SEC MARKETING RULE FAQS YIELD NEW GUIDANCE

Date: 20 March 2025

US Asset Management and Investment Funds Alert

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On 19 March 2025, the Securities and Exchange Commission staff issued updated frequently asked questions (FAQs) relating to Rule 206(4)-1 under the Investment Advisers Act of 1940 (the Marketing Rule) (available here). Broadly, the updated FAQs permit the use of extracted performance (including for individual positions) and certain performance-related characteristics on a gross basis in advertisements without also showing corresponding net-of-fee information, subject to certain conditions.

This guidance comes as a welcome relief to investment advisers who have been struggling with how to present this type of information on a net-of-fee basis.

BACKGROUND

The Marketing Rule, adopted in 2021, included new standardized performance presentation requirements, including that gross "performance" must always be presented with equal prominence as net-of-fees performance for the same time period. This requirement has created uncertainty for investment advisers about the presentation of information related to or derived from performance information (e.g., yield, coupon rate, contribution to return, volatility, sector or geographic returns, attribution analyses, and other similar metrics) (Performance-Related Characteristics), as "performance" is not defined in the Marketing Rule. Specifically, investment advisers were often unsure whether a given Performance-Related Characteristic was or was not "performance" for the purposes of the Marketing Rule, and, in many circumstances, there was no clear appropriate methodology to calculate net-of-fees performance for many Performance-Related Characteristics.

In addition, under the prior version of the FAQs from 11 January 2023, the staff had taken the view that the performance of any subset of a portfolio, including a single security or position, would be considered "extracted performance" under the Marketing Rule and therefore subject to the requirement that gross performance information be accompanied by net-performance information. This requirement also created challenges for investment advisers, as it was not clear how fees and expenses should be applied to a single investment and resulted in divergent industry practices.

The new FAQs clarify the circumstances in which investment advisers may present Performance-Related Characteristics and extracted performance (e.g., the performance of individual investments) on a gross-of-fees basis without also showing the corresponding net-of-fees performance, subject to the following conditions, which are the same for both FAQs:

- The Performance-Related Characteristic or extracted performance is clearly identified as being calculated on a gross basis without the deduction of fees and expenses;

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- The Performance-Related Characteristic or extracted performance is accompanied by a presentation of the total portfolio's gross and net performance consistent with the requirements of the rule;
- The total portfolio's gross and net performance is presented with at least equal prominence to, and in a manner designed to facilitate comparison with, the gross Performance-Related Characteristic or extracted performance; and
- The gross and net performance of the total portfolio is calculated over a period that includes the entire period over which the Performance-Related Characteristic or extracted performance is calculated.

The FAQs also provide the following important clarifications:

- The staff noted that it was not taking a position on whether any particular Performance-Related Characteristic is “performance” under the Marketing Rule, and that nonperformance characteristics would not be subject to the Marketing Rule's conditions on performance. In other words, nonperformance characteristics do not need to be shown on a gross basis. At the same time, however, the staff made clear that total return, time-weighted return, return on investment, internal rate of return, multiple on invested capital, and total value to paid-in capital are considered “performance” under the Marketing Rule, regardless of how they are labeled.
- Gross and net performance of the total portfolio does not need to be shown on the same page as the Performance-Related Characteristics or extracted performance so long as the presentation facilitates a comparison of that information with the gross and net performance of the total portfolio (e.g., presented on a page prior to the Performance-Related Characteristics).
- Advisers may present Performance-Related Characteristics calculated from the gross performance of a representative account without showing the representative account's net performance if accompanied by the gross and net performance of the representative account's composite.
- Performance-Related Characteristics and extracted performance are not required to be calculated under the one-, five-, and 10-year (or since inception) periods, provided the information presented is calculated over a single, clearly disclosed period.

GOING FORWARD

Advisers seeking to avail themselves of this new flexibility should review the presentation of Performance-Related Characteristics and extracted performance in their advertisements and update their disclosure and policies and procedures to ensure that their advertisements align with the new conditions.

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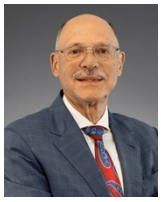
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