

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

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

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. 3/

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.

3/ 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.

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. 4/ 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. 5/

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

4/ 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.

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