

THE SEC'S MARKETING RULE

LESSONS (AND QUESTIONS) ONE YEAR LATER

Christine Lombardo, Jack O'Brien, Christine Schleppegrell,
Steve Stone, Ellen Weinstein

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Presenters



Christine Lombardo



Jack O'Brien



**Christine Ayako
Schleppegrell**



Steve Stone



Ellen Weinstein

Roadmap

- Overview of Marketing Rule
- SEC FAQs and Risk Alerts
- Examination Priorities
- Enforcement Actions
- FINRA Proposal
- Issues and Questions

The SEC's Marketing Rule – Overview

- Expanded definition of “advertisement”
 - Types of private fund communications in and out of scope
- General prohibitions
- Framework for use of performance advertising
 - Gross and net
 - 1-, 5-, and 10-year time period requirements (private funds excluded)
 - Related
 - Extracted
 - Predecessor
 - Hypothetical
- Third-party ratings
- Testimonials & Endorsements

Marketing Rule SEC FAQs and Risk Alerts

- On September 19, 2022, the SEC's Division of Examinations issued a [Risk Alert](#) to investment advisers identifying the staff's initial Marketing Rule exam initiatives and areas of review
 - Written policies and procedures should include objective and testable means reasonably designed to prevent violations of the Marketing Rule
 - Substantiation requirement, performance advertising requirements, and books and records
- SEC FAQs - last updated January 11, 2023
 - Time Period Requirement
 - Gross and Net Performance / Extracted Performance
- On June 8, 2023, the SEC's Division of Examinations issued a [Risk Alert](#) to investment advisers identifying the staff's additional areas of focus
 - General prohibitions, testimonials and endorsements, third-party ratings, Form ADV

2024 SEC Examination Priorities

- 2024 priorities indicate a continued focus on investment advisers and marketing practices, including compliance with Marketing Rule
 - *Marketing practice assessments for whether advisers, including advisers to private funds, have: (1) adopted and implemented reasonably designed written policies and procedures to prevent violations of the Advisers Act and the rules thereunder including reforms to the Marketing Rule; (2) appropriately disclosed their marketing related information on Form ADV; and (3) maintained substantiation of their processes and other required books and records. Marketing practice reviews will also assess whether disseminated advertisements include any untrue statements of a material fact, are materially misleading, or are otherwise deceptive and, as applicable, comply with the requirements for performance (including hypothetical and predecessor performance), third-party ratings, and testimonials and endorsements.*

Enforcement Actions

- Several enforcement actions have been issued to date under new Marketing Rule
 - No grace period for compliance
- August 21, 2023 – first settled action announced relating to use of hypothetical performance metrics in advertisements
- September 11, 2023 – Actions against nine investment advisers resulting from SEC Marketing Rule sweep
 - All actions involved advertising hypothetical performance to the general public (i.e., publicly accessible website)
 - Two of the nine also involved alleged books and records violations
 - Penalties ranging from \$50,000 to \$175,000
- SEC Division of Enforcement's investigation of potential Marketing Rule violations is ongoing
- Focusing on technicalities

FINRA – Proposed Rule Exception for Projections

- Filed with the SEC on November 13
- Permitted to include projections of performance or targeted returns:
 - Institutional communications
 - Communications distributed or made available solely to qualified purchasers that that promote or recommend a private placement that is sold solely to qualified purchasers
- Conditions on the member firm:
 - Must have written policies and procedures to ensure communication is relevant to the likely financial situation and investment objectives of the recipient investor
 - Must have a reasonable basis for the criteria used and assumptions made in calculating the projection or targeted return, and retain supporting written records
 - Proposed Supplemental Material .01 sets forth multiple factors to consider
 - Prominent disclosures of hypothetical nature and no guarantee of achievement
 - Must provide sufficient information to investor to understand calculation and risks

Issues and Questions

- Scope of definition of “advertisement”
- Dividend yields as portfolio characteristics vs. performance advertising
- Processes for monitoring for disqualified persons functioning as solicitors
- Calculation of model fees
- Creating (and disclosing) net extracted performance
- Social Media
- Substantiation
- Books and Records
- Nexus with ESG strategies and related SEC Staff focus
- Intersection of Marketing Rule and new Private Fund Adviser Rules
- Artificial Intelligence and Predictive Data Analytics

Christine M. Lombardo



Philadelphia

+1.215.963.5012

New York

+1.212.309.6629

christine.lombardo@morgan
lewis.com

Christine Lombardo advises investment managers and broker-dealers on financial regulatory matters. She concentrates her practice on securities regulation for a broad range of financial firms including retail asset managers, private fund managers, family offices, broker-dealers, other professional traders, and high-net-worth individuals. Christine also counsels legal, compliance, and business personnel on the structure, operation, and distribution of advisory programs, including digital advisory offerings, and investment products, including hedge funds, private equity funds, venture capital funds, real estate funds, and other alternative investment products.

Morgan Lewis

Jack O'Brien



Philadelphia

+1.215.963.4969

john.obrien@morganlewis.com

John J. "Jack" O'Brien counsels registered and private funds and fund managers in connection with organizational, offering, transactional, and compliance matters. He regularly works with a variety of different fund structures, including open-end and closed-end funds, exchange-traded funds, and hedge funds. He also counsels investment adviser and broker-dealer clients on various matters, particularly with respect to registration and disclosure, marketing regulations, pay-to-play issues, and transactions in exchange-traded funds.

Morgan Lewis

Christine Ayako Schleppegrell



Washington, DC
+1.202.739.5259
christine.schleppegrell@morg
anlewis.com

Christine Ayako Schleppegrell counsels asset managers on legal, regulatory, and compliance matters, focusing on advisers to private funds (private equity, hedge, venture capital, infrastructure, real estate, credit) and separately managed accounts. She spent several years in private practice and more recently at the US Securities and Exchange Commission (SEC), including in leadership roles in the Division of Investment Management. While at the SEC, Christine led the Private Funds Branch during a time of landmark rulemaking impacting private fund advisers—she draws on this experience to advise on current and pending regulations and to guide clients through enforcement and examination proceedings.

Steven W. Stone



Washington, DC

+1.202.739.5453

steve.stone@morganlewis

.com

Steven W. Stone is a securities lawyer who counsels clients on regulations governing broker-dealers, investment advisers and bank fiduciaries, and pooled investment vehicles. Head of the firm's financial institutions practice, Steve counsels most of the largest and most prominent US broker-dealers, investment banks, investment advisers, and mutual fund organizations. He regularly represents clients before the US Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA), both in seeking regulatory relief and assisting clients in enforcement or examination matters.

Ellen G. Weinstein



New York

+1.212.309.6106

ellen.weinstein@morganewis.
com

Ellen Weinstein focuses her practice on a wide range of securities regulatory issues facing investment advisers, including private investment funds and large financial institutions. She provides counsel to these companies on regulatory compliance, SEC examinations, preparation of policies and procedures, and structure and operations.

While in law school, Ellen served as a legal intern at the US Securities and Exchange Commission and the Consumer Financial Protection Bureau. Prior to joining Morgan Lewis, Ellen worked at a leading cryptocurrency exchange, focusing on emerging regulatory and compliance issues in the fintech space.

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