

**Rule 206(4)-1(a)(1), 206(4)-1(a)(5)**

**March 24, 1998**

**DALBAR, Inc.**

**TOTAL NUMBER OF LETTERS: 2**

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

**March 24, 1998**

**RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT Our Ref. No. 97-453-CC**

**DALBAR, Inc.**

**File No. 132-3**

Your letter dated March 20, 1998 requests assurance that we would not recommend enforcement action to the Commission under Section 206(4) of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 206(4)-1(a)(1) thereunder if, as described in your letter, DALBAR, Inc. ("DALBAR"), any investment adviser, or any associated person of an adviser, uses certain numerical ratings creed by DALBAR in investment adviser advertisements.

#### **FACTS**

DALBAR is a research firm that conducts survey research regarding financial institutions and, based on the survey findings, issues ratings of these institutions. DALBAR has conducted a survey to measure the effectiveness of services rendered by investment advisers n1 and/or their investment advisory representatives ("IARs"). n2 You state that DALBAR intends to conduct subsequent surveys on a quarterly basis using substantially identical questionnaires; however, an adviser or IAR will be permitted to participate and be rated only once a year. n3

You represent that DALBAR will not be affiliated with any adviser or IAR participating in the surveys. You state that DALBAR will solicit advisers and IARs to participate in a survey for a \$ 500 fee, paid in advance, per participating IAR, or if a rating is sought only for an adviser, per adviser. n4 You represent that to participate in DALBAR's survey, an adviser and any participating IAR must have: (1) at least five years of experience as a financial adviser; (2) a minimum of 100 clients from whom a fee or commission was earned within the prior 12 months, or at least \$ 15 million in client assets under management; and (3) no record of any regulatory sanctions imposed within the past five years by the Commission, state securities regulators or any self-regulatory organization as that term is defined in Section 3(a)(26) of the Securities Exchange Act of 1934.

You state that DALBAR will send uniform questionnaires to all clients of a participating IAR, except when an IAR has a sufficient number of clients to permit a statistically valid sampling. You represent that if a participating IAR has fewer than 300 clients from whom the IAR has earned a fee within the prior 12 months, DALBAR will send each of these clients a questionnaire prepared by DALBAR. If a participating IAR has 300 or more clients from whom the IAR earned an advisory fee, DALBAR will send questionnaire to a statistically valid sample of these clients that it randomly selects. n5 You also state that if an adviser wants to receive a firm-wide rating, the adviser must provide DALBAR with a list of all of its IARs, who then provide DALBAR with a list of all their clients from whom the IAR earned a fee within the last 12 months. DALBAR sends all of these clients a questionnaire. If, however, an adviser has 100 or more IARs, DALBAR then randomly will select at least 10% or 100 of the IARs (whichever is higher), and will send a questionnaire to each client, or a statistically valid sample of clients, of these IARs. n6 Thus, you assert that advisers seeking firm-wide ratings will not be able to pre-determine which clients will participate in the survey or which IARs will be the subject of the survey. n7

You represent that the questionnaire has not been prepared to produce any pre-determined results that could benefit any adviser or IAR. Rather, you represent that the questionnaire is structured to make it equally easy for a client to give negative or positive responses. n8 You state that the questionnaire contains a series of questions with four multiple choice answers. You further represent that DALBAR will not perform any subjective analysis of the survey results, but instead assigns numerical ratings based on the aggregate client responses for each adviser or IAR. Each possible client response corresponds to a number from 1 to 4. You state that for each survey question, DALBAR averages the responses of an advisers or IAR's clients to obtain a rating for that question. Each adviser or IAR also is rated in three major categories - performance, trust, and satisfaction -- by averaging the client responses to the questions in those categories. n9 You represent that DALBAR will not issue ratings to an adviser or IAR unless the ratings are statistically valid with respect to that adviser or IAR.

You state that DALBAR will publicly release the names of the advisers and IARs who satisfy certain minimum rating guidelines and will publish some or all of the survey results in its written directories and on its Internet web site. You represent that, among other information, these published listings will identify clearly the percentage of survey participants who have received each of the designations described in note 9 and the total number of survey participants. In addition, you state that DALBAR expects some advisers and IARs to refer to their ratings and/or to other relevant survey ratings of their services in their own advertisements or sales materials.

## **ANALYSIS**

Section 206(4) of the Advisers Act generally prohibits any investment adviser from engaging in any act, practice, or course of business that the Commission, by rule, defines as fraudulent, deceptive or manipulative. Rule 206(4)-1(a)(1) under the Advisers Act provides that it is a fraudulent, deceptive or manipulative act, practice or course of business within the meaning of Section 206(4) for any investment adviser registered or required to be registered as such with the Commission to publish, circulate, or distribute any advertisement which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or concerning any advice, analysis, report, or other service rendered by the investment adviser.

When the Commission adopted Rule 206(4)-1, it stated that testimonials were inherently misleading because "by their very nature they emphasize the comments and the activities favorable to the investment adviser and ignore those which are unfavorable." n10 The rule forbids the use of a testimonial "because the testimonial may give rise to a fraudulent or deceptive implication, or mistaken inference, that the experience of the person giving the testimonial is typical of the experience of the adviser's clients." n11 Although the term "testimonial" is not defined in Rule 206(4)-1, we consistently have interpreted that term to include a statement of a client's experience with, or endorsement of, an investment adviser. n12 We also have taken the position, however, that an article by an unbiased third party concerning an investment adviser's performance is not a testimonial unless it includes a statement of a client's experience with, or endorsement of the adviser. n13

You maintain that the ratings produced and used in the manner described in your letter are not testimonials within the meaning of Rule 206(4)-1(a)(1). First, you argue that the ratings assigned by DALBAR are reports by an unbiased third party that do not contain any statement regarding the experience of any particular client with an adviser or IAR. Second, you argue that the ratings themselves do not constitute client testimonials because they do not directly or indirectly emphasize statements by one or more clients that are favorable to the investment adviser or IAR and ignore those that are unfavorable. Finally, you argue that even if the ratings are considered to be indirect testimonials by the clients of advisers and IARs, the "experience" being conveyed is not the experience of a single client or a group of clients selected by the adviser or IAR. You state that a DALBAR rating is, at most, the collective experience of all clients responding to the survey.

We believe that a DALBAR rating is a testimonial because the rating is an implicit statement of clients' experiences with an adviser or IAR and because the rating purports to convey the experience of a hypothetical average, or typical, client with an adviser or IAR. As a result, we believe that a DALBAR rating would be a testimonial by DALBAR, notwithstanding that it is third-party report. n14 For the same reasons, we also consider a DALBAR rating to be a testimonial by an adviser's clients, indirectly made through DALBAR.

Nonetheless, we would not recommend enforcement action to the Commission under Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(1) thereunder if DALBAR, any adviser, or any associated person of an adviser publishes, circulates, or distributes advertisements containing DALBAR ratings prepared in the manner described in your letter. We believe that the use of these ratings in advertisements would not raise any of the dangers that Rule 206(4)-1(a)(1) was designed to prevent because, based upon your representations, a DALBAR rating does not emphasize the favorable client responses or ignore the unfavorable responses; n15 a DALBAR rating represents all, or a statistically valid sample, of the responses of an adviser's or IAR's clients; the questionnaire that is sent to the clients of participating advisers and IARs has not been prepared to produce any pre-determined results that could benefit any adviser or IAR; the questionnaire is structured to make it equally easy for a client to give negative or positive responses; and DALBAR does not perform any subjective analysis of the survey results, but instead assigns numerical ratings after averaging the client responses for each adviser or IAR.

In taking this position, we rely in particular on your representations discussed in the previous paragraph and your representations that: (1) participating advisers and IARs will have met the eligibility criteria described above, or similar criteria reasonably designed to ensure that a participating adviser or IAR has an established and significant history and a record free from regulatory sanctions; (2) DALBAR will not be affiliated with any participating adviser or IAR; n16 (3) DALBAR will survey all or, as appropriate, a statistically valid sample, of a participating adviser's or IAR's clients; (4) all participating advisers and IARs are charged a uniform fee, paid in advance; (5) DALBAR will not issue ratings to an adviser or IAR unless the ratings are statistically valid with respect to that adviser or IAR; and (6) any survey results published by DALBAR will contain information that clearly identifies the percentage of survey participants who have received each designation listed in note 9 and the total number of survey participants. You should note that any different facts or representations may require a different conclusion.

We note that the use of DALBAR ratings in advertisements by investment advisers and IARs would be subject to Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder. Rule 206(4)-1(a)(5) makes it a fraudulent, deceptive or manipulative act, practice, or course of business within the meaning of Section 206(4) of the Advisers Act for any investment adviser to publish, circulate, or distribute, directly or indirectly, any advertisement that contains any untrue statement of a material fact or that is otherwise false or misleading. Whether a particular advertisement is false or misleading depends upon all of the relevant facts and circumstances. n17 Generally, an advertisement may be considered false or misleading if it implies, or would lead a prospective client to infer, something about the adviser or IAR or its clients' experiences that would not be true if all material facts had been disclosed. n18

We express no view on whether a particular presentation of DALBAR ratings in an advertisement by advisers or IARs would violate Section 206(4) and Rule 206(4)-1(a)(5). We are, however, taking the opportunity to provide guidance regarding some factors that advisers and IARs should consider when determining whether any advertisement containing a DALBAR rating is false or misleading:

1. Whether the advertisement discloses the criteria on which the rating was based;

2. Whether an adviser or IAR advertises any favorable rating without disclosing any facts that the adviser or IAR knows would call into question the validity of the rating or the appropriateness of advertising the rating (e.g., the adviser or IAR knows that it has been the subject of numerous client complaints relating to the rating category or in areas not included in the survey);
3. Whether an adviser or IAR advertises any favorable rating without also disclosing any unfavorable rating of the adviser or IAR (or the adviser that employs the IAR);
4. Whether the advertisement states or implies that an adviser or IAR was the top-rated adviser or IAR in a category when it was not rated first in that category;
5. Whether, in disclosing an adviser's or IAR's rating or designation n19, the advertisement clearly and prominently discloses the category for which the rating was calculated or designation determined, the number of advisers or IARs surveyed in that category, and the percentage of advisers or IARs that received that rating or designation;
6. Whether the advertisement discloses that the rating may not be representative of any one client's experience because the rating reflects an average of all, or a sample of all, of the experiences of the adviser's or IAR's clients;
7. Whether the advertisement discloses that the rating is not indicative of the adviser's or IAR's future performance; and
8. Whether the advertisement discloses prominently who created and conducted the survey, and that advisers and IARs paid a fee to participate in the survey.

Veena K. Jain  
Staff Attorney

#### **Footnotes**

n1 You state that DALBAR expects that most of the investment advisers surveyed will be registered with the Commission.

n2 The term "investment advisory representatives" refers to those natural persons employed by investment advisers who render investment advisory services to an adviser's clients.

n3 You state that the description of the DALBAR program applies to activities that already have been conducted as well as activities to be conducted in the future. The no-action assurances provided in this letter, however, apply only to activities relating to the DALBAR program that take place in the future in accordance with the facts and representations in your letter.

n4 As applicable, the discussion in this letter regarding participating IARs also applies to participating Advisers that have no IARs who are being rated.

n5 If an IAR earned an advisory fee from 300 to 1,000 clients in the past twelve months, DALBAR will send the questionnaire to 100 of those clients that it randomly will select. If an IAR earned an advisory fee from 1,001 to 2,000 clients in the past twelve months, DALBAR will send the questionnaire to 150 of those clients that it randomly selects. If an IAR earned an advisory fee from more than 2,000 clients in the past twelve months, DALBAR will send the questionnaire to 200 or more of those clients that it randomly selects. In subsequent surveys, DALBAR may adjust these guidelines based on prior response rates, although it always will survey a sufficient number of clients to have a statistically valid sample. If an adviser or IAR participates in subsequent DALBAR surveys, DALBAR will randomly select the clients from a group that includes clients of the adviser or IAR from whom the adviser or IAR earned advisory fees in the past year as well as clients who were listed by the adviser or IAR for any previous DALBAR survey.

n6 DALBAR will follow the same procedures as described in note 5.

n7 You represent that the survey responses will be kept confidential by DALBAR. You state that no adviser or IAR will have access to the responses of any client. Additionally, you state that DALBAR will not disclose to any adviser or IAR which of its clients responded or did not respond to the survey. You represent that DALBAR randomly will contact certain clients to confirm the validity of their responses.

n8 The questionnaire asks about:

- (1) the length of time that the IAR has provided services to the client;
- (2) the client's overall rating of the IAR;
- (3) the client's satisfaction rating regarding eight different types of advisory services;
- (4) the client's rating of the IAR's financial results to date for the client;
- (5) the extent to which the IAR puts the client's interests ahead of the IAR's own interests;
- (6) the client's satisfaction levels with various aspects of the IAR's services; and
- (7) client information.

n9 IARs and advisers are rated from 1 (poor) to 4 (excellent) in each category. DALBAR assigns those IARs and advisers who are rated from 3.75 to 4.0 an "Excellent" designation, those who are rated from 3.5 to 3.74 a "Very Good" designation, and those who are rated from 3.0 to 3.49 a "Good" designation.

n10 Advisers Act Release No. 121 (Nov. 2, 1961) (adopting Rule 206(4)-1).

n11 Richard Silverman (pub. avail. Feb. 25, 1985) ("Silverman").

n12 See, e.g., Cambiar Investors, Inc. (pub. avail. Aug. 28, 1997).

n13 See Silverman; New York Investors Group, Inc. (pub. avail. Sept. 7, 1982) ("New York Investors").

n14 You cite Stalker Advisory Services (pub. avail. Jan. 18, 1994) ("Stalker") in support of your assertion that the mere payment of compensation by an adviser to an unbiased third party does not transform a report by the third party about the adviser's performance into a prohibited testimonial. We note, however, that the third-party report in Stalker was not a testimonial, regardless of the payment of any fee to the third party by the adviser, because the third party merely verified and published the investment performance of certain accounts managed by the adviser, which performance the adviser could have published directly without implicating Rule 206(4)-1(a)(1). In contrast, DALBAR solicits the views of clients about their experience with an adviser or IAR, thus creating a rating that contains an implicit statement of the experience of a typical client with the adviser or IAR. Because we conclude that a DALBAR rating contains a client testimonial, and that therefore a DALBAR rating is itself a testimonial, we do not need to determine whether DALBAR's receipt of compensation from participating advisers or IARs would transform a DALBAR rating into a testimonial.

n15 Because an adviser or IAR can receive DALBAR ratings in various categories, we note that an advertisement for an adviser or IAR that included one or more favorable ratings while ignoring one or more unfavorable ratings could present the dangers that Rule 206(4)-1(a)(1) was designed to prevent.

n16 We note that if an investment adviser participated in a survey of its clients that was created or conducted by that adviser, or by a person affiliated with the adviser, the advertising, indirectly or directly, of any resulting ratings by that adviser could present the dangers that Rule 206(4)-1(a)(1) was designed to prevent.

n17 See e.g., Anametrics Investment Management (pub. avail. May 5, 1977) (whether a communication is misleading will depend upon all of the particular facts, including the form and content of the communication, the implications or inferences arising out of the context of the communication, and the sophistication of the prospective client). See also In the Matter of LBS Capital Management, Inc., Advisers Act Release No. 1644 (July 18, 1997), and In the Matter of Spear & Staff, Inc., Advisers Act Release No. 188 (March 25, 1965) ("In appraising advertisements . . . we do not look only to the effect that they might have had on careful analytical persons. We look also to their possible impact on those unskilled and unsophisticated in investment matters.").

n18 See, e.g., New York Investors Group.

n19 See note 9.

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**INQUIRY-1: KIRKPATRICK & LOCKHART LLP  
1800 MASSACHUSETTS AVENUE, N.W.  
2ND FLOOR  
WASHINGTON, D.C. 20036-1800  
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**Advisers Act/Section 206(4) and Rule 206(4)-1(a)(1)**

**March 20, 1998 Douglas J. Scheidt, Esq.  
Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
Judiciary Plaza  
450 Fifth Street, N.W.  
Washington, D.C. 20549**

**Re: DALBAR Inc. Request for No-Action Relief**

Dear Mr. Scheidt:

On behalf of DALBAR, Inc. ("DALBAR"), I respectfully request that the Division of Investment Management staff advise me that it will not recommend enforcement action based on Section 206(4) of the Investment Advisers Act of 1940 (the "Advisers Act") and Rule 206(4)-1(a)(1) thereunder against DALBAR or any investment adviser (or any associated person thereof) as a result of investment adviser advertisements that include DALBAR ratings as described below.

**I. BACKGROUND**

DALBAR is a nationally recognized research firm that has been in business since 1976. DALBAR specializes in conducting survey research in order to issue ratings of financial institutions. The DALBAR ratings are designed to indicate how effectively each participating firm in the surveyed industry is meeting the needs of its clients.

DALBAR has conducted a survey that is designed to measure the effectiveness of services rendered by investment advisers ("Advisers") and/or their investment advisory representatives ("IARs"). n1 Based on the results of this survey, each participating Adviser and IAR received numerical ratings. DALBAR intends to continue this program on a quarterly basis using substantially identical questionnaires; however, Advisers and IARs will be permitted to participate in the program and be rated only once every year. n2

To qualify to participate in DALBAR's program, an Adviser and any participating IAR must have (1) at least five years of experience as a financial adviser, (2) a minimum of 100 clients from whom a fee or commission was earned within the prior 12 months or at least \$ 15 million in client assets under management, n3 and (3) no record of any regulatory sanctions within the past five years by the Securities and Exchange Commission ("SEC"), state securities regulators or any self-regulatory organization as that term is defined in Section 3(a)(26) of the Securities Exchange Act of 1934. Qualifying Advisers and IARs will be solicited by DALBAR to participate in this survey for a fee, paid in advance, of \$ 500 per survey per participating IAR or, if a rating is sought only for an Adviser, per Adviser. n4 DALBAR will have no affiliation with any Adviser or IAR participating in the survey.

DALBAR will send a uniform questionnaire to all clients of a participating IAR, except when an IAR has a sufficient number of clients to permit a statistical sampling of those clients. n5 The two-page questionnaire will seek the following information: (1) the length of time that the IAR has serviced the client; (2) the client's overall rating of the IAR (ratings range from "very poor" to "excellent");

(3) the client's satisfaction rating (ranging from "very dissatisfied" to "very satisfied") with respect to eight different types of advisory services (such as retirement planning and tax planning); (4) the client's ratings of the IAR's financial results to date for the client (ranging from "far below expectations" to "above expectations"); (5) the extent to which the IAR puts the client's interests ahead of the IAR's own interests; (6) the client's satisfaction levels with various aspects of the IAR's services (such as the clarity of explanations and timeliness of advice); and (7) client information, such as age, sex, employment status and value of investment portfolio.

The questionnaire consists of a series of questions with four specific multiple choice answers. The questionnaire has not been prepared in such a manner so as to produce any type of pre-determined results to the possible benefit of any particular Advisers or IARs. Rather, the questionnaire is structured so as to make it equally easy for a client to give negative or positive responses.

If an Adviser desires to receive a firm-wide rating, the Adviser must provide DALBAR with a list of all of its qualifying IARs, who then must provide DALBAR with a list of all of their clients. DALBAR sends all of these clients a questionnaire. However, if an Adviser has more than 100 IARs, DALBAR will select randomly at least 10% or 100 of the IARs (whichever is higher), and clients of these randomly selected IARs will be sent a questionnaire in accordance with the numerical guidelines set forth in footnote 5. Thus, Advisers seeking firm-wide rankings will not be able to pre-determine those IARs whose clients will be surveyed.

The questionnaire responses will be held in strict confidence by DALBAR. No Adviser or IAR will have access to the specific responses of any particular client. In addition, DALBAR will not advise any participating Adviser or IAR as to which of their clients responded to the survey and which did not respond. However, DALBAR randomly will contact certain clients to confirm the validity of their responses.

Each response by a client to a multiple choice question is assigned a numerical value ranging from 1 to 4. For each question, DALBAR averages the responses of all clients of an Adviser or IAR to obtain a rating for that question. Each Adviser or IAR receives ratings in three major categories -- performance, trust and satisfaction -- by averaging client responses to the questions in those categories. Based on the cumulative responses of all clients of an Adviser or IAR, as applicable who return a questionnaire, DALBAR will assign to each such Adviser or IAR a numerical rating for each category, with 4.0 being the highest possible rating. DALBAR will not issue ratings to an Adviser or IAR unless the ratings are statistically valid with respect to that Adviser or IAR. DALBAR will not perform any subjective analysis of the survey results; rather, DALBAR merely assigns numerical ratings based directly on the composite client responses to the survey for each participating Adviser or IAR. In addition, each participating Adviser or IAR will receive a written numerical analysis of the survey results of their clients. These results should enable the Adviser or IAR to identify those aspects of their services that are rated highly by their clients and those areas that need improvement.

As noted above, Advisers and IARs will receive numerical ratings for each category from 1 (poor) to 4 (excellent). Those Advisers and IARs who are rated from 3.75 to 4.0 will be assigned an "excellent" rating. Other participants with ratings of 3.0 or higher will receive the following designations: 3.0 to 3.49 - good; and 3.5 to 3.74 - very good.

DALBAR will release publicly the names of Advisers and IARs who satisfy certain minimum rating guidelines (such as ratings of 3.0 or higher) and will publish listings of some or all of its survey results in its own written directories and in its own Internet web site. Among other information, those published listings will identify clearly the percentage of survey participants who have received each of the designations described above and the total number of survey participants. In addition, DALBAR expects that Advisers and IARs who participate in the survey will refer to their overall survey rating and/or to other relevant survey of their services in their own advertisements or sales materials. This letter seeks no-action relief with respect to the proposed use of these

ratings (or ratings from subsequent surveys conducted to the same manner n6) in these advertisements and sales literature.

## **II. DISCUSSION**

Section 206(4) of the Advisers Act generally prohibits an investment adviser from engaging in any fraudulent, deceptive or manipulative conduct. Rule 206(4)-1(a)(1) provides that it shall constitute a violation of Section 206(4) for an investment adviser to distribute an advertisement which, directly or indirectly, refers to a testimonial concerning the adviser. The rule does not define what constitutes a "testimonial." However, the SEC staff regularly interprets this term to mean a client's statement of his or her experience with, or endorsement of an investment adviser. n7 The SEC staff also has stated that "testimonials are prohibited because they are likely to give rise to a fraudulent or deceptive implication or mistaken inference that the experience of the person giving the testimonial is typical of the experience of the adviser's clients." n8 Based on these criteria, the use by Advisers and IARs of DALBAR's ratings would not be a testimonial and would not contravene the purposes of the testimonial rule. To the contrary, the ratings can be a valuable piece of information to be considered by potential clients of the Advisers or the IARs.

The SEC staff also has stated that the use of a third-party report in an adviser's advertisement can constitute a prohibited testimonial if "it includes a statement of a customer's experience or endorsement." n10 The proposed DALBAR ratings do not directly or indirectly constitute such a statement by a customer. Indeed, these ratings are made explicitly by DALBAR, and not by any client. No individual client or group of clients will be mentioned in connection with the references to DALBAR's ratings.

The fact that DALBAR charges each participating IAR a fee does not compromise DALBAR's status as a bona fide, independent third party. DALBAR is in the business of producing independent third-party surveys and providing related information. Its business cannot succeed unless DALBAR maintains its integrity as an unbiased third party service provider. DALBAR has no intent to compromise its business. Moreover, DALBAR's rating process simply is not subject to any type of intentional bias for or against an identifiable group of IARs or their Advisers. The DALBAR ratings are a function of numerical calculations derived directly from the client survey responses. Thus, absent an error in its mathematical calculations, there simply is no way that DALBAR's actions have any effect on the rating for individual IARs or Advisers. In other words, there is no opportunity for the ratings issued to particular survey participants to be influenced due to the level of compensation paid to DALBAR by one or more such persons.

Moreover, the mere fact that every participant in the survey provides uniform compensation to DALBAR should not be construed to transform DALBAR's services and ratings into a prohibited testimonial. Every survey participant is subject to the same fee schedule, regardless of whether the participant ultimately receives DALBAR's highest rating or its lowest rating. The Advisers and IARs do not know how they will be rated when they pay to participate in the survey. In addition, the no-action letters cited above regarding third-party reports contain no authority for the proposition that this type of compensation transforms the ratings into a testimonial. If anything, the Stalker letter makes clear that the mere payment of compensation by an adviser to an unbiased third party in connection with a third-party report does not transform the report into a prohibited testimonial.

In *Stalker*, a registered investment adviser paid Money Manager Verified Ratings ("MMVR") -- an independent organization with no affiliation to the adviser -- to verify the adviser's investment performance for a category of client accounts. As summarized by the staff, "MMVR reviews client statements, verifies the [performance] calculations, and ranks the adviser in its respective category. These rankings are then used by financial publications, such as Barron's." The staff concluded as follows: Even though [the adviser] pays MMVR a fee to verify [the adviser's] investment performance, and MMVR's performance information may be included in a financial publication, paragraph (a)(1) [of Rule 206(4)-1] would not prohibit [the adviser] from using reprinted articles containing this performance information. [Emphasis added.] Similarly, the



compensation to be received by DALBAR should not cause the results of its surveys to be transformed into a testimonial prohibited by Rule 206(4)-1.

The staff's most recent no-action position dealing with the testimonial rule also supports the relief requested herein. In a letter issued on August 28, 1997, the staff advised Cambiar Investors, Inc. that the use of a partial client list in an adviser's advertisement does not constitute a testimonial. In so doing, the staff stated as follows: In prohibiting the use of testimonials, the Commission was concerned that such advertisements were inherently misleading because "by their very nature they emphasize the comments and activities favorable to the investment adviser and ignore those that are unfavorable." Advisers Act Release No. 121 (Nov. 2, 1961) (adopting Rule 206(4)-1). A partial client list neither emphasizes comments or activities favorable to the investment adviser nor ignores those that are unfavorable.

Based on this same logic, the use of DALBAR's ratings is not a testimonial. On their face, the ratings do not constitute a statement by clients of the adviser, but rather a conclusion by DALBAR, an unbiased third-party research company, based on DALBAR's pre-established numerical guidelines. Moreover, the ratings are not even an indirect statement by a select group of advisory clients. Unlike the SEC's concern cited above, the ratings do not directly or indirectly "emphasize" statements by one or more clients that are "favorable to the investment adviser and ignore those that are unfavorable." Rather, survey responses will be solicited from at least 100 clients of each participating IAR. In addition, in order for an Adviser to receive a rating, a similar number of clients of at least 10% or 100 of the Adviser's IARs (whichever is higher) must be surveyed.

Similarly, as noted above, the staff has stated that the purpose of the testimonial rule is to avoid the implication or inference "that the experience of the person giving the testimonial is typical of the adviser's clients." Even if DALBAR's ratings are construed to be an indirect testimonial due to the role of clients in the survey -- which we believe would be an inappropriate conclusion -- the "experience" being conveyed is not the experience of a single client or a selected group of clients. Rather, it is, at most, the collective experience of all clients responding to the survey. III. REQUEST FOR RELIEF

For the foregoing reasons, DALBAR respectfully requests that the SEC staff advise me that it will not recommend enforcement action to the SEC based on Section 206(4) of the Advisers Act or Rule 206(4)-1(a)(1) thereunder against DALBAR, any Adviser or any associated person thereof due to their use of DALBAR ratings as described above in advertisements and sales materials. n11

If you have any questions, or require additional information with respect to the contents of this letter, please contact me at (202) 778-9059.

Very truly yours,

Robert J. Zutz

#### **Footnotes**

n1 As used herein, the term IAR is not intended to have the same definition as set forth in SEC rules. Rather, it simply refers to those natural persons employed by investment advisers who render advisory services to an Adviser's clients.

n2 Thus, the description of the DALBAR program contained herein applies both to the activities that have already been conducted and to future program activity.

n3 As a result of this requirement, DALBAR expects that most, but not all, participating Advisers will be registered with the Securities and Exchange Commission as investment advisers under the Advisers Act.

n4 Thus, as applicable, references herein to participating IARs also apply to a participating Adviser that has no IARs who are being rated.

n5 DALBAR randomly will select clients from a group that includes persons from whom the Adviser or IAR has earned an advisory fee during the past 12 months and clients who were listed by the Adviser or IAR with respect to any prior DALBAR survey. In particular, if an IAR has fewer than 300 clients from whom the IAR has earned a fee within the prior 12 months, the questionnaire will be sent to each client. If an IAR has between 300 and 1,000 such clients, it will be sent to 100 randomly selected clients. If an IAR has between 1,001 and 2,000 such clients, it will be sent to 150 randomly selected clients. If an IAR has more than 2,000 clients, it will be sent to 200 or more randomly selected clients. In the future, DALBAR may adjust these guidelines based on prior response rates. However, DALBAR always will send questionnaires to a sufficient number of clients in order to have a statistically valid sample.

n6 DALBAR hopes to produce a quarterly survey using substantially identical questionnaires. Advisers and IARs who participate in subsequent surveys will be able to monitor those areas in which their services have improved or deteriorated.

n7 See, e.g., Cambiar Investors, Inc. (August 28, 1997) and the no-action letters cited in footnote 4 thereof.

n8 See, e.g., Multi-Financial Securities Corp. (November 9, 1995); CIGNA Securities, Inc. (September 10, 1991); and J.Y. Barry Arbitrage Management, Inc. (October 18, 1989). See also Investment Advisers Act Release No. 121 (November 2, 1961).

First and foremost, the ratings at issue are assigned by DALBAR, an independent research firm that has no affiliation or relationship with any Adviser or IAR other than as described in this letter. Although client responses to multiple choice questions on the survey questionnaire are the key determinant in the rating process, the ratings are made exclusively by DALBAR and do not directly or indirectly identify any individual client, let alone contain any statement regarding the experience of any particular client. The SEC staff has stated on many occasions that such unbiased third-party reports in advertisements are not testimonials prohibited by Rule 206(4)-1. n9

n9 See, e.g., Stalker Advisory Services (January 18, 1994) ("The staff takes the position that bona fide, unbiased third-party reports generally are not prohibited by the testimonial rule."); and Kurtz Capital Management (January 18, 1988) ("The staff takes the position that bona-fide third party reports generally are not covered by Rule 206(4)-1(a)(1), which prohibits the use of testimonials by an investment adviser.

n10 New York Investors Group, Inc. (September 7, 1982). See also In the Matter of Patricia Owen-Michel, Investment Advisers Act Release No. 1584 (September 27, 1996) (president of investment adviser sanctioned for numerous violations, including a testimonial rule violation for including in a promotional package a reprint of a newspaper article quoting a client's investment experience with the adviser).

n11 I note that no relief is being sought with respect to Rule 206(4)-1(a)(5), which prohibits an advertisement from containing any untrue statement of a material fact or from otherwise being false or misleading. Advertisements containing DALBAR ratings as described above would still be subject to these standards. As noted in Stalker Advisory Services, supra, "whether any advertisement is false or misleading will depend generally on the particular facts and circumstances surrounding its use."