

## Investment Management

October 16, 2024

### **SEC Settles Against Nine Investment Advisers for Marketing Rule Violations, Underscoring the Continued Priority of Marketing Rule Compliance**

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On September 9, the U.S. Securities and Exchange Commission (SEC) announced another series of settlements with registered investment advisers for violations of Rule 206(4)-1, as amended (Marketing Rule), under the Investment Advisers Act of 1940 (Advisers Act).<sup>1</sup> The settlements with these nine registered investment advisers resulted in a combined \$1.24 million in civil penalties. As we have previously written,<sup>2</sup> nearly two years following the effective date of the Marketing Rule, the SEC continues to focus on holding advisers accountable for not adhering to the Marketing Rule. These most recent settlements identify failures to adhere to various general prohibitions applicable to all advertisements and failures to satisfy the specific disclosure requirements and other applicable conditions when including testimonials, endorsements, or third-party ratings in an advertisement.

#### **Background**

Among the seven general prohibitions set forth in Rule 206(4)-1(a) of the Marketing Rule are the prohibitions on including an untrue statement of material fact in an advertisement and including material statements of fact that the investment adviser does not have a reasonable basis for believing they can substantiate the claims upon demand by the SEC. Pursuant to Rule 206(4)-1(b), a registered investment adviser is not permitted to include testimonials<sup>3</sup> or endorsements<sup>4</sup> in an advertisement, and an investment adviser may not provide compensation directly or indirectly for such a testimonial or endorsement unless the investment adviser complies with certain disclosure requirements and other conditions. The investment adviser must also have a reasonable basis for believing that the testimonial or endorsement complies with all other requirements of the Marketing Rule.

Similarly, pursuant to Rule 206(4)-1(c), an investment adviser may not include any third-party rating in an advertisement unless certain conditions are met. These include the investment adviser's reasonable belief that the questionnaire or survey used in the preparation of the third-party ratings made it equally easy for a participant to provide favorable and unfavorable responses. Additionally, the investment adviser must clearly and prominently disclose (or reasonably believe the third-party rating clearly discloses) the date on which the rating was given, the period of time upon which the rating was based, the identity of the third party that created and tabulated the rating, and, if applicable, that compensation was provided, directly or indirectly, by the investment adviser.

#### **Recent Cases**

##### *Substantiating Statements of Material Fact*

In four of the recent settlements,<sup>5</sup> the SEC determined that the investment advisers included an advertisement (in their respective public websites) material statements of fact that they were not able to substantiate. Each of the statements in question claimed that the investment adviser had either eliminated conflicts of interest or that the investment adviser provided investment advice conflict-free, without including any further context for such claims. The SEC concluded that each of those statements was inconsistent with statements made by the investment advisers in their respective Form ADV Part 2As and, as a result, each investment adviser made the statement of material fact regarding conflicts of interest without having a reasonable basis to believe that they would be able to substantiate such claims upon demand by SEC, in violation of Rule 206(4)(1)-(a)(2).

Similarly, in a settlement with another investment adviser, which also focused on the use of third-party ratings and is discussed further below, the SEC identified a statement on the investment adviser's website that one of its principals had been "named one of the top wealth managers by the readers of *San Diego Magazine* for 14 consecutive years."<sup>6</sup> The investment adviser was not able to substantiate that claim. According to the settlement, rather than being selected by readers of the referenced periodical, the investment adviser was selected by a third-party company using a different methodology. As a result, the SEC concluded that the investment adviser did not have a reasonable basis to believe that they would be able to substantiate the claim upon demand by the SEC.

### *Testimonials and Endorsements*

The SEC also determined that one of the investment advisers disseminated advertisements containing an endorsement claiming that the investment adviser was the "Official Wealth Management Partner" of a university athletic program, without including disclosures required by the Marketing Rule. The advertisements were disseminated on public websites, on social media platforms, in online videos, and on physical objects (e.g., bags and flags), often with the athletic program's logo. However, the university was not a client of the investment adviser, and the investment adviser had paid the university for the endorsement. The investment adviser failed to include clear and prominent disclosures that the endorsement was provided by a person other than a current client, that cash compensation was provided for the endorsement, and disclosures of any material conflicts of interest arising from the compensation arrangement.<sup>7</sup>

Separately, this same investment adviser included a page on their website titled "Testimonials," with select quotes from individuals expressing positive statements about the firm. In at least one instance, the investment adviser labeled a quote as a testimonial even though it was provided by a former client. Another quote on the page was provided by an individual whose status as a client could not be verified. The SEC noted that because these statements were provided by persons other than current clients, they constituted endorsements, not testimonials. As such, the investment adviser was required to provide clear and prominent disclosures that the endorsements came from non-clients, which it failed to do. The SEC stated that, as it previously has observed, required disclosures regarding testimonials and endorsements are intended to provide investors with important context for weighing the relevance of a testimonial or endorsement, without which the advertisement could mislead investors.

### *Third-Party Ratings*

The settlements with four of the investment advisers addressed the inclusion of third-party ratings in advertisements that did not include and were not accompanied by a clear and prominent disclosure regarding the date the rating was issued or the time period the rating covered.<sup>8</sup>

One of these four investment advisers included a statement that it had been named a "*Barron's* Top Advisor" in 2018. However, the advertisement did not disclose the date the rating was given, and the investment adviser had not attained the rating again.<sup>9</sup> Similarly, a second investment adviser included a statement that it had been recognized as one of the 500 "Top Advisers" in the United States without also disclosing that the principal of the firm had received the award more than 16 years prior.<sup>10</sup> A third investment adviser failed to disclose that its principal's third-party ratings as an "All-Star Analyst" and one of *Smart Money Magazine's* "Power 30" had been received between 2001 and 2004.<sup>11</sup>

Finally, another investment adviser referenced on its public website three different ratings, from three different sources, that were received in 2007, 2019, and 2020, respectively, but did not clearly and prominently disclose the date of those ratings or the time period upon which the ratings were based. This same adviser also misstated on its website two of the third-party ratings, claiming that the investment adviser was rated a "Top 12 Financial Advisor" by *Barron's* rather than a "Top 1200 Financial Advisor," and also that it had been rated a "Top 100 Women's Advisor" rather than one of the "Top 100 Women Financial Advisors." In the latter instance, the SEC stated that the claim suggested the rating was related to investment advice provided to women rather than for female investment advisers.

## **SEC Findings**

The SEC found that each of the investment advisers had willfully violated Section 206(4) of the Advisers Act and Rule 206-4(1) thereunder. Pursuant to Section 203(e) and Section 203(k) of the Advisers Act, the investment advisers were ordered to cease

and desist from committing or causing any violations and any future violations of the Marketing Rule and were ordered to pay fines ranging from \$60,000 to \$295,000.

## Takeaways

Investment advisers should carefully examine their policies and procedures to ensure ongoing compliance with the Marketing Rule. Investment advisers should also review their marketing materials to identify material statements of fact and confirm they have a reasonable basis to believe they will be able to substantiate such statements upon SEC demand; review any testimonials and endorsements in their marketing materials to confirm they are accurately attributed to either current clients or third parties and otherwise clearly and prominently disclose all required information; and review all third-party ratings in their marketing materials to ensure the ratings are accurately described, include required disclosures regarding dates and time periods covered, and otherwise comply with the Marketing Rule, including that they are not misleading.

Investment advisers should train relevant employees to identify material statements of fact in marketing materials and to develop an organized system for maintaining records that will enable the investment adviser to substantiate such claims upon demand from the SEC. Moreover, investment advisers should consider adding topics to their training sessions that discuss how to identify and eliminate superlatives in their advertisements, which by their nature are difficult to substantiate. In that vein, conducting a thorough review of existing trainings and expanding trainings for the marketing and investor relations teams, as well as other employees who develop or review advertisements, may help mitigate the risk of Marketing Rule violations. Additionally, enhanced trainings for relevant employees may help increase the efficiency of marketing material reviews by legal and compliance teams.

As always, having reasonably designed policies and procedures is critical, but investment advisers must also endeavor to foster a culture of compliance, including the proper “tone at the top,” pursuant to which leadership sets the tone for compliance with laws, rules and regulations, and adherence to company policies and procedures.

## Next Steps

For further information, guidance, and clarity on how investment advisers can approach and tailor their policies and procedures (and testing thereof) and associated trainings related to the Marketing Rule, please reach out to the authors of this article or to your regular Lowenstein Sandler contact directly.

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<sup>1</sup> [https://www.sec.gov/newsroom/press-releases/2024-121?utm\\_medium=email&utm\\_source=govdelivery](https://www.sec.gov/newsroom/press-releases/2024-121?utm_medium=email&utm_source=govdelivery).

<sup>2</sup> See <https://www.lowenstein.com/news-insights/publications/articles/slew-of-recent-sec-enforcement-actions-guidance-for-registered-investment-advisers-october-2023-moss-goret-zadourian-lipton>; <https://www.lowenstein.com/news-insights/publications/client-alerts/sec-finds-advisers-compliance-with-marketing-rule-still-lacking-despite-examination-and-enforcement-focus-im>; see also <https://www.sec.gov/newsroom/press-releases/2024-46> (SEC settlement on April 12, 2024, of \$200 thousand against five registered investment advisers for Marketing Rule violations), <https://www.sec.gov/newsroom/press-releases/2023-173> (SEC settlement on September 11, 2023, of \$850 thousand against nine registered investment advisers for Marketing Rule violations).

<sup>3</sup> “Testimonial” is defined as any statement by a current client or investor in a private fund advised by the investment adviser: (i) about the client or investor’s experience with the investment adviser or its supervised persons; (ii) that directly or indirectly solicits any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser; or (iii) that refers any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser. See Rule 206(4)-1(e)(17).

<sup>4</sup> “Endorsement” is defined as any statement by a person other than a current client or investor in a private fund advised by the investment adviser that: (i) indicates approval, support, or recommendation of the investment adviser or its supervised persons or describes that person’s experience with the investment adviser or its supervised persons; (ii) directly or indirectly solicits any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser; or (iii) refers any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser. See Rule 206(4)-1(e)(5).

<sup>5</sup> See <https://www.sec.gov/files/litigation/admin/2024/ia-6679.pdf>; <https://www.sec.gov/files/litigation/admin/2024/ia-6686.pdf>; <https://www.sec.gov/files/litigation/admin/2024/ia-6680.pdf>; <https://www.sec.gov/files/litigation/admin/2024/ia-6682.pdf>.

<sup>6</sup> See <https://www.sec.gov/files/litigation/admin/2024/ia-6684.pdf>.

<sup>7</sup> See <https://www.sec.gov/files/litigation/admin/2024/ia-6681.pdf>.

<sup>8</sup> See <https://www.sec.gov/files/litigation/admin/2024/ia-6678.pdf>; <https://www.sec.gov/files/litigation/admin/2024/ia-6684.pdf>; <https://www.sec.gov/files/litigation/admin/2024/ia-6683.pdf>; <https://www.sec.gov/files/litigation/admin/2024/ia-6685.pdf>.

<sup>9</sup> See <https://www.sec.gov/files/litigation/admin/2024/ia-6684.pdf>.

<sup>10</sup> See <https://www.sec.gov/files/litigation/admin/2024/ia-6683.pdf>.

<sup>11</sup> See <https://www.sec.gov/files/litigation/admin/2024/ia-6685.pdf>.

## Contacts

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