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SEC News Roundup: Private Funds Rule Compliance Date Set, Nine Investment Advisers Charged in Breach of Marketing Rule, in Rare Action, Investment Adviser Found to be Acting as an Illegal Broker-Dealer

Client Alert | October 2, 2023

The Securities and Exchange Commission (the "**SEC**" or the "**Commission**") remains intensely focused on the regulation of the private investment funds industry. This roundup summarizes three recent enforcement and administrative items private fund advisers should be aware of.

1. Private Funds Rules Effective Dates Set

On August 23, 2023, the Commission adopted a package of new rules (the "**Private Funds Rules**") for private fund advisers ("**PFAs**") promulgated under the Investment Advisers Act of 1940 (the "**Advisers Act**"), which were summarized in our recent client alert **here**.[1] [2] The Private Funds Rules were published in the Federal Register on September 14, 2023, and **will therefore become effective on the dates set forth below**. Note, however, that the Private Funds Rules are being challenged in court by an array of industry groups led by the National Association of Private Fund Managers, represented by Gibson Dunn. The U.S. Court of Appeals for the Fifth Circuit recently granted the challengers' motion to expedite the case, which requested a decision by the end of May 2024. The deadlines below are therefore subject to cancellation if this litigation succeeds in securing the vacatur of the Private Funds Rules altogether.

For purposes of the below table, private fund advisers with $1.5 billion or more in private fund assets under management are referred to as **"Larger Advisers,"** and private fund advisers with less than $1.5 billion in private fund assets are referred to as **"Smaller Advisers."**

Date	Requirement
November 13, 2023	All registered investment advisers (including those without private fund clients) must keep a written record of their annual review of their compliance program (Rule 206(4)-7(b))
September 14, 2024	Subject to certain exceptions, both Larger Advisers and Smaller Advisers (registered or unregistered) with must comply with: • the Preferential Treatment Rule (Rule 211(h)(2)-3) • the Restricted Activities Rule (Rule 211(h)(2)-1)

Related People

Kevin Bettsteller

Lauren Cook Jackson

Gregory Merz

Shannon Errico

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	Registered Larger Advisers must comply with: • the Adviser-Led Secondaries Rule (Rule 211(h)(2)-2)
March 14, 2025	***Registered*** Larger Advisers and Smaller Advisers must comply with: • The Audit Requirement (Rule 206(4)-10) • Quarterly Statement Requirements (Rule 211(h)(1)-2) All Smaller Advisers (registered or unregistered) must comply with: • the Restricted Activities Rule (Rule 211(h)(2)-1) • the Preferential Treatment Rule (Rule 211(h)(2)-3 ***Registered*** Smaller Advisers must comply with: • the Adviser-Led Secondaries Rule (Rule 211(h)(2)-2)

More details regarding the nuances related to each rule are summarized in the client alert linked above.

2. **Nine Investment Advisers charged in breach of Marketing Rule**[3]

On September 12, 2023 the SEC announced that it had conducted an enforcement sweep with respect to violations of the hypothetical performance requirements under Advisers Act Rule 206(4)-1 (the "**Marketing Rule**"). As a result, nine investment advisers were found to have violated the Marketing Rule for the alleged advertising of **hypothetical performance to the general public** on public websites without adequate policies and procedures in place "reasonably designed to ensure that the hypothetical performance was relevant to the likely financial situation and investment objectives of the intended audience." This is consistent with the Marketing Rule's Adopting Release, in which the Commission stated that this requirement meant that **hypothetical performance would generally not be appropriate for general advertising to retail investors**.[4]

We expect that the majority of our PFA clients are not in the practice of putting performance projections into the public sphere so as to avoid general solicitation and preserve their exemption from registration of their offerings under the Securities Act of 1933 (the "**Securities Act**") and registration of their funds under the Investment Company Act of 1940 (the "**Investment Company Act**"). **Any clients who engage in general solicitation in reliance on Rule 506(c) of Regulation D under the Securities Act should be aware that advertising materials containing hypothetical performance information should be tightly controlled**, and should note that investors who only meet the "accredited investor" status are not likely to be deemed sophisticated enough to understand hypothetical performance solely by virtue of such status.

In addition, *all* advisers should take note that **we expect the SEC will continue to focus on violations of the Marketing Rule in its routine examinations.** We recommend ensuring that counsel has reviewed any marketing materials in pitchbooks and private placement memoranda ahead of providing those materials to prospective investors. In addition, it bears reminding that **many sponsors have historically been in the habit of providing a previous fund's annual or quarterly reports to prospective investors in a new fund, or inviting prospective new fund investors to annual meetings where existing fund performance is discussed**. Any materials, including, but not limited to, investment committee memoranda, related to older funds that are discussed with or provided to prospective ***new*** investors in a forthcoming fund should be carefully reviewed to ensure compliance with the Marketing Rule.

3. In Rare Action, Investment Adviser Found to be Acting as an Illegal Broker-Dealer

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On September 12, 2023, the Commission entered an Order Instituting Administrative and Cease-and-Desist Proceedings against a registered PFA, pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (the "**Exchange Act**") and Section 203(e) of the Advisers Act (the "**Order**").[5] In the Order, the Commission found that the PFA had "willfully violated Section 15(a)(1) of the Exchange Act" which makes it unlawful to "effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security … unless such broker or dealer is registered in accordance with [the other relevant provisions of the Exchange Act]."[6] The PFA was ordered to pay disgorgement of $594,897, prejudgment interest of $76,896 and a civil monetary penalty of $150,000, totaling $821,793 in sanctions for **operating as an unregistered broker-dealer when it received fees in exchange for placing its investment advisory clients into certain third party investment vehicles (that primarily held real estate) without being registered with the Commission as a broker-dealer**. The Order does not allege or imply any other aggravating factor (e.g., fraud, unsuitability) with respect to the offerings, and describes the conduct as having occurred between 2012 and 2021.

This action is notable because we have historically seen staff of the SEC address this type of conduct by issuing deficiencies during the course of examinations of investment advisers instead of referring the matter for enforcement action in the absence of other aggregating factors, such as fraud in the underlying offering. Advisers who facilitate introductions of potential investors to issuers should ensure that they do not receive any sort of compensation or fees in exchange for such referrals, unless registered as a broker dealer.

Additional Enforcement Forecast for the Future

Congress recently allocated additional funds to the Commission for the current fiscal year which the Commission has indicated that it plans to use to **hire 400 more staff members, including 125 new personnel for its Enforcement Division**.[7] As a result, we believe broad ranging enforcement action against private fund managers will only become more frequent in the future.

We would welcome the opportunity to speak with you and provide guidance in light of the developments discussed above.

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[1] *See* A Guide to Understanding the New Private Funds Rules, Gibson, Dunn & Crutcher, LLP (Aug. 25, 2023), link.

[2] *See* Private Fund Advisers; Documentation of Registered Investment Adviser Compliance, Investment Advisers Act Release No. IA-6383 (Aug 23, 2023), link.

[3] A copy of the press release and the settlement orders may be found here: https://www.sec.gov/news/press-release/2023-173.

[4] *See* Investment Adviser Marketing, Investment Advisers Act Release No. IA-5653 (Dec. 22, 2020), link.

[5] Order Instituting Administrative and Cease-and Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Securities Exchange Act of 1934 Release No. 98354, Investment Advisers Act of 1940 Release No. 6415 (Sept. 12, 2023), link.

[6] Securities Exchange Act of 1934, 15 U.S.C.A. § 78o (West).

[7] *See* 2023 Mid-Year Securities Enforcement Update, Gibson, Dunn & Crutcher, LLP (Aug. 7, 2023), link.

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Gibson Dunn's lawyers are available to assist with any questions you may have regarding the issues and considerations discussed above. Please contact the Gibson Dunn lawyer with whom you usually work in the firm's Investment Funds practice group, or the following authors:

Kevin Bettsteller – Los Angeles (+1 310-552-8566, kbettsteller@gibsondunn.com) Lauren Cook Jackson – Washington, D.C. (+1 202-955-8293, ljackson@gibsondunn.com) Gregory Merz – Washington, D.C. (+1 202-887-3637, gmerz@gibsondunn.com) Shannon Errico – New York (+1 212-351-2448, serrico@gibsondunn.com) Zane E. Clark – Washington, D.C. (+1 202-955-8228 , zclark@gibsondunn.com)

Investment Funds Group: Jennifer Bellah Maguire – Los Angeles (+1 213-229-7986, jbellah@gibsondunn.com) Kevin Bettsteller – Los Angeles (+1 310-552-8566, kbettsteller@gibsondunn.com) Albert S. Cho – Hong Kong (+852 2214 3811, acho@gibsondunn.com) Candice S. Choh – Los Angeles (+1 310-552-8658, cchoh@gibsondunn.com) John Fadely – Singapore/Hong Kong (+65 6507 3688/+852 2214 3810, jfadely@gibsondunn.com) A.J. Frey – Washington, D.C./New York (+1 202-887-3793, afrey@gibsondunn.com) Shukie Grossman – New York (+1 212-351-2369, sgrossman@gibsondunn.com) James M. Hays – Houston (+1 346-718-6642, jhays@gibsondunn.com) Kira Idoko – New York (+1 212-351-3951, kidoko@gibsondunn.com) Gregory Merz – Washington, D.C. (+1 202-887-3637, gmerz@gibsondunn.com) Eve Mrozek – New York (+1 212-351-4053, emrozek@gibsondunn.com) Roger D. Singer – New York (+1 212-351-3888, rsinger@gibsondunn.com) Edward D. Sopher – New York (+1 212-351-3918, esopher@gibsondunn.com) William Thomas, Jr. – Washington, D.C. (+1 202-887-3735, wthomas@gibsondunn.com)

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