

**PUBLIC**

**AUG 6 1996**

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 95-506-CC  
Nicholas-Applegate  
Mutual Funds  
File No. 811-7428

By letter dated August 5, 1996, you request our assurance that we would not recommend enforcement action to the Commission under Section 34(b) of the Investment Company Act of 1940 ("1940 Act"), Section 206 of the Investment Advisers Act of 1940 ("Advisers Act") or Rule 206(4)-1 thereunder 1/ if Nicholas-Applegate Mutual Funds (the "Portfolios") include in their prospectuses information concerning the performance of certain non-investment company (i.e., private) accounts managed by Nicholas-Applegate Capital Management ("NACM"), under the circumstances described below.

Facts

Each Portfolio is a feeder fund in a master-feeder arrangement and invests all of its assets in a corresponding series ("Fund") of a master trust. NACM manages the assets of each Fund. You state that the prospectus for each Portfolio, during the first year of the Portfolio's operations, has included information concerning the performance of NACM's similarly managed private accounts, in accordance with the staff's no-action letter issued to Growth Stock Outlook Trust, Inc. (pub. avail. Apr. 15, 1986) ("Growth Stock"). In Growth Stock, the staff took a no-action position with respect to a closed-end investment company that proposed to include in its prospectus the performance of its investment adviser's similarly managed private accounts during the first year of the fund's operations, based on representations that (1) the performance was for all of the adviser's private accounts that were managed with investment objectives, policies and strategies substantially similar to those used in managing the fund; (2) the relative sizes of the fund and the private accounts were sufficiently comparable to

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1/ Section 206 of the Advisers Act and Rule 206(4)-1 thereunder prohibit an investment adviser from making any false or misleading statement in any advertisement. You have requested no-action relief under Rule 206(4)-1 on the theory that a Portfolio's prospectus might be deemed to be an "advertisement" for NACM's advisory services and because the staff's letter to Growth Stock Outlook Trust, Inc. (infra) was analyzed under that provision. While we are granting your request, we do not believe that a prospectus that includes NACM's private account performance would necessarily constitute an advertisement for advisory services. See Munder Capital Management (pub. avail. May 17, 1996) (stating that documents relating specifically to a fund are not advertisements for advisory services under Rule 206(4)-1 if they are not designed to maintain existing clients or solicit new clients for the adviser).

ensure that the private account performance would be relevant to a potential investor in the fund; and (3) the prospectus clearly disclosed that the performance information related to the adviser's management of private accounts and that such information should not be interpreted as indicative of the fund's future performance.

The staff's no-action position in Growth Stock has been viewed as being limited to a fund's first year of operations. You maintain that, because of this position, a mutual fund that has been in operation for more than one year but not long enough to have established its own long-term performance record is at a competitive disadvantage in marketing itself against other funds and investment products having longer performance records. 2/ You state that this disadvantage is most evident in the retirement plan marketplace, where investors typically are concerned with long-term performance.

#### Requested Relief

You propose to include information concerning NACM's private account performance in each Portfolio's prospectus, beyond the first year of the Portfolio's investment operations. 3/ You represent

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- 2/ You state that, in addition, a position taken by the National Association of Securities Dealers, Inc. ("NASD") precludes the Portfolios from providing NACM's private account performance in sales material. The NASD has stated that presenting an adviser's track record in advertising or sales literature may be a violation of its Rules of Fair Practice (now Rules of Conduct) because the private account performance may lead investors to conclude that the fund will perform as well as the adviser's private accounts. NASD Regulatory and Compliance Alert at 7-8 (June 1992). You have not requested, and we do not express, any view regarding the inclusion of NACM's private account performance information in Rule 482 advertisements or supplemental sales literature.
- 3/ In connection with your request, you represent that NACM's private account performance composites will include the performance of all of NACM's private accounts with investment objectives, policies and strategies substantially similar to those of a Portfolio. We note that, in our view, an adviser may choose to exclude certain similar accounts from a composite, so long as such exclusion would not cause the composite performance to be misleading. See Fiduciary Management Associates (pub. avail. Mar. 5, 1984) (adviser's use of prior performance information is not misleading when, among other things, the performance of those accounts to be  
(continued...)

that private account performance information will be updated no less frequently than annually. You maintain that, if private account performance information is fairly presented and accompanied by clear disclosure, including such information in a prospectus is not misleading.

### Analysis

Section 34(b) of the 1940 Act, in relevant part, makes it unlawful for an investment company to (1) include in a registration statement filed with the Commission any untrue statement of a material fact, or (2) omit to state any fact necessary in order to make the information in a registration statement not materially misleading. <sup>4/</sup> Section 34(b), however, does not prohibit a fund from including additional, non-required information in its prospectus. The general instructions for completing an investment company registration statement on Form N-1A or Form N-2 under the 1940 Act and the Securities Act of 1933 contemplate that a fund may include non-required information. Those instructions state that a fund may include information in addition to that called for by the applicable items of the form, "provided that such information is not incomplete, inaccurate, or misleading" and does not, "by virtue of its nature, quantity, or manner of presentation, obscure or impede understanding of the information that is required to be included." <sup>5/</sup> A fund that seeks to include non-required information in its prospectus is responsible for ensuring that

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<sup>3/</sup>(...continued)

used was not "materially different" from the performance of prior accounts that were not being used). Cf. J.P. Morgan Investment Management, Inc. (pub. avail. May 7, 1996) (advertising performance that reflects the deduction of a model fee would not be misleading when the performance figures are no higher than those that would have resulted had actual fees been deducted).

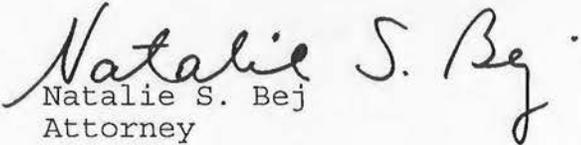
<sup>4/</sup> See Fred Alger Management, Inc., Investment Company Act Release No. 17358 (Feb. 26, 1990) (finding violation of Section 34(b) when a registered fund failed to include information in its prospectus necessary to make presentation of adviser's private account performance not misleading). Similarly, an investment adviser that causes a fund to include false or misleading information in the fund's prospectus could be deemed to be engaging in fraudulent conduct with respect to a client, in violation of Section 206 of the Advisers Act.

<sup>5/</sup> See General Instruction G to Form N-1A, General Instructions for Parts A and B, Instruction 2. See also General Instructions to Form N-2, General Instructions for Parts A and B, Instruction 2.

such information is not misleading and does not obscure or impede understanding of required information. 6/ Whether a fund has fulfilled this responsibility is an inherently factual question that the staff will not address in the context of a request for no-action relief.

### Conclusion

We agree that neither Section 34(b) of the 1940 Act nor Section 206 of the Advisers Act would prohibit the Portfolios from including in their prospectuses NACM's private account performance information, provided that such information is not presented in a misleading manner and does not obscure or impede understanding of information that is required to be included in the prospectuses. 7/

  
Natalie S. Bej  
Attorney

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6/ You represent that, to comply with Section 34(b) and the instructions to Form N-1A, the Portfolios will ensure that NACM's private account performance will be given no greater prominence than the Portfolios' performance, and will be accompanied by disclosure to the effect that the private account performance does not represent the historical performance of the Portfolios and should not be interpreted as indicative of the future performance of the Portfolios. You further represent that the private account performance composite will be compared to an appropriate securities index, in a manner consistent with Item 5A of Form N-1A. In a telephone conversation with the staff, you also have represented that the prospectuses specifically will disclose that private accounts are not subject to certain investment limitations, diversification requirements, and other restrictions imposed by the 1940 Act and the Internal Revenue Code, which, if applicable, may have adversely affected the performance result of the private account composite. Telephone conversation between Jane Kanter of Katten Muchin & Zavis and Natalie Bej of this office on July 2, 1996.

7/ This response should not be construed as providing no-action assurance with respect to any particular presentation of private account performance information.

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1940 Act/Section 34(b)  
Advisers Act/Section 206 and Rule 206(4)-1

August 5, 1996

ACT IAA / ICA  
SECTION 206 / 34(b)  
RULE 206(4)-1  
PUBLIC  
AVAILABILITY 8-6-96

**BY HAND DELIVERY**

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

**Re: Use of Prior Performance Information regarding  
Nicholas-Applegate Capital Management ("NACM")  
by the Nicholas-Applegate Mutual Funds (the "Trust")**

Dear Sirs:

On behalf of the Trust, an open-end management investment company, which is registered under the Investment Company Act of 1940, as amended (the "1940 Act") and whose shares are registered under the Securities Act of 1933, as amended (the "Securities Act"), and NACM, an investment adviser registered under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), and the investment adviser to Nicholas-Applegate Investment Trust (the "Master Trust"), an open-end management investment company registered under the 1940 Act, we hereby request that the staff of the Securities and Exchange Commission (the "Commission" or "SEC") agree not to recommend any enforcement action to the Commission under Section 34(b) of the 1940 Act or Section 206 of the Advisers Act or Rule 206(4)-1 under the Advisers Act, if after the first year of operation of each Portfolio, as defined herein, the prospectus for each such Portfolio includes information regarding the prior performance of accounts similarly managed by NACM.

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## I. Facts

The Trust and the Master Trust were each organized as a business trust under the laws of Delaware in December 1992. The Trust currently consists of 48 separate investment portfolios ("Portfolios"). Nine Portfolios ("Series A Portfolios")<sup>1</sup> have an initial sales charge and low annual distribution fees. Nine Portfolios ("Series B Portfolios")<sup>2</sup> have a contingent deferred sales charge and annual distribution fees. Nine Portfolios ("Series C Portfolios")<sup>3</sup> have a contingent deferred sales charge and annual distribution fees. Nine Portfolios ("Qualified Portfolios")<sup>4</sup> are offered to certain qualified pension and profit-sharing plans and tax-exempt investors. Eleven Portfolios ("Institutional Portfolios")<sup>5</sup> are offered to institutional investors and high net worth individuals and other eligible purchasers. Both the Qualified Portfolios and Institutional Portfolios are offered without any sales charge or distribution fees. One Money Market Fund Portfolio is offered to all investors without any sales charge and with low annual distribution fees.

Each Portfolio invests all of its assets in a corresponding series of the Master Trust (each a "Fund," collectively the "Funds"), which has the same investment objectives, policies,

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<sup>1</sup> The Series A Portfolios currently are the: Emerging Growth Portfolio A; Core Growth Portfolio A; Income and Growth Portfolio A; Balanced Growth Portfolio A; Government Income Portfolio A; International Growth Portfolio A; Emerging Countries Portfolio A; Worldwide Growth Portfolio A; and Global Growth and Income Portfolio A.

<sup>2</sup> The Series B Portfolios currently are the: Emerging Growth Portfolio B; Core Growth Portfolio B; Income and Growth Portfolio B; Balanced Growth Portfolio B; Government Income Portfolio B; International Growth Portfolio B; Emerging Countries Portfolio B; Worldwide Growth Portfolio B; and Global Growth and Income Portfolio B.

<sup>3</sup> The Series C Portfolios currently are the: Emerging Growth Portfolio C; Core Growth Portfolio C; Income and Growth Portfolio C; Balanced Growth Portfolio C; Government Income Portfolio C; International Growth Portfolio C; Emerging Countries Portfolio C; Worldwide Growth Portfolio C; and Global Growth and Income Portfolio C.

<sup>4</sup> The Qualified Portfolios currently are the: Emerging Growth Qualified Portfolio; Core Growth Qualified Portfolio; Income and Growth Qualified Portfolio; Balanced Growth Qualified Portfolio; Government Income Qualified Portfolio; International Growth Qualified Portfolio; Emerging Countries Qualified Portfolio; Worldwide Growth Qualified Portfolio; and Global Growth and Income Qualified Portfolio.

<sup>5</sup> The Institutional Portfolios currently are the: Emerging Growth Institutional Portfolio; Core Growth Institutional Portfolio; Income and Growth Institutional Portfolio; Balanced Growth Institutional Portfolio; International Growth Institutional Portfolio; Emerging Countries Institutional Portfolio; Worldwide Growth Institutional Portfolio; Global Growth and Income Institutional Portfolio; Mini-Cap Growth Institutional Portfolio; Fully Discretionary Fixed Income Institutional Portfolio; and Short-Intermediate Fixed Income Institutional Portfolio.

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strategies, and restrictions as the Portfolio. Conversely, each underlying Fund may have up to five corresponding Portfolios.<sup>6</sup>

Since each Portfolio invests all of its assets in a corresponding Fund, the Trust does not have an investment adviser. The assets of each Fund are managed by NACM, subject to the direction of the Master Trust's Board of Trustees.<sup>7</sup>

NACM is a California limited partnership that was founded in 1984. NACM currently manages over \$30 billion of discretionary assets for numerous clients, including qualified and non-qualified pension and profit-sharing plans ("retirement plans") of corporations, public retirement systems, unions, university endowments, foundations and other institutional investors, investment companies sponsored by NACM, and individuals.<sup>8</sup> NACM's general partner is Nicholas-Applegate Capital Management Holdings, L.P., a California limited partnership of which the general partner is Nicholas-Applegate Capital Management Holdings, Inc., a California corporation owned by Arthur E. Nicholas.<sup>9</sup>

Currently, after the first year of operation, the prospectuses for the Portfolios do not include any information concerning the prior performance of NACM's advisory accounts that are managed with investment objectives, policies, and strategies substantially similar to those employed by NACM in managing each of the Portfolios (hereinafter referred to as "NACM's prior performance").<sup>10</sup> In the first year of operation, however, certain prospectuses for the

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<sup>6</sup> Currently, each Fund may have five corresponding Portfolios. However, some Funds have fewer Portfolios because a full complement of Portfolios was not created at the same time as the underlying Fund. Thus, in some instances, Portfolios were created at the same time as the underlying Fund, and in other instances, they were created, or will be created, at a later date.

<sup>7</sup> The Board of Trustees of the Trust reviews the actions of the Trust's administrator, Investment Company Administration Corporation ("Administrator"), and the Trust's distributor, Nicholas-Applegate Securities ("Distributor"), and decides upon general matters of policy with respect to each Portfolio.

<sup>8</sup> Some of these retirement plans are subject to the requirements of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and others are not.

<sup>9</sup> Mr. Nicholas is a Trustee and the Chairman of the Board of Trustees of the Trust, a Trustee and the Chairman of the Board of Trustees of the Master Trust, and the Managing Partner and Chief Investment Officer of NACM. Mr. Nicholas is the principal architect of NACM's investment strategies.

<sup>10</sup> Nevertheless, in calculating performance data for use in prospectuses, statements of additional information, advertisements, and sales literature for the Series A, B, and C, Qualified and Institutional Portfolios that correspond with the Income and Growth, Core Growth, International Growth, and Emerging Growth Funds, the Trust currently  
(continued...)

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Portfolios have included information concerning NACM's prior performance, as permitted by the SEC staff<sup>11</sup> in accordance with the conditions set forth in the *Growth Stock Outlook Trust, Inc.* no-action letter described below.<sup>12</sup> In addition, that prior performance information complies with the detailed standards for preparing and presenting adviser performance information formulated by the Association for Investment Management and Research ("AIMR"), except that net rather than gross performance is presented.

The Trust proposes to include information concerning NACM's prior performance in prospectuses for the Portfolios ("Prospectuses") beyond the first year of operation of a Portfolio. That prior performance information will be prepared and presented in accordance with AIMR standards, except that NACM's prior performance information will be calculated on a net rather than gross basis. The Prospectuses also will include standardized information concerning the prior performance of the Portfolios in compliance with the requirements of Item 22 of Form N-1A. Information concerning the prior performance of each Portfolio and NACM's prior performance will be displayed with equal prominence in the Prospectuses. NACM's prior performance with respect to each Portfolio also will be compared with an appropriate securities index that is administered by an entity that is not affiliated with the Trust, the Distributor or NACM.<sup>13</sup> In addition, the Prospectuses will include, as needed, a textual explanation or other disclosure concerning any facts regarding the prior performance of the Portfolios and that of NACM that should be brought to the recipient's attention.

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<sup>10</sup>(...continued)

includes in such calculations the performance of certain predecessor limited partnerships and a pooled trust managed by NACM, in reliance upon and in accordance with the standards articulated in the MassMutual Institutional Funds no-action letter. SEC No-Action Letter (pub. avail. Sept. 28, 1995) (the "MassMutual Letter"). In the MassMutual Letter, the SEC staff stated that it would not recommend enforcement action if, subject to the standards specified in the letter, the calculation of total return used in the prospectuses, statements of additional information, advertisements, and sales literature of certain series of an open-end management investment company included performance data of certain predecessor entities. The MassMutual Letter also noted that because each series is essentially a continuation of a predecessor entity, "the limitations set forth in the Growth Stock [L]etter do not apply here. Accordingly, the Trust's use in its prospectus of performance data that incorporate the [predecessor entities'] performance need not be limited to the first year of the operations." In light of this precedent, in this letter the Trust is not seeking relief with respect to the use of such performance data in the prospectuses for the Portfolios noted above, including whether such use complies with the conditions set forth in the MassMutual Letter.

<sup>11</sup> *Infra.* n.19 and accompanying text.

<sup>12</sup> *Infra* n.18 and accompanying text.

<sup>13</sup> This presentation is expected to be consistent with Item 5A of Form N-1A in that the securities index will be adjusted to reflect reinvestment of dividends on securities in the index, but will not be adjusted to reflect expenses of either the Portfolios or the advisory accounts managed by NACM.

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NACM and the Trust believe the Prospectuses should include information concerning NACM's prior performance because, among other things, the inclusion of such information will provide investors with more complete and accurate information on which to base their investment decisions. The importance of such information in the investment evaluation and selection process has been especially significant to retirement plan sponsors and other fiduciaries, who typically request information concerning an investment adviser's long-term investment results in order to fulfill their fiduciary duties in assessing a particular mutual fund as an investment alternative for their retirement plans. Finally, NACM and the Trust believe that the continued use of NACM's prior performance in Prospectuses is consistent with the SEC's general policies governing prior performance presentations in prospectuses and sales literature.

## II. Analysis

Section 34(b) of the 1940 Act makes it unlawful to make any untrue statement of a material fact in any document, including prospectuses, required to be filed under the 1940 Act.<sup>14</sup> Section 206 of the Advisers Act<sup>15</sup> makes it unlawful to make any false or misleading statement of a material fact to any advisory client or prospective advisory client, including, pursuant to Rule 206(4)-1 under the Advisers Act,<sup>16</sup> any such statement in any advertisement. For the reasons discussed below, the inclusion of accurate and complete information, fairly presented, concerning NACM's prior performance should not, by itself, render the Prospectuses false and misleading in contravention of the foregoing provisions.

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<sup>14</sup> Section 34(b) provides in pertinent part that "[i]t shall be unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this title....It shall be unlawful for any person so filing, transmitting, or keeping any such document to omit to state therein any fact necessary in order to prevent the statements made therein, in light of the circumstances under which they were made, from being materially misleading."

<sup>15</sup> Section 206 provides, in pertinent part, that "[i]t shall be unlawful for any investment adviser . . . directly, or indirectly: (1) to employ any device, scheme, or artifice to defraud any client or prospective client; (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client; . . . (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative."

<sup>16</sup> Rule 206(4)-1 provides, in pertinent part, that "[i]t shall constitute a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of Section 206(4) of the Act, for any investment adviser, directly or indirectly, to publish, circulate or distribute any advertisement . . . (5) Which contains any untrue statement of a material fact, or which is otherwise false or misleading."

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#### A. Regulatory Background

Since as early as 1983, the SEC staff has permitted new registrants of closed-end investment companies to include in their prospectuses performance information concerning other similar accounts or investment companies managed by the same investment adviser.<sup>17</sup> In 1986, the SEC staff granted no-action relief to a closed-end investment company, Growth Stock Outlook Trust, Inc., and its investment adviser to permit that investment company to include in its prospectus, during the investment company's first year of operation, information regarding the prior performance of accounts managed by the investment adviser, provided the three conditions specified in the Growth Stock Letter were met.<sup>18</sup> The SEC staff also stated that it would not object if any other closed-end investment company relied on this position under the circumstances specified in the Growth Stock Letter. The SEC staff emphasized, however, that this position was available only during an investment company's first year of operation.

Starting in 1989, a number of newly organized open-end investment companies ("mutual funds") began to include the prior performance of their investment advisers in their prospectuses. Such performance information was included in such prospectuses in a fairly uniform manner and purportedly in compliance with the three conditions specified in the Growth Stock Letter. The SEC staff stated in its Letter to Registrants, dated February 22, 1993, that it would not object to the use of investment adviser prior performance information in prospectuses or supplemental sales literature of mutual funds provided the conditions contained in the Growth Stock Letter were satisfied.<sup>19</sup> Furthermore, the SEC staff stated that, with respect to mutual funds, "[t]he performance of related funds and private accounts may only be used in a prospectus or Statement

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<sup>17</sup> See, e.g., Prospectus for Z-Seven Fund, Inc., at 19-20 (dated December 29, 1983).

<sup>18</sup> *Growth Stock Outlook Trust, Inc.*, SEC No-Action Letter (pub. avail. Apr. 15, 1986) (the "Growth Stock Letter"). The SEC staff imposed the following three conditions. First, "[a]ny performance information included in the [fund's prospectus] must be for all of the adviser's private clients' accounts which were managed with investment objectives, policies, and strategies substantially similar to those to be employed by the adviser in managing the Fund." Second, "[t]he relative sizes of the fund and the private clients' accounts managed with investment objectives, policies, and strategies substantially similar to those to be employed in managing the Fund should be sufficiently comparable to ensure that the performance of the accounts would be considered relevant to a potential investor in the Fund." Finally, "[t]he [prospectus] makes clear that the performance information therein relates to the adviser's management of private accounts and that this information should not be interpreted as indicative of future performance of the Fund."

<sup>19</sup> See Letter from Carolyn B. Lewis, Assistant Director, SEC Division of Investment Management, to Registrants (Feb. 22, 1993) ("the Lewis Letter").

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of Additional Information or accompanying sales literature in the case where the fund itself does not have any performance history."<sup>20</sup>

While the SEC staff has not objected to the use of adviser prior performance information in supplemental sales materials during a mutual fund's first year of operation, the National Association of Securities Dealers, Inc. ("NASD") has consistently taken the position that inclusion of an adviser's prior performance information in supplemental sales literature for a new mutual fund is inappropriate because ". . . it may lead investors to conclude that the new fund would perform as well as the adviser's previous accounts . . . ." <sup>21</sup> This position presumably is based on the general prohibitions contained in Article III, Section 35(d) of the NASD's Rules of Fair Practice regarding misleading advertisements or sales literature. Nevertheless, the NASD in this context, has expressly noted that its position applies only to investment company sales literature and that its jurisdiction, of course, does not extend to the content of mutual fund prospectuses.<sup>22</sup>

As a result of this position of the NASD, new or more recently formed mutual funds that attempt to compete with existing investment products, including mutual funds with long-term track records, are placed at a significant competitive disadvantage because they are unable to use sales literature to provide investors and financial intermediaries with necessary historical information concerning the prior investment performance of their investment advisers. Rather, they are limited to providing only the information that is currently permitted to be included in

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<sup>20</sup> *Id.* at 8. In support of its position, the Lewis Letter cited the Growth Stock Letter, discussed above, and *Advertising by Investment Companies*, Investment Company Act Release No. IC 16245, 40 SEC Docket 145 (Feb. 2, 1988) ("Release 16245"). In Release 16245, the Commission stated, in pertinent part, that "the amendments to Rule 482 do preclude performance information about any related entity to the fund such as its adviser, *i.e.*, other funds or private accounts controlled by the adviser, where the use of such performance is intended as a substitute for the performance of the fund." *Id.*, 40 SEC Docket at 156 n.31. We believe that this statement should not preclude the relief sought herein because NACM's prior performance information will be provided not as a substitute for, but in addition to a Portfolio's performance history.

<sup>21</sup> *See, e.g.*, NASD Regulatory & Compliance Alert, Vol. 6, No. 2, 7-8 (June 1992) (the "NASD Alert").

<sup>22</sup> Notwithstanding that Prospectuses are not "advertisements or sales literature" for the Portfolios, the Growth Stock Letter indicates that the Prospectuses could be deemed by the SEC staff to be "advertisements" for the services of an investment adviser, such as NACM in its capacity as the investment adviser to the Funds, as the term "advertisement" is used in Rule 206(4)-1 under the Advisers Act. Accordingly, this request also seeks no-action relief with respect to Section 206 of the Advisers Act and Rule 206(4)-1 thereunder. However, we are aware that the SEC staff has recently noted that "we would not view documents relating specifically to one or more investment companies, such as prospectuses, advertisements or sales literature, as designed to maintain existing clients or solicit new clients for the adviser unless the documents are directed to such persons or refer to advisory services that are offered to such persons". *Munder Capital Management*, SEC No-Action Letter (pub. avail. May 17, 1996).

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the mutual fund's prospectus or statement of additional information during the first year of the mutual fund's operations.

This competitive disadvantage is most pronounced in the retirement plan marketplace because sponsors and fiduciaries of, and financial intermediaries for, retirement plans ("Plan Sponsors") usually request certain information, including information concerning the adviser's record of past performance, in order to fulfill their fiduciary duties under ERISA.<sup>23</sup> As fiduciaries, Plan Sponsors that are not covered by ERISA have similar obligations.

The NASD staff's position, as articulated above, prevents many mutual funds from providing investors (and Plan Sponsors) with materials that contain the type of information they need or usually request in order to make an informed decision about the selection of a new mutual fund investment. NACM and the Trust believe that the inclusion of NACM's prior performance information in the Prospectuses after the first year would reduce the competitive imbalance confronted by new mutual funds while providing investors and Plan Sponsors with additional meaningful information in evaluating their investment decisions. Moreover, as described in further detail below, NACM and the Trust are of the view that the inclusion of NACM's prior performance information in the Prospectuses after the first year (i) is not per se misleading and (ii) is consistent with the SEC staff's current position permitting the inclusion of such performance information in a mutual fund's prospectus during the first year of the mutual fund's operations.

#### **B. Inclusion of Prior Performance Information Is Not Per Se Misleading**

NACM and the Trust believe that inclusion in the Prospectuses of NACM's prior performance information is not per se misleading for a number of reasons. First, the prior performance information that will be included in the Prospectuses will be presented in accordance with the three conditions specified in the Growth Stock Letter. Moreover, NACM's prior performance information will comply with the detailed criteria for preparing and presenting adviser performance information formulated by AIMR, except that net rather than gross

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<sup>23</sup> In soliciting investment advisers to manage plan assets, Plan Sponsors (as plan fiduciaries) must make such selections in accordance with ERISA's "prudence" standard as set forth in Section 404 of ERISA. This prudence standard has been construed to require Plan Sponsors to "employ the appropriate methods to investigate the merits of an investment . . ." *Donovan v. Mazzola*, 716 F.2d 1226, 1232 (9th Cir. 1983). Thus, in *Whitfield v. Cohen*, 682 F. Supp. 188, 193 (S.D.N.Y. 1988), in granting summary judgment for the Department of Labor, the court held that a plan trustee had breached his fiduciary duty in connection with the placement of plan assets with an investment fund where the trustee failed to satisfy the ERISA prudence standard by not independently investigating, among other things, (i) the investment adviser's experience "in the particular area of investments under consideration and with other ERISA plans," and (ii) the investment adviser's "past performance with investments of the type contemplated."

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performance information will be used. AIMR's Performance Presentation Standards "are a set of guiding ethical principles intended to promote full disclosure and fair representation by investment managers in reporting their investment results. A secondary objective is to ensure uniformity in reporting so that results are directly comparable among investment managers."<sup>24</sup> As a result, the information concerning NACM's AIMR-formulated "composites"<sup>25</sup> that is intended to be included in the Prospectuses will be prepared and presented in accordance with well-recognized and independently verified criteria in accordance with AIMR requirements, designed to provide full and fair disclosure of adviser performance information.

In this regard, it should be noted that the Growth Stock Letter was issued in 1986, before the AIMR standards were introduced,<sup>26</sup> before the SEC amended Rule 482 under the Securities Act and Forms N-1A, N-3, N-4, and the guidelines thereto for the purpose of standardizing the calculation and disclosure of investment company performance information,<sup>27</sup> and before the SEC staff provided certain no-action interpretive guidance as to the presentation and calculation of investment adviser performance.<sup>28</sup> Accordingly, to the extent that the SEC staff's position in the Growth Stock Letter was motivated by a concern that advisers would present their performance in confusing or idiosyncratic formats, the existence of the foregoing regulatory and ethical standards, and NACM's and the Trust's commitment to comply with those standards, should obviate that concern in this instance.

Finally, because the Prospectuses have no inherent space limitations they provide ample opportunity for appropriate textual or other disclosure to resolve any potential ambiguities that may be raised by the presentation of NACM's prior investment performance. The Trust and NACM propose to utilize this opportunity fully to explain any of the facts concerning NACM's prior performance that should be brought to the attention of the recipient of such information.

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<sup>24</sup> AIMR, Performance Presentation Standards, at ix (1993).

<sup>25</sup> See *id.* at 5-9 for an explanation of how AIMR-formulated composites are constructed, maintained and presented.

<sup>26</sup> The AIMR Standards were first introduced in 1987. *Id.* at v.

<sup>27</sup> See Release 16245, *supra* n.20.

<sup>28</sup> See, e.g., *Investment Company Institute*, SEC No-Action Letter (pub. avail. Sept. 23, 1988), which describes the four conditions that must be satisfied to provide gross rather than net adviser prior performance to certain prospective clients. See also *Clover Capital Management, Inc.*, SEC No-Action Letter (pub. avail. Oct. 28, 1986). Investment advisers, in making presentations to prospective clients and financial intermediaries concerning their private account expertise, may in accordance with the criteria described in that and other SEC staff no-action letters provide such persons with information concerning their prior investment performance, provided such materials do not omit any material facts or are not otherwise false or misleading.

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**C. Inclusion of Prior Performance Information in This Context Is Consistent with the SEC Staff's Current Position**

The inclusion of NACM's prior performance information in the Prospectuses is consistent with the SEC staff's current position that inclusion of such information in a prospectus during the first year of a mutual fund's operations is permissible. The SEC staff's current position implicitly acknowledges that adviser prior performance information is not per se misleading, as long as it is accurate and complete and appropriate accompanying disclosure is made.<sup>29</sup> That is precisely what NACM and the Trust propose to do in the Prospectuses.

Moreover, the Trust's continued use of NACM's prior performance information after the completion of a Portfolio's first year of operation should be even less likely to cause an investor or Plan Sponsor to draw an inappropriate conclusion regarding how a Portfolio will perform, particularly since that prior performance information will be accompanied by the Portfolio's own performance history. In other words, one could assert that an investor or Plan Sponsor could be more easily misled or confused by the inclusion in a prospectus during a mutual fund's first year of operation of its adviser's prior performance information because the recipient does not have any performance record for the mutual fund to compare with the performance history of its adviser. In later years, on the other hand, presentation in a prospectus of the adviser's prior performance information could be easily compared to the presentation of the mutual fund's own historic performance.<sup>30</sup> Accompanying textual disclosure will further enhance the value of this comparison and reduce the possibility of confusion or mistake on the part of an investor or Plan Sponsor.

Finally, the relief sought only requests the SEC staff's assurance that it will not recommend any enforcement action to the Commission under the cited provisions if information concerning NACM's prior investment performance is included in the Prospectuses, as described above. Notwithstanding the requested relief, NACM and the Trust's Board of Trustees will remain responsible for assuring that the information provided does not otherwise violate these provisions by ensuring that such information is true, complete, and fairly presented, and its presentation meets the applicable prospectus disclosure requirements.

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<sup>29</sup> In fact, in an analogous context, the SEC has required the disclosure of past performance information. Instruction 8 to Guide 5 to Form S-11, *Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships*, requires a narrative summary of the prior performance of programs sponsored by the general partners and its affiliates and tables showing, among other things, the operating results of prior programs (Appendix II, Table III) and the results of completed programs (*id.*, Table IV).

<sup>30</sup> NACM and the Trust will undertake to update NACM's prior performance information (as included in the Prospectus) at least as frequently as they update the Trust's own historic performance (as included in Prospectus or Statement of Additional Information) but, at minimum, at least annually.

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**III. Conclusion**

Based upon the foregoing, we hereby respectfully request that the SEC staff agree not to recommend any enforcement action to the Commission under Section 34(b) of the 1940 Act, or Section 206 of the Advisers Act or Rule 206(4)-1 under the Advisers Act, if NACM and the Trust include information concerning NACM's prior performance in the Prospectuses in the manner described herein.

Very truly yours,

*Jane A. Kanter*

Jane A. Kanter

cc: E. Blake Moore, Jr.