

Updated SEC Marketing Rule FAQ Relaxes Requirements with Respect to Presenting Hypothetical Net Performance Figures

On March 19, 2025, the Securities and Exchange Commission (**SEC**) Division of Investment Management added to its Marketing Rule Frequently Asked Questions (**FAQ**). One of the added responses reverses a position that was previously taken by SEC staff and should result in a more reasonable approach to applying the full and fair disclosure principles that the rule was intended to establish. Following are the two questions that have been added or updated and implications for investment advisers and private fund managers.

A. Extracted Performance

The SEC updated its response to whether an adviser that presents gross performance of one investment or a group of investments from a private fund or portfolio (**extracted performance**) must also show net performance for such single investment or group of investments. In this new guidance, the SEC noted that they would not object if an adviser presents extracted performance on a gross basis without providing corresponding net performance, if the adviser abides by the following guidelines:

- The extracted performance must be clearly identified as gross performance;
- The extracted performance must be accompanied by the total fund or portfolio's gross and net performance consistent with the requirements of the Marketing Rule;
- The gross and net performance of the fund or portfolio must be provided with equal prominence to the extracted performance in a manner designed to facilitate comparison; and
- The gross and net performance of the fund or portfolio must be calculated over a period that includes the entire period over which the extracted performance is calculated, which may be a single, clearly disclosed period.

Our Thoughts

Prior to the compliance date for the Marketing Rule, many advisers and private fund managers presented fund returns on both a gross and net basis. However, most firms did not calculate or report portfolio company or project-level returns, or performance for specific sectors, industries, or subsets within a portfolio, on a net basis. This was due, in part, to the fact that performance of such portfolio companies or projects was not directly reduced by management fees and other fund expenses and therefore, there was not a clearcut or standard methodology for calculating net performance at the portfolio company or project level. Moreover, sophisticated investors typically did not request or expect such net performance by portfolio company, and, in fact, many investors found such information confusing and unnecessary. However, based on prior guidance provided by the SEC staff in its FAQ, public statements, and examination findings that all extracted performance must be presented on a net basis, many investment advisers and private fund managers have begun calculating and reporting a hypothetical net return at the portfolio company or project level and for any subset of a portfolio.

Going forward, this will no longer be required, assuming the adviser follows the criteria noted above. Advisers and private fund managers will be able to cautiously remove hypothetical net returns that have been added solely for the purpose of complying with the Marketing Rule, from performance

presentations, annual meeting materials, quarterly and periodic investment updates, and other materials that present returns for individual portfolio companies or projects, returns for sub-sets of a portfolio, or attribution analysis for portfolio returns.

B. Portfolio Investment Characteristics

The SEC further addressed whether the presentation of certain portfolio and investment characteristics (e.g., yield, coupon rate, contribution to return, volatility, sector or geographic returns, attribution analyses, the Sharpe ratio, the Sortino ratio, and other similar metrics) should be treated as “performance” under the Marketing Rule and would require that any such characteristics reported on a gross basis without deducting fees and expenses must also be reported on a net basis after the deduction of all fees and expenses. The new guidance acknowledged that it is unclear whether such investment characteristics are performance and that calculating such characteristics net of fees and expenses may be impossible or lead to misleading or confusing results.

Accordingly, the SEC confirmed that it would not object to the presentation of one or more gross characteristics of a portfolio or investment without providing a corresponding net characteristic, so long as the adviser follows the same stipulations as noted above for extracted performance.

Our Thoughts

In our experience, industry practices regarding the presentation of portfolio investment statistics and characteristics are more varied from firm-to-firm, and not all firms had embraced or adopted an approach to calculate and present hypothetical net statistics or characteristics. However, for investment advisers and private fund managers that have done so, this relaxation of the Marketing Rule’s interpretation will allow those firms to more readily utilize investment statistics and characteristics, when appropriate, and alleviate the need to calculate or present hypothetical net statistics that are not clearly calculated or understood by investors.

Recommended Next Steps

Investment advisers and private fund managers should review their marketing materials and performance presentations to determine whether they have utilized extracted performance or portfolio investment characteristics and may wish to adjust such materials in line with the new guidance. Firms choosing to revise performance presentations to remove hypothetical net performance calculations and investment characteristics should review such materials to ensure that they comply with the specific conditions established in the FAQ, that the information presented is accurate and not misleading, and that such materials avoid the general prohibitions set forth under the Marketing Rule. Moreover, firms should review their Marketing Policy & Procedures and make updates as needed to correspond to the new FAQ guidance. In addition, if in response to Item 5L. (3) of Form ADV an adviser answered Yes to whether any of the adviser’s advertisements included hypothetical performance solely because the adviser provided a net return for a Fund’s portfolio companies in its advertisements, the adviser should consider whether to amend its response to No if removing the net figure going forward.

Standish Compliance can work with clients to review and update marketing materials and applicable policies and procedures as needed.

See FAQ - <https://www.sec.gov/rules-regulations/staff-guidance/division-investment-management-frequently-asked-questions/marketing-compliance-frequently-asked-questions>