Blogs
September 14, 2023
Marketing Exam Sweep Bears Fruit

The U.S. Securities and Exchange Commission (SEC) announced on September 11, 2023, settlement agreements with nine registered investment advisers. All were charged with advertising hypothetical performance on their websites without adopting and implementing policies and procedures required by Rule 206(4)-1 (the Marketing Rule) under the Investment Advisers Act of 1940 (Advisers Act).

"Hypothetical performance" includes any model, back-tested, targeted, projected, or other performance information not actually achieved by and in managing a client.

Conditions on Hypothetical Performance Advertising

The Marketing Rule, which became effective in November 2022, revamped the Advisers Act advertising rules that had been in place for decades. It prohibits registered advisers from advertising hypothetical performance *unless* the adviser:

- Adopts and implements policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the likely financial situation and investment objectives of the intended audience.
- Provides sufficient information to enable the intended audience to understand the criteria used and assumptions made in calculating the hypothetical performance.
- Provides (or for private fund investors, provides or offers to provide promptly) sufficient information to enable the intended audience to understand the risks and limitations of using hypothetical performance in making investment decisions.

The Settlements

The SEC alleged that each of the nine firms advertised hypothetical performance to mass audiences on their websites without the requisite policies, procedures, and disclosures. Each firm agreed that if it planned to advertise hypothetical performance in the future, it would adopt and implement appropriate policies and procedures, and provide written certification of such, with supporting evidence, within 30 days of the settlement order.

The hypothetical performance at issue in the nine settlements was:

- Derived from model portfolios.
- Back-tested against data from periods prior to the strategy's launch.

All nine firms agreed, without admitting or denying any findings, to pay civil penalties ranging from $50,000 to $175,000, for $850,000 in combined penalties.

This cluster of settlements followed the first settlement from the SEC's ongoing Marketing Rule exam sweep, which was announced in late August. There, the SEC alleged that an adviser with "multiple complex strategies" misleadingly advertised through its mobile trading application annualized performance results "as high as 2,700 percent" without accompanying "material information, for example, that the hypothetical performance projections assumed that the strategy's performance in its first three weeks would continue for an entire year." Without admitting or denying any findings, among other things, the adviser agreed to pay $192,454 in disgorgement and prejudgment interest and an $850,000 civil penalty to be distributed to affected clients.

More To Come

These settlements are no surprise after the SEC staff's advance warning to advisers that it would begin enforcing the Marketing Rule immediately following the compliance date and the staff's additional guidance on its expectations from earlier this summer. There are certainly more enforcement actions to come, as the hypothetical performance requirements are only one aspect of the many-pronged Marketing Rule. Indeed, the SEC's director of enforcement, took the occasion of the September 11, 2023, press release to emphasize that "we will remain vigilant and continue our ongoing sweep to ensure that investment advisers comply with the Marketing Rule."

Please feel free to contact us for assistance with or questions about Marketing Rule compliance.

Explore more in

Investment Management