



Investment Management Update

January 2023

New SEC Marketing Rule FAQ Addresses Gross and Net Returns in Certain Private Fund Performance Advertising

On January 11 the staff of the SEC's Division of Investment Management issued a [new FAQ](#) related to Rule 206(4)-1 (Marketing Rule) under the Investment Advisers Act of 1940, as amended. The FAQ explicitly affirms the application of the Marketing Rule's net returns requirement when an adviser shows the performance of one investment or a group of investments of a private fund.

Net Performance Requirement

The Marketing Rule, adopted in late 2020 with a mandatory compliance date of November 4, 2022, significantly overhauled the marketing and advertising framework for SEC-registered investment advisers. Among other things, it imposes a number of specific requirements and prohibitions with respect to the presentation of performance returns.

One such provision prohibits an adviser from presenting gross performance unless the advertisement also presents net performance

- with at least equal prominence to and in a format designed to facilitate comparison with the gross performance; and
- calculated over the same time period and using the same type of return and methodology as the gross performance.

Under the Marketing Rule, the net returns requirement applies to presentation of the performance results of an entire portfolio as well as returns of a subset of investments extracted from a portfolio (extracted performance).

Relevance to Private Fund Performance

Private fund advisers often include in their advertising materials investment-level returns and case studies that present performance returns for a single investment. Many also include performance attribution, breaking out returns for a subset of a portfolio by geography, industry or other criteria considered relevant to investors, generally in comparison to a benchmark. Historically, such returns have been typically calculated gross of fees and expenses.

Since the adoption of the Marketing Rule, industry participants have questioned whether single investment returns and performance attribution presented by private fund advisers are – or should be – considered extracted returns and, as such, must include net returns alongside gross returns. In particular, some have pointed to the challenges of applying fees and expenses at the investment (rather than portfolio) level, which can require application of a variety of complex assumptions.

Marketing Rule FAQ Affirms SEC Staff View

With the release of the FAQ, the SEC staff has put to rest any remaining question around the application of the Marketing Rule to these presentations of private fund performance. The FAQ states explicitly that “[t]he 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” and that “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.”

The SEC staff went on to remind private fund advisers that they have an obligation to provide tailored disclosures, including the assumptions, factors and conditions that contributed to the performance. In the case of performance of a single investment or subset of investments, this will require robust disclosures regarding how net returns were calculated.

FOR MORE INFORMATION

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