



SEC New Marketing Rule - Performance Disclosure Checklist

Per the updated guidance from the Securities and Exchange Commission (“SEC”) there are new considerations registered investment advisers must consider when presenting investment performance in an advertisement. The updated guidance in the marketing rule applies to all communications made by a registered investment adviser that the SEC deems an advertisement. Below is a list of the key considerations a firm can use to determine if a presentation is considered an advertisement under the marketing rule:

1. The SEC defines an advertisement as any direct or indirect communication made by an investment adviser that is registered, or required to be registered, with the SEC. For GIPS compliant firms, the Marketing rule is applicable to and includes GIPS Reports.
2. The SEC marketing rule is designed to capture communications that are commonly considered advertisements and was intentionally set as a broad definition.
3. The SEC definition of an advertisement includes compensated testimonials and endorsements that historically were considered solicitations under the solicitation rule.
4. The SEC definition of an advertisement does not include customized forms of communication that were designed solely for the specific recipient, and that communication is done in a one-on-one setting, such as live oral communications.
5. The SEC definition of an advertisement does not include responses to unsolicited client requests.

If any communication with your intended audience meets the above definition, the SEC marketing rule will apply. The following is a checklist of information that you should consider in light of these rules:

PERFORMANCE PRESENTATION REQUIREMENTS

USE OF COMPOSITE PERFORMANCE

- The marketing rule requires performance of related portfolios to be presented, meaning the presentation of portfolios with substantially similar investment strategies. Related performance can be presented as:
 - An aggregation (“Composite”) of related portfolios, or
 - Presentation of each individual related portfolio
- Unlike GIPS, the SEC marketing rule does not require every discretionary portfolio that fits the mandate to be included in the aggregation of related portfolios. This approach allows some related portfolios to be excluded, as long as the aggregation of the selected portfolios does not result in better performance than if all had been included. If portfolios are excluded, your organization is required to demonstrate that exclusion of some portfolios does not result in better performance.

NET RETURNS

- Net performance returns must be presented. These must be presented net of:
 - Advisory fees paid to the advisor and
 - Any fees associated with the underlying investment vehicles.
- If the firm provides custody services for clients, net performance also needs to be reduced by associated custody fees.
- Unlike with the GIPS standards, the SEC marketing rule does not require net composite returns to be reduced by transaction fees. However, it is acceptable to show net performance that has been reduced by transaction fees.

GROSS RETURNS

- Gross performance returns may be shown in advertisements in addition to net performance returns. When presenting gross performance returns, they must be :
 - Presented in equal or lesser prominence than net performance.
 - For the same time period as net performance.
 - Calculated using the same methodology as net performance.
 - Presented as the same type of return (TWR or MWR) as net performance.
- The presentation of gross and net performance must be presented in a way that allows comparison between the two return streams (e.g., side-by-side).
- Unlike with the GIPS standards, the SEC marketing rule does not require gross returns to be reduced by transaction fees and expenses. However, it is acceptable to show gross performance that has been reduced by transaction fees.

WHAT IS CONSIDERED “PERFORMANCE”

- The marketing rule requires performance of related portfolios to be presented net-of-fees. But what does the SEC consider performance?
 - Any statistic that demonstrates how much an investor earned from an investment is considered performance. This includes extracted performance such as sector and holdings-level performance.
 - Attribution is typically not considered performance, however, if the statistic shown is intended to demonstrate an amount earned, it could be considered performance. Contribution is considered performance.
 - Performance appraisal metrics (e.g., sharpe ratio) are generally not considered performance, but each should be evaluated individually to determine if it demonstrates an amount earned by the portfolio.
 - Similarly, for other portfolio characteristics like yield, these could be considered performance if material to the total return of the portfolio.

PERIODS OF PERFORMANCE PRESENTATION

- The marketing rule requires advertisements containing performance to present one-, five-, and ten-year returns or since inception return if the composite track record is shorter than one of these prescribed time periods.
 - For example, if a composite has a track record of six years, the advertisement is required to show the one-, five-, and since inception (six-year) returns.
 - Presenting benchmark returns is encouraged (but not required) in advertisements. When shown, the benchmark needs to be presented for the same periods as the composite track record. If no benchmark is shown, there should be a good reason it is not presented. A reasonable example to exclude a benchmark would be if no relevant benchmarks were available that provide a meaningful comparison to the composite. This may happen when the composite is particularly unique.
- The marketing rule requires presented performance to be shown through the most recent calendar year-end at a minimum. More recent periods may be presented if desired.
 - If extreme market conditions have existed since the last calendar year-end, it may be considered misleading to exclude more recent periods. Best practice is to present performance more often than annually. Most do this quarterly.
- The SEC believes it is reasonable to update performance within a one-month period. Therefore, advertisements updated annually should be updated with the most recent calendar-year data before the end of January the following year.

NON-FEE-PAYING PORTFOLIOS

- The marketing rule does not allow the presentation of portfolios that do not pay a management fee (in these scenarios, the gross return would be equivalent to the net return). When composites include non-fee-paying portfolios, there are several options:
 - Apply a model fee to the entire composite to calculate and present net performance. See above for requirements when applying a model fee to composite performance.
 - Apply a model fee to the specific non-fee-paying portfolios included in the composite. Again, see above for model fee requirements (the same rule applies at the portfolio level).
 - Remove all non-fee-paying portfolios from the composite performance track record.
- Reduced-fee-paying and waived-fee portfolios must be reviewed in light of this rule to ensure that their net returns are being reduced by what would be expected for a full fee-paying portfolio.

PORTABILITY

- The marketing rule allows the presentation of portable performance (known as “predecessor performance” per the SEC). This rule covers when an advisor is allowed to present and link performance that was achieved by their current team while at a prior firm. The SEC will only allow firms to present the portable performance if the firm meets the following requirements:
 - The individual(s) that were primarily responsible for managing the strategy remains the same between the prior firm and the new firm.
 - The strategy managed at the new firm is managed in a substantially similar fashion to how it was managed at the prior firm.
 - Predecessor performance must include portfolios from the prior firm that were managed in a substantially similar fashion unless the exclusion of any portfolio would not result in better performance. In other words, the performance track record must follow the same expectations as outlined in “Use of Composite Performance” above.
 - Disclosures are clearly and prominently included to explain that the performance was achieved at a prior firm, and the time periods it represents.
 - There is no break in the performance track record.
 - The individual(s) primarily responsible for managing the predecessor performance remain at the new firm.

MODEL FEES

- Net performance may be calculated with actual or model fees. If using model fees, there are two options to consider when determining the appropriate model fee to apply:
 - Present net performance that has been deducted by the highest fee applicable to the intended recipients of the marketing material.
 - Present a model fee that is appropriate given the fees that have been paid throughout the history of the performance track record.

CARVE OUTS

- The marketing rule considers the aggregation of carve-out performance to be hypothetical performance because it is a sub-set of a managed portfolio.
- If carve-out performance is shown, the firm must also present, or offer to present, performance of the entire composite from which the extracted performance was taken from.
- Firms that show hypothetical performance must have strong internal controls to manage and monitor who receives hypothetical performance from the firm. Only sophisticated investors (as defined by the firm) may receive presentations with hypothetical performance.

MODEL PERFORMANCE

- The marketing rule considers model performance to be hypothetical performance because it is not the result of actual assets being managed by the registered investment adviser.
- Firms that show hypothetical performance must have strong internal controls to manage and monitor who receives hypothetical performance from the firm. Only sophisticated investors (as defined by the firm) may receive presentations with hypothetical performance.

COMPLIANCE DATES

- The marketing rule became effective as of November 4th, 2022.
- There is no partial compliance of the rule.

**Please note that additional disclosures may be required depending on each unique situation. This checklist focuses on the most common situations where changes may apply and is not to be interpreted as an all-encompassing checklist for disclosures and unique situations. Please also consult with your legal and SEC compliance teams for review and further guidance prior to the distribution of marketing materials.*



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