Marketing Compliance Frequently Asked Questions

Updated February 6, 2024

The staff of the Division of Investment Management has prepared the following responses to questions related to the adoption of amendments to rule 206(4)-1 under the Investment Advisers Act of 1940 in December 2020. The staff expects to update this document from time to time to include responses to additional questions. These responses represent the views of the staff of the Division of Investment Management. They are not a rule, regulation, or statement of the Securities and Exchange Commission (the "Commission"). The Commission has neither approved nor disapproved these FAQs or the answers to these FAQs. The FAQs, like all staff guidance, have no legal force or effect: they do not alter or amend applicable law, and they create no new or additional obligations for any person.

The adopting release for the amendments to rule 206(4)-1 is available at https://www.sec.gov/rules/final/2020/ia-5653.pdf. If you have questions about the application of these rules, please contact the Division of Investment Management Chief Counsel's Office at 202-551-6825 or IMOCC@sec.gov.

Compliance Date (March 18, 2021)

Q: I understand that an adviser must comply with the amended adviser marketing rule with respect to its advertising and solicitation activities by the compliance date (November 4th, 2022), which is 18 months after the effective date of the rule. May an adviser choose to comply with some of the marketing rule requirements before the compliance date, but not comply with others?

A: No. An adviser may choose to comply with the amended marketing rule in its entirety any time starting on the effective date, May 4th, 2021. Until an adviser transitions to the amended marketing rule, the adviser would continue to comply with the previous advertising and cash solicitation rules and look to the staff's positions under those rules. The staff believes an adviser may not cease complying with the previous advertising rule and instead comply with the amended marketing rule but still rely on the previous cash solicitation rule. Advisers are reminded that they should review their compliance policies and procedures in light of regulatory developments, including the adoption of the amended marketing rule. In addition, the staff believes that when advisers transition to the amended marketing rule, they will need to implement any revisions to the written compliance policies and procedures necessary so that they are reasonably designed to prevent violations of the amended marketing rule. Advisers are also reminded that they are required to maintain a copy of all compliance policies and procedures in effect at any time within the previous five years, and that it should be clear when those policies and procedures were in effect.

Time Period Requirement (April 14, 2021)

Q: The marketing rule prohibits an adviser from displaying performance results in an advertisement, unless certain requirements are satisfied. For example, an advertisement, except for an advertisement that includes private fund performance information, must include performance results for prescribed time periods ending on a date that is no less recent than the most recent calendar year-end. My firm is not able to calculate its one-, five-, and ten-year performance data immediately following a calendar year-end, but anticipates having updated performance figures within one month of the calendar year-end. However, my firm has performance information that is current as of the third quarter of that calendar year ("interim performance information"). May my firm instead use the interim performance information in an advertisement?

A: The staff would not object if you are unable to calculate your one-, five-, and ten-year performance data in accordance with rule 206(4)-1(d)(2) immediately following a calendar year-end and you use performance information that is at least as current as the interim performance information in an advertisement until you can comply with the calendar year-end requirement. The staff believes that a reasonable period of time to calculate performance results based on the most recent calendar year-end generally would not exceed one month. The interim performance information remains subject to the other provisions of the marketing rule, including the general prohibitions.

Gross and Net Performance (January 11, 2023)

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?

A. Yes. The staff believes that displaying the performance of one investment or a group of investments in a private fund is an example of extracted performance under the new marketing rule.[1] Because the extracted performance provision was intended, in part, to address the risk that advisers would present misleadingly selective profitable performance with the benefit of hindsight, the staff believes the provision should be read to apply to a subset of investments (i.e., one or more). Accordingly, an adviser may not show gross performance of one investment or a group of investments without also showing the net performance of that single investment or group of investments, respectively.[2] In addition, the adviser must satisfy the other tailored disclosure requirements as well as the general prohibitions, including the general prohibition against specific investment advice not presented in a fair and balanced manner, when showing extracted performance.[3]

Calculating Gross and Net Performance (February 6, 2024)

Q: Must gross and net performance shown in an advertisement always be calculated using the same methodology and over the same time period?

A: Yes. Although the marketing rule does not prescribe any particular methodology or calculation for performance, the rule requires that any presentation of gross performance be accompanied by a presentation of net performance that has been calculated over the same time period and using the same type of return and methodology as the gross performance.[4] In addition, net performance must be presented in a format designed to facilitate comparison with gross performance.[5]

The staff understands that certain advisers to private funds may wish to present gross internal rate of return ("Gross IRR") that is calculated from the time an investment is made (without reflecting fund borrowing or "subscription facilities")[6] and then present net internal rate of return ("Net IRR") that is calculated from the time investor capital has been called to repay such borrowing.[7] In the staff's view, if an adviser chooses to exclude the impact of such subscription facilities from the fund's Gross IRR, it cannot then include them in the Net IRR that is presented to comply with section (d)(1) of the marketing rule. In other words, when an adviser advertises its private fund's performance in terms of Gross IRR and Net IRR, presenting Gross IRR that is calculated without the impact of fund-level subscription facilities compared only to Net IRR that is calculated with the impact of fund-level subscription facilities would violate the marketing rule. The staff believes that such a presentation would result in

IRR calculations being made across different time periods (e.g., Gross IRR calculations beginning when funds initially use their lines of credit to acquire investments, and Net IRR calculations beginning only once all capital commitments are called and the lines of credit are retired).

This practice would also result in the use of different methodologies being used for the Gross and Net IRRs (i.e., calculating performance without and with the impact of fund-level subscription facilities). Such a presentation would also violate the provision requiring presentations of performance in a format designed to facilitate comparison between net and gross performance.[8] Accordingly, in the staff's view, if an adviser were to include in an advertisement the Gross IRR of a private fund calculated from before capital commitments are called, then it would need also to show the Net IRR calculated from the same time before capital commitments are called (i.e., including the effect of fund-level subscription facilities in its calculation).

Further, in the staff's view, an adviser would violate the general prohibitions (e.g., Rule 206(4)-1(a)(1) and Rule 206(4)-1(a)(6)) if it showed only Net IRR that includes the impact of fund-level subscription facilities without including either (i) comparable performance (e.g., Net IRR without the impact of fund-level subscription facilities) or (ii) appropriate disclosures describing the impact of such subscription facilities on the net performance shown. The staff believes that presenting only Net IRR that includes the impact of fund-level subscription facilities could mislead investors by suggesting that the fund's advertised performance is similar to the performance that the investor has achieved from its investment in the fund alone.

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[1] Extracted performance means "the performance results of a subset of investments extracted from a *portfolio*." Rule 206(4)-1(e)(6). *See* section II.E.5 of the adopting release.

[2] The rule prohibits any presentation of gross performance in an advertisement unless the advertisement also presents net performance. *See* section II.E.1 of the adopting release. The gross and net performance requirement applies to not only an entire portfolio but also to any portion of a portfolio that is included in extracted performance. *See* sections II.E.1(a) and (b) and the definitions of gross and net performance in rule 206(4)-1(e)(7) and (10) ("*Net performance* means the performance results of a *portfolio* (or portions of a portfolio that are included in *extracted performance*…")). The adopting release also states that the rule requires that advisers that show extracted performance must show net and gross performance for the applicable subset of investments extracted from a portfolio. *See* section II.E.1.a. of the adopting release (discussing gross performance).

[3] The adopting release states that "advisers should evaluate the particular facts and circumstances that may be relevant to investors, including the assumptions, factors, and conditions that contributed to the performance, and include appropriate disclosures or other information such that the advertisement does not violate the general prohibitions…or other applicable law." *See* section II.E.1 of the adopting release (discussing the net performance requirement). In addition, it would be considered "misleading under the final rule to present extracted performance in an advertisement without disclosing whether it reflects an allocation of the cash held by the entire portfolio and the effect of such cash allocation, or of the absence of such an allocation, on the results portrayed." *See* section II.E.5 of the adopting release (discussing extracted performance).

[4] Rule 206(4)-1(d)(1) prohibits an investment adviser from, directly or indirectly, disseminating any advertisement that includes "any presentation of gross performance, unless the advertisement also presents net performance: (i) with at least equal prominence to, and in a format designed to facilitate comparison with, the gross performance; and (ii) calculated over the same time period, and using the same type of return and methodology, as the gross performance."

[5] *Id*.

[6] Fund-level subscription facilities include, for example, any subscription facilities, subscription line financing, capital call facilities, capital commitment facilities, bridge lines, or other indebtedness incurred by a private fund, or on its behalf, that is secured by the unfunded capital commitments of the private fund's investors.

[7] A private fund's internal rate of return can be described, for example, as the discount rate that causes the net present value of all cash flows throughout the life of the private fund to be equal to zero.

[8] *Id*.

Modified: Feb. 8, 2024