Portfolio Manager Lift-Outs, Investment Performance Portability, and the CFA Institute Member

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I. OVERVIEW

This article reviews: (i) general professional standards and expectations of investment professionals as fiduciaries to their clients and employers; (ii) general principles of "lift outs" imposed on investment professionals; (iii) specific principles of "lift-outs" imposed on members of the CFA Institute ("CFAI"), formerly known as the Association for Investment Management and Research ("AIMR")[1], by the CFAI's Code of Ethics and Standards of Professional Conduct ("Code and Standards"); and (iv) the rules governing the use of the investment performance record earned at a prior firm pursuant to the portability and record-keeping requirements under the Global Investment Performance Standards ("GIPS" or the "Standards"),[2] and the Investment Advisers Act of 1940, as amended (the "Advisers Act") and the rules thereunder.

II. INDUSTRY PRINCIPLES AND PRACTICES AFFECTING INVESTMENT ADVISERS AND INVESTMENT PROFESSIONALS

A. General Fiduciary Duties of Investment Advisers[3] and Investment Professionals[4]

All investment advisers and investment professionals employed by an investment adviser[5] are subject to Section 206 of the Advisers Act, gener-

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ally referred to as the "anti-fraud provision," which provides that it is unlawful for an investment adviser "to engage in any act, practice or course of business which is fraudulent, deceptive, or manipulative."[6] The Supreme Court in *SEC v. Capital Gains Research Bureau, Inc.* also interpreted this section of the Advisers Act to impose a general fiduciary duty on all investment advisers by operation of law.[7] In addition to recognizing the obvious congressional intent of the Advisers Act to eliminate or at least create the disclosure of all conflicts of interest which might incline an investment adviser to render investment advice that was not disinterested, the Supreme Court in its decision stated that Section 206 of the Advisers Act also reflected the delicate nature of the fiduciary relationship between investment advisers and their clients.[8] Ultimately, this fiduciary obligation to the client imposed by operation of the Advisers Act requires that an investment adviser exercise "an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' his clients."[9] Furthermore, in addition to the fiduciary duties owed by all investment professionals to their clients, investment professionals who are also officers and directors in their investment firm owe additional fiduciary duties to their employer. These duties mirror the common law and statutorily imposed duties of care and loyalty.

1. Owed to Their Clients

"An investment adviser is a fiduciary who is required to serve the interests of his client with undivided loyalty."[10] These fiduciary duties are owed to their clients as mandated by the Advisers Act.[11] The investment professional, as a fiduciary, is charged with having more industry knowledge than the average person, and thus, must always act prudently and with discretion regarding the assets of his or her clients. Furthermore, the fiduciary duty required of investment professionals exceeds that which is acceptable in many other business relationships because the investment professional is held in a position of trust. [12] "The Advisers Act was aimed at eliminating conflicts of interest between an investment adviser and his clients. Consequently, an investment adviser must not effect transactions in which he has personal interest in a manner that could result in preferring his own interest to that of his advisory clients."[13] "Thus, an investment adviser must not only refrain from effecting, on his/her own behalf, securities transactions which are inconsistent with his fiduciary obligations; he should also be reasonably certain that persons associated with him/ are not improperly utilizing the information which they obtain in the conduct of the investment advisory business in such a manner as to adversely affect the interests of the clients or limit the adviser's ability to fulfill his fiduciary obligations."[14]

There are several guiding provisions of the Advisers Act and regulations that delineate conduct that constitutes a breach of an investment adviser's fiduciary duties in all circumstances. For example, Section 206 of the Advisers Act specifically outlines behavior, which if committed by an investment adviser automatically breaches that fiduciary duty owed to the client: (1) the use of any device or scheme to defraud any client or prospect; (2) conduct in any transaction or course of business which operates as a fraud or deceit upon any client or prospect; (3) when acting as a principal for his or her own account, the effectuation of a sale or purchase of a security for the account of a client, without providing the client with a written disclosure of the capacity in which the investment adviser is acting and without obtaining the consent of the client for that transaction; and (4) conduct in any act or practice which is fraudulent, deceptive or manipulative.[15] Additionally, Rule 206(4)-1 under the Advisers Act, makes it a breach of an adviser's fiduciary duty to "publish, circulate, or distribute any advertisement … (5) [w]hich contains any untrue statement of a material fact, or which is otherwise false or misleading."[16] Finally, investment advisers will also be in breach of their fiduciary duties by failing to comply with applicable regulations or investment firm requirements, which govern the disclosure of client information to nonaffiliated third parties.[17]

In addition to aforementioned regulations and provisions of the Advisers Act, investment advisers will likely owe their clients additional fiduciary obligations. The specific contours of the fiduciary duties owed by investment advisers to their clients will vary depending on the particular circumstances present in the relationship between the fiduciary and its client. Thus, taking into account the particular facts and circumstances of a fiduciary's relationship with its client, all investment decisions "should continuously occupy an impartial and disinterested position, as free as humanly possible from the subtle influence of prejudice, conscious or unconscious; he should scrupulously avoid any affiliation, or any act, which subjects his position to challenge in this respect."[18]

2. Owed to Their Employer

In addition to the fiduciary duties owed to their clients, investment professionals who are also officers or directors in their investment firm must adhere to specific fiduciary duties owed to their employer. The business affairs of an investment adviser firm are conducted under the ultimate direction of its directors and officers. Each director and officer has a legal duty, known as the duty of care, to exercise reasonable care in the performance of his or her duties as a director or officer. Under the reasonable care standard, a director or officer must at all times exercise such care, including reasonable inquiry, requiring an attentiveness and alertness, that an ordinary prudent person in a like position would use under similar circumstances. Using this standard of care, each officer and director must always act in a manner he believes to be in the best interests of the business management firm.[19] Each director or officer may be liable for a breach of this duty even though he or she has not received any profit from the transaction being challenged. Generally, a director or officer does not violate his or her duty of care for acts of mere negligence. However, reckless or grossly negligent acts or omissions on the part of the individual may be considered violations of the duty of care.[20]

Directors and officers are required in their deliberations to undertake a very careful review of all relevant factors. Directors and officers are expected, acting honestly and diligently, to use their best efforts to exercise reasonably informed business judgment solely in the interests of the company and not for their personal benefit. The duty of each director and officer to invoke the business judgment rule requires (1) the ability to inform themselves, prior to making a public decision, of all material information reasonably available to them, and (2) having become so informed, must then act with requisite care in the discharge of their duties.[21] The business judgment rule is an important defense that, if applicable, reduces the liability exposure of directors to claims of mismanagement or breach of their duty for care.[22]

In addition to the duty of care owed to an investment management firm, investment professionals who are also directors and officers owe a duty of loyalty to the company and this duty is absolute.[23] Directors and officers, as fiduciaries, occupy positions of trust and confidence on which the investment management firm must rely. They must exert all reasonable and lawful efforts to ensure that the investment management firm is not deprived of any advantage to which it is entitled. A director or officer's duty of loyalty requires scrupulous observation of a duty (1) to protect the interests of the investment management firm, and (2) to refrain from doing anything to injure it.[24] Therefore, the director or officer must be aware of any action on his part which may amount to the taking of an employer's business opportunity. For example, a director or officer may not compete with the company for clients or attempt to profit personally from a transaction between the company and a third party.

Furthermore, any "secret" profit gained by a director or officer by reason of any violation of or disregard for the obligations of the director or officer cannot be retained but must be accounted for to his or her employer.[25] As a consequence of this doctrine, personal advantage may arise when the company's funds are used by the director or officer in buying property that he or she then resells to the company at a profit, or if an officer or director purchases shares of a target company that the company is seeking to acquire under a buy-and-sell agreement, or if its officers and directors secretly operate a competing business, or if a director or officer prevents his or her company from going into a business which would be in direct competition with him or her.[26] Likewise, the director or officer cannot use the company's assets for his or her own benefit without proper authorization. Such activities are also known as "self-dealing." However, a director or officer may conduct personal transactions with his company if he can prove that he did not gain unfair or secret profits and that the transaction was fully fair and in the best interests of the company as a whole.[27]

The precise nature of the fiduciary duties owed by investment professionals holding the position of officer or is derived through the applicable statutes, the relevant state statutes of the jurisdiction in which they conduct business and/or all relevant federal statutes, and the terms of the corporate charter.[28] Generally, however, in their practical application the duties of care and loyalty prevent these investment professionals from placing their own financial interests ahead of their employer's, taking any business action that results in harm to their employer, assisting a competitor to gain advantage over their employer, and disclosing confidential and proprietary information of their employer. Those duties mirror the duties owed by investment professionals who are officers and directors under the Code and Standards.

B. General Principles of "Lift-Outs" in the Investment Profession

"Lift-outs" are common in the investment community. Generally speaking, the term "lift-out" is used to describe a circumstance in which one investment firm seeks to acquire a specialized team of investment professionals, already working together, from another firm in the industry.[29] When this situation arises, each member of the lift-out team is under a duty to act in the best interests of his or her current employer at all times until his or her employment duties officially cease.[30] Departing employees may not use employer resources, such as phone, fax or email accounts, to interact with the firm that seeks to employ them. Client lists and prospective client lists may not be shared with the firm seeking to perform the lift-out, and prior to his or her departure, the employee cannot, in any manner, solicit his or her employer's clients or prospects.[31] The employee cannot collude with other employees to bring about the mass resignation of other coworkers, and further, must not engage in any planning that involves conspiracy, secrecy or deceit. At all times during or subsequent to the lift-out, any misappropriation and/or misuse of employer trade secrets or confidential information is strictly forbidden. Furthermore, without the proper supporting records and documentation, which may be obtained only with the consent of the previous employer or the separate permission of a client,[32] departing employees cannot represent their past performance record at their previous employer as their own, as past performance is viewed as being earned by the firm at which it was achieved, not of an individual investment professional or an investment team.[33]

II. CFAI CODE OF ETHICS AND STANDARDS OF PROFESSIONAL CONDUCT

A. Background

The CFAI, a global nonprofit professional association was established in 1990 through the combination of two predecessor professional organizations: the Financial Analyst Foundation ("FAF") and the Institute of Chartered Financial Analysts ("ICFA"). The CFAI promulgates and enforces voluntary, ethics-based professional and investment performance-reporting standards for the investment industry. The CFAI is comprised of individual members who hold the CFAI designation and other individual members who are active in the investment business and agree to adhere to the organization's Articles of Incorporation and Bylaws, the CFAI Code and Standards, and other rules relating to professional conduct, which are amended and interpreted from time to time.[34]

1. Origins of the Code of Ethics and Standards of Professional Conduct

An important goal of CFAI is to ensure that the organization and its members develop, promote, and follow the highest ethical standards in the investment industry. The CFAI Code and Standards are the cornerstone of the CFAI's values to advance the interests of the global investment community by maintaining the highest standards of professional excellence and integrity.[35] Since their inception in the 1960s by both the FAF and ICFA, the Code and Standards have advanced the integrity of CFAI members[36] and have increasingly provided guidance to investment industry participants by serving as an ethical model for its professionals globally. Through its implementation, the Code and Standards have played a critical role in setting the investment profession's standard for the level of professional conduct for investment professionals when exercising their fiduciary duties owed to their employers and clients. The Code and Standards have become the benchmark for all professional conduct of investment professionals employed by investment firms that provide investment advice to institutional investors[37], to be measured against, when they are acting in a fiduciary capacity both to their employer and to the investment firm's clients. Working in tandem, the Code and Standards set forth principles that define the professional conduct required of CFAI members and set minimum rules of fair and ethical behavior to which each member must adhere. [38]

The Code and Standards coexist with a jurisdiction's laws and regulations governing permissible professional behavior. A course of conduct, however, that may be legal per se under applicable jurisdictional laws and regulations, will not necessarily translate into conduct that is proper under the Code and Standards. Laws and regulations will override the Code and Standards when in conflict, but where the Code and Standards impose a more stringent professional standard, they control as CFAI members are held to a higher standard.[39]

The Code and Standards developed from within the broader framework of the CFAI Professional Conduct Program ("PCP"). The leading objectives of the PCP are to: (1) provide ethics and professional conduct education; (2) review and revise the Code and Standards, the CFAI Standards of Practice Handbook, similar CFAI publications, and other ethics and professional conduct material; (3) establish ethics and professional conduct standards subject to Board approval; (4)investigate and conduct proceedings in connection with professional conduct matters; (5) impose disciplinary sanctions for proceedings related to ethics and professional conduct.[40] Two professional conduct committees, the Standards of Practice Council ("SPC") and the Disciplinary Review Committee ("DRC"), administer the PCP.[41] The SPC periodically reviews and revises the Code and Standards to ensure that the needs and challenges facing professionals in the investment industry are adequately addressed.[42] The DRC is responsible for the enforcement of the Code and Standards and has the ultimate authority to sanction a member for a violation.[43]

2. Enforcement of the Code of Ethics and the Standards of Professional Conduct

CFAI has professional conduct jurisdiction over its members.[44] Enforcement of the Code and Standards through the PCP is fundamentally "based on the principle of self-disclosure."[45] Under the CFAI Bylaws, each member is required to sign and file an annual Professional Conduct Statement.[46] The Professional Conduct Statement is a form prepared by CFAI inquiring into an individual member's professional conduct and activities, specifically requiring the annual disclosure of any matters that question that member's professional conduct, such as involvement in civil litigation, a criminal investigation, or being the subject of a written complaint. In addition to this requirement of self-disclosure, members are also encouraged to report on another's possible violation of the Code and Standards. Any information indicating professional misconduct received from the Professional Conduct Statement, other members, outside individuals, or as a result of legal or regulatory proceedings instituted against a member, may serve as the basis of a professional conduct inquiry.[47]

CFAI Bylaws and Rules of Procedure for Proceedings Related to Professional Conduct control the procedures and sanctions employed to enforce the Code and Standards on members. The role of the DRC is not simply to discipline people. Enforcement of the Code and Standards serve to the preserve the integrity of CFAI and its members.[48] When warranted, the DRC will initiate an investigation into whether or not a member's conduct has violated the Code and Standards. Broadly speaking, this examination "may include a written explanation from the member; interviewing the member, complaining parties, and third parties; and collecting documents and records in support of the investigation."[49] If, upon review of the materials obtained during the investigation, it is determined by the Designated Officer[50] that disciplinary action is appropriate, the Designated Officer is authorized to impose the necessary sanction. Dependent upon the severity of the member's violation, the following sanctions, in increasing levels of severity, may be imposed: private censure, public censure, a timed suspension of CFAI membership, a timed suspension of the member's right to use the CFA designation, revocation of CFAI membership, revocation of the member's right to use the CFA designation, summary suspension, and suspension or revocation of individuals further participation in the CFA Professional Designation Study and Examination Program. When public sanctions are issued, notices of disciplinary action are published in a CFA publication, which is sent to all members. Additionally, the CFAI may provide the member's primary regulator or regulators with information pertaining to the disciplinary action.

B. Fundamental General Principles of the Code of Ethics and Standards of Professional Conduct

The Code and Standards use fundamental general principles to provide an overall expectation of the ethical professional conduct required of each CFAI member. The Code of Ethics in its entirety is a broad statement of ethical principles guiding the professional practices of CFAI members. It requires that all members "[a]ct with integrity, competence, diligence, respect, and in an ethical manner with the public, clients, prospective clients, employers, employees, colleagues in the investment profession, and other participants in the global capital markets," "place the integrity of the investment profession and their interests of the clients above their own personal interests," "use reasonable care and exercise independent professional judgment when conducting investment analysis, making investment recommendations, taking investment actions, and engaging in other professional activities," "practice and encourage others to practice in a professional and ethical manner that will reflect credit on members and their profession," "promote the integrity of, and uphold the rules governing, capital markets," and "maintain and improve professional competence and strive to maintain and improve the competence of other investment professionals."[51] The Standards of Professional Conduct then flow from these general ethical guidelines.

The Standards of Professional Conduct address many specific areas of the investment profession. However, each professional situation encountered in the industry cannot be anticipated, and thus, the Standards of Professional Conduct also set forth fundamental principles which apply in all situations. In all professional activities, members are expected to maintain knowledge of and "comply with all applicable laws, rules and regulations," including the Code and Standards, to which they are subject, and members shall "not knowingly participate or assist in and must dissociate from any violation of such laws, rules or regulations."[52] The Standards of Professional Conduct not only require CFAI members to be aware of and comply with all laws, rules, and regulations governing their own conduct, but also state that it is incumbent on each member to avoid tacitly or knowingly participating in the violations of others.

C. Standards of Professional Conduct Duties and Responsibilities

In addition to these overarching general principles, the Standards of Professional Conduct also stipulate that members owe specific duties and responsibilities to the profession, their employers, their clients and prospects, and the investing public. Integrated into these specific duties and responsibilities are the general principles and practices, as previously discussed, which affect all investment professionals.

1. Duty to the Profession

CFAI members owe a duty to the investment profession not to engage in professional misconduct. A responsibility borne by all members is to "not engage in any professional conduct involving dishonesty, fraud, deceit, or misrepresentation or commit any act that reflects adversely on their professional reputation, integrity, or competence."[53] CFAI members are to avoid all personal behavior that would reflect poorly on the entire profession, and each member is expected to be aware of the professional implications and consequences of personal actions taken. Readily ascertainable violations include convictions of a felony or crime punishable by more than one year in prison, or of a misdemeanor involving moral turpitude. Repeated misdemeanor offenses or engagement in acts that indicate a disregard for the law are also a breach of this duty to the profession. More often than not, however, members breach this duty simply by engaging in intentional and calculated dishonest or deceitful behavior.

2. Duty to the Employer

An accepted governing principle of a CFAI member's duty to his or her employer is that all members owe a duty of loyalty to their employer. Specifically, members "must act for the benefit of their employer and not deprive their employer of the advantage of their skills and abilities, divulge confidential information, or otherwise cause harm to their employer."[54] A CFAI member's duty of loyalty to his or her employer is also consistent with the duty of loyalty owed to his or her client.[55] "As is generally known, an investment adviser is a fiduciary,"[56] which is implemented through the actions of its officers and directors. Where, however, an employer has hired CFAI members, the employer's duties to its clients are also exercised for the benefit of its clients through their CFAI member employees. Accordingly, an employer is entitled to rely on the duties of its CFAI member employee as required under the Code and Standards.

a. Disclosure of Conflicts to Employer

Similar to the general fiduciary duties of investment professionals, the Standards of Professional Conduct impose the requirement that CFAI members must at all time act in the best interest of their employer by placing their employer's interests before their own.[57] This duty of loyalty focuses on the responsibilities owed to the employer if and when conflicts of interest arise between the CFAI member and his or her employer. "When reporting conflicts of interest to employers, CFAI members should give their employer enough information to assess the impact of the conflict. By complying with employer guidelines, CFAI members allow their employers to avoid potentially embarrassing and costly ethical or regulatory violations."[58]

"Reportable situations include conflicts that would interfere with rendering unbiased advice and conflicts that would cause a CFAI member or candidate not to act in the employer's best interests." [59]Specific situations include, "ownership of stocks analyzed or recommended, participation in outside boards, and financial and other pressures that may influence a decision."[60] Even the mere appearance of a conflict may have substantial detrimental effects on an employer's business and reputation. CFAI members must protect the interests of their employer by refraining from any conduct that might cause injury, deprive it of profit, or deprive it of the advantage of an employee's skills or abilities. "Any potential conflict that could prevent clear judgement in or full commitment to the execution of the CFAI member's duties to the employer should be reported to the CFAI member's employer and promptly resolved." [61]Finally, if it becomes necessary for a CFAI member to report a conflict or a potential conflict. Simply revealing to an employer that a conflict may exist is not enough; the disclosure must be meaningful. CFAI members need to provide sufficient information upon which the employer may determine whether a conflict or potential conflict of interest exists, and if so, the impact of the conflict.

b. Disclosure of Independent Practice to Employer

CFAI members must refrain from independent competitive activity that may conflict with the business of their employer. "Members who plan to engage in independent practice for compensation must provide notification to their employer describing the types of services the member will render to prospective independent clients, the expected duration of the services, and the compensation for the services. [62] As one might anticipate, employers are unlikely to consent to an employee undertaking an independent and competitive business practice, and therefore employees are often in this position where they continue to be employed while they make preparations to go into a competitive business.

"A departing employee is generally free to make arrangements or preparations to go into a competitive business before terminating the relationship with the employee's employer provided that such preparations do not breach the employee's duty of loyalty."[63] Until their resignations become effective, CFAI members are still obligated to act in their employer's best interests and must not engage in any conduct that would breach this duty. Similar to the general principles guiding the industry practice of lift-outs, CFAI members must refrain from the following conduct when leaving their employer: misappropriation of trade secrets, misuse of confidential information, solicitation of employers clients prior to cessation of employment, self-dealing (appropriating for one's own property business opportunity or information belonging to one's employer, and misappropriation of clients or client lists.[64]

c. Responsibilities of Supervisors

Supervisory responsibilities are also encompassed within a CFAI member's duty to its employer. "Members and Candidates must make reasonable efforts to detect and prevent violations of applicable laws, rules, regulations, and the Code and Standards by anyone subject to his or her supervision or authority."[65] Any investment professional who has employees subject to their control or influence exercises supervisory responsibility. The CFAI expects its members to have a comprehensive understanding of the Code and Standards and be able to apply this understanding in the performance of their supervisory duties. Once a CFAI member's supervisor learns that the Code and Standards may have been violated, a timely investigation must be initiated to determine the extent of the wrongdoing.[66] It is critical that a supervisor be sensitive to potential conflicts between his or her own self-interests and his or her supervisory activities and must certainly not under any circumstances encourage a subordinate to engage in behavior that is in violation of the CFAI Standards of Professional Conduct.

3. Duty to Clients and Prospects

a. Fiduciary Duties

Duties are also owed to clients and prospects. Each CFAI member is to understand that he or she must adhere to the fiduciary responsibility he or she assumes with each client. "Members and Candidates must act for the benefit of their clients and place their clients' interests before their employer's or their own interests. In relationships with clients, Members and Candidates must determine applicable fiduciary duty and must comply with such duty to persons and interests to whom it is owed."[67] A fiduciary is an individual charged with the duty or obligation of acting for the benefit of another in matters coming within the scope of the relationship between the parties.[68] The duties that investment professionals owe as a result of their fiduciary relationship often exceed that which is ordinarily acceptable in another business relationship because the fiduciary is in a position of trust.[69] CFAI members owe undivided loyalty to their clients and must always place their client's interests before their own. Importantly, "the duty of loyalty, prudence and care owed to the individual client is especially important because the professional investment manager typically possess greater knowledge then the client. Particular care must be taken to ensure that the goals of the investment manager or the firm in placing business, selling products, or executing security transactions do not conflict with the best interests and objectives of the client."[70]

To fulfill the fiduciary obligations owed to their clients under the Code and Standards, CFAI members must at all times when providing investment services to their clients conform their conduct to abide by the following principles among others: (1) disclose all possible conflicts of interest so that clients can evaluate the conflict; (2) preserve the confidentiality of client information; and (3) serve the best interests of the client.[71]

b. Preservation of Confidentiality

The CFAI Standards of Professional Conduct require CFAI members to be vigilant in the preservation of confidential information communicated by employers, clients and prospects. Specifically, "Members and Candidates must keep information about current, former, and prospective clients confidential unless: (i) [t]he information concerns illegal activities on the part of the client or prospective client, (ii) [d]isclosure is required by law, or (iii) [t]he client or prospective client permits disclosure of the information."[72] This standard is applicable when "(1) the member receives information on the basis of his or her special ability to conduct a portion of the client's [or employer's] business or personal affairs, and (2) the member receives information that arises from or is relevant to that portion of the client's [or employer's] business that is the subject of the special or confidential relationship."[73] The exception, of course, is that if the confidential information pertains to illegal activities by the client or employer, the CFAI member may have a legal obligation to report the activities to the appropriate authorities. Inappropriate disclosures of client information may be avoided if employees limit all conversations regarding information received from a client to authorized fellow coworkers who are also working for the same client. CFAI members must also be cautious not to reveal confidential information relating to their employer's business as this duty of confidentiality addresses information received in the context of the employer member relationship.[74]

4. Duty to the Investing Public

CFAI members are also charged with duties to the investing public. The CFAI Standards of Professional Conduct state that particular care is owed when presenting performance figures to members of the investing public. "A member must give a fair and complete presentation of performance information whenever communicating data with respect to the performance history of individual accounts, composites or groups of accounts, or composites of an analyst or firm's performance results. Further, member should not imply that client will obtain or benefit from a rate of return that was generated in the past."[75] These requirements address any practice that would lead to the misrepresentation of a CFAI member's performance record or the performance record of the CFAI member's employer. Fair and complete presentation of performance data is required whenever communicating the performance history of individual accounts, composites of groups of accounts, or composites of an investment professional's or investment adviser's performance results. To avoid violating the CFAI Standards of Professional Conduct relating to performance presentation, CFAI members must consider the knowledge and sophistication of the presentation's audience, consider the types of disclosures necessary to fully explain the reported results, and maintain sufficient data and reports used to calculate the performance presented.

III. GIPS

A. JURISDICTION

1. Scope

To achieve the goal of industry-wide uniformity in the presentation of performance information, the CFAI adopted a revised version of the GIPS Standards. As a result the AIMR-PPS standards fully converted to GIPS standards effective January 1, 2006.[76] The CFAI Standards of Professional Conduct work in conjunction with the GIPS standards, both seeking to satisfy the investing public's need for a shared, accepted set of standards for the calculation and presentation of investment firms' performance results. Compliance with GIPS standards is the best method to meet the obligations of the Standards of Professional Conduct.[77]

The GIPS standards are created, sponsored and interpreted by CFAI. The Standards are designed to provide an ethical framework for the calculation and presentation of the investment performance history of an investment management firm.[78] Compliance with the Standards is voluntary.[79] However, once a firm claims compliance, it must comply at all times on a firmwide basis.[80] On January 1, 2006, the AIMR-PPS, the U.S. and Canadian version of GIPS, was replaced by a revised version of GIPS. All performance presentations of investment firms claiming AIMR-PPS compliance that include performance results for periods after December 31, 2005, must meet all of the requirements of the revised GIPS standards.[81] Performance presentations that include results only through December 31, 2005, may still be prepared in compliance with the 1999 version of GIPS.[82] Firms that claimed compliance with AIMR-PPS can consider AIMR-PPS compliance as equivalent to GIPS compliance for periods prior to December 31, 2005.[83] The term "GIPS" as used herein is in reference to the revised GIPS standards as of January 1, 2006.[84]

2. Ethical Standards with Nominal User Protections

The GIPS standards are ethical standards, not legally required, enforced, or interpreted. Laws and regulations override the GIPS standards when in conflict.[85] However, if the Standards impose a higher standard than law and regulation, the Standards control. The Standards are interpreted by the Investment Performance Council ("IPC") of the CFAI, which consists of 36 members from 14 countries.[86]

Under this framework, the IPC delegates interpretation of the Standards to the IPC Interpretations Subcommittee, which "has the responsibility of ensuring the integrity, consistency, and applicability of the GIPS standards by providing guidance to the public on practical issues and clarifying areas of confusion."[87] In addition, CFAI employees staff the "Standards Helpdesk," which accepts requests for assistance. The primary purpose of the Standards Helpdesk is to assist firms in compliance with the Standards by responding to specific questions. In addition, members of the IPC, CFAI staff, and others active in CFAI activities as volunteers, publicly and privately speak on the Standards and various approaches to GIPS compliance, including interpretations of various provisions of the Standards.

3. Limitations on the Standards Interpretations

Laws and regulations are issued pursuant to transparent processes with numerous protections for the public, including the U.S. Administrative Procedures Act[88] and related laws that require transparency, attempt to eliminate bias, conflict, and influence, and give additional protections to those who are affected by proposed and implemented regulations. In contrast, no such protections exist for those who comply with the Standards. CFAI, as a nongovernmental entity, is not required to comply with such laws and regulations designed to protect individuals and entities from governmental oversight. As a result of the lack of governmental oversight in the development and interpretation of the Standards, the CFAI is free to change the Standards or its interpretations at any time without consultation or notice.

4. Enforcement Jurisdiction

CFAI's enforcement of the Standards is limited to individuals that are members of CFAI and are involved in the preparation or presentation of historical performance by a firm claiming GIPS compliance. CFAI does not have any authority over a firm that does not claim compliance with the Standards. Claiming compliance with the Standards is voluntary. It is only when a firm claims compliance with GIPS the obligation to follow the requirements set forth in calculating and presenting performance under the Standards is triggered. Firms that claim compliance with GIPS are expressly required to comply with all "updates, reports, guidance statements, interpretations or clarifications published by the CFA Institute and the Investment Performance Council . . . ."[89]

According to the Standards, local country regulators are urged to supervise country compliance with GIPS and any other country-specific standards that may exist. In the United States, the Securities and Exchange Commission (the "SEC") takes an active role in enforcing the Standards.[90] As part of its investment adviser inspection program, the SEC staff will determine whether a firm's claim of compliance with the GIPS is accurate. The SEC staff will examine in detail aspects of a firm's compliance with the Standards, including firm definition, discretion definition, composite creation and maintenance, calculation methodology, recordkeeping, and presentations. The SEC's jurisdiction with respect to the Standards is based on whether a firm claims compliance with GIPS since a false claim of GIPS compliance may violate the antifraud provisions of Section 206(4) of the Advisers Act.[91] The SEC cannot impose the Standards on any firm that does not claim compliance with the Standards.

B. PORTABILITY ISSUES

1. GIPS Portability Standards

"Portability" of performance refers to the ability of one investment adviser to reference in his or her own investment performance presentation the historical performance record of either a predecessor investment adviser or that of the predecessor's investment adviser's portfolio manager's performance achieved while at another firm. Under the GIPS portability standards, the historical performance record of an investment firm belongs to that firm. A firm's performance record is the product of many factors beyond personnel, including processes, discipline and strategy.[92] If specific GIPS standards requirements are met, a firm claiming GIPS compliance is *required* under the Standards to "link" the historical performance record of the prior firm to its ongoing performance record, thus creating the appearance of a continuous performance history.[93] Where such linking is required under the Standards, multiple firms may claim the same performance history as their own.[94] If the GIPS standards requirements are not met, nonportable performance is *per se* prohibited from being linked to the ongoing performance of a firm claiming GIPS compliance.[95] However, a firm may present the performance of the prior firm as supplemental information so long as the presentation is consistent with the Standards' ethical principles, contains appropriate disclosures, and is otherwise compliant with the IPC Guidance Statement on the Use of Supplemental Information.[96]

A portability analysis under the Standards involves an evaluation of a number of issues, and the presence or lack of a particular fact is not necessarily determinative of whether investment performance is portable. Rather, "[d]ue to the unique circumstances surrounding the use of prior performance results, portability of performance must be addressed on a case-by-case basis."[97] Standard 5.A.4 and the IPC Guidance Statement on Performance Record Portability ("Portability Guidance Statement") each state that when a portfolio manager, group of managers, or an entire firm joins a new firm, a composite's past performance must be linked to the ongoing results of the new firm if all of the following conditions are true for that composite:

- substantially all the investment decision-makers are employed by the new firm (*i.e.,* research department, portfolio managers, and other relevant staff);

- the staff and investment decision-making process remain intact and independent within the new firm;
- the new firm has records that document and support the reported performance; and
- the new firm discloses that the performance results from the old firm are linked to the performance record of the new firm.[98]

In addition to the foregoing, the Portability Guidance Statement requires that the *entire* composite history from the old firm, including all portfolios included in the composite, must be used by the new firm and supported by the records necessary to substantiate the performance history of that composite.[99]

In essence, the crux of the determination of whether portability of a prior firm is required is whether the historical records "still warrant having the same label as the old entity."[100] Ultimately, the "applicability and integrity of the performance record is only as good as the ongoing integrity of the strategy and all the contributing factors."[101]

In addition to requiring the transfer of substantially the same investment decision-making processes and personnel, both the Standards and the Portability Guidance Statement require that the presentation of linked performance be supported by records that document and support that performance.[102] The Standards explicitly require that each firm claiming GIPS compliance maintains sufficient records to permit, if needed, the recalculation of account-level and composite-level returns.[103] A fundamental principle of the Standards is the need for firms to be capable of substantiating or recalculating their performance history if questioned by a potential client, verifier, or regulator. All firms are required under the Standards to retain supporting documentation, such as confirmations and statements "that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return (current and historical performance results) of any or all managed accounts that the advisor uses in advertisements."[104] Firms must have supporting documentation for each year that the firm shows performance results for all portfolios that are reflected in the performance shown.[105] Therefore, in order for a firm to properly present the previous performance history of prior firm, *i.e.,* in order for the historical performance to be portable, the new firm must have the underlying data necessary to recreate the performance of its composites for those periods, including beginning and ending market values of all portfolio holdings and intra-period cash flows for the composite for each account in the composite. Although the Standards do not identify specific records that will suffice, records that would be needed to meet the GIPS standards recordkeeping requirement are typically custodian statements that include a list of all holdings and inflows and outflows.[106] If records are not readily available, the new firm can obtain supporting records in one of two ways: (i) obtain permission of the prior firm to obtain copies of the supporting records; or (ii) attempt to obtain the supporting records from third parties such as clients, custodians, or consultants.[107] Should the new firm be unable to acquire or obtain access to the records supporting the prior firm's performance, the new firm may not properly link to the prior firm's historical performance.

2. SEC Portability Requirements

Although the GIPS standards are considered the industry standard for the ethical presentation of performance results, every investment adviser that is registered or required to be registered under the Advisers Act must also adhere to the advertising rules thereunder and to the various pronouncements on prohibited advertising practices by the SEC and its staff.[108] To the extent that the Standards conflict with law or regulation, law or regulation will always control.[109] However, "[c]ompliance with applicable law or regulation does not necessarily lead to compliance with the GIPS standards."[110]

Section 206(4) of the Advisers Act prohibits an investment adviser from engaging in any act, practice, or course of business that the SEC, by rule, defines as fraudulent, deceptive or manipulative. Rule 206(4)-1(a)(5) thereunder deems the distribution of any advertisement that contains an untrue statement of a material fact or is otherwise false or misleading as a fraudulent, deceptive or manipulative act.[111] In a 1977 no-action letter, the SEC staff published general guidelines for when the staff would deem an advertisement to be misleading within the meaning of Section 206(4) of the Advisers Act.[112] The staff stated that whether a communication is misleading depends upon the particular facts and circumstances, including (1) the form and content of a communication, (2) the implications or inferences arising out of the content of a communication, and (3) the sophistication of the prospective client.

Subsequently, a number of SEC staff no-action letters considered whether an investment adviser's advertisement containing performance results of accounts managed by a predecessor would be misleading and therefore deemed fraudulent for purposes of Section 206(4) and Rule

206(4)-1. These no-action letters take the position that an advertisement that includes prior performance of accounts managed by portfolio managers at their prior place of employment will not, in and of itself, be misleading under Section 206(4) and Rule 206(4)-1 thereunder so long as:

(1) the person(s) managing accounts at the investment adviser are also those primarily responsible for achieving the prior performance results;[113]

(2) the accounts managed at the prior investment adviser are so similar to the accounts currently under management that the performance would provide relevant information to prospective clients;[114]

(3) all accounts that were managed in a substantially similar manner are advertised unless the exclusion of any such account would not result in materially higher performance;[115]

(4) the advertisement is consistent with SEC staff interpretations with respect to the advertisement of performance results;[116] and

(5) the advertisement includes all relevant disclosures, including that the performance results were from accounts managed at another entity.[117]

Through no-action letters and administrative proceedings, the SEC and its staff has emphasized that an investment adviser who advertises the prior performance of another investment adviser may not do so unless it can comply fully with the recordkeeping requirements of Rule 204-2(a)(16) (the "Rule").[118] The Rule generally requires that each federally registered investment adviser maintain:

> all accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with the investment adviser).[119]

The Rule also provides that an investment adviser is deemed to satisfy the requirements of the Rule if, with respect to the performance of its managed accounts, the adviser retains: (i) all account statements so long as they reflect all debits, credits, and other transactions in the client's account for the period of the statement; and (ii) all worksheets that are necessary to demonstrate the calculation of the performance or rate of return of the managed accounts.[120] In adopting the release to the Rule, the SEC emphasized that these account statements must be prepared contemporaneously with the period reported and that all account statements for the period for which performance is calculated be kept, irrespective of whether a particular account is included in the computation of an advertised performance figure.[121] The SEC staff has acknowledged that neither the Rule nor the releases proposing or adopting the Rule states that this safe harbor for managed accounts is the exclusive method of satisfying the requirements of the Rule.[122] However, as a matter of policy, the SEC staff will not provide no-action assurances under the Rule regarding whether an investment adviser's particular records are sufficient to form the basis of or demonstrate the calculation of the investment performance of an investment adviser's managed accounts.[123] The SEC's purpose in adopting the Rule was to assist SEC examiners in their efforts to substantiate performance claims made by investment advisers in their advertisements.[124]

Although the Rule may be satisfied through the reliance on internally generated records, the SEC staff has noted that investment advisers can facilitate the SEC's examination of advertised performance by maintaining: (i) records prepared by a third party (*e.g.,* custodial and brokerage statements) that confirm the accuracy of client account statements and other performance-related records maintained by the adviser; and (ii) reports prepared by an independent auditor that verify performance.[125] In taking this position, the SEC staff acknowledged the value of third party records for not only assisting in the verification of performance claims, but also enabling SEC examiners to confirm client assets and review for the misappropriation of client funds and securities.[126]

IV. CONCLUSION

The "lifting out" of one or more CFAI members to a new investment firm is fraught with numerous conflicting duties, fiduciary obligations, detailed regulatory requirements, and the CFAI standards, including its Code of Ethics, Standards of Professional Conduct and Global Investment Performance Standards. Further complicating such an event is the general principle that investment performance is earned by a firm, not an individual. Accordingly, in order for the hiring firm that claims GIPS compliance to use the investment performance track record earned at the firm from which the investment professional was "lifted out," the hiring firm must meet all of the performance portability requirements of both the SEC and CFAI's GIPS standards, a very high hurdle that many firms will find difficult to achieve.

NOTES

1. On May 9, 2004, members of AIMR changed the organization's name to "CFA Institute." Global Investment Association, AIMR, changes name to "CFA Institute," CFA Institute Press Release, May 9, 2004. Available at: http://www.cfainstitute.org/pressroom/04releases/20040506_03.html.

2. On January 1, 2006, the Association for Investment Management and Research Performance Presentation Standards ("AIMR-PPS"), the U.S. and Canadian version of GIPS, was replaced by a revised version of GIPS.

3. Section 2.19 of the CFAI Bylaws (amended July 22, 2005) (hereinafter, "CFAI Bylaws") defines an investment professional as "an individual who evaluates or applies financial, economic and statistical data as part of the Investment Decision-Making Process,"

4. Section 202 (a)(11) of the Investment Advisers Act of 1940, as amended (the "Advisers Act") defines an investment adviser as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities…."

5. For purposes of this Section II A and Section II A.1., the responsibilities imposed on an investment adviser are also applicable to investment professionals employed by an investment adviser. See Section II A.2.

6. Section 206(4) of the Advisers Act.

7. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 193-195 (1963).

8. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 193-195 (1963).

9. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 193-195 (1963). (quoting 1 Harper and James, The Law of Torts (1956), 541.)

10. *See in re* Kidder, Peabody & Co., Inc., Edward B. Goodnow, SEC Release No. 232 (Oct. 16, 1968).

11. *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 193-195 (1963).

12. *See in re* Alfred C. Rizzo, SEC Release No. IA-897 (Jan. 11, 1984).

13. *See in re* Kidder, Peabody & Co., Inc., Edward B. Goodnow, SEC Release No. IA-232 (Oct. 16, 1968).

14. *See in re* Kidder, Peabody & Co., Inc., Edward B. Goodnow, SEC Release No. IA-232 (Oct. 16, 1968).

15. Section 206 of the Advisers Act.

16. Rule 206(4)-1 under the Advisers Act.

17. *See generally* Regulation S-P, 17 C.F.R. Section 248.1-248.30.

18. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. at 193-195 (quoting Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, pursuant to Section 30 of the Public Investment Management, Investment Supervisory, and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong. 2d Sess., 66-67).

19. William E. Knepper, Et. Al., Liability of Corporate Officers and Directors, §§3-01 to3-02, at 3-(1)-3-(4) (7th ed. 2003).

20. See William E. Knepper, Et. Al., Liability of Corporate Officers and Directors. §2-07, at 2-18-2-21.

21. See William E. Knepper, Et. Al., Liability of Corporate Officers and Directors, §2-07, at 2-17.

22. See William E. Knepper, Et. Al., Liability of Corporate Officers and Directors, § 2-01, at 2-1.

23. See William E. Knepper, Et. Al., Liability of Corporate Officers and Directors, §4-01, at 4-2.

24. See William E. Knepper, Et. Al., Liability of Corporate Officers and Directors, §4-01, at 4-2.

25. See William E. Knepper, Et. Al., Liability of Corporate Officers and Directors, §5-02, at 5-4.

26. See William E. Knepper, Et. Al., Liability of Corporate Officers and Directors, §4-24, at 4-(60)-4-(61).

27. See William E. Knepper, Et. Al., Liability of Corporate Officers and Directors, §4-02, at 4(4)-4(6).

28. See William E. Knepper, Et. Al., Liability of Corporate Officers and Directors, § 5.01, at 5-1.

29. A "lift-out" is defined as, "[t]he hiring of a team or other group of employees from a company sometimes by an insurgent insider." Reed, Stanley Foster, M&A Deskbook (2001).

30. See Jet Spray Cooler, Inc. v. Crampton, 361 Mass. 835, 839 (1972) (in the absence of an express contract not to disclose information, the duty not to disclose arises from basic principles of equity and an implied contract stemming out of the employer-employee relationship).

31. See Warner-Lambert Co. v. Execuquest Corp., 427 Mass. 46, 49 (1998) (supporting the proposition that information that does not fit the technical definition of a trade secret still is entitled to protection if the information is confidential or proprietary).

32. See Horizon Asset Management, LLC, SEC No-Action Letter (pub. avail. Sept. 13, 1996).

33. See discussion of performance portability under GIPS standards, infra.

34. See Section 3.5(a)(i) of the CFAI Bylaws.

35. CFA Institute Standards of Practice Handbook (9th Edition, 2005), P. v.

36. "The classes of members in CFA Institute are Regular Members, Affiliate Members, Charterholder Members, and Member Societies." Section 3.1 of the CFAI Bylaws. A Regular Member "is an individual who has met the membership requirements set forth in Section 3.2 of the Bylaws and whose membership has not been revoked or suspended." Section 2.32 of the CFAI Bylaws. An Affiliate Member "is an individual who has met the membership requirements set forth in Section 3.3 of the Bylaws and whose membership has not been revoked or suspended." Section 2.2 of the CFAI Bylaws. A Charterholder Member "is an individual who has met the membership requirements set forth in Section 3.4 of the Bylaws and whose membership has not been revoked or suspended." Section 2.9 of the CFAI Bylaws. A Member Society "is an organization established for purposes substantially similar to the purpose set forth in CFA Institute Articles of Incorporation and accepted as a Member Society of CFAI." Section 2.20 of the CFAI Bylaws.

37. Institutional Investor is defined as an "organization that trades large volumes of securities. Some examples are mutual funds, banks, insurance companies, pension funds, labor union funds, corporate profit-sharing plans, and college endowment funds." Dictionary of Finance and Investment Terms, p. 335-336 (6th ed., 2003).

38. Standards of Practice Handbook, P. 2.

39. Standards of Practice Handbook, P. 7-8.

40. See Section 11.1 of the CFAI Bylaws.

41. Section 11.7 of the CFAI Bylaws.

42. Section 11.9 of the CFAI Bylaws.

43. Section 11.8 of the CFAI Bylaws.

44. Section 3.5 of the CFAI Bylaws.

45. Standards of Practice Handbook, P. ix.

46. Section 3.5(b)(i) of the CFAI Bylaws.

47. Standards of Practice Handbook, P. ix.

48. See generally "Tall Order: A Behind-the-Scenes Look at Professional Conduct Enforcement," Christine Martin, CFA Magazine, Sept/Oct. 2003, pp. 54-55.

49. Standards of Practice Handbook, P. ix.

50. The Designated Officer is a CFA Institute member appointed to oversee the CFAI PCP. Section 2.12 of the CFAI Bylaws. The Author was the Designated Officer of the CFA Institute from 1993 to 2000.

51. CFAI Code of Ethics (effective Jan. 1, 2006).

52. Standard I(A) of the CFAI Standards of Professional Conduct.

53. Standard I(D) of the CFAI Standards of Professional Conduct.

54. Standard IV(A) of the CFAI Standards of Professional Conduct.

55. See discussion of CFAI members fiduciary duties owed to their clients, infra.

56. Adoption of Amendment to Rule 204-2 under the Investment Advisers Act of 1940, SEC Release No. IA-203 (Aug. 11, 1966).

57. Standards of Practice Handbook, P. 83.

58. Standards of Practice Handbook, P. 115.

59. Standards of Practice Handbook, P. 115.

60. Standards of Practice Handbook, P. 115.

61. Standards of Practice Handbook, P. 115.

62. Standards of Practice Handbook, Pgs. 83-84.

63. Standards of Practice Handbook, P. 84.

64. See Standards of Practice Handbook, P. 84.

65. Standard IV(C) of the CFAI Standards of Professional Conduct, ("Duties to Employers—Responsibilities of Supervisors").

66. See Standard IV(C) of the CFAI Standards of Professional Conduct, ("Duties to Employers—Responsibilities of Supervisors").

67. Standard III(A) of the CFAI Standards of Professional Conduct, ("Duties to Clients—Loyalty, Prudence and Care").

68. See Standard III(A) of the CFAI Standards of Professional Conduct, ("Duties to Clients—Loyalty, Prudence and Care").

69. See Standard III(A) of the CFAI Standards of Professional Conduct, ("Duties to Clients—Loyalty, Prudence and Care").

70. Standards of Practice Handbook, Pgs. 53-54.

71. See Standards of Practice Handbook, Pgs. 53-54.

72. Standard III(E) of the CFAI Standards of Professional Conduct—("Duties to Clients—Preservation of Confidentiality").

73. Standards of Practice Handbook, P. 79.

74. See Standards of Practice Handbook, P. 79.

75. Standards of Practice Handbook, P. 75.

76. CFAI Summary of Changes to Required Provisions in Sections 0-5, available at www.cfainstitute.org.

77. Standards of Practice Handbook, P. 75.

78. "The GIPS standards are ethical standards for investment performance presentation to ensure fair representation and full disclosure of a firm's performance." GIPS Introduction, I.D.10(b).

79. Global Investment Performance Standards Handbook §1-2, p. 1 (1st ed. 2002).

80. Guidance Statement on Definition of the Firm (Revised) (effective Jan. 1, 2006) (hereinafter, "Firm Definition Guidance Statement").

81. See GIPS Introduction, I.F.13 ("All presentations that include performance results for periods after 31 December 2005 must meet the requirements of the revised GIPS standards."); Questions and Answers on the Revised GIPS Standards (effective Jan. 1, 2006), p. 1.

82. See GIPS Introduction, I.F.13 ("Performance presentations that include results through 31 December 2005 may be prepared in compliance with the 1999 version of the GIPS standards.") (emphasis added); Questions and Answers on the Revised GIPS Standards (effective Jan. 1, 2006), p. 1.

83. Questions and Answers on the Revised GIPS Standards (effective Jan. 1, 2006), p. 1.

84. Firms that claim GIPS compliance are typically investment advisers, banks, insurance companies and other entities that render investment advice.

85. GIPS Introduction, I.D.10(i) ("In cases where applicable local or country-specific law or regulation conflicts with the GIPS standards, the Standards require firms to comply with the local law or regulation and make full disclosure of the conflict.").

86. GIPS Background of the GIPS standards.

87. Global Investment Performance Standards Handbook §1-4, p. 2 (1st ed. 2002).

88. 5 U.S.C.A. § 500 et seq.

89. Standard 0.A.15

90. See e.g., In re Stan D. Kiefer & Associates and Stanley D. Kiefer, SEC Release No. IA-2023 (Mar. 22, 2002); In re Schield Management Company et. al, SEC Release No. IA-1872 (May 31, 2000); In re Engebretson Capital Management, Inc. and Lester W. Engebretson, SEC Release No. IA-1825 (Sept. 13, 1999).

91. Section 206(4) of the Advisers Act.

92. See Guidance Statement on Performance Record Portability (Revised) (effective Jan. 1, 2006) (hereinafter, "Portability Guidance Statement"), p.1.

93. See id. at p. 2. Performance that is not portable may be presented as "supplemental information" attached to a fully compliant GIPS report, but such nonportable performance may not be linked to the ongoing performance record. Supplemental information is defined as "any performance-related information included as part of a compliant performance presentation that supplements or enhances the required and/or recommended disclosure and presentation provisions of the GIPS standards. Supplemental information should provide users of the composite presentation with the proper context in which to better understand the performance results." Guidance Statement on the Use of Supplemental Information, p. 1 (effective Jan. 1, 2006) (hereinafter, "Supplemental Information Guidance Statement"). A new firm may represent the historical record of the prior firm as supplemental information to a fully compliant performance presentation so long as (i) the performance is clearly identified as the past record of a prior firm, (ii) the performance is not linked to the performance of the new affiliation, (iii) the performance is supported with appropriate records, and (iv) the use of the past performance record is relevant. See Portability Guidance Statement, p. 1.

94. See Portability Guidance Statement, p. 1.

95. See Supplemental Information Guidance Statement, p. 2. The only exception to this prohibition is when the performance is specifically requested by a prospective or currently client in a one on one presentation. See id., ("This Guidance Statement does not prohibit firms from preparing and presenting information according to specific request from prospective clients.").

96. See Supplemental Information Guidance Statement, p. 2. The only exception to this prohibition is when the performance is specifically requested by a prospective or currently client in a

one on one presentation. See id., ("This Guidance Statement does not prohibit firms from preparing and presenting information according to specific request from prospective clients.").

97. AIMR-PPS Interpretation on Portability (Q: "With regard to portability, if 11 of the 13 investment professionals left their old firm to join a new firm (along with all of the support staff), can the new firm meet the criteria for linking performance history?").

98. See Standard 5.A.4; Portability Guidance Statement, p.2.

99. See also Portability Guidance Statement, Application No. 2 ("In addition to meeting all the elements of the Guidance Statement, in order for a firm to be able to link the composite from the old firm to the on-going performance of the new firm, the entire composite performance history, including all portfolios, must be used.").

100. Portability Guidance Statement, Application No. 2 ("In addition to meeting all the elements of the Guidance Statement, in order for a firm to be able to link the composite from the old firm to the on-going performance of the new firm, the entire composite performance history, including all portfolios, must be used.") at p. 1.

101. Portability Guidance Statement, Application No. 2 ("In addition to meeting all the elements of the Guidance Statement, in order for a firm to be able to link the composite from the old firm to the on-going performance of the new firm, the entire composite performance history, including all portfolios, must be used.").

102. Standard 5.A.4(a)(iii); Portability Guidance Statement, p. 2.

103. See Standard 1.A.1 ("All data and information necessary to support a firm's performance presentation and to perform the required calculations must be captured and maintained."). The IPC has proposed, but has not yet adopted, a Guidance Statement on Portfolio Recordkeeping Requirements. See IPC Proposed Guidance Statement on Portfolio Recordkeeping Requirements (hereinafter "Proposed Recordkeeping Guidance Statement").

104. AIMR Performance Presentation Standard Handbook, at p. 79 (2nd ed. 1997).

105. Global Investment Performance Standards Handbook § 4-1.A.1, p. 1 (1st ed. 2002).

106. Proposed Recordkeeping Guidance Statement, p. 1 ("Although most firms are looking for a very precise list of the minimum supporting evidence that must be maintained in order to be able to recreate the firm's performance history, there is not a single list of records that will suffice in all situations.").

107. See Global Investment Performance Standards Handbook § 4-5, p.5 (1st ed. 2002) ("If the records are not readily available, [a firm] can seek the permission of the team's previous firm to obtain copies or try to obtain them from third parties who may have retained the records such as clients, custodians or consultants.").

108. See Rule 206(4)-1 under the Advisers Act.

109. See GIPS Introduction, I.G.26 ("Where existing laws or regulations already impose performance presentation standards, firms are strongly encouraged to comply with the GIPS standards in addition to those local requirements.").

110. GIPS Introduction, I.G.26 ("Where existing laws or regulations already impose performance presentation standards, firms are strongly encouraged to comply with the GIPS standards in addition to those local requirements.").

111. The SEC has disciplined advisers for advertising another adviser's performance improperly, deeming such practice to be a violation of Section 206(4) and Rule 206(4)-1(a)(5). See e.g., Seaboard Investment Advisers, SEC Release No. IA-1431 (Aug. 3, 1994).

112. Anametrics Investment Management, SEC No-Action Letter (pub. avail. May 5, 1977).

113. Fiduciary Management Associates, Inc., SEC NO-Action Letter (pub. avail. Mar. 5, 1984). See also Great Lakes Advisors, SEC No-Action Letter (pub. avail. Apr. 3, 1992) (finding that it may be misleading for an adviser to advertise the performance results of accounts managed

at an employee's prior place of employment when the employee was one of several persons responsible for selecting the securities for those accounts).

114. Horizon Asset Management, LLC, SEC No-Action Letter (pub. avail. Sept. 13, 1996).

115. Horizon Asset Management, LLC, SEC No-Action Letter (pub. avail. Sept. 13, 1996); Conway Asset Management Incorporated, SEC No-Action Letter (pub. avail. Jan. 27, 1989) (allowing newly registered adviser solely owned by an employee to use performance data of several accounts managed by employee prior to registration); Fiduciary Management Association, Incorporated, SEC No-Action Letter (pub. avail. Mar. 5, 1984).

116. See, e.g., Clover Capital Management, Inc., SEC No-Action Letter (pub. avail. Oct. 28, 1986) (stating that Rule 206(4)-1(a)(5) prohibits an advertisement that (i) fails to disclose the effect of material market or economic conditions on the results portrayed; (ii) includes model or actual results that do not reflect the deduction of advisory fees, brokerage or other commissions, and any other expenses that a client paid or would have paid; (iii) fails to disclose whether and to what extent returns reflect the reinvestment of dividends and other earnings; (iv) suggests the potential for profit without disclosing the possibility of loss; (v) compares model or actual results to an index without disclosing all material facts relevant to the comparison; (vi) fails to disclose any material conditions, objectives or investment strategies used to obtain the results portrayed; (vii) fails to disclose prominently the limitations inherent in model results, if applicable; (viii) fails to disclose, if applicable, that the conditions, objectives, or investment strategies of the model portfolio changed materially during the time period portrayed and, if so, the effect of any such change on the results portrayed; (ix) fails to disclose, if applicable, that any of the securities contained in, or the investment strategies followed with respect to, the model portfolio do not relate, or only partially relate, to the type of advisory services currently offered by the adviser; (x) fails to disclose, if applicable, that the adviser's clients had investment results materially different from the results portrayed in the model; or (xi) fails to disclose prominently, if applicable, that the results portrayed relate only to a select group of the adviser's clients, the basis on which the selection was made, and the effect of this practice on the results portrayed if material).

117. See, e.g., Horizon Asset Management, LLC, SEC No-Action Letter (pub. avail. Sept. 13, 1996).

118. Horizon Asset Management, LLC, SEC No-Action Letter (pub. avail. Sept. 13, 1996); Taurus Advisory Group (pub. avail. July 15, 1993); Great Lakes Advisors, Inc., SEC No-Action Letter (pub. avail. Apr. 3, 1992). See also In re Seaboard Investment Advisers, Inc., SEC Release No. IA-1431 (Aug. 3, 1994).

119. Rule 204-2(a)(16) under the Advisers Act. Rule 204-2(e)(3)(i) generally requires such books and records to be maintained and preserved in an easily accessible place for a period of not less than five years, the first two years in an appropriate office of the adviser, from the end of the fiscal year during which the adviser last published or otherwise directly or indirectly disseminated the advertisement or communication. The Advisers Act performance recordkeeping requirements are applicable to the delivery of performance information to "ten or more persons" in the aggregate. Accordingly, if a specific performance calculation is requested by a potential client, or the client's consultant, that is unique to a particular situation and does not go to more than nine persons, then the performance recordkeeping requirements are not applicable. This exception is typically relied upon by investment advisers that prepare specific information in response to consultant's questionnaires.

120. Rule 204-2(a)(16).

121. Recordkeeping by Investment Advisers, SEC Release No. IA-1135, at fn. 3 (Aug. 17, 1988) (Adopting Release).

122. Salomon Brothers Asset Management Inc., SEC No-Action Letter (pub. avail. July 23, 1999). Rule 204-2(a)(16) may also be satisfied by retaining published materials listing the net asset values of an account together with worksheets demonstrating the performance calculations based on the net asset values, provided the net asset values were accumulated contemporaneously

with the management of the account. See Solomon Brothers Asset Management Inc., SEC No-Action Letter (pub. avail. July 23, 1999).

123. Jennison Associates LLC, SEC No-Action Letter (pub. avail. July 6, 2000).

124. Recordkeeping by Investment Advisers, SEC Release No. IA-1135, at fn. 3 (Aug. 17, 1988) (Adopting Release); Recordkeeping by Investment Advisers, SEC Release No. IA-1093 (Nov. 5, 1987) (Proposing Release).

125. Jennison Associates LLC, SEC No-Action Letter (pub. avail. July 6, 2000). When reviewing auditor reports, the SEC indicated that it will consider all the facts and circumstances relating to the quality of the audit, including whether: (i) the auditor is appropriately independent from the investment adviser; (ii) the auditor reports are based on the review of data that were accumulated contemporaneously with the management of the relevant accounts; (iii) the auditor reviews sufficient information to afford a reasonable basis for its conclusions (e.g., by reviewing custodian and brokerage statements and confirming data directly with custodians and brokers) and prepares the auditor reports in accordance with appropriate auditing standards); (iv) the adviser or the auditor maintains records underlying the auditor reports (i.e., audit work papers) and the SEC staff has access to such records; (v) the performance verified by the auditor is consistent with the performance derived from other records maintained by the investment adviser; and (vi) whether the auditor reports include a clear and specific description of the standard used by the investment adviser to calculate performance. Jennison Associates LLC, SEC No-Action Letter (pub. avail. July 6, 2000).

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