Davis Polk

Investment Management & Funds Regulatory Update - January 2026

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In this issue, we discuss a compliance risk alert and new FAQs both regarding the Advisers Act Marketing Rule, proposed amendments to the small entity definitions for purposes of the Regulatory Flexibility Act, and a CFTC no-action letter regarding relief from CPO registration for certain registered advisers.

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Rules and regulations

SEC proposes amendments to the small entity definitions for investment companies and investment advisers for purposes of the Regulatory Flexibility Act

On January 7, 2026, the SEC proposed amendments to the definitions of "small business" and "small organization" under the Investment Company Act and Advisers Act rules that determine which investment companies, investment advisers and business development companies qualify as small entities for purposes of the Regulatory Flexibility Act (RFA). The

SEC stated in its proposing release that: "[a]mending the definitions would help ensure the [SEC]'s regulatory flexibility analyses capture a more meaningful population of 'small entities' given asset growth over the past decades and, in turn, provide a clearer opportunity for public comment on the [SEC]'s regulatory analyses with respect to this population."

According to the proposing release, the SEC's proposal would:

- amend the definitions of "small business" and "small organization" in Rule 0-10 under the Investment Company Act to: "(i) increase the net asset threshold for investment companies from $50 million to $10 billion; and (ii) refer, for purposes of aggregating the net assets of related funds, to a 'family of investment companies' as that term is used in Item B.5 of Form N-CEN rather than to a 'group of related investment companies' as used in the current rule;"
- amend the definitions of "small business" and "small organization" in Rule 0-7 under the Advisers Act to increase the regulatory assets under management threshold from $25 million to $1 billion and to make related conforming changes to the relevant control relationship thresholds in such definitions;
- request comment on whether to amend the total assets threshold in Rule 0-7 under the Advisers Act (which currently excludes from the small entity definitions any adviser that has total assets of $5 million or more on the last day of its most recent fiscal year), as well as the related control relationship threshold;
- amend Form ADV to revise the instructions and Item 12 of Part 1A of Form ADV, and Rule 203-3(b) under the Advisers Act, to make conforming changes in connection with the proposed amendments, including as they relate to continuing hardship exemptions from electronic filing requirements for advisers; and
- amend Rule 0-10 under the Investment Company Act and Rule 0-7 under the Advisers Act to allow the SEC to make subsequent inflation adjustments to the asset thresholds by order every 10 years.

The public comment period will be open for 60 days after the date of publication of the proposing release in the Federal Register.

Industry update

SEC Examinations Division staff issues risk alert regarding investment advisers' compliance with the Advisers Act Marketing Rule

On December 16, 2025, the SEC's Division of Examinations staff (staff) issued a risk alert to provide investment advisers, investors and other market participants with additional information regarding investment advisers' compliance with Rule 206(4)-1 (Marketing Rule) under the Advisers Act. The staff noted that this risk alert addresses the staff's observations regarding compliance with Marketing Rule provisions under Rule 206(4)-1(b) (the Testimonials and Endorsements Provisions) and Rule 206(4)-1(c) (the Third-Party Ratings Provisions).

Observations related to the Testimonials and Endorsements Provisions

The risk alert outlined observations of instances where advisers used testimonials (statements from current clients or investors in private funds advised by the adviser) and endorsements (statements made by all other persons) without adherence to some or all of the requirements for both compensated and uncompensated testimonials or endorsements:

- **Most commonly observed non-compliance**: the staff indicated that the most common reason for a testimonial or endorsement to be considered non-compliant was that it did not provide the required disclosures at the time the testimonial or endorsement was disseminated. According to the risk alert, such testimonials or endorsements were often presented on advisers' websites (including websites using alternative business names). The staff also observed advisers using lead-generation firms, social media influencers, adviser referral networks and "refer-a-friend" programs without recognizing that in some instances these arrangements created an endorsement or testimonial.
  - The staff observed that many advisers who utilized testimonials and endorsements in advertisements updated their written compliance policies and procedures, while others had not.
  - The risk alert noted that advisers that did not update their compliance policies and procedures, and advisers that updated their policies and procedures but did not implement them, appeared not to comply with the Marketing Rule.

- **Clear and prominent disclosures**: the staff observed the following instances of advertisements which did not properly provide disclosures in a clear and prominent manner as is required under the Marketing Rule:
  - Instances of hyperlinked disclosures;
  - Disclosures that were in a smaller or lighter font than the testimonials to which they were related;
  - Advertisements that incorporated current client testimonials or former client endorsements without clearly and prominently disclosing that such testimonials and endorsements were provided by current or former clients;
  - Advisers providing compensation in the form of gift cards to clients to write reviews on third-party websites without a basis to reasonably believe that the person giving the testimonial complied with disclosure requirements for paid testimonials; and
  - Advertisements which did not provide one or more of the required clear and prominent disclosures such as:
    - Whether the promoter was a current client or investor in a private fund advised by the investment adviser;
    - If the promoter was paid cash or non-cash compensation; and
    - If the promoter had a material conflict of interest.

- **Disclosure of material terms of compensation arrangements**: The staff observed advisers that did not disclose the material terms of compensation arrangements including:
  - Not providing a description of the compensation provided directly or indirectly to the promoters for testimonials or endorsements included in the advertisements.
  - Providing only generic disclosures about compensation arrangements while omitting material information, including compensation terms of referral payments for social media influencers.

- **Disclosure of material conflicts**: The staff observed advisers that did not disclose material conflicts arising from the advisers' relationships with promoters and/or compensation arrangements, including:
  - A failure to disclose material conflicts resulting from a promoter's financial interest in promoted advisers, including clients of advisers who were also:
    - investors in the promoted advisers; or
    - principals or officers of other advisory firms with a sub-advisory or other significant relationship with the promoted advisers.

- **Oversight and compliance**: The staff observed advisers that did not appear to comply with the requirement that an adviser have "a reasonable basis for belief" that testimonials or endorsements comply with the Testimonials and Endorsements Provisions. The staff observed instances of:
  - Advisers who were unaware or unable to demonstrate that they satisfied this reasonable basis for belief requirement;
  - Failure to maintain compliance policies and procedures or written agreements with promoters enabling the adviser to satisfy the reasonable basis for belief requirement; and
  - Failure to enter into or maintain written agreements with paid promoters that adequately described the scope of the agreed upon promotion and the terms of the compensation for the promotion.
    - According to the risk alert, these failures included instances of arrangements wherein a promoter was compensated for less than $1,000 on an individualized basis but did not meet the *de minimis* threshold because the promoter's total compensation exceeded $1,000 during the preceding twelve (12) months.

- **Ineligible persons**: The staff observed advisers that did not appear to comply with the prohibition on compensating ineligible persons for endorsements. For example, some promoters who were disqualified due to disciplinary histories with state securities regulators still received compensation for endorsements.
- **Promoter affiliated with the adviser**: The staff observed advisers using affiliated promoters who did not meet the disclosure and agreement requirements of the Testimonials and Endorsements Provisions or the conditions required to be exempt from such requirements. The staff noted that this affiliation was not readily apparent or disclosed to clients or investors at the time the testimonials or endorsements were disseminated, and instead such affiliations were only disclosed after the prospective clients or investors were introduced to the adviser.

Observations related to the Third-Party Rating Provisions

According to the risk alert, the staff also observed advisers that disseminated advertisements that did not appear to comply with the Third-Party Ratings Provisions:

- **Failure to comply with some or all requirements**: The staff observed advisers using third-party ratings while failing to comply with some or all requirements for the use of third-party ratings. Some such third-party ratings were found on advisers' websites, social media profiles, marketing brochures, press releases and blogs.
- **Due diligence**: The staff observed advisers using various methods to comply with the "due diligence requirement" under the Third-Party Ratings Provisions, which requires advisers to have a reasonable basis for believing that questionnaires or surveys used in the preparation of third-party ratings are structured to make it equally easy to provide both favorable and unfavorable responses and not designed to produce predetermined results. For example, the staff observed advisers reviewing publicly disclosed information about questionnaire or survey methodology, obtaining questionnaires or surveys used in the preparation of the rating, and seeking representations from the ratings agencies regarding the aspects of how the questionnaires were designed, structured and administered.
  - However, the staff also observed advisers that did not establish policies or procedures to satisfy the due diligence requirement, or take steps to meet this requirement, such as by obtaining or reviewing the questionnaires or surveys that were used in preparation of the ratings.
- **Clear and prominent disclosures**: The staff observed advisers that included third-party ratings in advertisements without providing some or all of the requisite clear and prominent disclosures, or having a reasonable basis for believing that the third-party ratings included the required disclosures. In conjunction with their review, the staff observed the following:
  - Advisers that included links to third-party ratings websites that did not contain the proper disclosures.
  - Third-party ratings included in adviser advertisements that did not clearly and prominently display the date the ratings were given or the period of time the ratings were based on.
  - Ratings with a reference to a range of years in which the adviser was the recipient of the third-party rating but the dates included by the adviser listed a year in which the adviser did not receive the award.
  - Logos in advertisements that did not clearly and prominently identify the third-party that created and tabulated the ratings.
  - Provision of direct or indirect compensation in connection with obtaining or using third-party ratings without including disclosures of payments including payments made for:
    - The use of the third-party rating provider's logos or reprints;
    - Priority placements in advertisements for enhanced or upgraded exposure;
    - Payments made for referrals to the advisers.
  - Advisers that paid third-party ratings fees to be in contention for ratings without disclosing such payments.
  - Disclosures that were not clear or prominent, such as those:
    - Using hyperlinks;
    - Using smaller text font for disclosures; or
    - Placing disclosures at the bottom of the website, pages away from the ratings themselves.

In the risk alert, the staff noted that it continues to focus on advisers' compliance with the Marketing Rule, and urged advisers to reflect on their own practices, policies and procedures and to implement modifications as necessary to their training, supervisory oversight and compliance programs.

SEC Investment Management Division staff issues updated FAQs regarding Advisers Act Marketing Rule

On January 15, 2026, SEC Investment Management Division staff (the Staff) updated its FAQs regarding compliance with Rule 206(4)-1 under the Advisers Act (the Marketing Rule) by issuing responses to two new questions addressing

these topics. The new FAQs provide additional clarification regarding (i) the use of actual fees versus model fees when presenting net performance, and (ii) the application of the Marketing Rule's disqualification provisions to compensated testimonials and endorsements involving certain self-regulatory organization (SRO) final orders.

Use of model fees in net performance

The first new FAQ addresses whether an adviser would violate the general prohibitions of Rule 206(4)-1(a) by advertising net performance that reflects the deduction of the actual fees charged to a portfolio, when the fees anticipated to be charged to the advertisement's intended audience are expected to be higher.

In its response, the Staff explained that the Marketing Rule's definition of "net performance" permits net performance to be calculated using either (i) the fees and expenses actually paid by a client or investor, or (ii) a model fee, subject to specified conditions. However, the Staff emphasized that, in certain circumstances, presenting only net performance calculated using actual fees may be inconsistent with the Marketing Rule's general prohibitions.

The Staff highlighted footnote 590 of the Marketing Rule's adopting release (the Adopting Release), which provides that, when the fee anticipated to be charged to the intended audience is higher than the actual fees charged, the adviser must use a model fee that reflects the anticipated fee in order not to violate the Marketing Rule's general prohibitions. The FAQ notes that some advisers have interpreted this footnote as categorically requiring the use of a model fee and prohibiting the presentation of net performance calculated using actual fees in these circumstances.

Citing the Adopting Release, the Staff highlighted that the general prohibitions are intended to provide advisers with flexibility and regulatory certainty, and that whether the use of actual fees is misleading depends on the facts and circumstances of each advertisement. In the Staff's view, whether presenting net performance calculated using actual fees would violate the general prohibitions depends on all relevant facts and circumstances, including the nature and clarity of disclosures. The Staff further indicated that advisers may use various approaches to illustrate the effect of differences between actual fees and anticipated fees on performance, rather than relying exclusively on a single method.

Testimonials and Endorsements – SRO final orders

The second new FAQ addresses whether the Staff would recommend enforcement action if an adviser compensates a person for a testimonial or endorsement when that person was subject to a final order by an SRO of the type described in section 203(e)(9) of the Advisers Act within the prior 10 years, but was not barred or suspended from acting in any capacity under the rules of that SRO.

The Staff explained that Rule 206(4)-1(b)(3) generally prohibits an adviser from compensating a person for a testimonial or endorsement if the adviser knows, or in the exercise of reasonable care should know, that the person is subject to a disqualifying event (as defined in the Marketing Rule) within the preceding 10 years. Such disqualifying events include final orders issued by SROs based on violations involving fraudulent, manipulative or deceptive conduct.

The Staff noted, however, that the definition of "disqualifying event" excludes certain SEC orders or opinions that do not bar, suspend or otherwise prohibit the individual from acting in any capacity under the federal securities laws, provided that the individual complies with the terms of the order or opinion and specified disclosures are included in the advertisement. The FAQs noted that the SEC explained that it adopted this exclusion to permit individuals to engage in compensated testimonial and endorsement activities when the SEC has not barred or suspended them, subject to appropriate conditions.

Applying the same rationale to orders by SROs, the Staff stated that it would not recommend enforcement action if a person subject to a qualifying SRO final order engages in compensated testimonial or endorsement activities, provided that the same specified conditions are met. Specifically, the Staff noted that it would not recommend enforcement action under Rule 206(4)-1(b)(3) if:

- The sole reason the person is an ineligible person (as defined in the Marketing Rule) is the SRO's final order;
- The SRO did not expel or suspend the person from membership, bar or suspend the person from association with other members or otherwise prohibit the person from acting in any capacity;
- The person is in compliance with all terms of the SRO's final order, including payment of any disgorgement, interest, penalties or fines; and
- For a period of 10 years following the date of the final order, any advertisement containing the testimonial or endorsement discloses that the person is subject to an SRO order and includes the order, or a link to the order, if available.

CFTC staff issues no-action letter regarding relief from CPO registration for certain SEC-registered investment advisers

On December 19, 2025, the Market Participants Division (MPD) of the Commodity Futures Trading Commission (CFTC) issued No-Action Letter 25-50 (Letter 25-50)[1] in response to a request from the Managed Funds Association seeking restoration of the former CFTC Rule 4.13(a)(4) exemption from registration as a commodity pool operator (CPO) for "QEP-only" pools. Letter 25-50 provides interim no-action relief that restores, in a more limited manner, the rescinded CFTC Rule 4.13(a)(4) registration exemption for certain SEC-registered investment advisers that operate private funds offered solely to qualified eligible persons (QEPs).[2] The relief permits eligible managers to avoid or withdraw from CPO (and, in some cases, commodity trading advisor (CTA)) registration with respect to qualifying pools. This relief is intended as a bridge while the CFTC evaluates whether and how to undertake rulemaking to reinstate or codify similar relief, but the relief is not time-limited by its terms. The relief does not modify or displace existing exemptions and exclusions under CFTC Rules 4.5 and 4.13; instead, it operates as an additional pathway to relief from CPO registration for eligible managers.

Who can rely on the relief?

The relief is available only to SEC-registered investment advisers that manage private funds qualifying as "commodity pools" and whose interests are offered exclusively to QEPs. It is particularly relevant to managers that previously relied on former Rule 4.13(a)(4) exemption and, after its recission, subsequently registered as CPOs (often becoming NFA members). It may also be relevant to certain managers who currently rely on the CFTC Rule 4.13(a)(3) exemption from CPO registration (sometimes referred to as the *de minimis* exemption) because the no-action relief does not impose any quantitative limits on commodity interest trading activity by the fund.

Key eligibility requirements include:

- The adviser is an SEC-registered investment adviser.
- The relevant pools are offered only to QEPs and otherwise operate as private funds.
- The adviser files Form PF with respect to the covered private funds (subject to limited nuances for certain QEP-only pools).
- The adviser complies with specified CFTC notice and recordkeeping requirements associated with electing to rely on the letter.

The relief does not impose a specific investor notice or redemption right requirement, but managers may wish to consider whether offering or side letter documentation should be updated and whether investor communications are advisable in light of changed regulatory status.

Practical implications for private fund managers

Letter 25-50 meaningfully reduces the ongoing compliance and supervisory burden for eligible advisers that have maintained CPO and, in some cases, CTA, registration solely because they manage QEP-only private funds that trade in commodity interests (e.g., futures or swaps). Managers that currently rely on the *de minimis* trading exemption in Rule 4.13(a)(3) may also consider transitioning certain pools to reliance on Letter 25-50 to eliminate derivatives usage limits, where appropriate. Managers contemplating reliance on Letter 25-50 should consider whether the private funds that are "commodity pools" have an investor base limited to QEPs and are eligible under the Form PF and other conditions.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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[1] CFTC Letter No. 25-50 (Mkt. Participants Div. Dec. 19, 2025), https://www.cftc.gov/node/257516.

[2] "Qualified eligible persons" are defined under CFTC Rule 4.7 and include (i) "qualified purchasers," as defined in Section 2(a)(51)(A) of the Investment Company Act, (ii) "knowledgeable employees" as defined in Rule 3c-5 under the Investment Company Act and (iii) certain other categories of investors as identified in CFTC Rule 4.7(a)(6).