

SEC Issues Risk Alert on the Most Frequent Advertising Rule Compliance Issues and Use of Accolades in Advertisements

September 21, 2017

I. Advertising Rule Compliance Issues

On September 14, 2017, the staff of the SEC's Office of Compliance Inspections and Examinations (OCIE) issued a [National Examination Program Risk Alert](#) on the most frequent advertising rule compliance issues identified in OCIE examinations of investment advisers. This Risk Alert reflected issues identified in deficiency letters generated in the course of over 1,000 adviser examinations conducted by OCIE staff.

The most frequent deficiencies that OCIE staff had identified in connection with Rule 206(4)-1 under the Investment Advisers Act of 1940 (the Advertising Rule) were reported in the following four primary areas:

- **Misleading Performance Results**
 - Advisers that presented performance results without deducting advisory fees.
 - Advertisements that compared performance results to a benchmark but did not include disclosures about any significant differences between the adviser's strategies and the benchmark.
 - Advertisements that contained hypothetical and back-tested performance results, but did not explain how these returns were derived and did not include other material information regarding the performance results.
- **Misleading One-on-One Presentations**
 - Advisers that advertised performance results gross of fees in certain one-on-one presentations, but did not include potentially relevant disclosures from the 1988 SEC Staff No-Action Letter to the Investment Co. Institute.

Advisers that failed to disclose that advertised gross performance results did not reflect the deduction of advisory fees and that client returns would be reduced by such fees and other expenses.

- **Misleading Claims of Compliance with Voluntary Performance Standards** – Advisers that claimed that their advertised performance results complied with voluntary performance standard (such as GIPS®) that did not.
- **Past Specific Recommendations (Cherry Picking)** – Advisers that included only profitable stock selections or recommendations in presentations, client newsletters or on their websites, without including the unprofitable selections, and otherwise meeting the conditions set forth in the Advertising Rule. The staff also observed advisers who appeared to have relied on SEC staff no-action letters regarding this provision of the Advertising Rule without meeting the conditions of those letters.
 - Advertisements that included an adviser's best performing holdings, but did not include an equal number of the worst performing holdings. [The TCW Group](#), SEC Staff No-Action Letter (Nov. 7, 2008).
 - Advertisements that included objective, nonperformance-based selection of past specific recommendations, but failed to disclose that they did not represent all securities recommended to clients during a particular period, and that discussed in advertisements the profits realized by the specific recommendations. [Franklin Management, Inc.](#), SEC Staff No-Action Letter (Dec. 10, 1998).

The Risk Alert also observed advisers that were deficient in adopting or implementing compliance policies and procedures under Rule 206(4)-7 of the Investment Advisers Act (the Compliance Rule) designed to prevent "deficient advertising practices," including procedures to:

- Review and approve of advertising materials prior to use;
- Determine criteria for including or excluding accounts from a composite; and
- Confirm the accuracy of performance information.

II. Use of Accolades in Advertisements

The Risk Alert also reported on a 2016 examination sweep of nearly 70 advisers that focused on "touting" in marketing materials. OCIE staff observed advisers that published materially misleading advertisements containing references to awards or rankings conferred by third parties that failed to disclose material facts about the awards or rankings, including:

- Accolades that had been obtained by submitting false or misleading information in the applications for such accolades.
- Marketing materials that referenced stale ranking or evaluation information.
- Advertisements that did not disclose:
 - The relevant selection criteria for the awards or rankings;
 - Who created and conducted the survey that the awards or rankings were drawn from; or
 - The fact that an adviser paid a fee to participate in or distribute the results of the survey.
- Advertisements that contained references to professional designations that had lapsed or that did not explain the minimum qualifications required to attain such designations.
- Advertisements that contained testimonials in contravention of the Advertising Rule.

III. Conclusion

The Risk Alert did not contain any new interpretive position or policies. Advisers can expect OCIE staff to continue to focus examination resources in the area of marketing, which OCIE historically has found to contain a rich source of deficiencies and enforcement referrals. Accordingly, advisers should ensure that they understand the Advertising Rule, and have adopted and implemented robust policies and procedures to comply with the rule. Such policies and procedures should be reviewed periodically to conform with both evolving regulatory expectations and changes in the adviser's own marketing practices.

- **Stephen T. Mears**

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- **Christopher M. Wells**