Association for Investment Management and Research

TOTAL NUMBER OF LETTERS:

SEC-REPLY-1:
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

December 18, 1996

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 96-21-CC
Association for Investment Management and Research
File No. 132-3

Your letter of December 3, 1996 requests our assurance that we would not recommend enforcement action to the Commission if, in presenting performance information, an investment adviser ("Presenting Adviser") that seeks to comply with certain minimum performance presentation standards ("PPS") developed by the Association for Investment Management and Research ("AIMR") advertises performance as follows: n1

> (1) The Presenting Adviser provides gross and net-of-fee performance for composites of the Presenting Adviser's accounts that include mutual fund accounts, provided that the gross and net performance are both presented with equal prominence in a format designed to facilitate ease of comparison and are accompanied by appropriate disclosure explaining how the performance figures were calculated and not identifying any specific mutual fund included within the composite.
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> (2) The Presenting Adviser includes the performance of both its non-wrap fee accounts and wrap fee accounts in the same composite, and calculates the composite performance by deducting from the performance of non-wrap fee accounts a "model fee" equal to the highest fee charged to a wrap fee account in the composite.
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> (3) The Presenting Adviser calculates net-of-fee performance for an account managed by a number of advisers including the Presenting Adviser ("multi-manager accounts"), by deducting from the performance of that portion of the account managed by the Presenting Adviser those fees related to the management of that portion by the Presenting Adviser, such as transaction costs and all fees paid to the Presenting Adviser or any of its affiliates.

1. The Presentation of Composites Including Mutual Fund and Non-Mutual Fund Accounts

You first inquire whether a Presenting Adviser may provide, in advertisements and one-on-one presentations, both gross- and net-of-fee performance results for composites n2 that include both mutual funds and non-mutual fund accounts. Specifically, you represent that a Presenting Adviser would display both gross and net performance results with equal prominence and in a format designed to facilitate ease of comparison of the gross and net results. You also represent that these results would be accompanied by disclosure explaining how the performance figures were calculated. n3 Finally, to avoid any inference that the presentation is a promotion or advertisement for a particular mutual fund, you state that this disclosure will not identify any specific mutual fund included within the composite.

Section 206(4) of the Investment Advisers Act of 1940 ("Advisers Act") prohibits any act, practice or course of business that the Commission, by rule, defines as fraudulent, deceptive or manipulative. Rule 206(4)-1(a)(5) under the Advisers Act provides that it is a fraudulent, deceptive or manipulative act for any investment adviser to distribute, directly or indirectly, any advertisement that contains any untrue statement of a material fact or that is otherwise false or misleading. In Clover Capital Management, Inc. (pub. avail. Oct. 28, 1986) ("Clover Capital"), the staff interpreted Rule 206(4)-1(a)(5) to prohibit advertisements that include performance results that do not reflect the deduction of advisory fees, brokerage commissions, and any other expenses that a client would have paid or actually paid. n4

The first issue presented by your letter is whether an investment adviser may distribute an advertisement that presents both gross- and net-of-fee performance information for a composite of the adviser's accounts. You maintain that an adviser would not violate Rule 206(4)-1(a)(5) if it distributes an advertisement presenting gross and net performance with equal prominence and in a format designed to facilitate ease of comparison, provided that the advertisement contains sufficient disclosure to ensure that the material presented is not misleading. The staff agrees that such an advertisement would not be prohibited by the Rule. n5

The second issue raised by your letter is whether the presentation of a gross-of-fee composite that includes the performance of one or more mutual funds managed by the adviser would be subject to the requirements governing investment company advertisements and sales literature. Under the Securities Act of 1933 (Rule 482(e)(3)) and the Investment Company Act (Rule 34b-1) n6, any performance information in mutual fund advertisements or sales literature must include standardized total return calculated under a formula that requires the deduction of all fees and expenses paid by the fund. You represent, however, that the disclosure accompanying the composite would not identify any specific mutual fund that is included in the composite. In our view, as long as an advertisement for investment advisory services does not include an explicit or implicit reference to a particular fund, it would not be an advertisement for a fund. n7 Therefore, in our view the standardized performance requirements of Rule 482 and Rule 34b-1 referenced above would not apply to such an advertisement.

2. The Presentation of Performance of a Composite Including Wrap Fee and Non-Wrap Fee Accounts

You propose that Presenting Advisers deduct from non-wrap fee accounts that are included with wrap fee accounts in a composite, a "model fee" equal to the highest fee charged to a wrap fee account in the composite. You represent that the highest fee charged to a wrap fee account would be higher than any fee charged to a non-wrap fee account included in the composite. n8

In such a case, the staff would not consider it a fraudulent or deceptive practice under Rule 206(4)-1 if an adviser presents net performance that reflects the deduction of actual fees from wrap fee accounts and the deduction of a model fee, equal to the highest fee charged to a wrap fee account, from non-wrap fee accounts, provided that the advertisement contains sufficient disclosure to ensure that the information presented is not misleading. n9

3. The Calculation of Net Performance Results

You request our views regarding which fees a Presenting Adviser must deduct in calculating the net-of-fee performance of a "multi-manager" account. n10 You propose that, for purposes of calculating the net-of-fee performance of an adviser's portion of a multi-manager account included in a composite, a Presenting Adviser should be required to deduct only those fees related to its management of the account. You represent that performance results would be accompanied by disclosure that specifically identifies the types of fees deducted.

In Clover Capital, the staff took the position that performance information in an advertisement should reflect the deduction of "advisory fees, brokerage or other commissions, and any other expense that a client would have paid or actually paid". In Investment Company Institute (pub. avail. July 24, 1987), the staff took the position that custodial fees need not be deducted from net performance, and stated that "information about the fees the adviser charged clients in the sample is material to evaluating the investment experience of those clients and the adviser's competence. . . ."

In the staff's view the fees relevant to an evaluation of the investment experience of the adviser's clients and of the adviser's competence are those fees or charges related to the adviser's management of the account. The staff believes that, at a minimum, these fees and charges include: 1) all transaction costs; and 2) all fees or charges paid to the adviser or an affiliate of the adviser.

Our position with respect to the calculation of net performance is not limited to the performance of multi-manager accounts. The net-of-fee performance of any investment advisory account may be calculated by deducting only the fees described above.

4. Conclusion

We would not recommend enforcement action to the Commission if an adviser includes performance information in advertisements and one-on-one presentations calculated and set forth in the manner described above. This position is based on the facts and representations set forth in your letter and described above. You should note that any different facts or representations might require a different conclusion.

Eileen M. Smiley
Senior Counsel

Footnotes

n1 AIMR is a global non-profit membership organization consisting of investment analysts, portfolio managers and other investment decision makers. The staff views expressed in this letter are not conditioned in any way on an adviser complying with AIMR's PPS. In addition, the staff views included in this letter are in no way intended to indicate any position with respect to AIMR's PPS generally.

N2 You state that a basic component of AIMR's PPS is the use of composites in investment performance presentations. You define a composite as an aggregation into a single performance presentation of portfolios or asset classes that are managed with a similar strategy or investment objective. You represent that, under the AIMR standards, all fee-paying discretionary portfolios must be included in one or more of an adviser's composites. We note that the staff has taken the position that an adviser may choose to exclude from a composite certain similarly managed accounts, so long as doing so would not cause the composite performance to be misleading. Nicholas-Applegate Mutual Funds (pub. avail. Aug. 6, 1996).

n3 The disclosure accompanying gross-of-fee performance would specifically state that the performance does not reflect the payment of investment advisory fees and other expenses that would be incurred in the management of an account.

n4 The staff took the position that the presentation of gross performance data alone may be false and misleading because it could imply, or cause a potential advisory client receiving the data to infer, something about the adviser's competence or about future investment results that was not true. The Commission subsequently commenced several enforcement actions against investment advisers that advertised only gross-of-fee performance. See In the Matter of Hazel B. Canham, Advisers Act Rel. No. 1386 (Admin. Proc. File No. 3-8067) (Sep. 30, 1993); In the Matter of Eric S. Emory and Renaissance Advisors, Inc., Advisers Act Rel. No. 1283 (Admin. Proc. File No. 3-7530) (July 22, 1991); In the Matter of Makrod Investment Associates Inc., John Thomas O'Donnell, Advisers Act Rel. No. 1176 (Admin. Proc. File No. 3-7220) (July 3, 1989); In the Matter of Harvest Financial Group, Inc. and Stephen S. Duklewski, Jr., Advisers Act Rel. No. 1155 (Admin. Proc. File No. 3-7146) (Feb. 21, 1989); In the Matter of Managed Advisory Services, Inc. and Henry L. Chisea, Advisers Act Rel. No. 1148 (Admin. Proc. File No. 3-7107) (Dec. 27, 1988).

n5 We note that the staff has previously taken the position that an adviser's presentation of gross-of-fee performance results without net-of-fee results would not be misleading if made only in one-on-one presentations to sophisticated investors, provided that sufficient disclosures are made and the investors are given the opportunity to inquire about fees. Investment Company Institute (pub. avail. Sept. 23, 1988).

n6 Rule 34b-1 under the Investment Company Act provides that sales literature for open-end funds other than money market funds, containing performance information is deemed to be misleading unless it includes, among other things, the total return calculations required under Rule 482(e)(3). See also Form N-1A, Item 22(b). Rule 34b-1 was adopted pursuant to Section 34(b) of the Investment Company Act, which prohibits persons from making any untrue statement of material fact in documents relating to investment companies that are required to be filed with the Commission. Advertisements and sales literature used by an open-end investment company or its underwriter must be filed, or be deemed filed, with the Commission pursuant to Section 24(b) of, or Rule 24b-3 under, the Investment Company Act.

n7 Cf. Rule 135a under the Securities Act of 1933, which provides that generic advertisements that do not specifically refer by name to the securities of a particular investment company or to the investment company itself will not be deemed offers of those investment company securities if certain other conditions are met.

n8 You also represent that the performance results would be accompanied by a schedule detailing the actual fees applicable to wrap fee accounts.

n9 The staff addressed a similar issue in J.P. Morgan Investment Management, Inc. (pub. avail. May 7, 1996). In that letter, the staff took the position that an adviser may advertise performance reflecting the deduction of a model fee when doing so would result in performance figures that are no higher than those reflecting the deduction of actual fees.

n10 For this discussion, we define a multi-manager account as a single account in which different advisory firms each manage a separate portion of the account's assets.

INQUIRY-1:

AIMR
Association for Investment Management and Research
5 Boars Head Lane . P O Box 3668 . Charlottesville, Virginia 22903
Phone 804-977-6600 . Fax 804-977-1103

December 3, 1996

Jack W. Murphy, Esquire
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Mr. Murphy:

The Association for Investment Management and Research n1 (AIMR) is writing seeking no-action assurances from the Staff of the Securities and Exchange Commission (SEC) with regard to certain investment advisory management firm's (investment adviser) performance issues related to the AIMR Performance Presentation Standards (AIMR-PPS(TM)) currently being considered by AIMR's PPS Implementation Committee.

Summary

AIMR requests no-action relief from the SEC Staff with regard to the following proposed clarifications to the AIMR PPS standards:

> (1) Non-wrap fee accounts, which are included in the same composite as wrap fee accounts and are to be presented to wrap fee customers, must reflect a "model-wrap fee" equal to the highest fee charged against the wrap fee accounts in the composite when the "model-wrap fee" is higher than the actual non-wrap investment management fee.
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> (2) Composites that include mutual fund assets must be presented net of fees, and may be presented on a gross of fee basis. The gross and net of fee results must be presented with equal prominence in a format designed to facilitate ease of comparison. Disclosure must not identify any specific mutual fund the performance of which is included in the composites.
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> (3) Net of fee presentations for composites that include an investment adviser's performance managing a portion of the assets of a multi-managed account may reflect the deduction of only those fees related to the management of the assets by the adviser. A statement of those fees and costs that have been deducted must be included with the performance.

Background

An essential element of AIMR's mission is the establishment of the highest ethical standards required to be followed by all AIMR members and candidates for the CFA designation program (members). To assist its members in complying with these ethical standards. AIMR and its predecessor organization, the Financial Analysts Federation, developed and adopted the AIMR-PPS standards. The AIMR-PPS standards identify minimum levels of accepted ethical standards for presenting investment performance. n2 They are intended to promote fair representation and full disclosure in presentations of investment performance results. The AIMR-PPS standards also promote uniformity and comparability among such presentations, enabling investors to accurately evaluate and compare investment results of various investment advisers. The AIMR-PPS standards satisfy several additional goals; they improve the service offered to investment adviser clients, enhance the professionalism of the industry, and bolster self-regulation.

Since 1990, the AIMR-PPS Implementation Committee, a standing AIMR committee, is responsible for the ongoing implementation and interpretation of the AIMR-PPS standards. As warranted, and with AIMR Board approval, the Implementation Committee provides clarification and modification of the AIMR-PPS standards.

A basic element of the AIMR-PPS standards is the use of composites in investment performance presentations. A composite is the aggregation of portfolios or asset classes, which are managed with a similar strategy or investment objective, into a single performance presentation. n3 In a composite format, prospective clients are shown the performance results of the investment adviser firm without displaying individual account performance. Prospective clients are advised that a list and description of all of an investment adviser firm's composites are available upon request. Information regarding any specific account is not provided in the composite presentation.

The AIMR-PPS standards require the use of composites because they help to ensure that investors receive a fair and complete representation of an adviser's past performance record. Composites ensure that all accounts sharing a particular investment style, strategy and objective are included in performance presentations, thus providing a more complete record than the use of a "representative account" or partial composite that leaves out accounts that have terminated.

The Implementation Committee has received numerous inquiries concerning the AIMR-PPS standards as they relate to the presentation of investment results under certain circumstances. AIMR often assists its members in complying with SEC requirements in furtherance of high ethical standards in the investment management industry. In this connection, over the last few months the following issues have arisen for which further clarification from the Staff is needed:

> (1) Whether non-wrap fee accounts included in the same composite as wrap fee accounts, to be presented to wrap fee customers, can reflect a "model-wrap fee" equal to the highest fee charged against the wrap fee accounts in the composite when the "model-wrap fee" is higher than the actual non-wrap investment management fee.
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> (2) Whether a composite including mutual funds can be presented to potential clients on a gross of fee basis if it is also presented on a net of fee basis, and gross and net of fee results are presented with equal prominence in a format designed to facilitate ease of comparison and no specific mutual fund included in the composite is identified.
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> (3) Whether a composite that includes investment adviser accounts that consist of a portion of the assets of a multi-managed account can be presented to potential clients on a net of fee basis after deducting only those fees and costs related to the management of the assets by the adviser, including transaction costs and all fees and charges paid by the account to the investment adviser or an affiliate of the investment adviser, provided that it is accompanied with a statement indicating those fees and costs that have been deducted.

Wrap Fee Accounts

Unlike traditional separate investment accounts, in which customers are charged separate fees for the services they receive, a single fee is charged against a wrap fee account for several combined services. As a result, management fees, transaction costs and other service costs in a wrap fee account are difficult to separate and identify.

AIMR recommends that wrap fee accounts be grouped in separate composites from non-wrap fee accounts. The performance of wrap fee composites must be shown on a net of fee basis. This requirement comes, in part, from the belief that wrap fee customers should be shown a composite which accurately illustrates the fee and the performance of relevant wrap fee accounts. The inclusion of low fee-paying non-wrap fee accounts into the composite could improperly distort the results and mislead customers.

The use of separate wrap fee and non-wrap fee composites, however, may not always provide wrap fee customers with a complete picture of the investment adviser's performance history. For example, the inclusion of non-wrap fee accounts in wrap fee account composites may be the only method of presenting a meaningful performance history to wrap fee customers for investment management firms with few wrap fee accounts, or a limited history of participating in a wrap fee program. In addition, because transaction costs in wrap fee accounts generally are inseparable from management fees, the presentation of wrap fee composites on a gross of fee basis reflects the deduction of no transaction or other fees. Therefore, a combination of wrap fee and non-wrap fee accounts in one composite must always be shown on a net of fee basis. To provide guidance in this situation, the Implementation Committee n4 has determined to recommend, subject to Staff concurrence, that investment management firms who combine wrap fee and non-wrap fee accounts in the same composite, for purposes of selling wrap fee accounts, deduct from the non-wrap fee accounts a "model-wrap fee" equal to the highest fee charged against the wrap fee accounts in the composite when the "model-wrap fee" is higher than the actual investment management fee deducted from the non-wrap fee accounts. n5 A copy of the fee schedule would be presented with the composite as required by the AIMR-PPS standards. To use this mixed model fee approach, however, the highest fee charged to any wrap fee account will be higher than any fee charged to a non-wrap fee account included in the composite. These requirements protect against misrepresentation of performance or fees and minimize investor confusion.

The AIMR-PPS standards provide guidance as to appropriate method for the deduction of the "model fee." It is the same procedure applicable to the deduction of management fees when management fees are paid outside of the investment account. This same provision is to be used by the investment adviser when applying the highest fee charged against the wrap fee accounts in the composite to the non-wrap fee accounts included in the same wrap fee composite. The fee is to be allocated over the measurement period at least quarterly. The fee treatment must be applied consistently over all portfolios, composites and time periods.

The SEC Staff has previously permitted the use of model fees when advertising historical performance in Securities Industry Association (November 27, 1989) (SIA). In SIA, the Staff permitted the use of model fees for advisers that could not reconstruct actual fees for purposes of advertising historical net performance. n6 Although the Staff in SIA permitted model fees to be used only during a temporary time period, the Staff's position reflects a recognition that model fees may be appropriate in limited circumstances. More recently, in J.P. Morgan Investment Management, Inc. (May 7, 1996) the SEC staff permitted the use of performance advertising that reflects the deduction of a model fee provided the resulting performance figures would be no higher than those that would have resulted from deduction of the actual fees.

The SEC Staff has indicated a willingness to consider the use of model fees in the circumstances described above. Therefore, we request confirmation that the Staff will not recommend enforcement action against AIMR members and others that claim compliance with the AIMR-PPS standards for following the AIMR-PPS Implementation Committee's interpretation and using model fees in presenting non-wrap fee and wrap fee accounts in the same composite.

Composite Format

The AIMR-PPS standards currently recommend that investment management firms present their composite performance (to non-wrap fee customers) on a gross of fee basis unless to do so would conflict with applicable law.

The AIMR-PPS Implementation Committee takes the position, subject to Staff concurrence, that investment advisers who act as advisers to separate investment accounts as well as mutual funds n7 may include mutual fund accounts in a composite on a gross of fee basis, and must also present composite results on a net of fee basis, if the requirements of the AIMR-PPS standards are followed. In addition, the gross and net of fee composite results must be presented with equal prominence in a format designed to facilitate ease of comparison. The accompanying disclosure must not identify any specific mutual fund included in the composite.

In Investment Company Institute (August 24, 1987) (ICI1), the Staff stated that "the primary purpose of advertising actual results derived from a sample of client accounts is to show prospective clients the kind of investment experience they might have had as clients of that adviser and to permit them to evaluate the adviser's competence and ability to manage accounts." The Staff further expressed the concern that advertising actual results of advisory accounts on a gross of fee basis may imply, or may lead a customer to infer, something about the investment experience that would not be true if the advertisement included information about actual advisory fees and expenses. n8 The Staff later permitted in Investment Company Institute (September 23, 1988) (ICI2) the use of performance data on a gross of fee basis in one-on-one presentations where the client has the opportunity to discuss with the adviser the types of fees that the client will pay. n9

In one-on-one presentations aimed at separate investment account clients and not mutual fund sales, the investment experience relevant to customer accounts would not include fees imposed in a mutual fund context. Moreover, any mutual fund's performance would appear in a composite in coordination with other investment results. The accompanying disclosure would not identify any specific mutual fund included within the composite. In the absence of performance related to a specific mutual fund, customers would be unable to draw any inference about any particular mutual fund's performance. The inclusion of the mutual fund's performance would be solely illustrative of the investment adviser's performance in managing assets with similar objectives, risk factors, and other common features that are appropriately included in a composite. Both gross and net of fee composite results are required to be presented with equal prominence in a format designed to facilitate ease of comparison.

AIMR believes that the presentation of mutual fund performance included in composite investment results on a gross of fee basis as described above is the most relevant and appropriate method of describing an investment adviser's performance history. As such, AIMR requests the Staffs assurance that it will not recommend enforcement action against AIMR members and others that claim compliance with the AIMR-PPS standards for including mutual fund performance in their composites if: (i) the AIMR-PPS standards requirements are met; (ii) gross and net of fee results are presented with equal prominence in a format designed to facilitate ease of comparison; and (iii) the accompanying disclosure does not identify any specific mutual fund included in the composite.

Allocation of Expenses

AIMR receives numerous inquiries from investment advisers that have been hired to manage a portion of an account's assets. Such multi-manager assignments are common for defined benefit plans and more recently mutual funds. In such a multi-manager account, different investment management firms manage a separate portion of the account's assets. The AIMR-PPS standards are applicable to such investment advisers who manage portions of a single account. In such cases, the fees charged may not be related at all to the investment adviser's management of assets. Such investment advisers present their composites to prospective clients for the purpose of illustrating the performance capabilities of the investment adviser.

In ICI1, the Staff recognized that certain fee arrangements, i.e. those between a client and its custodian, are not subject to the control of the investment adviser and thus need not be reflected in investment adviser's performance figures. On this basis, the AIMR-PPS standards recommend that investment advisers report performance on a gross of fee basis, but only after deduction of fees and expenses related to the management of the assets by the adviser. Such fees include transaction costs and all fees or charges paid to the investment adviser or an affiliate of the investment adviser.

The AIMR-PPS Implementation Committee believes it could be misleading to require an investment adviser, which is only advising on a portion of an account's assets and is not otherwise responsible for total account operations, to report performance on a net of fee basis, after deduction of all account fees, related to the management of the assets by the adviser.

Such a presentation also would not raise concerns of the variety expressed by the Staff in the Clover and ICI1 letters. n10 It is not possible for a prospective client to invest in the particular account in reliance on something the prospective client may infer from the presentation. The presentation materials are not being shown by the investment adviser for the purpose of offering or selling the account. The purpose of the performance materials is solely to illustrate to the prospective client the capabilities of the investment adviser and enable a prospective client to make an "apples to apples" comparison of the performance history among investment advisory firms.

AIMR requests the Staff's assurance that it will not take action against AIMR members and others that claim compliance with the AIMR-PPS standards and that act as investment advisers to multi-manager accounts if they present their composite performance data of the assets that the investment adviser manages, on a basis net of only those fees related to the management of the assets by the investment adviser, including transaction costs and all fees or charges paid to the investment adviser or an affiliate.

AIMR believes that the foregoing clarifications of Staff positions will benefit investors by creating a more uniform method of presenting performance results. With the Staff's concurrence, the AIMR-PPS Implementation Committee intends to clarify the AIMR-PPS standards such that investment advisers, when claiming compliance with the AIMR-PPS standards, are required to present the performance of similar accounts in an identical manner, as set forth above. AIMR believes that these revisions will enable investors to better conduct evaluations of investment advisers.

AIMR appreciates the attention the Staff has given to the consideration of this no-action request. The AIMR-PPS Implementation Committee welcomes the opportunity to discuss this no-action letter request with the Staff. Please call me at (804) 980-9720, or in my absence, Diane E. Ambler of Mayer, Brown & Platt at (202) 778-0641, if you have any questions about this request or if you would like any additional information.

Sincerely yours,
Michael S. Caccese

Footnotes

n1 AIMR is a global non-profit membership organization with more than 60,000 members and candidates comprised of investment analysts, portfolio managers, and other investment decision makers employed by investment management firms, banks, broker-dealers, investment company complexes, and insurance companies. AIMR's mission is to serve investors through its membership by providing global leadership in education on investment knowledge, sustaining high standards of professional conduct and administering the Chartered Financial Analyst ("CFA") designation program.

n2 The AIMR-PPS standards contain both required provisions and recommended provisions. To claim compliance with the AIMR-PPS standards, a firm must comply with all of the applicable mandatory requirements of the Standards. Compliance with the AIMR-PPS standards' ethical principles often requires a firm to apply general principles of full and fair disclosure in addition to the minimum requirements and mandatory disclosures.

n3 All actual, fee-paying discretionary portfolios are to be included in one or more of a firm's composites. Non-fee paying portfolios may be included in composites if such inclusion is disclosed. At least ten-year records or since the firm's inception, if shorter) are shown in any presentation.

n4 The Implementation Committee formed the Wrap Fee Subcommittee, consisting of AIMR members and staff, to address some of the issues relating to wrap fee accounts. Members of the SEC staff served as, observers of the meetings of the Wrap Fee Subcommittee in which this recommendation was developed.

n5 When presenting a composite for purposes of selling non-wrap fee accounts the current requirement of the AIMR-PPS standards on reporting gross or net of fees is to be followed. The AIMR-PPS standards recommend that performance be presented gross of management fees, except where this will conflict with the Staff's position on advertising performance. If the composite is presented gross of fees and includes wrap fee accounts, those wrap fee accounts must be presented either: (i) net of all fees; or (ii) net of actual transaction costs.

n6 When the SEC Staff required performance results to include actual fees in Clover Capital Management, Inc. (October 28, 1986) (Clover), advisers that had not previously maintained records reflecting fees charged against specific accounts were unable to present historical net performance. The SEC Staff permitted the use of model fees for periods prior to May 27, 1990 in recognition of this problem.

n7 The AIMR-PPS standards referred to herein apply only to mutual funds subject to the jurisdiction of the United States Federal Securities Laws.

n8 The SEC has expressed a similar concern with the offer and sale of mutual funds, which is embodied in the regulations pertaining to the advertisement of mutual funds (Rule 482) and the anti-fraud rules regarding the offer and sale of mutual funds (Rule 156). These regulations do not apply to the situation posed, however, because the performance of the mutual fund would be presented solely for comparison purposes as part of a composite presentation. Neither the individual mutual fund performance nor the identity of specific mutual funds included in the composite would be disclosed. Rather, only the composite performance of all of the accounts included in the composite would be presented.

n9 In ICI2. the Staff permitted the investment adviser to present performance results on a gross of fee basis in presentations in which the investment adviser met individually with an investor, and the investor had an opportunity to ask questions concerning the performance data. ICI2 also sets forth certain disclosures that are required to be made if a gross of fee presentation format is used.

n10 In Clover and ICI1, the Staff expressed concern that the presentation of performance results on a gross of fee basis could cause an investor to infer incorrectly something about the investment adviser's competence or about the future results of an account.