

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4999 / August 31, 2018

ADMINISTRATIVE PROCEEDING
File No. 3-18704

In the Matter of

**MASSACHUSETTS FINANCIAL
SERVICES COMPANY,**

Respondent.

**ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT
TO SECTIONS 203(e) AND 203(k) OF
THE INVESTMENT ADVISERS ACT OF
1940, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS
AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Massachusetts Financial Services Company (“Respondent” or “MFS”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. This matter arises from material misstatements and omissions by registered investment adviser MFS to certain of its advisory clients and others concerning hypothetical stock returns associated with MFS's blended research stock ratings. In 2001, MFS introduced its blended research strategies to investors. The blended research strategies combine research ratings from MFS's fundamental analysts and quantitative models to manage portfolios of stocks for client investment.

2. From approximately 2006 to 2015, MFS advertised that the basis of its blended research philosophy was that fundamental and quantitative management styles excel in differing market conditions, and that blending fundamental and quantitative stock ratings could over time yield better returns than either type of ratings alone. To illustrate the validity of its claim that blending two sources of ratings was better than one source alone, MFS advertised the results of a hypothetical portfolio of stocks rated "buy" by both MFS's fundamental analysts and quantitative models. In its advertisements, MFS showed how this hypothetical portfolio had annualized returns from 1995 forward that exceeded the annualized returns of either a hypothetical portfolio of fundamental "buy" rated stocks or a hypothetical portfolio of quantitative "buy" rated stocks.

3. MFS's advertisements that demonstrated the superior returns of the hypothetical portfolio of stocks rated "buy" by both MFS's fundamental analysts and quantitative models were misleading because the materials failed to disclose that some of the quantitative ratings used to create the hypothetical portfolio were determined using a retroactive, back-tested, application of MFS's quantitative model. Specifically, for the period 1995-2000, MFS used back-tested quantitative ratings. For the period 2000-2003, MFS used some live quantitative ratings and some back-tested ratings. In some advertisements, MFS also falsely claimed that the hypothetical portfolio was based on MFS's own quantitative stock ratings dating back to the mid-1990s, even though before 2000 MFS did not have a quantitative research department or generate its own quantitative stock ratings. MFS started the performance period in 1995 instead of 2000 or 2003 because its stored fundamental ratings dated back to 1995 and the longer period reflected multiple market environments; but inclusion of the market environments in the back-tested period also contributed to the superior performance of the blended "buy" ratings portfolio. MFS advertised these hypothetical returns to institutional clients and prospective institutional clients, financial intermediaries (including broker-dealers, insurance companies, and investment advisers) and consultants. As a result, MFS violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder by publishing, circulating, and distributing advertisements that contained misleading statements of material fact.

¹ The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

4. MFS's misleading advertisements were due in part to a failure to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder, as required by Section 206(4) of the Advisers Act and Rule 206(4)-7. Specifically, MFS failed to adopt and implement policies and procedures reasonably designed to prevent inaccurate advertisements that it directly or indirectly published, circulated, or distributed.

Respondent

5. **Massachusetts Financial Services Company** (SEC File No. 801-17352) is an investment adviser that has been registered with the Commission since 1982. As of December 31, 2017, MFS had approximately \$378 billion in regulatory assets under management, including approximately \$362 billion in mutual funds and other pooled investment vehicles, and approximately \$16 billion in separately managed accounts for institutional clients.²

Facts

MFS's Blended Research Marketing Materials – Two Research Sources Are Better Than One

6. MFS, which was founded in 1924, is historically a fundamental-based active investment manager. In 2000, MFS established a quantitative-based research department, and that department began to develop what MFS now refers to as "blended research" strategies.

7. MFS's blended research process involves making investment decisions using both MFS fundamental and MFS quantitative research ratings. MFS constructs blended research portfolios by combining fundamental and quantitative ratings to arrive at a blended stock score, and by using a portfolio optimization process that considers the blended scores along with risk and other portfolio constraints. For example, if a blended research portfolio was primarily invested in large capitalization domestic stocks, subject to other portfolio constraints, MFS would generally overweight relative to the portfolio's benchmark such stocks rated "buy" by both MFS's fundamental analysts and quantitative models, and, conversely, MFS would generally underweight relative to the portfolio's benchmark such stocks rated "sell" by both MFS's fundamental analysts and quantitative models.

8. MFS has developed several different blended research strategies, including U.S. equities and global equities strategies, and MFS uses these strategies to manage several MFS mutual funds and separately managed accounts. As of May 31, 2018, MFS had a total of approximately \$21 billion in assets under management invested in its blended research strategies.

² Regulatory assets under management include the securities portfolios for which MFS provides continuous and regular supervisory or management services.

9. In 2003, MFS developed an internal analysis referred to internally as the “research proof” that calculated annualized returns since February 1995 (the earliest month for which MFS had stored fundamental ratings) for six hypothetical baskets of stocks, including: (i) all stocks rated “buy” by MFS’s fundamental research; (ii) all stocks rated “buy” by MFS’s quantitative research; (iii) all stocks rated “buy” by both MFS’s fundamental and quantitative research (referred to as the “fundamental-quant intersection”); (iv) all stocks rated “sell” by MFS’s fundamental research; (v) all stocks rated “sell” by MFS’s quantitative research; and (vi) all stocks rated “sell” at the fundamental-quant intersection. These hypothetical baskets of stocks consisted of all MFS rated stocks in each category, equally weighted, and rebalanced monthly (assuming no transactions costs), without other portfolio constraints associated with an investable portfolio. MFS updated the research proof analysis every quarter.

10. Beginning in 2006 and concluding at the end of 2015, MFS used its research proof analysis to create data (and later in that period a bar chart) that was included in certain MFS advertisements. The chart compared the annualized returns, from February 1995 through the date of the most recent quarter-end prior to publication, for each of the research proof’s hypothetical baskets. The chart consistently showed that the hypothetical portfolios of “buy” stocks at the fundamental-quant intersection performed better than either the hypothetical portfolio of stocks rated “buy” by MFS’s quantitative model or the hypothetical portfolio of stocks rated “buy” by MFS’s fundamental research. The chart also depicted that the hypothetical portfolio of “sell” stocks at the fundamental-quant intersection performed worse than either the hypothetical portfolio of stocks rated “sell” by MFS’s quantitative model or the hypothetical portfolio of stocks rated “sell” by MFS’s fundamental research. Using the chart, MFS advertised a “[c]lear alpha benefit from combining MFS fundamental and quantitative research.” MFS used the chart to support its philosophy that, over time, blended stock ratings provided better return potential than fundamental or quantitative ratings alone. In various advertisements, MFS alternatively labeled the chart the “basis of philosophy,” one of the “underpinnings of blended research,” or the “basis of blended research.”

11. MFS included the bar chart in three types of written marketing materials directed to institutional investors and financial intermediaries that were considering MFS blended research products for their own customers or clients:

- a. Beginning around 2006 and concluding at the end of 2015, MFS marketed the chart in a standard slide deck provided to the following: (1) institutional clients and prospective institutional clients such as public pension plans (and consultants hired by such institutions) that were considering a separate account investment in an MFS blended research strategy; (2) financial intermediaries such as broker-dealers that were conducting due diligence on whether to recommend MFS’s blended research mutual funds to their registered representatives on behalf of their retail customers; and (3) institutions that offered an MFS blended research fund as a series in their own investment trust or retained MFS to sub-advise a portion of the institution’s mutual fund using a blended research strategy.
- b. Beginning in 2012, MFS routinely included the research proof chart in response to formal requests for proposal (“RFPs”) from the same type of market participants.

- c. In late 2013, MFS published a white paper regarding its blended research philosophy that contained the research proof chart. That white paper was provided to institutional investors and investment professionals such as financial advisors.

12. MFS restricted use of advertisements containing the research proof chart to institutional clients and prospective institutional clients, financial intermediaries such as broker-dealers and investment advisers, and investment consultants. MFS generally provided such advertisements along with accurate descriptions of actual blended research products and actual standardized returns from such products compared to a benchmark.

MFS's Advertisements Failed To Disclose That The Research Proof Chart Included Quantitative Ratings Determined By Back-Testing MFS's Quantitative Models

13. Back-testing involves the retroactive application of an investment strategy or methodology to a historical set of data. Back-tested performance attempts to illustrate how a portfolio would have performed during a certain historical period if the portfolio had been in existence during that time. Back-tested performance carries the risk that the performance depicted is not due to successful predictive modeling.

14. The research proof chart that MFS included in advertisements used fundamental ratings generated by MFS in real time; some quantitative ratings determined in real time; and some quantitative ratings determined by back-testing. Specifically, the quantitative ratings for the period 1995-2000 for all stocks and for the period 2000-2003 for some stocks were the result of the retroactive application of MFS's quantitative model. After 2003, MFS updated the research proof chart each quarter using quantitative ratings derived in real time from its current quantitative models and current market data. Although the research proof chart was consistently labeled "hypothetical," none of MFS's advertisements disclosed that the research proof chart was based in part on back-tested quantitative ratings.

MFS's Advertisements Failed To Disclose That The Back-Tested Period Contributed To the Superior Performance Of The Hypothetical Blended Portfolio

15. From 2003, when MFS first developed the research proof analysis, it calculated the annualized returns of each hypothetical portfolio of stocks since February 1995, the first month for which MFS had stored fundamental research ratings. When in 2006 MFS included results from the research proof in advertisements, it presented the annualized returns since February 1995, including a period (1995-2003) when some or all of the quantitative rating were back-tested.

16. MFS included the back-tested period (1995-2000 for all quantitative ratings and 2000-2003 for some quantitative ratings) because it had stored fundamental ratings since 1995 and the longer period reflected multiple market environments, including two periods that MFS asserted favored quantitative investment styles and one period that MFS asserted favored fundamental investment styles.

17. Using the back-tested period in the research proof made the annualized cumulative returns from the hypothetical fundamental-quant intersection significantly better relative to the comparable returns from the quant model alone. If MFS had instead relied only on actual and not back-tested quantitative ratings, by showing hypothetical annualized returns back to only 2000 or 2003, then the hypothetical blended portfolio of buy-rated stocks would have outperformed the hypothetical quantitative-only portfolio to a much smaller extent. With respect to buy-rated stocks, the period 1995-1999 was the period with the best results from the hypothetical fundamental-quant intersection basket, relative to the hypothetical quantitative-only basket.

MFS Falsely Claimed That Its Quantitative Research Dated Back to the Mid-1990s

18. In RFP responses and its white paper, MFS represented falsely that the research proof chart was based on MFS quantitative ratings dating back to the mid-1990s. Specifically, the RFP responses stated:

Using fundamental and quantitative rating data at MFS since the mid-1990s, we evaluated whether or not stocks that were buy-rated by fundamental research, buy-rated by quantitative research, and buy-rated by both sources of research added value relative to the market benchmark... Additionally, we wanted to see if the same three categories of sell-rated stocks lagged that same broad market benchmark... The unconstrained simulation illustrated . . . shows the powerful results generated by combining MFS' two sources of research. (emphasis added)

19. Similarly, in the white paper, under a heading that stated, "Two is better than one," MFS stated:

*In order to assess the blended approach, we used *fundamental and quantitative rating data gathered by MFS since the mid-1990s* and evaluated stocks that were buy- or sell-rated by fundamental research, buy- or sell-rated by quantitative research and buy- or sell-rated by both sources of research... The data show that the combination of the two independent and complimentary sources of alpha provides greater return potential than when the fundamental and quantitative signals do not overlap or intersect. The same phenomenon also holds true on the short side... (emphasis added)*

20. In a narrative following the research proof chart, MFS further stated in RFP responses that both its fundamental and quantitative sources of research had outperformed the market on an equal-weighted basis over the period beginning February 1995.

21. These statements about MFS's quantitative data and research were materially false and misleading because MFS did not generate its own quantitative models or research before 2000.

22. In late 2015, MFS compliance decided to remove the research proof chart from advertisements.

MFS Failed to Adopt and Implement Adequate Policies and Procedures

23. MFS lacked policies and procedures reasonably designed to prevent inaccurate statements about the research proof chart. Personnel in the group responsible for managing blended research strategies generally knew that the research proof analysis calculated returns dating back to February 1995, when MFS had started comprehensively to store its fundamental ratings. The personnel in this group also understood that some of the quantitative ratings were back-tested. This information was not clearly and consistently communicated to MFS personnel responsible for preparing and reviewing advertisements containing the chart. In at least one instance, the architect of the research proof analysis flagged as “not true” the RFP statement that MFS quantitative ratings dated to the mid-1990s. Although the statement was subsequently revised in part, it remained misleading. Nor was the portfolio manager who flagged the untrue statement asked to review the revised statement for accuracy.

24. MFS compliance personnel were unaware that some of the quantitative ratings were back-tested, and thus lacked pertinent facts when determining whether MFS’s advertisements complied with the federal securities laws.

25. MFS used different groups of compliance personnel to review the blended research advertisements prepared for different audiences, which contributed to advertisements describing the history of MFS’s ratings in different ways. As a result, compliance personnel reviewing one type of marketing document did not know that another type of advertisement described the history of MFS’s quantitative ratings in a different way.

26. Based on the foregoing, MFS failed to adopt and implement policies and procedures reasonably designed to prevent false and misleading advertisements.

Violations

27. As a result of the conduct described above, Respondent willfully³ violated Section 206(2) of the Advisers Act, which prohibits any investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. A violation of Section 206(2) may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.*

28. As a result of the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder, which makes it a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of Section 206(4) of the Advisers Act to, among other things, directly or indirectly publish, circulate or distribute an advertisement which contains any untrue statement of material fact, or which is

³ A willful violation of the securities laws means merely “that the person charged with the duty knows what he is doing.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor “also be aware that he is violating one of the Rules or Acts.” *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

otherwise false or misleading. The marketing decks and white papers, as well as the RFP responses that routinely included the research proof chart, were written communications addressed to more than one person which offered investment advisory service with regard to securities, and were therefore advertisements as defined by Advisers Act Rule 206(4)-1(b). A violation of Section 206(4) and the rules thereunder does not require scienter, and may rest on a finding of simple negligence. *Steadman*, 967 F.2d at 647.

29. As a result of the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require investment advisers registered or required to be registered with the Commission to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules.

Retention of Compliance Consultant

30. In determining to accept Respondent's Offer, the Commission considered MFS's voluntary retention of a compliance consultant to, among other things, conduct a comprehensive review of MFS's written compliance policies and procedures with respect to the publication, circulation, or distribution of MFS's advertisements concerning its investment models, research ratings, or strategies.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. MFS shall cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1(a)(5) and 206(4)-7 thereunder.

B. MFS is censured.

C. MFS shall, within 10 days of the entry of this Order, pay a civil penalty in the amount of \$1,900,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying MFS as the Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert Baker, Assistant Director, Asset Management Unit, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, 24th Floor, Boston, MA 02110.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary