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The SEC Issues Marketing Rule FAQ on Calculating Gross and Net Performance

by David Tang and Michael Schmieder

The staff ("Staff") of the SEC's Division of Investment Management recently issued a new FAQ (the "FAQ") on Rule 206(4)-1 (the "Marketing Rule") under the Investment Advisers Act of 1940 in which the Staff confirmed that the Marketing Rule requires that a presentation of gross performance must be accompanied by a presentation of net performance calculated over the same period and using the same type of return and methodology as the gross performance.[1] Further, net performance must be presented in a format designed to facilitate comparison with gross performance.

The FAQ specifically addresses the practice of presenting gross internal rate of return ("Gross IRR") that is calculated from the date an investment is made, without accounting for the use of fund-level subscription facilities, while presenting net internal rate of return ("Net IRR") calculated from the time the adviser issues the capital call to investors to repay the borrowing. The Staff believes this practice violates the Marketing Rule because Gross IRR and Net IRR are calculated across different time periods using different methodologies. Additionally, this practice does not present gross and net performance in a format designed to facilitate a comparison between the two.

The Staff added that advisers presenting Net IRR impacted by fund-level subscription facilities must also include either (i) Net IRR without the impact of the fund-level subscription facilities or (ii) appropriate disclosures describing the effect of such subscription facilities on Net IRR.

Dorsey Observations

Advisers that utilize subscription facilities and present Net IRR at the fund level should ensure that their marketing materials comply with the FAQ. Advisers would be well-advised to confirm that the time periods and methodology used to calculate Gross IRR and Net IRR are the same. Dorsey's compliance services are available to assist advisers with compliance with the Marketing Rule.

Related People

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[1] SEC Division of Investment Management Marketing Compliance Frequently Asked Questions