

The SEC Renews its Emphasis on Compliance with the New Marketing Rule

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On June 8, 2023, the Securities and Exchange Commission's ("SEC") Division of Examinations ("Division") released a risk alert (the "Risk Alert") outlining the SEC's broadened examination priorities with respect to revised Rule 206(4)-1 (the "Marketing Rule") under the Investment Advisers Act of 1940 (the "Advisers Act"). The Marketing Rule, which became effective on May 4, 2021, with a compliance deadline of November 4, 2022, significantly reformed old advertising-related rules, and codified numerous SEC no-action letters previously applicable to registered investment advisers' marketing practices.

Initial Marketing Rule Exam Areas of Review

The Risk Alert expands upon another SEC risk alert issued by the Division on September 19, 2022 (the "September 2022 Risk Alert"), which highlighted the following four examination focus areas with respect to the Marketing Rule:

- Marketing Rule Policies and Procedures (*i.e.*, have advisers adopted and implemented written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder, including the Marketing Rule);
- Substantiation Requirements (*i.e.*, do advisers have a reasonable basis for believing they will be able to substantiate material statements of facts in advertisements upon demand by the SEC, including claims about performance);
- Performance Advertising Requirements (*i.e.*, are advisers in compliance with the performance advertising requirements under the Marketing Rule, including with respect to "predecessor," "extracted," and "hypothetical" performance); and
- Books and Records (*i.e.*, are advisers in compliance with the recordkeeping requirements of Rule 204-2 under the Advisers Act, including with respect to advertisements disseminated to prospective investors and clients).

Continuing Review for Compliance with Marketing Rule General Prohibitions

In the Risk Alert, the SEC indicated it has focused, and would continue to focus, on whether advisers have complied with the general principles-based prohibitions under the Marketing Rule. Those prohibitions include, but are not limited to:

1. Making untrue statements of material facts or omitting material facts in advertisements.
2. Not providing fair and balanced treatment of associated material risks or limitations when discussing potential benefits resulting from the adviser's services or methods of operation.
3. Referencing specific investment advice provided by the adviser in advertisements in a manner that is not fair and balanced.
4. Including information in advertisements that is otherwise materially misleading.

Additional Marketing Rule Areas of Emphasis

In addition, the Risk Alert indicated that SEC examinations would focus on other aspects of the Marketing Rule, including requirements on advisers' usage of testimonials and endorsements, third-party ratings, and new reporting requirements in the Form ADV.

Testimonials and Endorsements

With respect to testimonials and endorsements used in an adviser's marketing materials, the SEC indicated that it would consider the following during examinations:

- Whether the testimonial or endorsement includes clear and prominent disclosures of the promoter's status as a current client or investor of the adviser, of the fact that the promoter is compensated (if applicable), and of material conflicts of interest;
- Whether the adviser has a reasonable basis for believing the testimonial or endorsement complies with the requirements of the Marketing Rule;
- Whether the adviser has entered into a written agreement with the promoter (except where the two parties are affiliated or where only *de minimis* compensation is provided for the testimonial or endorsement); and
- Whether the adviser has provided compensation to any person the adviser knew or reasonably should have known was an "ineligible person" under the Marketing Rule for receipt of such compensation.

Third-Party Ratings

As for third-party ratings, the SEC emphasized that inclusion of such ratings in advertisements must be accompanied by clear and prominent disclosure of the following:

1. The date the rating was given and the period of time upon which the rating was based.
2. The identity of the third party that created the rating.
3. Any compensation provided by the adviser for the rating.

In addition, examinations will review whether advisers had a reasonable basis for believing that any questionnaires or surveys used for third-party ratings were designed to make it equally easy for a participant to provide both favorable and unfavorable responses and not prepared to produce a predetermined result.

Form ADV

Finally, the SEC indicated that examinations would assess whether advisers have accurately completed the new advertising-related questions in the Form ADV (in particular, Item 5.L. of Part 1A of the form).

The SEC has consistently demonstrated its attention to and focus on the Marketing Rule, and advisers should review their advertisements practices, policies, and procedures in order to ensure full compliance with its requirements.

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