

NEW MARKETING RULE - RECAP

As we have seen over the last month in our publications, the new Marketing Rule is complex and has several new items and disclosures to comply with. CRP is breaking down the implementation over several educational resources, including May, June, and July TMIC and TMR. In this educational resource, we will focus on **Books and Records, Implementation, and Policies and Procedures.**

- ☑ Reviewing the definition and prohibitions of the New Marketing Rule under the act (*highlighted in May 2022 TMIC*)
- ☑ Adopting, replacing, and implementing new requirements of using Third-Party Ratings and Performance Information (*highlighted in May 2022 TMR*)
- ☑ Adopting, replacing, and implementing new requirements of using Testimonials, and Endorsements (*highlighted in June 2022 TMIC*)
- ☑ Amendments to firm's books and records, implementation, and adoption of policies and procedures (*highlighted in June's TMR*)
- ☑ **Implementing Next Steps & Training IARs** (*highlighted in this month's TMIC & TMR*)

TRAIN/EDUCATE YOUR EMPLOYEES ON THE NEW MARKETING RULE

Schedule your Firm's IAR Training on the New Marketing Rule

- Refer to SAMPLE Training PowerPoint presentation to assist in training and documenting for the Compliance file.
- Document what materials were used in the training and who attended. This could be asked for on an SEC Exam!
- Refer to TMIC/TMR publications for supplemental information on training IARS on the new Marketing Rule.

CRP IMPLEMENTATION ASSISTANCE

As indicated in our July TMIC, complete the Marketing Rule Implementation Checklist and schedule time with CRP to work through what may apply to your firm. CRP can assist your firm and tailoring your Compliance program and what policies will be addressed and updates to ADV for best efforts implementation before November 4, 2022. Note: Several firms may pick and choose what they will want to use in advertisements - testimonials, endorsements, performance, third party ratings or elect to use promoters. Policies and procedures need to be updated to your current Manual and tailored accordingly.

POLICIES AND PROCEDURES

The new Marketing Rule replaces the current advertising and cash solicitation rules. Last month, we provided sample policies and procedures. These sample policies and procedures need tailoring to what aspects of the rule your firm will implement. It's important to take time to customize the language. The SEC will review your firm's policies for consistency in the ADV reporting disclosure and actual use of your marketing materials. We encourage firms to work with CRP on the additions to your Manual. Several sections are affected throughout the Manual and suggested edits will be provided over the next few publications for areas the current language should be deleted.

SEC STATEMENT ON SINGLE-STOCK LEVERED AND/OR INVERSE ETFs

It's no surprise the SEC issued a statement earlier this week expressing concern about use of leveraged and inverse ETFs. A new type of complex exchange-traded products will become available to investors in the U.S.: single-stock levered and/or inverse exchange-traded funds - and not to mention we are in a period of market stress and/or volatility. The statement, issued from the Office of Investor Education and Advisory on July 11th, warns of perhaps a greater risk for investors and the markets, for individuals not properly educated on the operations of such products especially pronounced in volatile markets and how these products can act in unexpected ways. The use of complex products and addressing the investor protection concerns has been at the forefront of the SEC agenda in recent years. As with other complex exchange-traded products, the highlight single-stock ETFs may be useful to certain *investors who understand their unique features* but are risky for investors and potentially for the markets, as well.

One SEC Commissioner commented, "Because of the features of these products and their associated risks, it would likely be challenging for an investment professional to recommend such a product to a retail investor while also honoring his or her fiduciary obligations or obligations under Regulation Best Interest." Be certain, your firm's next exam will focus on training and understanding these products, proper disclosure of risk, and holding periods and what types of clients hold complex products.

Lori J. Schock
Director, Office of Investor Education and Advocacy
July 11, 2022

Today and in the coming weeks, a new type of complex exchange-traded product will become available to investors in the U.S.: single-stock levered and/or inverse exchange-traded funds. For years, the Office of Investor Education and Advocacy, staff in other Divisions and Offices, and a number of Commissioners have warned that complex products present several risks to investors. These new products are no exception, as they provide levered and/or inverse exposure to a single security, which can present risks for investors.

Holding a levered and/or inverse single-stock ETF is not the same as holding the underlying stock, a traditional ETF, or even a non-single stock levered and/or inverse ETF. It is riskier for several reasons. Importantly, like many other complex exchange-traded products, levered and/or inverse single-stock ETFs aim to provide returns over extremely short time periods (in some cases even a single day). New risks may emerge for investors who hold these products for longer. Investors should be aware that if they were to hold these funds for longer than a day, the performance of these funds may differ significantly from the levered and/or inverse performance of the underlying stock during the same period of time.

Additionally, unlike traditional ETFs, or even other levered and/or inverse ETFs, these levered and/or inverse single-stock ETFs track the price of a single stock rather than an index, eliminating the benefits of diversification. Because levered single-stock ETFs in particular amplify the effect of price movements of the underlying individual stocks, investors holding these funds will experience even greater volatility and risk than investors who hold the underlying stock itself.

Though these products will be listed and traded on an exchange, they are not right for every investor. Levered and/or inverse single-stock ETFs pose risks that are unique and complex. We encourage all investors to consider these risks carefully before deciding to invest in levered and/or inverse single-stock ETFs.

CCO TAKEAWAY:

- **REQUIRE TRAINING AND APPROVAL FOR ADVISORS USING THESE TYPES OF PRODUCTS. DO THE ADVISORS UNDERSTAND THE RISKS AND HOLDING PERIODS?**
- **DISCLOSE THE ADDITIONAL RISKS TO CLIENTS. ENSURE DELIVERY PROSPECTUS HAS BEEN MADE TO CLIENT.**
- **UPDATE ADV PART 2A, ITEM 8, TO REFLECT LANGUAGE REGARDING THE USE OF THESE PRODUCTS IF YOUR FIRM UTILIZES IN STRATEGIES.**

BEST EXECUTION REVIEW

In July, your CCO monthly tasks include review of Best Execution. In its interpretive release, Release No. 34-23170, Securities; Brokerage and Research Services, issued April 28, 1986, the Commission stated that as a fiduciary, a money manager has an obligation to obtain "best execution" of client transactions under the circumstances of the particular transaction. In addition, the Commission stated that advisers are required to evaluate the quality and cost of services periodically and systematically what they receive from broker-dealers with whom they have placed client orders, including custodians. The SEC likes to see the analysis documented and maintained as a measure of best practices and strong internal controls.

Below offer some tips for CCOs in reviewing their recommended Custodian(s) this month:

- **REVIEW Quarterly** - or as appropriate the Best Execution Report from your Custodian (Report Name differs with each Custodian but they do exist! --- TD's Report Name: "Post Trade Report", Schwab's Report name: "Best Execution Quality Report". Pull sample of trades to review. Compare the price variance from the market price and the execution price.
- **DOCUMENT Annually** - Qualitative and Quantitative Review of Custodian. (*Refer to Sample Checklist below to assist with Review*).

Topics of Review include:

- Execution capabilities including the ability to handle trades and answer calls in a volatile market
- Financial responsibility, obtain the audit or FOCUS Report from the executing firm
- Value of research or brokerage provided
- Technology provided
- Willingness, ability, facilities, and infrastructure to work with investment advisor firms
- Administrative resources
- Responsiveness
- Pricing for services provided
- Compare 606 reports from various Custodians and retain for file. CRP has provided three different Custodian 606 reports for your ease of conducting this review. Refer to the attachments on this month's TMIC email.

For Firms who go to the Street for Fixed Income Trades: Be sure to document the executing price with public quote sources. If you have a Bloomberg, compare your trade on TRACE.