

# 2024 / Investment Adviser Compliance Conference

MARCH 6-8 / WASHINGTON, DC

EFFECTIVE STRATEGIES & BEST PRACTICES

## Marketing Rule Compliance: Best Practices

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EFFECTIVE STRATEGIES  
& BEST PRACTICES

## Agenda

- Implementation: Lessons Learned
- General Prohibitions and Statements of Fact
- New Marketing Rule FAQ on Private Fund Performance
- Attribution
- Yield

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## Implementation: Lessons Learned

- Examination focus areas
  - Performance
    - Hypothetical performance
    - Presentation of gross and net performance
    - Subscription lines of credit
  - Substantiation of material facts!

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## Implementation: Lessons Learned

- Implementation challenges
  - Performance
    - Responding to FAQ guidance
    - Attribution, contribution, and risk metrics
    - Consultant databases
  - Endorsements and testimonials
    - Dealing with intermediaries
    - Influencers
    - Oversight
  - Identification of “advertisements”

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## Dealing With Influencers

- Who are your partners?
  - Consider roles and responsibilities, synergies
- Inform Legal and Compliance of the proposed activity
- Due diligence
  - Talent background questionnaire, written agreement
- Legal guidance
  - Conflicts, disclosures, contract, payment terms
- Compliance and/or Marketing Review approval of final prior to launch
  - Retain supporting documentation in an accessible location

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## Substantiation Requirement

- Rule 206(4)-1(a)(2)
- “An advertisement may not ... include a material statement of fact that the adviser does not have a reasonable basis for believing it will be able to substantiate upon demand by the Commission”
- If unable to substantiate a material statement of fact, then the adviser will be presumed to not have a reasonable basis
- When developing compliance procedures, ask yourself: How could I rebut that presumption?

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## Statements of Fact?

- “Our unique approach unites expert independent thinking, disciplined risk management and diverse perspectives with a deep understanding and care for clients.”
- “We have cultivated a culture committed to understanding and anticipating clients’ needs, and producing superior investment performance. We embed diversity, equity and inclusion in everything we do.”
- “We offer more choices than any other firm in our industry.”

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## Statements of Fact?

- Use of images in a pitchbook
- Celebrity images on a website
- Cartoons?

Aomaru



Knowledgeable about money, solid stuff. I'll tell you about the best information and services.



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## General Prohibitions

- Also consider the other general prohibitions!
  - Untrue or misleading implications or inferences
  - Discussions of potential benefits without fair and balanced treatment of material risks or limitations
  - Otherwise materially misleading

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## FAQ on Private Fund Performance

- Issued on February 6, 2024
- Addresses the presentation of net and gross IRR by managers of private funds that use subscription credit facilities
- Marketing Rule requires that when gross and net performance are shown, the net performance must be:
  - Presented with at least equal prominence to, and in a format designed to facilitate comparison with, the gross performance; and
  - Calculated over the same time period, using the same type of return and methodology as the gross performance

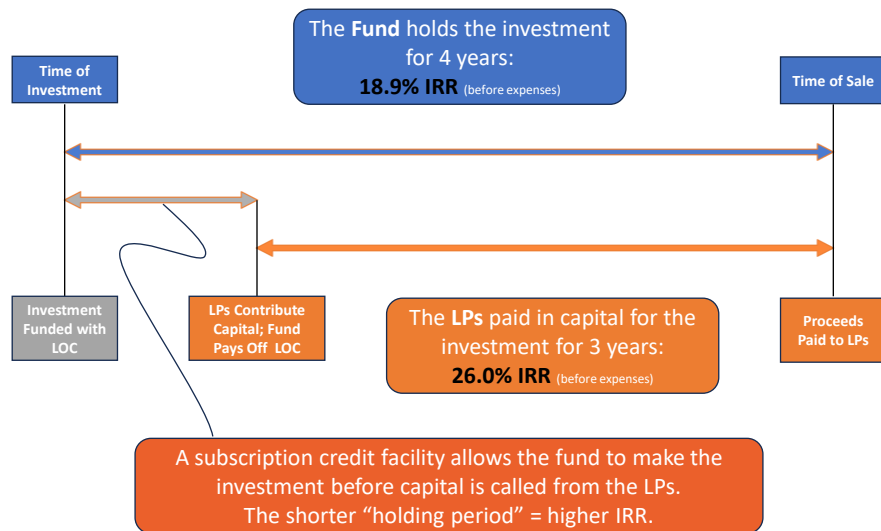
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## FAQ on Private Fund Performance

- When a subscription credit facility is used, fund IRRs can be calculated with or without the impact of the subscription facility
- The IRR “with” the impact of the subscription facility is calculated from the time of the first capital call
  - Represents the experience of the fund investor; calculation period is shorter
- The IRR “without” the impact of the subscription facility is calculated from the time of the first investment
  - Represents the experience of the fund; calculation period is longer

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## FAQ on Private Fund Performance

- Many fund managers present:
  - Gross IRR from the time of a fund's first investment (i.e., without the impact of the subscription facility)
  - Net IRR from the time of LP capital calls (i.e., with the impact of the subscription facility)
- FAQ states that this practice violates the Marketing Rule
  - Gross and net returns are not presented for the same time periods

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## FAQ on Private Fund Performance

- If the manager presents gross IRR from the time of a fund's first investment, it must also present the net IRR calculated from the time of the first investment
  - Both returns are calculated without the impact of the subscription facility
- If the manager presents net IRR from the time of LP capital calls (i.e., the return with the impact of the subscription facility), must include **either**:
  - Net IRR calculated from the time of the first investment; or
  - Disclosure describing the impact of the subscription facility on net performance

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## FAQ on Private Fund Performance

- Additional considerations:
  - Compare to Quarterly Statement requirements
  - Application of the FAQ guidance to NAV loans
  - Which communications are affected?
  - Timing and next steps

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## Performance required to be net

- When presenting gross performance, a firm is required to present corresponding net performance
- This requirement applies to extracted performance, including performance of individual investments
- Firms must define what they consider to be “performance”

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## Attribution

- Advertisements often contain different types of performance-related data under the general heading “Attribution”
  - Sector returns
  - Contribution to return
  - Attribution effects
  - Risk metrics

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## Attribution

- Are sector returns “performance” that must be net?
  - These returns are not relative attribution that explains the excess, active, or relative return
  - They explain the sources of return of a portfolio in isolation rather than in comparison with a benchmark
- Is contribution to return “performance” that must be net?
  - Contribution to return is the product of the security or sector weight multiplied by the security/sector return
  - It explains which securities or sectors had the greatest or smallest impact on the total portfolio return

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# Attribution

- Are attribution effects “performance” that must be net?
  - Performance attribution is a set of techniques used to identify the sources of the excess return of a portfolio against its benchmark in order to understand the consequences of active investment decisions
- Are risk metrics “performance” that must be net?
  - Risk metrics generally describe risks or characteristics of a portfolio relative to a given benchmark.
- Ask yourself: “If I invest \$100 in the portfolio (or any subset of the portfolio) at the beginning of the period, how much will I have at the end of the period?”

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# SAMPLE ATTRIBUTION REPORT

2 Factor Attribution									
12/31/2015 - 12/30/2016 Economic Sector									
	European Select Fund			MSCI Europe			Attribution Analysis		
	Port. Average Weight	Port. Total Return	Port. Contrib. To Return	Bench. Average Weight	Bench. Total Return	Bench. Contrib. To Return	Allocation Effect	Selection + Interaction Effect	Total Effect
<b>Total</b>	<b>100.00</b>	<b>6.02</b>	<b>6.02</b>	<b>100.00</b>	<b>2.58</b>	<b>2.58</b>	<b>3.08</b>	<b>0.37</b>	<b>3.44</b>
⊗ Financials	18.59	10.23	-0.05	18.96	-1.59	-0.77	-1.24	2.68	1.44
⊗ Health Care	10.40	7.70	0.87	13.67	-9.38	-1.44	0.42	1.63	2.05
⊗ Consumer Staples	11.04	-0.19	0.48	15.51	-0.32	0.06	-0.03	0.87	0.85
⊗ Real Estate	4.77	5.81	0.73	1.49	-2.77	-0.05	-0.25	0.21	-0.04
⊗ Information Technology	1.69	-7.53	-0.01	4.29	4.08	0.20	-0.25	0.09	-0.17
⊗ Utilities	3.48	5.07	0.06	3.82	-5.59	0.25	0.08	0.08	0.15
⊗ Telecommunication Services	0.99	-5.60	-0.07	4.74	-13.34	-0.79	0.60	0.05	0.65
⊗ [Cash]	0.48	-0.28	-0.00	--	--	--	-0.02	--	-0.02
⊗ Energy	5.23	44.06	1.45	6.95	32.36	2.22	0.22	-0.62	-0.40
⊗ Consumer Discretionary	7.36	-11.79	-0.94	10.79	-1.49	-0.24	0.35	-1.26	-0.91
⊗ Industrials	22.06	4.32	0.90	12.49	11.23	1.47	1.02	-1.50	-0.48
⊗ Materials	13.92	14.75	2.59	7.31	28.72	2.16	2.17	-1.86	0.32

Source: FactSet

Sector Contribution Returns

Attribution Effects

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## Yield

- Yield is the amount of income an investment earned (or is expected to earn) for a specific period of time, relative to the current price
  - It assumes the investments are held constant for that period of time
- There are many types of yield, presented for different purposes
- Dividend yield (trailing twelve months) – the past 12 months of dividends per share as a percentage of the current stock price
  - Example: In the past twelve months, Stock A paid a \$2 dividend semi-annually. The stock is currently valued at \$100. The dividend yield is calculated as  $(4/100) = 4.00\%$
- Is yield “performance” that must be net?

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