CFA Institute

Navigating the SEC Marketing Rule: Common Pitfalls & Best Practices

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Agenda

- **Where We Stand Today**
- **Net Performance: When & How**
  - New Marketing Rule FAQs
  - FN 590
- **Comparing the Marketing Rule and the GIPS standards**
  - Carve Outs/Extracted Performance
  - Performance Portability

Where We Stand Today

Jan. 1, 2020
Effective Date for 2020 Edition of the GIPS Standards

Dec. 22, 2020
SEC Adopts the Marketing Rule

May 4, 2021
Marketing Rule becomes Effective

Nov. 4, 2021
Marketing Rule Compliance Date

Sept. 19, 2022
EXAMS Risk Alert highlighting Marketing Rule focus areas

Aug. 21, 2023
First Marketing Rule enforcement action

Feb. 6, 2024
SEC Staff FAQ Issued: Subscription Lines of Credit

April 17, 2024
EXAMS Risk Alert sharing Marketing Rule observations

March 19, 2025
SEC Staff FAQs Issued: Extracts & Portfolio Characteristics

Question: When is Net Performance Required?

Answer: Any time Gross Performance is included in an advertisement!

Key requirements when including net performance:

- Presentation
- Calculation
- Time Period

This applies to any presentation of any type of gross performance in an advertisement, except…

New Marketing Rule FAQs

Extracted performance may be shown on a gross only basis *if*:

- The extract is clearly identified as gross of fees;
- The performance of the portfolio or composite from which the extract was derived is also presented:
    - Consistent with the requirements of the Marketing Rule;
    - On a gross and net basis, to demonstrate the effect of fees;
    - With at least equal prominence to and in a manner designed to facilitate comparison with the extract; and
    - Over a period of time that includes the entire period over which the extract is calculated.

Portfolio or investment characteristics may be shown on a gross only basis *if*:

- The characteristic is clearly identified as gross of fees;
- The performance of the portfolio or composite from which the characteristic was derived is also presented:
    - Consistent with the requirements of the Marketing Rule;
    - On a gross and net basis, to demonstrate the effect of fees;
    - With at least equal prominence to and in a manner designed to facilitate comparison with the characteristic; and
    - Over a period of time that includes the entire period over which the characteristic is calculated.

New Marketing Rule FAQs: Challenging Scenarios

Can extracts or characteristics of hypothetical performance be presented on a gross-only basis?

- Clearly, some hypothetical performance can be; see footnote 1.
- Does it play out differently for different types of hypothetical performance?
  - Backtests
  - Projections
  - Models
  - Composites of Extracts and Extracts of Composites
- Considerations
  - What does the Commission/Staff care about?
  - Is what is shown meaningful?

Can extracts or characteristics of predecessor performance be shown on a gross-only basis?

- Are you also in compliance with the predecessor performance requirements?
- Potential overlap with hypothetical performance
- Considerations
  - Higher-risk presentations?
  - What does the Commission/Staff care about?

Net Performance: Actual vs. Model Fees

Net performance may be calculated by deducting:

- The **actual fees** a client or investor has paid or would have paid; <u>or</u>
- A **model fee** *if*:
  - Doing so would result in performance figures that are no higher than if the actual fee had been deducted; or
  - Equal to the highest fee charged to the intended audience to whom the advertisement is disseminated

Net Performance: Footnote 590

Adopting Release FN 590

"If the fee to be charged to the intended audience is anticipated to be higher than the actual fees charged, the adviser must use a model fee that reflects the anticipated fee to be charged in order not to violate the rule's general prohibitions."

Carve-Outs and Extracted Performance

MARKETING RULE

- Extracted performance can be a subset of any investments from a portfolio
- Must present (or for private fund advertisements, offer to provide) performance of the total portfolio the extracted performance is pulled from
- A composite of carve outs is treated as hypothetical performance

GIPS STANDARDS

- Carve-outs must be representative of a distinct investment strategy
- Do not need to present performance of the total portfolio that carve-out performance is taken from
- A composite may include carve-outs

Marketing Rule: Performance Portability

Predecessor performance may be shown provided that:

- Person(s) **primarily responsible** for achieving prior performance results continue to manage accounts at the advertising adviser
- Accounts managed at predecessor adviser are **sufficiently similar** to accounts managed at advertising adviser
- All accounts **managed in a substantially similar manner** are advertised *unless* exclusion of any account would not result in materially higher performance or alter the presentation of any prescribed time periods
- Advertisement clearly and prominently includes **all relevant disclosures** and indicates performance results were from accounts managed at another entity

GIPS Standards: Performance Portability

Prior firm performance may be used and linked to the acquired firm's performance if:

- **Substantially all of the investment decision makers** are employed by the new or acquiring firm
- The **decision-making process** is substantially intact and independent within the new or acquiring firm
- The new or acquiring firm has **records** to support the performance
- There is **no break** in the track record between the past firm or affiliation and the new or acquiring firm

Marketing Rule vs. GIPS Standards

MARKETING RULE

If the portability tests are no longer met because the person(s) primarily responsible for achieving the prior performance no longer manage accounts, the ported performance **should not be used**

GIPS STANDARDS

Once the portability tests are met, the prior performance becomes the performance of the new or acquiring firm and can **always be used**

Questions?

Thank you!