

**INVESTMENT ADVISER PERFORMANCE ADVERTISING: SEC'S DIVISION  
OF INVESTMENT MANAGEMENT ISSUES NEW LETTER EXPANDING  
THE ABILITY OF ADVISERS TO USE ANALYSIS OF PAST SPECIFIC  
RECOMMENDATIONS IN ADVERTISEMENTS**

In November 2008, the Securities and Exchange Commission's Division of Investment Management issued a significant no-action letter expanding the ability of a registered investment adviser to use performance analytics in advertisements. In the *TCW Group, Inc.* letter, the Division indicated that it would not recommend enforcement action if, subject to the conditions summarized below, a registered investment adviser uses performance-based criteria to identify "best" and "worst" performers that will be disclosed in the adviser's marketing materials.<sup>1</sup> Prior to this letter, registered investment advisers were prohibited from including this type of information in advertisements.

*Background*

Section 206(4) and Rule 206(4)-1 under the Investment Advisers Act of 1940 generally prohibit investment advisers that are registered, or required to be registered, from using certain performance information in advertisements.<sup>2</sup> The Division had addressed the inclusion of specific recommendations in at least two letters that predate the *TCW* letter, but neither letter permitted the use of performance-based selection criteria in advertisements.

In a 1998 no-action letter issued to Franklin Management, the Division took the position that, notwithstanding the language of Rule 206(4)-1, a registered investment adviser could include in its advertisements certain information regarding the performance of some, but not all, of the individual securities recommended by the adviser.<sup>3</sup> The Division stated its view that so long as securities were selected for inclusion in an advertisement by "objective, non-performance based criteria consistently applied,"<sup>4</sup> an investment adviser would be restricted in its ability to "cherry-pick" its best-performing securities—the danger that the Rule was designed to address. In taking the no-action position, the Division required, among other things, that the selection criteria be applied to a portfolio consistently over time, and that the adviser provide disclosure in the advertisement regarding the selection methodology and bring the limited nature of the information included in the advertisement to investors' attention.<sup>5</sup>

---

<sup>1</sup> The *TCW Group, Inc.*, SEC No-Action Letter (Nov. 7, 2008), available at <http://sec.gov/divisions/investment/noaction/2008/tcwgroup110708.htm>.

<sup>2</sup> Advertisements by Investment Advisers, 17 C.F.R. § 275.206(4)-1 (2008). Among other things, the Rule generally makes it a fraudulent act under the Advisers Act to refer in an advertisement "directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person . . ." *Id.*

<sup>3</sup> Franklin Management, SEC No-Action Letter (Dec. 10, 1998).

<sup>4</sup> *Id.*

<sup>5</sup> The *TCW* letter contains additional detail regarding requirements for advertisements complying with the letter.

The Division in 2004 further clarified that performance information (including performance of specific securities recommended by an adviser) provided in response to unsolicited requests from clients or prospective clients would not be considered an “advertisement” within the meaning of Rule 206(4)-1.<sup>6</sup> In *TCW*, the Division builds on the *Franklin* and *ICAA* letters by allowing advisers to provide advertisements to prospective clients that contain information about the positive or negative effect on a representative account of specific past recommendations.

### *The TCW Letter*

In *TCW*, the Division permits the use of analytics in advertisements relating to an adviser’s recent performance and the attributes of certain of its investment strategies. More specifically, the Division said it would not recommend enforcement action under Section 206(4) of the Advisers Act or Rule 206(4)-1(a)(2) thereunder against *TCW*’s registered investment adviser subsidiaries for distributing advertising materials that include “Best Performers/Worst Performers” charts. These charts would demonstrate the effect that individual holdings in a representative account for a particular investment strategy had on the account’s return during a specified period. Advertising materials including the charts could be distributed to prospective clients and consultants regardless of whether they specifically requested the information.

An adviser considering using a Best Performers/Worst Performers chart in its advertisements should take note of several conditions set out in the *TCW* letter.<sup>7</sup> In essence, these conditions are that:

- The chart must include no fewer than five holdings that contributed most positively to the representative account’s performance and an equal number of holdings that contributed most negatively to that account’s performance;
- The chart must provide both the average weight of the selected securities in the portfolio and the contribution of the selected securities to the account’s overall return;
- The selected securities must be chosen from all securities in an account during the period in a “mechanical and objective manner” and based only on their relative impact on the performance of the account during the period;
- The presentation and number of securities reported in the charts must be consistent from period to period; and
- Certain disclosures must be made regarding the calculation methodology and interpretation of the chart.

---

<sup>6</sup> Investment Counsel Ass’n. of America, Inc., SEC No-Action Letter (Mar. 01, 2004) (the “ICAA” letter). In this letter, the Division also confirmed that a written communication by an investment adviser to its existing clients generally would not be an “advertisement” for purposes of the Rule merely because it discusses the adviser’s past specific recommendations concerning securities held by those clients.

<sup>7</sup> The letter describes the calculation methodology used and provides additional detail regarding the charts and related disclosure requirements.

The *TCW* letter represents a continuation of the relaxation by the Division of the prohibition imposed by Rule 206(4)-1(a)(2) under the Advisers Act on the use of the performance of selected securities in advertising by investment advisers registered under the Advisers Act so long as the adviser uses objective and mechanical methods for selecting those securities. The letter is important because it permits advisers to provide analytical context to the performance of representative accounts, while addressing concerns over cherry-picking that are otherwise presented.

\* \* \* \* \*

If you have any questions concerning the foregoing or would like additional information, please contact Margery K. Neale (212-728-8297, [mneale@willkie.com](mailto:mneale@willkie.com)), David W. Blass (202-303-1114, [dblass@willkie.com](mailto:dblass@willkie.com)), Jai Massari (202-303-1133, [jmassari@willkie.com](mailto:jmassari@willkie.com)), or the attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099 and has an office located at 1875 K Street, NW, Washington, DC 20006-1238. Our New York telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our Washington, DC telephone number is (202) 303-1000 and our facsimile number is (202) 303-2000. Our website is located at [www.willkie.com](http://www.willkie.com).

November 20, 2008

Copyright © 2008 by Willkie Farr & Gallagher LLP.

All Rights Reserved. This memorandum may not be reproduced or disseminated in any form without the express permission of Willkie Farr & Gallagher LLP. This memorandum is provided for news and information purposes only and does not constitute legal advice or an invitation to an attorney-client relationship. While every effort has been made to ensure the accuracy of the information contained herein, Willkie Farr & Gallagher LLP does not guarantee such accuracy and cannot be held liable for any errors in or any reliance upon this information. Under New York's Code of Professional Responsibility, this material may constitute attorney advertising. Prior results do not guarantee a similar outcome.