



CFA Institute

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SEC Marketing Rule Developments

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K&L GATES

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AGENDA

- Marketing Rule Developments - Exam Update and Enforcement Actions
- Marketing Rule 202 – Answers to Frequent Questions
 - Scope of the Rule
 - Application of the General Prohibitions – Fair and Balanced
 - Performance Presentation
 - Hypothetical Performance
- Your Questions



SEC Examinations

- Current (and potentially perennial) SEC staff focus
- Exam and enforcement sweeps
- Currently targeting advisers who use hypothetical performance



Marketing Rule Developments - Enforcement Actions

- First Marketing Rule enforcement action announced on August 21st.
- The second through tenth enforcement actions announced on September 11th.
- All involved the use of hypothetical performance metrics.
- Order alleges firms violated the Marketing Rule by:
 - failing to adopt and implement policies and procedures reasonably designed to ensure that the hypothetical performance was relevant to the likely financial situation and investment objectives of the intended audience; and
 - in the initial action, by failing to provide certain information underlying the hypothetical performance advertised.



Marketing Rule Developments – Enforcement Actions

- Key Takeaways
 - Within the context of retail investors, website availability was prominently discussed in the SEC’s orders.
 - Provides insight on the SEC’s focus on hypothetical performance and its public availability.



Reminder: What is an “Advertisement”?

Any direct or indirect communication to more than one person (**or to one or more persons if the communication includes hypothetical performance**) that:

- offers new investment advisory services with regard to securities to **prospective** :
 - clients; or
 - investors in a private fund advised by the investment adviser or
- offers new investment advisory services with regard to securities to **current** :
 - clients; or
 - investors in a private fund advised by the investment adviser.



What does “offers new advisory services” mean?

- Intended to scope out discussions with existing clients about their existing investments.
- SEC dropped proposed definition that would have included communications to “retain” clients.
- Rule only applies to offers of new or additional advisory services with regard to securities to current clients as advertisements.
 - Materials sent to current clients may be deemed advertisements if used with prospective clients.
- Application to the presentation of third-party performance.



What is not an Advertisement?

Does not include:

- Extemporaneous, live, oral communications
- Information in a **statutory or regulatory notice, filing, or other required communication**
 - provided that such information is reasonably designed to satisfy the requirements of such notice, filing, or other required communication
- Communication that includes hypothetical performance that is provided:
 - In response to an unsolicited request for such information; or
 - To a prospective or current investor in a private fund advised by the investment adviser in a one-on-one communication



General Prohibitions – Fair and Balanced

An Advertisement may not:

- Discuss any potential benefits to clients or investors connected with or resulting from the investment adviser's services or methods of operation without providing **fair and balanced** treatment of any material risks or material limitations associated with the potential benefits;
- Include a reference to specific investment advice provided by the investment adviser where such investment advice is not presented in a manner that is **fair and balanced**; or
- Include or exclude performance results, or present performance time periods, in a manner that is not **fair and balanced**.



Presentation of Performance

- Gross and net of fees performance required in equal prominence
- Presentation over prescribed time periods (1, 5, 10 or since inception)
 - Other time periods are permitted, subject to general requirements
- Disclosures should be clear and prominent
- Performance commentary should be fair and balanced
- Risk disclosure should include material risks
- Not all performance-related data represent “performance” in all cases (e.g., yields)



What is Hypothetical Performance?

- Performance results that were not actually achieved by a portfolio of the adviser. Includes:
 - Performance derived from **model portfolios**;
 - Performance that is **backtested** by the application of a strategy to data from prior time periods when the strategy was not actually used during those time periods; and
 - **Targeted or projected** performance returns with respect to any portfolio or to the investment advisory services with regard to securities offered in the advertisement.



What is NOT Hypothetical Performance?

- Actual performance results (including applied performance results, e.g., growth of \$10,000 chart)
- Extracted Performance
- Deduction of Model Fees
- After-Tax Performance
- Composite Performance



Considerations for Hypothetical Performance

- Certain data may be deemed hypothetical performance depending upon use, e.g.:
 - Index Performance – if presented as performance that could be achieved by a portfolio
 - Yields – if estimated and used to indicate the performance of a portfolio
- Linking actual to index performance



Showing Hypothetical Performance

- Policies and procedures;
- Disclosures on criteria and assumptions and risks and limitations;
- Limited to “intended audience”
 - Can be based on “types of investors” (e.g., Qualified Purchaser, Qualified Client, etc.);
- Recordkeeping
 - Who is the “intended audience”?



Resources

- Sign up for K&L Content [Stay Informed | K&L Gates \(emailcc.com\)](#)
- K&L speakers
 - [Lance C. Dial | People | K&L Gates \(klgates.com\)](#)
 - [Pamela A. Grossetti | People | K&L Gates \(klgates.com\)](#)
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Questions?

