

SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISORS ACT OF 1940, Release No. 121

November 2, 1961

TEXT:

ADOPTION OF RULE 206(4)-1 UNDER THE INVESTMENT ADVISERS ACT OF 1940

On August 8, 1961, in Investment Advisers Act Release No. 119, the Commission published its revised proposal to adopt Rule 206(4)-1 defining certain advertisements by investment advisers to be fraudulent, deceptive or manipulative within the meaning of Section 206(4) of the Investment Advisers Act of 1940. The Commission has carefully considered the comments and suggestions made on the original and revised proposals and has adopted the rule in the form stated below, effective January 1, 1962.

In September 1960 Section 206 of the Act was amended to make the anti-fraud provisions of Section 206 applicable to all investment advisers, whether registered or not, and to add a new subsection (4). This new subsection prohibits any investment adviser from engaging in any act, practice or course of business which is fraudulent, deceptive or manipulative and gives the Commission the power, by rules and regulations, to define and to prescribe means reasonably designed to prevent such acts and practices.

When considering the provisions of the rule it should be borne in mind that investment advisers are professionals and should adhere to a stricter standard of conduct than that applicable to merchants, securities are "intricate merchandise", and clients or prospective clients of investment advisers are frequently unskilled and unsophisticated in investment matters.

Subparagraph (1) of paragraph (a) of the rule prohibits advertisements containing testimonials of any kind concerning the investment adviser or any advice, analysis, report or other service rendered by the investment adviser. The Commission finds that such advertisements are misleading; by their very nature they emphasize the comments and activities favorable to the investment adviser and ignore those which are unfavorable. This is true even when the testimonials are unsolicited and are printed in full.

Subparagraph (2) of paragraph (a) prohibits an investment adviser from using an advertisement which refers, directly or indirectly, to specific recommendations which the investment adviser has made in the past, except that it does not prohibit an advertisement which sets out, or offers to furnish a list of all recommendations made by the investment adviser within the immediately preceding period of not less than one year if the advertisement, and the list if it is furnished separately, contain specified information with respect to relevant prices and the nature of the recommendation, and a specified cautionary legend in print or type as large as the largest print or type used in the body or text. The Commission believes that material of this nature, which may refer only to recommendations which were or would have been profitable and ignore those which were or would have been unprofitable, is inherently misleading and deceptive, and consequently the rule prohibits this type of advertising unless all recommendations for a minimum specified period are included.

Subparagraph (3) prohibits an advertisement which represents, directly or indirectly, that any graph, chart, formula, or other device being offered can in and of itself be used to make investment determinations. It also prohibits any advertisements which represent, directly or indirectly, that any graph, chart, formula or other device being offered can or will assist any person in making his own investment decisions unless it also prominently discloses the limitations and difficulties encountered in the use of the particular graph, chart, formula or device being offered.

Subparagraph (4) prohibits an advertisement from representing that any report, analysis or other service will be obtained free or without charge unless it is in fact entirely free and subject to no conditions or obligations.

Subparagraph (5) contains a more general provision which makes it unlawful for an investment adviser to use any advertisement if it contains any untrue statement of material fact or is otherwise false or misleading.

The rule defines the term "advertisement" to include notices, circulars, letters or other written communications addressed to more than one person, and notices or other announcements in any publication, or by radio or television, if they offer (1) any analysis, report or publication concerning securities, or (2) any graph, chart, formula or other device to be used in making any investment determination, or (3) any other investment advisory service with regard to securities.

The Commission believes that this rule, foreclosing the use of advertisements which have a tendency to mislead or deceive clients or prospective clients, is necessary to implement the statutory mandate contained in Section 206(4) of the Act, as amended.

The Commission has not made this rule effective until January 1, 1962 so that investment advisers who have made arrangements for the publication of specific advertisements in the immediate future may avoid unnecessary complications. However, investment advisers should carefully scrutinize all advertisements to be used after January 1, 1962 and should instruct their various agents, including particularly their advertising agencies, to note carefully the provisions of the rule so that advertisements used after the effective date of the rule will be in compliance with it.

Statutory Basis

The Commission, acting pursuant to the provisions of the Investment Advisers Act of 1940, as amended, and particularly Sections 206(4) and 211(a) thereof, and deeming such action necessary and appropriate to the exercise of its functions and powers under the Act and necessary to prevent fraudulent, deceptive and manipulative acts and practices by investment advisers, hereby adopts Rule 206(4)-1 as stated below, effective January 1, 1962.

Text of Rule 206(4)-1

Rule 206(4)-1. Advertisements by Investment Advisers.

(a) It shall constitute a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of Section 206(4) of the Act, for any investment adviser, directly or indirectly, to publish, circulate or distribute any advertisement:

(1) which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or concerning any advice, analysis, report or other service rendered by such investment adviser; or

(2) which refers, directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person; provided, however, that this shall not prohibit an advertisement which sets out or offers to furnish a list of all recommendations made by such investment adviser within the immediately preceding period of not less than one year if such advertisement, and such list if it is furnished separately: (A) state the name of each such security recommended, the date and nature of each such recommendation (e.g., whether to buy, sell or hold), the market price at that time, the price at which the recommendation was to be acted upon, and the market price of each such security as of the most recent practicable date, and (B) contain the following cautionary legend on the first page thereof in print or type as large as the largest print or type used in the body or text thereof: 'it should not be assumed that recommendations

made in the future will be profitable or will equal the performance of the securities in this list'; or

(3) which represents, directly or indirectly, that any graph, chart, formula or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents, directly or indirectly, that any graph, chart, formula or other device being offered will assist any person in making his own decisions as to which securities to buy or sell, or when to buy or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use; or

(4) which contains any statement to the effect that any report, analysis, or other service will be furnished free or without charge, unless such report, analysis or other service actually is or will be furnished entirely free and without any condition or obligation, directly or indirectly; or

(5) which contains any untrue statement of a material fact, or which is otherwise false or misleading.

(b) For the purposes of this rule the term 'advertisement' shall include any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities."

By the Commission.