, further violating Rule 206(4)-1(b)(1).

Clear and Prominent Disclosures

In the order, the SEC referenced the adopting release of the Marketing Rule[10] to emphasize that clear and prominent disclosures provide important context to the audience for weighing the relevance of a testimonial or endorsement. It would be expected that a statement from a current client would carry more weight than a statement from someone who had never been a client of the investment adviser. Likewise, the order quoted the adopting release to say the SEC staff "continue to believe this disclosure [of compensation] will provide investors with important context for weighing the relevance of the testimonial or endorsement."[11] With this in mind, firms must take disclosures into account when making use of testimonials and endorsements:

- **Provide Disclosures:** When a firm enters into a compensation agreement for a testimonial or endorsement, it should provide adequate disclosures and contractually require their clear and prominent presence in all disseminations in the compensation agreement itself. Train marketing and sales personnel to be aware of these needs and of the need to include compliance at the outset for any promotional relationships.

- **Monitor for Compliance:** If a firm disseminates or has third parties disseminate testimonials and endorsements, consider monitoring periodically for continued compliance. This monitoring is in addition to the initial marketing review. It can be documented to strengthen your compliance program. Compliance-approved materials will contain necessary disclosures, but a third party may not heed their importance. Checking a few public statements from a third party for disclosures is a good idea. Better yet, include a quality control clause in the compensation agreement.

- **Review Sponsorships and Public Relationships for Disclosure Risks:** Here, "Official Wealth Management Partner" was enough of a statement of approval for the statement to be an endorsement, but there are still questions on where the line is for a general statement to become one of approval, support or recommendation. Is "proud sponsor" enough? Does a public message of thanks for a

charitable gift include words of support? What about "official partner" without a reference to wealth management? These are open questions. The order should prompt compliance programs to review current relationships and public statements to see how the firm is described. A good deed should not create a bad examination.

If the compliance department is not looking out for these statements, be aware that the SEC is. Not only must firms indicate their use of testimonials and endorsements on the ADV Part 1, but the SEC Division of Examinations has been making broad requests for advertisements and other categories of communication to sample for proper use of disclosures.[12]

II. Third-Party Ratings, Rankings, and Awards

The most common violation out of the nine enforcement actions were missing disclosures for third-party ratings. More specifically, failing to disclose the date or time-period covered by the rating, ranking or award. Third-party ratings are another method of third-party promotion permitted under the Marketing Rule. Like promotion through testimonials and endorsements, third-party ratings require clear and prominent disclosures. Ratings must clearly and prominently disclose the date the rating was given and the period of time the rating was based on, the identity of the third party that made the rating, and, if applicable, that compensation was provided directly or indirectly by the investment adviser to the third party to obtain or use the rating.[13]

A positive of the rule is that this disclosure requirement simplifies questions over whether an old rating, ranking or award should be excluded for being out of date. If you have to include the date under the rule, the SEC staff believed this would "reduce the incentives of investment advisers to include third-party ratings that might be stale or otherwise misleading."[14] In practice, that has been true. In my own work with portfolio managers, I have encountered several instances of an old award from a manager's college days or early career being referenced on biographical pages and marketing presentations. When one manager understood that an old award would have to say "1999" at the end to survive marketing review, he decided it was not worth including. It is still listed on his CV with the date. In marketing presentations, it has been removed entirely.

The SEC observed that "information from an earlier period, may not reflect the current state of an investment adviser's business."[15] Inclusion of older ratings creates a risk of being "misleading without clear and prominent disclosure of the rating's date."[16] When the date is not included, the audience can get the wrong idea of the investment adviser's current accomplishments. If we are being honest, that is probably why they get left out. Whether it is the investment adviser, marketing personnel, or PR firms, the old date says yes, we attained this rating, and also says we have never attained it since. The following third-parting ratings present in advertisements were the basis of monetary penalties in the enforcement actions. See the date added in brackets and note how the message changes when the required disclosure is included where it belongs:

- Named one of *Fortune Magazine's* "All-Star Analysts" **[in 2001 and 2002]**[17]
- Named one of *Smart Money Magazine's* "Power 30" **[in 2002 and 2004]**[18]
- Pacesetter Impact Award from Schwab **[2007]**[19]
- Future 50 award winner from *Citywire RIA* **[2019]**[20]
- Top 300 Registered Investment Advisor from *The Financial Times* **[2020]**[21]
- *Barron's* Top Adviser **[2018]**[22]
- Named top manager for 14 consecutive years by the readers of *San Diego Magazine* **[undated, and firm could not substantiate that the manager achieved the rating for 14 consecutive years]**[23]
- Recognized by *Reuters AdvisePoint* as one of 500 "Top Advisers" in the United States **[2007]**[24]

Clear and Prominent Disclosures Redux

A missing date is very easy to prosecute. If a clear and prominent disclosure is required to be present and it is not there, you are in violation. For several firms the missing date was the only violation cited and the sole basis for a monetary penalty. Recall that under the Marketing Rule there are several disclosures that are held to the "clear and prominent" standard[25] (1)Testimonials and Endorsements, (2) Third-Party Ratings, (3) Net Performance, and (4) Predecessor Performance. Because these disclosures must be present, compliance programs must be able to review marketing and ensure these disclosures are not truncated, absent, or obscured behind a link. Mistakes in the presentations of these disclosures are easy to spot by the SEC. Marketing reviewers should be trained to look for these disclosures to avoid the costly error of leaving them out and facing a monetary penalty.

For third-party ratings to meet the clear and prominent standard, the date, the identity of the rater and a description of compensation must appear right next to the rating itself. The SEC pointed this out in the adopting release: "[i]n order to be clear and prominent, the disclosure must be at least as prominent as the third-party rating."[26] Firms I work with have been issued deficiencies for disclosures of the date, identity, or compensation information that are behind a link, or appear only on the landing page of a website, instead of on each page alongside the third-party rating. The Division of Examinations also indicated in a Risk Alert that presenting disclosures in an unreadable font on websites and videos would violate the prohibition against advertisements that are otherwise materially misleading.[27] Be careful. If your firm has drafted adequate disclosures, keep them in the same place as the third-party rating, in the same font, and you can be confident the disclosures are both clear and prominent.

III. Substantiation and Untrue Statements of Material Facts

The next most common charges were for substantiation and untrue statements of material facts. The second general prohibition under the Marketing Rule prohibits investment advisers from including in advertisements any material statement of fact that the investment adviser does not have a reasonable basis for believing it will be able to substantiate upon demand by the SEC staff.[28] Marketing reviewers have worked tirelessly to make sure opinions are called out with "we believe," "in our view," etc. Compliance programs have made the collection of data back-ups and supporting documentation part of the procedures around created marketing. The more superlative the statement, the more compliance programs have pushed for material to be saved down that substantiates that statement. While we have yet to see an SEC enforcement action on opinions stated as facts, these enforcement actions tackle another issue. Untrue statements cannot be substantiated.

Conflicts Need Context

Four investment advisers had advertisements that claimed the firm's advice or services are free of all conflicts of interest.[29] This could not be substantiated to the SEC's satisfaction because it simply is not true. In each action, the SEC staff pointed to Part 2A of Form ADV where each investment adviser disclosed a variety of conflicts of interest associated with providing advisory services. Looking at the statements in question, you can see where a claim of being free of all conflicts would catch the attention of the SEC:

- *"a true fiduciary that puts the client first by aligning incentives and* ***eliminating conflicts of*** interest"[30]
- *"serve[s] individuals and institutions independently,* ***with no conflict of*** interest"[31]
- *"provides clients with* ***conflict-free*** advice"[32]
- *"****free from conflicts of*** interest"[33]
- *"deliver an unbiased,* ***conflict-free****...level of service to our* clients"[34]

In each action, the SEC noted that context was not provided for the claim. Perhaps a reference to the base level conflicts in the firm's brochure or a softening from being completely free from conflict to having few conflicts would have saved these firms from a monetary penalty. No investment adviser has a reasonable basis to believe it can substantiate being free from all conflict. Advisers who charge a fee, are motivated by assets under management, can be at odds with clients due to industry activities and affiliations, can have conflicts with clients due to transactions, trading, and many other possible conflicts of interest. A firm could talk about how it mitigates its conflicts to put clients first or could demonstrate how its advice is independent. However, the SEC will not accept a claim that a firm is free from all conflicts, and no firm will be able to substantiate such a claim.

It would be wise to take to heart that a reasonable basis to substantiate a claim when demanded by the SEC must meet the SEC's interpretation of the claim and not that of the firm. The SEC and its staff have put time and effort into guidance, risk alerts, and instructions on the myriad ways firms must disclose conflicts. Claims of being "conflict-free" clearly hit a nerve. Similarly, in examinations I have been a part of, statements contrasting the fiduciary standard of advisers against the suitability standard of brokers were heavily scrutinized. The adviser referenced its requirements to disclose conflicts of interest in the ADV, and that it is regulated by the Advisers Act, implying that banks and brokers were only regulated by FINRA. The SEC examiners were quick to point out that brokers are regulated by the SEC too, not just FINRA, are held to disclosure requirements under Regulation Best Interest, and are regulated by the Securities and Exchange Act. The SEC examiners found these statements to be false and misleading. The firm revised its webpage with the offending comparison during the course of the exam, but the SEC examiners still issued a deficiency for these statements. If advertising makes use of regulatory language in an attempt to set the firm apart, decide whether you can substantiate the claim to the SEC's satisfaction.

Knowns and Unknowns

The enforcement actions also included simple, untrue statements of material fact. These misstatements can be a challenge for compliance programs and marketing reviewers that are unfamiliar with the facts surrounding a claim. Materiality is hard to pin down without context. Here are the original statements paired with some of the factual information the SEC used to label each a misstatement of a material fact:

Misstatement	Factual Information at Issue
"Top 12 Financial Advisor" [35]	Top **1200** Financial Advisor.[36]
"Top 100 Women's Advisor" [37]	Top 100 **Women Financial** Advisors.[38]
Named top manager "14 consecutive years"[39]	**Multiple years**, but the firm could not substantiate 14 consecutive years.[40]
Named "by the readers of *San Diego Magazine*"[41]	Selected by a **third-party company** hired by the magazine that did not incorporate input from readers.[42]
Purported membership in "Fiduciary Firm"[43]	"Fiduciary Firm" is **a non-existent**[44]**organization.**
Testimonial disclosed as from a "client"[45]	Testimonial is from a **former client** who no[46]longer has assets with the firm.

These untrue statements could stem from innocent mistakes like typos, bad revisions, or failures to review facts that become untrue over time. Rooting out misstatements is a challenge. Professional fact-checkers face this same challenge – how many times have politicians been found lying when they claimed to attend universities that the did not attend, claimed to be part of volleyball teams that do not exist, and claimed to be present for historical events when they were somewhere else at the time? Marketing reviewers will not know whether they are reading fact or fiction, but they can still protect the firm from violations.

- **Focus on Statements that Put the Firm or Personnel in a Good Light**: While the substantiation requirement made firms examine statements about strategies and products, these enforcement actions all focused on descriptions of the firm or personnel. Review your "about us" webpage, biographies of staff members, and general marketing. The more frequently a factual statement is used, the more important it is to fact-check it.
- **Test for Substantiation**: If documentation is not already saved down supporting a factual claim, sample current marketing and test the most conspicuous statements about the firm or personnel. Trust but verify. Even if senior personnel claim the accolades, see if documentation can be collected substantiating the claim.
- **Consistency is Key**: When you have approved language describing an element of your firm such as an award, keep to that same description. The statement "Top 100 Women's Advisor" was found to be a violation by the SEC where the award was actually for an individual named to the "Top 100 Women Financial Advisors." The SEC found that this "misstatement suggested the rating related to investment advice provided to women instead of an award for female investment advisers."[47] Fact-check initially and keep approved language consistent overtime.

Motivation

As difficult as it can be, compliance programs must comply with requirements for third-party promotion, in the form of testimonials, endorsements, and third-party ratings, and for substantiation where needed. Compliance programs should demand that authors of marketing substantiate their factual claims to make sure the firm has a reasonable basis that it truly can substantiate those claims when demanded by the SEC staff. Likewise, advertisements should be reviewed for accurate disclosures. If you anticipate having trouble getting buy-in on the marketing review process, the possibility of a monetary penalty for advertisements could be motivation.

Violations	Amount of Fine [48]	AUM of Firm [49]
Untrue claim of "conflict free" advice that could not be substantiated	$325,000	$4.2 billion
Failure to include date of Third-Party Ratings	$295,000	$5.2 billion
Failure to include date of Third-Party Ratings and Untrue statement of fact	$150,000	$1.68 billion
Failure to include clear and prominent disclosures for testimonials and/or endorsements	$90,000	$463 million
Untrue claim of "conflict free" advice that could not be substantiated	$85,000	$676 million
False statement that could not be substantiated and Untrue claim of "conflict free" advice that could not be substantiated	$85,000	$248 million
Failure to include date of Third-Party Ratings, and description of the rating's methodology that cannot be substantiated	$80,000	$399 million
Untrue claim of "conflict free" advice that could not be substantiated	$70,000	$345 million
Failure to include date of Third-Party Ratings	$60,000	$191 million

The amount of monetary penalties varied from firm to firm, but the size of the firm did seem to influence the calculation.

These latest enforcement actions make clear that investment advisers will be held to the requirements of the Marketing Rule. The SEC is looking for violations for multiple advertising issues. Now is the time to review your compliance program and procedures for marketing review. Make sure your team is aware of required

disclosures and has procedures to check for them every time they are necessary. Test factual statements and save supporting documentation. The industry has been asking for SEC guidance about the Marketing Rule. Now that we have these SEC enforcement actions, our compliance programs must adjust to the expectations of the SEC.

[1] *SEC CHARGES NINE INVESTMENT ADVISERS IN ONGOING SWEEP INTO MARKETING RULE VIOLATIONS* (2024, September 9). https://www.sec.gov/newsroom/press-releases/2024-121

[2] *17 CFR 275.206(4)-1(e)(1)(ii): An advertisement includes "[a]ny endorsement or testimonial for which an investment adviser provides compensation, directly or indirectly, but does not include any information contained in a statutory or regulatory notice, filing, or other required communication, provided that such information is reasonably designed to satisfy the requirements of such notice, filing, or other required communication."*

[3] *17 CFR 275.206(4)-1(d)(17)*

[4] *17 CFR 275.206(4)-1(d)(5)*

[5] *17 CFR 275.206(4)-1(b)(1)*

[6] *Id.*

[7] *Id.*

[8] Order- Howard Bailey Securities, LLC, at 2, https://www.sec.gov/files/litigation/admin/2024/ia-6681.pdf

[9][1] *HOWARD BAILEY FINANCIAL BECOMES OFFICIAL WEALTH MANAGEMENT PARTNER OF NOTRE DAME ATHLETICS* (2023, March 23).https://fightingirish.com/howard-bailey-financial-becomes-official-wealth-management-partner-of-notre-dame-athletics/

[10] *Marketing Rule Adopting-Release, at 92-93,* https://www.sec.gov/files/rules/final/2020/ia-5653.pdf

[11] *Marketing Rule Adopting-Release, at 94,* https://www.sec.gov/files/rules/final/2020/ia-5653.pdf

[12] *SAMPLE NEW EXAM ADVERTISING QUESTIONS* (2023, April 20). https://www.regcompliancewatch.com/sample-new-exam-advertising-questions/

[13] *17 CFR 275.206(4)-1(c)(2)*

[14] *Marketing Rule Adopting-Release, at 315,* https://www.sec.gov/files/rules/final/2020/ia-5653.pdf

[15] *Id.* at 162

[16] *Id.*

[17] Order- Richard Bernstein Advisors LLC., at 3, https://www.sec.gov/files/litigation/admin/2024/ia-6685.pdf

[18] *Id.*

[19] Order- Abacus Planning Group Inc., at 3, https://www.sec.gov/files/litigation/admin/2024/ia-6678.pdf

[20] *Id.*

[21] *Id.*

[22] Order- Beta Wealth Group Inc., at 3, https://www.sec.gov/files/litigation/admin/2024/ia-6684.pdf

[23] *Id.*

[24] Order- Professional Financial Strategies Inc., at 3, https://www.sec.gov/files/litigation/admin/2024/ia-6683.pdf

[25] *17 CFR 275.206(4)-1(b)(1), 17 CFR 275.206(4)-1(c)(2), 17 CFR 275.206(4)-1(d)(1)(i), 17 CFR 275.206(4)-1(d)(7)(iv), and 17 CFR 275.206(4)-1(d)(7)* (As a precaution, I would also add Hypothetical Performance to this list. While Hypothetical Performance does not have an explicit "clear and prominent" standard, a disclosure on the page indicating that the calculation is a hypothetical back-test for example, would keep the presentation from misleading the investor into believing it was actual performance).

[26] *Marketing Rule Adopting-Release, at 160,* https://www.sec.gov/files/rules/final/2020/ia-5653.pdf

[27] Initial Observations Regarding Advisers Act Marketing Rule Compliance, 2024, April 17, at 8, https://www.sec.gov/files/exams-risk-alert-marketing-observation-2024.pdf

[28] *17 CFR 275.206(4)-1(a)(2)*

[29] Order- Integrated Advisors Network LLC, https://www.sec.gov/files/litigation/admin/2024/ia-6682.pdf; Order- TS Bank d/b/a Callahan Financial Planning, https://www.sec.gov/files/litigation/admin/2024/ia-6686.pdf; Order- Droms Strauss Advisors, Inc,

https://www.sec.gov/files/litigation/admin/2024/ia-6680.pdf; Order- AZ Apice Capital Management LLC, https://www.sec.gov/files/litigation/admin/2024/ia-6679.pdf

[30] Order- Integrated Advisors Network LLC, at 3, https://www.sec.gov/files/litigation/admin/2024/ia-6682.pdf

[31]Order- TS Bank d/b/a Callahan Financial Planning, at 3, https://www.sec.gov/files/litigation/admin/2024/ia-6686.pdf

[32]Order- Droms Strauss Advisors, Inc, at 3, https://www.sec.gov/files/litigation/admin/2024/ia-6680.pdf

[33]Order- AZ Apice Capital Management LLC, at 3, https://www.sec.gov/files/litigation/admin/2024/ia-6679.pdf

[34]*Id.*

[35]Order- Abacus Planning Group Inc., at 3, https://www.sec.gov/files/litigation/admin/2024/ia-6678.pdf

[36]*Id.*

[37]*Id.*

[38]*Id.*

[39] Order- Beta Wealth Group Inc., at 2, https://www.sec.gov/files/litigation/admin/2024/ia-6684.pdf

[40]*Id.*

[41] Order- Beta Wealth Group Inc., at 3, https://www.sec.gov/files/litigation/admin/2024/ia-6684.pdf

[42]*Id.*

[43] Order- TS Bank d/b/a Callahan Financial Planning, at 2, https://www.sec.gov/files/litigation/admin/2024/ia-6686.pdf

[44]*Id.*

[45] Order- Howard Bailey Securities, LLC, at 4, https://www.sec.gov/files/litigation/admin/2024/ia-6681.pdf

[46]*Id.*

[47]Order- Abacus Planning Group Inc., at 3, https://www.sec.gov/files/litigation/admin/2024/ia-6678.pdf

[48]*SEC CHARGES NINE INVESTMENT ADVISERS IN ONGOING SWEEP INTO MARKETING RULE VIOLATIONS* (2024, September 9). https://www.sec.gov/newsroom/press-releases/2024-121

[49] In descending order: Order- Integrated Advisors Network LLC, at 3, https://www.sec.gov/files/litigation/admin/2024/ia-6682.pdf; Order- Richard Bernstein Advisors LLC., at 2, https://www.sec.gov/files/litigation/admin/2024/ia-6685.pdf; Order- Abacus Planning Group Inc., at 2, https://www.sec.gov/files/litigation/admin/2024/ia-6678.pdf; Order- Howard Bailey Securities, LLC, at 2, https://www.sec.gov/files/litigation/admin/2024/ia-6681.pdf; Order- Droms Strauss Advisors, Inc, at 2, https://www.sec.gov/files/litigation/admin/2024/ia-6680.pdf; Order- TS Bank d/b/a Callahan Financial Planning, at 2, https://www.sec.gov/files/litigation/admin/2024/ia-6686.pdf; Order- Beta Wealth Group Inc., at 2, https://www.sec.gov/files/litigation/admin/2024/ia-6684.pdf; Order- AZ Apice Capital Management LLC, at 2, https://www.sec.gov/files/litigation/admin/2024/ia-6679.pdf; Order- Professional Financial Strategies Inc., at 2, https://www.sec.gov/files/litigation/admin/2024/ia-6683.pdf

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