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TRACKING THE PERFORMANCE OF THE ADVISERS ACT MARKETING RULE SINCE ITS INCEPTION

Over two years have passed since the compliance date for the amendments to Rule 206(4)-1 (the "Marketing Rule" or the "Rule") adopted by the SEC under the Investment Advisers Act of 1940 (the "Advisers Act"). Since that date, the SEC Staff's focus on Marketing Rule compliance has been intense. This article summarizes Marketing Rule developments since the November 4, 2022 compliance date, including SEC Staff guidance, risk alerts, examination priorities, and enforcement actions, and discusses related on-going implementation challenges.

By Aaron J. Russ and Kelley A. Howes *

Amidst the growth of the asset management industry,[1] investment advisers continue to seek opportunities to distinguish themselves in the market and attract new clients by offering innovative products and services, developing new methods of delivering investment advice, and leveraging technological advancements. Investment advisers also need to communicate these innovations to current and potential clients and investors, and such communications are generally "advertisements" for purposes of the Rule. Investment adviser marketing has long been a focus of the SEC, given the potential risks of misleading clients.

To modernize the Rule and consolidate decades of prior SEC Staff guidance, the SEC adopted significant amendments to Rule 206(4)-1 on December 22, 2020 (the "Amendments").[2] As revised, the Marketing Rule imposes a set of seven principles-based general prohibitions that apply to all advertisements disseminated by registered investment advisers ("investment advisers"),[3] in addition to specific

[1] Joseph Lai & Ju-Hon Kwek, Beyond the Balance Sheet: North American Asset Management 2024, McKinsey & Company (Sept. 18, 2024) *available at* https://www.mckinsey.com/industries/financial-services/our-insights/beyond-the-balance-sheet-north-american-asset-management-2024 (reporting that the global asset management industry's collective assets under management grew to a record $132 trillion as of June 2024); *see* Investment Adviser Industry Snapshot 2024, Investment Advisers Association and COMPLY (2024) (stating that over the past six years, over 24 million more individuals have engaged an investment adviser for asset management — a rate of growth in the number of individual clients of 12.8% per year).

[2] Investment Adviser Marketing, Adv. Act Rel. No. IA-5653 (Dec. 22, 2020) (hereinafter, the "Adopting Release"). Before the Amendments, the SEC had not updated Rule 206(4)-1 since its adoption in 1961.

[3] The Rule does not strictly apply to exempt reporting advisers ("ERAs") or other investment advisers that are not registered with the SEC. However, such investment advisers are subject to the antifraud provisions of Section 206 of the Advisers Act and,

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conditions that apply to advertisements that contain performance, testimonials, endorsements, and third-party ratings. Notably, the Amendments expand the Rule to apply to investment adviser communications and solicitation activities directed to investors in private funds.[4]

Over two years have passed since the November 4, 2022 compliance date for the Amendments and, to date, the SEC and its Staff have not been shy about their interest in scrutinizing investment advisers' Marketing Rule compliance. In numerous speeches and at industry events, senior SEC officials have repeatedly reaffirmed the Rule as a top priority.[5] Additionally, the SEC Staff have published Marketing Rule risk alerts, examination priorities, and responses to frequently asked questions ("FAQs") addressing the Rule and the Amendment, as discussed below. Most notably, the SEC's Division of Enforcement ("Enforcement") Staff conducted an enforcement sweep focusing on the Marketing Rule, which resulted in numerous enforcement actions against investment advisers to date and shows no signs of abating, as discussed in Section III below.

Several implementation challenges have arisen as the industry grapples with novel applications of the Rule. This article canvasses those topics and discusses the current Marketing Rule landscape after more than two years of experience with implementation of the Amendments.

I. SEC STAFF GUIDANCE AND OTHER STATEMENTS

A. SEC Staff Risk Alert

On April 17, 2024, the SEC's Division of Examinations ("EXAMS") Staff published a risk alert (the "Risk Alert") identifying Marketing Rule observations from recent investment adviser examinations, marking the Staff's third[6] risk alert addressing the Marketing Rule since 2021.[7] In the Risk Alert, the Staff identified various deficiencies it observed regarding investment advisers Marketing Rule practices, including issues involving policies and procedures, performance advertising, books and records, and the Rule's general prohibitions. The Staff also highlighted deficiencies that involved a more nuanced application of the Rule, including advertisements that, for example:

- Presented net performance returns reflecting lower fees than those that were offered to the advertisement's intended audience;[8]

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in certain instances, Rule 206(4)-8 thereunder. Thus, it is possible that the SEC could use these provisions to apply the same Marketing Rule standards to ERAs and unregistered investment advisers, given that the Marketing Rule addresses many practices that the SEC believes are inherently misleading.

[4] The Rule applies to such communications in addition to Rule 206(4)-8 under the Advisers Act, which imposes requirements on communications by investment advisers to investors and prospective investors in pooled investment vehicles. Several commenters noted this overlap in response to the Rule's Proposing Release.

[5] *See, e.g.*, Remarks at SEC Speaks 2024 by Sanjay Wadhwa (Apr. 3, 2024) *available at* https://www.sec.gov/newsroom/speeches-statements/sanjay-wadhwa-sec-speaks-2024-04032024.

[6] EXAMS published its first risk alert on the Marketing Rule on September 19, 2022, to describe the initial areas of review in examinations of investment advisers for compliance with the Marketing Rule. *See* Examinations Focused on the New Investment Adviser Marketing Rule, SEC Division of Examinations Risk Alert (Sept. 22, 2022). EXAMS' second risk alert on the Marketing Rule, published on June 8, 2023, expanded on the first risk alert and notes that EXAMS Staff would be increasing their focus on other Marketing Rule-related areas during examinations, such as testimonials and endorsements, third-party ratings, and Form ADV. Examinations Focused on Additional Areas of the Adviser Marketing Rule, SEC Division of Examinations Risk Alert (June 8, 2023).

[7] Initial Observations Regarding Advisers Act Marketing Rule Compliance, SEC Division of Examinations Risk Alert (Apr. 17, 2024).

[8] The Marketing Rule provides flexibility to an investment adviser to calculate net performance by deducting the actual fees and

- Included benchmark index comparisons but did not define the index or provide sufficient context to enable an understanding of the basis for such comparison or disclose that the benchmark performance did not include the reinvestment of dividends;
- Did not include disclosures in advertisements that provided necessary context, such as indicating that the advertised performance occurred during time periods when most investors would have experienced similar returns, given the performance of the market overall;
- Excluded certain investments without providing sufficient information and context, such as investments that were written off as a loss or were lower-performing investments;
- Did not disclose the relevant time period for advertised performance or did not disclose whether the returns were calculated for the same time period as other performance information included in the same advertisement; and
- Included the performance of only realized investments in the total net return figure and excluded unrealized investments.

Notably, the Risk Alert indicated that the EXAMS Staff observed investment advisers that failed to comply with the Rule's requirement that an advertisement may not include a material statement of fact if the investment adviser does not have a reasonable basis for believing it will be able to substantiate such fact upon demand by the Commission (the "substantiation requirement").[9] If an adviser is unable to substantiate the material claims of fact made in an advertisement upon demand, SEC Staff will presume that the investment adviser did not have a reasonable basis for its belief.[10] With respect to this substantiation requirement, the Risk Alert specifically identified statements that an investment adviser was "free of all conflicts," when actual conflicts existed, and false statements regarding the education, experience, and professional designations of adviser personnel. EXAMS Staff also cited statements by investment advisers regarding environmental, social, and governance ("ESG") investment mandates where no such mandates were actually used.[11]

The Risk Alert foreshadowed SEC enforcement actions specifically focused on the Rule's substantiation requirement. Approximately five months after the Risk Alert, the SEC announced settled charges against nine registered investment advisers for violating the Marketing Rule by disseminating advertisements that included untrue or unsubstantiated statements of material fact or testimonials, endorsements, or third-party ratings that lacked required disclosures, levying $1,240,000 in combined civil penalties.[12]

B. Staff FAQ on the Rule's Time Period Requirement

The Rule requires that any advertisement that includes performance results must include performance results for prescribed time periods (i.e., one-, five-, and 10-year periods) ending on a date that is no less recent than the most recent calendar year-end, except for an advertisement that includes private fund performance information.[13] On April 21, 2021, the SEC Staff published guidance in response to an FAQ ("FAQ #1") addressing concerns by the industry that this requirement could preclude investment advisers from advertising any performance in advertisements early in the calendar year, because the performance data for the required time period may not be available as of the end of the most recent calendar year-end. FAQ #1 granted some flexibility to investment advisers, stating that an investment adviser could instead use performance information that is current as of the third quarter of the

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expenses that a client or investor paid or a model fee that complies with certain conditions. Rule 206(4)-1(e)(10) under the Advisers Act. However, in this observation in the Risk Alert, the Staff arguably suggests that the investment adviser should have applied a model fee (instead of the actual fee) that corresponded with what the audience would have paid.

[9] Rule 206(4)-1(a)(2) under the Advisers Act.

[10] Adopting Release, *supra* footnote 2, at 71.

[11] Enforcement Staff continues to focus on investment advisers' statements regarding ESG practices. On November 8, 2024, the SEC issued a settled action against an investment adviser for making misleading statements about the percentage of company-wide assets under management that integrated ESG factors in investment decisions, in violation of Rule 206(4)-1 under the Advisers Act and other provisions. *In the Matter of Invesco Advisers, Inc*., Adv. Act Rel. No. IA-6770 (Nov. 8, 2024). The conduct in this matter took place before the Rule's November 4, 2022 compliance date, and thus was subject to the prior version of Rule 206(4)-1; however, the same conduct would likely violate the current version of the Rule if it occurred today.

[12] *Infra* at Section III.C.

[13] Rule 206(4)-1(d)(2).

prior calendar year, for a "reasonable period of time" after the end of the prior calendar year, which the Staff believes *generally* would not exceed one month. However, a one-month grace period may not be sufficient in all cases for an investment adviser to calculate the relevant performance over the required time periods. FAQ #1 does not indicate whether and in what circumstances it may be reasonable to use third-quarter performance beyond the one-month grace period. This lack of clarity provides unnecessary regulatory risk for investment advisers that maintain large composites or composites that include private funds (including fund-of-funds) or other private investments alongside other types of portfolios, since it may be difficult to collect the investment level data necessary to calculate year-end performance for the composite over the required time periods within a one-month grace period.

FAQ #1 also notes that any advertisement that relies on this guidance is still subject to the Rule's general prohibitions. Accordingly, investment advisers that rely on FAQ #1 should disclose that the advertised performance is presented as of the third quarter of the prior calendar year. Additionally, an investment adviser should consider whether other material facts regarding that performance should be disclosed, including whether there have been changes to the performance since the end-of-third-quarter results presented in the advertisement.

C. Staff FAQ on Gross and Net Performance

The Marketing Rule prohibits an investment adviser from presenting gross performance in any advertisement unless the advertisement also presents net performance: (1) with at least equal prominence to, and in a format designed to facilitate comparison with, the gross performance and (2) that is calculated over the same time period and using the same type of return and methodology as the gross performance. On January 11, 2023, the SEC Staff published guidance in response to another FAQ ("FAQ #2") clarifying that the Rule's gross and net requirement applies to the presentation of a single investment, including in the context of a case study.

Many investment advisers to private funds ("private fund managers") regularly present case studies of one or more portfolio companies in advertisements to help illustrate the adviser's style or strategy, among other reasons. Unfortunately, while FAQ #2 reflects a relatively straightforward application of the Rule,[14] it does not address how an investment adviser should properly calculate net performance for a single investment (or a subset of investments).

The Rule generally permits an investment adviser to calculate net performance by applying the actual fees that were charged to clients or a model fee that complies with certain conditions. Typically, private fund managers charge management fees based on the collective assets of the private fund, not on an investment-by-investment basis. Thus, when presenting the performance of a single investment within a private fund, the private fund manager must implement a methodology to attribute fund-level fees and expenses to the fund's individual investments to derive a net performance figure for each investment.

The SEC Staff has not provided guidance advising on the appropriateness of any particular methodology. Nevertheless, regardless of the methodology used, the Rule's general prohibitions likely require that the advertisement disclose such methodology. The investment adviser should also consider disclosing the fact that the fees and expenses were charged at the fund-level, not to the specific portfolio company, and that the net performance presented was not actually achieved by any client or investor. Finally, investment advisers that present the performance of a single investment (including case studies) in an advertisement must also be mindful of the Rule's requirement to present performance in a fair and balanced manner, the Rule's conditions for extracted performance, and the SEC's on-going concerns with cherry-picking.

D. Staff FAQ on Subscription Lines of Credit

On February 6, 2024, the Staff published guidance in response to an FAQ ("FAQ #3") that addresses the application of the Rule's gross and net requirement to the performance of private funds that use subscription lines of credit. Private fund managers may use a subscription line of credit to fund an initial acquisition of an investment and call investor capital later to repay the funds borrowed under that line of credit. In FAQ #3, the Staff addresses what it believes to be a common practice, whereby a private fund manager reports a private fund's gross performance calculated from the date that the investment was made with funds borrowed under a subscription facility, but reports net performance calculated from the date that investor capital was called

[14] The Rule's definition of "gross performance" explicitly includes the performance results of a portfolio (or portions of a

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portfolio that are included in extracted performance). Rule 206(4)-1(e)(7).

to repay such borrowed funds. The Staff stated that this practice would violate the Rule because the net and gross performance are not presented in a format designed to facilitate comparison — i.e., from the same date.[15]

The Staff also expressed concerns that calculating net performance from the date when capital is called from investors, rather than the date of the private fund's acquisition of an investment, may inflate the performance of the private fund. The Staff suggested that even if an advertisement presents both gross and net performance of a private fund from the date when capital is called to repay funds borrowed under a subscription facility, the advertisement should either: (1) include net performance calculated from the initial date that the investment was made with the borrowed funds or (2) include disclosures that describe the impact of the subscription facility on the fund's advertised performance. If the adviser opts for the second approach, it is unclear from FAQ #3 whether the Staff expects that the disclosure would include the numeric difference between the two net internal rate of return ("IRR") figures, or whether a statement generally disclosing the existence of a difference will suffice. However, FAQ #3 includes a reminder that the Rule's general prohibitions apply in all cases, indicating that the materiality of the difference between the two net IRR figures may be a relevant consideration.

E. 2025 Exam Priorities and Other Examination Efforts

On October 21, 2024, EXAMS announced its 2025 Examination Priorities (the "2025 Priorities"), highlighting areas that it expects to target during examinations in 2025. As in prior years, the 2025 Priorities identified the Marketing Rule as a top priority for investment adviser examinations in 2025. The 2025 Priorities' focus on the Marketing Rule is not a surprise. For years, the EXAMS Staff's standard document request has requested a broad universe of marketing materials disseminated by an investment adviser over an identified period (e.g., six months to a year).

The EXAMS Staff's recent document requests have instructed investment advisers to produce materials available on the internet, such as websites and blogs, as either a PDF of a printout or an electronic archive. Accordingly, it is important that investment advisers maintain organized records of their marketing materials and supporting information given the breadth of these requests and investment advisers' prompt production obligations under Rule 204-2 under the Advisers Act. A delay in producing marketing materials can indicate sloppiness or expose an investment adviser to a violation of Rule 204-2 under the Advisers Act.

EXAMS Staff are also requesting information about events sponsored or attended by the investment adviser, suggesting that the Staff is assessing whether investment advisers are treating materials used in connection with such events as "advertisements" under the Rule.[16] Additionally, recent document requests have asked for records of the investment adviser's responses to requests for proposals, due diligence questionnaires, and other questionnaires, indicating that the Staff may assess whether the investment adviser had treated these materials (perhaps incorrectly) as one-on-one communications that do not qualify as "advertisements" under the Rule.[17] In many cases, these types of communications will be "advertisements" under the Rule because they are actually disseminated to multiple persons, despite being personalized for a single recipient.[18]

Finally, the 2025 Priorities specifically noted that upcoming examinations will assess whether private fund managers have established adequate policies and procedures to comply with the Marketing Rule and whether their actual practices conform to these policies and procedures. Prior to the Amendments, Rule 206(4)-1 did not apply to communications to investors in private funds. Thus, for many private fund managers, EXAMS Staff will likely be probing newly adopted (and perhaps untested) policies and procedures during examinations.

[15] Although FAQ #3 explicitly addresses a limited fact pattern involving subscription lines of credit, the underlying principle in this guidance applies more broadly. Investment advisers should be vigilant in confirming that gross and net performance included in an advertisement are calculated from the same date.

[16] While extemporaneous, live, and oral communications, such as unprepared speeches, are not advertisements under the Rule, any written materials used in connection with a speech or presentation (including a script used in a speech) generally are advertisements under the Rule, depending on the content. Adopting Release, *supra* footnote 2, at 39–40.

[17] Investment Advisers: Assessing Risks, Scoping Examinations, and Requesting Documents, SEC Division of Examinations Risk Alert (Sept. 6, 2023).

[18] Adopting Release, *supra* footnote 2, at 28.

II. ENFORCEMENT ACTIONS

A. *Artificial Intelligence Actions*

On March 18, 2024, the SEC settled two enforcement actions with registered investment advisers involving false and misleading claims about their use of artificial intelligence ("AI").[19] In each action, the SEC found that the investment adviser had disseminated advertisements (including on its website) stating that it had incorporated AI into various aspects of its advisory business, when in fact it had not done so. The SEC also found that each investment adviser had failed to adopt and implement adequate written policies and procedures to ensure compliance with the Rule, in violation of Rule 206(4)-7 under the Advisers Act. In one order, the SEC found that the investment adviser's compliance manual did not specify a clear advertising review and approval process that would enable the firm's personnel and consultants to understand their respective roles and responsibilities in that process.[20] In the other order, the SEC found that the investment adviser's policies and procedures did not include safeguards to ensure that hypothetical performance was only disseminated to a sophisticated audience as required under the Marketing Rule.[21] The SEC also found that the investment adviser had failed to produce records to the SEC substantiating claims made in the relevant advertisements, in violation of the Rule's substantiation requirement — an area that would become a focus in later SEC enforcement actions.[22]

Senior SEC officials have highlighted these actions to convey the seriousness of potential securities laws issues that may arise in connection with the use of AI. Notably, at a conference in April 2024, the SEC's former Director of Enforcement, Gurbir Grewal, suggested that the SEC could seek to hold an investment adviser's Chief Compliance Officer personally liable for the firm's AI-related violations.[23] The 2025 Priorities also highlighted AI as a top priority for EXAMS Staff in upcoming examinations. Indeed, document requests from EXAMS Staff have already sought information about investment advisers' AI practices. Investment advisers should canvas their existing use of AI and consider how they are addressing the fiduciary, recordkeeping, marketing, and other compliance obligations related to these practices, including whether they have adopted and implemented policies and procedures regarding AI use.

B. *Hypothetical Performance Enforcement Actions*

The SEC has settled numerous enforcement actions against investment advisers for violations of the Marketing Rule since 2023, many of which focused on the Rule's restrictions on the use of hypothetical performance and generally followed the same fact pattern.[24] In these orders, the SEC found that the investment advisers had advertised hypothetical performance publicly on its website without adopting and implementing adequate policies and procedures reasonably designed to restrict the dissemination of hypothetical performance to a sophisticated audience.

While the Marketing Rule does not expressly prohibit the dissemination of hypothetical performance to the general public, the SEC effectively took this position in the Rule's Adopting Release, noting that "advisers generally would not be able to include hypothetical performance in advertisements directed to a mass audience or intended for general circulation."[25] If an investment adviser includes hypothetical performance in an advertisement, the Rule requires that the investment adviser adopts and implements policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the likely financial situation and investment objectives of the intended audience of the advertisement.[26] Accordingly, an investment adviser's dissemination of hypothetical performance on a publicly available website — which would not enable the investment adviser to form any conclusions about the likely financial situation and investment objectives of the intended audience — is inconsistent with the Rule.

Finally, on November 1, 2024, the SEC settled an action with an investment adviser that included violations of the Rule's hypothetical performance conditions similar to the actions noted above, but also

[19] *In the Matter of Delphia (USA) Inc.*, Adv. Act Rel. No. IA-6573 (Mar. 18, 2024); *In the Matter of Global Predictions Inc.*, Adv. Act Rel. No. IA-6574 (Mar. 18, 2024).

[20] *In the Matter of Delphia (USA) Inc.*, Adv. Act Rel. No. IA-6573 (Mar. 18, 2024).

[21] *In the Matter of Global Predictions Inc.*, Adv. Act Rel. No. IA-6574 (Mar. 18, 2024).

[22] *Infra* at Section III.C.

[23] Isenberg, David, SEC Enforcement Hints at CCO, CISO Liability for AI, Ignites (Apr. 17, 2024).

[24] *See, e.g.*, *In the Matter of Gea Sphere, LLC*, Adv. Act Rel. No. IA-6585 (Apr. 12, 2024); *see, e.g.*, *In the Matter of Monex Asset Management, Inc.*, Adv. Act Rel. No. IA-6587 (Apr. 12, 2024).

[25] Adopting Release, *supra* footnote 2, at 220.

[26] Rule 206(4)-1(d)(6)(i) under the Advisers Act.

found that the investment adviser had disseminated paid endorsements (including via social media) from professional athletes that lacked required disclosures.[27] Under the Rule, registered investment advisers are prohibited from including any endorsement in an advertisement unless, among other things, the investment adviser clearly and prominently discloses that the endorsement was given by a person other than a current client, that compensation was provided for the endorsement, and a brief statement of any material conflicts of interest on the part of the person giving the endorsement.[28] The SEC's order found that the investment adviser had failed to include these disclosures in numerous advertisements that featured paid endorsements. While the SEC's enforcement focus on hypothetical performance will likely continue, this settled action perhaps represents an expansion of that focus into the compensated endorsement requirements of the Rule.

C. Substantiation Requirement Enforcement Actions

As noted above, the Rule's substantiation requirement prohibits an investment adviser from disseminating an advertisement that includes a material statement of fact for which the investment adviser does not have a reasonable basis to substantiate upon demand by the Commission.[29] On its face, this requirement limits the type of factual statements an investment adviser may include in advertisements.[30] However, this requirement also implicitly imposes a recordkeeping obligation on an investment adviser, especially considering that Staff can and will request that investment advisers produce the records substantiating statements of material fact in examinations or investigations.

On September 9, 2024, the SEC announced settled charges against nine registered investment advisers for violating the Marketing Rule by disseminating advertisements that included untrue or unsubstantiated statements of material fact, among other violations.[31] Specifically, the orders identified statements that the investment adviser provided "conflict-free advice," had "no conflict of interest," or was a "true fiduciary that puts the client first by aligning incentives and eliminating conflicts of interest," without providing additional and necessary context.[32] For example, the orders noted that these investment advisers had disclosed various conflicts of interest in their Form ADV Part 2A brochure, contradicting statements implying that the investment adviser had no conflicts of interest. Other orders found that the investment adviser claimed to have achieved certain rankings in trade publications, which could not be substantiated.[33] Notably, many of these actions cited a single unsubstantiated statement of material fact as a violation of Rule 206(4)-1(a)(2), signaling that the SEC will be vigilant in enforcing any violations of the Rule, regardless of the number of noncompliant statements.

III. OTHER IMPLEMENTATION CHALLENGES

In addition to the issues discussed above, the Amendments have caused several implementation challenges for investment advisers. For example, the Rule's lack of an explicit definition of "performance" has caused certain investment advisers to question when and how the Rule's performance conditions apply. In addition, the Rule's conditions for the use of predecessor performance, and related recordkeeping provisions under Rule 204-2, present challenges for investment advisers involved in mergers and acquisitions and investment advisory personnel moving to new advisory firms.

A. Definition of "Performance"

The Rule does not define the term "performance," and investment advisers have therefore struggled to determine whether certain types of information should be treated as performance under the Rule. This

[27] *In the Matter of Wahed Invest, LLC*, Adv. Act Rel. No. IA-6763 (Nov. 1, 2024).

[28] Rule 206(4)-1(b)(1)(i).

[29] Rule 206(4)-1(a)(2) under the Advisers Act.

[30] The requirement does not apply to statements of the investment adviser's *opinion*; thus, recasting statements of material fact as statements of the investment adviser's opinion can help avoid this substantiation requirement. However, note that the Rule's other general prohibitions apply. Thus, for example, a statement of an investment adviser's opinion could not be materially misleading.

[31] SEC Charges Nine Investment Advisers in Ongoing Sweep into Marketing Rule Violations, U.S. Securities and Exchange Commission (Sept. 9, 2024), *available at* https://www.sec.gov/newsroom/press-releases/2024-121.

[32] *In the Matter of Droms Strauss Advisors, Inc. d/b/a Droms Strauss Wealth Management*, Adv. Act Rel. No. IA-6680 (Sept. 9, 2024); *see, e.g.*, *In the Matter of Integrated Advisors Network LLC*, Adv. Act Rel. No. IA-6682 (Sept. 9, 2024); *see, e.g.*, *In the Matter of AZ Apice Capital Management LLC*, Adv. Act Rel. No. IA-6679 (Sept. 9, 2024).

[33] *See, e.g.*, *In the Matter of TS Bank d/b/a Callahan Financial Planning*, Adv. Act Rel. No. IA-6686 (Sept. 9, 2024).

determination has notable implications. For example, any information that constitutes performance in an advertisement will generally trigger the Rule's gross and net requirement, the time period requirement, the Rule's other performance restrictions, and recordkeeping obligations pursuant to Rule 204-2 under the Advisers Act.[34] However, it may not be feasible for an investment adviser to calculate net performance for certain types of statistics. While certain data and statistics are undoubtably performance under the Rule — e.g., the internal rate of return of a private fund or the total returns for a separately managed account — it is not clear whether other types of data and statistics commonly included in investment adviser marketing materials should be treated as performance.

For example, investment advisers may include attribution effects in their advertisements to demonstrate how certain attributes or segments of a portfolio may have contributed to, or detracted from, the overall performance results of the portfolio. While this does not reflect the actual performance that a client ultimately achieves, it is an important datapoint about that performance and a component of the client's overall performance. Similarly, an investment adviser may include risk-related statistics (e.g., beta or standard deviation), performance-related characteristics (e.g., alpha, information ratio, Sharpe ratio), or an investment's yield. In each case, the statistic does not represent the actual performance achieved by an advisory client, but arguably relates to, and describes, the portfolio's performance.

The Staff has not taken a definitive position on whether this information is performance under the Marketing Rule, and market practices vary.[35] As one potential approach, an investment adviser could create an inventory of the type of statistics and datapoints it typically includes in advertisements, and document in writing whether it believes each statistic likely does or does not constitute performance, based on an assessment of how it is used, the information it conveys, and the underlying policy objectives of the Rule's performance conditions. Implementing a consistent, documented approach for each statistic with supporting rationale can demonstrate an investment adviser's good faith efforts to comply with the Rule, if ever second-guessed by the Staff during an examination or investigation.

B. Predecessor Performance

The Rule imposes conditions on any advertisement that presents "predecessor performance," which the Rule defines as "investment performance achieved by a group of investments consisting of an account or a private fund that was not advised at all times during the period shown by the investment adviser advertising the performance."[36] The SEC views predecessor performance as potentially misleading because it may imply that an investment adviser achieved performance for which other investment personnel were actually responsible. Issues with predecessor performance commonly arise when investment personnel attempt to port their performance track record to a new investment adviser. Similarly, new private fund advisers that launch their first fund may seek to use a track record achieved at a prior firm or in a personal capacity. An investment adviser may also acquire another investment advisory firm or practice and seek to use the acquired firm's track record. In all cases, such activity can implicate the Rule's conditions for predecessor performance.

Under the Rule, an investment adviser may not include predecessor performance in an advertisement unless:

- the persons who were primarily responsible for achieving the prior performance results currently manage accounts at the advertising adviser;
- the accounts managed at the predecessor investment adviser are sufficiently similar to the accounts managed at the advertising investment adviser and the performance results provide relevant information to the clients or investors;
- all accounts that were managed in a substantially similar manner are advertised (subject to certain permitted exclusions); and
- the advertisement clearly and prominently includes all relevant disclosures, including that the

[34] For example, Rule 204-2(a)(16) under the Advisers Act requires registered investment advisers to maintain records or documents that are necessary to form the basis for, or demonstrate the calculation of, any performance or rate of return of any or all managed accounts.

[35] In some public comments, certain SEC staff members have suggested that whether any information is performance could depend on how it is used in the advertisement and whether it is intended to demonstrate the results that a client should expect to achieve with the advertised investment. However, these do not represent the SEC's or the Staff's official opinion.

[36] Rule 206(4)-1(e)(12).

performance results were from accounts managed at another entity.[37]

The Rule does not define "primarily responsible," but the SEC stated that this term generally refers to the person or persons who have the authority or influence in making the decisions that produced the investment results.[38] When more than one person is involved in making investment decisions, advisers should consider the varying levels of authority and influence that each person has in making those decisions.[39] This is highly fact-dependent and will require an investment adviser that seeks to present predecessor performance to ensure that its investment personnel have sufficient evidence supporting their relevant authority for prior investment decisions.

In addition to the conditions imposed by the Rule regarding predecessor performance, Rule 204-2 under the Advisers Act requires an investment adviser that presents predecessor performance to retain original records to support such performance.[40] Thus, if an investment adviser wishes to include in its track record the performance achieved by a prior investment adviser (or achieved by personnel working at a prior investment adviser), the investment adviser must obtain records to support the calculation of that predecessor's performance. In practice, this can present challenges, since departing advisory personnel may be prohibited (e.g., in employment agreements or otherwise) from taking the firm's performance records when moving to another investment adviser.

Investment professionals should keep this negotiating point in mind when entering into a relationship with a new advisory firm, as securing rights to these records upfront can preserve the investment professional's ability to use a track record later in his or her career. Similarly, in addition to securing appropriate supporting records, an investment adviser that acquires another investment advisory firm and wishes to use the performance track record of the target firm must ensure that there is sufficient continuity of investment personnel to enable it to comply with Rule 206(4)-1(d)(7)(i). This can be challenging in investment adviser acquisitions, as the acquiring firm will need to obtain assurances or otherwise incentivize the investment personnel from the acquiree who was primarily responsible for managing the relevant investment strategy to join the acquiring firm and continue managing the strategy. Finally, investment advisers should consider creating internal records that memorialize the facts and information supporting the conclusion that any predecessor performance complies with the conditions of Rule 206(4)-1(d)(7), given the fact-intensive nature of those conditions and the Rule's substantiation requirement.

IV. CONCLUSION

Investment advisers have had more than two years since the Marketing Rule's compliance date to ensure that their marketing practices align with the Rule. Given the intensity of the SEC Staff's Marketing Rule examination and enforcement efforts to date, however, investment advisers should consider testing the effectiveness of their marketing review processes. In particular, investment advisers should consider their marketing practices regarding the dissemination of hypothetical performance, the use of AI across the adviser's business, and the use of compensated endorsements. Investment advisers should also consider whether key marketing and compliance personnel have been properly trained on the Rule. Finally, investment advisers should prepare for SEC examinations by ensuring that records of advertisements (including endorsements disseminated by third parties) are properly maintained and organized, in addition to records that substantiate statements of material fact included in any advertisement. ■

[37] Rule 206(4)-1(d)(7).

[38] Adopting Release, *supra* footnote 2, at 232.

[39] *Id.*

[40] Rule 204-2(a)(16) under the Advisers Act.

SHAREHOLDER PROPOSALS IN THE 2024 PROXY SEASON

The proxy "season" that coincides each year with annual shareholder meetings for the majority of calendar year-end public companies often features new developments and trends with regard to shareholder proposals. Reviewing these can assist companies in responding to significant developments and may provide a preview of what to expect in the upcoming year. This article examines these developments from the 2024 proxy season.

By Ryan J. Adams *

At a general level, the 2024 proxy season reflected a continuation of many trends that began in the 2022 proxy season and continued into 2023. In this regard, shareholder proposal submissions overall increased, but investor support for proposals voted on continued to decrease. Companies also continued to find better success than in recent years with respect to no-action requests submitted to the U.S. Securities and Exchange Commission's Division of Corporation Finance (the "Staff") to exclude shareholder proposals, though proponents explored novel ways to promote their agendas. These and other subjects are discussed in more detail below.

SHAREHOLDER PROPOSALS – SUBMISSIONS AND VOTING TRENDS

Overall, the number of shareholder proposals submitted to companies for inclusion in their proxy statements in the 2024 proxy season increased slightly from the prior year. With over 900 submissions, shareholders submitted the highest number of proposals in nearly a decade. This follows a recent trend of increased shareholder engagement with companies, specifically through the submission of shareholder proposals.

Similarly, consistent with recent trends, while the number of proposals that ultimately made it onto companies' ballots increased, voting support was low. Average support across all shareholder proposals voted on was about 23%, roughly level with average support in 2023 and representing a continued trend downward.

Regarding the types of proposals that were submitted, they can broadly be categorized as relating to governance, environmental, and social ("ESG") matters. Proposals focusing on governance matters increased by about 13% from 2023. These numbers are skewed, however, by the presence of a wide-ranging campaign from the United Brotherhood of Carpenters union, which submitted nearly 40 proposals seeking mandatory director resignation policies for directors failing to receive majority support in an election.[1] Average support for governance proposals voted on increased to 42% from 31% in 2023. These results may have been influenced, however, by high support for proposals requesting companies eliminate supermajority voting provisions and declassify boards, which buoyed the overall average.

As for environmental proposals, submissions were essentially flat from last season. Among the proposals that went to a vote, average support decreased to about 17%, down from 21.3% in 2023 and 33.3% in 2022. Support for these proposals has continually decreased after a high of around 40% in 2021.

Similarly, submissions of socially focused proposals were flat with last season's submissions. Of the social proposals that went to a vote, average support decreased slightly to 13.5% from 17.2% in 2023 and 23.2% in 2022.

The decline in average support for both environmental and social proposals is notable, as the issues raised by these types of proposals have been focal points for investors and the public in recent years. While the low and continually decreasing support for

[1] Notably, a significant number of companies incorporated in Delaware were able to successfully exclude these proposals by arguing to the Staff that the proposals would violate state law.

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such proposals may seem surprising, this trend may be attributable to a distinct regulatory shift in the treatment of these proposals.

Support for environmental and social proposals has been trending downward since 2022, following record support in 2021. This timing coincides with policy changes by the Staff, including the publication of Staff Legal Bulletin No. 14L in November 2021, that generally have made it easier for proponents to withstand exclusionary no-action requests submitted to the Staff pursuant to Exchange Act Rule 14a-8. In this regard, in the 2022 proxy season, the Staff granted no-action relief in only about 41% of cases compared to 70% in the 2021 proxy season (which was generally consistent with historical averages). This increased difficulty in excluding shareholder proposals under Rule 14a-8 not only has the effect of increasing proposals on ballots, but also may have provoked more shareholders to submit proposals to begin.

Perhaps as a reaction to the overload of shareholder proposals being voted on, the three largest institutional investors in the United States have steadily stepped back from supporting most environmental and social proposals. According to news sources, BlackRock's support for environmental and social proposals dropped from 41.3% in the 2021 proxy season, to 23.7% in 2022, 8.7% in 2023, and 4% in 2024. Vanguard's support went from 29.6% in 2021, to 12% in 2022, to 3% in 2023, and 0% in 2024. Similarly, State Street went from supporting 43.7% in 2021, to 28.6% in 2022, to 21.2% in 2023, and to approximately 6.5% in 2024. In its 2023 Investment Stewardship Annual Report, BlackRock Investment Stewardship stated "Shareholders submitted a record number of proposals in 2023 and the quality of proposals continued to decline. Because so many proposals were overly prescriptive, lacking economic merit, or simply redundant, they were unlikely to help promote long-term shareholder value and received less support from shareholders, including BlackRock, than in years past."[2]

Nevertheless, decreasing investor interest has not deterred proponents from continuing to submit environmental and socially focused proposals. It remains to be seen whether this trend will continue going forward.

[2] https://www.blackrock.com/corporate/literature/publication/annual-stewardship-report-2023-summary.pdf.

"ANTI-ESG" PROPOSALS HAVE LITTLE IMPACT

The 2024 proxy season saw a rise in "anti-ESG" proposals. In an inverse of traditional environmental and social shareholder proposals, these proposals, among other things, allege that shareholder returns have been harmed by companies' commitments to diversity and sustainability efforts and call for reports that challenge diversity, equity, and inclusion ("DEI"), greenhouse gas reduction efforts, and anti-discrimination policies.

Politically conservative shareholder proposals are not a new development, but the volume of such proposals has grown exponentially in recent years and increased dramatically in the 2024 proxy season. Over 100 proposals were submitted on "anti-ESG" topics in 2024.

Despite the increase in anti-ESG proposals, though, investor support for these proposals was small. Even more so than traditional environmental and social proposals, where investor support has been steadily waning (as discussed above), support for anti-ESG proposals that were voted on in the 2024 proxy season was only 2.4% on average. In addition, no proposal received double-digit support. Given the increasing backlash against corporate DEI initiatives, however, it seems unlikely that the inflow of anti-ESG proposals will subside. Whether they gain any meaningful investor support remains to be seen.

SEC STAFF NO-ACTION LETTER DETERMINATIONS

While shareholder proposal submission and voting trends largely tracked those of the prior two proxy seasons, a notable development in the 2024 proxy season was an increase in the success rates of no-action requests submitted to the Staff under Exchange Act Rule 14a-8.

By way of background, Rule 14a-8 provides the basis for shareholders to submit proposals to companies. A company generally must include a shareholder's proposal in its proxy materials unless the proposal fails to satisfy any of several specified procedural or substantive requirements. If a company intends to exclude a proposal from its proxy materials, it is required under Rule 14a-8(j)(1) to file its reasons for doing so with the SEC, which typically comes in the form of "no-action requests" to the Staff seeking its concurrence that the company may exclude a shareholder proposal.

In that context, companies submitted approximately 50% more no-action requests in 2024 than in 2023, and the Staff granted relief in more cases than the prior year — with about a 68% concurrence rate as opposed to

approximately 56% concurrence rate in the prior season (and 41% in 2022). In this sense, the success rate in the 2024 proxy season could be viewed as a return to norms, but numbers alone do not tell the full story.

Of no-action requests submitted to the Staff, the "ordinary business" basis for exclusion was most commonly cited, with procedural bases following, then substantial implementation, violation of the proxy rules, and violation of the law. Notably, among ordinary business no-action requests, more than two-thirds made an argument that the proposal "micromanaged" the company.

While Staff concurrence rates overall increased, success rates improved for ordinary business arguments, violation of law arguments, and substantial implementation grounds, but decreased for procedural bases.

As it concerns the ordinary business exclusion, many Staff decisions were relatively straightforward. For instance, the Staff granted relief on ordinary business grounds for proposals on topics such as what type of food hospitals serve patients and for a proposal that would have required a relocation of a company's headquarters. On the other hand, the Staff denied relief for some new proposals, finding that the issues raised in the proposals "transcended ordinary business." Most notably, the Staff denied no-action relief for ordinary business arguments in connection with proposals relating to the use of artificial intelligence and ethical guidelines related thereto, finding that those proposals raised issues that transcended ordinary business.

Spotlight on Micromanagement

Perhaps the biggest surprise from Staff no-action decisions in the 2024 proxy season was the re-emergence of successful "micromanagement" arguments. A subset of the ordinary business exclusion, a proposal may be excluded if it micromanages a company "by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment."[3]

This came as a surprise partly in fact due to the recent history of micromanagement decisions, which has been consistent with the general tightening of no-action relief discussed above. Going further back, micromanagement relief has historically been rare. Micromanagement then enjoyed a brief renaissance beginning in the 2018 proxy season following updated guidance in Staff Legal Bulletin No. 14I. When the Gary Gensler-led SEC released Staff Legal Bulletin No. 14L, however, the Staff explicitly rescinded this prior guidance and instituted a stricter framework for analyzing micromanagement arguments. Subsequently, it became more difficult for companies to succeed on micromanagement grounds and companies responded naturally by trying the argument less frequently. In the 2024 proxy season, though, both the submission and success rate for micromanagement no-action requests unexpectedly rebounded.

In this regard, companies argued micromanagement in 62 no-action requests in 2024, up from 41 in 2023 — and those arguments had a success rate of 66%, more than double the 2023 success rate of 31%. Notably, the Staff granted relief to micromanagement arguments in some instances where it previously had denied relief — indicating that the Staff's approach to micromanagement may be becoming more lenient.

For example, there were a number of successful micromanagement arguments on shareholder proposals addressing environmental matters, which have historically been difficult to exclude. Among others, proposals excluded on the basis of micromanagement requested actions including reports on greenhouse gas emissions of company clients, greenhouse gas emissions related to specific goods and services, the adoption of specific greenhouse gas emissions reduction targets, and reports on the divesture of assets with "material climate impact."

Moreover, in the fall of 2024, the Staff granted relief on the basis of micromanagement for a proposal focused on corporate lobbying, which appears to reverse a historical Staff position. Specifically, the proposal at issue requested a report disclosing the company's policies and procedures governing direct and indirect lobbying, along with payments used for lobbying, including the recipient and the amount of such payments, and information about the company's decision-making and governance oversight related to these payments. Similar proposals have been a mainstay of the shareholder proposal ecosystem for years and have historically been difficult to exclude. Further, in

[3] SEC Release No. 34-40018 (May 21, 1998).

2019, another company was unsuccessful in arguing that a nearly identical proposal impermissibly micromanaged the company. Thus, the 2024 decision appears to represent a shift in the Staff's decision-making with regard to micromanagement arguments.

This and other decisions, however, should not be interpreted to mean that micromanagement arguments are available in all instances. While the 2024 proxy season featured some indications that the Staff is applying a more flexible view of the micromanagement exception, the individual facts and circumstances of each proposal are critical in determining whether the exclusion applies.

Substantial Implementation Remains Difficult

In recent years, companies have struggled to succeed on substantial implementation arguments and the 2024 proxy season was no different. The Staff granted relief to only one-third of no-action requests that sought relief on the basis of substantial implementation. In many cases, any deviation from the proposal's request resulted in a denial of relief on this basis.

Notably, the substantial implementation basis for exclusion has been the subject of proposed amendments to Rule 14a-8 since 2022, when the SEC proposed modifications to the exception that would permit exclusion "[i]f the company has already implemented the essential elements of the proposal." In particular, the proposing release noted that the proposed amendment would permit a shareholder proposal to be excluded as substantially implemented only if the company has implemented "all" of its essential elements.[4]

Although this amendment has not been adopted as a final rule yet, no-action request results have appeared to indicate that the Staff applies a strict test to substantial implementation arguments. While the success rate for no-action requests seeking exclusion on substantial implementation grounds increased slightly from 2023, it still remained well below the success rate in 2021. Notably, no social or environmental proposals were successfully excluded on substantial implementation grounds in 2024.

There may be some light on the horizon for companies, however, as a result of the 2024 Presidential Election. It appears unlikely that a Republican-led SEC will adopt the 14a-8 amendments as proposed and could instead scrap the amendments entirely. In this case, the Staff may return to its traditional view of substantial implementation arguments.

RISE IN NON-RULE 14A-8 SHAREHOLDER PROPOSALS

A number of proponents in the 2024 proxy season employed a unique, and arguably manipulative, tactic of submitting business matter proposals (as opposed to director nominations) under companies' advance notice bylaws, providing an end run around the procedural and substantive limitations of Rule 14a-8 shareholder proposals. While "floor" proposals have been used at annual meetings throughout the years, such proposals are relatively rare and typically inconsequential because Exchange Act Rule 14a-4(c) typically enables a company to exercise its discretionary voting authority to vote against those proposals so long as the proponent does not solicit its own proxies.

This year, however, the floor proposal tactic was successfully used in a relatively novel way by the United Mine Workers of America ("UMWA") and American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO") at Warrior Met Coal, Inc. when the UMWA distributed its own proxy materials to shareholders. Avoiding the threat of discretionary voting used against it, the UMWA and AFL-CIO together submitted five non-binding shareholder proposals to Warrior Met Coal on corporate governance issues, bypassing the limitation under Rule 14a-8 of only one proposal per proponent. Two of the proposals received majority support.

While it remains to be seen if more proponents incur the time and expense to take the Rule 14a-4 floor proposal route to avoid the requirements and limitations of Rule 14a-8, companies should ensure they are familiar with their advance notice bylaws, to the extent they have any, and if not, strongly consider adopting advance notice bylaws.

SHAREHOLDER PROPOSAL LITIGATION

Consistent with some rising tension between companies and shareholders, the 2024 proxy season also featured notable litigation concerning the Rule 14a-8 shareholder proposal process.

In one matter, Exxon Mobil Corp. filed a complaint in federal court against a shareholder proponent who had submitted an environmental proposal to the company, seeking a declaratory judgment that it could exclude the proposal. Notably, the company eschewed the no-action process with the Staff, bringing its issue directly to

[4] SEC Release No. 34-95267 (July 13, 2022).

court. The company's complaint took issue with the proposal, but also the Staff's application of Rule 14a-8, alleging that inconsistent interpretations of Rule 14a-8 in recent years has caused an increase in the number of proposals submitted and voted on. In June 2024, the court dismissed the complaint after the proponent not only withdrew its proposal, but agreed to "refrain henceforth from submitting any proposal" to the company relating to similar environmental matters.

A resolution was reached in another matter involving a shareholder proponent that sued the SEC after a proposal it had submitted in 2022 was deemed excludable by the Staff. The proponent, the National Center for Public Policy Research, initially asked the SEC Staff and Commission to reconsider the Staff's decision, but was declined review. Subsequently, the proponent sued the SEC, alleging that the no-action letter review process represented arbitrary and capricious rulemaking outside of the SEC's authority. The National Association of Manufacturers intervened in the litigation, challenging the validity of Rule 14a-8 itself and alleging that it forces companies to compel certain speech.

In November 2024, the court dismissed the proponent's lawsuit, finding that the issue was moot because the company included the proponent's proposal in its 2023 proxy statement despite receiving no-action relief, and further held that even if the case were not moot, it could be dismissed due to a lack of subject matter jurisdiction because Staff no-action letters represent non-binding views issued as guidance and are not a final order or agency action that would provide the court with subject matter jurisdiction under the Exchange Act or the Administrative Procedure Act.

LOOKING AHEAD

The effect of the 2024 Presidential Election and ensuing leadership changes at the SEC create uncertainty for the shareholder proposal no-action review process, and how that may extend to shareholder proposal submission and voting trends. It seems possible (and perhaps even likely) that a new SEC administration may take a different approach to analyzing Rule 14a-8 no-action requests than its predecessor. While the precise methods of any change and the resulting impact are difficult to predict, companies and investors should stay apprised of developments and brace for change as the 2025 proxy season unfolds. ■

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