

## DCS ALERT: DIVISION OF INVESTMENT MANAGEMENT MARKETING RULE FAQ

JANUARY 11, 2023:



On January 11, 2023 the SEC Division of Investment Management issued an additional Marketing Rule FAQ. The newly issued FAQ addresses gross and net performance requirements applicable to private fund case studies, single investments and/or groups of investments, i.e. extracted performance. Specifically, the Question provides as follows:

**Q. When an adviser displays the gross performance of one investment (e.g., a case study) or a group of investments from a private fund, must the adviser show the net performance of the single investment and the group of investments?**

In responding “yes,” the Division of Investment Management provides that displaying the performance of one investment or a group of investments in a private fund is an example of extracted performance under the Marketing Rule. The extracted performance provisions of the Marketing Rule are intended to address the presentation by advisers of selective profitable performance with the benefit of hindsight, and these requirements are applicable to a subset of investments. Therefore, an adviser may not show gross performance of one or a group of investments without showing net performance.

The Division of Investment Management also reminds advisers of the application of the General Prohibitions of the Marketing Rule to any such marketing materials. Specifically, that extracted performance marketing materials must be presented in a fair and balanced manner.

### Summary of Marketing Rule Extracted Performance Requirements – Application of the General Prohibitions

As a reminder, the following requirements relating to extracted performance are provided in the Marketing Rule or otherwise described in the Adopting Release –

- An adviser is prohibited from presenting extracted performance in an advertisement unless the advertisement provides, or offers to provide promptly, the performance results of the total portfolio from which the performance was extracted.

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- The Adopting Release for the Marketing Rule provides the following examples regarding compliance with the General Prohibitions when presenting extracted performance –
  - o It would be misleading for an adviser to present extracted performance without disclosing that it represents a subset of a portfolio's investment.
  - o It would be misleading to include, or exclude, performance results, or present performance time periods, in a manner that is not fair and balanced and able to be substantiated.
  - o Extracted performance would likely be false or misleading if it excludes investments that fall within the represented selection criteria.
  - o The Marketing Rule does not require an adviser to provide detailed information regarding the selection criteria and assumptions underlying the extracted performance, unless the absence of such disclosures, based on the facts and circumstances, would result in performance information that is misleading or otherwise violates the General Prohibitions.
  - o Advisers should take into account the intended audience for the extracted performance in crafting disclosures.
  - o Depending upon the facts and circumstances, presenting extracted performance without accounting for the allocation of cash could imply that the allocation of cash had no effect on the extracted performance and would likely be misleading. It is viewed as misleading to present extracted performance in an advertisement without disclosing whether it reflects an allocation of cash held by the entire portfolio and the effect of the allocation, or the absence of the allocation, on the portrayed results.

Also as a reminder, the Marketing Rule defines extracted performance as “the performance results of a subset of investments extracted from a portfolio.” Therefore, performance that is extracted from multiple portfolios is not extracted performance as defined in the Marketing Rule because it is not a subset of investments extracted from a portfolio. Performance presented in this manner is generally deemed by the SEC to be hypothetical performance, and subject to all of the Marketing Rule requirements applicable to hypothetical performance marketing material.

Here is the link to the FAQs: <https://www.sec.gov/investment/marketing-faq>