Davis Polk

Investment Management & Funds Regulatory Update - September 2024

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In this issue we discuss, among other things, recent enforcement actions involving investment advisers and alleged violations of the Marketing Rule under the Advisers Act.

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Rules and regulations

SEC adopts reporting enhancements for registered investment companies and provides guidance on open-end fund liquidity risk management programs

On August 28, 2024, the Securities and Exchange Commission (SEC) adopted amendments to reporting requirements on Forms N-PORT and N-CEN intended to provide the SEC and investors with more timely information about registered open-end funds, registered closed-end funds and exchange-traded funds organized as unit investment trusts. Please see our recent client update for more information on this topic.

Litigation

SEC settles charges for alleged failures to follow "biblically responsible investment" strategy as disclosed

?On September 19, 2024, the SEC issued an order (the Inspire Order) instituting and settling administrative and cease-and-desist proceedings against Inspire Investing, LLC (Inspire), an Ohio-based registered investment adviser with approximately $2.5 billion in assets under management. The SEC alleges that Inspire represented to investors that it would apply a "science- and data-driven" methodology to employ a "biblically responsible investing" strategy but failed to apply and follow that strategy as represented. The Inspire Order follows several other SEC orders settling similar charges against advisors that allegedly did not follow stated procedures for ESG-driven investing.

According to the Inspire Order, since 2017, Inspire has managed several exchange-traded funds (ETFs) employing Inspire's "biblically responsible investing" strategy. Inspire represented, in its brochure and ETF prospectuses, that Inspire used an "objective" and "rules-based" methodology to assign an "Inspire Impact Score" to prospective investments, and to exclude companies that engage in certain conduct or products, such as alcohol, cannabis, gambling, pornography, and tobacco, or certain political advocacy. Inspire also published on its website a white paper that described its Inspire Impact Score as reflecting a "rules-based, scientifically rigorous methodology."

The SEC alleges that Inspire's actual investment processes deviated from its representations to investors. The Inspire Order states that Inspire instead "relied on manual research by a small staff" of employees, and did not use "best-practice disciplines of data science" to screen companies for investment. The SEC alleges that, as a result, Inspire ETFs and managed accounts invested in companies that engaged in activities contrary to Inspire's stated policies. As a result, Inspire materially misrepresented its investment strategy to clients, and also, failed to adopt and implement written policies and procedures designed to ensure adherence to its stated policies.

On account of the conduct described above, the SEC alleges that Inspire violated Sections 206(2) and 206(4) of the Advisers Act, and Rules 206(4)-7 and 206(4)-8 thereunder, as well as Section 34(b) of the Investment Company Act.

Inspire agreed to retain an independent compliance consultant to review Inspire's policies and procedures and to make recommendations, and to implement those recommendations, to be censured, to pay a civil money penalty of $300,000, and to cease and desist from further violations.

While the Inspire Order might be the first SEC enforcement action based on failure to follow a stated "biblically responsible investing" strategy, it is a direct analogue to several recent enforcement actions arising out of alleged failures to follow stated ESG-driven investment guidelines—and an application of the basic premise that representations to investors must accurately describe the adviser's investment processes.

SEC settles charges with nine investment advisers as part of "sweep" of marketing rule violations

For several years, the SEC has been engaged in an ongoing enforcement "sweep" targeting alleged violations of Rule 206(4)-1 under the Advisers Act (the Marketing Rule), which was significantly amended in 2020 with a compliance deadline of November 4, 2022.

On September 9, 2024, the SEC announced the most recent batch of settlements entered into as part of this "sweep," i.e., settlements with nine investment advisers who allegedly engaged in a variety of practices prohibited by the Marketing Rule.

- Abacus Planning Group, Inc. (Abacus), a South-Carolina based registered investment adviser with approximately $1.68 billion in assets under management, allegedly violated the Marketing Rule by misstating on its website awards it had received (for example, stating it was rated a "Top 12 Financial Advisor" by *Barron's* when in fact it had been rated a "Top 12000 Financial Advisor"), and by failing to identify the date on which the rating was given and the time period on which the rating was based. Abacus agreed to pay a civil money penalty of $150,000.
- AZ Apice Capital Management (AZ Apice), a Miami-based registered investment adviser with approximately $345 million in assets under management, allegedly violated the Marketing Rule by misstating on its website that it was "free of conflicts of interest" without providing context for that claim, and while disclosing certain conflicts of interest in its Form ADV. AZ Apice agreed to pay a civil money penalty of $70,000.
- Droms Strauss Advisors, Inc. (Droms Strauss), a St. Louis-based registered investment adviser with approximately $676 million in assets under management, allegedly violated the Marketing Rule by misstating on its website that it

provided “conflict-free advice” without providing any context for this claim, and while disclosing various conflicts of interest in its Form ADV. Droms Strauss agreed to pay a civil money penalty of $85,000.

- Howard Bailey Securities, LLC (Howard Bailey), an Indiana-based registered investment adviser with approximately $463 million in assets under management, allegedly violated the Marketing Rule by disseminating advertisements that contained endorsements without including required disclosures under the Marketing Rule regarding compensation and conflicts of interest. For example, Howard Bailey allegedly directly and indirectly disseminated advertisements containing an endorsement that it was the “Official Wealth Management Partner” of a certain university’s athletic program (Athletic Program). The Athletic Program was not a current client and Howard Bailey paid compensation for such endorsement, which was included on Howard Bailey’s social media platforms, and the Athletic Program’s and third-party public websites and arena Jumbotron, without the required disclosures under the Marketing Rule. Howard Bailey agreed to pay a civil money penalty of $90,000.
- Integrated Advisors Network LLC (Integrated Advisors), a Dallas-based registered investment adviser with approximately $4.2 billion in assets under management, allegedly violated the Marketing Rule by publishing on its website the statement that it “eliminate[s] conflicts of interest” without providing context for the claim and while disclosing certain conflicts of interest in its Form ADV. Integrated Advisors agreed to pay a civil money penalty of $325,000.
- Professional Financial Strategies, Inc. (Professional Financial Strategies), a Pittsford, New York-based registered investment adviser with approximately $191 million in assets under management, allegedly violated the Marketing Rule by disclosing on its website that its principal had been recognized as one of 500 “top advisers” in the United States without disclosing that the principal received the award in 2007. Professional Financial Strategies agreed to pay a civil money penalty of $60,000.
- Beta Wealth Group, Inc. (Beta Wealth Group), a San Diego-based investment adviser with approximately $399 million in assets under management, allegedly violated the Marketing Rule by disclosing on its website that *Barron’s* had rated it a “Top Advisor” without disclosing that it had been given that rating in 2018 and had not attained it since. Beta Wealth Group agreed to pay a civil money penalty of $80,000.
- Richard Bernstein Advisors LLC (Richard Bernstein), a New York-based registered investment adviser with approximately $5.2 billion in assets under management, allegedly violated the Marketing Rule by publishing on its website that its principal was named one of *Fortune Magazine’s* “All Star Analysts” and one of *Smart Money Magazine* ’s “Power 30” without disclosing that those ratings had been given more than 20 years prior. Richard Bernstein agreed to pay a civil money penalty of $295,000.
- TS Bank d/b/a/ Callahan Financial (Callahan Financial), an Omaha-based registered investment adviser with approximately $248 million in assets under management, allegedly violated the Marketing Rule by publishing on its website that it was a “Member” of “Fiduciary Firm,” which the order states is a “non-existent organization.” Callahan Financial also allegedly stated on its website that it had “no conflict of interest” without providing any context for this claim, and while disclosing various conflicts of interest in its Form ADV. Callahan Financial agreed to pay a civil money penalty of $85,000.

These enforcement actions demonstrate the importance of ensuring that all marketing materials are accurate and comply with the Marketing Rule, ranging from material in public, investor-directed websites to sports arena Jumbotron ads.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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