

**ALERTS**

# SEC Marketing Rule Update: Risk Alert Pinpoints Examination Findings to Date

**May 28, 2024**

*The SEC's Examination Staff continues to focus on investment adviser's compliance with the Marketing Rule. In a recent Risk Alert, the Examination Staff identified specific deficiencies it has found both as to the content of advertisements and compliance policies and procedures related to marketing activities. This Alert describes key features of the Examination Staff's findings and highlights useful compliance practices.*

On April 17, 2024, the staff ("Staff") of the SEC's Division of Examinations issued a Risk Alert ("Risk Alert") titled, "Initial Observations Regarding Advisers Act Marketing Rule Compliance", summarizing the Staff's "preliminary observations" from its review of registered investment advisers' ("Advisers") compliance with Rule 206(4)-1 ("Marketing Rule") during recent SEC examinations. This Risk Alert, which follows two prior Risk Alerts from June 2023<sup>[1]</sup> and September 2022<sup>[2]</sup> related to the Marketing Rule, serves to highlight: (i) the Staff's ongoing scrutiny of Advisers' compliance with the Marketing Rule; and (ii) the importance of ensuring not only that the content of an Adviser's advertisements comply with the requirements of the Marketing Rule, but that the Adviser also complies with its Form ADV disclosure obligations, and its obligations under Rule 206(4)-7 ("Compliance Rule")<sup>[3]</sup> and Advisers Act Rule 204-2 ("Books and Records Rule") under the Advisers Act.<sup>[4]</sup>

The Staff's observations align with what we continue to see the Staff focus on during SEC examinations with regard to Marketing Rule compliance. The Staff, during examinations, routinely requests and reviews:

- Copies of all “advertisements” used during the relevant examination period;
- Explanations for the Adviser’s responses to Form ADV Part 1A, Item 5.L;
- Current marketing policies and procedures;
- Documentation of placement agent agreements and other “endorsement” arrangements; and
- Documentation maintained as the substantiation of material statements of fact, performance reporting and third party rankings used in the Adviser’s advertisements.

Notably, the Risk Alert comes just days after the SEC announced a second set of enforcement cases following an ongoing sweep focused on Marketing Rule compliance.[5] In those cases, the SEC found that the five firms 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, as required by the Marketing Rule. The SEC alleged that one Adviser violated other requirements of the Marketing Rule by 1) including false and misleading information in its advertisements; 2) being unable to substantiate performance shown in its advertisements; 3) failing to enter into written agreements for compensation for endorsements; and 4) failing to comply with the Adviser’s recordkeeping obligations under the Advisers Act.

In announcing these enforcement actions, Co-Chief of the Enforcement Division’s Asset Management Unit Corey Schuster highlighted the Enforcement Division’s focus on Marketing Rule violations through use of “targeted initiatives” to ensure that Advisers fully comply with their obligations under the Rule. This is the second set of cases that the SEC has brought as part of an ongoing targeted sweep concerning Marketing Rule violations after charging nine advisory firms in September 2023.[6]

## **Key Deficiencies in the Content of Advertisements**

The Staff’s review of substantive compliance with the Marketing Rule focused on compliance with the Rule’s General Prohibitions.[7] The Staff observed and provided specific details regarding a litany of deficiencies in the following areas:

- Untrue and unsubstantiated statements of material fact;
- Omission of material facts and misleading inferences;
- Unfair and unbalanced treatment of material risks or limitations;
- References to specific investment advice that were not presented in a fair and balanced manner;
- Inclusion or exclusion of performance results or time periods in manners that were not fair and balanced; and
- Advertisements that were otherwise materially misleading as a result of font size, visibility of disclosures, etc., particularly on websites and in videos.

The Staff's observations provide the following important reminders:

*Be Truthful, Be Accurate and Be Able to Substantiate* – The Staff observed advertisements that included various statements of material fact that appeared to be untrue or that could not be substantiated. These observations provide insight as to what the Staff considers to be material statements of fact related to an Adviser's business strategy and what types of statements the Staff will expect that an Adviser substantiate if such claims are being used in marketing materials. The Staff noted that certain statements appeared to be untrue on account of omitting material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading and that it observed advertisements that included information that caused untrue or misleading implications or inferences to be drawn regarding material facts relating to the Adviser, highlighting among other examples:

- Claims that an Adviser is different from other Advisers because they act in the "best interest of clients," without disclosing that all Advisers have a fiduciary duty to act in their clients' best interests;
- Recommendations of certain investments (e.g., on podcasts or websites) without disclosing the conflicts of interest attributed to the compensation paid to, or received by, the Adviser for such recommendations;
- Statements that the Adviser was "seen on" national media, implying appearances in national news media, without disclosing that the "appearances" were in fact paid advertisements and 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;

- Presentation of performance information 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 were offered to the intended audience, and omitted material information regarding fees and expenses used in calculating returns;
- Inclusion of third-party ratings that (i) implied that the Adviser was the sole top recipient of certain awards when the awards went to multiple recipients or the Adviser was not the top recipient, (ii) failed to disclose that the Adviser or that Adviser personnel nominated fellow employees for certain awards, and (iii) indicated that the Adviser was 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 or the number of clients of the Adviser; and
- Inclusion of testimonials on the Adviser's website without any disclosures explaining the context of the testimonials, implying that the testimonials were about the Adviser's services rather than a third-party product.

*Don't Omit Material Facts or Make Misleading Inferences—and Keep Context in Mind When Showing Performance* – The Staff similarly observed advertisements that appeared to omit material facts necessary to make certain statements made by Advisers, in light of the circumstances, not misleading as well as advertisements that included information that could have reasonably caused untrue or misleading implications or inferences to be drawn concerning material facts relating to the Adviser. The Staff also highlighted advertisements that contained untrue or misleading performance claims, including, among other deficiencies:

- Performance information that did not provide adequate disclosure regarding the share classes included in the performance returns;
- Net of fees performance returns calculated using lower fees than were offered to the intended audience; and

- Omission of material information regarding fees and expenses used in calculating returns.

With respect to advertisements containing performance, the Staff observed 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;
- Performance presentations that contained outdated market data information or included lower investment costs than were currently available to clients;
- Statements about an Adviser's performance track record that reflected securities not actually bought or sold in client accounts;
- Claims that the Adviser achieved above average performance results without clarifying that the Adviser did not yet have clients or performance track records; and
- Statements regarding 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 due to general market performance.

These observations provide additional insight into the Staff's views as to what might constitute material statements of fact related to performance figures and demonstrate that Advisers should pay careful attention when including any reference to performance (hypothetical or actual) in their marketing materials.

*Include Risk and Limitations Disclosures – Including in Social Media Posts*

– The Staff observed advertisements that included statements about the potential benefits connected with the Advisers' services or methods of operation that did not appear to provide fair and balanced treatment of any material risks or material limitations associated with the potential benefits. For example, the Staff observed advertisements on social media that highlighted performance information without also disclosing the material risks and limitations associated with the potential benefits. Advisers may find it challenging to include proper disclaimers on websites, blogs and social media posts, however it is nonetheless sometimes

required under the Marketing Rule and seeking solutions for how to incorporate this information is a priority.

*Selection of Investments in Marketing Materials Must Be Fair and Balanced* – The Staff observed advertisements that included references to specific investment advice that were not presented in a fair and balanced manner — noting in particular that it had observed advertisements that included only the most profitable investments or specifically excluded certain investments without providing sufficient information and context to evaluate the rationale for the exclusion, such as investments that were written off as a loss or were lower performing investments. The Staff also observed advertisements that included or excluded certain performance results or presented performance time periods in a manner that was not fair and balanced. With respect to policies and procedures, the Staff also observed Advisers that had not established criteria in their policies and procedures to ensure references to specific investment advice shown in advertisements were presented in a fair and balanced manner.

*Size Matters* – The Staff observed advertisements that appeared to otherwise be materially misleading, due to presenting disclosures in an unreadable font on websites or in videos.

## **Compliance Beyond Content**

The remainder of the Staff's observations in the Risk Alert extend beyond the content of Advisers' marketing materials and relate to 1) Compliance Rule deficiencies, 2) Books and Records Rule deficiencies and 3) Form ADV deficiencies. These three additional areas of note are seemingly independent of whether or not the content of an Adviser's advertisements complied with the Marketing Rule.

*Advisers Must Say What They Do and Do What They Say: Compliance Rule Obligations Not Satisfied When Policy Gaps Exist* – With respect to an Adviser's obligation to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act, including the Marketing Rule, the Staff noted that many Advisers have adopted compliance policies and procedures that include processes to comply with the Marketing Rule. These policies include providing training to relevant personnel and implementing processes to review and approve advertisements before dissemination. The Staff nonetheless observed instances of deficient policies, such as policies that were not sufficiently

tailored to address the specific advertising or record retention practices of the Adviser, resulting in gaps in the policies' ability to prevent violations of the Marketing Rule and/or the Books and Records Rule.

The Staff also noted instances where policies were updated to reflect the Marketing Rule, but not implemented as written. For example, the Staff noted that it had observed policies that required net performance be included in any performance advertisements, but such Advisers' advertisements did not include net performance, resulting in not only a violation of the Marketing Rule, but also the Advisers' own policies. We also have observed deficiency letters that take this "layering approach" to non-compliant advertisements by layering onto a Marketing Rule deficiency for failing to comply with the Marketing Rule, a Compliance Rule deficiency for failing to comply with the Adviser's own marketing policies. Adviser's policies should be formally documented, sufficiently detailed and properly tailored to the Adviser's actual marketing practices, in addition to being frequently updated to reflect the Adviser's current marketing practices.

*Maintaining Books and Records Obligations* - In light of an Adviser's obligation to keep accurate books and records, an Adviser's marketing policies should also address the preservation and maintenance of required records. All types of communications that could potentially be required books and records should be evaluated for retention purposes, including social media posts, and Advisers should ensure they maintain all necessary documentation supporting any performance figures included in advertisements, and, to the extent applicable, completed questionnaires and surveys used in the preparation of third party ratings.

*Reminder to Update ADV Disclosures* - The Staff also observed that many Advisers had updated their Form ADV, including Part 1A, Item 5.L disclosures related to advertising practices and Part 2A, Item 14 brochure disclosures related to client referrals and other compensation, when applicable. However, the Staff observed Marketing Rule deficiencies on Form ADV, such as Advisers that inaccurately reported whether their advertisements included third-party ratings, performance results or hypothetical performance. The Staff also observed that some Advisers had failed to update their Form ADV Part 2A, Item 14 disclosures which continued to reference provisions of the prior and now superseded "cash solicitation rule", as well as Advisers that inaccurately disclosed material terms and compensation figures regarding their referral arrangements.

Advisers should ensure that their ADV disclosures regarding their marketing practices are accurate.

## Conclusion

Compliance with the Marketing Rule requires careful attention to the substance of an Adviser's marketing materials and also includes developing and following specific and tailored policies and procedures to ensure proper compliance with both the Marketing Rule as well as the Compliance Rule, the Books and Records Rule, and all Form ADV requirements.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] See also [SEC Marketing Rule Update: Additional Focus Areas in Examinations](#), Schulte *Alert* (June 23, 2023) available here.

[2] See also [SEC Marketing Rule Update: What Private Fund Advisers Should Be Thinking About as the November 4 Compliance Date Approaches](#), Schulte *Alert* (Sept. 20, 2022) available here.

[3] 17 CFR § 275.206(4)-7

[4] 17 CFR § 275.204-2

[5] See [SEC Charges Five Investment Advisers for Marketing Rule Violations](#), SEC Press Release (April 12, 2024) available here.

[6] See [SEC Sweep into Marketing Rule Violations Results in Charges Against Nine Investment Advisers](#), SEC Press Release (Sept. 11, 2023) available here.

[7] The Marketing Rule's General Prohibitions prohibit advertisements from including: (i) an untrue statement of a material fact or omitting a material fact necessary to make the statement made, in light of the circumstances under which it was made, not misleading; (ii) 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 Commission; (iii) 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; (iv) discussing any potential benefits to clients or investors connected with or resulting from the Adviser's services or methods of operation without providing fair and balanced treatment of any associated material risks or limitations; (v) referencing specific investment advice provided by the Adviser in a manner that is not fair and balanced; (vi) including or excluding performance results, or presenting performance time periods, in a manner that is not fair and balanced and (vii) providing information that is otherwise materially misleading.

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