

**Pub. Avail. May 7, 1996**  
**J.P. Morgan Investment Management, Inc.**

**TOTAL NUMBER OF LETTERS: 2**

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

**May 7, 1996**

**Our Ref. No. 95 667 CC**  
**J.P. Morgan Investment**  
**Management, Inc.**  
**File No. 801 21011**

**RESPONSE OF THE OFFICE OF CHIEF COUNSEL**  
**DIVISION OF INVESTMENT MANAGEMENT**

Your letter of February 1, 1996 requests our assurance that we would not recommend enforcement action to the Commission under Section 206(4) of the Investment Advisers Act of 1940 (the "Advisers Act") or Rule 206(4)-1 thereunder if J.P. Morgan Investment Management, Inc. ("JPMIM"), a registered investment adviser, advertises the performance of a particular investment strategy by calculating the performance of accounts for which JPMIM employs that strategy and deducting from that performance the highest advisory fee charged to any account employing that strategy during the performance period.

You state that JPMIM provides investment advisory services, typically to institutional investors, with respect to a wide range of asset classes and sectors. Although JPMIM has fee schedules for its various investment strategies, you state that some clients may negotiate and pay fees lower than those specified in the schedules. Because of these fee variations JPMIM proposes to present the composite performance of accounts for which it employs a particular investment strategy by deducting the highest fee charged to any account employing that strategy during the performance period. You represent that any quotation of this performance data will be accompanied by disclosure that the performance reflects the deduction of the highest fee charged.

Section 206(4) of the Advisers Act prohibits an 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)(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 took the position that Rule 206(4)-1(a)(5) requires that advertised performance reflect the deduction of advisory fees that a client would have paid or actually paid. In Securities Industry Association (pub. avail. Nov. 27, 1989) ("SIA"), the staff was asked to modify the position taken in Clover Capital so that an adviser could advertise performance information that reflected a "model fee," which in one instance was described as the highest fee charged to an account included in a composite. The staff granted relief only with respect to performance that occurred prior to May 27, 1990, stating that performance occurring after that date must reflect the deduction of the fees actually charged to the adviser's clients.

You maintain that, notwithstanding the staff's position in SIA, advertising performance that reflects a model fee in the manner that you propose would not be fraudulent, deceptive, or misleading and therefore would not violate Section 206(4) or Rule 206(4)-1(a)(5). We agree. In order to obtain the ease of calculation that derives from using a model fee, JPMIM is willing to advertise lower performance numbers than it could have in reliance on Clover Capital. When an adviser advertises performance that is no higher than that which reflects the deduction of actual fees, there appears

to be little chance that an investor would be misled. In our view, therefore, assuming appropriate accompanying disclosure, Rule 206(4)-1(a)(5) does not prohibit an adviser from advertising performance that reflects the deduction of a model fee when doing so would result in performance figures that are no higher than those that would have resulted if actual fees had been deducted.

Accordingly, we would not recommend enforcement action to the Commission if JPMIM advertises the composite performance of accounts for which it employs a particular investment strategy by deducting a model fee equal to the highest fee charged to any account employing that strategy during the performance period. Because this response is based on the facts and representations in your letter, you should note that any different facts or representations might require a different conclusion.

Veena K. Jain  
Attorney

### **Footnotes**

1 The staff provided limited relief in recognition of the fact that many advisers did not, at the time of SIA's request, have records enabling them to calculate performance net of actual fees.

2 Documentation reflecting the manner in which the model fee is calculated should be maintained by the adviser under Advisers Act Rule 204 2(a)(16) as part of the calculation of performance data used in advertisements.

3 You should note that this position does not depend on the client's level of sophistication.

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**February 1, 1996**

**Office of the Chief Counsel**  
**Division of Investment Management**  
**Securities and Exchange Commission**  
**450 Fifth Street, N.W.**  
**Washington, D.C. 20549**

Ladies and Gentlemen:

We are writing on behalf of J.P. Morgan Investment Management Inc. ("JPMIM") to request your advice that the Staff will not recommend enforcement action if JPMIM advertises historical performance of certain of its different investment strategies by deducting the highest fee charged to a customer employing each such strategy during the relevant period.

### **I. FACTS**

JPMIM is an investment adviser registered under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), with assets under management exceeding \$ 150 billion for approximately

1,000 clients. The average account size is \$ 100 million and, with limited exception, account size ranges from \$ 20 million to \$ 1.5 billion.

JPMIM's clients typically are institutional investors such as: pension and other employee benefit plans of corporations, state and local governments, and labor unions; other tax exempt organizations, such as charitable foundations, educational institutions, endowments and foreign governments; and insurance companies, investment companies, and other corporations and off shore entities.

JPMIM offers advisory services across a wide range of asset classes and sectors. Annual fees for the most often used types of services typically range from .30 of 1% for the first \$ 75 million in fixed income accounts to .60 of 1% for the first \$ 25 million in equity and balanced accounts; however, some clients may negotiate lower fees.

JPMIM desires to disseminate to existing and potential clients brochures describing its various investment strategies and their performance. It believes that clients would find the inclusion of performance information in the brochures useful in their decision making process.

JPMIM believes that providing a strategy's performance based on actual fees would not be practicable because of the fee variations. To ensure that a recipient of a brochure does not receive information that overstates performance, JPMIM is prepared [to present performance for a particular investment strategy after deducting the highest fee it charges to a customer employing that strategy during the period for which performance is reported.] To make certain that readers would be aware of this practice, it proposes to add the following legend to the performance information:

Performance figures are net of fees charged to customers. For each strategy shown, the performance has been reduced by the amount of the highest fee charged to any JPMIM customer employing that particular strategy during the period under consideration. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. JPMIM's fees are available upon request and also may be found in Part II of its Form ADV. Past performance does not guarantee future results.

For the reasons set forth below, we are of the opinion that the use of the proposed fee calculation in advertisements would not violate the Advisers Act.

## **II. DISCUSSION**

No statute or rule of the Commission specifically prohibits the use of so called "model" fees in the manner JPMIM proposes. In a no action letter, Securities Industry Assoc. (1989 SEC No Act. LEXIS 1177 (November 27, 1989)), the Staff expressed its view that, after a grace period following the publication of the letter, any advertisement that includes performance data must reflect deduction of an adviser's actual fees. The Staff's position was based on its interpretation of the Rules under Section 206 of the Advisers Act and, in particular, Rule 206(4)-1(a)(5).

As the Staff wrote in a later letter on a related issue:

Rule 206(4)-1... defines the use of certain specific types of advertisements by advisers as fraudulent, deceptive, or manipulative. Paragraph (a)(5) of rule 206(4)-1 makes it 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.

Clover Capital Management, Inc., 1991 SEC No Act. LEXIS 978, \*3 (July 19, 1991).

The Staff's response continues:

As a general matter, whether any advertisement is false or misleading will depend on the particular facts and circumstances surrounding its use, including (1) the form as well as the content of the advertisement, (2) the implications or inferences arising out of the advertisement in its total context, and (3) the sophistication of the prospective client. Id. (Citation omitted)

We believe JPMIM's proposal to advertise performance in the manner described to highly sophisticated investors who are informed by an appropriate legend of the basis on which historical performance is calculated would not be fraudulent, deceptive or misleading. Accordingly, we are of the opinion that JPMIM's proposed actions would not violate the Advisers Act and, in particular, Section 206 and the relevant Rules thereunder.

We are hopeful of receiving your favorable response. If the Staff is unable to grant the requested relief, we would appreciate the opportunity to discuss your conclusions before you formally reply to our request.

Very truly yours,  
STROOCK & STROOCK & LAVAN