

**BRANDES**  
INVESTMENT PARTNERS

October 31, 2002

Association for Investment  
Management and Research  
P.O. Box 3668  
Charlottesville, VA 22903

Re: AIMR-PPS Standards – Wrap Fees

Ladies and Gentlemen:

We at Brandes Investment Partners LLC ("Brandes")<sup>1</sup> are pleased to have this opportunity to comment on the Association for Investment Management and Research's ("AIMR") proposed Guidance Statement on Wrap Fee Performance ("Guidance Statement"). Our commitment to AIMR's goal of fair representation and full disclosure of investment performance is demonstrated by our longstanding use of AIMR compliant materials in marketing our firm to current and potential clients. Additionally, we employ 65 AIMR-designated Chartered Financial Analysts ("CFAs").

Brandes participates as a portfolio manager in wrap-fee programs sponsored by approximately 36 different firms and manages over \$16 billion in assets under these programs. We may well be the world's single largest, non-sponsor, wrap fee investment adviser ("manager"). This is in addition to the approximately \$30 billion in institutional client assets managed by the firm. Due to our years of experience managing wrap-fee accounts, we recognize the difficulty in attempting to reconcile performance presentations for wrap-fee programs with the compliance regime developed under AIMR's Performance Presentation Standards ("AIMR-PPS") and we appreciate AIMR's efforts to assist wrap-fee managers in complying with AIMR-PPS. However, based on our experience, we believe that the Guidance Statement, as currently drafted, does not adequately address many of the realities associated

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<sup>1</sup> Brandes is a California based, federally registered investment adviser that makes notice filings to do business in all fifty states, the District of Columbia and Puerto Rico. Additionally, Brandes is registered to do business in six Canadian Provinces and in Ireland. We manage approximately \$50 billion in client assets for more than 100,000 separate clients including individuals, banks, pooled investment vehicles, pension plans, mutual funds, state and municipal governments, and wrap-fee accounts.

with the nature of the relationship between wrap-fee sponsors and managers.

Brandes is also a member of the Investment Counsel Association of America ("ICAA") and generally endorses the ICAA's comments on the Guidance Statement. In particular, the ICAA expressed concerns about the Guidance Statement's treatment of, among other things, recordkeeping and performance presentations. We agree that these are the two principal areas in which the Guidance Statement fails to take into consideration the nature of the wrap-fee industry as compared to non-wrap advisor services.

First, the Guidance Statement fails to recognize the fundamental reality that sponsors hire managers; managers do not hire sponsors. Unlike non-wrap, institutional clients, sponsors often do not consider a manager's AIMR-compliance to be relevant to the decision to include the manager in a wrap-fee program. We understand many sponsors are not AIMR-PPS compliant, do not keep the records required to produce AIMR-PPS compliant presentations and would likely not be responsive to managers' requests to facilitate the managers' desire to be AIMR-PPS compliant.

Moreover, the Guidance Statement seems to view a wrap-fee program as a relationship between the manager and the client under which certain functions are "outsourced. . . to the wrap sponsor."<sup>2</sup> The truth is that managers generally have only a remote and indirect relationship with the sponsor's wrap-fee clients.<sup>3</sup> Wrap-fee clients look to their sponsor to suggest an investment program that will then be implemented by the manager(s). Contact between the manager and clients is often contractually limited. For the most part, sponsors jealously guard their relationships with their clients and retain responsibility for communicating the results of the investment program to their clients.

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<sup>2</sup> The Guidance Statement notes, accurately, that this means that "many [managers] do not maintain nor have access to the data necessary to substantiate performance." The implication that managers have the option to maintain this data is unfair. In fact, the sponsors generally refuse to provide access to this data. As discussed herein, managers are not in the position to compel production of the data. The Guidance Statement fails to appreciate the nature of the services provided by the various parties. The sponsor, not the manager, is responsible for the maintenance of data not because the manager has outsourced this responsibility, but because the data itself is produced through the custodial and execution functions provided by the sponsor.

<sup>3</sup> There are instances in which advisers have created their own wrap-fee programs and have outsourced functions such as brokerage and custody. In these instances, advisers do have direct access to the wrap-fee clients. However, these programs are not typical of the wrap-fee business. Most wrap programs are sponsored by a registered broker-dealer that provides the brokerage, custody and related back-office services itself or through affiliates and then outsources the discretionary investment management services.

The Guidance Statement operates from an assumption that managers participate to a significant degree in the solicitation of wrap-fee clients. Unlike the institutional world, managers do not directly solicit clients using presentations designed to highlight their ability to manage wrap-fee accounts. In the wrap-fee context, managers market their services to sponsors, not to clients. Sponsors are sophisticated parties who understand and prefer gross of fees presentations that allow them to more accurately compare the performance of managers. Indeed, Brandes, like most managers, uses its institutional performance results to market itself to wrap-fee sponsors. Many in the industry regard wrap accounts as being accounts of the sponsor that most properly belong on the sponsor's composite. Once a manager is accepted into a wrap-fee program, it is the sponsor who designs any material describing the achievements of the manager. As suggested in the Guidance Statement, sponsors have little interest in presenting to clients a manager's performance record of managing assets for other sponsors. Sponsors use the materials presented to them by managers to determine which managers in the sponsor's program are most appropriate for the client's needs. At this point, the sponsor will provide the client with materials reflecting, among other things, the performance of each of the suggested managers in a form designed by the sponsor. Sponsors generally base these materials on the institutional performance of the manager, adjusted as the sponsor deems appropriate to account for the fees to be charged under its wrap-fee program.

The manager is generally not permitted to participate in the client's selection process. The manager does not have the leverage to require that presentations to the client be AIMR-compliant. In fact, aside from providing the raw data, managers have little input into the sponsor's presentations to clients. Sponsors design materials as they see fit, subject to the advertising requirements of the Investment Advisers Act of 1940, as amended (the "Act"), and the rules thereunder. Sponsors may design materials as general marketing literature or as one-on-one presentations where the sponsor, but generally not the manager, will be available to take questions from the client and make those disclosures to the client that it deems to be appropriate. While AIMR-complaint sponsors may desire to present AIMR-compliant numbers for the managers, it is unlikely that those sponsors that are not AIMR-compliant (including many of the largest retail broker-dealers) will have the ability or desire to conform presentations to AIMR's exacting standards.

Once the client settles on a manager, the sponsor maintains a proprietary interest in the client. As a result, while many contracts between the sponsor and the manager require the manager to be available to respond to client questions, these contracts also make it clear that this is a "don't call them, we'll call you" situation.

Often, the manager is prohibited from making direct contact with a sponsor's wrap-fee client. Although the wrap-fee client is considered to be a client of both the sponsor and the manager, the contractual relationship assures that there is not an equal service partnership between the sponsor and the manager. Instead, the manager's role has been stripped to the bare minimum of providing advice. Nearly all other front- and back-office functions are performed by the sponsor itself or by other service providers on behalf of the sponsor. These functions include implementing the manager's investment decisions, placing transactions, maintaining records of account performance, and presenting this performance to the client. These are roles controlled by the manager in its institutional business that allow the manager to maintain the types of records required for AIMR-compliant verification. Lacking this control in the wrap-fee context means that the manager can neither create nor maintain the requisite records for AIMR compliance.

The Guidance Statement offers two "solutions" to the recordkeeping problem.<sup>4</sup> Neither solution, however, recognizes the technological or practical barriers that managers face in the wrap-fee context. The first solution, "plac[ing] reliance on the performance calculated by the wrap fee sponsor, provided the firm takes the necessary steps to satisfy that the information provided by the wrap fee sponsor meets the requirements of the standards and, if necessary, obtains an agreement with the wrap fee sponsor to secure access to the underlying records," is impractical. It would place the manager in the position of auditor over the sponsor's relationship with the client. As noted above, sponsors jealously guard this relationship.<sup>5</sup> Sponsors are not likely to allow increased access to their proprietary records simply to facilitate the manager's desire to remain AIMR-compliant. Managers who select this "solution" will be at a competitive disadvantage.

The second "solution," shadow accounting, is technologically and economically infeasible. This solution requires a manager to maintain duplicate records. Shadow accounting would require managers to reconcile countless client accounts with every sponsor in whose program the manager participates. As noted by the Money Management

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<sup>4</sup> AIMR standards are often more restrictive than those under the Act. The Guidance Statement notes that compliance "with all applicable local law or regulation [is required including] the laws and regulations relating to record keeping." While AIMR notes that this may be difficult for wrap-fee managers to satisfy, in fact the Guidance Statement asks managers to go well beyond the records required to be kept for wrap-fee accounts by the Securities and Exchange Commission.

<sup>5</sup> Many agreements between sponsors and managers participating in their wrap fee programs contractually limit the manager's access to information about the client and/or the manager's ability to use information to compete with the sponsor.

Institute ("MMI") in its comment letter, as well as in a recent white paper,<sup>6</sup> each sponsor has its own systems. Brandes would thus be required to reconcile performance results for thousands of client accounts using thirty-six different accounting systems. The white paper notes that "account reconciliation is . . . an issue for those managers that maintain in-house portfolio accounting systems that are intended to mirror sponsor systems. The sponsors maintain the official books and records for the portfolios and do not reconcile these with the managers. . . . [This] is problematic because of the volume of accounts as well as the differing procedures necessary to identify the reconciling items from sponsor to sponsor."<sup>7</sup> Because reconciliation across systems is technologically infeasible, managers wishing to employ shadow accounting will incur the enormous expense required to reconcile these records by hand. This action would be economically infeasible on a large scale. Wrap-fee managers already receive lower fees in discretionary wrap accounts than in other discretionary accounts they manage because they provide none of the ancillary functions. Managers who desire to use shadow accounting to maintain AIMR compliance will be forced to either demand higher fees or accept lower margins. In many cases, managers will be forced to abandon the wrap fee business as unprofitable, or abandon AIMR compliance as incompatible with maintaining wrap-fee business. Again, AIMR-compliant managers will be placed at a competitive disadvantage.

With regard to the section of the Guidance Statement captioned "Presenting to Prospective Wrap Fee Sponsors or Prospective Clients", we feel that that the statement "investment management firms must group wrap fee portfolios in a composite according to the same investment style or strategy, regardless of the sponsor . . ." raises additional concern. Given the relationship that we have described above between the sponsors and the managers and the fact that each wrap-fee program is so highly particularized in respect of fees, charges, expenses, accounting and performance calculation protocols as well as investment policies and restrictions, we feel that such a "super composite" can be of little objective value to clients considering investing through any particular wrap-fee program. The only way a "super composite" can be accomplished is to shadow each account in every program on a single portfolio accounting system. If not, a manager would have to include all its accounts from each sponsor into a composite, which would include and combine literally

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<sup>6</sup> See Operational Interfaces in the Separately Managed Account Industry, August 2002. ("Operational Interfaces"). This white paper, authored by Deloitte & Touche on behalf of MMI, notes the "lack of standardized protocols and processes" in the wrap fee industry. As a result, connectivity between sponsors and managers is compromised, constricting the flow of data between the parties with regard to front- and back-office functions.

<sup>7</sup> Operational Interfaces at 5.

all forms of calculation methodology known to exist (trade date vs settlement date, true time weighted vs modified methods, accrual vs cash, different pricing sources, different inclusion criteria, etc.) Such a composite would be worse than the so called "catch-all" or "dustbin" composite that is frowned upon.

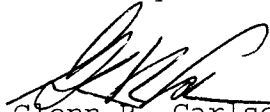
Because AIMR-compliant presentations are neither required by sponsors nor presented to wrap-fee clients, the costs of complying with the Guidance Statement (as currently drafted) far outweigh the benefits provided by the Guidance Statement. Given the significant recent growth in the amount of assets committed by investors to wrap-fee programs, it is crucial that any guidance recognize the manner in which these programs operate. Should the Guidance Statement be adopted in its current form, Brandes and many other managers will be forced to choose between maintaining AIMR-PPS compliance and continuing in the wrap-fee business.

The concerns discussed above cannot be cured simply by applying a new regime prospectively or granting additional time to comply with the Guidance Statement. We believe that AIMR's desire to provide additional guidance at this time is admirable but that more consideration is necessary to "do the job right." As such, we at Brandes respectfully suggest that AIMR shelve the currently proposed Guidance Statement and convene a roundtable of industry representatives to discuss the proper way to harmonize the presentation of wrap-fee performance with the existing AIMR-PPS standards in a manner that recognizes the unique structure of the wrap-fee industry. Brandes would be eager to participate in such a roundtable.

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We appreciate the opportunity to comment on the Guidance Statement and we welcome any questions you might have about our views. Please contact our General Counsel, Gerald W. Wheeler, or me should you require further assistance.

Sincerely,



Glenn R. Carlson, CFA  
Chief Executive Officer  
Brandes Investment Partners LLC