



SEC Division of Investment Management Staff Releases Updated FAQ Regarding Marketing Rule Compliance

On January 11, 2023, the staff of the SEC's Division of Investment Management (the "**Division Staff**") updated its list of frequently asked questions ("**FAQs**") related to amended Rule 206(4)-1 (the "**Marketing Rule**") under the Investment Advisers Act of 1940. The updated FAQ clarifies that performance of a single investment (i.e., a case study) is "extracted performance" subject to the net performance requirements under the Marketing Rule, which had been a point for which SEC-registered investment advisers ("**investment advisers**") have sought clarification. The relevant Q&A is included below and the full FAQ is available [here](#).

Extracted Performance – Updated FAQ

In the FAQ, the Division Staff confirmed that the performance of one investment (or a group of investments) is an example of "extracted performance" under the Marketing Rule. As a result, an investment adviser "may not show gross performance of one investment or a group of investments *without also showing the net performance of that single investment or group of investments, respectively.*" (emphasis added)

Takeaway

The updated guidance has significant implications for marketing materials prepared by investment advisers. Calculating accurate net performance for a single investment, or group of investments, will be difficult for many investment advisers, particularly for investment advisers who receive performance-based compensation and allocate expenses on a portfolio-wide basis.

Marketing Compliance Frequently Asked Questions

Gross and Net Performance

Q. When an adviser displays the gross performance of one investment (e.g., a case study) or a group of investments from a private fund, must the adviser show the net performance of the single investment and the group of investments?

A. Yes. The staff believes that displaying the performance of one investment or a group of investments in a private fund is an example of extracted performance under the new marketing rule.[1] Because the extracted performance provision was intended, in part, to address the risk that advisers would present misleadingly selective profitable performance with the benefit of hindsight, the staff believes the provision should be read to apply to a subset of investments (i.e., one or more). Accordingly, an adviser may not show gross performance of one investment or a group of investments without also

showing the net performance of that single investment or group of investments, respectively.[2] In addition, the adviser must satisfy the other tailored disclosure requirements as well as the general prohibitions, including the general prohibition against specific investment advice not presented in a fair and balanced manner, when showing extracted performance.[3]

[1] Extracted performance means “the performance results of a subset of investments extracted from a portfolio.” Rule 206(4)-1(e)(6). See section II.E.5 of the adopting release.

[2] The rule prohibits any presentation of gross performance in an advertisement unless the advertisement also presents net performance. See section II.E.1 of the adopting release. The gross and net performance requirement applies to not only an entire portfolio but also to any portion of a portfolio that is included in extracted performance. See sections II.E.1(a) and (b) and the definitions of gross and net performance in rule 206(4)-1(e)(7) and (10) (“Net performance means the performance results of a portfolio (or portions of a portfolio that are included in extracted performance..”). The adopting release also states that the rule requires that advisers that show extracted performance must show net and gross performance for the applicable subset of investments extracted from a portfolio. See section II.E.1.a. of the adopting release (discussing gross performance).

[3] The adopting release states that “advisers should evaluate the particular facts and circumstances that may be relevant to investors, including the assumptions, factors, and conditions that contributed to the performance, and include appropriate disclosures or other information such that the advertisement does not violate the general prohibitions... or other applicable law.” See section II.E.1 of the adopting release (discussing the net performance requirement). In addition, it would be considered “misleading under the final rule to present extracted performance in an advertisement without disclosing whether it reflects an allocation of the cash held by the entire portfolio and the effect of such cash allocation, or of the absence of such an allocation, on the results portrayed.” See section II.E.5 of the adopting release (discussing extracted performance).

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