

GPS INSIGHTS

GIPS® CONFERENCE – SEC UPDATE

The 2014 GIPS Standards Annual Conference was held on September 18-19, 2014 at the Westin Copley Place in Boston, Massachusetts. During the conference, Andrew Bowden, the director of the SEC Office of Compliance Inspections and Examinations (OCIE), discussed OCIE's current focus areas and recent performance advertising related enforcement actions.

OCIE's priorities related to performance include reviewing the accuracy and completeness of advisers' claims about their investment objectives and performance. For example, staff will test hypothetical and back-tested performance, review the use and disclosure of composite performance, confirm supporting records, and discuss compliance oversight of marketing materials.

Given the focus on hypothetical and back-tested performance results and composite performance figures, it is not surprising that there have been several recent enforcement cases related to performance advertising. Mr. Bowden discussed lessons that he took away from these recent cases, which included: 1) firms who claim GIPS compliance must adhere to all of the requirements outlined by the GIPS standards, otherwise the false claim would be considered a material misrepresentation under the securities laws, 2) firms must not misrepresent or make inaccurate claims of GIPS verification, and 3) never provide false documents to examiners.

Mr. Bowden assured the audience that claiming compliance with the GIPS standards is not a red flag to examiners. However, he did indicate that SEC staff periodically review information made available on advisers' websites as part of the process for establishing a risk score for each of the 11,500+ advisers. If an advisory firm makes a claim of GIPS compliance online and the SEC staff determines that the advertising materials do not satisfy the presentation requirements of the GIPS standards, this will increase the firm's overall risk score. Jonathan Boersma, Executive Director of the GIPS standards, later noted that his staff recently visited ten regional SEC offices to train examination staff on the requirements of the GIPS standards.

GPS Considerations for Advertising Hypothetical and Back-tested Results

- 1) Confirm, document and test the process used to derive hypothetical and back-tested results.
- 2) Ensure disclosures are robust enough to dispel the misleading suggestion that model performance represents actual trading/assets.
- 3) Use a comprehensive disclosure checklist when compiling and reviewing materials. Several SEC No-Action letters give advisers a safe harbor for presenting hypothetical and back-tested results, if followed consistently.
- 4) Disclosures should not be buried in small text at the back of the pitch book or flash report.
- 5) The GIPS standards prohibit linking hypothetical and back-tested results to actual performance results.

Significant efforts continue to focus on advisers who have been registered for more than three years and never examined. Mr. Bowden indicated that since taking on this specific initiative, the SEC has examined 225 firms that had not been examined previously. Often these exams are focused risk-based examinations which may include an emphasis on marketing/advertising, compliance with the custody rule, completeness of filings, specific allocation of trades, or cherry-picking.

ABOUT US

Guardian Performance Solutions LLC (GPS) is a specialty compliance consulting firm dedicated to assisting investment advisers with performance advertising. Areas of focus and expertise include reviewing performance advertisements for adherence with regulatory requirements and working with investment management firms to achieve and maintain compliance with the Global Investment Performance Standards (GIPS®). Because GPS does not provide verification services, GPS is free from independence concerns and can take a hands-on approach to developing and managing an adviser's GIPS compliance program.

Additional information can be found at www.GuardianPerformanceSolutions.com.