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SEC UPDATE

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Third Risk Alert and Counting: SEC's Observations of Marketing Rule Deficiencies Show Continued Challenges with Implementation

It's been only two years since the required compliance date for the US Securities and Exchange Commission's (SEC) amended Rule 206(4)-1¹ (the Marketing Rule) under the Investment Advisers Act of 1940, as amended (Advisers Act). Since the Marketing Rule's adoption, the SEC Staff of the Division of Investment Management (IM) has issued four FAQs² and the SEC's Division of Examinations (EXAMS) has issued three risk alerts on the rule.³ Despite this guidance, advisers are still struggling with implementation and interpretation issues, making the Marketing Rule ripe for further regulation through enforcement.

EXAMS issued its Initial Risk Alert in September 2022, ahead of the Marketing Rule's November 2022 compliance date, outlining the aspects it expected to focus on during the rule's initial exam phase. The Initial Risk Alert announced EXAMS' intention of conducting a number of specific national initiatives, as well as a broad review through the examination process, for compliance with the Marketing Rule that include, but are not limited to, policies and procedures, substantiation requirements, performance advertising, and books and records. The

Second Risk Alert was issued in June 2023, and announced EXAMS' focus on additional Marketing Rule-related areas of emphasis, including the use of testimonials and endorsements, third-party ratings, and the accuracy of Form ADV disclosures.

The Second Risk Alert did not share specific observations of deficiencies from EXAMS' initial exam phase. However, in September 2023—months after the required disclosure date for all advisers completing the new Form ADV Marketing Rule items⁴—the SEC announced its first set of Marketing Rule cases resulting from its ongoing sweep concerning Marketing Rule violations. Nine firms were charged in that first round, each on the basis that they advertised hypothetical performance to mass audiences on their websites without having the required policies and procedures. Two of the charged advisers also failed to maintain required copies of their advertisements.⁵

On March 18, 2024 the SEC settled with two SEC registered investment advisers over statements about their use of artificial intelligence (AI). Although these cases received attention as the first of the SEC's AI enforcement efforts, the charges were based in the Marketing Rule's general prohibitions.⁶

On April 12, 2024 the SEC announced its settlement with five SEC-registered investment advisers for Marketing Rule violations. All five firms had advertised hypothetical performance to the

general public on their websites without adopting and implementing policies and procedures reasonably designed to ensure that the hypothetical performance was relevant to the likely financial situation and investment objectives of each advertisement's intended audience. One of the advisers was found to have violated additional regulatory requirements, including advertising misleading model performance, failing to substantiate advertised performance, and committing recordkeeping and compliance violations. That adviser also failed to enter into written agreements with people it compensated for endorsements.⁷

After that steady stream of thematic enforcement actions, on April 17, 2024, EXAMS finally issued its Third Risk Alert, to discuss EXAMS' initial observations of Marketing Rule compliance, particularly relating to Form ADV, Advisers Act Rule 206(4)-7 (the Compliance Rule), Advisers Act Rule 204-2 (the Books and Records Rule), and the Marketing Rule's General Prohibitions.

EXAMS' 2025 examination priorities⁸ highlight a continued focus on adviser compliance with the Marketing Rule with assessments on whether advisers have established adequate policies and procedures and whether their actual practices conform to them. While it is possible EXAMS may issue additional Marketing Rule risk alerts based on observations from its 2025 exam program, advisers should review the lessons learned from the prior Marketing Rule enforcement actions as well as the observed deficiencies noted in the Third Risk Alert and consider whether they need to fine tune their compliance programs to address highlighted areas of concern. Below is a summary of EXAMS' observations discussed in the Third Risk Alert.

Observations on Compliance, Books and Records Rule, and Form ADV

The Staff observed the following failures of advisers to address their marketing practices in their policies and procedures under the Advisers Act Compliance Rule 206(4)-7:

- **Form ADV:** Many advisers updated their Form ADVs to include advertising-related disclosures. Nevertheless, inaccuracies were detected, including incorrect disclosure regarding featured third-party ratings, performance results, or hypothetical performance. Additionally, some advisers had not deleted references to Advisers Act Rule 206(4)-3, the now-rescinded Cash Solicitation Rule. Where referral arrangements existed, some advisers failed to disclose such arrangements, or otherwise omitted material terms and compensation details of such arrangements in response to Item 14 of Form ADV Part 2A.
- **Advisers Act Rule 206(4)-7 Compliance Rule:** Common issues identified in the design and implementation of policies and procedures related to the Marketing Rule include policies that are informal that were not in writing, policies that only contain general descriptions and expectations related to the Marketing Rule, and policies that were updated but not implemented.
- **Advisers Act Rule 204-2 Books and Records Rule:** The Staff observed deficiencies related to books and records related to marketing, such as failures to maintain documentation related to performance claims and copies of questionnaires or surveys used in third-party ratings.

Compliance With the Marketing Rule's General Prohibitions

The Staff identified several common deficiencies among advisers related to the Marketing Rule's General Prohibitions, including:

- **Untrue or Unsubstantiated Statements of Material Facts:** Some advertisements contained material statements that were either untrue or could not be substantiated upon demand, such as the assertion that advisers were "free of all conflicts," when actual conflicts existed, and erroneous representations regarding adviser

personnel education, experience, and professional designations. EXAMS also cited references to environmental, social, and governance (ESG) investment mandates where no such mandates were actually used.

- **Omission of Material Facts or Misleading Inference:** Advertisements occasionally omitted necessary material facts or presented information that could lead to misleading implications about the adviser. Such advertisements included statements, such as the adviser being different than others because it acts in the “best interest of clients” (without disclosing that all advisers have a fiduciary duty), or that the adviser was “seen on” national media (implying an appearance rather than a paid advertisement). Other violative statements included misleading third-party ratings and testimonials and statements or omissions related to performance advertising.
- **Fair and Balanced Treatment of Material Risks or Limitations:** Some advertisements included statements about potential benefits of advisers’ services without providing a fair and balanced treatment of the material risks or limitations associated therewith.
- **References to Specific Investment Advice:** Certain advertisements did not present specific investment advice in a fair and balanced manner. For example, they excluded certain investments without providing sufficient information and context to evaluate the rationale (such as, investments were written off). Some advisers also did not have established criteria in their policies and procedures to ensure that references to specific investment advice were provided in a fair and balanced manner.⁹
- **Inclusion or Exclusion of Performance Results or Time Periods in Manners That Were Not Fair and Balanced:** Some advertisements did not disclose the time period, or whether the returns were calculated for the same time period as additional performance information included in the same advertisement. Some advertisements also

included or excluded certain performance results in manners that were not fair and balanced, (for example, they included the performance of only realized investments in the total net return figure and excluded unrealized investments).

- **Materially Misleading Advertisements:** Some advertisements were found to present disclosures in unreadable font on websites or in videos.

Despite EXAMS’ efforts to promote compliance through its Risk Alert outreach, violations persist. On September 9, 2024, the SEC settled charges against nine registered investment advisers for violating the Marketing Rule by disseminating advertisements that included untrue or unsubstantiated statements of material fact or testimonials, endorsements, or third-party ratings that lacked required disclosures.¹⁰

On November 1, 2024, the SEC settled charges against an investment for violations of the Marketing Rule. The order found that the adviser disseminated advertisements containing paid endorsements from professional athletes that lacked required disclosures and advertised hypothetical performance to the general public on its website without adopting and implementing required policies and procedures.¹¹

On November 8, 2024, the SEC charged Invesco Advisers for making misleading statements about supposed investment considerations in violation of the anti-fraud provisions of Section 206(4) of the Advisers Act, the Marketing Rule’s General Prohibitions as well as Rule 206(4)-8 (prohibiting fraudulent conduct with respect to any investor or prospective investor in a pooled investment vehicle).¹²

Marshall Gandy, the SEC’s National Associate Director-IA/IC Examination Program recently spoke at the National Society of Compliance Professional’s (NSCP) 2024 National Conference and indicated additional risk alerts may be forthcoming.¹³ With the 2024 Presidential Election results in, it’s not yet clear how the coming change in administration will impact the SEC and EXAMS’ priorities for the

remainder of its 2025 exam year and beyond. In the meantime, advisers should take to heart Grady's words of wisdom he shared with NSCP, "say what you do, do what you say."

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NOTES

¹ See *SEC, Final Rule: Investment Adviser Marketing*, Rel. No. IA-5653 (Dec. 20, 2020) (Marketing Rule Adopting Release) (adopting amendments under the Advisers Act to create a single rule that replaces the prior advertising and cash solicitation rules and modernizes rules that govern investment adviser advertisements and payments to solicitors).

² See *SEC.gov | Marketing Compliance Frequently Asked Questions*.

³ See Risk Alert: Examinations Focused on New Investment Adviser Marketing Rule (Sept. 19, 2022) (the Initial Risk Alert); Risk Alert: Examinations Focused on Additional Areas of the Adviser Marketing Rule (June 8, 2023) (the Second Risk Alert); and Risk Alert: Initial Observations Regarding Advisers Act Marketing Rule Compliance (April 17, 2024) (the Third Risk Alert).

⁴ See Form ADV, Part 1A, Item 5.L and Part 2A, Item 14 brochure disclosures related to client referrals and other compensation.

⁵ <https://www.sec.gov/newsroom/press-releases/2023-173>.

⁶ <https://www.sec.gov/newsroom/press-releases/2024-36>.

⁷ <https://www.sec.gov/newsroom/press-releases/2024-46>.

⁸ EXAMS' 2025 examination priorities cover the SEC's fiscal year 2025, which started October 1, 2024.

⁹ On February 6, 2024, the SEC's Division of Investment Management issued a response to its Marketing Compliance FAQs regarding the calculation of net and gross performance of portfolios utilizing subscription lines of credit. The Staff stated an adviser would violate Rule 206(4)-1(a)(1) and Rule 206(4)-1(a)(6)) if it showed only net IRR that includes the impact of fund-level subscription facilities without including either (i) comparable performance (*e.g.*, net IRR without the impact of fund-level subscription facilities) or (ii) appropriate disclosures describing the impact of such subscription facilities on the net performance shown. See *SEC.gov | Marketing Compliance Frequently Asked Questions*.

¹⁰ <https://www.sec.gov/newsroom/press-releases/2024-121>.

¹¹ <https://www.sec.gov/enforcement-litigation/administrative-proceedings/ia-6763-s>.

¹² *SEC.gov | SEC Charges Invesco Advisers for Making Misleading Statements About Supposed Investment Considerations*.

¹³ On October 30, 2024, Grady was a panelist at NSCP's General Session: SEC Examination Leaders Forum. In addition to the Marketing Rule, Grady mentioned additional risk alert topics, including registered investment companies, artificial intelligence and digital assets. EXAMS in fact issued a risk alert on November 4, 2024, Registered Investment Companies: Review of Certain Core Focus Areas and Associated Documents Requested.

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