

SEC Issues Third Marketing Rule Risk Alert for Investment Advisers

WRITTEN BY

Genna Garver | John P. Falco | Matthew A. Ramsey

RELATED PROFESSIONALS

Paul A. Steffens | Genna Garver | Julia D. Corelli | Stephanie Pindyck Costantino | John M. Ford

On April 17, the U.S. Securities and Exchange Commission's (SEC) Division of Examinations (EXAMS) issued its third [risk alert](#) on the amended Rule 206(4)-1 (the Marketing Rule) under the Investment Advisers Act of 1940 (Advisers Act). EXAMS issued its [first risk alert](#) on the Marketing Rule ahead of its November 2022 required compliance date, outlining the aspects it expected to focus on during its initial exam phase. About seven months after the rule's required compliance date, EXAMS issued a [second risk alert](#), detailing its next exam phase, including its increased focus on additional Marketing Rule-related aspects. The third alert includes EXAMS' preliminary observations of its Marketing Rule exams, aiming to promote accurate completion of Marketing Rule items in Form ADV, compliance with Advisers Act Rule 204-2 Books and Records rule, and adherence to the general prohibitions set forth in Rule 206(4)-1(a). A summary of EXAMS' observations is set forth below:

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

- **Advisers Act Rule 206(4)-7 Compliance Rule:** Advisers have generally incorporated Marketing Rule processes into their compliance policies and procedures, with many requiring pre-approval of advertisements. However, some policies were found to be inadequately designed or implemented, leading to potential violations. Common issues identified include policies only containing general descriptions and expectations related to the Marketing Rule, informal policies that were not in writing, and policies that were updated but not implemented.
- **Advisers Act Rule 204-2 Books and Records Rule:** Advisers have updated their policies to include Marketing Rule-related books and records requirements. Despite these updates, deficiencies were noted, such as failures to maintain necessary documentation to support performance claims and copies of questionnaires or surveys used in third-party ratings.
- **Form ADV:** Many advisers had updated their Form ADVs to include advertising-related disclosures. Nevertheless, inaccuracies were detected, including incorrect reporting on advertisements that featured third-party ratings, performance results, or hypothetical performance. Additionally, some advisers had not updated outdated references to Advisers Act Rule 206(4)-3), the prior Cash Solicitation Rule. Some indicated that no referral arrangements existed, or otherwise omitted material terms and compensation details of referral arrangements on Form ADV, Part 2A, Item 14.

Compliance With the Marketing Rule's General Prohibitions

EXAM's review identified several deficiencies in compliance with 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. The risk alert serves as a reminder that if an adviser is unable to substantiate the material claims of fact made in an advertisement upon demand, EXAMS will presume that the adviser did not have a reasonable basis for its belief.
- **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. Notably, the risk alert also highlighted several misleading performance advertisements, such as those that:

Did not provide adequate disclosure regarding the share classes included in the performance returns.
Used lower fees in calculations for net of fees performance returns than those offered to the intended audience.

Omitted material information regarding fees and expenses used in calculating returns.

Included index benchmark comparisons without defining the index or providing sufficient context to enable an understanding of the basis for such comparison, or failing to disclose that the benchmark performance did not include the reinvestment of dividends.

Contained outdated market data information only (e.g., market data from more than five years prior).

Contained investment products that were no longer available to clients and included lower investment costs than were available.

Presented advisers’ performance track record with securities that were not purchased by the advisers in a similar manner in their clients’ accounts.

Included claims that the advisers achieved above average performance results without clarifying that the advisers did not yet have clients or performance track records.

Included 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 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.
- **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, (e.g., they included the performance of only realized investments in the total net return figure and excluded unrealized investments).
- **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 (e.g., 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.^[1]

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

A copy of EXAMS' alert is available at <https://www.sec.gov/exams/announcement/risk-alert-041724>.

Marketing Rule Enforcement Actions

In September 2023, 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.

On March 18, 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 related to the Marketing Rule's general prohibitions.

On April 12, 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.

Next Steps

Advisers are advised to thoroughly review and update, as needed, their marketing practices, Form ADV disclosures, and policies and procedures related to the Marketing Rule and Books and Records Rule, in light of EXAMS' observations.

^[1] On February 6, 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](#).

RELATED INDUSTRIES + PRACTICES

- [Investment Funds + Investment Management Services](#)