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GPS INSIGHTS

LESSONS LEARNED FROM OCIE RISK ALERT RELATED TO ADVERTISING

In September 2017, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a [National Exam Program Risk Alert](#) that outlines recently identified compliance issues related to the Advertising Rule, 206(4)-1. None of the items noted were a surprise, as they are common themes that have been brought up over the last several years through deficiency letters, enforcement actions and speeches related to investment adviser advertising. Nevertheless, the Risk Alert is a valuable tool for investment advisers as it consolidates the type of problems other firms have encountered into one document and may help readers to avoid making the same mistakes.

The issues specifically identified include:

- **Misleading Performance Results**, such as:
 - Presenting results without deducting advisory fees
 - Comparing results to a benchmark but not including disclosure about the limitations inherent in such comparisons and not disclosing that the advertised strategy materially differed from the composition of the benchmark
 - Presenting results that contain hypothetical or back-tested performance results, but not explaining how these returns were derived and not including other potentially material information regarding the performance results

- **Misleading One-on-One Presentations**, such as:
 - Presenting gross only results that did not reflect the deduction of advisory fees and not disclosing that client returns would be reduced by such fees and other expenses
- **Misleading Claims of Compliance with Voluntary Performance Standards**, such as materials that include:
 - Disclosing that results complied with a certain voluntary performance standard (such as the GIPS standards), when it was not clear to staff that the performance results in fact adhered to the performance standard's guidelines
- **Cherry-Picked Profitable Stock Selections**, such as:
 - Including profitable stock selections in advisers' presentations, client newsletters, and on their websites, without meeting the conditions set forth in the Advertising Rule
- **Misleading Selection of Recommendations**, such as:
 - Disclosing only certain past specific investment recommendations and not all recommendations and not making all representations required within the TCW Group and Franklin No-Action letters such as:
 - Presenting best performing holdings but not simultaneously including an equal number of the worst performing holdings
 - Not disclosing that the specific recommendations did not represent all securities purchased, sold, or recommended to clients during that period
 - Discussing in advertisements the profits realized by the specific recommendations
- **Inadequate Advertising Policies and Procedures** that did not address:
 - The process for reviewing and approving advertising materials prior to their publication or dissemination

- The parameters for which accounts were included or excluded from performance calculations (i.e., composite construction)
- Confirming the accuracy of performance results in compliance with the Advertising Rule

The Alert also outlined the findings from the so-called “**Touting Initiative**” that was launched last year, which included:

- **Misleading Use of Third Party Rankings or Awards**
 - References to awards or rankings that failed to disclose material facts such as date, number of participants and if the firm paid to participate
- **Misleading Use of Professional Designations**
 - References to professional designations that have lapsed or that did not explain the minimum qualifications required
- **Testimonials**
 - Client endorsements published in firm websites, social media pages, reprints of third party articles, or pitch books

The complete Risk Alert can be [viewed here](#).

ABOUT GPS

Guardian Performance Solutions (“GPS”) provides compliance consultation services to investment management firms located throughout the country. Our expertise and focus is on reviewing performance advertisements for adherence with regulatory requirements, drafting necessary advertising disclosures, and working with firms to achieve and maintain compliance with the Global Investment Performance Standards (GIPS®).

We partner with clients and actively work as a direct extension of the in-house team to document GIPS policies and procedures, determine criteria for composite construction, calculate performance, create the firm’s list of composites, maintain GIPS compliant disclosure presentations, and we also liaison with the firm’s verifier to oversee an efficient and timely verification project. Additional information can be found at www.GuardianPerformanceSolutions.com.