1992 WL 105179 (S.E.C. No - Action Letter)

(SEC No-Action Letter)

Great Lakes Advisors, Inc.

Publicly Available April 3, 1992

SEC LETTER

***1 1940 Act / s -- / Rule 206(4)-1(a)(5)**

April 3, 1992

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By letter dated August 21, 1991, you request assurance that the staff would not recommend enforcement action to the Commission if, as more fully described in your letter, **Great Lakes Advisors**, Inc., a registered investment adviser ("Great Lakes"), uses certain performance data of its predecessor, Continental Capital Management Corporation ("Old CCMC").

Great Lakes began business on August 1, 1990 when it acquired eighty-four percent of the dollar value of the Old CCMC accounts. [1] You state that Mr. Edward J. Calkins ("Calkins") is responsible for managing the equity and convertible portions, and Mr. Steven W. Rost ("Rost") is responsible for managing the fixed-income portion, of Great Lakes' investment portfolios. From January 1, 1985 through July 31, 1990, when Great Lakes acquired Old CCMC, Calkins was responsible for developing Old CCMC's investment philosophy for equity and convertible security portfolio selections. From January 1, 1985 to July 1, 1990, Old CCMC selected equity securities by consensus among Calkins and two or three others. [2] You state that, although Old CCMC did not, except in rare cases, select an equity security in a discretionary account without Calkins' concurrence and participation, other individuals also played a significant role in this process.

Beginning on November 1, 1988, when he joined Old CCMC, Rost was solely responsible for fixed-income portfolio selections. Rost selected and managed Old CCMC's fixed-income portfolio securities using the same investment philosophy Old CCMC applied prior to his arrival.

You argue that, with appropriate disclosure, Great Lakes's use of Old CCMC's equity performance data for the period from January 1, 1985 to July 1, 1990, and fixed-income performance data for the period from January 1, 1985 to November 1, 1988, would not violate rule 206(4)–1(a)(5) under the Investment Advisers Act of 1940. Rule 206(4)–1(a)(5) generally prohibits any investment adviser from publishing, circulating or distributing, directly or indirectly, any advertisement which contains any untrue statement of a material fact, or which is otherwise false or misleading.

The staff previously has taken the position that it may not be misleading for an adviser to use performance data of a predecessor if (1) no individual other than the successor's portfolio manager played a significant part in the performance of the predecessor's accounts that were transferred to the successor adviser; and (2) the performance of the predecessor's accounts that were not transferred to the successor adviser did not differ materially from the performance of the transferred accounts. [3] Because individuals other than Calkins played a significant role in managing Old CCMC's equity accounts from January 1, 1985 to July 1, 1990, Great Lakes' use of Old CCMC's performance data for this time period would be misleading under rule 206(4)–1(a)(5). [4] In addition, Rost played no role in managing Old CCMC's fixed-income accounts for the period from January 1, 1985 to November 1, 1988. Therefore, Great Lakes' use of Old CCMC's fixed-income performance data from that period also would be misleading. We do not believe that disclosure alone would be sufficient to make the proposed use of Old CCMC's equity and fixed-income performance data not misleading.

***2** Accordingly, on the basis of the facts and representations in your letter, we cannot assure you that we would not recommend enforcement action to the Commission if Great Lakes used the performance data of Old CCMC's equity accounts from January 1, 1985 to July 1, 1990, and fixed-income accounts from January 1, 1985 to November 1, 1988.

Lawrence B. Stoller
Attorney

August 21, 1991
Mr. Thomas S. Harman
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549
Re: **Great Lakes Advisors**, Inc. File No. IA 801–36915

Dear Mr. Harman:

Great Lakes Advisors, Inc. ("Great Lakes") has asked that we seek assurance that, under the circumstances set out in this letter, the Staff will not recommend that the Securities and Exchange Commission take any enforcement action under the Investment Advisers Act ("Act") regarding the use by Great Lakes of performance data which, with appropriate disclosure of the role played by specific portfolio managers, reflects performance of Great Lakes' predecessor, Continental Capital Management Corporation ("Old CCMC") during the period before substantially all of the accounts of Old CCMC were acquired by Great Lakes.

Facts

Great Lakes, located in Chicago, Illinois, and owned by Messrs. Raymond O. Wicklander, Jr., Edward J. Calkins, Steven W. Rost and Ms. Nancy A. Boeselager, is registered as an investment adviser under the Act. It began business on August 1, 1990, when, with the consent of the transferred accounts, it acquired substantially all of the on-going business of Old CCMC by acquiring 84% in dollar value [1] of the investment advisory accounts previously advised by Old CCMC. At closing, Great Lakes also acquired Old CCMC's name for a period which ended effective August 1, 1991, when Great Lakes took its present name. Old CCMC was dissolved after closing.

Great Lakes' advisory business is managed by Messrs. Wicklander, Calkins, and Rost; Ms. Boeselager is in charge of its trading. Its clients, and potential clients, are sophisticated institutions. Mr. Wicklander has overall responsibility for Great Lakes' marketing and client relations; Mr. Calkins is responsible for managing the equity and convertible portion of investment portfolios; and Mr. Rost is responsible for managing the fixed-income portion of investment portfolios. They are assisted by a staff of four, including Ms. Boeselager, who is responsible for trading; that staff had worked for Old CCMC and came over to Great Lakes at closing of the acquisition

In selecting and managing investments for Great Lakes' clients, Messrs. Calkins and Rost follow the same investment philosophy and style which they adhered to when selecting and managing investments for Old CCMC's clients. Beginning January 1, 1985, and continuing for the entire period through July 31, 1990, when Old CCMC sold to Great Lakes, Mr. Calkins was the individual primarily responsible for developing the articulation of this philosophy and style at Old CCMC in both the equity and the convertible areas. Thus, in the equity area, Old CCMC's documents from 1985 through 1990 reflect an overall statement of equity portfolio policy as "a value-oriented investment policy" or a "value-oriented philosophy", and carry this policy into overall investment characteristics: "Stocks with low price-earning ratios, low price-to-book value ratios, above average yields and well developed management objectives and strategies are emphasized" (1985 – 1988); "successful value investment means to own companies with rising earning power, to buy and sell stocks at attractive market valuations, and to diversify the portfolio effectively. General characteristics of individual holdings include rising ROE, low price earnings and price book-value ratios and above average current yields" (1989 – 1990). Of course, Mr. Calkins continues in that role for Great Lakes, and its present articulation of philosophy and style is the same as Old CCMC's was. The characteristics of Old CCMC's equity portfolio over the years, as well as the characteristics of Great Lakes' equity portfolios since August 1, 1990, evidence the result of the consistent application of that philosophy and style.

***3** In addition to developing his articulation of equity philosophy and style, Mr. Calkins both participated in, and played a leading role in monitoring, its application, to assure that individual portfolio selections or dispositions contributed to the portfolio's meeting applicable overall criteria. Thus, while, during the period from 1985 to July 1, 1990, [2] the actual selection of equity securities for purchase or sale was achieved by consensus among Mr. Calkins and two or three others (including Mr. Wicklander), it is fair to say that, without Mr. Calkins' concurrence and participation in the consensus (with rare exceptions), no action was taken on an individual equity security in a discretionary account.

Similarly, in the area of convertible securities, Mr. Calkins was the person responsible for developing the articulation of Old CCMC's basic investment philosophy and style and he continues responsible for basic convertible investment philosophy at Great Lakes. Again, documents from mid–1985 through 1990 reflect an overall statement of policy articulated (1985–1988) as "designed to capitalize on the appreciation opportunities of convertible securities attributable to participating in the underlying equity, and to offer an above-average current yield. Volatility is below that of a pure equity portfolio" and later articulated (1989–1990) as "Portfolio emphasis is on value, or a preference for low premiums and break-even periods, sufficient yield advantage, and good call protection." This basic investment philosophy for convertible securities continues in Great Lakes.

In the convertible area, in addition to developing the articulation of philosophy and style for Old CCMC, from mid–1985 Mr. Calkins was also solely responsible for monitoring its application and for portfolio selections and dispositions. He continues to do so for Great Lakes.

In the fixed-income area, since November 1, 1988, when he joined Old CCMC, Mr. Rost has been the person solely responsible for the actual selection of securities for purchase and sale. He has done so for both Old CCMC and Great Lakes by applying the same investment philosophy and style that was being used by Old CCMC in the period from 1984 to his arrival. That investment philosophy uses, as its foundation, the concept of adjusting the "modified duration" of fixed-income portfolios so as to keep them within a narrow band (+ or − 10%) of the fixed-income market's modified duration as reflected in a given fixed-income index (Shearson Lehman Government Corporate Index) used since 1984 by Old CCMC and still so used by Great Lakes. Old CCMC's fixed-income portfolio characteristics and performance in the period from January, 1985, to November 1, 1988 (preceding Mr. Rost's arrival), and the characteristics and performance of that portfolio post-November 1, 1988, for Old CCMC and for Great Lakes are essentially similar.

Chicago Regional Office Position

***4** In a routine examination of Great Lakes, the Chicago Regional Office of the Securities and Exchange Commission objected to the performance data which Great Lakes was distributing to prospective clients and third-party consultants on two grounds: (1) that certain information presented did not pertain to Great Lakes' management; and (2) because Great Lakes failed to disclose certain material facts relevant to the performance data presented. The objections raised with respect to disclosure, other than those which related to inclusion of performance data prior to August 1, 1990, were met by additional disclosure. However, in the area of past performance data, the Chicago Office relied on the position, stated in Fiduciary Management Associates, Inc. (February 2, 1984), that "the dissemination of information pertaining to investment performance prior to the effective dates of registration may not be misleading in and of itself if no other personnel besides the principals of a current registrant played a significant part in the management of the accounts whose performance is presented for those years." Accordingly, the Chicago Office took the position that, since no principals of the registrant managed the fixed-income accounts during the period 1984 to 1988, inclusion of performance data for fixed-income accounts for that period violates Rule 206(4)–1(a)(5) and that, since the principals of Great Lakes "were not solely responsible for [[predecessor's] equity performance for the period 1985 to August 1, 1990, the inclusion of that performance data in its promotional brochures, too, would be objectionable under Rule 206(4)–1(a)(5) unless the persons not subsequently employed by Registrant had an insignificant role in attaining those investment results." The Chicago Office went on to state that additional informative disclosures would not be sufficient to cure the problem "if in fact other non-Registrant personnel played a significant role in the performance achievements described above." It requested that Great Lakes cease dissemination of its fixed-income performance for the period 1984 to November, 1988, and its equity performance for the period 1985 to August, 1990, or risk willful violation of Rule 206(4)–1(a)(5) under the Act. By letter dated July 10, 1991, Great Lakes advised that it had done so. [3] At the same time, it advised the Chicago Regional Office that it respectfully disagreed with its conclusion and wished to seek review of the Chicago Regional Office's position.

Opinion and Discussion

In our opinion, under the circumstances in this case, with appropriate factual disclosure, the use by Great Lakes of Old CCMC's equity performance data for periods from January 1, 1985, to July 1, 1990, and of fixed-income performance data for periods from January 1, 1985, to November 1, 1988, would not violate Rule 206(4)–1(a)(5) under the Act. [4]

***5** Our conclusion has two bases. First, that Great Lakes is a continuation of the business of Old CCMC, with a new owner, and that its management of equity and fixed-income portfolios is, in essence, a continuation of Old CCMC's management of those portfolios, so that Fiduciary Management does not apply. Second, that in light of Clover Capital Management (October 28, 1986), full disclosure of facts with respect to management in the period prior to November 1, 1988 (for fixed-income performance) and prior to July 1, 1990 (for equity performance) does cure the concerns raised by Fiduciary Management.

As indicated above, On August 1, 1990, Great Lakes acquired the business of Old CCMC by acquiring substantially all of Old CCMC's accounts. Those accounts had been managed under a consistently applied investment philosophy and style in the equity area, the fixed-income area, and the convertible area. The record shows (Exhibit A) that the equity performance produced by this philosophy or style, viewed in terms of investment characteristics (price earnings ratios, price to book value ratios, yields, ROE) were essentially consistent pre-August 1, 1990, and post-August 1, 1990. In addition, in the equity area, Mr. Calkins, now equity manager for Great Lakes, had been the party responsible for articulation of that philosophy for old CCMC and, while he had not been the sole decision maker on the purchase and sale of equity securities by Old CCMC, in carrying out that philosophy, and while others cannot be said to have played an insignificant role in that regard, Mr. Calkins had been a critical person to the consensus required for purchase and sale, i.e. without his concurrence and participation in the consensus (with rare exceptions), particular securities were not purchased or sold. In the fixed-income area, those accounts and other accounts had also been managed prior to, and after, Mr. Rost's arrival in November, 1988, under a consistently applied investment philosophy, which, as the record shows, produced results that varied little pre-Rost and post-Rost. Again, as to convertibles, the responsibility since 1985 has been that of Mr. Calkins.

Great Lakes' succession to management of substantially all of Old CCMC's accounts is simply not Fiduciary Management. This is not a case of departure of a manager with some accounts, where the concern is whether that manager is justified in using past performance data for those particular accounts. Great Lakes merely represents a change in the ownership of CCMC accomplished through an asset sale, rather than through a stock sale. Both quantitatively (in terms of accounts transferred) and qualitatively (in terms of consistent investment philosophy and investment criteria, applied over long periods of time to the accounts transferred, and in terms of account investment management), it is a continuation of Old CCMC and its investment management. Were the situation reversed, with Old CCMC continuing and Messrs. Rost, Calkins and Wicklander leaving and being replaced by new managers operating under the same investment approach, all that the Commission has ever required is disclosure of the change. (Even where an individual has been regarded as key to an adviser's success, as in the case of Peter Lynch and Fidelity Magellan Fund, the Commission has permitted continued use of past performance, with appropriate disclosure.) Or, had the acquisition been a stock acquisition, departure of one or more investment managers would not prevent use of pre-acquisition performance data with appropriate disclosure. The same principle—full disclosure of investment philosophy and of the comings and goings of key personnel—should apply here, where all that has really changed is ownership of the adviser. In its presentation on: Performance Reporting Standards for Investment Managers, Applying the AIMR Performance Presentation Standards (December 5, 1990; March 19, 1991), the Association for Investment Management and Research states, pertinently:

> ***6** "Changes in a manager firm's organization should not lead to an altering of composite results. Results achieved in an organization are the organization's responsibility; changes in personnel do not constitute a justifiable reason to alter composite performance results."

In our opinion, Old CCMC's performance results to August 1, 1990, are results of essentially the same organization, and the extent of Mr. Calkins' involvement in specific equity decisions, or the fact that Mr. Rost did not join Old CCMC until November 1, 1988, in AIMR's words, "do not constitute a justifiable reason to alter composite performance results."

We also view Clover Capital Management, Inc. (October 28, 1986) as supporting our opinion. Before Clover, the Staff's view was that a hypothetical or model portfolio could not be used. After Clover, with appropriate disclosure, model investment results can be advertised even if the securities contained in, or the investment strategies followed with respect to, the model portfolio "do not relate, or only partially relate, to the type of advisory services currently offered by the adviser" (Clover, Emphasis added). Model results can be advertised for a portfolio "managed ... with the same investment philosophy ... use[d] for client accounts" (Clover). The key is the Staff's recognition that disclosure of material facts in dealing with a model portfolio is sufficient. Clover makes this point very clearly: What the standard of Rule 206(4)–1(a)(5) prohibits is the implication, or the possibility of inference, of "something about the adviser's competence or about future investment results that would not be true had the advertisement included all material facts. Any adviser using such an advertisement must ensure that the advertisement discloses all material facts concerning the model or actual results so as to avoid these unwarranted implications or inferences...."

If, with disclosure, a model portfolio (indeed, a model portfolio managed with a strategy that does not relate or only partially relates to the type of advisory service currently being offered), can be used with appropriate disclosure, certainly a portfolio, equity or fixed-income, which reflects consistent application by a present organization and its predecessor, of an investment philosophy or style, and fully discloses the precise role that present management played, or did not play, in the past performance (in the manner set out above in this letter), should be permitted. To take the position that, in this case, the problem addressed by Fiduciary Management cannot be cured by disclosure is to ignore the important change which Clover recognizes. To permit use of a model portfolio with disclosure, but not permit use of a prior organization's performance with disclosure, applies far too rigid a standard to actual results. Disclosure of actual performance (again with appropriate disclosure of roles played, or not played) is certainly more meaningful disclosure than disclosure of a model. A potential client—in Great Lakes' case, all sophisticated institutions capable of understanding and evaluating that disclosure—can see what actually happened by consistent application of philosophy and style, can read the disclosures that dispel any implication or inference that Messrs. Rost, Calkins or Wicklander played any part other than they actually did in achieving the performance results, and can see a real world outcome, as opposed to a hypothetical. In a case such as Great Lakes, what Clover permits for a model portfolio should also be permitted for an investment continuum of philosophy, style and related portfolio characteristics, unchanged by the (disclosed) roles played by specific managers or the (disclosed) change in ownership of organization.

***7** In conclusion, we are of the opinion that, accompanied by disclosure of what Messrs. Rost, Calkins and Wicklander actually did, and did not do, in achieving the performance results shown, and what others may have done, the performance data which reflects Old CCMC performance in the equity and fixed-income areas since 1985 would not be misleading and would not violate Rule 206(4)–1(a)(5) under the Act.

If you have any questions or want to discuss this matter further, do not hesitate to contact the undersigned. If you are unable to issue the requested response to this letter, we would appreciate the opportunity to speak with you prior to your issuing any response.

Very truly yours,

Paul J. MillerSONNENSCHEIN NATH & ROSENTHAL8000 Sears TowerChicago Illinois ??(312) 876–8000

Footnotes

1 Old CCMC transferred twelve percent in dollar value of Old CCMC accounts to another Old CCMC employee who had been responsible primarily for those accounts. Four percent in dollar value of the Old CCMC accounts did not consent to transfer to Great Lakes.

2 Calkins was solely responsible for convertible security portfolio selections.

3 Fiduciary Management Associates, Inc. (pub. avail. Feb. 2, 1984); Conway Asset Management, Inc. (Jan. 27, 1989). We note that rule 204–2(a)(16) under the Act generally requires an investment adviser to keep all documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts that the adviser uses in advertisements or other communications distributed to 10 or more persons. This requirement applies also to a successor's use of a predecessor's performance data.

4 Where an adviser selects portfolio securities by consensus or committee decision making, it may be difficult to attach relative significance to the role played by each group member. Under certain circumstances, it may not be misleading for a successor adviser, composed of less than 100% of the predecessor's committee, to use the performance data of the predecessor's committee. We believe, however, that, at a minimum, there would have to be a substantial identity of personnel among the predecessor's and successor's committees.

1 Management of 12% in dollar value of Old CCMC accounts was transferred by Old CCMC to another Old CCMC employee, who had been primarily responsible for relations with those accounts, and 4% in dollar value of Old CCMC accounts did not consent to transfer to Great Lakes.

2 After July 1, 1990, Mr. Calkins was solely responsible for these selections.

3 On August 8, 1991, Great Lakes confirmed to the Chicago Regional Office that Mr. Calkins was solely responsible for the equity portion of client accounts during July, 1990, and that, consistent with Fiduciary Management, it would be including that month in its performance figures.

4 Since both the setting of philosophy and style, and the actual management of convertibles, were solely the responsibility of Mr. Calkins throughout the period, even under Fiduciary Management, the convertible performance in Old CCMC can be shown by Great Lakes. The same is true with respect to equity performance since July 1, 1990, and, in light of the role of Mr. Rost, with respect to fixed-income performance since November 1, 1988.

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