SEC Settles with Investment Adviser over 2015 False Performance Claims

Tuesday, January 12, 2016

On November 16, 2015, the SEC announced settled administrative proceedings against Virtus Investment Advisers, Inc. ("Virtus"), a registered investment adviser that operates as a “manager of managers,” for publishing advertisements that contained untrue statements of material fact and for failing to adopt and implement reasonably designed policies and procedures regarding the retention of books and records necessary to support the basis for performance obtained by other advisers or sub-advisers in advertisements directly or indirectly distributed by Virtus. According to the SEC’s order, the matter stemmed from Virtus’s engagement in 2009 of an unaffiliated registered investment adviser, F-Squared Investments, Inc. ("F-Squared"), to sub-advice certain Virtus-advised mutual funds based on F-Squared’s AlphaSector strategy, which employed a signaling algorithm to rebalance a portfolio of exchange-traded funds and was also used for certain separately managed accounts advised by Virtus. F-Squared’s own advertising of the AlphaSector strategy was described by the SEC as “materially inflated, and hypothetical and back-tested,” in a separate SEC enforcement order concerning F-Squared in December 2014, although F Squared advertised the investment strategy as “not backtested.”

According to the SEC, from May 2009 to September 2013, in certain client presentations, marketing materials, SEC filings and other communications, Virtus falsely stated that (1) the AlphaSector strategy had a history that dated back to April 2001 and had been in use since then, and (2) the strategy had significantly outperformed the S&P 500 Index from April 2001 to September 2008. However, the SEC alleged, no F-Squared or other client assets tracked the strategy from April 2001 to September 2008. In addition, the order states that the hypothetical and back-tested track record of AlphaSector from April 2001 to September 2008 was substantially inflated, a result of F-Squared incorrectly implementing signals in advance of when such signals actually could have occurred. (The SEC’s December 2014 order concerning F-Squared indicated that virtually all of AlphaSector’s claimed outperformance relative to the S&P 500 Index for the pre-October 2008 period was attributable to the data compilation error, which, the SEC alleged, was ignored by F-Squared and its principal.)

Virtus consented to the entry of the order finding that it violated Sections 204, 206(2) and 206(4) of the Advisers Act and Rules 204-2(a)(16), 206(4)-1(a)(5), 206(4)-7 and 206(4)-8 thereunder. The order also finds that Virtus caused certain mutual funds that it advised to violate Section 34(b) of the 1940 Act. Without admitting or denying the findings, Virtus agreed to pay $13.4 million in disgorgement, $1.1 million in prejudgment interest and a $2 million penalty.


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