



Composites: Considering the New SEC Marketing Rule and the GIPS Standards

SUMMARY

The November 4, 2022 deadline for the new SEC Marketing Rule requires firms to create and maintain composites in order to market their performance. Many investment managers are looking to the Global Investment Performance Standards (GIPS®) for guidance and best practices, leading some to consider taking the necessary steps to claim GIPS compliance. Here, we address some of the most frequently asked questions about this process.

SETTING THE STAGE

November 4, 2022 is the deadline to comply with the new [SEC Marketing Rule](#)¹. Adopted on May 4, 2021, the rule requires, among other things, that investment management firms utilize composites when presenting investment performance. Given the 18-month lead time to implement the new requirements, the SEC has indicated that it does not intend to offer extensions to firms failing to meet the deadline. Many are now scrambling to implement the necessary structures and policies to comply with the rule. Because composites are also a core tenant of compliance with the GIPS standards, firms are considering leveraging the Standards to enhance their businesses.

THE NEW SEC MARKETING RULE REFERENCES THE GIPS STANDARDS, AS DOES A RECENT FINRA RULE. HOW DO THE STANDARDS ALIGN WITH REGULATORY REQUIREMENTS?

Compliance with the Standards is viewed favorably by regulators. The SEC has long recognized the value of the GIPS standards. The new marketing rule includes 26 references to the Standards and encourages firms to follow many of the same requirements. The rule requires firms to create composites around similarly managed portfolios when marketing the performance of a strategy, which mirrors the approach that the GIPS standards have taken since their creation. The exercise of putting accounts in composites is not new to GIPS-compliant firms but can present a real challenge to those unfamiliar with the nuances of creating and managing composites. If firms are going through the effort to create and manage strategy composites for the first time, it is reasonable to consider adopting the GIPS standards. We anticipate some will take these additional steps to become GIPS compliant given the many associated benefits.

FINRA also recognizes the value and validity of the GIPS standards. For retail communications of private placement offerings, it requires an IRR and associated metrics to be calculated according to the Standards.

WHY DO FIRMS CHOOSE TO CLAIM GIPS COMPLIANCE?

The GIPS standards are ethical rules for calculating and presenting investment performance. Even though compliance has always been optional, according to CFA Institute, at least [85 of the top 100 asset managers](#)² in the world are GIPS compliant. By following a standardized approach, asset managers can compete with other firms on a level field, and investors and clients can fairly assess asset managers. Some managers will adopt the Standards because they think it is the right thing to do and to demonstrate to their clients that they are adhering to industry best practices.

GIPS compliance reinforces an asset manager's commitment to transparency, fairness, and promoting investor interests. The vast majority of firms comply to keep up with their competitors, and to be able to say "yes" when responding to RFPs and populating consultant databases. The Standards have become so ingrained in the institutional space that it is a competitive disadvantage if a firm does not comply. Non-complaint firms, no matter how great their track record is, are at a disadvantage. We have seen firms risk missing tight RFP deadlines and scramble in order to be able to answer "yes" to the question, "Does your firm claim compliance with the GIPS standards?"

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IS THERE AN ADDITIONAL APPETITE FOR THE GIPS STANDARDS BEING THAT THEY HAVE BEEN IN PLACE FOR OVER 20 YEARS?

The marketplace is always growing and changing, which necessitates changes to the GIPS standards. In periodically adjusting the Standards to the marketplace, they remain relevant and become applicable to different asset classes and segments of the market, and thus a broader range of asset managers. A prime example of this is asset owners, who, until 2015, could not claim compliance with the GIPS standards but have since embraced the opportunity to enhance their commitment to integrity and transparency. New firms entering the market, existing firms that want to compete for institutional mandates, and M&A activity are all drivers in continued interest in the GIPS standards and create additional demand for implementation. Clear guidelines, supporting standardized performance calculations, reporting and disclosure, offered by the GIPS standards, are the foundation of stakeholder reporting.

WHAT IS INVOLVED IN BECOMING COMPLIANT? WHAT SHOULD FIRMS EXPECT?

Compliance with the GIPS standards is not a simple, box-checking exercise. Depending on the size and complexity of your firm, GIPS compliance can be a challenge, especially if you do not have guidance from experienced professionals, be it an in-house or an external advisor. It involves a comprehensive review of a firm's organization, strategies, policies and procedures, and internal control environment. The Standards specify certain calculation, reporting, and disclosure requirements, but the heart of compliance revolves around the creation and maintenance of composites. Composites are comprised of portfolios managed to a specific investment strategy or style and are intended to present a fair and unbiased picture of the performance of the strategy. Consistent with what is required by the new SEC marketing rule, firms must establish policies, procedures, and controls to ensure that the composites' integrity remains intact, containing all portfolios that are managed according to the strategy and excluding all that are not. Composites should be consistent with how the firm markets its strategies.

The GIPS standards contain many specific and nuanced requirements, and many firms seek guidance from specialized consultants with expertise in understanding and applying the Standards across various types and sizes of firms. They can help firms avoid pitfalls and can make the implementation process much more effective and efficient. Knowing the implications of certain policies on the front end will often save time, money, and frustration in the long term. Ensuring that a firm's systems are designed to support compliance and are operating efficiently is also an important step in the process. These and other considerations are hard to gauge in a vacuum without having the knowledge of what other firms in the industry do.

HOW MERADIA CAN HELP

Meradia is well positioned to help you navigate the SEC's new marketing rule, assess your firm's readiness to adopt the GIPS standards, or begin the work of implementing the Standards. With over two decades of experience in performance measurement, our team can help you understand the complexities of compliance, realize efficiencies, and optimize your operations.

¹ [SEC.gov, Final Rule: Investment Advisor Marketing](https://www.sec.gov/final-rule-investment-advisor-marketing)

² [CFA Institute Global Investment Performance Standards, 30th Anniversary GIPS® Facts](#)



Jonathan A. Boersma, CFA, is a Senior Manager at Meradia and oversees investment performance regulatory consulting services, including pre-verification for firms complying with the Global Investment Performance Standards (GIPS®). He leverages 28 years of financial services experience to guide clients through the complex transformations, and operational preparations required for adopting industry and regulatory frameworks. Prior to joining Meradia, Jonathan led the CFA Institute's ethics and performance standards group, most recently serving as Head of Professional Standards and Executive Director of the Global Investment Performance Standards (GIPS®).



Natasha E. Romanova, CIPM, is a Consultant at Meradia, supporting clients through operational transformation. She has helped firms achieve and maintain GIPS compliance as well as advised on industry best practices. Prior to joining Meradia, Natasha served as a Principal Consultant with ACA Performance Services where she advised asset management clients on performance measurement and marketing initiatives, as well as executed GIPS verification procedures from start to finish.



Meradia
Info@Meradia.com
www.Meradia.com