ALERTS

SEC Marketing Rule Update: What Private Fund Advisers Should Be Thinking About as the November 4 Compliance Date Approaches

September 20, 2022

By Nov. 4, 2022 (the "Compliance Date"), registered investment advisers ("RIAs") must comply with the requirements of amended Rule 206(4)-1 (the "Amended Marketing Rule").[1] The Amended Marketing Rule will significantly impact RIAs' marketing materials and other investor communications, performance calculations and related disclosures as well as existing and new placement agent arrangements. In addition, RIAs will need to review and likely revise their Form ADV, compliance policies and procedures, and recordkeeping practices.

Just yesterday, the SEC Division of Examinations Staff released a Risk Alert[2] reminding RIAs of their obligations under the Amended Marketing Rule and offering steps that advisers should take to ensure they meet their obligations by the Compliance Date. Notably, the Staff indicated that it intends to "conduct a number of specific national initiatives, as well as a broad review through the examination process, for compliance with the Marketing Rule."[3] The Risk Alert noted that these initiatives and examinations will focus on, but not be limited to, the following areas: adoption and implementation of policies and procedures, compliance with the substantiation requirement, compliance with the various performance advertising requirements and compliance with the books and records requirements.

In light of this Risk Alert and with only a few weeks until the Compliance Date, RIAs should currently be taking steps to:

(i) Finalize marketing policies and procedures to reflect the requirements of the Amended Marketing Rule;

(ii) Confirm all "advertisements" disseminated on or after the Compliance Date comply with the requirements of the Amended Marketing Rule and in particular the substantiation requirement;

(iii) Confirm all "advertisements" that include performance comply with the various performance reporting requirements, as applicable (e.g., net performance, related performance, extracted performance, hypothetical performance and predecessor performance);

(iv) Confirm that recordkeeping policies and procedures as well as recordkeeping practices are updated to reflect the requirements of the Amended Marketing Rule and related amendments to Rule 204-2;

(v) Confirm that endorsement or testimonials, including placement agent and other solicitation agreements, comply with the requirements of the Amended Marketing Rule; and

(vi) Consider whether and when Form ADV amendments will need to be made in order to reflect new disclosure requirements under the Amended Marketing Rule.

While many RIAs have been preparing to comply with the Amended Marketing Rule for some time now, as the Compliance Date approaches, RIAs should consider several key items:

- *The scope of marketing materials subject to the Amended Marketing Rule is broad.* The Amended Marketing Rule includes a two-prong definition of "advertisement." The first prong includes "any direct or indirect communication an investment adviser makes to more than one person, or to one or more persons if the communication includes hypothetical performance, that offers the investment adviser's investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the investment adviser or offers new investment advisory services with regard to securities to current clients or investors in a private fund advised by the investment adviser. . . ."[4] Extemporaneous, live oral communications, information contained in statutory or regulatory notices and filings and certain one-on-one communications are excluded from this definition.

The second prong generally includes "any endorsement or testimonial for which an adviser provides compensation, directly or indirectly. . . ."[5] This prong expands coverage of solicitation arrangements to include placement agent arrangements for private fund investors.

RIAs should inventory all investor communications and assess which now meet the definition of "advertisement." RIAs also should evaluate current and future placement agent agreements and other similar investor referral or solicitation arrangements to ensure compliance with the Amended Marketing Rule.

- *Marketing materials may need significant revisions and enhanced disclosures.* RIAs should assess what changes need to be made to their marketing materials prior to the Compliance Date in order to comply with new requirements. Relevant updates can include changes and/or additions to disclosures, content and structure of materials, including performance-related information. For funds in the market prior to the Compliance Date, RIAs should consider what changes need to be made to marketing materials if fundraising efforts will continue after the Compliance Date. Similarly, RIAs should assess what marketing materials have been made available to prospective investors prior to the Compliance Date and whether, under the Amended Marketing Rule, such materials may need to be revised if they continue to be made available to prospective investors after the Compliance Date (e.g., prior letters to investors).

- *Performance calculations may need to be revised.* The Amended Marketing Rule sets forth specific requirements with regard to the presentation of performance, including, among other things, requirements with respect to the presentation of gross and net performance, hypothetical performance, related performance and extracted performance. RIAs should be reviewing how they present various performance metrics in their marketing materials, including the underlying performance calculation methodologies and related disclosures, to ensure such performance presentations comply with the requirements of the Amended Marketing Rule.

- *Material statements of fact are now subject to substantiation.* The Amended Marketing Rule prohibits advertisements that 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. RIAs should evaluate the material statements of facts included in their marketing material and how such statements are substantiated.

- *Compliance policies and procedures will need to be revised.* The Amended Marketing Rule will require policies and procedures to be updated and revised, as appropriate, to ensure they are reasonably designed to prevent violations of the Amended Marketing Rule. In most cases, marketing policies will require substantial changes addressing the content of advertisements, the use of performance information (including hypothetical performance) and placement agent arrangements, among other changes. RIAs should be reviewing and updating their compliance policies and procedures accordingly.

- *Form ADV will need to be amended.* Firms should evaluate when and how their Form ADV needs to be amended. New disclosures with respect to an adviser's marketing materials are included in Part 1A of Form ADV, and changes made to comply with the Amended Marketing Rule may be responsive to items in Part 2A as well.

- *Recordkeeping policies and practices will need to be revised.* The Amended Marketing Rule adds certain recordkeeping obligations, which require updates to an RIA's recordkeeping policies and procedures and, in some cases, changes to an RIA's recordkeeping practices. RIAs should review these requirements now to ensure they will be able to comply with them by the Compliance Date.

- *Training should be undertaken to assist relevant personnel with understanding the requirements of the Amended Marketing Rule.* Due to the significant impact that the Amended Marketing Rule will have on an RIA's marketing materials, investor communications, performance calculations and placement agent arrangements, training sessions for relevant personnel (e.g., investor relations, marketing and other investor-facing personnel as well as finance and compliance personnel) can be helpful for ensuring that such personnel understand how the requirements of the Amended Marketing Rule will impact their day-to-day activities.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] Investment Adviser Marketing, 86 Fed. Reg. 13024, 13093 (March 5, 2021). The Amended Marketing Rule, like its predecessor, applies to any investment adviser registered or required to be registered with the SEC under Section 203 of the Investment Advisers Act of 1940, as amended, but does not apply to investment advisers that are not required to register with the SEC, such as exempt reporting advisers ("ERAs"). *Id.* at 13026 n.21. However, marketing materials prepared by ERAs must comply with general anti-fraud obligations applicable to all advisers. *See id.* at 13032 and 13039–40. ERAs may look to certain aspects of the Amended Marketing Rule, in particular the general prohibitions set forth therein, as a guide to complying with general anti-fraud requirements. *See e.g., id.* at 13042.

[2] *See* Examinations Focused on the New Investment Adviser Marketing Rule (Sept. 19, 2022), available here.

[3] *See id.* (emphasis added).

[4] 17 C.F.R. § 275.206(4)-1(e)(1)(i) (emphasis added).

[5] 17 C.F.R. § 275.206(4)-1(e)(1)(ii) (emphasis added).

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