

Insights

SEC RISK ALERT ON COMPLIANCE WITH THE MARKETING RULE- EXAMINATION OBSERVATIONS

Apr 26, 2024

On April 17, 2024, the Division of Examinations (the “Division”) of the Securities and Exchange Commission (the “SEC”) published a Risk Alert entitled: “Initial Observations Regarding Advisers Act Marketing Rule Compliance” (the “Alert”). This Alert reinforces prior Division publications^[1] that addressed SEC-registered investment advisers’ compliance with Rule 206(4)-1 (the “Marketing Rule”) under the Investment Advisers Act of 1940, as amended (the “Advisers Act”).

The Alert also follows recent settlements that resulted from an ongoing SEC enforcement sweep on compliance with the Marketing Rule (see our prior summaries, “SEC enforcement sweep regarding hypothetical performance” and “SEC enforcement sweep regarding hypothetical performance - round 2”). The Alert and such settlements provide valuable guidance on how advisers should review and enhance their policies and procedures in preparation of upcoming SEC staff examinations.

The Alert contains observations with respect to compliance with (1) items of the Marketing Rule pertaining to Rule 206(4)-7 under the Advisers Act (the “Compliance Rule”), Rule 204-2 under the Advisers Act (the “Books and Records Rule”) and certain disclosure requirements pertinent to Form ADV; and (2) the Marketing Rule’s general prohibitions^[2] (the “General Prohibitions”). We discuss each in turn.

OBSERVATIONS REGARDING COMPLIANCE RULE, BOOKS AND RECORDS RULE AND FORM ADV

COMPLIANCE RULE

With respect to the Compliance Rule, the Alert notes that advisers generally have updated their marketing policies and procedures in light of the Marketing Rule and have implemented pre-approval processes for advertisements. However, the staff has observed policies and procedures that:

- Consisted only of general descriptions and expectations related to the Marketing Rule.

- Did not address applicable marketing channels utilized by the advisers, such as websites and social media.
- Were informal rather than in writing.
- Were incomplete, not updated, or partially updated for certain applicable marketing topics.
- Were not tailored to address advisers' specific advertisements (*g.*, policies and procedures to address the General Prohibitions, and advertising requirements for testimonials, endorsements, and third-party ratings utilized by advisers in advertisements).
- Did not adequately address the preservation and maintenance of advertisements and related documents, such as copies of any questionnaires or surveys used in the preparation of a third-party rating (in the event the adviser has received such documents) included or appearing in any advertisement.
- Were updated to reflect the Marketing Rule but were not implemented. For example, the staff observed advisers' policies that required net of fees performance to be included with any performance advertisement; however, the staff observed those same advisers including only gross performance in advertisements.

BOOKS AND RECORDS RULE

With respect to the Books and Records Rule, the staff has observed that advisers typically have updated their policies and procedures to reflect Marketing Rule-related books and records maintenance and preservation requirements. Nevertheless, the staff observed Marketing Rule-related books and records deficiencies, including:

- Advisers completed questionnaires or surveys used in the preparation of a third-party rating but did not maintain a copy of such questionnaires.
- Advisers did not maintain copies of information posted to social media.
- Advisers did not maintain documentation to support performance claims included in advertisements.

FORM ADV

As for Form ADV, the Alert notes that in certain cases advisers failed to indicate that they published third-party ratings and actual or hypothetical performance results and did not accurately disclose matters relating to referral arrangements.

OBSERVATIONS REGARDING COMPLIANCE WITH THE MARKETING RULE'S GENERAL PROHIBITIONS

With respect to the General Prohibitions, the Alert identifies several deficiencies, specifically:

UNTRUE STATEMENTS OF MATERIAL FACT AND UNSUBSTANTIATED STATEMENTS OF MATERIAL FACT

- Advertisements stating that advisers were “free of conflicts” when actual conflicts existed.
- Advertisements stating material facts about the advisers’ businesses that were inaccurate, including: (1) statements that a network of personnel perform advisory services for clients when a sole individual performs such services; and (2) statements representing erroneous adviser personnel qualifications, such as their education, experience, and professional designations.
- Advertisements describing material facts about advisory services or products offered that were inaccurate, including: (1) referencing certain investment mandates of the advisers in advertisements when there were no such mandates used by the firms (*g.*, ESG mandates); (2) claiming that investment processes were validated by professional institutions when they were not; (3) stating that the adviser considered certain risk tolerances when recommending investment strategies when all clients were placed into the same strategy without consideration of risk tolerances; (4) referencing a list of approved securities that did not exist; (5) referencing formalized securities screening processes that did not exist; and (6) misrepresenting the advisers’ client base, such as describing the adviser as a “private fund adviser” when the firm did not advise any private funds.
- Advertisements publicizing the receipt of certain awards or accolades that were not received.

OMISSIONS OF MATERIAL FACT OR MISLEADING INFERENCE

- Advertisements contained statements that advisers were different from other advisers because they acted in the “best interest of clients,” without disclosing that all investment advisers have a fiduciary duty to act in their clients’ best interests.
- Advertisements recommended certain investments (*g.*, on podcasts or websites) without disclosing the conflicts of interest attributed to the compensation paid to or received by the advisers for such recommendations.
- Advertisements that contained untrue or misleading claims, such as: (1) stating that the advisers were “seen on” national media, implying appearances in national news media, without disclosing that the “appearances” were in fact paid advertisements; and (2) advertising images of celebrities in marketing materials in a manner that implied the celebrities endorsed the firms when such celebrities did not endorse the firms.

- Advertisements that contained untrue or misleading performance claims, including: (1) advertising cumulative profits that the advisers believed were not achievable or were impossible to achieve without unlimited money to invest; (2) presenting performance information that did not provide adequate disclosure regarding the share classes included in the performance returns; (3) using lower fees in calculations for net of fees performance returns than were offered to the intended audience; and (4) omitting material information regarding fees and expenses used in calculating returns.
- Advertisements cited SEC registration beyond factual statements as to advisers' registration status in a way to imply that SEC registration was representative of a particular level of skill or ability, or that the SEC had either approved or passed upon the advisers' business practices. The staff also observed advisers including the SEC logo on their websites with the purpose of implying that the websites or the advisers had been approved or endorsed by the SEC.
- Advertisements contained third-party ratings: (1) implying the advisers were the sole top recipients of certain awards when the awards went to multiple recipients or the advisers were not the top recipients; and (2) indicating that the advisers were highly rated by various organizations without disclosing that the methodologies for such ratings were based primarily or solely on factors that were not related to the quality of investment advice, such as assets under management, the number of clients, or that adviser personnel nominated fellow employees for such awards.
- Advertisements included testimonials that were misleading. For example, advisers included testimonials from clients of a third-party product on the advisers' websites without any disclosures explaining the context of the testimonials, implying that the testimonials were about the advisers' services rather than the third-party product.
- Performance advertisements contained information that was misleading, such as:
 - Benchmark index comparisons that did not define the index or provide sufficient context to enable an understanding of the basis for such comparison or disclose that the benchmark performance did not include reinvestment of dividends.
 - Performance presentations that contained: (1) outdated market data information only (*g.*, market data from more than five years prior); or (2) investment products that were no longer available to clients and included lower investment costs than were currently available.
 - Statements or presentations regarding: (1) advisers' performance track record with securities that were not purchased by the advisers in a similar manner in their clients' accounts; (2) claims that the advisers achieved above average performance results without clarifying that the advisers did not yet have clients or performance track records; and (3) investment recommendations containing performance information that did not include disclosures to provide context to the presentations, such as advertising performance during time periods

when most investors would have experienced the advertised performance returns because of general market performance.

FAIR AND BALANCED PRESENTATION

The Alert also identifies deficiencies in complying with the Marketing Rule's fair and balanced requirements, specifically (1) social media that focus on the potential benefits connected with the advisers' services or methods of operation without providing a fair and balanced treatment of any material risks or material limitations associated with such benefits; and (2) cherry-picking profitable investments, manipulation of time periods and presenting disclosures in unreadable fonts.

CONCLUSION

Registered investment advisers should review their own policies and procedures and advertisements in light of the specific, commonly observed deficiencies cited in the Alert.

[1] See, e.g., SEC Division of Examinations, [2024 Examination Priorities](#); SEC Division of Examinations, [2023 Examination Priorities](#); SEC Risk Alert: [Examinations Focused on Additional Areas of the Adviser Marketing Rule](#) (June 8, 2023); and SEC Risk Alert: [Examinations Focused on the New Investment Adviser Marketing Rule](#) (September 19, 2022).

[2] See Advisers Act, Rule 206(4)-1(a).

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