

## COMMENT LETTER

April 29, 2016

# ICI Submits Comment Letter on CFA Institute Draft Guidance Statement on Broadly Distributed Pooled Funds (pdf)

April 29, 2016 CFA Institute Global Investment Performance Standards 915 E. High Street Charlottesville, VA 22902 Re: Guidance Statement on Broadly Distributed Pooled Funds

Dear Sir or Madam: The Investment Company Institute, on behalf of its entire membership,<sup>1</sup> appreciates the opportunity to comment on the Exposure Draft of the Guidance Statement on Broadly Distributed Pooled Funds (“Draft Guidance”) that the GIPS Technical Committee (the “Committee”) of the CFA Institute has issued.<sup>2</sup> If implemented, the Draft Guidance would apply to all firms (“Firms”) that claim compliance with the Global Investment Performance Standards (“GIPS”), many of which are ICI members. It would impose a number of problematic new requirements on fund offering documents and marketing material. As explained in detail below, we do not support adoption of the Draft Guidance. We fundamentally object to layering the proposed standards on the robust fund performance reporting and disclosure requirements already in place in numerous jurisdictions around the globe. Regulated funds and their predominantly retail investors have been well-served by regulators’ emphasis on developing a highly detailed and prescriptive set of performance reporting and disclosure requirements for offering documents and marketing material. This includes the comparative work conducted and best practices

1 The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s U.S. fund members manage total assets of \$16.9 trillion and serve more than 90 million U.S. shareholders. Members of ICI Global, the international arm of ICI, manage total assets of U.S. \$1.5 trillion.

2 The Draft Guidance is available at

[www.gipsstandards.org/standards/Documents/Guidance/exposure\\_draft\\_public\\_comment\\_pooled\\_funds\\_gs.pdf](http://www.gipsstandards.org/standards/Documents/Guidance/exposure_draft_public_comment_pooled_funds_gs.pdf). CFA Institute April 29, 2016 Page 2 put forward by the International Organization of Securities Commissions (“IOSCO”). Where there is no regulatory void, efforts by non-regulatory bodies to impose requirements bring no appreciable benefits, and impose significant costs and burdens on affected Firms and their funds. To the extent that the CFA Institute believes that regulatory efforts to date have been inadequate, a more targeted approach to improving standards would be far more prudent. Such an approach could include setting forth recommended or voluntary standards for Firms, or requiring compliance with new standards only in those materials in which a Firm affirmatively claims

compliance with GIPS. I. Role of GIPS and Summary of the Draft Guidance In many jurisdictions (including the United States), regulators have not imposed specific requirements on how investment firms (as distinct from the regulated funds they manage) should present the firms' (as distinct from the funds') investment performance to prospective clients. According to the CFA Institute, "The goals in developing and evolving the Global Investment Performance Standards (GIPS) are to establish them as the recognized standard for calculating and presenting investment performance around the world and for the GIPS standards to become a firm's 'passport' to market investment management services globally."<sup>3</sup> GIPS are mandatory only for those firms that claim compliance with the standards. A number of our members claim compliance with GIPS and see value in the standards. Many institutional investors prefer working with Firms that comply with GIPS. GIPS have fostered clarity, rigor, and consistency in performance reporting for separately managed accounts, private funds, and composites containing accounts and funds of all types. We therefore commend the CFA Institute for its work to date. GIPS currently require that Firms<sup>4</sup> make every reasonable effort to provide a compliant presentation<sup>5</sup> to all prospective clients. Firms generally have not interpreted this to require distribution of compliant presentations to prospective fund investors.<sup>6</sup> 3 Global Investment Performance Standards (2010), CFA Institute ("Global Investment Performance Standards") at 1, available at [www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n5.1](http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n5.1). 4 GIPS defines a "firm" as "[t]he entity defined for compliance with the GIPS standards." Global Investment Performance Standards at 33. 5 GIPS defines a compliant presentation as "a presentation for a composite that contains all the information required by the GIPS standards and may also include additional information or supplemental information." Global Investment Performance Standards at 32. 6 Firms have interpreted this provision as not applying to the funds they manage. These Firms view the funds (rather than the fund shareholders) as their clients, and/or they have determined that compliance with applicable law (which may conflict) supersedes. CFA Institute April 29, 2016 Page 3 The purpose of the Draft Guidance is to address the application of GIPS to broadly distributed pooled investment vehicles.<sup>7</sup> It specifically would apply to any Firm that is marketing a fund to more than one investor, and would not apply to situations in which a Firm is marketing a strategy with a composite (i.e., an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy) that includes a fund. Additionally, it would apply only to Firms that manage one or more funds and also are responsible for the creation of the fund offering documents and fund-specific marketing material. The Draft Guidance suggests that extending GIPS in this way would be beneficial to investors, Firms, and regulators. The Draft Guidance addresses Firms' obligations with respect to their fund offering documents, fund-specific marketing material, and compliant presentations. Specifically, the Draft Guidance would: • require that fund offering documents and marketing material include a number of items (the "Required Items");<sup>8</sup> • recommend, but not require, that these materials include information about sales charges and a claim of compliance with GIPS; and • require Firms to provide a compliant presentation to a prospective fund investor upon request.

II. Background on Applicable Regulation for Funds Regulated funds are the most comprehensively regulated investment product in jurisdictions worldwide. Regulated funds serve as the vehicle through which millions of people save and invest to 7 Such vehicles would include mutual funds, open-ended investment companies (OEICs), investment companies with variable capital (ICVCs), unit trusts, and sociétés d'investissement à capital variable (SICAVs) ("funds"). Throughout this letter, we generally use "funds" to mean "regulated funds." The term "regulated funds" includes regulated open-end U.S. funds, which are comprehensively regulated under the Investment Company Act of 1940 ("1940 Act"), and regulated non- U.S. funds that are organized or formed outside the U.S. and substantively regulated to make them eligible for

sale to retail investors (e.g., funds domiciled in the European Union and qualified under the UCITS Directive (“UCITS”)). 8 Specifically: (i) the description of the fund’s investment mandate, objective, or strategy; (ii) an indication of the fund’s risk, as either a qualitative narrative or a quantitative metric, as mandated by the local regulators; (iii) fund returns calculated according to the methodology and for the time periods required by local laws or regulations (if there is no mandated methodology, the Draft Guidance provides one that must be used); (iv) benchmark total returns and the benchmark description; and (v) the currency used to express performance. These requirements would apply only to materials that present investment performance, and the Draft Guidance makes clear that if local laws or regulations prohibit a required item from being included in a fund offering document or marketing material, then that item must be excluded. CFA Institute April 29, 2016 Page 4

meet their most important financial goals. The substantial advantages that these funds provide to investors—including professional money management, diversification, and reasonable cost—are consistent across international borders. They include the benefit of substantive government regulation and oversight, as befits an investment product eligible for sale to retail investors. All regulated funds typically are subject to substantive regulation in a number of areas, including disclosure (e.g., form, delivery, and timing).<sup>9</sup> Although the governing rules in different jurisdictions are not identical, they share similarities. Indeed, such rules reflect common principles developed by IOSCO<sup>10</sup> for regulated funds (which IOSCO refers to as “collective investment schemes” or “CIS”) as well as IOSCO’s more detailed work on core areas of CIS regulation.<sup>11</sup> Of most relevance, IOSCO has issued (i) a report on performance presentation standards for CIS, which examines those standards in multiple jurisdictions and also contains general presentation principles;<sup>12</sup> and (ii) a report that recommends best practice standards for the presentation of CIS performance in advertisements.<sup>13</sup> These IOSCO standards recognize that CIS performance information raises important investor protection issues for national regulators, and that jurisdictions may appropriately regulate CIS performance presentations. A regulated fund’s offering documents and marketing material are important for the fund, its shareholders, and financial advisers. Consequently, as is evidenced by the IOSCO reports, this is an area for which national regulators have crafted rules appropriate to their own jurisdictions. In many

9 Other areas typically include form of organization, separate custody of fund assets, mark-to-market valuation, and investment restrictions (e.g., leverage, types of investments or “eligible assets,” concentration limits, and/or diversification standards). 10 The IOSCO Objectives and Principles of Securities Regulation set out 38 principles of securities regulation; these principles are based on the following three objectives of securities regulation: protecting investors; ensuring that markets are fair, efficient and transparent; and reducing systemic risk. See [www.iosco.org/about/?subsection=display\\_committee&cmtid=19&subSection1=principles](http://www.iosco.org/about/?subsection=display_committee&cmtid=19&subSection1=principles). IOSCO upgraded and strengthened these Principles in 2010. See [www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf). 11 See, e.g., Principles Regarding the Custody of Collective Investment Schemes’ Assets (Oct. 2014), available at [www.iosco.org/library/pubdocs/pdf/IOSCOPD454.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD454.pdf); Principles for the Valuation of Collective Investment Schemes (May 2013), available at [www.iosco.org/library/pubdocs/pdf/IOSCOPD237.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD237.pdf); Examination of Governance for Collective Investment Schemes: Part I (June 2006), available at [www.iosco.org/library/pubdocs/pdf/IOSCOPD219.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD219.pdf), and Part II (Feb. 2007) (“CIS Governance Part II”), available at [www.iosco.org/library/pubdocs/pdf/IOSCOPD237.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD237.pdf); Conflicts of Interest of CIS Operators (May 2000), available at [www.iosco.org/library/pubdocs/pdf/IOSCOPD108.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD108.pdf). 12 Performance Presentation Standards for Collective Investment Schemes (May 2002), available at [www.iosco.org/library/pubdocs/pdf/IOSCOPD130.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD130.pdf). 13 Performance Presentation

Standards for Collective Investment Schemes: Best Practice Standards (May 2004), available at [www.sec.gov/about/offices/oia/oia\\_investman/schemes.pdf](http://www.sec.gov/about/offices/oia/oia_investman/schemes.pdf). CFA Institute April 29, 2016 Page 5 jurisdictions, the requirements for regulated funds are quite specific and detailed, particularly with respect to performance reporting. In the U.S., Congressional statutes require registration of regulated funds' shares and govern the operations of those funds. The Securities and Exchange Commission ("SEC") regulates funds, and has detailed requirements that govern the content of fund statutory prospectuses, summary prospectuses<sup>14</sup> and sales material.<sup>15</sup> These regulations specify information funds are required, permitted, and prohibited from including in their documents. The Financial Industry Regulatory Authority ("FINRA") has detailed rules governing fund sales material that apply to registered broker-dealers (including principal underwriters<sup>16</sup> and other broker-dealer intermediaries that are commonly instrumental in selling fund shares).<sup>17</sup> Regulation of fund performance disclosure occupies a prominent place in these requirements. The prospectus, summary prospectus, and sales literature regulations all require funds to calculate investment performance in accordance with a single prescribed methodology.<sup>18</sup> That methodology mandates how money market funds calculate various types of yield, and other funds calculate average annual total returns (including on an after-tax basis) and yields. In sum, the SEC and FINRA have substantial, carefully-developed, and clear regulations that address performance reporting and the contents of U.S. fund prospectuses and sales material. Similarly, authorities in other countries and regions have rules relating to performance reporting and the contents of fund disclosure. For example, in the European Union ("EU"), UCITS are subject to specific requirements regarding their offering documents and advertisements, which come from European regulatory authorities and/or national securities regulators. In particular, the UCITS Directive sets out the framework for the Key Investor Information Document ("KIID"), a stand-alone, <sup>14</sup> See generally Form N-1A (registration statement for open-end registered funds) and Rule 498 ("Summary Prospectuses for Open-End Management Investment Companies") under the Securities Act of 1933 (the "1933 Act"). <sup>15</sup> See generally Rules 156 ("Investment Company Sales Literature") and 482 ("Advertising By an Investment Company as Satisfying Requirements of Section 10") under the 1933 Act and Rule 34b-1 ("Sales Literature Deemed to be Misleading") under the 1940 Act. <sup>16</sup> Registered investment advisers manage funds, and principal underwriters offer their shares. <sup>17</sup> See generally FINRA Rule 2210 ("Communications with the Public"), FINRA Rule 2212 ("Use of Investment Company Rankings in Retail Communications"), FINRA Rule 2213 ("Requirements for the Use of Bond Mutual Fund Volatility Ratings"), and FINRA Rule 2214 ("Requirements for Use of Investment Analysis Tools"). FINRA Rule 2210 in particular imposes a number of content requirements on retail communications (e.g., standard fund advertisements), and also requires filing of these materials with FINRA. FINRA staff then reviews and provides comments on these materials. <sup>18</sup> See, e.g., Items 4(b)(2) and 26 of Form N-1A, SEC Rule 482(d) and (e), SEC Rule 34b-1(b), and FINRA Rule 2210(d)(5). Funds also must show investment performance in their annual shareholder reports in a highly prescribed way, using this same computation methodology. See Item 27(b)(7) of Form N-1A. CFA Institute April 29, 2016 Page 6 pre-contractual 2-page document containing essential features of the fund, including past performance.<sup>19</sup> There are significant restrictions on the ability to depart from the prescribed format or to insert additional wording that is not set out in the template specified by the European Securities Markets Authority ("ESMA").<sup>20</sup> UCITS also must produce a full prospectus (the exact contents of which are governed by the regulatory authority in the domicile of the UCITS), which generally must contain all information necessary for an investor to make an informed judgment of the investment proposed to them and the associated risks. Advertisements must be fair, balanced, and not misleading. Further, EU laws prohibit fund managers from including information in marketing material

that is contradictory to what is being presented in the KIID. Canada, likewise, has prescriptive rules governing the content, form, and presentation of fund information provided to prospective investors, as well as in statements provided throughout an investor's holding of a retail mutual fund. The Fund Facts is a 2-page pre-sale document that provides key information about a fund, including risks, investment mix, fees, and performance over the past 10 years. Fund Facts "must contain only the information that is specifically mandated or permitted by" the prescribed form.<sup>21</sup> A prospectus still must be prepared and filed, the form and content of which is prescribed.<sup>22</sup> Similar to the requirements applicable in the U.S. and the EU with respect to advertisements, Canadian law provides that "a sales communication must not be untrue or misleading or include a statement that conflicts with information that is contained in the ... prospectus."<sup>23</sup>

III. ICI's Views on the Draft Guidance Because of our significant concerns, we do not support adoption of the Draft Guidance. Fundamentally, we object to overlaying the proposed standards on the existing fund performance

19 See Directive 2009/65/EC (as amended) and Commission Regulation 583/2010. 20 Additionally, European lawmakers are currently considering significant changes in the disclosure of performance information in a new Key Information Document under the Packaged Retail Investment and Insurance-Based Investment Products Regulation, which may require the disclosure of future performance scenarios in place of the current requirement to show past performance. 21 See Form 81-101F3 Contents of Fund Facts Documents, General Instruction 8, adopted by the Canadian Securities Administrators. Form 81-101F3 is available beginning on page 82 of the unofficial consolidation copy of National Instrument 81-101 Mutual Fund Prospectus Disclosure, available at [www.osc.gov.on.ca/documents/en/Securities-Category8/ni\\_20140922\\_81-101\\_81-101cp-unofficial-consolidated.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category8/ni_20140922_81-101_81-101cp-unofficial-consolidated.pdf). 22 See Form 81-101F1, beginning on page 28 of the unofficial consolidation copy of National Instrument 81-101 Mutual Fund Prospectus Disclosure. 23 See section 15.2 of National instrument 81-102, of the Canadian Securities Administrators. An unofficial consolidation copy is available at [www.osc.gov.on.ca/documents/en/Securities-Category8/ni\\_20140922\\_81-102\\_81-102cp-unofficial-consolidated.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category8/ni_20140922_81-102_81-102cp-unofficial-consolidated.pdf).

CFA Institute April 29, 2016 Page 7 reporting and disclosure requirements that national regulators promulgate and administer. More specifically, the Draft Guidance would be burdensome and costly for Firms to implement, is ambiguous in certain key respects, and within some jurisdictions could undermine comparability in offering documents and marketing material. A more targeted approach, however, could improve global practices considerably without interfering with the substantial, carefully-developed, and clear regulation that already exists, while avoiding unnecessary costs and burdens on Firms. We discuss our specific concerns in this Section III. In Section IV, we recommend how the CFA Institute could offer Firms fund-related guidance in a beneficial manner that does not raise these concerns.

A. The Draft Guidance's Subject Matter is Included in National Regulators' Mandates Investor protection broadly, and the contents of offering documents and marketing material in particular, fall within the competence and supervisory mandate of national securities regulators. Pursuant to their authority, many of these regulators have adequately and effectively "occupied the field" with respect to disclosure and performance reporting requirements. Therefore, overlaying GIPS in those instances is unnecessary and inappropriate, and the CFA Institute should not substitute its judgment for that of these regulators worldwide. If there is a regulatory gap (as there was for separate accounts in many jurisdictions prior to GIPS), the efforts of professional associations and industry groups can be beneficial. But if no such gap exists, professional association and industry group guidance only creates confusion, which does not advance investors' best interests.

B. Compliance Would be Burdensome and Costly for Firms The Required Items are broadly similar in theme to U.S. funds' current prospectus and summary

prospectus disclosure obligations, but differ in certain key respects. Significantly, U.S. funds would be unable to insert certain items—most notably, benchmark descriptions in most cases<sup>24</sup> and the currency used to express performance—into their summary prospectuses, or the summary sections of their statutory prospectuses.<sup>25</sup> Similarly, the UCITS KIID requirements, as well as Canada's 24 Funds are required to provide disclosure about additional indexes, or when they change indexes. <sup>25</sup> The General Instructions to Form N-1A state, "Items 2 through 8 [i.e., the items comprising summary section of the prospectus, and those that generally correspond to the Draft Guidance's Required Items] may not include disclosure other than that required or permitted by those Items." Similarly, Rule 498 (the rule governing summary prospectuses) states, "Except as otherwise provided in this paragraph (b), provide the information required or permitted by Items 2 through 8 of Form N-1A, and only that information, in the order required by the form." Likewise, funds could not legally provide a claim of compliance with GIPS (a recommended item in the Draft Guidance) in the summary prospectus or the summary section of the statutory prospectus. The Form requirements also provide very detailed instructions about showing performance for multi-class funds, which differ from those in the Draft Guidance (e.g., the SEC indicates that in certain situations a multi-class fund prospectus should provide certain specified information for the share class with the longest performance period (rather than the most expensive share class), and the SEC provides more latitude for funds to show existing class performance in a prospectus CFA Institute April 29, 2016 Page 8 prescriptive rules governing the content, form, and presentation of fund information provided to prospective investors (and in statements provided throughout an investor's holding of a retail mutual fund), leave little room to include Required Items. U.S. fund advertising regulations are not as prescriptive as those for prospectuses and summary prospectuses, so they would neither require nor prohibit funds from including the Required Items in their marketing material (although funds could encounter objections to doing so through the FINRA review process). Likewise, advertising regulations applicable to UCITS are not as prescriptive and generally would not require nor prohibit inclusion of the Required Items. Including all of the Required Items in marketing material (or offering documents, to the extent legally permissible), however, would likely lead to substantial new costs for Firms. As an initial matter, any final guidance would require Firms to determine whether, and if so how, to attempt to comply with it and existing regulations. This legal and compliance "gap analysis" would be a significant undertaking for all Firms, and would become geometrically costly and burdensome for Firms that manage and distribute funds in multiple jurisdictions, each with its own applicable regulatory requirements. Once this analysis is complete, Firms then likely would coordinate with other personnel and service providers to revise fund offering documents and marketing material accordingly. This in turn would result in additional costs paid to service providers (e.g., legal counsel, consultants, and printers) and in some cases, regulatory bodies.<sup>26</sup> These are revisions that Firms otherwise would not have made, and costs that they otherwise would not have incurred, but for seeking GIPS compliance. To cite one prominent example, funds currently are not required to show benchmark returns in marketing material. Although a benchmark may be included in marketing material, some funds choose not to do so, in part because index providers charge licensing fees and may require additional disclosures for their use in fund materials, as well as other cost and space constraint considerations. Perhaps more importantly, the Required Items would limit funds' ability to tailor marketing material based on the medium used and intended audience. Together, the SEC and FINRA advertising rules for U.S. funds are highly prescriptive in some respects (e.g., how funds must calculate and present performance) and more principles-based in others (e.g., advertisements must be fair and balanced, and cannot be misleading). These regulations reflect the carefully considered judgments of regulatory authorities, which weigh the potential costs and benefits to funds and their shareholders.

Within these limits, funds have flexibility to convey chosen information, and regulators have never required that advertisements convey all information that is material to investors—the prospectuses that all offering a new share class). Finally, the Form requirements differ for new funds, which are not required to include performance information in their prospectuses until they have annual returns of at least one calendar year. 26 In the U.S., FINRA members are generally required to refile retail communications (which includes marketing material) and pay filing fees when they make material changes to them. CFA Institute April 29, 2016 Page 9

shareholders must receive serve that purpose. Similarly, the EU’s framework requires that UCITS advertisements be fair, balanced and not misleading. UCITS are a globally distributed fund type, so this approach is well-suited to the variety and number of countries into which a UCITS may be sold to investors. This approach allows the creator of a document to consider the information that it wants to communicate and the relevant market to determine the information that is most appropriate. Further, this approach also allows UCITS to better accommodate different local marketing rules. Marketing material is only one source of information provided or made available to investors, and it is part of a larger mix of information. And given advances in technology in many countries, it is easier than ever for investors to access and review other sources of fund information, which lessens the need for any one communication (particularly marketing material) to include, directly and visibly, all information deemed necessary. If regulators (or other standard-setting entities) take an overly broad or prescriptive view of what marketing material must include, the material loses its utility to both funds and investors. In this respect, requiring incorporation of all Required Items into marketing material would make it start to resemble U.S. summary prospectuses or other short-form offering documents. The scope of the information on investment mandate, objective or strategy is quite broad,<sup>27</sup> and the scope of the required risk disclosure is vague and potentially broad.<sup>28</sup> Requiring marketing material to convey all of this information reflects a fundamental misunderstanding of marketing material—it complements, rather than serves as a substitute for, the prospectus. More is not always better, and in some respects it can be worse.<sup>29</sup> Many regulators around the globe, as well as funds themselves, have done commendable work in combatting “disclosure creep,” and efforts to impose new disclosure requirements threaten to undermine this work. Ultimately, Firms following the Draft Guidance would be placed at a distinct disadvantage in their ability to create clean, targeted, and useful fund marketing material. 27 The Draft Guidance states the following at n. 7: “The description of the investment mandate, objective, or strategy of a pooled fund should include its purpose, the boundaries within which the fund is supposed to invest (e.g., in what regions, asset classes, sectors, and types of securities), and investment policies. It must include all key features of the pooled fund and enough information to allow prospective pooled fund investors to understand the key characteristics of the pooled fund’s investment mandate, objective, or strategy.” 28 The Draft Guidance states, “An indication of the pooled fund’s risk, as either a qualitative narrative or a quantitative metric, as mandated by the local regulators. If the local regulators do not require or prohibit a specific risk measure, the firm may choose the risk measure to present.” In the U.S., funds’ obligations with respect to risk disclosure in marketing material are largely principles-based. For instance, under FINRA Rule 2210, funds must “provide balanced treatment of risks and potential benefits” and must not produce misleading communications. While some risk disclosure is customary, it is not necessarily lengthy narrative disclosure. It is unclear how, if at all, Firms’ U.S. funds would alter their advertisements to comply with this Required Item. 29 In the U.S., FINRA staff has recognized this. In December 2014, FINRA published a Retrospective Rule Review Report (available at [www.finra.org/sites/default/files/p602011.pdf](http://www.finra.org/sites/default/files/p602011.pdf)) in which FINRA staff recommended consideration of facilitating simplified and more effective risk disclosure. CFA Institute April 29, 2016 Page 10

Firms’ legal challenges and costs would extend beyond

attempting to harmonize disparate disclosure obligations. The Draft Guidance would require Firms to provide a compliant presentation to a prospective fund investor upon request. Within a U.S. fund complex, the principal underwriter, subject to FINRA Rules, would generally fulfill these types of requests, in part because investment advisers generally do not interact directly with prospective fund shareholders. But FINRA's longstanding position is that the presentation of related performance information in communications used with retail investors does not comply with FINRA Rule 2210(d).<sup>30</sup> Thus, the entity within the fund complex typically tasked to handle such requests—the principal underwriter—often would be prohibited from fulfilling them. Other broker-dealer intermediaries with which fund investors often interact directly also would be subject to this prohibition. Moreover, compliant presentations (which often would include composite performance information of a number of other funds and accounts) would have significantly less value to prospective fund investors than the specific performance information of the fund itself. In the U.S., the SEC does not require related performance information in the prospectus; as noted above, FINRA does not permit its use in retail communications involving mutual funds, on investor protection grounds. Aside from regulatory constraints, a Firm may very well agree with FINRA's basic investor protection rationale, and conclude that providing retail investors with related performance information in the form of a compliant presentation could be confusing and possibly even misleading to retail investors. We see no reason for a non-regulatory entity to attempt to override these considered judgments. These are a few examples of the compliance difficulties that Firms would face in the U.S. alone. If the Draft Guidance is adopted, Firms will no doubt uncover many more across jurisdictions. Quite simply, the more costly, burdensome, and limiting GIPS and related guidance become, the less attractive the standards will be for existing Firms and those firms that are considering becoming GIPS-compliant. If the Draft Guidance is adopted as proposed, it could cause many Firms to reassess their relationship with GIPS. Some might redefine the entities included in their respective "Firm" definitions by excluding the funds they manage.<sup>31</sup> This would be an unfortunate result. By effectively opting out of this fund-related guidance, a Firm's "GIPS footprint" would be reduced, and the Firm's

<sup>30</sup> See, e.g., Interpretive Letter to Edward P. Macdonald, Hartford Funds Distributors, LLC (May 12, 2015), available at: [www.finra.org/industry/interpretive-letters/may-12-2015-1200am](http://www.finra.org/industry/interpretive-letters/may-12-2015-1200am). This interpretive letter defines "related performance information" as "actual performance of all separate or private accounts or funds that have (i) substantially similar investment policies, objectives, and strategies, and (ii) are currently managed or were previously managed by the same adviser or sub-adviser that manages the registered mutual fund that is the subject of an institutional communication." FINRA staff permits the inclusion of related performance information in mutual fund communications to institutional investors subject to a number of conditions, but this narrow exception would be limited in its utility in this context. <sup>31</sup> Even this step would be burdensome for Firms, because it would involve complicated technical issues and revisions to existing composites. CFA Institute April 29, 2016 Page 11

composites (which would no longer include funds) would become less comprehensive and therefore less useful to the potential clients that consider them in evaluating the Firm's investment management prowess. Other Firms might cease maintaining GIPS compliance altogether. Such moves would not promote investor interests (including investor confidence), advance the GIPS principle of full disclosure, or otherwise benefit the Firm, its prospective clients, or prospective fund investors in any way. C. The Draft Guidance Is Ambiguous in Key Respects The Draft Guidance contains ambiguities that make it difficult to ascertain its precise reach, even within fund complexes that are included within a GIPS-compliant Firm definition. For instance, the Draft Guidance states that it "applies only to firms that manage one or more pooled funds and are also responsible for the creation of the official pooled fund documents mandated by regulators and the fund-specific marketing



material.” (emphasis added) In the U.S., funds typically contract with investment advisers to manage portfolio assets and principal underwriters to handle distribution of fund shares. Investment advisers and principal underwriters are often distinct legal entities providing distinct services to funds. The funds’ principal underwriters may be primarily, or even entirely, responsible for creating marketing material. For fund complexes structured in this way (and assuming the principal underwriter is not included in the definition of “Firm”), it would appear that the Draft Guidance would not apply to the funds’ marketing material. In fact, it is not clear that the investment adviser would be “responsible for creating” fund prospectuses and summary prospectuses in all cases.<sup>32</sup> The precise reach of the Draft Guidance is similarly uncertain for funds in non-U.S. jurisdictions, depending on the jurisdiction’s legal framework and the allocation of responsibilities among the various relevant entities. In addition to the ambiguities discussed above, other important terms are not defined or explained in sufficient detail, raising questions about potential application, including the following:

- “broadly distributed pooled fund”: The Draft Guidance provides a number of examples, but does not specify whether exchange-traded funds and closed-end funds would be included. Moreover, it does not specify how broadly a fund’s distribution must be to qualify for coverage under this guidance. <sup>32</sup> In this regard, it is worth keeping in mind the U.S. Supreme Court’s *Janus Capital Group, Inc. et al. v First Derivative Traders* decision. 131 S.Ct. 2296 (2011). The Supreme Court acknowledged that the investment adviser was significantly involved with preparing the prospectuses, but held that the adviser did not “make” any statements in the prospectuses. The Supreme Court pointed out that the fund was legally distinct from its investment adviser and “decline[d] the invitation to disregard the corporate form.” CFA Institute April 29, 2016 Page 12
- “fund-specific marketing material”: As we understand the definition, for material to qualify it would need to (i) include the particular pooled fund’s objective and strategy, (ii) present investment performance, and (iii) be intended for distribution to all prospective pooled fund investors who are considering investing in that specific pooled fund. With respect to the second element, it is unclear whether “investment performance” would include—in addition to traditional total return information—information about yields, third party rankings, or other rankings against peer funds. With respect to the third element, it is unclear whether materials that are made available to all prospective investors (e.g., information about funds on websites or mobile applications) would be included, or whether something more specific is meant.

D. The Draft Guidance Could Undermine, Rather than Promote, Comparability

One of the stated objectives of the Draft Guidance is to increase consistency of information across funds. Given that (i) jurisdictions differ with respect to what they require, permit, and prohibit in offering documents and marketing material and (ii) the Draft Guidance attempts to be appropriately deferential to these regulatory regimes, absolute uniformity is not possible. This is true when evaluating all materials across jurisdictions; all materials of a given Firm that offers funds in multiple jurisdictions; and materials within a single jurisdiction. Indeed, one irony is that the Draft Guidance could in some ways undermine its objective of comparability, rendering funds’ offering documents and marketing material within particular jurisdictions less comparable. As explained above, U.S. funds are subject to very detailed and prescriptive rules with respect to their prospectuses, summary prospectuses, and marketing material. This fosters a high degree of comparability, particularly in prospectuses. If Firms become subject to a parallel set of requirements, then it is reasonable to expect some divergence in their funds’ prospectuses compared to those of non-GIPS-compliant firms. (Such a result could obtain even among prospectuses within a single complex with both a Firm and one or more non-compliant firms.) Moreover, Firms would not all interpret the final guidance in the same way and likely would differ in their views regarding the extent to which current regulatory requirements preempt. These difficulties in interpretation and application would play out across a number of jurisdictions.

In sum, asking Firms, funds, and their other service providers to follow two sets of instructions when preparing offering documents and marketing material—particularly where those providing the instructions have not coordinated in any meaningful way<sup>33</sup>—is not conducive to consistency. <sup>33</sup> While in the U.S. marketing material is subject to both SEC and FINRA rules, the SEC maintains oversight of FINRA, and there is general coordination in areas such as advertising. CFA Institute April 29, 2016 Page 13 As for comparability across jurisdictions, any related benefits would be academic for retail investors in many jurisdictions (including the U.S.), who for a number of reasons generally purchase only shares of funds that are domiciled or registered in their jurisdiction. For these investors, the more relevant and important form of comparability is that within their jurisdictions, which well-developed regulatory frameworks already promote.

#### IV. Alternative Approaches That Would Advance CFA Institute’s Objectives

In light of the foregoing, the CFA Institute has more targeted means at its disposal to improve global practices without imposing costs and burdens on Firms and placing them in a compliance thicket of competing and sometimes contradictory obligations. It could simply make all items in the Draft Guidance “recommended” and thus voluntary for Firms to implement. To the extent that regulators in certain jurisdictions have not addressed items covered in the Draft Guidance, the final guidance could develop a foothold in those places, due to market practice or regulation. Market participants could come to view it as “best practices,” much as GIPS are perceived in some highly-regulated jurisdictions with respect to performance reporting for separately managed accounts, private funds, and composites. Furthermore, some regulators could see merit in the guidance and formally adopt some or all of its recommendations, providing even greater regulatory clarity and comparability. Either way, overall standards and comparability within those jurisdictions likely would improve, and Firms would largely be spared the challenges that mandatory guidance otherwise would present. Alternatively, or additionally, the Committee could take an approach similar to that of the current GIPS Advertising Guidelines, which state: “These guidelines only apply to firms that already satisfy all the requirements of the GIPS standards on a firm-wide basis and claim compliance with the GIPS standards in an advertisement. Firms that choose to claim compliance in an advertisement must follow the GIPS Advertising Guidelines or include a compliant presentation in the advertisement. ... The calculation and advertisement of pooled unitized investment vehicles, such as mutual funds and open-ended investment companies, are regulated in most markets. The GIPS Advertising Guidelines are not intended to replace applicable laws and/or regulations when a firm is advertising performance solely for a pooled unitized investment vehicle.”<sup>34</sup> (emphasis added) With respect to this Draft Guidance, the CFA Institute could limit any new requirements to specific offering documents and marketing material that affirmatively claim GIPS compliance.<sup>35</sup> This targeted <sup>34</sup> Global Investment Performance Standards at 25. <sup>35</sup> If the CFA Institute adopts this disclosure approach, we still would oppose requiring Firms to provide compliant presentations upon request, for the reasons set forth above. CFA Institute April 29, 2016 Page 14 approach has the benefit of (i) providing Firms with some flexibility, and (ii) ensuring greater comparability of those materials that explicitly highlight GIPS compliance. ■ ■ ■ ■ ■ We appreciate the opportunity to provide comments on the Draft Guidance. If you have any questions with respect to U.S. regulated funds, please contact me at (202) 218-3563 or Matthew Thornton at (202) 371-5406; for questions regarding non-U.S. regulated funds, please contact Eva Mykolenko at (202) 326-5837. Sincerely, /s/ Dorothy Donohue Deputy General Counsel—Securities Regulation cc: CFA Institute Board of Governors Beth Hamilton-Keen, CFA Attila Koksai, CFA Frederic P. Lebel, CFA Mark Lazberger, CFA Aaron Low, CFA Scott Proctor, CFA Colin McLean, FSIP Sunil Singhanian, CFA Heather Brilliant, CFA George Spentzos, CFA, FSIP Robert Jenkins, FSIP Lynn Stout Paul Smith, CFA Zouheir Tamim El Jarkass, CFA Giuseppe Ballocchi, CFA Michael G.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.