Proskauer

SEC Issues Risk Alert Announcing Exams Focused on New Marketing Rule

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On Monday, September 19, 2022, the SEC's Division of Examinations issued a Risk Alert announcing their intent to conduct targeted reviews of registered investment advisers regarding compliance with amended Advisers Act Rule 206(4)-1 (the "Marketing Rule"), following the mandatory compliance date on November 4, 2022.[1] Reviews will be conducted both as part of specific national initiatives (sometimes referred to as "sweep" exams, which often focus on one or several related topics) as well as through the normal course of its routine compliance examinations of registered investment advisers.

While such a focus has been long and widely anticipated across the industry, the SEC's announcement came as somewhat of a surprise in that it is unusual for the Division of Examinations to so prominently highlight a special examination focus area in advance, outside of the annual announcement of the Division's examination priorities.[2] The effect is therefore to provide greater emphasis on what seems likely to be a deep and prolonged focus by the SEC on investment adviser marketing practices. And in adopting such a strong examination focus on these issues while significant interpretive questions remain unanswered,[3] the likelihood increases that the SEC examination staff – or its individual members – will begin to interpret and apply the amended Rule during the examination process in unanticipated ways.

Given the extensive and nuanced changes under the amendments, all investment advisers should begin surveying their marketing materials and practices, and their policies and procedures, in order to determine what changes will be necessary or advisable. In many respects, these changes will likely be substantial, as we discussed in our recent installment of "The Bottom Line" series.

There is still time for investment advisers to effectively identify and prioritize the necessary changes to ensure compliance with these new requirements. Please contact one of our Private Funds Group partners for more information about the amended Marketing Rule.

Following is a brief summary of the examination focus areas highlighted by the Risk Alert:

- **Marketing Rule Policies and Procedures**. Whether the adviser has adopted adequate policies and procedures, as well as compliance controls with objective and testable methods such as "internal pre-review and approval of advertisements, reviewing a sample of advertisements based on risk, or pre-approving templates."
- **Backup for Factual Statements**. Whether the adviser can provide substantiation for material factual statements, as now required under the amended Marketing Rule.
- **Performance Advertisements**. Whether investment performance information (*i.e.*, track record) within an advertisement meets the requirements under the amended Marketing Rule:
    - *Net Returns*: Net performance must accompany any gross performance information;
    - *Standard Performance Periods*: Non-private fund performance information must include one, five, and ten-year periods;
    - *Statement of SEC Approval*: Advisers may not make any statement indicating SEC review or approval of performance information;
    - *Related Performance*: Where an advertisement includes the performance of any portfolio other than the one being advertised, the performance results for all other portfolios with substantially similar investment policies, objectives, and strategies must also be shown (with narrow exceptions);
    - *Extracted Performance*: Where the performance of a subset of investments extracted from a portfolio is shown, then the advertisement must provide, or offer to provide promptly, the performance results of the total portfolio;
    - *Hypothetical performance*: Where showing hypothetical performance (*i.e.*, investment performance not achieved by any portfolio), the adviser must adopt certain related policies and procedures and be accompanied by appropriate disclosures; and
    - *Predecessor Performance*: Where showing investment performance generated at a prior investment advisory firm, the relevant investment personnel must have been primarily responsible for having generated that performance at the prior firm (per the SEC's historical guidance on this topic, as codified by the amendments).
- **Books and Records**. Whether the adviser is complying with the new books and records requirements adopted under the related amendments to Rule 204-2.

- **Form ADV**. Whether the adviser is complying with the new advertising-related disclosure requirements in Item 5.L adopted under related amendments to Form ADV (which requires the adviser to check off one or more boxes indicating whether it employs any of the enumerated advertising practices).[4]

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[1] Please see Proskauer's February 2021 Alert for additional information on these amendments.

[2] The Division's 2022 Examination Priorities contained very little emphasis on this topic at all, aside from one reference to "marketing practices" within the entire 32-page document. Please see Proskauer's April 2022 Alert for additional background on this annual announcement.

[3] Despite previously acknowledging that these amendments were likely to result in "practice changes" for advisers, replacing a regime "on which advisers have relied for decades", and despite encouraging advisers to "actively engage with Commission staff as questions arise in planning for implementation", the SEC and its staff have yet to publish any formal guidance clarifying any aspect of the amended Rule's application in specific scenarios beyond those contained in the 2020 Adopting Release.

[4] Investment advisers are only obligated to amend Item 5.L as part of their annual amendment. Accordingly, advisers generally would not be obligated to amend their Form ADV to include this information until the next annual amendment following November 4, 2022 (*i.e.*, by March 31, 2023, for an adviser with a December 31 fiscal year-end).

Related Professionals

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