



SEC Unveils the Aberrational Performance Inquiry for Hedge Funds

Dear Clients and Friends,

On December 1, 2011, the Securities and Exchange Commission (“SEC” or “Commission”) announced enforcement actions against three advisory firms and six individuals. These actions are part of a broad Commission initiative to combat fraud in hedge funds. The program, known as the Aberrational Performance Inquiry, aims to identify “abnormal” fund performance, that is, fund performance that is inconsistent with fund strategies and/or benchmarks.

The SEC now uses proprietary risk analytics to identify aberrational performance. Such performance might include consistently outperforming market indexes or consistently achieving positive performance with low volatility levels. Robert Khuzami, who directs the SEC’s Division of Enforcement, has indicated that the Commission will pay particular attention to returns consistently greater than three percent of their respective market index. With these targeted inquiries, the SEC intends to thwart various illegal practices such as “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.”

The Commission’s application of risk analytics and proprietary software represents a significant evolution in its enforcement practices. As a result, hedge fund managers, particularly those who have been successful over time, will be subject to increased scrutiny in terms of their supporting the legal achievement of investment results. Firms that can explain their strategies concisely, that have transparent operational and pricing policies, and that partner with known and reputable service providers will have an easier time defending their performance. As an additional measure to satisfy increased investor and regulator transparency requirements, many firms are turning to third-party attestations of performance results.

To aid hedge fund managers in supporting their performance track records, ACA Beacon has developed a third-party performance certification service. Please click on this [link](#) for more information on this service. For answers to any other questions on this issue, contact Christie Dillard at (866) 279-0750.

Best regards,

ACA Compliance Group

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