



Today's Objectives

- Provide an update of current SEC areas of focus.
- Discuss SEC investment performance compliance requirements.
 - Focus on investment adviser matters.
 - Mutual Funds have separate, specific rules governing performance (be mindful of the “text box rule”).
- Provide practical tips to help you address the SEC's requirements.
- Address your questions.



Key Areas of Interests to the SEC

- Conflicts of Interests:
 - SEC is interested in advisers' conflicts.
 - Be mindful of potential conflicts, such as significant business and personal relationships.
- Gifts:
 - Both giving and receiving of gifts – significant focus now.
 - Impacts both clients and business partners (vendors, etc.).
- Personal Trading:
 - Always a hot topic and area of focus.
- On the Horizon:
 - Revamped ADV Part II.
 - Anti-Money Laundering Policies.
 - Revised Record Retention Rules.



SEC – Areas of Focus

- Active examination program.
 - Largest 100 advisers – examined routinely.
 - Advisers considered “High Risk” – examined routinely.
 - Other advisers – examined periodically.
- Expect intense scrutiny of performance calculation processes during an exam.
 - Regardless of whether an accounting firm verifies performance.
- Current adviser advertising rules are outdated, but no sign of significant changes in the near future.

SEC Expectations – Overview

- Investment performance matters fall under the SEC's advertising rules.
- Advertising defined: any communication that offers investment advisory services to more than one person.
- Practically, SEC applies broad definition to include all written communications that offer advisory services to:
 - Prospective clients.
 - Consultants.
 - Existing clients or other outside parties (when offering advisory services).
- Advertising standards generally do not apply to reporting on a client's account.
 - Anti-fraud (i.e., fair and balanced) provisions still apply.



GIPS vs. SEC

- GIPS represents a higher standard.
 - Voluntary standards – not an SEC requirement.
 - GIPS provides specific standards – SEC does not.
- SEC's view of GIPS compliance.
 - Officially, doesn't endorse.
 - However – will review thoroughly if adviser claims GIPS compliance.
- While GIPS is a higher standard, don't assume all standards are consistent with SEC expectations.
- Relationship with GIPS verification firm:
 - Ensure advice complies with both SEC and GIPS standards.



General Advertising Rules

- SEC provides a relatively wide degree of latitude to advisers.
- SEC's current approach: patchwork legislation through no-action letters.
- Key SEC standard: advisers are prohibited from using communications that are false and misleading.
 - Whether communication is false or misleading depends on circumstances of each use.
 - Caution: subject to hindsight evaluation by SEC.
- Advertising rules fall under Section 206 – anti-fraud provision of the Advisers Act.



Use of Net Returns

- Net-of-fee performance information may be used with any client or prospect.
- In calculating net-of-fee performance:
 - Deduct advisory fees, brokerage commissions and other expenses that have, or would have, been paid by the client.
 - Custodial fees are not required to be deducted.
- May deduct actual fee paid by client, standard fee schedule or adviser's highest standard fee.
 - Disclose the basis used to deduct fees.
- Gross-of-fee performance data may be used with net-of-fee performance data.
 - Net-of-fee performance data should be displayed with equal prominence as the gross-of-fee information.



Use of Gross-Only Returns

- SEC allows stand-alone gross-of-fee performance in certain one-on-one presentations.
 - “One-on-one” defined: private meeting with sophisticated client (including groups) with opportunity to question fees.
- Adviser may forward gross-of-fee performance figures to consultants. Instruct consultant to:
 - Use performance results on a one-on-one basis.
 - Provide prospect with applicable disclosures.
- Disclosures required:
 - Performance figures do not reflect the deduction of investment advisory fees.
 - Client or prospect’s return will be reduced by advisory fees.
 - Adviser’s fees are described in Part II of Form ADV.
 - A representative example (table, chart, graph or narrative) showing the effect of investment advisory fee on value of portfolio.



Model Performance

- Definition: results of hypothetical or model portfolios that do not represent actual client account performance.
- Advisers may use results if following disclosed:
 - Limitations inherent in model results. For example:
 - Model is fully invested with no cash holdings.
 - Estimated trading costs of model may be less than the trading costs incurred by actual accounts.
 - Material changes in the conditions, objectives or investment strategies during the period advertised, if applicable.
 - Securities or strategies included in model portfolio do not fully relate to services currently offered by adviser, if applicable.
 - Adviser's clients had investment results that were materially different from model, if applicable.



Past Recommendations

- Advisers prohibited from referring to past specific profitable recommendations.
 - Unless list all recommendations made within previous year.
 - SEC considers discussing profitable recommendations while omitting unprofitable ones as “cherry-picking”.
- Practically, SEC’s stance effectively eliminates use of past recommendations in marketing materials.
- Marketing Departments should exercise caution in creating materials.
 - Easy to unknowingly incorporate past profitable recommendation.
 - Example: inclusion of sample of a profitable buy and sell with overview of research and investment management process.



Record Retention Requirements

- Performance data and documentation forming the basis of performance data for:
 - The period reported; and
 - At least five years from the end of the fiscal year in which performance data was last used.
- Includes records supporting performance from a predecessor firm.
- As a practical standard, keep all supporting performance information for the life of the firm.
- Maintain all account statements/records for the periods in which performance is calculated.
 - Including accounts not included in the performance figures.



General Compliance Tips

- Adviser compliance departments should review all advertising materials before use with outside parties.
- Educate staff on appropriate use of investment performance.
 - Often underappreciated.
 - Educate Sales and Marketing Departments.
- Regularly review SEC-required records.



Compliance Services

- Compliance Program Development and Update
- Continuous CCO Support
- Compliance Program Review and Testing
- Gap Analysis
- SEC Examination Assistance
- Sub-Adviser Due Diligence
- Expert Witness

Strategic Services

- M&A Due Diligence/Integration
- Strategic Planning
- Business Start-Up
- Fund Service Provider Assessment/ Search
- Fund Feasibility Study
- Mutual Fund Board Consulting
- Part-Time CFO
- Work Flow Mapping and Operational Efficiency Analysis

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Jeff is a founding principal of Vista360 and shares responsibility for the firm's strategic direction and client servicing. Jeff has 13 years of investment industry experience – currently assisting investment advisers and mutual fund companies with compliance and strategic matters. Previously, Jeff was Senior Vice President of Operations and Compliance and a member of the Senior Management Committee as well as the Board of Directors for U.S. Bancorp Asset Management, a \$120 billion investment management firm. Jeff also held audit positions with Robert W. Baird & Company, Inc. and Price Waterhouse, LLP. He earned a bachelor's degree in accounting from Illinois Wesleyan University.

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