

**Alert | Financial Regulatory & Compliance/
Investment Management**



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SEC Cracks Down on Marketing Rule Violations: Takeaways for Investment Advisers

On Aug. 9, 2024, the Securities and Exchange Commission initiated administrative and cease-and-desist proceedings against a U.S. registered investment adviser (the Adviser). This action resulted from the Adviser's failure to comply with the SEC **amended Marketing Rule** under the Investment Advisers Act of 1940 (Advisers Act), adopted to modernize rules that govern investment adviser advertisements and payments to solicitors.

Specifically, the Adviser had advertised hypothetical performance on its public website without implementing policies and procedures to ensure the performance data was relevant to the intended audience's financial situation and investment objectives.

Background

The Marketing Rule, which the SEC amended in December 2020, replaced the then-current advertising rule's broad limitations with principles-based provisions to accommodate the evolution and interplay of technology and investment advice, including through tailored requirements for certain types of advertisements. Most relevant in this instance, the Marketing Rule restricts investment advisers from including hypothetical performance in advertisements unless they design policies and procedures to ensure the performance data is relevant to the likely financial situation and investment objectives of the intended audience.

During the relevant period, the Adviser's website featured advertisements with hypothetical performance derived from model portfolios aimed at a general audience, not a specific intended audience, while the firm lacked compliant policies and procedures.

The SEC censured the Adviser, ordered it to cease and desist from committing future violations of Section 206(4) of the Advisers Act and Rule 206(4)-1, imposed a \$430,000 penalty, and required it to make several undertakings. These undertakings required that the Adviser evaluate, update, and review its policies and procedures related to advertisements containing hypothetical performance. The SEC noted that in March 2024, the Adviser appointed a new executive team, including a new chief executive officer, chief compliance officer, and chief legal officer, who promptly assessed the situation and cooperated fully with the SEC staff.

Implications for Investment Advisers

This enforcement action underscores the SEC's rigorous scrutiny of compliance with the Marketing Rule, particularly concerning the use of hypothetical performance in advertisements. Investment advisers should clearly communicate with clients and prospective clients about the nature of hypothetical performance data and the assumptions underlying such data.

Given the SEC's continuing focus on the Marketing Rule, investment advisers should consider:

- Reviewing and updating compliance policies to ensure hypothetical performance data is relevant to the financial situation and investment objectives of the targeted audience and includes clear disclosures about the assumptions underlying the data.
- Maintaining detailed records of the broader policies and procedures implemented to comply with the Marketing Rule.
- Preparing for SEC examinations and an increased SEC focus on marketing practices and properly documenting compliance review of all advertising materials, as related to both drafts and final versions, and specifically with respect to the adviser's reasonable basis for making the material statements of fact in those advertisements.
- Performing periodic internal audits of marketing materials and compliance practices to identify and rectify any potential issues, including related to the performance advertising requirements in the Marketing Rule, before they attract regulatory scrutiny.
- Regularly training marketing and compliance teams on the latest regulatory requirements and best practices for advertising, including Marketing Rule-specific policies and procedures, conducting periodic workshops and refreshers to ensure ongoing Marketing Rule compliance awareness, based on the then current marketing practices of the adviser.
- Reviewing and addressing the additional questions concerning their marketing practices included in amended Form ADV.

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