

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 6433 / September 25, 2023

ADMINISTRATIVE PROCEEDING
File No. 3-21711

In the Matter of

**WELLESLEY ASSET
MANAGEMENT, INC.**

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 Wellesley Asset Management, Inc. (“WAM” or “Respondent”).

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 it 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:

Summary

1. This matter arises from material misstatements and omissions in marketing materials by registered investment adviser WAM, directly and indirectly, to certain of its advisory clients and prospective clients concerning an index² (the "WAM Index") that WAM created in January 2013 to depict the performance of its convertible bond investment strategy from January 2000 forward. A convertible bond is a type of fixed income investment that can be converted into shares of stock of the issuer of the bond. WAM used WAM Index performance graphs in advertisements from February 2015 to March 2022, a period when WAM's investment strategy focused exclusively on convertible bonds. WAM's written advertisements, however, failed to fully and fairly disclose the methodologies it used to construct the index. Among other things, WAM at times failed to adequately disclose that the WAM Index included hypothetical performance. WAM also presented the WAM Index's performance during at least three client webinars and misstated that the WAM Index represented composite returns from its convertible bond strategy. WAM voluntarily discontinued advertising the WAM Index in March 2022.

2. WAM violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-1 thereunder by publishing, circulating, and distributing advertisements that contained misleading statements of material fact. In addition, WAM failed to design and implement written compliance policies and procedures regarding advertising-related disclosures in violation of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

Respondent

3. Respondent Wellesley Asset Management, Inc. ("WAM") is a Massachusetts corporation with its principal place of business in Wellesley, Massachusetts. WAM was founded in 1991 and registered with the Commission as an investment adviser in June 2002. As of March 2023, WAM reported approximately \$2.4 billion of regulatory assets under management and invests on behalf of approximately 1,800 clients. Most of WAM's clients are individuals who invest in its convertible bond strategy; WAM also advises three registered mutual funds, two private funds, pensions, charities, insurance companies, and corporations.

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

² An "index" is a hypothetical portfolio of securities, cash, or other investments. One well-known index is the Standard & Poor's 500 Index, which is an index of 500 stocks chosen for market size, liquidity, and industry sector and is designed to be a leading indicator of U.S. equities. Some indexes represent a particular economic sector and enable investors to evaluate the performance of an overall sector. Other indexes are customized indexes designed to reflect the performance of a particular investment strategy. The WAM Index was an example of a customized index designed to depict the performance of WAM's convertible bond strategy.

Facts

The WAM Index Depicted 13 Years of Historical Performance Based on Two Different Constituent Selection Methodologies

4. In 2013, WAM created the WAM Index as a tool to explain its convertible bond strategy. WAM engaged Thomson Reuters to calculate the index using convertible bonds that WAM selected. From 2013 to May 2020 the index was known as the Thomson Reuters Wellesley Absolute Convertible Bond Index (“TRW Index”). In May 2020, the WAM Index was rebranded from TRW to the Refinitiv Wellesley Convertibles Index (“RWC0”) after Thomson Reuters was rebranded as Refinitiv. Although WAM created the WAM Index in 2013, the WAM Index depicted performance from January 2000 forward.

5. WAM Index performance for the period 2000-2012 was calculated using two different methodologies to select constituent securities for the index:

- a. Index performance for the period January 2000 to February 2002 was based on actual contemporaneous trades of convertible bonds in WAM client accounts (separately managed accounts, or “SMAs”). WAM used all SMA accounts’ convertible bond holdings and weighted the holdings as if all of the securities were held in one account. The WAM Index excluded cash and any other SMA holding that was not a convertible bond.
- b. Index performance for the period from February 2002 to December 2012 was calculated based on contemporaneous trades in a hypothetical portfolio that WAM began managing in February 2002. The hypothetical portfolio, called the Limited Risk Investing (“LRI”) portfolio, was a simulated portfolio, *i.e.*, it did not actually make investments, although the securities were selected according to WAM’s convertible bond strategy. The LRI portfolio historically held some investments other than convertible bonds, but those holdings were excluded for purposes of constructing the index. The LRI portfolio (and therefore the WAM Index for the February 2002 to December 2012 time period) generally held the same convertible bonds held by some WAM clients, but trade dates were not always consistent between clients’ actual trades and LRI hypothetical trades. In addition, WAM’s clients sometimes held different percentages of a particular convertible bond than the percentage of the bond held in the LRI portfolio (and therefore the percentage reflected in weighting for the WAM index).

6. WAM used a third methodology to select constituent securities from 2013 forward. Starting in 2013, which is when WAM created the WAM Index, the index’s holdings generally tracked the convertible bonds held by a registered mutual fund advised by WAM.

WAM's Index Advertisements

7. Following the WAM Index's creation in 2013, WAM marketed the index's performance to its prospective and existing clients. WAM Index advertisements contained disclosures that changed over time when periodically reviewed and revised by WAM's internal and external legal and compliance professionals, but those revisions did not adequately disclose the methodologies used to create the index.

8. In February 2015, WAM prepared disclosures for WAM advertisements describing the two methodologies for the periods before the WAM Index's 2013 creation: "Index performance for the period from February 2002 to the creation date is calculated based upon a model portfolio maintained by [WAM]. Index performance from inception [January 2000] to February 2002 is backtested performance based upon historical trading for certain accounts. [The WAM Index] is intended to represent a strategy with the goals of absolute returns and outperforming both equities and fixed income over complete market cycles deploying convertible bonds." These disclosures omitted that WAM Index performance for January 2000 to February 2002 was based only on convertible bond holdings in SMA client accounts and excluded cash and securities held by those accounts that were not convertible bonds. In addition, the disclosure concerning index construction from February 2002 through December 2012 stated that it was based upon a model portfolio, when WAM did not maintain a model to make investment decisions on behalf of clients. Instead, WAM Index performance during this period was based on convertible bond securities held in the hypothetical LRI portfolio.

9. WAM, in consultation with internal and external compliance and legal professionals, revised WAM Index disclosures between 2018 and 2022.

- a. In approximately May 2018, WAM revised the description of the WAM Index performance for the period January 2000 to February 2002 to read: "Index performance from inception date of January 1, 2000 to February 2002 is hypothetical performance based upon historical trading of convertible bonds in all WAM client accounts. Performance of securities other than convertible bonds in client accounts in this period are excluded from the index performance calculation." The disclosure continued to contain the same description of performance for the period after February 2002.
- b. In May 2020, when the WAM Index was rebranded, WAM revised the index disclosures to state: "[WAM Index] performance from its inception date of January 1, 2000 to February 2002 is representative performance based upon actual trading of convertible bonds in WAM client accounts." The revised disclosures omitted any description of how index performance was calculated for the period after February 2002.
- c. In January 2022, WAM revised the WAM Index disclosures to state: "The [WAM Index], which is a hypothetical index, was created to show a convertible bond strategy of buying convertible bonds at or near par value [WAM

Index] performance does not represent performance in any client account, nor is it representative of any actual trading in any client account [WAM Index] performance from its inception date of January 2000 to 2002 is based on a retroactive selection of convertible bonds from client accounts. Index performance for the period from February 2002 to the creation date is calculated based upon a model portfolio maintained by WAM. Thomson Reuters (now Refinitiv) became the calculation agent for the index in 2013[.] [WAM] has discretion of [sic] the selection of index constituents and [the index] does not represent a selection of bonds in any one client account nor is [it] representative of performance received in any client account. [WAM Index’s] holdings may differ from the holdings of WAM products.”

10. The above disclosures from February 2015 to January 2022 were inadequate because they (i) failed to state that WAM did not use a model to make investment decisions on behalf of clients and (ii) omitted that hypothetical LRI portfolio investments other than convertible bonds were excluded for the period February 2002 to December 2012.

11. In March 2022, WAM discontinued use of its index advertisements.

12. On at least three occasions during the period December 2017 to December 2020, WAM used graphs depicting the WAM Index during webinars with groups of existing clients in its convertible bond strategy. The advertisements used in the webinars disclosed that performance was hypothetical, that “direct investment in an index is not possible,” that “[i]ndex performance does not reflect the cost of trading, management fees and expenses,” and that WAM Index “holdings may differ from holdings of WAM products.” However, WAM misstated in these webinars that the WAM Index represented composite returns and on at least one occasion described it as “a composite of all of our clients’ separately managed accounts.” The WAM Index was not a composite of actual client returns, nor were SMAs the basis of the index other than for the initial period of January 2000 to February 2002. Distinct from the WAM Index, WAM did maintain composites of actual client account performance prepared on a net basis, reflecting the deduction of fees and trading expenses. When presenting performance to groups of clients, WAM’s compliance policies and procedures required it to present performance on a net basis.

WAM’s Advertisements Made Misleading Representations About The Performance of Past WAM Hypothetical Investment Recommendations

13. From at least 2016 to 2021, WAM’s standard client presentation deck included a slide showing a sample convertible bond that experienced gains during a period when the issuer’s stock price had declined. This slide was designed to demonstrate that an investor in WAM’s convertible bond strategy would have fared better than an investor who had purchased the issuer’s stock. The disclosure accompanying the slide stated that “[t]his slide is for educational purposes only” and “illustrative in nature.” In presenting this information during at least three webinars with groups of existing clients, however, WAM made a statement suggesting that its clients had participated in the successful convertible bond investment as depicted. In fact, WAM’s clients had

not all purchased or sold the convertible bonds on the dates depicted in the slides and therefore had not all experienced the performance depicted in the slide.

WAM's Policies and Procedures Were Inadequately Designed and Implemented

14. During the February 2015 to March 2022 time period, WAM failed to adequately design and implement compliance policies and procedures for performance advertising. WAM's Investment Adviser Policies and Procedures Manual had a section called "Performance" that required certain disclosures for advertising "model performance results." WAM's manual stated that model performance results should provide model performance net of advisory fees, brokerage commissions, and other expenses that a client would have paid. Despite its disclosure stating that the WAM Index construction from February 2002 through December 2012 was based upon a model portfolio, WAM's advertisements and webinars presented the WAM Index without a deduction of advisory fees, brokerage commissions, and other expenses. Further, while WAM's compliance policy required advertising materials to be accurate, WAM did not adopt procedures for compliance personnel to verify the accuracy or completeness of disclosures used in advertising or procedures to supply compliance personnel with sufficient information to make that assessment.

Violations

15. As a result of the conduct described above, WAM willfully³ violated Section 206(2) of the Advisers Act, which prohibits an investment adviser, directly or indirectly, from engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." Scienter is not required to establish a violation of Section 206(2), which 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, 194-95 (1963)).

16. As a result of the conduct described above, WAM 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 otherwise false or misleading. This rule was replaced by a new Marketing Rule with an effective date of May 4, 2021 and a compliance date of November 4, 2022, but WAM voluntarily withdrew its index advertisements before November 4, 2022.

³ "Willfully," for purposes of imposing relief under Section 203(e) of the Advisers Act, "means no more than 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." *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). The decision in *The Robare Group, Ltd. v. SEC*, which construed the term "willfully" for purposes of a differently structured statutory provision, does not alter that standard. 922 F.3d 468, 478-79 (D.C. Cir. 2019) (setting forth the showing required to establish that a person has "willfully omit[ted]" material information from a required disclosure in violation of Section 207 of the Advisers Act).

17. As a result of the conduct described above, WAM 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 the rules thereunder.

WAM's Remedial Efforts

18. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent. First, in March 2022, WAM voluntarily discontinued its use of the WAM Index in WAM's advertisements. WAM is now in the process of terminating its contract with the WAM Index calculation agent so that the WAM Index will cease to exist. Second, after discontinuing its use of the WAM Index in its advertisements, WAM retained outside legal and compliance professionals to conduct a review of its marketing materials and policies and procedures with respect to the Commission's current Investment Adviser Marketing Rule that became effective for WAM on November 4, 2022. Finally, WAM has engaged an outside compliance consultant to conduct a review of WAM's current policies and procedures pertaining to, among other areas, performance advertising, including the use of hypothetical performance, speaking engagements with clients or prospective clients, including the use of scripts or talking points in connection with such engagements, and employee training related to compliance with the new Marketing Rule.

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. WAM 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 and 206(4)-7 thereunder.

B. WAM is censured.

C. WAM shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$1,000,000.00 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 Wellesley Asset Management, Inc. as a 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 Andrew Dean, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 Pearl Street, Suite 20-100, New York, New York 10004-2616.

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.

Vanessa A. Countryman
Secretary