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Investment Funds & Private Capital

SEC Enforcement Continues Thematic Focus on Hypothetical Performance

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On April 12, 2024 the SEC announced additional settlements ([available here](#)) with five registered investment advisers (the “Advisers”) for alleged violations of the Investment Advisers Act’s new marketing rule (Rule 206(4)-1, the “Marketing Rule”). The SEC stated that these enforcement actions were a product of its ongoing and targeted Marketing Rule sweep. This follows the SEC’s first two enforcement actions under the Marketing Rule from August and September of 2023 (see our Client Alerts [available here](#) and [here](#)). Like the SEC’s previous enforcement activity under the Marketing Rule, these most recent settlements also focused on violations resulting from the advertisement of hypothetical performance to the general public on the Adviser’s respective websites, without having adopted 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.¹ In addition to censure and an agreement to cease and desist from continuing the practice, the Advisers paid penalties totaling \$200,000. The relatively modest fines may suggest a willingness by the SEC to pursue enforcement for comparatively minor infractions that do not implicate actual investor harms, rather than, as has sometimes been the case in prior years, allowing an investment adviser to address and remediate the issue in the SEC examination context.

Why it matters:

With more frequent Marketing Rule enforcement actions, the SEC is signaling its continuing focus on certain target issues. Sponsors should continue to pay attention to SEC enforcement activity in this area so they are able to evaluate evolving SEC target areas (e.g., from hypothetical performance advertising issues to another Marketing Rule-based issue). Additionally, given the recency of the Marketing Rule, sponsors should continue to carefully review new and legacy advertising materials for consistency with the Marketing Rule, including with respect to any developing issues on which the SEC signals it will focus (e.g., with respect to the SEC’s recent FAQ regarding the impact of the use of a subscription line on certain performance advertising metrics (see Client Alert on this topic, [available here](#))).

¹ As we have previously noted, although private fund sponsors may utilize hypothetical performance information in their marketing materials, it is not a common practice for a private fund sponsor to include any performance information (hypothetical, historical or otherwise) on its website.

Key Takeaways:

- The SEC's ongoing sweep for Marketing Rule compliance continues to produce enforcement actions relating to the use of hypothetical performance
 - Investment advisers that use hypothetical performance in their marketing materials should ensure that they have tailored their policies and procedures for consistency with the Marketing Rule's related requirements
- Two of the five investment advisers cited by the SEC had removed the hypothetical performance from their websites prior to SEC Staff involvement
 - Although the SEC observed that these investment advisers received reduced penalties as a result, the proactive remediation did not prevent these Advisers from facing enforcement
- In addition to non-compliance with respect to hypothetical performance, one Adviser was cited for various other areas of non-compliance with the Marketing Rule, including:
 - making false and misleading statements in advertisements, advertising misleading model performance, being unable to substantiate performance shown in advertisements, failing to enter into written agreements with compensated endorsers, among other recordkeeping and compliance failures
 - This Adviser faced the stiffest fine (although still relatively modest), totaling \$100,000, indicating that widespread Marketing Rule non-compliance will be treated more severely
- As we have explained in the past, there is a slate of pending SEC rules applicable to registered investment advisers—to the extent the recent Marketing Rule sweep with rolling enforcement pattern represents the SEC's preferred approach for policing compliance with new rules, advisers should be careful to devote the time and resources necessary for ensuring a timely compliance transition

Go Deeper:

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