Could Your Stellar Returns Trigger an SEC “Aberrational Performance Inquiry”?

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The SEC first mentioned its “Aberrational Performance Inquiry” initiative back in 2011. Under the initiative, the SEC uses proprietary risk analytics to evaluate hedge fund returns. Performance that appears inconsistent with a fund’s investment strategy or other benchmarks forms a basis for further scrutiny. Per our prior post, it has now produced seven SEC enforcement actions.
The initiative is a joint effort among the SEC’s Division of Enforcement, the Office of Compliance, Inspections and Examinations, and the Division of Risk, Strategy and Financial Innovation.
“We’re using risk analytics and unconventional methods to help achieve the holy grail of securities law enforcement – earlier detection and prevention,” said the Director of the SEC’s Division of Enforcement, Robert Kuzami in 2011. “This approach, especially in the absence of a tip or complaint, minimizes both the number of victims and the amount of loss while increasing the chance of recovering funds and charging the perpetrators,” he added.

Practices targeted by the Aberrational Performance Inquiry include “fraudulent valuation of portfolio holdings, misuse of fund assets, and misrepresentations to investors about critical attributes such as performance, assets, liquidity, investment strategy, valuation procedures, and conflicts of interest,” according to the SEC.

Additional comments by SEC officials have also indicated that the initiative is not limited to hedge funds. Robert Kaplan and Bruce Karpati, who head the SEC’s Asset Management Unit, have stated that they are also using analytics to study the data supplied by all advisers — “beyond performance and beyond hedge funds.”

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