

# Investment Management Alert

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

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## SEC Risk Alert Spells Out the Agency's Expectations for Investment Advisers as New Marketing Rule Takes Effect

As we noted in the October 2022 edition of our *Investment Management Update*, on September 19, 2022, the U.S. Securities and Exchange Commission's (SEC's) Division of Examinations (Examinations) issued a [risk alert](#) to inform persons registered, or required to be registered, with the SEC as investment advisers (Advisers) about areas of focus during upcoming examinations relating to the amended Rule 206(4)-1 (Marketing Rule) under the U.S. Investment Advisers Act of 1940 (Advisers Act).

The Marketing Rule replaced two separate rules and a patchwork of regulatory guidance that previously governed advertising practices and solicitation arrangements for Advisers. With the compliance date of the Marketing Rule slated for November 4, 2022, the investment management industry has been avidly awaiting guidance on many aspects of the new rule.

When the Marketing Rule was adopted on December 22, 2020, it represented a significant overhaul to the SEC's approach to regulating how Advisers advertise themselves and their investment products, including private funds, and how they communicate with their clients and investors. While the Marketing Rule codified certain longstanding SEC interpretive positions, it also imposed many new and detailed compliance requirements, including revisions to the definition of "advertisement," a new disclosure, oversight and disqualification framework applicable to testimonials and endorsements, and new disclosure and preparation criteria requirements applicable to the use of third-party ratings. For more information on these requirements, see "[SEC Adopts Modernized Marketing Rule for Investment Advisers](#)" in the June 2021 issue of our *Investment Management Update*.

Looking forward, as indicated in the risk alert, Examinations intends to conduct a number of specific national initiatives to ensure compliance with the Marketing Rule that will include, among others, the following areas:

### Marketing Rule Policies and Procedures

Examinations stated that it will review whether Advisers have adopted and implemented written policies and procedures reasonably designed to prevent violations of the Advisers Act, including the Marketing Rule. The risk alert restated the SEC's guidance from the Marketing Rule's [adopting release](#) that "for ... compliance policies and procedures to be effective, they should include objective and testable means reasonably designed to prevent violations of the final rule in the advertisements the adviser disseminates."

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The risk alert further provides that an example of “objective and testable” means could include, but are not limited to, conducting an internal pre-review and approval of advertisements, reviewing a sample of advertisements based on risk, or pre-approving templates.

## Substantiation Requirement

As noted in the June 2021 *Investment Management Update*, the Marketing Rule will require Advisers to have a “reasonable basis” for believing that they are able to substantiate a material statement of fact included in an advertisement upon demand by the SEC. Accordingly, the risk alert provides that this is another area on which Examinations will focus. As noted in the adopting release, Advisers can demonstrate a reasonable belief by (i) creating a record contemporaneous with the advertisement demonstrating the basis for their belief or (ii) choosing to implement policies and procedures to address how this requirement is met.

The risk alert goes on to provide that, if an Adviser is unable to substantiate a material statement of fact when the SEC demands it, the SEC will presume that an Adviser does not have a “reasonable basis” for its belief.

## Performance Advertising Requirements

Examinations also stated that it will review whether Advisers are in compliance with the Marketing Rule’s detailed performance advertising requirements, including the prohibitions on use of the following performance-related information in any advertisement:

- gross performance, unless the advertisement also presents net performance;
- any performance results, except the performance results of private funds, unless such results are provided for specific time periods (specifically, one-, five- and 10-year periods);
- any statement that the SEC has approved or reviewed any calculation or presentation of performance results;

- if an advertisement includes the performance of portfolios other than the portfolio being advertised, unless performance results are included for all other portfolios with substantially similar investment policies, objectives and strategies as the portfolio being offered in an advertisement (with limited exceptions);
- performance results of a subset of investments extracted from a portfolio, unless the advertisement provides, or offers to provide promptly, the performance results of the total portfolio;
- hypothetical performance, unless the adviser adopts and implements policies and procedures reasonably designed to ensure that the performance is relevant to the likely financial situation and investment objectives of the intended audience and the adviser provides certain additional information; and
- predecessor performance, unless (i) the personnel primarily responsible for achieving the predecessor performance manage accounts at the advertising adviser and (ii) the accounts that were managed by those personnel at the predecessor adviser are sufficiently similar to the accounts that they manage at the advertising adviser. In addition, the advertising adviser must include all relevant disclosures clearly and prominently in the advertisement.

## Books and Records

The risk alert goes on to conclude and remind Advisers that Rule 204-2 under the Advisers Act (Books and Records Rule) and the Form ADV questionnaire were also amended in connection with the Marketing Rule. The Books and Records Rule requires Advisers to retain certain records, such as records of all disseminated advertisements, including internal working papers, performance-related information and documentation for oral advertisements, testimonials and endorsements. The amended Form ADV questionnaire requires Advisers to provide additional information about their marketing practices.

Examinations stated that it will review compliance with the Books and Records Rule and the risk alert reminds Advisers of their obligations to accurately complete the new Form ADV questions in their next annual Form ADV amendment.