

Insights

SEC ENFORCEMENT SWEEP REGARDING HYPOTHETICAL PERFORMANCE

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On September 11, 2023 the U.S. Securities and Exchange Commission (the “**SEC**”) announced charges against nine registered investment advisers for advertising hypothetical performance to the general public on their websites without adopting and/or implementing policies and procedures as required by Rule 206(4)-1 (the “**Marketing Rule**”) under the Investment Advisers Act of 1940, as amended. Each of the firms settled the charges for penalties ranging between \$50,000 and \$175,000. See the SEC’s [press release](#) regarding the enforcement sweep. This enforcement sweep builds on the SEC staff’s earlier Risk Alerts cited in the press release that stressed the importance of compliance with the Marketing Rule.

Hypothetical performance under the Marketing Rule is defined as “performance results that were not actually achieved by any portfolio of the investment adviser” and includes, but is not limited to:

- Performance derived from model portfolios;
- Performance that is backtested by the application of a strategy to data from prior time periods when the strategy was not actually used during those time periods; and
- Targeted or projected performance returns with respect to any portfolio or to the investment advisory services with regard to securities offered in the advertisement.

What is particularly notable about the charges is the absence of allegations that the performance presented was incorrect or somehow fraudulent. Rather, the charges focused on the need for implementing policies and procedures before presenting such performance, maintaining books and records as required by the Marketing Rule and ensuring that any presentation of hypothetical performance is shown in a manner that is relevant to the likely financial situation and investment objectives of the intended audience of the advertisement. In other words, such performance should not appear on websites accessible to the general public.

In the SEC press release, the Director of the SEC’s Division of Enforcement indicated that the SEC is likely to continue to focus heavily on the issue of hypothetical performance and noted that it is crucial that investment advisers adopt and implement policies and procedures designed to comply

with the hypothetical performance rule given that the “attention-grabbing power” of such advertisements “may present an elevated risk for prospective investors whose likely financial situation and investment objectives don’t match the advertised investment strategy.”

Particularly in light of these settled enforcement actions, we recommend that investment advisers conduct an internal review either to develop or strengthen their policies and procedures regarding dissemination of hypothetical performance and also review any existing hypothetical performance advertised on their websites to confirm that restrictions are in place to limit such advertisements to the intended audience

RELATED PRACTICE AREAS

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