MONTHLY COMPLIANCE TASKS

Please be sure to check your SmartRIA CCO portal to keep up with your monthly Compliance tasks or utilize the CCO Scorecard included in our This Month in Compliance email. Please contact the following for:

• **Login and Portal Requests:**	**Sara Sparks:**	**ssparks@thecomplianceresource.com**
• **Task Related Questions:**	**Nancy Harry:**	**nharry@thecomplianceresource.com**
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Compliance Resource Partners will be releasing a NEW feature into our SmartRIA compliance portal this month. We'll review the new feature live and go through a quick demo with the SmartRIA team on ways your firm can use this feature to enhance your compliance program. You don't want to miss it!
Register Now:
May 12, at 10:00 AM MT register
May 12 at 2:00 PM MT register

MARKETING RULE - PERFORMANCE

Revised Rule 206(4)-1(d) replaces the years of regulatory guidance (i.e., Clover) on performance advertising with **seven** standards that apply to performance.

1. **Gross and Net Performance**. An adviser may not advertise gross performance without including net performance in a format designed to compare the two. Net performance must be shown with equal prominence to the gross performance and must be calculated over the same period of time, using the same type of return and methodology as the gross performance.

   Although—with the limited exceptions discussed below—the final rule does not require that advertised performance be accompanied by specific disclosure, however, the SEC warns that disclosure may be necessary to ensure that an advertisement is not false or misleading. The SEC suggests that particular facts and circumstances may warrant the following disclosures:

   - the material conditions, objectives, and investment strategies used to obtain the advertised results;
   - whether and to what extent the advertised results reflect the reinvestment of dividends and other earnings;
   - the effect of material market or economic conditions on the results portrayed;
   - the possibility of loss; and
   - the material facts relevant to any comparison made to the performance of an index or other benchmark.

2. **Time Periods**. An adviser cannot advertise the performance of a portfolio or composite of related portfolios without including performance results of the same portfolio or composite for 1-,5- and 10-year periods. If the relevant portfolio did not exist for a particular prescribed period, the adviser must substitute performance for the life of the portfolio.

Each presentation must be made with equal prominence and must end on a date no less recent than the most recent calendar year-end. However, to satisfy the marketing rule's general prohibitions, presentation of more recent performance results might also be required.

3. **No SEC Endorsement**. An adviser cannot state or imply that the SEC has reviewed or approved the calculation or presentation of performance results in an advertisement.

4. **Related Performance**. The revised marketing rule generally prohibits an adviser from advertising-related performance unless the advertisement includes all related portfolios. "Related performance" is the performance of one or more portfolios with substantially similar investment policies, objectives, and strategies as those advertised, either on a portfolio-by-portfolio basis (each, a "related portfolio") or as a composite aggregation of all portfolios falling within stated criteria. For example, an adviser may determine that an account with material client constraints or other differences is not substantially similar to the advertised account; different fees and expenses alone would not justify an account's exclusion.

   An advertisement may exclude related performance if:

   (a) the advertised performance results are not materially higher than they would be if all related portfolios had been included; and
   (b) the exclusion of any related portfolio does not alter the presentation of the mandatory 1, 5- and 10-year time periods.

5. **Extracted Performance**. An adviser may not advertise the performance results of a subset of investments extracted from a single portfolio (i.e., "extracted performance") unless the advertisement provides or offers to promptly provide the entire portfolio's performance from which the advertised performance was extracted.

6. **Hypothetical Performance**. Sometimes advisers advertise performance results they did not actually achieve by managing portfolios. The revised marketing rule calls this "hypothetical performance," a term that includes, but is not limited to, model performance, back-tested performance, and targeted or projected performance.

   - Model portfolios include those managed alongside portfolios for actual investors, computer-generated models, and models the adviser creates or acquires from third parties that are not used for actual investors.
   - Back-tested performance is created by applying a strategy to data from prior time periods during which the strategy was not actually used.
   - Targeted returns reflect aspirational performance goals, while projected returns are the adviser's performance estimates, which often are based on historical data and assumptions. Targeted and projected returns relate to a portfolio or the advertised investment advisory services; they do not include general market projections or predictions about economic conditions.

   It would not be considered hypothetical performance when an interactive analysis tool is provided and allows a client or investor (or prospective client or investor) to produce simulations and statistical analysis that present the likelihood of various investment outcomes (i.e., certain investments or strategies are selected) and the adviser has a disclosure that:

   - describes the criteria and methodology used, including the tool's limitations and key assumptions;
   - explains that the results may vary with each use and over time;

- if applicable, describes the universe of investments considered in the analysis; explains how the tool determines which investments to select; discloses if the tool favors certain investments and if it does, explains the reason for the selectivity; and explains that other investments not considered may have characteristics similar or superior to those being analyzed; and
- the tool generates hypothetical outcomes.

In order to advertise hypothetical performance, an adviser must:

- adopt and implement policies and procedures reasonably designed to ensure that the performance is relevant to the likely financial situation and investment objectives of the advertisement's intended audience;
- provide sufficient information to enable the intended audience to understand the criteria used and assumptions made in calculating the performance;
- provide sufficient information to enable the intended audience to understand the risks and limitations of using hypothetical performance in making investment decisions.

These conditions are designed to ensure that hypothetical performance information is distributed to only those clients who have the resources and financial expertise necessary to understand the information. *The SEC believes that ads with hypothetical performance pose a high risk of misleading investors because the returns may have been optimized through hindsight and do not reflect the real-world consequences of bad investment decisions*.

A hypothetical performance advertisement need not portray results for the mandatory 1-, 5- and 10-year time periods and need not comply with the conditions applicable to related or extracted performance.

7. **Predecessor Performance**. The last type of performance the marketing rule addresses is "predecessor performance," which means the performance of a group of investments or accounts that were not managed at all advertised time periods by the adviser advertising the performance ("advertising adviser"). In some cases, the investments or accounts were managed by the adviser's predecessor firm; in other cases, they were managed by the adviser's advisory personnel when they were employed by another adviser. In either case, an adviser will be permitted to "tack" predecessor performance in an advertisement if the following four conditions are satisfied:

    1) The person or persons who were primarily responsible for achieving the prior performance also manage accounts at the advertising adviser. Where a committee was responsible for management at the predecessor firm, a committee with substantially the same members must manage the portfolios at the advertising firm.
    2) The accounts managed at the predecessor investment adviser are sufficiently similar to the accounts managed at the advertising adviser that the performance results would provide relevant information to clients or investors.
    3) All accounts that were managed in a substantially similar manner (i.e., accounts with substantially similar investment policies, objectives, and strategies) are included in the advertisement unless the exclusion of any such account would not result in materially higher performance, and unless the exclusion of an account does not alter the presentation of the mandatory 1-, 5- and 10-year time periods.
    4) The advertisement clearly and prominently discloses that the performance results were from accounts managed at another entity and includes all other relevant disclosures.