

ACT IAA  
SECTION 204  
RULE 204-2(a)(16)  
PUBLIC AVAILABILITY 7/6/00

July 6, 2000  
Our Ref. No. 20006261544  
Jennison Associates LLC  
File No. 801-5608

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Your letter of June 22, 2000 requests assurance that the staff would not recommend enforcement action to the Commission against Jennison Associates LLC ("Jennison") under Section 204 of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 204-2(a)(16) thereunder if Jennison retains only those records described in your letter to support its performance from 1969 to 1981, even though some of the underlying records that Jennison previously maintained to form the basis for, or demonstrate the calculation of, that performance under Rule 204-2(a)(16) were destroyed in a series of fires in 1997. As a matter of policy, we will not provide no-action assurances regarding whether an investment adviser's particular records are sufficient to form the basis for, or demonstrate the calculation of, the adviser's investment performance under Rule 204-2(a)(16). As discussed below, however, advisers who advertise their performance can facilitate examinations by the staff by maintaining the following records: (i) records prepared by a third party (e.g., custodial or brokerage statements) that confirm the accuracy of client account statements and other performance-related records maintained by the adviser; and (ii) reports prepared by an independent auditor that verify the advisers' advertised performance.

Facts

You state that Jennison, an investment adviser that is registered under the Advisers Act, was incorporated in 1969 and reorganized in 1998 as a limited liability company. Jennison provides investment advice primarily to institutional investors, such as endowments, foundations, public and corporate employee benefit plans, pension plans, and investment companies registered under the Investment Company Act of 1940. You state that Jennison provides advice as to both equity and fixed-income securities.

You state that Jennison includes composite performance in its institutional marketing materials for each of its investment strategies for periods dating back to the inception of each such strategy, the first of which was introduced in 1969. Jennison does not separately include the performance of any individual account in these materials.

You state that, for many years, Jennison maintained certain of the records relating to its investment advisory business at a document storage facility operated by Iron Mountain Incorporated ("Iron Mountain"), a full-service provider of records management and related services. In March 1997, Iron Mountain experienced three fires that resulted in extensive damage to two of its records management facilities, including the one used by Jennison. You state that all of Jennison's records that were stored with Iron Mountain

at this facility were destroyed in the fires. You state that the fires are believed to have been caused by arson and are under investigation by local, state, and federal authorities.

Upon completing its review of the records that remained after the fire, Jennison became concerned that it no longer had sufficient records to form the basis for, or demonstrate the calculation of, its investment performance from 1969 to 1981 (the "Relevant Period") for purposes of Rule 204-2(a)(16).<sup>1</sup> You state that Jennison wishes to continue to include in its marketing materials its performance for the Relevant Period. Further, Jennison believes that omitting the performance for the Relevant Period from its marketing materials could be materially misleading, because Jennison's performance since January 1982 is superior to its performance for the Relevant Period, both in absolute terms and in comparison with relevant benchmarks.

You state that Jennison maintains other records that it believes can be used to substantiate its composite performance achieved during the Relevant Period. In particular, Jennison has internally produced information for all managed accounts dating back to 1969 showing the market value of each account at the end of each month, along with any client contributions to, or withdrawals from, the account in each month, and the market value adjusted for the cash flows ("Account Information"). You state that the Account Information was entered into Jennison's computerized recordkeeping system based on paper statements that were produced by Jennison contemporaneously with the management of the relevant accounts, although these paper statements were subsequently lost in the fires. You note that the Account Information does not identify specific securities transactions or holdings in the accounts.<sup>2</sup>

In addition, you state that Jennison maintains reports ("Reports") that were prepared by an independent auditor, Ernst & Young (or one of its predecessors, Ernst & Ernst), annually since 1970. The Reports are based on Ernst & Young's examination of, among other things, performance evaluation summaries ("Summaries") that were prepared by Jennison contemporaneously with the management of the relevant accounts. You state that the Summaries show, on an individual, account-by-account basis, the performance achieved during the preceding year, on both a time-weighted and internal

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<sup>1</sup> You state that, in response to a request by the Commission's Office of Compliance Inspections and Examinations ("OCIE") soon after the fires, Jennison sent a letter to OCIE detailing which records were destroyed by the fires.

<sup>2</sup> You note that the Account Information also does not identify the amounts of all of the applicable fees and expenses for each account, nor does it identify which accounts are part of which composites. You state that Jennison maintains other records that include this information, which is necessary to calculate composite performance.

rate of return basis, in accordance with certain industry standards used at that time. You also state that the Reports were prepared by Ernst & Young in accordance with Generally Accepted Auditing Standards ("GAAS"). The Reports conclude that the Summaries present fairly the information set forth therein on the bases described in the Summaries, and that the methodology for computing the rates of return in the Summaries is derived from then-applicable industry standards.

You believe that Ernst & Young's examination of the Summaries in accordance with GAAS provides a high level of assurance as to the accuracy of the Summaries. You state that in accordance with GAAS, Ernst & Young reviewed sufficient competent financial matter through inspections, observations, inquiries, and confirmations to afford a reasonable basis for its conclusion. In particular, you state that Ernst & Young selected samples of Jennison's accounts and tested the calculation of account returns by comparing Jennison's monthly transaction journals and other records, including cash and asset reconciliations, with, among other things, custodian statements, transaction confirmations, and pricing information from third-party sources.

You state that Jennison also maintains worksheets that were created after the fires that demonstrate the calculation of the advertised composite performance based on the combination of Jennison's remaining records described above ("Worksheets"). In addition, you represent that Jennison has confirmed, and a Commission examiner would be able to verify, that for the Relevant Period, the account-by-account performance as derived from the Account Information is consistent in all material respects with the account-by-account performance in the Summaries as examined in the Reports, and that Jennison's advertised composite performance is consistent with that account-by-account performance.

### Analysis

Section 204 of the Advisers Act and Rule 204-2(a)(16) thereunder generally require registered investment advisers to maintain "all accounts, books, internal working papers, and any other records or 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 or securities recommendations" in any advertisement or other communication distributed to ten or more persons.<sup>3</sup> The purpose of Rule 204-2(a)(16) was to deter the

<sup>3</sup> Paragraph (a)(11) of Rule 204-2 generally requires advisers also to maintain all of their advertisements. Rule 204-2(e)(3) under the Advisers Act requires that the records described in Rule 204-2(a)(11) and (a)(16) be maintained and preserved in an easily accessible place for a period of not less than five years, the first two years in an appropriate office of the adviser, from the end of the fiscal year during which the adviser last published or disseminated the communication. For example, if an adviser's current

(footnote continued)

use of false or misleading performance advertisements by advisers by requiring advisers to make and keep for inspection by the Commission's examination staff all records necessary to substantiate the performance information in their advertisements. The rule also was designed to allow the staff to evaluate more effectively an investment adviser's compliance with Rule 206(4)-1 under the Advisers Act, which, among other things, prohibits false or misleading advertisements by investment advisers.<sup>4</sup>

In 1987, at the time the rule was proposed, several commenters were concerned that advisers would be required to maintain all documents of original entry supporting their performance claims, which would have required advisers to maintain a considerable amount of paper, the storage of which would have been very expensive. In response to these concerns, the rule as adopted in 1988 provides that an investment adviser shall be deemed to satisfy the requirements of the rule if, with respect to the performance of its managed accounts, the investment adviser retains all account statements, provided that they reflect all debits, credits, and other transactions in a client's account for the period of the statement, and all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts.<sup>5</sup> The staff notes that technology

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advertisement contains data based on the adviser's performance over the last ten years, the documents forming the basis for the adviser's performance for each of the ten years would be required to be kept for five years, the first two years in the adviser's office, after the end of the fiscal year in which the advertisement was last published. See Investment Advisers Act Release No. 1093 (Nov. 5, 1987) (proposing the addition of paragraph (a)(16) to Rule 204-2) (the "proposing release"). You have not asked, and we express no view regarding, whether Jennison has been in compliance with Rule 204-2(e)(3).

<sup>4</sup> See the proposing release, and Investment Advisers Act Release No. 1135 (Aug. 17, 1988) (adopting the addition of paragraph (a)(16) to Rule 204-2) (the "adopting release").

<sup>5</sup> See the adopting release. The rule provides a safe harbor for certain account statements and worksheets, but contemplates that the retention of other records also could satisfy the requirements of the rule. See, e.g., Salomon Brothers Asset Management Inc and Salomon Brothers Asset Management Asia Pacific Limited (pub. avail. July 23, 1999) ("Salomon"). In Salomon, the staff confirmed that published materials listing the net asset values of a managed account ("NAVs"), together with worksheets that demonstrate the calculation of performance based on those NAVs, could form the basis for, or demonstrate the calculation of, advertised performance under Section 204 and Rule 204-2(a)(16). The staff based its position, in part, on the fact that the published NAVs were accumulated contemporaneously with the management of the relevant account.

now allows advisers to receive electronic confirmations and statements from broker-dealers and custodians, and/or to store this information in an electronic format. Moreover, Commission rules allow advisers to maintain these and other documents electronically.<sup>6</sup>

As a matter of policy, the staff will not provide no-action assurances under Rule 204-2(a)(16) regarding whether an investment adviser's particular records are sufficient to form the basis for, or demonstrate the calculation of, the investment performance of the adviser's managed accounts or securities recommendations.<sup>7</sup> In other words, while the staff will provide general guidance to assist advisers in complying with the rule, we will not review (in the context of a no-action request) the contents of an adviser's particular records to determine whether the records satisfy the rule. Consistent with this policy, we decline to state whether Jennison's particular records are sufficient under Rule 204-2(a)(16).

We are taking this opportunity, however, to provide investment advisers who advertise their performance with information that may facilitate staff examinations of the accuracy of such performance and facilitate the examination process for investment advisers. In light of the importance of accurate performance advertising, and in recognition of recent instances of fraud by investment advisers who advertised inflated performance, we strongly urge advisers to maintain reliable supporting documentation for their performance claims. We recognize that the rule provides a safe harbor to advisers who maintain certain account statements and worksheets. In recent instances, however, the staff found that the advisers' own account statements were not reliable, because the advisers were inflating their performance in their advertisements and in their account statements. Thus, the inspection staff was unable to confirm the veracity of the advisers' performance based solely on examination of the advisers' account statements and other internally generated documents. Based on this experience, and on the availability of electronic storage technology that allows advisers to maintain third-party account statements and confirmations in electronic format, we take this opportunity to stress that advisers will facilitate the staff's examinations of their performance claims if advisers maintain custodial or brokerage statements that confirm the accuracy of the account statements and other internally generated documents that the advisers maintain.<sup>8</sup>

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<sup>6</sup> See Rule 204-2(g).

<sup>7</sup> See, e.g., Salomon, *supra* n.5.

<sup>8</sup> The staff notes that maintaining third-party records also will assist the Commission's examination staff in confirming client assets and reviewing for misappropriation and misuse of client funds and securities.

We also note that advisers who advertise their performance can further facilitate the staff's examination of their performance if they also maintain reports prepared by an independent auditor that verify that performance. When reviewing auditor reports as part of an assessment of whether an adviser maintains sufficient records under Rule 204-2(a)(16), the staff will consider all facts and circumstances relating to the quality of the audit, including the following factors:

- (i) whether the auditor is appropriately independent from the adviser;
- (ii) whether the auditor reports are based on the auditor's review of data that were accumulated contemporaneously with the management of the relevant accounts;
- (iii) whether the auditor reviews sufficient information to afford a reasonable basis for the auditor's conclusions (such as, for example, by reviewing custodian and brokerage statements, and by confirming data directly with custodians and brokers), and prepares the auditor reports, in accordance with appropriate auditing standards;
- (iv) whether the adviser or the auditor maintains the records underlying the auditor reports (i.e., audit work papers), and the staff is provided with access to such records;
- (v) whether the performance verified by the auditor reports is consistent with the performance derived from the other records maintained by the adviser; and
- (vi) whether the auditor reports include a clear and specific description of the standard used by the adviser to calculate performance.

  
David W. Grim  
Special Counsel

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Investment Advisers Act of 1940  
Section 204  
Rule 204-2(a)(16)

June 22, 2000

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## Jennison Associates LLC

Dear Mr. Scheidt:

We are writing on behalf of our client, Jennison Associates LLC ("Jennison"), an investment adviser registered under the Investment Advisers Act of 1940, as amended (the "Advisers Act"). We request confirmation that, based upon the facts and circumstances discussed below, the staff of the Division of Investment Management will not recommend any enforcement action to the Securities and Exchange Commission (the "SEC") against Jennison under Section 204 of the Advisers Act or Rule 204-2(a)(16) thereunder if Jennison retains those records described below to support its performance record from 1969 through 1981, even though some of the underlying records that Jennison previously maintained to form the basis for, or demonstrate the calculation of, that performance under Rule 204-2(a)(16) were destroyed in a series of fires in 1997.

### Background

Jennison is a United States-based investment advisory firm, incorporated in 1969 and reorganized in 1998 as a limited liability company. Jennison was employee-

owned until 1985, when it was acquired by the Prudential Insurance Company of America. Jennison is managed independently from Prudential; Jennison's management makes its strategic and day-to-day business and operational decisions.

Jennison provides investment advice primarily to institutional investors, such as endowments, foundations, public and corporate employee benefit plans, pension plans and investment companies registered under the Investment Company Act. Jennison provides advice as to both equity securities and fixed income securities.

Jennison includes composite performance figures in institutional marketing materials for each of its investment strategies for periods dating back to the inception of each such strategy (the first of which was introduced in 1969). It does not include the performance of any individual account in these materials.

For many years, Jennison has maintained certain of the records relating to its investment advisory business at a South Brunswick, New Jersey document storage facility run by Iron Mountain Incorporated ("Iron Mountain"). According to its filings with the SEC, Iron Mountain is America's largest records management company, as measured by its revenues in the United States, and is a full-service provider of records management and related services whose customers include more than half of the Fortune 500 companies and numerous legal, banking, healthcare, accounting, insurance, entertainment and government organizations.

In March 1997, Iron Mountain experienced three fires that resulted in extensive damage to two of its record management facilities in South Brunswick, New Jersey, including the one used by Jennison. According to Iron Mountain, approximately 1.0 million of the 1.2 million cartons stored at these facilities were destroyed, including all Jennison records stored there. The fires are believed to have been caused by arson and are under investigation by local, state and federal authorities. Thus, the destruction of Jennison's records was due entirely to events beyond Jennison's control.

Following the fires, Jennison developed and implemented a plan to restore the records that it was required to maintain as a registered investment adviser and as an investment adviser to registered investment companies. In addition, in response to a request of the SEC, it sent a letter to the SEC's Office of Compliance Inspections and Examinations detailing which records were destroyed by the fires. As a result of Jennison's efforts to restore its records, Jennison has become concerned that it may not literally have all of the records necessary to form the basis for the calculation of its composite performance information for its investment strategies from 1969 through 1981. Nevertheless, Jennison does have much of the records underlying that composite performance information, including annual attestations by independent auditors. Accordingly, Jennison believes it is appropriate to continue including in its composite

performance information Jennison's composite performance results from 1969 through 1981.

### Analysis

Section 204 under the Advisers Act requires that every investment adviser make and keep for prescribed periods such records as the SEC may prescribe by rule. Rule 204-2 under the Advisers Act generally requires investment advisers to maintain and preserve their records in an easily accessible place for five years after the fiscal year in which the record was created. The rule also permits advisers to store most records that are more than two years old outside of the adviser's offices. Paragraph (e)(3) of Rule 204-2 however, requires that advisers preserve certain records, including those required to be created under paragraph (a)(16), for longer periods. Paragraph (a)(16) requires that advisers make and keep accurate "[a]ll accounts, books, internal working papers, and any other records or 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" in communications to ten or more people. Paragraph (e)(3) requires that such records be preserved for five years after the fiscal year in which the communications are made, the first two years in an office of the adviser.

It has been Jennison's long-standing practice to store off-site only those records that it believed were permitted to be stored outside of its offices under Rule 204-2. Upon completing its review of the records that were destroyed by the fires, however, Jennison concluded that it may no longer have certain records that may be necessary to form the basis for the calculation of its investment performance from 1969 through 1981.

Specifically, Jennison no longer has records that show all of the securities transactions in its clients' accounts from 1969 through 1981 that form the basis for the calculation of its investment performance for that period. In particular, it does not have worksheets or client account statements. Jennison has attempted to re-create these records by obtaining duplicate account statements from its clients' custodians, but they did not have copies of such statements for those years.

Jennison, however, continues to have many records relevant to the calculation of its investment performance. In particular, Jennison has reports prepared by an independent auditor, Ernst & Young (or one of its predecessors), annually since 1970, examining Performance Evaluation Summaries of Jennison (in accordance with generally accepted auditing standards). Those Performance Evaluation Summaries show on an individual, account by account basis, the performance figures that were generated the preceding year, on both a time-weighted and internal rate of return basis, in accordance with certain industry standards used at that time. The Ernst & Young reports conclude that the Performance Evaluation Summaries present fairly the information set forth therein on the bases described in the summaries.

Under Generally Accepted Auditing Standards ("GAAS") in effect during the relevant periods, the reports by the auditor on Jennison's Performance Evaluation Summaries were subject to requirements that provide a high level of assurance as to the accuracy of the Summaries. In particular, the reports were subject to general standards, standards of field work, and certain standards of reporting. See Statement on Auditing Standards No. 1, "*Codification of Auditing Standards and Procedures*," Committee on Auditing Procedure, American Institute of Certified Public Accountants (1972).

The general standards addressed the qualifications of the auditor and the quality of its work. They required that the "examination [was] to be performed by a person or persons having adequate technical training and proficiency as an auditor." In addition, they required that "in all matters relating to the assignment, and independence in mental attitude is to be maintained by the auditor or auditors." Finally, they required that "[d]ue professional care is to be exercised in the performance of the examination in the preparation of a report."

The standards of field work required that the work be adequately planned and assistants, if any, be properly supervised. They also required that there be a proper study and evaluation of Jennison's internal control to determine the nature, extent, and timing of audit tests to be applied in the auditor's examination. Finally, they required that sufficient competent financial matter be reviewed through inspection, observations, inquiries, and confirmations to afford a reasonable basis for the auditor's opinion. Thus, in conducting their work on the Performance Evaluation Summaries, the auditor selected samples of Jennison's accounts and tested the calculation of account returns by comparing Jennison's monthly transaction journals and other records, including cash and asset reconciliations, to, among other things, custodian statements, transaction confirmations, and pricing information from third-party sources.

The standards of reporting required that the reports express a clear-cut indication of the character of the auditor's examination and the responsibility it is taking. (As noted above, in each report the auditor opined that the Performance Evaluation Summaries presented fairly the information therein, subject to the methodologies employed to measure and compute rates of return.) Because the Performance Evaluation Summaries, like the performance disclosures of all investment advisers, do not take the form of balance sheets, results of operations, and changes in financial position, the reports were not subject to certain GAAS reporting standards. In particular, the Summaries were not subject to Generally Accepted Accounting Principles ("GAAP"), because GAAP does not address investment performance. Thus, the reports of the auditor do not address whether the Performance Evaluation Summaries are consistent with GAAP. Instead, they disclose that the methodology for computing the rates of return presented in the Performance Evaluation Summaries is derived from then-applicable industry standards. (For example, the Summaries for 1969 and 1970 were

computed in accordance with the methods recommended by the Bank Administration Institute for evaluating investment management performance.)

Thus, we believe that the reports provide the SEC and potential investors a degree of assurance as to the accuracy of Jennison's disclosures concerning its past investment performance essentially equivalent or superior to that which would be achieved through an SEC inspection under the Investment Advisers Act.

In addition, Jennison has other information supporting its performance figures, specifically month-end market value and principal flow information for all managed accounts dating back to 1969, showing the market value of each account at the end of each month, along with any client contributions to, or withdrawals from, the account in each month, and the market value adjusted for the cash flows. The cash flows do not identify whether a withdrawal was due to investment advisory or other applicable fees or expenses. However, Jennison does maintain separate records reflecting actual advisory fees charged to each account.<sup>1</sup> All of this information had been entered into Jennison's computerized recordkeeping system based on paper statements that were produced contemporaneously with the management of the relevant accounts, although these paper statements were subsequently lost in the fire. This information does not identify specific securities transactions or holdings, or which accounts were included in a specific composite, however. Jennison does maintain separate records that identify the accounts included in its composites. Jennison also maintains worksheets that were created after the fires and that demonstrate the calculation of the advertised composite performance based on the combination of Jennison's remaining records described above.

Jennison has confirmed, and an SEC examiner would be able to verify, that for the years 1969 through 1981, account-by-account performance figures as derived from cash flows and the market values of the accounts are consistent in all material respects with account-by-account performance figures in the Performance Evaluation Summaries as examined by the auditor in its reports, and that Jennison's published composite performance figures are therefore consistent with such previously examined account-by-account performance figures. In addition, an SEC examiner could review Jennison's calculation of investment performance, based on those market values and cash flows. The examiner, however, would not be able to review specific securities holdings in an account and verify that their market prices at a particular point were consistent with the account market values in Jennison's records.

Of course, details regarding portfolio transactions and monthly holdings' summaries supporting the valuation information are available for all accounts from

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<sup>1</sup> While the cash flow and market value information does not identify the amounts of all applicable fees and expenses for each account, this information and the calculation of account performance is available separately on Jennison's recordkeeping system.

**January 1982 to present.** In addition, as with the years 1969 through 1981, Jennison has reports for those years prepared by the auditor examining, on an individual account by account basis, performance figures that were generated the preceding year.

Consequently, while certain records destroyed in the fires were used by Jennison to demonstrate compliance with paragraph (a)(16) of Rule 204-2, Jennison has sufficient documentation in the market value and cash flow information, Performance Evaluation Summaries and auditor reports relating to each composite to support the performance figures that it includes in marketing materials because, among other things, such data were generated subsequently but accumulated contemporaneously with the management of the accounts. In addition, the worksheets that were created by Jennison after the fires and which were based on the market value and cash flow information, auditor reports and Performance Evaluation Summaries are sufficient to demonstrate the calculation of the advertised composite performance for purposes of Rule 204-2(a)(16). Such documentation is also sufficient to establish that such performance figures are not false and misleading. Thus, Jennison's records are consistent with the policy behind the SEC's adoption of paragraph (a)(16). See Investment Advisers Act Release No. 1093 (November 5, 1987) (purpose is to allow SEC examiners "to more effectively review advertisements to determine compliance with the advertising rule"). In this regard, SEC examiners will continue to be able to review reports on the year-by-year performance figures for each account managed by Jennison and to review the cash flow and portfolio market value data for those accounts, from 1969 to the present. In addition, SEC examiners will be able to review details regarding portfolio transactions and monthly holdings' summaries supporting the valuation information from January 1982 to present.

Accordingly, Jennison believes it is appropriate to continue to provide investors with its performance record since 1969, rather than since January 1982. In this regard, Jennison notes that its performance record since January 1982 for its actively-marketed strategies is superior to its performance record from 1969 through 1981, both in absolute terms and in comparison to relevant benchmarks. Thus, Jennison is concerned that omitting its performance from 1969 through 1981 from investor materials would be misleading.

We understand that in the past the Commission staff has been reluctant to take a "no-action" position on whether or not particular records are adequate under Rule 204-2. We nonetheless request that, based on the facts and circumstances described above, the Division agree that it will not recommend any enforcement action under Section 204 of the Advisers Act or Rule 204-2(a)(16) thereunder if Jennison retains only those described above to support its performance record from 1969 through 1981, even though some of the underlying records that Jennison previously maintained to form the basis for, or demonstrate the calculation of, that performance under Rule 204-2(a)(16) were destroyed in a series of fires in 1997. It is important to note that: Jennison's records were destroyed by warehouse fires that were beyond its control; Jennison has

made a good faith effort to restore its records after the fires at substantial cost to Jennison; Jennison has records for the periods besides the period from 1969 through 1981; and Jennison has cash-flow information, third-party audit reports containing Performance Evaluation Summaries, and other data described above for the period from 1969 through 1981.

Sincerely yours,

*Marcia L. MacHarg*

Marcia L. MacHarg