



Testimonial Rule

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The SEC has brought several cases against registered investment advisers (“RIAs”) for violating Investment Advisers Act Rule 206(4)-1(a)(1), the Testimonial Rule.¹ A “testimonial” (which is not defined) is a type of “advertisement” which is broadly defined in clause (b) of the rule (see footnote 1). Testimonials are viewed by the SEC as *per se* misleading because they only discuss a favorable point of

¹ Investment Advisers Act Rule 206(4)-1 Advertisements by investment advisers:

(a) It shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Act (15 U.S.C. 80b-6(4)) for any investment adviser registered or required to be registered under section 203 of the Act (15 U.S.C. 80b-3), directly or indirectly, to publish, circulate, or distribute any advertisement:

(1) Which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or concerning any advice, analysis, report or other service rendered by such investment adviser; or

(2) Which refers, directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person: *Provided, however*, That this shall not prohibit an advertisement which sets out or offers to furnish a list of all recommendations made by such investment adviser within the immediately preceding period of not less than one year if such advertisement, and such list if it is furnished separately: (i) State the name of each such security recommended, the date and nature of each such recommendation (e.g., whether to buy, sell or hold), the market price at that time, the price at which the recommendation was to be acted upon, and the market price of each such security as of the most recent practicable date, and (ii) contain the following cautionary legend on the first page thereof in print or type as large as the largest print or type used in the body or text thereof: “it should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list”; or

(3) Which represents, directly or indirectly, that any graph, chart, formula or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents directly or indirectly, that any graph, chart, formula or other device being offered will assist any person in making his own decisions as to which securities to buy, sell, or when to buy or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use; or

(4) Which contains any statement to the effect that any report, analysis, or other service will be furnished free or without charge, unless such report, analysis or other service actually is or will be furnished entirely free and without any condition or obligation, directly or indirectly; or

(5) Which contains any untrue statement of a material fact, or which is otherwise false or misleading.

(b) For the purposes of this section the term *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 (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities.

view concerning the relevant RIA to the exclusion of negative views that may be held by certain other investors that are not quoted.

The SEC brought five cases² in July of 2018 and another case in September.³ The cases all involve public statements or videos by investors that were sanctioned by the relevant RIA. Statements by investors is the most risky type of testimonial; the rule, however, is not limited to testimonials by investors. It refers to any kind of testimonial which could be by anyone and it could refer to any type of service that an RIA renders, not just investment management services.

Given (i) the extremely broad nature of what the SEC could view as a testimonial, and (ii) the fact that the SEC is currently aggressively pursuing RIAs for violations of this rule, we suggest that RIAs carefully scrutinize any statements or quotations that are available to the public on a firm website or on any social media site that could be construed as a prohibited testimonial. This includes any statements that are made in a firm's marketing deck, pitch book or Due Diligence Questionnaire ("DDQ"). The fines for violating this rule have been relatively modest (\$10,000-\$200,000) but would have to be disclosed on Form ADV and in DDQs. This violation and resulting Form ADV disclosure could make an RIA ineligible for certain institutional investors and could be harmful to capital raising efforts.

Recent Cases:

In the Matter of Creative Planning, Inc., Advisers Act Release 5035 (September 18, 2018). See <https://www.sec.gov/litigation/admin/2018/ia-5035.pdf>. Creative Planning, Inc. ("CPI") purchased hundreds of radio announcements that contained prohibited client testimonials. A local radio host also became a CPI investor and praised CPI and his satisfaction with the advisory services he received during his radio program.

In the Matter of Romano Brothers & Company, Advisers Act Release 4965 (July 10, 2018). See <https://www.sec.gov/litigation/admin/2018/34-83613.pdf>. The adviser put investor testimonial videos on its website and on YouTube as part of its 50th anniversary celebration. The videos contained statements from dozens of investors indicating that the Romano Brothers provided them with income, security and peace of mind.

In the Matter of HBA Advisors, LLC, Advisers Act Release 4963 (July 10, 2018). See <https://www.sec.gov/litigation/admin/2018/ia-4963.pdf>. Investor testimonials were made available on various websites including Yelp and Facebook.

In the Matter of Brian S. Eyster, Advisers Act Release 4962 (July 10, 2018). See <https://www.sec.gov/litigation/admin/2018/ia-4962.pdf>. Eyster maintained a public website that advertised financial planning and advisory services and had testimonials by investors. The testimonials indicated that Eyster was, among other things, trustworthy and knowledgeable.

In the Matter of William M. Greenfield, Advisers Act Release 4961 (July 10, 2018). See <https://www.sec.gov/litigation/admin/2018/ia-4961.pdf>. The adviser maintained client testimonials on

² For the press release and links to the cases see <https://www.sec.gov/enforce/3-18586-90-s>.

³ For the press release and link to the case see <https://www.sec.gov/enforce/ia-5035-s>.

Google and Facebook. The public testimonials indicated that the adviser was trustworthy, provided a high level of service and helped clients to generate investment returns.

In the Matter of Leonard S. Schwartz, Advisers Act Release 4964 (July 10, 2018). See <https://www.sec.gov/litigation/admin/2018/ia-4964.pdf>. Schwartz created a business, Squeaky Clean Reputation Services, that solicited testimonials on behalf of certain RIAs. It is interesting to note that one adviser sent Schwartz the Testimonial Rule and asked him to cease and desist which he ignored.



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