



SEC Sweep into Marketing Rule Violations - Charges Against Nine Investment Advisers

What Happened?



The SEC set a 18-month deadline for advisers to become compliant with the new Amended Marketing Rule issued on December 22nd, 2020. The SEC conducted a sweep examination to determine compliance with the new rule, citing 9 Investment Advisers for advertising hypothetical performance to the general public on their websites in violation on the marketing rule. Gurbir S. Grewal, Director of the SEC’s Division of Enforcement, notes, *“Because of their attention-grabbing power, hypothetical performance advertisements may present an elevated risk for prospective investors whose likely financial situation and investment objectives don’t match the advertised investment strategy...”*

The SEC defines hypothetical performance as performance results that were not actually achieved by any portfolio of the investment adviser, such as those generated by applying the investment strategy to historic market data. By representing hypothetical data as actual data, investors may be misled as to the performance of the adviser.

What Did Convergence Know? Key Operational Risk Red-Flags



Convergence tracks business conditions in an Investment Adviser’s business that can signal the existence of “compliance stress.” A common stress signal is the Multi-Hatted Chief Compliance Officer (CCO), present in seven of the nine advisers cited or 78%! This 78% is over triple the percentage of high-risk advisers in the industry. So, for all you statisticians out there, it proves our point that “When you see smoke in the compliance room, there is likely some form of fire, and if left untended, the results can be unfortunate.”

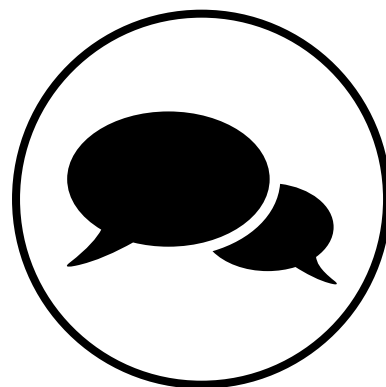
A Multi-Hatted CCO exists when the CCO also holds other key control roles. In these cases, the failure to comply with the marketing rule may have been caused, in part, by the CCO’s heavy workload, which is only exacerbated when they are multi-hatted. Convergence identifies and tracks business conditions that can create risks that lead to regulatory and civil cases and, worse, to investor losses. We designate, as ‘Watch’ factors, conditions that merit a higher level of investor attention, such as Multi-Hatted C-Suites. Regardless of the Adviser’s overall risk score, the ‘watch’ condition is noteworthy enough for you to pay it more attention. The Advisers cited in the SEC enforcement action had the following Convergence risk scores and ‘watch’ factors:

1. Banorte Asset Management Inc. - High-**Watch**
2. Trowbridge Capital Partners LLC - Medium-**Watch**
3. MRA Advisory Group - High-**Watch**
4. McElhenny Sheffield Capital Management - Medium-**Watch**
5. Macroclimate LLC - Medium
6. Linden Thomas Advisory Services LLC - High
7. Hansen and Associates Financial Group Inc - High-**Watch**
8. Elm Partners Management LLC - High-**Watch**
9. BTS Asset Management Inc. - High-**Watch**

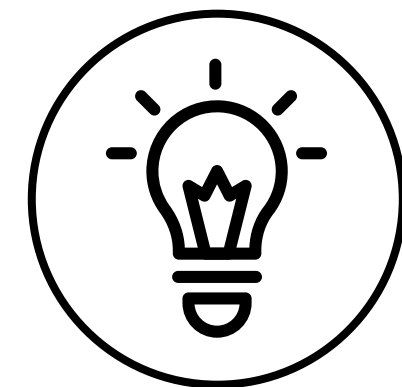
Tips for a Current or Potential Investee Adviser:



Look for signals of stress and complexity in your current or potential Adviser.



Ask them to describe the controls in place to ensure that a proper account review is conducted



Contact Garrett Davies to learn more about high-risk business conditions in SEC actions.