

SEC Publishes New Guidance on Advertising Gross and Net Performance

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Introduction

On Jan. 11, the Securities and Exchange Commission (SEC) issued a new FAQ response¹ discussing an investment adviser's obligations with respect to the use of gross and net performance information in the marketing of private funds under the Investment Advisers Act of 1940, as amended, related to amendments to Rule 206(4)-1 that became effective in November 2022 (the "Marketing Rule"). The FAQ response specifically addresses the question of whether displaying gross performance of one investment (e.g., a case study) or group of investments from a private fund requires the adviser to disclose the net performance of that single investment or group of investments in its marketing materials.

Gross and Net Performance

On the hot-button issue of the use of performance information, the Marketing Rule contains explicit instructions for investment advisers when they are incorporating performance information into their advertisements. Among other things, the Marketing Rule expressly provides that the presentation of gross investment performance requires also presenting net performance with (at least) equal prominence calculated for the same time period and using the same type of return and methodology as in the gross performance. According to the FAQ response, an adviser may not present gross performance of one investment or group of investments in marketing materials without also showing the net performance of that single investment or group of investments.

The SEC noted that displaying the performance of one investment or a group of investments in marketing materials constitutes extracted performance under the Marketing Rule. Extracted performance means "the performance results of a subset of investments extracted from a portfolio."²

While advisers may believe that the use of extracted performance like individual case studies in advertisements may benefit investors by providing helpful information about the performance of a particular investment or investments (typically, when an investment strategy is implemented successfully), the FAQ guidance crystallizes the SEC's concern that investors might be misled by an investment adviser's claims regarding the extracted performance without appropriate accompanying disclosures.

Practice Issues and Next Steps

While the guidance is silent on how to go about calculating net returns on an investment-by-investment basis, the practical effect of the new guidance is that advisers that have grown accustomed to presenting case studies and other types of extracted performance in their marketing materials will be compelled to create and incorporate thoughtful, transparent, and consistent fee and expense assumptions into these advertisements in order to make the information meaningful to investors and satisfy the expectations and demands of regulators. While we have seen various approaches to the calculation of net performance emerge in the market with respect to advertising extracted performance, with some approaches more prevalent than others, there is no one-size-fits-all approach. At this time, advisers should review their marketing materials that contain case studies and other extracted performance information and determine whether to update these materials in order to comply with the new guidance.

Please contact one of the listed authors of this Client Alert or your regular Lowenstein Sandler contact if you require assistance reviewing or revising your marketing materials or have any questions regarding the FAQ or the Marketing Rule.

¹ The response can be found [here](#).

² See Rule 206(4)-1(e)(6). See section II.E.5 of the adopting release.

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