

Investments Advisers Act of 1940

Section 206(4) and Rule 206(4)-1(a)(2)

The TCW Group, Inc.

November 7, 2008

RESPONSE OF THE OFFICE OF CHIEF COUNSEL DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 2007313104

File No. 801-6642 et al.

Your letter dated September 24, 2008 requests our assurance that we would not recommend enforcement action to the Securities and Exchange Commission (the "Commission") against The TCW Group, Inc.'s wholly owned investment adviser subsidiaries (the "TCW Advisers") under section 206(4) of the Investment Advisers Act of 1940 (the "Advisers Act") and rule 206(4)-1(a)(2) thereunder if the TCW Advisers distribute certain marketing materials to prospective clients and current clients who are not invested in the investment strategy to which the marketing materials relate, as described below, that show no fewer than five holdings that contributed most positively to a representative account's performance and an equal number of holdings that contributed most negatively to the representative account's performance.

Facts

You state the following: The TCW Advisers are registered with the Commission under the Advisers Act. The TCW Advisers distribute detailed analytical information regarding the recent performance and portfolio attributes of certain of their investment strategies ("Portfolio Analytics"),¹ in conjunction with presentations of composite performance information, to many existing TCW Adviser clients (with respect to the investment strategy in which such clients currently invest) and to prospective clients or their consultants upon their unsolicited request.²

Among the available Portfolio Analytics that are now, and may in the future be, provided by the TCW Advisers are the "Best Performers/Worst Performers Charts" ("Charts"). The Charts provide an analysis that is intended to demonstrate the effect that individual holdings in a representative account³ for a particular investment strategy had on the account's return during the measurement period (the "Measurement Period"). Therefore, the Charts are intended to supplement the TCW Advisers' presentation of the investment strategy's overall performance by providing information about how an adviser's investment decisions affected that performance.⁴ The Charts list, for the relevant period and identified investment strategy, no fewer than ten individual holdings, including a certain number of holdings that most positively contributed to the representative account's return for the period, and an equal number of holdings that most negatively contributed to the account's return for the Measurement Period (the "Holdings").⁵ The Charts provide both the average weight of the Holdings during the Measurement Period and the contribution of these Holdings to the representative account's return. These Holdings are selected from all of the representative account's holdings over the Measurement Period in a mechanical and objective manner by using the Calculation (defined below) to show their relative impact on the account's overall performance; they are not included or excluded for any other reason. The Calculation computes the contribution of each representative account holding by calculating the weight (i.e., percentage of the total account) invested in each holding multiplied by the rate of return for that holding during the Measurement Period (the "Calculation").⁶ The result shows each holding's contribution to the account's overall return during the Measurement Period.

Each Chart's presentation of information and number of Holdings will be consistent from Measurement Period to Measurement Period. Each page containing a Chart will disclose how to obtain (i) the Calculation's methodology, and (ii) a list showing the contribution of each holding in the representative account to the overall account's performance during the Measurement Period.⁷ In addition, the TCW Advisers will ensure that each Chart will include all information necessary to make the Chart not misleading, including presenting the best and worst performing Holdings on the same page with equal prominence, and with appropriate disclosure as discussed above, in close proximity to the performance information. For example, each page containing a Chart will disclose that:

- the Holdings identified do not represent all of the securities purchased, sold, or recommended for advisory clients; and
- past performance does not guarantee future results.

Consistent with prior staff guidance, each TCW Adviser currently distributes the Charts only to current clients (with respect to the investment strategy in which such clients currently invest)⁸ and to prospective clients or consultants who specifically make unsolicited requests for such information.⁹ However, each TCW Adviser wishes to provide the Charts to prospective clients and consultants who do not specifically request the information, and to current clients who are not invested currently in the investment strategy represented in the Chart. The TCW Advisers are concerned that providing the Charts to prospective clients, consultants, or current clients not invested currently in the investment strategy represented in the Chart who do not specifically make unsolicited requests for them may violate section 206(4) of the Advisers Act and rule 206(4)-1(a)(2) thereunder. The TCW Advisers argue that the Charts would provide useful information to this wider audience.

Analysis

Section 206(4) of the Advisers Act prohibits investment advisers 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)(2) under the Advisers Act generally provides that it is a fraudulent, deceptive or manipulative act, practice, or course of business for any investment adviser to publish, circulate, or distribute any advertisement "which refers, directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person" Rule 206(4)-1(a)(2), however, does not prohibit an advertisement "which sets out or offers to furnish a list of all recommendations made by such investment adviser" during the preceding year, provided that the advertisement or the list contains certain specific disclosures about the recommendations.¹⁰

When the Commission adopted rule 206(4)-1 under the Advisers Act, it stated that advertisements containing past specific recommendations were inherently misleading because "by their very nature they emphasize the comments and the activities favorable to the investment adviser and ignore those which were unfavorable."¹¹ The primary concern underlying the prohibition against advertisements containing past specific recommendations is that an adviser could "cherry pick" its profitable recommendations and omit the unprofitable ones.¹² Under those circumstances, an advertisement could fraudulently or deceptively imply that the recommendations listed, and their profitability, are representative of the experience of the adviser's clients. You are concerned that the Charts would violate section 206(4) of the Advisers Act and rule 206(4)-1(a)(2) thereunder if they are provided to prospective clients and consultants who do not specifically request the information, and to current clients who are not invested currently in the investment strategy represented in the Chart.¹³ You note, however, that we have provided no-action assurances to an adviser that sought to provide reports to prospective and existing clients that identified some, but not all, past specific recommendations under conditions designed to ensure that the reports did not raise the dangers that rule 206(4)-1(a)(2) under the Advisers Act was designed to prevent.¹⁴ You

assert that your proposed use of the Charts similarly does not raise the dangers that the rule was designed to prevent.

You state that the Calculation mechanically produces an equal number of best-performing Holdings and worst-performing Holdings for a Measurement Period. You argue that there is no subjectivity involved, and no opportunity for a TCW Adviser to cherry pick only successful holdings. For example, you represent that: (1) the Calculation will take into account consistently the weighting of every holding in the representative account that contributed to the account's performance during the Measurement Period, and the Charts will reflect consistently the results of the Calculation; (2) the Charts' presentation of information and number of Holdings will be consistent from Measurement Period to Measurement Period; and (3) the Charts will show no fewer than ten Holdings, including an equal number of Holdings that contributed most positively and negatively to the representative account's performance during the Measurement Period.

We believe that the Charts prepared and presented in the manner described in your letter could be useful information to prospective clients, consultants, and current clients not invested currently in the investment strategy represented in the Chart and do not raise the dangers that rule 206(4)-1(a)(2) was designed to prevent. Specifically, the Chart's presentation of Holdings produced by the Calculation does not appear to allow the TCW Advisers to cherry pick profitable recommendations and omit unprofitable ones.

Accordingly, based on the facts and representations in your letter, we would not recommend enforcement action to the Commission under section 206(4) of the Advisers Act and rule 206(4)-1(a)(2) thereunder against the TCW Advisers if, under the circumstances described in this letter, the TCW Advisers distribute Charts to prospective clients and their consultants and current clients who are not invested currently in the investment strategy represented in the Chart. Because our position is based on the facts and representations in your letter, you should note that any different facts or representations may require a different conclusion. This letter addresses only an adviser's responsibilities with respect to section 206(4) of the Advisers Act as defined solely by rule 206(4)-1(a)(2) thereunder. Advisers that distribute advertisements containing selected past recommendations must ensure that the advertisements comply with rule 206(4)-1(a)(5) under the Advisers Act.¹⁵ Advisers that distribute advertisements containing past specific recommendations also remain subject to the prohibitions of sections 206(1) and (2) of the Advisers Act.¹⁶

In taking this position, we rely in particular on your representations that:

- the Calculation will take into account consistently the weighting of every holding in the representative account that contributed to the account's performance during the Measurement Period, and the Charts will reflect consistently the results of the Calculation;
- each Chart's presentation of information and number of Holdings will be consistent from Measurement Period to Measurement Period;
- the Charts will show no fewer than ten Holdings, including an equal number of positive and negative Holdings;
- the Charts will disclose how to obtain: (i) the Calculation's methodology; and (ii) a list showing every holding's contribution to the overall account's performance during the Measurement Period;
- each Chart will include all information necessary to make the Chart not misleading, including presenting the best- and worst-performing Holdings on the same page with equal prominence, and with appropriate disclosure as discussed above, in close proximity to the performance information; and

- each TCW Adviser will maintain, and make available to the staff upon request, records that evidence: (1) the criteria used to select the specific securities listed in each Chart (i.e., the Calculation); (2) a list showing the contribution of each holding in the representative account to the overall account's performance during the Measurement Period; and (3) all supporting data necessary to demonstrate the calculation of the Chart's contribution analysis and to demonstrate the appropriateness of the Holdings included in each Chart.

Holly Hunter-Ceci
Attorney-Adviser

Endnotes

1 The TCW Advisers state that Portfolio Analytics generally include information relating to a portfolio's composition, performance, or other statistical measures (such as portfolio return, turnover, characteristics/weights, alpha, beta, tracking error, and the information ratio) that can be used to evaluate the portfolio in relation to a benchmark or peer group.

2 The TCW Advisers do not ask, and we take no position regarding, whether the TCW Advisers' use of any other information presented in conjunction with the Charts (as defined below) (e.g., the presentations of the composite information) complies with the federal securities laws.

3 The TCW Advisers do not ask, and we take no position regarding, whether the TCW Advisers' selection of the representative account complies with the federal securities laws.

4 The Measurement Period would consist of at least an entire calendar month, as computed as of the most recent calendar month's last trading day.

5 You argue that it will not always be the case that all of the Holdings on the "best" list will show positive contribution and all of the Holdings on the "worst" list will show negative contribution. If all of the positions in an account appreciate or are sold for a gain during the measurement period, then the "worst" list will show Holdings that contributed positively to performance, albeit to a lesser extent than those shown on the "best" list. Conversely, if all of the positions in an account depreciate or are sold at a loss during the measurement period, then the "best" list will show Holdings that contributed negatively to performance, albeit to a lesser extent than those shown on the "worst" list.

6 You argue that the weighting of each holding in the account is of equal if not greater importance to the holding's overall contribution to the performance of the account. For example, a holding that returned 100% but that constituted only 1% of the account would have less impact on the account's performance than a holding that returned 10% but constituted 20% of the account.

7 Each TCW Adviser will maintain, and make available to the staff upon request, records that evidence: (1) the criteria used to select the specific securities listed in each Chart (i.e., the Calculation); (2) a list showing the contribution of each holding in the representative account to the overall account's performance during the Measurement Period; and (3) all supporting data necessary to demonstrate the calculation of the Chart's contribution analysis and to demonstrate the appropriateness of the Holdings included in each Chart.

8 See Investment Counsel Association of America, Inc., SEC Staff No-Action Letter (Mar. 1, 2004) ("a written communication by an investment adviser to its existing clients generally would not be an advertisement within the meaning of rule 206(4)-1(b) merely because it discusses the adviser's past specific recommendations concerning securities that are or were recently held by each of those clients").

9 Id., stating that "a written communication by an investment adviser that does no more than respond to an unsolicited request by a client, prospective client or consultant for specific

information about the adviser's past specific recommendations is not an 'advertisement' within the meaning of rule 206(4)-1(b)."

10 Rule 206(4)-1(a)(2)(A) under the Advisers Act provides that the rule's prohibition against including past specific recommendations that were or would have been profitable in an advertisement does not apply if the advertisement includes or offers to furnish a list of all recommendations made by the adviser that includes the following information: (1) the name of each security recommended; (2) the date and nature of each recommendation (e.g., whether to buy, sell or hold); (3) the market price at the time of the recommendation; (4) the price of the security when the recommendation was to be acted upon; (5) the market price of each such security at the most recent practicable date; and (6) a disclaimer regarding the profitability of recommendations in the future.

11 Advisers Act Release No. 121 (Nov. 2, 1961).

12 See Starr and Kuehl, Inc., SEC Staff No-Action Letter (Apr. 17, 1976) (providing prospective clients with selected past issues of an adviser's newsletter in order to solicit new subscribers could violate rule 206(4)-1(a)(2) under the Advisers Act).

13 See Dow Theory Forecasts, Inc., SEC Staff No-Action Letter (Aug. 26, 1983) ("Rule 206(4)-1(a)(2) does not permit an advertisement which refers, directly or indirectly, to past specific recommendations of an investment adviser which were or would have been profitable to any person even if the advertisement offers to provide a full list of all recommendations made during the preceding period of not less than one year with all the details specified in the rule"). See also James B. Peeke & Co., SEC Staff No-Action Letter (Sept. 13, 1982); and J.D. Minnick & Co., SEC Staff No-Action Letter (Apr. 30, 1975).

14 See Franklin Management, Inc., SEC Staff No-Action Letter (Dec. 10, 1998) ("Franklin") (adviser represented that it would use objective, non-performance based criteria to select securities for reports, consistently applied; the reports would not discuss realized or unrealized profits or loss; the reports would include cautionary disclosures; and the adviser would maintain records regarding all recommendations and the selection criteria used to select the securities in the reports).

15 Rule 206(4)-1(a)(5) provides that it is a fraudulent, deceptive or manipulative act, practice or course of business within the meaning of section 206(4) of the Advisers Act for any adviser to distribute, directly or indirectly, any advertisement that contains any untrue statement of material fact or that is otherwise false or misleading. See Franklin, *id.* ("Advisers that distribute advertisements containing selected past recommendations must ensure that the advertisements comply with Rule 206(4)-1(a)(5) under the Advisers Act"). Whether a particular advertisement is false or misleading depends upon all the relevant facts and circumstances. See, e.g., Anametrics Investment Management, SEC Staff No-Action Letter (May 5, 1977) (whether an advertisement is misleading will depend upon all of the particular facts, including the form and content of the advertisement, the implications or inferences arising out of the context of the advertisement, and the sophistication of the recipient of the advertisement).

16 See Franklin, *supra* note 14.

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