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Investment Management Client Alert |
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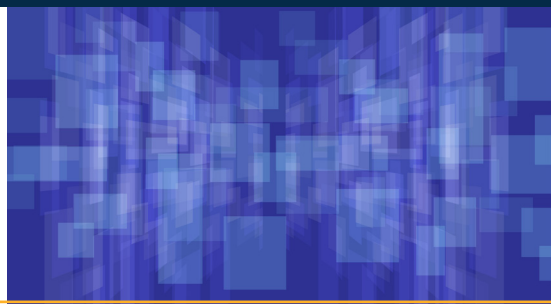
SEC Settles Charges Against RIAs for Misleading Conflict of Interest Disclosures Under the Marketing Rule



The U.S. Securities and Exchange Commission (SEC) on September 9 brought and settled four administrative proceedings against four registered investment advisers (respondent RIAs) under Section 206(4) of the Investment Advisers Act of 1940, as amended (Advisers Act), and Rule 206(4)-1 thereunder (the Marketing Rule) for including misleading conflict of interest disclosures in advertisements.[1]

The Relevant Facts

In each of the four orders instituting and settling proceedings, the SEC states that the respondent RIA disseminated advertisements over the internet essentially claiming that the respondent RIA or its investment adviser representatives (IARs) provide conflict-free advisory services (conflict-free services claim). The relevant conflict-free services claim for each respondent RIA was as follows:

- Respondent RIA is "free from conflicts of interest" and can "deliver an unbiased, conflict-free, best-in-class level of service to [its] clients."
- Respondent RIA's IAR "provides clients with conflict-free advice."
- Respondent RIA "serve[s] individuals and institutions independently, with no conflict of interest."
- Respondent RIA's IAR was "a true fiduciary that puts the client first by aligning incentives and eliminating conflicts of interest."

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[1] *In the Matter of AZ Apice Capital Management*, Release No. IA-6697 (September 9, 2024); *In the Matter of TS Bank d/b/a Callahan Financial Planning*, Release No. IA-6686 (September 9, 2024); *In the Matter of Droms Strauss Advisors d/b/a Droms Strauss Wealth Management*, Release No. IA-6680 (September 9, 2024); *In the Matter of Integrated Advisors Network*, Release No. IA-6682 (September 9, 2024). Concurrent with the proceedings, the SEC also brought and settled administrative proceedings against several RIAs for other types of Marketing Rule violations, including those related to third-party ratings. See Callahan Financial Planning (advertisements contained untrue statements about third-party ratings); *In the Matter of Abacus Planning Group*, Release No. IA-6678 (September 9, 2024) (advertisements contained untrue statements about third-party ratings, some of which were more than five years old, without disclosing the dates on which the ratings were given or the periods of time upon which the ratings were based); *In the Matter of Howard Bailey Securities*, Release No. 6681 (September 9, 2024) (advertisements claimed to contain two testimonials, but neither actually came from current clients or disclosed that the advertised endorsers were paid, non-clients); *In the Matter of Professional Financial Strategies*; Release No. 6683 (September 9, 2024), *In the Matter of Beta Wealth Group*, Release No. 6684 (September 9, 2024); and *In the Matter of Richard Bernstein Advisors* (Release No. 6685) (September 9, 2024) (advertisements included third-party ratings, some of which were more than five years old, without disclosing the dates on which the ratings were given or the periods of time upon which the ratings were based).

In each instance, the order states that the respondent RIA made the conflict-free services claim without reservation despite the fact that the respondent RIA's Form ADV Part 2A brochure specifically disclosed the presence of conflicts of interest in connection with the provision of advisory services.

The SEC further states in each order that the respondent RIA's conflict-free services claim was both material and a statement of fact and that the respondent RIA failed to substantiate the conflict-free services claim given the fact that the respondent RIA expressly disclosed the existence of conflicts of interest in its Form ADV Part 2A brochure, in violation of the Marketing Rule's unsubstantiated fact prohibition.[2]

Suggested Takeaways

- Investment advisers are fiduciaries that owe their clients a series of duties. These include a duty of loyalty to eliminate or at least expose through full and fair disclosure all conflicts of interest that might incline an investment adviser — consciously or unconsciously — to render advice that is not disinterested.[3] They also include a duty of care to act in the best interest of clients.[4] In other words, an investment adviser "cannot place its own interests ahead of the interests of its client."[5] It is important to keep in mind that compliance with these duties does not necessarily result in the complete elimination of all conflicts of interest. Few, if any, RIAs would be able to conduct their businesses free of all conflicts.
- The SEC seems to conclude in the proceedings that an RIA will be deemed to violate the unsubstantiated fact prohibition if it makes statements in its Form ADV Part 2A brochure or other documents that clearly refute or contradict a material statement of fact in its advertisements. In essence, these contradictory statements, in and of themselves, will be deemed conclusive proof that the RIA did not have a reasonable basis for the material statement of fact in its advertisements. To address this construction of the unsubstantiated fact prohibition, RIAs should carefully review all material statements of fact in their advertisements to ensure they do not conflict with statements made in their Form ADV Part 2A brochures or other documents.
- RIAs are not required to make and keep records substantiating material statements of fact in their advertisements at the time of creation or distribution.[6] Rather, they are merely required to have a reasonable basis for believing that they can substantiate these statements upon demand by the SEC. While this requirement significantly benefits RIAs to the extent that they are not required to make and keep lengthy records substantiating all material statements of fact when creating and distributing advertisements, RIAs should nevertheless consider reminding those persons responsible for reviewing advertisements to verify the accuracy of all material facts prior to distribution. For those firms that require responsible persons to complete a form or sheet signing off on all advertisements, consideration should be given to including a representation that the responsible person has a reasonable basis for believing that the statement can be substantiated.

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[2] The Marketing Rule provides that an advertisement may not include 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 SEC. See Rule 206(4)-1(a)(2). The Adopting Release for the Marketing Rule notes that the adviser's obligation to produce such materials on demand will last as long as the relevant advertisement needs to be retained under the Recordkeeping Rule. See Investment Adviser Marketing, Release No. IA-5653 (December 22, 2020). The Adopting Release also stated that "if an adviser is unable to substantiate the material claims of fact made in an advertisement when the Commission demands it, [the Commission] will presume that the adviser did not have a reasonable basis for its belief."

[3] See Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-5248 (June 5, 2019).

[4] Id.

[5] Id.

[6] See Adopting Release.

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