Marketing Practices of Portfolio Managers
Portfolio Management Association of Canada Conference: Best Practices in Client Communications

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Background:

• The marketing practices of portfolio managers (PMs) is an area of concern for the Canadian Securities Administrators (CSA) because PMs influence investors when marketing their firms’ services, skills and experience.

• When reviewing marketing materials the CSA relies on specific rules and instruments which are both prescriptive and principles-based.

• The CSA has provided suggested practices as guidelines to inform assessment of and compliance with the generally principles-based securities laws.
Deficiencies Identified

Generally, the deficiencies were grouped into one of the following areas:

- Preparation and use of hypothetical performance data
- Exaggerated and unsubstantiated claims
- Policies, procedures and internal controls
- Use of benchmarks
- Performance composites
- Holding out and use of names
- Other performance return issues
- Disclosure related issues
Suggested Guidance on Best Practices

The following is a summary of the suggested practices:

- Presenting actual client performance returns and not hypothetical performance data with its inherent risks and limitations except in limited circumstances when appropriate.
- Being able to substantiate all claims made in marketing materials.
- Developing and implementing written policies and procedures that govern firms’ marketing activities.
- Using benchmarks that are relevant and comparable to a PM’s investment strategy.
- Including all portfolios that meet the criteria of a composite in the composite.
- Firms and registered individuals using registered trade names and business titles that are not misleading.
- Reporting performance returns from a previous firm or a firm’s proprietary account only in limited circumstances where it is appropriate.
- Ensuring marketing materials contain disclosure that is accurate, meaningful and up-to-date.
Preparation and use of hypothetical performance data

**Definition:**
- Data that is not the performance of actual client portfolios which consists of either back-tested performance data (past period) or model performance data (real time or future periods).

**Concerns:**
- Hypothetical data poses several challenges including:
  - that investors may not be able to fully understand the risks and limitations of the data;
  - that any outcome can be achieved with the benefit of hindsight;
  - that the data might be misleading by appearing to be based on actual client performance.

**Guidance:**
- Know your audience’s level of sophistication, be clear and upfront about the data source, explain the methodology, and disclose the risks and limits of the data.
Exaggerated and unsubstantiated claims

Definition:
- Unsubstantiated or exaggerated claims concerning PMs’ performance, skills, proficiency, education, investment experience, and client service.

Concerns:
- Such claims may violate PMs’ obligations to deal fairly, honestly and in good faith with clients.
- Some investors may place undue reliance on these types of claims.
- Selectively omitted information may also make a statement misleading or false.

Guidance:
- PMs should be able to verify all claims.
- Investors should be easily able to assess the merits of claims using adequate references to the supporting information.
Policies, procedures and internal controls

**Background:**
- The CSA’s review found approximately 33% of PMs had deficiencies in:
  - inadequate written governing policies and procedures;
  - inadequate books and records of marketing activities;
  - a lack of review of marketing materials by compliance or independent personnel.

**Concerns:**
- The actual marketing procedures of PMs differ from the written policies.
- The above three areas suffer deficiencies placing many PMs in violation of securities legislation.

**Guidance:**
- PMs must establish compliant policies and procedures to provide guidelines on compliance, independent review and approval of materials, appropriate disclosure of data and models, and the use of benchmarks.
Use of benchmarks

**Definition:**
- A benchmark is a standard against which PMs’ investment strategies’ performance can be objectively compared and measured.

**Concerns:**
- Benchmarks may not be comparable to the PMs’ investment strategy.
- The benchmark may not be fully disclosed.
- Benchmarks may be presented in a different or misleading light.

**Guidance:**
- Ensure the use of relevant benchmarks (i.e. significantly comparable and similar to the investment strategy used).
- Ensure adequate disclosure such that the client can make a meaningful comparison between the benchmark and the PM’s performance.
Performance composites

Definition:
• An aggregation or grouping of the performance of one or more client portfolios with a similar investment objective or strategy.

Concerns:
• Inappropriate construction, presentation, and disclosure of performance composites resulting in inaccurate and unfair presentation of data.
• “Cherry picking” the best performance returns to boost results, or
• selectively omitting relevant portfolios to achieve the same.

Guidance:
• Calculate composite returns by asset-weighting the individual portfolio returns.
• Provide adequate disclosure to avoid misleading presentation.
• Establish written policies and procedures for the construction, presentation and disclosure of composites.
Holding out and use of names

**Definition:**
• This includes the inappropriate use of business & trade names, implying an individual is registered when they are not, and using the names of other registered firms without prior consent.

**Concerns:**
• Investors may be confused as to who they are dealing with or,
• what the experience, proficiency, and status of that individual is.

**Guidance:**
• Firms should use the full legal name or registered trade name in marketing.
• Individuals’ titles should be appropriate and not misleading.
• PMs should ensure there are adequate policies in place to review and approve the use of trade names and job titles.
Other performance return issues

**Background:**
- Problems may arise from using performance returns from (1) an individual’s previous firm or (2) proprietary firm and individual PM’s performance returns.

**Concerns:**
- PMs with limited or no track record marketed these types of returns.
- The new firm’s investment strategy may differ.
- The advising representative was not responsible for generating the presented returns.

**Guidance:**
- Present only the performance returns of the firms’ actual performance composites or investment funds since the firms have been registered.
- Consider if it is one of the limited cases where it may be appropriate to market the performance of a previous firm or a firm’s proprietary account.
Disclosure related issues

**Background:**
- In the CSA’s recent review a majority of PMs were deficient in this area.

**Concerns:**
- Outdated information.
- No disclosure of the source of third party information.
- Inadequate or inconsistent disclosure in offering memoranda and other offering documents from non-prospectus qualified investment funds.
- Inadequate or lacking performance return related disclosures.

**Guidance:**
- Marketing materials should disclose information that is accurate, meaningful and up-to-date.
- Implement a process to review and approve marketing materials consistent with internal policies, obligations, and legislation.
Social media for marketing: an emerging area

**Background:**
- Generally not yet used to market firms’ advisory services but the CSA anticipates that this area will increase in importance.

**Potential concerns:**
- PMs may not be keeping adequate records of business activities and client communications performed over interactive social media websites.

**Guidance:**
- Registered firms should consider:
  - establishing policies for review, supervision, retention and retrieval of materials on social media websites;
  - designating an individual responsible for such communications;
  - reviewing system adequacy and record retention and retrieval capability compliance.
Questions or comments?

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