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# SEC Issues New Marketing Rule FAQ Regarding Performance Results of Case Studies

by David Tang and Michael Schmieder

The staff ("Staff") of the SEC's Division of Investment Management recently issued an FAQ (the "FAQ") to clarify that, under Rule 206(4)-1 (the "Marketing Rule") of the Investment Advisers Act of 1940, an SEC-registered investment adviser ("adviser") may not present the gross performance of one investment (e.g., a case study) or a group of investments from a private fund in an advertisement without also showing the net performance of that one investment or group of investments.[1]

The Marketing Rule prohibits any presentation of gross performance in an advertisement unless the advertisement also presents net performance. Net performance is defined in part as the performance results of a portfolio, or portions of a portfolio that are included in extracted performance. According to the Staff, displaying the performance of one investment or a group of investments in a private fund is an example of extracted performance. The Staff reasoned that, since the extracted performance provision of the Marketing Rule was intended to protect investors from advisers that present misleading selective profitable performance with the benefit of hindsight, extracted performance should be read to apply to a subset, or one or more, investments. Accordingly, an adviser showing the gross performance of one investment or a group of investments must also show the net performance of that one investment or group of investments.

The Staff added that an adviser must satisfy the other tailored disclosure requirements and general prohibitions of the Marketing Rule when showing extracted performance, such as the performance results of case studies, including the Marketing Rule's general prohibition against specific investment advice that is not presented in a fair and balanced manner.

**Dorsey Observations**

The FAQ answers a significant open question related to the Marketing Rule. Advisers should identify advertisements that present the gross performance results of one investment, such as a case study, or a group of investments. In light of the FAQ,

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advisers must calculate and present net performance results of those investments. Advisers would be well-advised to document and disclose the assumptions and methodology underlying the calculation of net performance results of a single investment or subset of investments. Dorsey's outsource compliance services are available to advise and assist advisers with compliance with the Marketing Rule.

[1] SEC Division of Investment Management Marketing Compliance Frequently Asked Questions, *available at* https://www.sec.gov/investment/marketing-faq.