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Investment Data Compliance: Revised SEC Advertising and Marketing Guidelines for 2021 and Beyond

By Richard Jackson, CIMA®, and Daniel Quinn



INVESTMENTS & WEALTH INSTITUTE®

Investment Data Compliance

REVISED SEC ADVERTISING AND MARKETING GUIDELINES FOR 2021 AND BEYOND

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In December 2020, the Securities and Exchange Commission (SEC) issued its final revised rules governing investment management advertising and marketing under the Investment Advisers Act of 1940.¹ These new rules encompass a broad cross-section of marketing and advertising for investment managers. This article focuses on three key areas: investment data, testimonials, and social media.

It is important to recognize that the final rules have yet to be published in the *Federal Register*. Once they are, firms have 18 months to align their compliance functions with the new regulations. During this time, you should consider these new regulations carefully and work to develop a compliance strategy that ensures your firm stays out of the SEC's crosshairs.

The changes were first presented in December 2019, when, in a long overdue move, the SEC released proposed changes to its decades-old rules governing advertising and marketing for the investment management industry. After a year of comment and review, the SEC released the final rules.

Regulators have long struggled to apply the original rules (many of which were written in the late 1980s/early 1990s) to the world of the internet and social media. The problem was made even worse by fundamental changes over the past 30 years to the investment management industry itself. Advertising and marketing regulations written for the

Kennedy and Reagan eras no longer seemed sufficient, which brings us to today.

OLD RULES

Under the prior rules, advertising was viewed through an old-school lens focused on written communications, broadcast television, and radio advertising. Firms were prohibited from using client testimonials in these ads, as well as making any statement or claim that was “fraudulent, deceptive, or manipulative and, accordingly ... misleading.”

These old rules applied to four *per se* prohibitions:

- Testimonials concerning the investment advisor or its services
- Direct or indirect references to specific profitable recommendations that the investment advisor has made in the past
- Representing that any graph or other illustration can, by itself, be used to determine what to buy and sell or when
- Any implication that a product or service is offered free of charge if it's not, in fact, free of charge and without any obligations

When combined with the prohibitions against deceptiveness, these four prohibitions served as the tentpoles of the SEC's regulatory framework for advertising and marketing.

However, the concerns these prohibitions were instituted to combat still

exist; and in many ways they are even more pressing today, given the increasingly decentralized nature of the investment management industry.

After all, it was the decentralization of the investment industry that rendered the enforcement of these prohibitions unworkable.

How was the SEC able to reconcile these important concerns for investors' safety with a clear need to adapt to changing times and stay relevant into the future?

NEW RULES: ADVERTISING REDEFINED

The SEC's new rules seek to replace the four *per se* prohibitions with a series of broad, principles-based guidelines that, regulators believe, will provide the necessary flexibility as both technology and the industry continue to evolve.

An important change in the new rules is a redefinition of what constitutes advertising. In a change from the proposed rules, the SEC opted for a multifaceted definition that defines advertising as “direct and indirect communications” and/or “endorsements” and “testimonials” (which had been covered under the old Cash Solicitation Rule).

Direct and indirect communications.

These include any communication an investment advisor makes to more than one person (or to one or more persons if the communication includes the use of hypothetical performance), that offers investment advisory services or new

investment advisory services to current clients or investors. This expressly excludes: extemporaneous, live, oral communications; information contained in a statutory or regulatory filing; and various types of communications or situations where hypothetical performance is provided.

Endorsements and testimonials. A compensated testimonial or endorsement (both newly defined terms) will be considered an advertisement regardless of whether the communication is made orally or in writing, and regardless of whether it is delivered to one or more persons. In an expansion of the current rule, “compensation” will now include both cash and non-cash compensation, whether made directly or indirectly by an advisor.

A flexible definition. Importantly, the SEC is broadening the understanding of advertising dissemination. Seeking to expand beyond simple definitions that had in the past been limited to print and broadcast ads, the new guidance views dissemination much more expansively in hopes of maintaining future flexibility as technology continues to evolve.

NEW RULES: SEVEN PROHIBITED PRACTICES

The SEC also has described seven categories of prohibited practices. In keeping with the spirit of the new regulations, they are broadly written and designed to help these rules keep pace with technology and changes within the industry. The seven general prohibitions include:

Material misstatements or material omissions. An advertisement may not include any untrue statement of a material fact or omit anything the inclusion of which would make the ad misleading.

Making statements that cannot be substantiated upon SEC demand. You might find yourself in compliance trouble if you can’t prove the veracity of an advertisement during an audit.

Statements that are materially misleading under reasonable context or circumstance. Spin might work in politics, but it’s not allowed in investment management advertising or in an SEC audit. Be mindful.

Discussions of potential benefits to clients and investors that are not fair and balanced. An advertisement may not discuss any potential benefits to clients or investors connected with or resulting from the investment advisor’s services or methods of operation without also providing fair and balanced treatment of any material risks or limitations associated with the potential benefits. In short, you must speak to the risks as well as the benefits.

References to investment advice that are not presented in a fair and balanced manner. In other words, no cherry-picking of favorable investment results to market your products and services. This general prohibition replaces the current advertising rule’s specific ban on “past specific recommendations” and replaces it with a more principles-based approach.

Includes or excludes performance results that are not fair and balanced. An advertisement may not include or exclude performance results or present performance time periods in a manner that is misleading.

Anything otherwise materially misleading. This is a catch-all provision designed to ensure that even when the sum of the parts might be compliant, the SEC can act if the result is misleading.

It is important to remember this is only a summary of the new SEC rules. Our focus here is to help investment managers understand what these new rules mean for their marketing efforts.

USING SOCIAL MEDIA IN ADVERTISING

Perhaps the most confusing application of the old rules has been with social

media. However, the new rules do help clarify a few important issues around social media and investment management advertising.

As noted above, the new principles-based approach, which is designed to provide the SEC with flexibility, is not as helpful to managers as a specific list of restrictions. The SEC also has chosen to take what it is calling a “facts and circumstances” approach to certain scenarios.

Although there always may be ambiguity around social media advertising, we can identify the following key issues to prepare for:

- Because social media posts fall under the direct communications rule, they are considered advertising and must be compliant with SEC rules. Likes and comments in the Facebook age are not advertising, unless the advisor curates responses or otherwise edits, encourages, or affects the messaging in a way that benefits the manager.
- Employee social media posts might fall under the advertising rule unless the manager has explicit rules in place that prohibit employees from using their accounts for corporate promotion.

DATA MARKETING AND THE NEW SEC RULES

When we speak of data marketing, we mean use of the data generated by an investment manager’s operations to attract and retain clients. It can be both quantitative (returns, portfolio alpha, standard deviation, upside/downside capture) and qualitative (descriptions of your philosophy, process, people, and products).

So, data marketing is a constituent piece of a firm’s broader marketing strategy. Data is published (or distributed, if you prefer) to various channels, including a firm’s website, fact sheets, pitch books, and client communications.

But the most powerful place for this data to be published is in the investment databases, which makes it also the most fraught for non-compliance with the new rules.

The public databases, such as Morningstar, eVestment, Investment Metrics, and PSN, sell access to manager data alongside robust analytical tools that help their subscribers in the due diligence process.

The private databases, such as Mercer and Callan, use the data and their analytical tools internally on behalf of their consulting clients.

Think of the databases as a place with parts of thousands of requests for proposals (RFPs), updated regularly, that can be sorted and searched by hundreds of different data points in nearly limitless combinations.

Looking at database marketing within this context, the application of the new SEC rules starts to become clear. After all, over the past five to 10 years these databases have become the essential due diligence tool for consultants, institutions, and high-net-worth individuals.

These new proposed regulations likely will have a significant impact on how the SEC generally looks at investment data and what firms have specifically published in the investment databases.

INVESTMENT DATABASES ARE ADVERTISING

Because the investment databases should contain the qualitative and quantitative data that best helps managers tell their stories clearly, effectively, and truthfully, we will use it as a proxy for other marketing collateral (fact sheets, pitch books, website content, etc.) as well.

Investment data helps subscribers to make or support their decisions to hire specific investment advisors—that's marketing.

As always, the highest regulatory scrutiny is given to information provided by investment managers that influences this decision-making process.

Note that most, if not all, investment databases provide a disclaimer to their users that they do not ensure the accuracy of the data that firms have provided on their platforms, which emphasizes a firm's compliance responsibility when it comes to the accuracy and consistency of the data presented.

In the past, we have written articles highlighting some very strong anecdotal evidence that the SEC had been considering published data to be advertising. In conversations with investigators during audits, some managers described the auditors' beliefs that investment data should be a compliance issue to which investment management firms should pay attention:

... [D]uring our SEC review, the examiners made it clear that consultant databases would generally be considered advertising, especially if this was an avenue through which you obtained new clients.

and

During a recent SEC exam, the SEC staff asked about our advertising/marketing policies and procedures as it related to the consultant databases.

Later they verbally commented that we should ensure that we are complying with these policies and that we should be monitoring the information that is viewable on these databases.

They all but said that the databases should be considered advertising.

Now, we have proof in the new rules. In footnote 37 on page 18 of the SEC release, the agency specifically states:

... In the Matter of Profitek, Inc. ... The Commission brought an enforcement action against an investment adviser, asserting that it directly or indirectly distributed materially false and misleading advertisements, including by submitting performance information in questionnaires submitted to online databases that were made available to subscribers nationwide ...

Furthermore, the SEC writes:

We believe communications that investment advisers use to offer their advisory services have an equal potential to mislead—and should be subject to the rule—regardless of whether the adviser communicates directly or indirectly through a third party, such as a consultant, intermediary, or related person.

This is a clear-as-a-bell notice that what's published in the databases, in fact sheets and pitchbooks, and on the website is subject to strict regulatory scrutiny, and should thus be considered advertising in light of the new SEC definitions.

IMPORTANCE OF DATA MANAGEMENT UNDER THE NEW RECORDKEEPING RULE

Missing in this discussion thus far is any mention of the SEC's new record-keeping rules. They are quite extensive, and it is beyond the scope of this article to discuss them in a comprehensive way. But as far as investment data marketing is concerned, here are few of the relevant regulations:

- Investment advisors must make and keep records of all advertisements they disseminate (the old rule required only those advertisements sent to 10 or more people).
- The final rule requires advisors to maintain and preserve these records

“in an easily accessible place for a period of not less than five years.”

- Advisors must keep all requisite records to ensure compliance with the new rules surrounding the use of “hypothetical returns” in advertising (for a great recordkeeper this should not be an issue).

The new recordkeeping rule requires advisors to retain all accounts, books, internal working papers, and other documents necessary to demonstrate the calculation of performance. As such, we recommend keeping drafts of your narratives as well.

The final rule will require advisors to maintain documentation of communications relating to predecessor performance. If your firm was bought or sold, and the new entity wants to use since-inception performance, ensure that you retain appropriate documentation to substantiate these displays of predecessor performance.

Don't forget about the narratives. Each of these is a potential compliance landmine:

- How have you been describing yourself?
- Who have your employees been?
- Are you marketing their work as predecessor performance?
- How has your investment philosophy, process, etc. changed over time?

A comprehensive data management system is thus an essential best practice.

MARKETING YOUR ONE-, FIVE-, AND 10-YEAR PERFORMANCE RESULTS

The new SEC rules also require a more consistent presentation of portfolio performance; one that is more like the Securities Act Rule 482, which governs most mutual fund and exchange-traded fund advertising.

In short, the new regulations require investment managers to present the one-, five-, and 10-year performance of a portfolio or composite (private funds are excluded from this requirement). Investment managers may choose to market other time periods as well, but they are required to have one-, five-, and 10-year performance.

Additionally, if a product has a record of less than 10 years, advertisers must include performance since the inception date.

Investment managers also must ensure that each performance period shares equal prominence in an advertisement and have an ending date no later than December 31 of the most recent year ended.

A consistent presentation of a product's track record will offer investors an apples-to-apples comparison between products from different firms, and when evaluating registered funds against advisory strategies.

As far as investment data is concerned, managers must be aware of these regulations. Investment management marketers must adhere to the one-, five-, and 10-year (or since-inception) track record rule, because it is one that regulators would quite easily be able to identify and use as a pretext for initiating an audit.

If five-year performance is stupendous, but 10-year performance is less so, managers cannot choose to omit the underperformance, which is a clear compliance violation.

THE IMPORTANCE OF RECONCILIATION IN AVOIDING MATERIALLY MISLEADING DATA

Managers publish data to the databases and create marketing collateral for two reasons: to attract and to retain clients. That's the definition of advertising. With these new rules, it's clear the SEC believes so as well. So how can

investment managers step up their investment data compliance strategies to comply with the new regulations and improve their data marketing?

In addition to recordkeeping, the first thing investment managers must do is invest the time to create a repeatable process for assembling and organizing investment data. A warehousing solution must then be devised, either through in-house development or by working with a trusted partner.

This is important because the only way to ensure that the data is correct is through a rigorous process of reconciliation. Effective reconciliation is impossible unless the data is organized and warehoused in a way that promotes said reconciliation.

Effective, timely reconciliation is almost impossible using Excel spreadsheets. With tabs spanning multiple years, long track records can become confusing and difficult to discern. For every one person a firm has working with the data, two more should be checking and rechecking the work under a do-it-yourself process such as this.

If this type of rigorous reconciliation is not something your firm is doing every quarter, errors will begin seeping into your data. These could include mistakes such as a misplaced decimal point (a minor keystroke error that can have profound consequences—think 1.75 percent versus 17.5 percent), publishing outdated firm information, and erroneous narratives.

Admittedly, errors usually are unintentional and easily explained away. However, keep in mind:

- The SEC's posture is that lack of compliance, regardless of intent, can be, and usually is, sanctioned.
- Your prospective clients are the ones who run a database screen, invest time and resources researching your

firm and adding it to a watchlist. If they find out later your data is incorrect and unreliable, it's highly unprofessional and reflects poorly on a firm's internal controls. And if a firm can't keep its data straight, what else cannot be trusted?

Firms can avoid these pitfalls easily with a professional data strategy and proper reconciliation of both marketing and compliance.

AN OUNCE OF PREVENTION

Investment managers may ask, "How can I protect my firm?"

The answer is clear—establish policies and procedures that require compliance professionals to review all published data, including narratives, both before and after distribution.

The trained eye of a compliance professional will be able to identify and anticipate inconsistencies and make sure they are remedied before being presented to database subscribers.

Like any compliance program, investment data compliance must be an ever-evolving business practice in which all existing data is checked. This ensures future changes to a firm's data strategy is vetted. A firm's marketing

compliance protocol must ensure that regulators are not the first to discover any inconsistencies.

SUMMARY

The new regulatory changes encompass a much broader spectrum of investment management marketing and advertising than we examined here.

For too long, investment data that is published in public and private investment databases, marketing collateral, and websites has been divorced from a firm's larger marketing strategy, which means that compliance hasn't been as involved in the management and marketing of investment data as is now required.

Here are a few things managers can do to ensure their database marketing strategies are optimized and compliant:

- Automate the process as much as possible; reduce human interaction with the data to promote accuracy and efficiency.
- Ensure all data published to the databases has been thoroughly reconciled and that there is a uniform, repeatable procedure in place for doing so every time new data is published.
- All published data must be current, accurate, reflective of the firm's

existing market position, and relevant to the needs of the type of database subscriber a manager wants to work with today.

Remember, the final rules have yet to be published in the *Federal Register*. Once they are published, firms will have 18 months to align their compliance functions with the new rules. Use this time wisely to both carefully consider these new regulations and develop a compliance strategy that ensures your firm stays out of the SEC's crosshairs. 🟡

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ENDNOTE

1. Investment Adviser Marketing, SEC Release No. IA-5653 (December 22, 2020), <https://www.sec.gov/rules/final/2020/ia-5653.pdf>.

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