

The logo for K&L GATES is displayed in white, bold, sans-serif capital letters on a dark blue rectangular background. The background of the entire slide features a complex financial data visualization with a world map, various line and bar charts, and scattered numerical values in shades of blue and white.

# K&L GATES

Session VII

## Advertising Developments

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# SEC Advertising and Cash Solicitation Proposals



# SEC ADVERTISING AND CASH SOLICITATION PROPOSALS: OVERVIEW

- On **November 4, 2019**, the SEC proposed amendments to modernize rules addressing investment adviser advertisements and payments to solicitors
  - In proposing amendments, the SEC recognized:
    - Changes in technology and social media
    - Expectations of investors seeking advisory services
    - Evolution of industry practices
  - Comments due 60 days following publication in the Federal Register
- **The Advertising Rule (adopted 1961)**: Rule 206(4)-1 includes a general anti-fraud standard making it “unlawful to engage in any act, practice or course of conduct which is fraudulent, deceptive or manipulative,” along with specific prohibitions related to testimonials, past specific recommendations, charts/formulas, and advertising free services
- **The Cash Solicitation Rule (adopted 1979)**: Rule 206(4)-3 prohibits an adviser from paying a cash fee to a solicitor for client solicitations unless the adviser is registered under the Advisers Act, the solicitor is not subject to statutory disqualification, and a cash fee is paid pursuant to a written agreement



# PROPOSED CHANGES TO THE ADVERTISING RULE

## ■ Structural reforms:

- Principles-based provisions replace “prescriptive” prohibitions currently in the rule
- An advertisement may not:
  1. Include untrue statements and omissions
  2. Include unsubstantiated material claims and statements
  3. Include untrue or misleading implications or inferences
  4. Fail to disclose material risks or other limitations
  5. Include a reference to specific investment advice provided by the investment adviser unless presentation is fair and balanced
  6. Include or exclude performance results, or present performance time periods, in a manner that is not fair and balanced
  7. Otherwise be materially misleading



# PROPOSED CHANGES TO THE ADVERTISING RULE (CONT.)

- **Updated and broadened definition of “advertisement” to be more “evergreen”**
  - “Any communication, disseminated by any means, by or on behalf of an investment adviser, that offers or promotes the investment adviser’s investment advisory services or that seeks to obtain or retain one or more investment advisory clients or investors in any pooled investment vehicle advised by the investment adviser”
- **Tailored restrictions on certain practices:** Permit use of testimonials, endorsements, and third-party ratings, subject to certain conditions
  - Must disclose whether compensation provided
  - For testimonials and endorsements, must disclose whether the testimonial or endorsement came from a client or provided by or on behalf of the adviser
  - For third-party ratings, must disclose certain criteria pertaining to preparation



# PROPOSED CHANGES TO THE ADVERTISING RULE (CONT.)

- **General performance prohibitions:**
  - Gross performance unless schedule of fees/ expenses offered or provided
  - Statement that performance results have been approved/reviewed by the SEC
  - Performance results from fewer than all portfolios with substantially similar investment policies, objectives, and strategies, with limited exceptions
  - Performance results of subset of portfolio investments unless provide/offer all investments
  - Hypothetical performance without policies and procedures that ensure performance is tailored to the recipient, and the adviser must provide certain specified information about the hypothetical performance
- **Bifurcation between Retail Persons and Non-Retail Persons:**
  - Definitions
    - Non-Retail Persons: “qualified purchasers” or “knowledgeable employees”
    - Retail Persons: all other clients and investors
  - Tailored requirements for Retail Persons
    - Present net performance alongside gross performance
    - Present performance results of any portfolio or certain composite aggregations across 1-, 5-, and 10-year periods



# PROPOSED CHANGES TO THE CASH SOLICITATION RULE

- Expanded to cover:
  - All forms of compensation, subject to de minimis threshold
    - Directed brokerage, awards or other prizes, and free or discounted services
  - Current and prospective investors in any private fund
- New exemptions for:
  - De minimis compensation (less than \$100 in any 12 month period)
  - Advisers that participate in certain nonprofit programs
- Expanded list of disqualified solicitors
- Written agreement and separate investor disclosure required
  - Adviser must have reasonable basis to believe solicitor complied with agreement
  - New requirement to disclose any potential material conflicts of interest





# GIPS STANDARDS OVERVIEW

- Two historical sources of requirements regarding compliance
  - GIPS Standards (last revised and published in 2010)
  - Interpretive Guidance (Guidance Statements, Q&As, GIPS Handbook discussion)
- The 2020 GIPS Standards codify many of the requirements previously set forth in Interpretive Guidance
- Fundamentals of compliance:
  - Input data
  - Calculation methodology
  - Composite construction
  - Disclosures
  - Presentation and reporting
  - Detailed policies and procedures, verification (recommended)
- Compliance dates:
  - The 2020 GIPS Standards are effective **January 1, 2020**
  - GIPS Reports that include performance ending on or after **December 31, 2020** must comply with the 2020 GIPS Standards

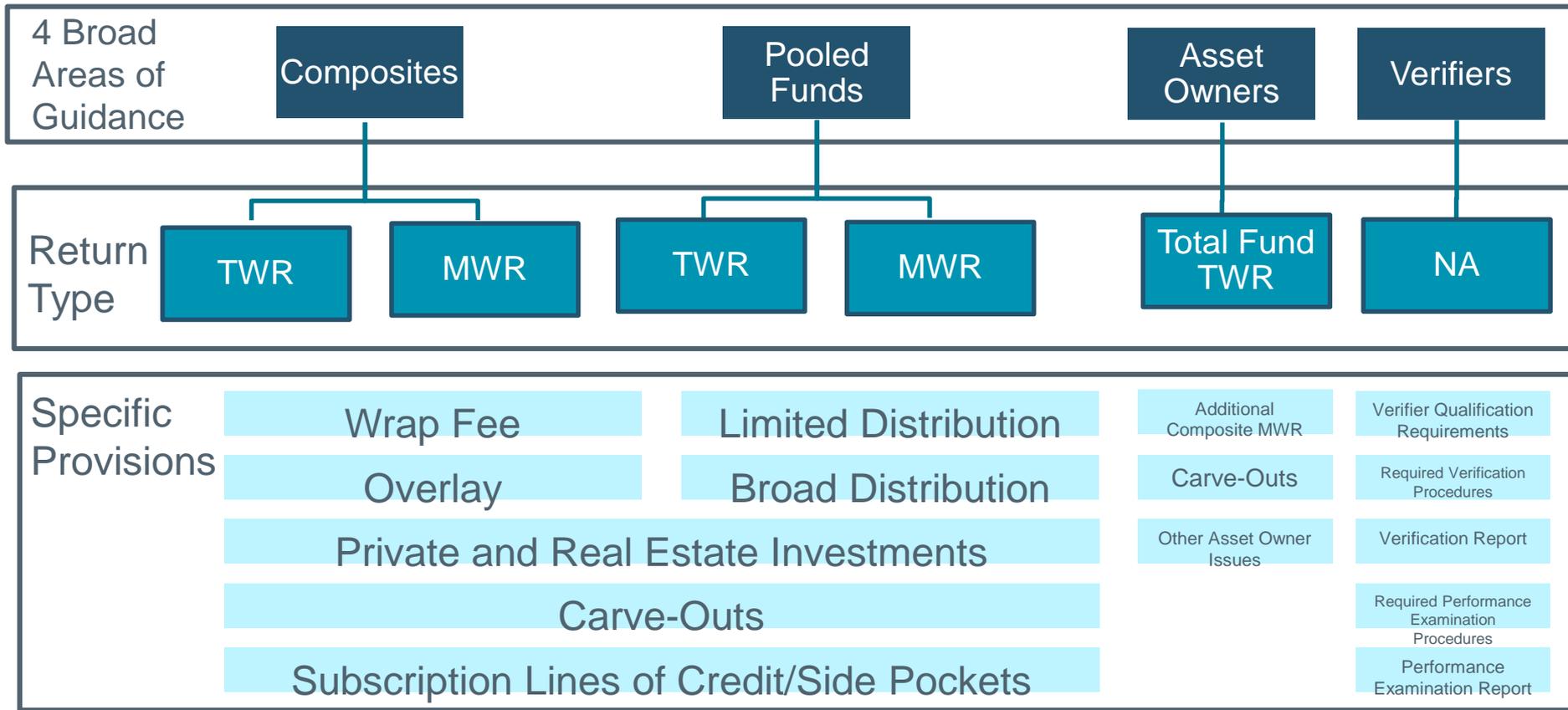


## WHY CHANGE THE GIPS STANDARDS?

- Composites are the foundation of the GIPS Standards, but composites are not always appropriate for private funds and similar vehicles
- Many pooled funds do not fit neatly into the current composite construction or GIPS reporting framework
- To make the GIPS Standards more relevant for all asset classes, including alternative funds/strategies
- To better address applicability for asset owners
- To consolidate standards that have expanded through interpretive guidance issued since 2010



# NEW LAYOUT OF THE 2020 GIPS STANDARDS



# MATERIAL CHANGES TO THE 2020 GIPS STANDARDS

- The “GIPS Report” → New Name for “GIPS Compliant Presentation”
  - For Composites: GIPS Composite Report
  - For Pooled Funds: GIPS Pooled Fund Report
  - For Asset Owners: GIPS Asset Owner Report
- Composites v. Pooled Funds:
  - Composites required for strategies **managed or offered** in a separate account format
  - No longer required to maintain “composites of one” if strategy only offered through pooled funds
  - **Broad Distribution Pooled Funds** not required to maintain a separate GIPS Pooled Fund Report
  - **Limited Distribution Pooled Funds** must present prospective investors with
    - A GIPS Composite Report for the pooled fund’s strategy; or
    - A GIPS Pooled Fund Report
- GIPS Pooled Fund Report
  - Requires similar statistics and disclosures to a GIPS Composite Report



# MATERIAL CHANGES TO THE 2020 GIPS STANDARDS (CONT.)

- Money Weighted Returns: MWRs can be used if the manager controls external cash flows AND at least one of the following is true: (i) closed end; (ii) fixed life; (iii) fixed commitment; or (iv) significant part of the investment strategy is in illiquid investments
- External Valuations:
  - External valuations required for real estate investments depending on whether investments are in an open end fund
  - 2020 GIPS Standards do not require other private market investments (e.g., private equity, credit) to obtain external, independent valuations
- Estimated Transaction Costs: May use estimated transaction costs only where actual transaction costs are not known
- Track Record Portability: If portability tests are met, firms are now allowed to choose if they will link to performance from a prior firm on a composite-specific or pooled fund-specific basis
  - 2020 GIPS Standards add a **fourth portability test** - There must be no break in the track record between the past firm and the new firm
- Return of Carve Outs: A composite with carve outs must include all carve outs across the firm that represent the same strategy—No cherry picking!



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