

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4498 / August 25, 2016

ADMINISTRATIVE PROCEEDING
File No. 3-17494

In the Matter of

**PROSPERA FINANCIAL
SERVICES, INC.,**

Respondent.

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

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Prospera Financial Services, Inc. (“Respondent” or “Prospera”).

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 Cease-and-Desist Proceedings Pursuant to Section 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing 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:

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.

Summary

1. This matter arises from misstatements made by registered investment adviser Prospera to certain of its advisory clients, including clients with separately managed accounts invested in F-Squared Investments, Inc.'s ("F-Squared") strategy. Prospera advertised the strategy by negligently relying on F-Squared's materially inflated, and hypothetical and back-tested, performance track record that F-Squared misrepresented.

2. AlphaSector is a sector rotation strategy based on an algorithm that yields a signal indicating whether to buy or sell nine industry exchange-traded funds ("ETFs") that together made up the industries in the S&P 500 Index. From April 2012 through the present, Prospera has offered the AlphaSector strategy to its clients.

3. From September 2011 to October 1, 2013, in reliance on F-Squared's false statements, Prospera's AlphaSector advertisements falsely stated that: (a) assets had been invested in the AlphaSector strategy from April 2001 to September 2008; and (b) the track record had significantly outperformed the S&P 500 Index from April 2001 to September 2008. In fact, no client assets had tracked the strategy from April 2001 through September 2008. In addition, F-Squared miscalculated the historical performance of AlphaSector from April 2001 to September 2008 by incorrectly implementing signals in advance of when such signals actually could have occurred. Prospera took insufficient steps to confirm the accuracy of F-Squared's historical data and other information contained in the materials. In addition, Prospera did not obtain sufficient documentation that substantiated F-Squared's advertising claims in the materials. As a result of this inaccurate compilation of historical data by F-Squared, Prospera advertised the AlphaSector strategy by using hypothetical and back-tested historical performance that was inflated substantially over what performance would have been if F-Squared had applied the signals accurately.

4. As a result, Prospera violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder by publishing, circulating, and distributing advertisements that contained untrue statements of material fact. Prospera likewise did not make and keep true, accurate and current records or documents necessary to form the basis for or demonstrate the calculation of the performance or rate of returns that it circulated and distributed, as required by Section 204(a) of the Advisers Act and Rule 204-2(a)(16) thereunder.

Respondent

5. **Prospera Financial Services, Inc.** (SEC File No. 801-65845) is an investment adviser and broker-dealer registered with the Commission since 1982 (as a broker-dealer) and 2006 (as an investment adviser) and is headquartered in Dallas, Texas. As of March 11, 2016, Prospera had regulatory assets under management of approximately \$1.37 billion.²

²Regulatory assets under management include the securities portfolios for which Prospera provides

Other Relevant Persons

6. **F-Squared Investments, Inc.** (“F-Squared”) (SEC File No. 801-69937) is an investment adviser that was registered with the Commission from March 2009 until January 2016, and is headquartered in Wellesley, Massachusetts. In October 2008, F-Squared launched its first AlphaSector index. F-Squared sub-licensed its approximately 75 AlphaSector indexes to unaffiliated third parties who managed assets pursuant to these indexes. On December 22, 2014, the Commission instituted a settled fraud action against F-Squared in which F-Squared admitted, among other things, to making the materially false claims that (a) the signals that formed the basis of the AlphaSector index returns had been used to manage client assets from April 2001 to September 2008; and (b) the signals resulted in a track record that significantly outperformed the S&P 500 Index from April 2001 to September 2008. *See In the Matter of F-Squared Investments, Inc.*, Admin. Proceeding No. 3-16325 (Dec. 22, 2014).

7. **Howard Brian Present** (“Present”), age 55, resides in Wellesley, Massachusetts. In 2006, Present co-founded F-Squared and was the President and CEO until his separation in 2014. On December 22, 2014, the Commission filed a civil complaint alleging fraud charges against Present in the United States District Court for the District of Massachusetts, which is pending. *See SEC v. Present*, No. 1:14-cv-14692 (D. Mass. filed Dec. 22, 2014).

Facts

Prospera’s Relationship With F-Squared

8. In 2011, F-Squared introduced Prospera to its AlphaSector strategies. Prospera began considering whether it would enter into a model manager agreement with F-Squared whereby Prospera would establish an investment product based on F-Squared’s AlphaSector sector rotation strategy. F-Squared marketed AlphaSector to Prospera as an ETF sector rotation strategy that was based on an algorithm that yields a “signal” indicating whether to buy or sell nine industry ETFs.³ If the algorithm produced buy signals for three or fewer sector ETFs, the AlphaSector strategy provided for some or all of the assets to be invested in cash equivalents.

9. F-Squared described the strategy falsely to Prospera by, among other things, representing that: (a) the AlphaSector strategy had been used to manage client assets from April

continuous and regular supervisory or management services.

³ F-Squared created several AlphaSector strategies and sub-licensed approximately 75 AlphaSector indexes. The AlphaSector indexes that are the subject of this matter, including the AlphaSector Premium Index and the AlphaSector Rotation Index, are based on investments in U.S. equity ETFs. As with all indexes, the performance of the AlphaSector Premium Index and AlphaSector Rotation Index is inherently hypothetical in the sense that the indexes do not purport to reflect the performance of any particular client or account. However, the AlphaSector Premium Index and AlphaSector Rotation Index were advertised as being based on a strategy that had been in place since 2001 and therefore the performance of these indexes was advertised as “not backtested” when in fact the performance *was* back-tested.

2001 to September 2008, often calling it a “live” track record; and (b) the track record had significantly outperformed the S&P 500 Index from April 2001 to September 2008. In reality, no assets tracked the strategy until 2008 and the back-tested track record was substantially overstated. F-Squared’s AlphaSector sales and marketing materials shared with Prospera claimed that clients actually achieved these performance returns for the April 2001 to September 2008 time period. In turn, Prospera took portions of F-Squared’s advertisements, including claims concerning the live nature of the track record and the significant outperformance claim, and disseminated its own advertisements to its clients and prospective clients without having a reasonable basis to conclude that F-Squared’s exceptional performance claims were true.

Prospera’s Advertisements Contained Misstatements

10. From September 2011 to October 1, 2013, Prospera, in advertising its own advisory services, disseminated AlphaSector performance advertisements for its own separately managed account strategies that failed to disclose the AlphaSector track record for the period April 2001 to September 2008 was hypothetical and back-tested. Prospera typically distributed these advertisements through electronic mail to its clients and prospective clients. As described above, Prospera’s AlphaSector advertisements also substantially overstated the performance of the back-tested track record during this period based on the false information provided by F-Squared. In October 2013, Prospera removed the references in its advertising materials to any performance information of F-Squared for periods prior to September 2008.

Prospera Failed to Have A Reasonable Basis to Believe the Accuracy of the Performance and Performance-Related Claims in the Advertisements

11. Prospera knew or should have known that it did not have a reasonable basis to believe that AlphaSector’s advertising claims were accurate. Prospera knew or should have known that F-Squared’s AlphaSector strategy purported performance contained in Prospera’s advertising materials was exceptional over the 2001-2008 period in that it significantly outperformed the S&P 500 Index and purported to involve actual results notwithstanding that the AlphaSector strategy was not launched until 2008. With regard to the performance claims, Prospera included in its AlphaSector advertisements a general statement indicating that third parties were the source of the performance data and that Prospera did not guarantee the accuracy. Prospera relied solely on documents making performance claims that were prepared and provided by F-Squared without any other substantiation. Having taken insufficient steps to confirm the accuracy of the AlphaSector performance data and not having obtained sufficient documentation that would have substantiated F-Squared’s advertised performance and performance-related claims in Prospera’s advertising materials, Prospera failed to have a reasonable basis to believe that AlphaSector’s performance was accurate when included in its own advertisements for clients considering the strategy.

Prospera Failed to Maintain Adequate Books and Records

12. Prospera was required to make and keep true, accurate and current records or documents necessary to form the basis for or demonstrate the calculation of the performance or rate of return that it circulated or distributed to ten or more persons. In marketing its own

advisory services, Prospera circulated and distributed the 2001-2008 historical performance of the AlphaSector strategy in client presentations and marketing materials and other communications to numerous clients, investors, and potential investors. However, Prospera never made or kept sufficient records or documents to form the basis for or demonstrate the calculation of the historical performance or rate of return of the AlphaSector strategy.

Violations

13. As a result of the conduct described above, Respondent violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder, which make 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. A violation of Section 206(4) and the rules thereunder does not require scienter. *SEC v. Steadman*, 967 F.2d 636, 647 (D.C. Cir. 1992).

14. As a result of the conduct described above, Respondent violated Section 204(a) of the Advisers Act and Rule 204-2(a)(16) thereunder. Section 204(a) of the Advisers Act requires investment advisers to make and keep certain records as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. Rule 204-2 under the Advisers Act requires investment advisers registered or required to be registered to make and keep true, accurate and current various books and records relating to their investment advisory business, including all accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 203(k) of the Advisers Act, Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 204(a) and 206(4) of the Advisers Act and Rules 204-2(a)(16), and 206(4)-1(a)(5) thereunder.

B. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty of one hundred thousand dollars (\$100,000) 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 Prospera Financial Services, Inc. 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 Jeffrey B. Finnell, Assistant Director, Asset Management Unit, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5010.

C. 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