Investment Services Regulatory Update

October 2022

Monthly Version

VedderPrice

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GUIDANCE & ALERTS

SEC Staff Issues Risk Alert on New Investment Adviser Marketing Rule

On September 19, 2022, the SEC's Division of Examinations issued a risk alert highlighting the staff's observations about review areas for upcoming examinations focused on the new investment adviser marketing rule, amended Rule 206(4)-1 under the Investment Advisers Act. The SEC adopted the new marketing rule on December 22, 2020 to provide for a single rule in place of the previous advertising and cash solicitation rules. The new marketing rule has a compliance date of November 4, 2022, meaning that any advertisements disseminated on and after that date are subject to the new rule.

The staff stated that future examinations based on the new marketing rule will focus on, among others things, the following areas:

- Whether investment advisers have adopted and implemented written policies and procedures reasonably designed to prevent violations of the new marketing rule, including whether policies include objective and testable methods to prevent violations in advertisements. The risk alert noted examples of such methods identified in the adopting release for the new marketing rule, which include internal pre-review and approval of advertisements, a risk-based review of a sample of advertisements and pre-approving templates.
- Whether advisers have a reasonable basis for believing they can substantiate statements of material fact published in advertisements. In the adopting release for the new marketing rule, the SEC suggested that advisers consider preparing records contemporaneous with any advertising material that substantiate material statements in the advertisement or implement policies and procedures to address the substantiation requirement.
- Whether advisers comply with performance advertisement requirements and prohibitions on including the following content in advertisements:
  - Gross performance results in the absence of net performance;
  - Performance results that are not provided for specific time periods (not applicable to the performance of private funds);
  - Statements to the effect that the SEC has approved or reviewed calculations or presentations of performance results;
  - If an advertisement includes performance information for portfolios other than the portfolio being advertised, performance results from fewer than all portfolios with investment policies, objectives and strategies substantially similar to those of the portfolio being offered in the advertisement, subject to limited exceptions;
  - Performance results of a subset of investments in a portfolio, unless the advertisement provides, or offers to provide promptly, performance results of the whole portfolio;
  - Hypothetical performance results, unless the adviser adopts and implements policies and procedures to ensure that the performance information is relevant to the likely financial situation and investment objectives of the target audience and the adviser provides certain additional information; and
  - Predecessor performance returns, unless the same personnel responsible for achieving the predecessor performance returns manage accounts at the current adviser and the predecessor accounts previously managed by those personnel are sufficiently similar to the accounts they currently manage. Any advertisements providing predecessor performance returns must clearly and prominently include all relevant disclosures.

The staff will also focus on whether investment advisers are complying with new books and records requirements implemented in connection with the new marketing rule.

The SEC staff encouraged investment advisers to appropriately address modifications to training, supervisory, oversight and compliance programs in accordance with the new marketing rule.

The risk alert is available here.

Litigation and Enforcement Proceedings

ENFORCEMENT DEVELOPMENTS

SEC Settles Charges against 16 Firms for Alleged Recordkeeping Failures from "Off-Channel Communications"

On September 27, 2022, the SEC announced the settlement of administrative proceedings brought against 15 broker-dealers and one affiliated investment adviser for alleged violations of the recordkeeping provisions of the Securities Exchange Act of 1934. The proceedings arose out of widespread use of "off-channel communications"—employees' use of personal devices to communicate business matters by personal text messages or other text messaging platforms, such as WhatsApp—which generally were not maintained or preserved by the firms. The press release announcing the settlements stated that the firms' failure to maintain and preserve required records likely deprived the SEC of such records for use in various investigations, and that the alleged compliance failures involved employees at multiple levels of authority, including supervisors and senior executives.

The firms agreed to pay combined penalties of more than $1.1 billion and to implement improvements to their compliance policies and procedures to address the violations. Each firm was ordered to cease and desist from future violations of the relevant recordkeeping provisions, and were required to retain compliance consultants to aid the firms in conducting comprehensive reviews of their policies and procedures related to retaining electronic communications on personal devices and dealing with non-compliance by employees.

The Director of the SEC's Division of Enforcement, Gurbir S. Grewal, noted that other broker dealers and asset managers who are subject to similar recordkeeping requirements "would be well-served to self-report and self-remediate any deficiencies."

The SEC's press release is available here.

SEC Settles Charges Against Adviser for Violating Proxy Voting Rule

On September 20, 2022, the SEC announced that it had settled charges against a registered investment adviser for alleged violations of its obligation to vote proxies on behalf of clients in a manner that is in the clients' best interests.

According to the SEC's order, the investment adviser had engaged a third-party service provider to vote proxies on behalf of registered funds it advised. From January 2017 through January 2022, the adviser had a standing instruction that directed the service provider to vote the funds' securities in favor of any proposal put forth by the respective issuers' management and against any shareholder proposals. Throughout the relevant period, the service provider voted proxies in this manner without exception, and the adviser never deviated from the standing instruction. Further, the SEC alleged that the adviser did not review proxy materials for more than 200 shareholder meetings for which it cast votes, nor did it take any other steps to determine whether votes were cast in the best interests of fund shareholders. During this time, the adviser stated in its Form ADV that proxies are voted in clients' best interests. The adviser also had in place policies and procedures requiring that the adviser vote proxies with the goals of, among other things, maximizing the value of fund investments and promoting accountability of management and boards, and that reasonable care and diligence be exercised to ensure that voting rights are properly and timely exercised.

The SEC found that the investment adviser had willfully violated Section 206(2) of the Investment Advisers Act, which makes it unlawful for any adviser to engage in a transaction, practice or course of business that operates as a fraud or deceit upon a client or prospective client; Section 206(4) of the Advisers Act, which makes it unlawful for any adviser to engage in any act, practice or course of business that is fraudulent, deceptive or manipulative; and Rule 206(4)-6 under the Advisers Act, which requires advisers to adopt and implement written policies and

procedures that are reasonably designed to ensure that advisers vote client securities in the best interests of clients.

In the settlement of the charges, without admitting or denying the findings set forth in the SEC's order, the investment adviser agreed to be censured, to cease and desist from committing or causing violations of applicable law and regulation and to pay a $150,000 civil penalty.

The SEC's order is available here. A related press release is available here.

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Vedder Price's Investment Services Group has received a 2021 Go-To Thought Leadership Award from the National Law Review in recognition of the Group's regular securities law thought leadership contributions and outstanding analysis of issues affecting the asset management industry.

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Investment Services Group

With significant experience in all matters related to design, organization and distribution of investment products, Vedder Price can assist with all aspects of investment company and investment adviser securities regulations, compliance issues, derivatives and financial product transactions, and ERISA and tax inquiries. Our highly experienced team has extensive knowledge in structural, operational and regulatory areas, coupled with a dedication to quality, responsive and efficient service.