

Let's Go Crazy¹ – A Princely Look at How the SEC's New Marketing Rule Impacts Solicitors and State Licensing and Registration

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Dearly beloved [compliance officers]
 We are gathered here today
 To get through this thing called “life” [and the investment adviser marketing regime]
 Electric word, life advertising
 It’s been means around forever since the 1960s and that’s a mighty long time
 But I’m here to tell you there’s something else
 The afterworld new SEC Marketing Rule
 A world of never-ending happiness [well—at least it’s much better than the old rule]
 You can always see the sun, day or night, and testimonials and endorsements are now okay
 So when you call up that shrink old solicitor in Beverly Hills
 You know the one, Dr. Everything’ll-Be-Alright-So-Long-As-I’m-Properly-Licensed-To-Receive-This-Referral-Fee
 Instead of asking him how much of your time is left he gets paid for this referral
 Ask him how much of your mind does he even need to be registered, babe
 ‘Cause in this life
 Things are much harder than in the afterworld [unless you understand the new Marketing Rule]
 In this life
 You’re on your own [Nah, don’t worry, the NSCP has your back]
 And if de-elevator tries to bring you down
 Go crazy (Punch a higher floor) [and call up this special Marketing Rule edition of Currents]

In addition to being a generational musical talent and transformative artist, singer, guitarist, songwriter, producer, dancer, and performer, Prince Rogers Nelson (aka Prince, The Artist Formerly Known as Prince, and The Artist) was truly “best-in-class” when it came to marketing, even turning his name into a symbol.²

As a tribute to Prince then, we endeavor to explore the nuances of the new SEC Marketing Rule, and in particular, the issues and challenges surrounding how the Marketing Rule impacts solicitors, state licensing and registration requirements. So put on your brightest Raspberry Beret³ and let’s dive into the Controversy⁴ with a quick history lesson.

D.M.S.R.⁵ – ‘Dat Main Solicitor Regime⁶

The prior Cash Solicitation Rule articulated that an adviser could only pay a cash fee to a person in return for client referrals if the adviser complied with the requirements of Rule 206(4)-3. Those requirements stated in relevant part: (1) the adviser must be **registered**; (2) the solicitor could **not be subject to statutory disqualification**; (3) the fee is paid pursuant to a **written agreement**; (4) **for third party solicitors**, they **must provide written disclosures and a copy of the adviser’s brochure**; and (5) prior to or at the time of entering into a signed advisory agreement, the adviser must receive a **signed and dated acknowledgement from the client** indicating they received the adviser’s brochure and solicitor’s written disclosure document. Exciting, exciting stuff. Not Starfish and Coffee⁷ good, but you know—nice.

1. <https://www.youtube.com/watch?v=eCM2dEWGf-o>.

2. It’s very unclear whether Prince cared about SEC marketing and advertising compliance. Basically, we think Prince is awesome, and we like compliance, so we combined the two. The end.

3. https://www.youtube.com/watch?v=l7vRSu_wsNc.

4. <https://www.youtube.com/watch?v=4gazNwzC4H0>.

5. https://www.youtube.com/watch?v=n_YPtrOe4G8.

6. The actual acronym stands for something else, but we needed a title for this section. See footnote 1.

7. <https://www.youtube.com/watch?v=TG4PqmShvHI>.

After being approved in December 2020 and hitting the Federal Register in March 2021, the **new SEC Marketing Rule** (Marketing Rule) officially became effective on May 4, 2021 and merged and replaced the existing Advertising and Cash Solicitation Rules. When coupled with the removal of prohibitions against testimonials and endorsements, the Marketing Rule effectively reestablished many of the previous guideposts on the marketing, solicitation, and promotional activity of all SEC-registered investment advisers. Under the Marketing Rule, solicitation activities are now regulated as “testimonials” and “endorsements” to the extent they fall within the rule’s new definition of an “advertisement.”⁸ Generally, a compensated testimonial or endorsement will meet the definition of “advertisement.” By contrast, for an uncompensated testimonial or endorsement to be considered an “advertisement,” the communication must be made orally or in writing, to one or more persons, and must offer the investment adviser’s investment advisory services. For any communications falling within the definition of an “advertisement,” the adviser must comply with the rule’s conditions for such communications.⁹

Essentially, the requirements of the Marketing Rule cover communications from both traditional “solicitors” as well as a new, much broader set of individuals known as “promoters.” In the commentary to the final rule release, the SEC referred to this dynamic as follows: “While we traditionally referred to those who engaged in compensated solicitation activity under the current solicitation rule as “solicitors,” we use the term “promoter” in this release to refer to a person providing a testimonial or endorsement, whether compensated or uncompensated.” We will also use the term “provider” at times when discussing a person providing an uncompensated testimonial or endorsement.”¹⁰ Furthermore, the promotional activities being performed by these promoters (or the subset group of solicitors) now includes the solicitation of private fund investors (rather than just the conventional investment advisory clients).

All of these new requirements beg the question, what happens to the prior regulatory framework applicable to solicitors, both at the state and federal level? Will certain solicitation activities previously requiring state licensing and registration now be considered exempt, so long as such activities are properly disclosed and supervised? To answer these questions and help set the table, let’s talk a bit about testimonials and endorsements.

Nothing Compares 2 U¹¹ – A Brief Look at Testimonials and Endorsements

The definition of testimonials appears to be very straightforward--any statement by a current client or investor in a private fund advised by the investment adviser either (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 or investor to be a client of, or an investor in a

8. Under the Marketing Rule, “advertisement” means:

(i) Any direct or indirect communication an investment adviser makes to more than one person, or to one or more persons if the communication includes hypothetical performance, that offers the investment adviser’s investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the investment adviser or offers new investment advisory services with regard to securities to current clients or investors in a private fund advised by the investment adviser, but does not include:

(A) Extemporaneous, live, oral communications;

(B) 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; or

(C) A communication that includes hypothetical performance that is provided:

(1) In response to an unsolicited request for such information from a prospective or current client or investor in a private fund advised by the investment adviser; or

(2) To a prospective or current investor in a private fund advised by the investment adviser in a one-on-one communication; and

(ii) Any 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.

9. Under the old Advertising and Cash Solicitation Rules, if a paid blogger and adviser satisfied the requirements of the Cash Solicitation Rule, technically a blogger could be paid for referring clients by having a hyperlink to the adviser’s website in or near a favorable blog post about the adviser. As long as the adviser did not involve itself in the preparation of the information in the blog (entanglement) and did not explicitly or implicitly endorse or approve the information in the blog after its publication (adoption), the blog would not necessarily fall within the old definition of “advertisement,” and therefore would not necessarily be a prohibited testimonial. Under the Marketing Rule, however, a positive blog that indirectly solicits clients for an adviser who compensates the blogger for such referrals would fall within the definition of an “advertisement” and must comply with the rule’s conditions and prohibitions.

10. <https://www.sec.gov/rules/final/2020/ia-5653.pdf>, page 8, Footnote #6.

11. <https://www.youtube.com/watch?v=cpGA0azFdCs>.

private fund advised by, the investment adviser; or (iii) that 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.

Endorsements, however, appear to cover a much broader set of promotional activities and include statements by people other than current clients or private fund investors that indicate approval, support, or recommendation of the adviser or describe their experience with the adviser.¹² Under the Marketing Rule, an “endorsement” includes 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;
- 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
- 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.¹³

Beyond the plain text of the definition, though, the SEC includes as endorsements:

- Opinions or statements by persons about the investment advisory expertise or capabilities of the adviser or its supervised persons;
- Statements about an adviser or its supervised person’s qualities (e.g., trustworthiness, diligence, or judgment); and
- Statements about an adviser or its supervised person’s expertise or capabilities in other contexts, when the statements suggest that the qualities, capabilities, or expertise are relevant to the advertised investment advisory services.¹⁴

Notably, the adopting release is silent as to the meaning of the term “support,” which leaves the door open for the SEC to broadly construe it to mean any activity that could implicitly subject the prospect to any bias on the part of such endorser.

The SEC declined to provide exemptions from the definitions of testimonials and endorsements for the provision of impersonal investment advice, participants in refer-a-friend programs, publishers who create their own content (e.g., bloggers) and those who refer clients from networking relationships. The SEC did adopt partial exemptions for de minimis compensation, affiliated personnel, registered broker-dealers, and certain persons to the extent they are covered by rule 506(d) of Regulation D under the Securities Act with respect to a securities offering.¹⁵ In the final rule adopting release, the SEC also clarified that the following communications generally would not be treated as endorsements:

- Content prepared by and/or disseminated by a third-party marketing service or news publication paid by the adviser.
- A list containing the names and contact information of prospective investors sold by a non-investor to an adviser (without more activity) as long as neither seller nor the adviser indicates to any prospect the identity of such seller.

12. <https://www.sec.gov/rules/final/2020/ia-5653.pdf>, page 44.

13. Final rule 206(4)-1(e)(5)(i).

14. Adopting Release.

15. <https://www.sec.gov/rules/final/2020/ia-5653.pdf>, page 13.

Solicitors: Cash Solicitation Rule vs. New Marketing Rule

Old Rule	New Rule
Only cash payments allowed	Includes cash and non-cash, including gifts, fee rebates and fee waivers
No de minimis exemption	De minimis exception: no agreement required, can be “bad actors” – for compensation of less than \$1,000 for one year
Separate disclosure document signed by referred clients	Separate disclosure document not required and can be delivered orally (as long as recordkeeping requirements are met), but CLEAR and PROMINENT that endorsement is paid and conflict exists
Form ADV Brochure delivery required	Form ADV Brochure delivery not required
Written agreement required	Written agreement required (unless de minimis payment or specific affiliates providing endorsement)
Not applicable to private fund investments	Applies to private fund investments

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To Adopt or Not to Adopt the New Marketing Rule? The Question is a Sign O’ the Times¹⁷

All SEC registered investment advisers must comply with the Marketing Rule with respect to its advertising and solicitation activities by the November 4th, 2022 compliance date.

While early adoption of the Marketing Rule is permitted, it’s on an all-or-nothing basis. Advisers may not adopt the newly permitted marketing practices, such as the use of testimonials and endorsements, while still relying on the previous Cash Solicitation Rule. Advisers must continue to comply with the previous Advertising and Cash Solicitation Rules and look to the staff’s positions under those rules, until an adviser transitions to the Marketing Rule in its *entirety*.¹⁸

Advisers will need to review and update their current policies and procedures in light of the Marketing Rule before transitioning to the new rule. In addition, advisers should ensure their current policies and procedures are sufficient and effectively implemented to prevent violations under the previous versions of the Advertising and Cash Solicitation Rules until they transition to the Marketing Rule. Given the extended compliance period, it’s possible advisers with inadequate policies and procedures may find themselves engaging in marketing practices that are permitted under the Marketing Rule, but in violation of the previous rules. Indeed, SEC exams generally look *back* at a firm’s compliance over a period of time. Compliance should engage with their business teams on their intentions for taking advantage of the Marketing Rule’s expanded permissible marketing practices and make sure the firm is not gun-jumping adoption. There is still plenty of time for firms to be examined under the previous rules so Compliance must stay the course through transition. Depending on the facts and circumstances, the Division staff may view noncompliance during this compliance period as either a violation of the previous rules or noncompliant, partial and early adoption of the Marketing Rule, which may be six of one, half a dozen of the other when it comes to enforcement.

16. The chart was taken from the NSCP Webinar, “Sharing Solutions: Implementing the New SEC Marketing Rule.”

17. <https://www.youtube.com/watch?v=8EdxM72EZ94>.

18. <https://www.sec.gov/investment/marketing-faq>.

While many promoters acting as solicitors may find themselves subject to broker dealer or state investment adviser registration requirements, not all promoters will need to register. For SEC registered advisers, if the promoter is a supervised person under the control of the adviser (sometimes referred to as an “associated person” in the adopting release¹⁹), they do not need to separately register with the SEC as an investment adviser solely as a result of their endorsement of the adviser. If the promoter is not a supervised person under the control of an SEC registered investment adviser, providing an endorsement may trigger registration for providing advice to others as to the selection or retention of an investment manager or managers.²⁰ Even still, whether a promoter is an investment adviser also depends on whether they are *in the business* of providing investment advice. A person is *in the business* of providing investment advice if it:

- holds itself out as an investment adviser or as one who provides investment advice;
- receives any separate or additional compensation that represents a clearly definable charge for providing advice about securities, regardless of whether the compensation is separate from or included within any overall compensation, or receives transaction-based compensation if the client implements the advice; or
- on anything other than rare, isolated and non-periodic instances, provides specific investment advice, including a recommendation or analysis about specific securities or specific categories of securities.²¹

Indeed, a promoter may not fall within the definition of an investment adviser if the promoter gives only nonperiodic advice, provided that it receives no separate, additional or transaction-based compensation for performing such services and does not hold itself out as an investment adviser. If the promoter is soliciting an investor for a private investment vehicle (such as a hedge fund or private equity fund) with some regularity, the promoter could be participating in transactions of securities issued by the private investment vehicle at key points in the chain of distribution, which requires a broker dealer license. Promoters should check applicable state securities laws and FINRA rules to determine whether or not providing endorsements could trigger licensing requirements.

By way of example, the following quote from the adopting release does an excellent job of framing the concepts detailed above:

If the promoter is a supervised person of the adviser for which it is providing a testimonial or endorsement, the promoter does not need to separately register with the Commission as an investment adviser solely as a result of his or her activities as a promoter.²² A promoter also must determine whether it is subject to certain state law and certain FINRA rules, including any applicable state licensing requirements applicable to individuals.²³ To be clear, we are not making a presumption that a person providing an endorsement or testimonial meets the definition of investment adviser or broker-dealer and must register

19. <https://www.sec.gov/rules/final/2020/ia-5653.pdf>, Section II.A.3(e).

20. Not all solicitors provide investment advice. In its 1997 adopting release for the Cash Solicitation Rule, the SEC stated a person could be a solicitor within the meaning of the rule if he supplies the names of clients to an investment adviser, even if he does not specifically recommend to the client that he retain that adviser. See *Requirements Governing Payments of Cash Referral Fees by Investment Advisers*, Release No. 688, at n. 8 (July 12, 1979) [44 FR 42126 (Jul 18, 1979)].

21. See Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons who Provide Investment Advisory Services as a Component of Other Financial Services, Advisers Act Release No. 1092 (Oct. 8, 1987), at Section II.A.2. While there are exclusions from the definition of “investment adviser,” those exceptions are not likely to apply to endorser. For example, the “publishers’ exclusion under Advisers Act section 202(a)(1)(D), applies when there is a publication: (1) of a general and impersonal nature, in that the advice provided is not adapted to any specific portfolio or any client’s particular needs; (2) “bona fide” or genuine, in that it contains disinterested commentary and analysis as opposed to promotional material; and (3) of general and regular circulation, in that it is not timed to specific market activity or to events affecting, or having the ability to affect, the securities industry. However, endorsements would likely not meet the “bona fide” test as their intended nature is to be promotional, nor would the commentary be disinterested if the endorser received compensation.

22. An adviser’s registration with the Commission covers its supervised persons, provided that their advisory activities are undertaken on the adviser’s behalf.

23. Most states impose registration, licensing, or qualification requirements on investment adviser representatives who have a place of business in the state, regardless of whether the investment adviser is registered with the Commission or the state. See Staff of the U.S. Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Jan. 2011), available at <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>, at 86. See also rule 203A-3(a)(1) (definition of “investment adviser representative”). In some states, a third-party solicitor will be subject to state qualification requirements to the extent state investment adviser statutes apply to solicitors. See Release 1633, supra footnote 4, at text accompanying n.125.

under the Act or the Exchange Act, respectively. Nor are we making a presumption that such person may or may not be an associated person of a registered investment adviser. Indeed, we agree that some promoters may meet the definition of associated person of an investment adviser depending on the facts and circumstances.²⁴ Others may not.²⁵ Under the final Marketing Rule, if an adviser determines that a person providing an endorsement or testimonial is an associated person, the adviser should have requisite control of such person.²⁶

On a final note, while the Marketing Rule is final, we wouldn't party like it's 1999²⁷ just yet. The industry hasn't exactly received any Diamonds and Pearls²⁸ from the Staff when it comes to guidance on how to implement the Marketing Rule. For many CCOs trying their best to implement the rule without additional guidance, this is what it sounds like When Doves Cry.²⁹

We expect industry best practices to arise in general, but especially with respect to these challenging areas of the Marketing Rule needing further clarification. We also expect certain state securities regulators to review their current rules regarding the activities of solicitors and whether certain promoters should be subject to further regulation. Keep a look out for future editions of NSCP Currents to address these regulatory developments, and let us (help) guide you to the Purple Rain.³⁰ ■

24. See Nesler Comment Letter (arguing that an SEC-registered adviser should be entitled to treat a nonemployee solicitor as an "associated person" as long as the adviser exercises control and supervision over such solicitor in connection with the performance of its solicitation activities).

25. See Pickard Djinis Comment Letter (describing that solicitors that perform paid unscripted media campaigns on behalf of advisers, may not be under the adviser's control). Such a paid solicitor may not be a "person associated with the investment adviser," depending on the facts and circumstances.

26. See rule 204A-1(a) (requiring adviser codes of ethics that, among other things, require supervised persons to comply with applicable Federal securities laws).

27. <https://www.youtube.com/watch?v=rblt2EtFfC4>.

28. https://www.youtube.com/watch?v=hwUKR_9Xdns.

29. <https://www.youtube.com/watch?v=UG3VcCAIUgE>. Sorry, we had to. You understand. Please note, we don't actually know what it sounds like when doves cry.

30. https://www.youtube.com/watch?v=TvnYmWpD_T8.