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Insights

SEC ENFORCEMENT SWEEP REGARDING HYPOTHETICAL PERFORMANCE - ROUND 2

Apr 18, 2024

On April 12, 2024, the U.S. Securities and Exchange Commission (the "**SEC**") announced settled charges against five registered investment advisers for violations of Rule 206(4)-1 (the "**Marketing Rule**") under the Investment Advisers Act of 1940, as amended (the "**Advisers Act**"). These charges reflect an ongoing enforcement sweep regarding performance presentation under the Marketing Rule and follow a similar sweep against nine registered investment advisers in September 2023. See our client alert on the prior sweep.

In four of the five most recent enforcement actions, the advisers were charged with advertising hypothetical performance to the general public on their websites without adopting and implementing policies and procedures reasonably designed to ensure that the hypothetical performance was relevant to the likely financial situation and investment objectives of each advertisement's intended audience. The SEC made no allegations against these four advisers that the hypothetical performance was misleading.

The clear message from these actions echoes the SEC's objections to presenting hypothetical performance to mass audiences, as stated in the adopting Release for the Marketing Rule:

> "We believe that advisers generally would not be able to include hypothetical performance in advertisements directed to a mass audience or intended for general circulation. In that case, because the advertisement would be available to mass audiences, an adviser generally could not form any expectations about their financial situation or investment objectives."[1]

Each of these four firms already had removed the hypothetical performance from its website before being contacted by the SEC staff, and their penalties ranged from $20,000 to $30,000.

In the fifth enforcement action, the adviser was charged with a litany of violations under the Advisers Act, which included allegations that the advertised performance was false and misleading:

> "[The adviser] violated various provisions of the … Marketing Rule, including by making false and misleading claims about its performance, failing to present net performance information alongside gross performance, being unable to substantiate performance claims upon demand

> by the [SEC], advertising hypothetical performance on its public website without adopting and implementing required policies and procedures, and failing to enter into written agreements with persons giving compensated endorsements. …[It] did not maintain copies of advertisements that appeared on its website, nor did [it] maintain books and records demonstrating the calculation of performance in its advertisements. [It] also failed to conduct an annual review of its compliance policies and procedures required under [SEC] rules and failed to implement certain of those policies and procedures."

This adviser apparently did not institute corrective action before being contacted by the SEC staff, but it did take a number of voluntary remedial steps, including removal of violative advertisements from its website and retention of a compliance consultant. The adviser was also charged with violations of the Investment Company Act of 1940, as amended. It was assessed a $100,000 penalty.

CONCLUSION

Given the SEC's scrutiny on compliance with the Marketing Rule, investment advisers should conduct an internal review to develop or strengthen their policies and procedures regarding dissemination of hypothetical performance. Moreover, they should ensure that any existing advertisements containing hypothetical performance are appropriately limited to an appropriate audience.

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[1] *See* Investment Adviser Marketing, Investment Advisers Act Release No. IA-5653 (Dec. 22, 2020) at 220.

RELATED CAPABILITIES

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