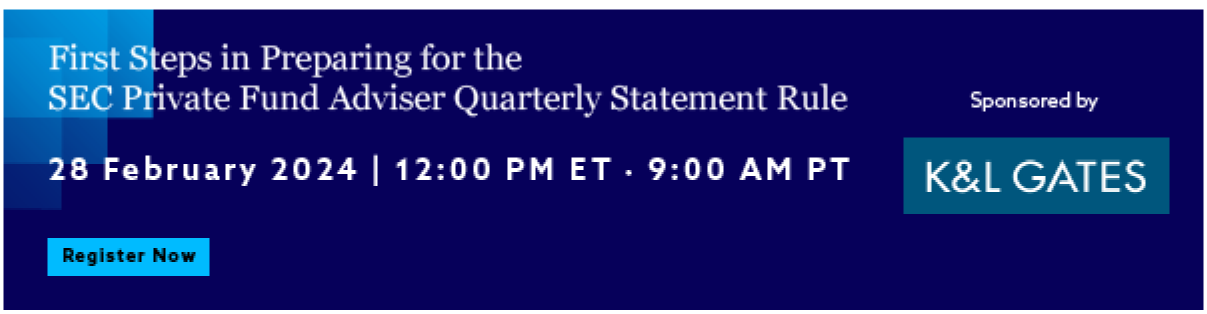
February 2024 Edition

SEC Private Fund Adviser Rules Webinar

Do you have questions on navigating the SEC Private Fund Adviser Quarterly Statement Rule? Join CFA Institute and attorneys from K&L Gates to gain clarity on key considerations and ensure your preparation is off to a solid start.

First Steps in Preparing for the SEC Private Fund Adviser Quarterly Statement Rule
28 February 2024
12:00 PM ET / 9:00 AM PT

Register Now



Take the SEC Marketing Rule Survey

The CFA Institute United States Investment Performance Committee (USIPC) and the Investment Adviser Association (IAA) have created a joint survey to identify and report on current practices and industry trends for complying with the performance requirements of the SEC Marketing Rule. Topics include which types of data are considered to be performance and must be presented on a net basis, and which types of prospects may receive hypothetical performance.

If your firm is subject to the SEC Marketing Rule, we want to hear from you! We welcome participation from firms that do or do not claim compliance with the GIPS standards. This survey is anonymous, and any data released will be in aggregate form. Entity-specific information will never be released to any party outside of CFA Institute or the IAA.

The survey is open through 1 April 2024. We greatly appreciate your participation, which will assist us in providing valuable information to the investment adviser compliance community. The survey should take no more than 15 minutes to complete.

Take Survey

New SEC Marketing Rule FAQ Issued

On 6 February 2024, the U.S. Securities and Exchange Commission (SEC) issued a new Marketing Rule FAQ addressing advertisements that include internal rates of return (IRRs) for private funds that use subscription facilities. When subscription facilities are used, two types of fund IRRs can be calculated:

- The IRR with the impact of the subscription facility is calculated from the time of the first capital call.
- The IRR without the impact of the subscription facility is calculated from the time of the first investment.

The IRR with the impact of the subscription facility represents the experience of the fund investors; the return will be calculated for a shorter time period and the IRR will be higher. The IRR without the impact of the subscription facility represents the experience of the fund; the return will be calculated for a longer time period, and the IRR will be lower. Gross and net IRRs may be calculated for both types of IRRs.

The Marketing Rule requires that any presentation of gross performance be accompanied by a presentation of net performance that has been calculated over the same time period and using the same type of return and methodology as the gross performance. Additionally, net performance must be presented in a format designed to facilitate comparison with gross performance. The FAQ addresses how to apply these requirements when various IRRs can be calculated.

Common practice is for an adviser to present a fund's Gross IRR from the time of the first investment (i.e., without the impact of the subscription facilities) along with the Net IRR from the time of the first capital call (i.e., with the impact of the subscription facilities.) The FAQ states that this practice would violate the Marketing Rule. If an adviser presents a fund's Gross IRR without the impact of subscription facilities, it must present the Net IRR without the impact of the subscription facilities, so that the two returns are calculated for the same time period.

The FAQ also states that presenting only the Net IRR with the impact of the subscription facilities (i.e., for the shorter time period) would violate the general prohibitions of the Marketing Rule. If the adviser wishes to present the Net IRR with the impact of the subscription facilities, it must either (1) present the Net IRR without the subscription facility or (2) provide appropriate disclosures describing the impact of such subscription facilities on the net performance shown. The SEC staff believes that presenting only Net IRR with the impact of subscription facilities could mislead investors by suggesting that the fund's advertised performance is similar to the performance that the investor has achieved from its investment in the fund alone.

How does this guidance in the FAQ compare with the requirements in the GIPS standards? We are happy to say that this guidance generally aligns with the requirements of the GIPS standards. The GIPS standards require firms to present IRRs both with and without the subscription facility, with one exception. Firms are not required to present IRRs without the subscription facility if the subscription facility has the following characteristics:

- The principal was repaid within 120 days using committed capital drawn down through a capital call; and
- No principal was used to fund distributions.

Firms that claim compliance with the GIPS standards and that used subscription facilities for very short time periods may need to perform additional calculations not done previously. However, these calculations will also be required by the SEC's Private Fund Adviser Quarterly Statement Rule, which will require Gross and Net IRRs, both with and without the impact of subscription facilities. We expect that many advisers have all of these calculations well under way.

New Blog Post on GIPS Compliance by the Numbers

Last month, we shared the exciting news that all of the top 25 global asset managers claim compliance with the GIPS® standards for all or some of their assets. For more statistics and information on the organizations that claim compliance with the GIPS standards, read our new blog post, "GIPS Compliance by the Numbers."

Dear GIPS Standards Help Desk

This month's question asks whether a firm can create a catch-all composite for accounts that do not meet the requirements of any of their composites.

Question: Are we able to create a catchall composite for accounts that do not meet the requirements for any of our composites? For example, if our firm has a $1mm minimum requirement and the account is only $500k, and we have full discretion, can we put this account in a composite with all other fully discretionary accounts that do not meet the definition of our composites for one reason or another?

Answer: As stated in the explanation of Provision 3.A.2 in the GIPS Standards Handbook, non-discretionary segregated accounts must not be included in a firm's composites. Some firms, however, may group together some or all of the firm's non-discretionary segregated accounts in order to simplify account administration. For purposes of complying with the GIPS standards, such a group is not a composite and must not be included on the firm's list of composite descriptions.

Portfolios within a composite must be managed to a similar investment mandate, objective, or strategy. Creating a catchall composite that holds portfolios that do not meet a composite definition, including portfolios classified as non-discretionary, would not be appropriate. If a composite has a composite minimum and the portfolio is below the composite minimum, that portfolio would be considered non-discretionary and must not be included in a composite. A composite minimum represents the size below which a portfolio is considered too small to be managed to a specific strategy because the strategy cannot be fully implemented.

Investment Foundations Certificate® Live Learning Series
The Investment Foundations Certificate® provides learners with an overview of the essentials of finance, ethics, and investment roles, providing a clear understanding of the global investment industry, including terminology and foundational concepts. The certificate is designed for those aspiring to, or currently working within, support roles across the investment and finance industries.

To mark the one-year anniversary of the revamped Investment Foundations Certificate, we are offering a series of six Live Learning webinars from February to May 2024. We invite interested individuals to engage with curriculum-shaping instructors and gain practical knowledge.

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New CFA Institute Digital Member Experience
Many readers of the GIPS Standards Newsletter are members of CFA Institute. Members can log in to a new Digital Member Experience at https://my.cfainstitute.org. This exclusive platform provides a gateway to the wealth of benefits included with a CFA Institute membership. Click here to see an introductory video from Randi Tolber, Managing Director, Member and Society Relations. With this new platform, members can easily find the full spectrum of benefits in one convenient place. From a single login, members can access career resources, CFA Institute research, professional learning, society membership, and much more.