

Special Alert

April 24, 2024

SEC Division of Examinations Risk Alert: Initial Observations Regarding Advisers Act Marketing Rule Compliance



On April 17, 2024 the Securities and Exchange Commission (“SEC”) Division of Examinations (the “Division”) issued a Risk Alert regarding investment advisers’ compliance with amended Investment Advisers Act Rule 206(4)-1 (the “Marketing Rule”). The observations contained in the Risk Alert focus on the completion of Marketing Rule Items in Form ADV and promote compliance with Advisers Act Rule 206(4)-7 (the “Compliance Rule”), Advisers Act Rule 204-2 (the “Books and Records Rule”) as well as the Marketing Rule’s General Prohibitions.

Compliance Rule

In the Adopting Release for the Marketing Rule, the SEC says that advisers should address marketing practices in their policies and procedures under the Compliance Rule. Such policies and procedures should be reasonably designed and implemented to address compliance with the Marketing Rule.

The Division provides in the Risk Alert that in general, advisers updated their written policies and procedures to establish a process for reviewing advertisements, with many advisers requiring preapproval of advertisements before distribution. The Marketing Rule does not require preapproval of advertisements before distribution, and as provided in the Adopting Release for the Marketing Rule, advisers can address compliance through different policies and procedures, including reviewing a sample of advertisements based on risk or pre-approving templates.

In the Risk Alert, the Division provides observed examples of advisers' policies and procedures that were not reasonably designed or implemented to address compliance with the Marketing Rule. These examples include policies and procedures that:

- Consisted only of general descriptions and expectations related to the Marketing Rule;
- Did not address all relevant distribution channels, such as websites and social media;
- Were incomplete or otherwise not updated;
- Were not tailored to the advisers' advertising profile, e.g. did not address third-party ratings when such were utilized by an adviser;
- Did not adequately address the maintenance of required records; and
- Were not implemented.

Books and Records Rule

The Division provides the following examples of observed deficiencies relating to the Books and Records Rule:

- Advisers not retaining completed third-party rating questionnaires;
- Advisers not maintaining copies of social media posts; and
- Advisers not maintaining documentation to support performance claims in advertisements.

Form ADV Completion

The Division provides the following observations regarding advisers inaccurately reporting on Form ADV Part 1A, specifically that their advertisements did not include:

- **Third-party ratings, when adviser websites and social media posts touted advisers as being ranked in various third-party ratings;**
- **Performance results, when performance results were included in marketing materials; and**
- **Hypothetical performance, when hypothetical performance was included in advertisements.**

In addition, the Division notes advisers used outdated language in their Form ADV Part 2A referencing the provisions of the prior Cash Solicitation Rule, inaccurately indicating that no referral relationships existed, and failing to include material terms and compensation of referral arrangements.

Marketing Rule's General Prohibitions

The Marketing Rule contains seven general prohibitions (the "General Prohibitions") applicable to all advertising. By way of summary, the seven general prohibitions are as follows:

- **Including any untrue statement of a material fact, or omitting to state a material fact necessary in order to make the statement made, in the light of the circumstances under which it was made, not misleading.**
- **Including a material statement of fact that the adviser does not have a reasonable basis for believing it will be able to substantiate upon demand by the SEC.**
- **Including information that would reasonably be likely to cause an untrue or misleading implication or inference to be drawn concerning a material fact relating to the adviser.**
- **Discussing any potential benefits to clients or investors connected with, or resulting from, the investment adviser's services or methods of operation without providing fair and balanced treatment of any material risk or material limitations.**
- **Referencing specific investment advice provided by the investment adviser where such investment advice is not presented in a manner that is fair and balanced.**
- **Including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced.**
- **Providing information that is otherwise materially misleading.**

The Division details in the Risk Alert observed advertisement deficiencies relating to the General Prohibitions. The following are examples of noted deficiencies.

Untrue Statements of Material Fact and Unsubstantiated Statements of Material Fact

- **Stating that advisers were “free of all conflicts” when conflicts existed.**
- **Stating inaccurate material facts, including:**
 - o **Referencing investment mandates (e.g. ESG) when such mandates were not used by the adviser;**
 - o **Claiming that investment processes were validated by professional organizations, when they were not;**
 - o **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;**
 - o **Referencing a list of approved securities that did not exist;**
 - o **Referencing a formalized securities screening processes that did not exist;**
 - o **Misrepresenting the adviser’s client base, e.g. stating the adviser was a “private fund adviser” when the firm did not advise any private funds; and**
 - o **Publicizing the receipt of awards that were not received.**

Omission of Material Facts or Misleading Inference

- **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 interest.**
- **Recommending investments (e.g. on podcasts or websites) without disclosing conflicts of interest attributed to compensation paid to, or received by, the adviser.**
- **Untrue or misleading claims, such as:**

- o **Stating that the advisers were “seen on national media,” implying appearances in national news media, without disclosing that those were paid advertisements; and**
- o **Advertising images of celebrities in a manner that implied the celebrities endorsed the adviser when that was not the case.**
- **Untrue or misleading performance claims, including:**
 - o **Advertising cumulative profits that the advisers believe were not achievable or were impossible to achieve without unlimited money to invest;**
 - o **Not including adequate disclosure regarding the share classes included in the performance returns;**
 - o **Using lower fees in the calculations of net fees performance returns than were offered to the intended audience of the advertisement;**
 - o **Omitting material information regarding fees and expenses used in calculating the returns.**
- **Referencing SEC registration in a manner that implied a particular level of skill or ability, or that the SEC had either approved or passed upon the advisers’ business practices.**
- **Including the SEC logo on their website implying that the websites and/or advisers had been approved or endorsed by the SEC.**
- **Third-party ratings:**
 - o **Implying advisers were the sole top recipients of certain awards when there are multiple recipients or the advisers were not the top recipients; and**
 - o **Indicating being highly rated by various organizations without disclosing the methodologies for the rating, which were not based on factors related to the quality of investment advice, e.g. assets under management, number of clients.**
- **Including testimonials from clients of a third-party product provider on the advisers’ websites without disclosures explaining the context/that the testimonial was for the third-party product provider and not the adviser.**
- **Performance advertisements:**

- o **Benchmark comparisons that did not define the index or provide sufficient context to enable an understanding of the basis or disclose that the benchmark performance did not include the reinvestment of dividends;**
- o **Outdated market data information (market data from more than 5 years prior);**
- o **Investment products being included that were no longer available to clients and included lower costs than were available;**
- o **Statements or presentations regarding:**
 - **Performance track records that were not purchased by advisers in a similar manner in their clients' accounts;**
 - **Claims that advisers achieved above average performance results without clarifying that the advisers did not yet have clients or performance track records; and**
 - **Performance information that did not include disclosures to provide context, 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 Treatment of Material Risks or Limitations

- **Advertisements on social media that highlighted performance information without also disclosing the material risks and limitations associated with the potential benefits.**

References to Specific Investment Advice That Were Not Presented in a Fair and Balanced Manner

- **Including only the most profitable investments or specifically excluding certain investments without providing sufficient disclosure to evaluate the rationale.**

Inclusion of Exclusion of Performance Results or Time Periods in Manners That Were Not Fair and Balanced

- **Not disclosing the time period in the advertisement or whether the returns were calculated for the same time period as additional information in the same advertisement.**



- **Including performance of only realized investments information in the total net return figure and excluding unrealized investments.**

Advertisements That Were Otherwise Misleading

- **Presenting disclosures in an unreadable font on websites or videos.**

Questions? Contact the DCS Team

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Kevin Woodard

President

(513) 977-8646

Kevin.woodard@dinsmorecomplianceservices.com

Jeff Chapman

Director of Client Relations

(513) 977-8647

Jeff.chapman@dinsmorecomplianceservices.com

dinsmorecomplianceservices.com