



December 6, 2001

Professional Standards and Advocacy
AIMR
P.O. Box 3668
Charlottesville, VA 22903

Dear Sir or Madam:

Thank you for allowing us to comment on the proposed Guidance Statement on Composite Definition (draft GS). Our comments are as follows:

1. The draft GS states "If the portfolio falls below the minimum due to market movements, the firm must leave the portfolio in the original composite until there is a documented change in client guidelines or acknowledgement from the client that the firm considers the portfolio too small to implement the composite strategy." We believe that this guidance is impractical. First, if the composite minimum represents the amount needed for discretion, a portfolio below the minimum would not be representative of the strategy, and its performance would deviate from other composite portfolios. Second, requiring acknowledgement from the client that the portfolio is too small would be a burdensome task and may be difficult to accomplish, as well as complicate client relations. Third, it may be very difficult to determine exactly why a portfolio has fallen below the minimum. Often a portfolio will fall below the minimum due to a combination of market movement and client activity. Instead, we suggest the following guidance for all portfolios, regardless of the reasons for the fall below the minimum value:

"A firm should review portfolios for compliance with composite minimums at the beginning of the measurement period (typically a month). If a portfolio does not meet the composite minimum for two consecutive measurement periods, it should be removed from the composite temporarily, until it reaches the composite minimum. The portfolio should be re-included in the composite once its beginning market value exceeds the composite minimum. Additionally, firms should consider using a tolerance level for portfolios falling below the minimum."

By evaluating portfolios at the beginning of the period, there would be no upward bias as poorly performing portfolios would be included in the composite for the period in which the market value fell below the minimum. Additionally, by treating all portfolios consistently there would be no opportunity for judgment as to whether a portfolio fell below the minimum due to depreciation or capital withdrawal. Finally, allowing for a two month "test period" combined with a

strictly enforced threshold, such as within 5% of the minimum, would prevent frequent changes in composite populations.

2. The draft GS states “Once a portfolio is removed, the firm must determine if the portfolio meets any other composite definition and must include it in the appropriate composite(s) in a timely and consistent manner.” If a firm has determined that a portfolio must have a certain minimum market value in order to be discretionary, then a portfolio that falls below the minimum would be considered non-discretionary and would not qualify for inclusion in any composite. The current language seems to suggest that a firm may create numerous composites using the same style, with the only difference being market values. This would contradict the philosophy behind the current guidance. We suggest deleting this language from the draft GS.
3. The third Guiding Principle states “Firms must disclose the definition of each composite.” We believe additional guidance should be provided as to what must be disclosed to meet this requirement and to differentiate between composite definition and composite criteria.
4. If a firm redefines a composite, the draft GS states “In case of a change, it must be fully disclosed...” We believe that a firm should also have to fully disclose a composite name change as part of the composite definition, even if the composite is not redefined.
5. While not specifically addressed by the draft GS, many firms create composites as a “subset” of a large composite. For example, a firm may have a “Total Equity Composite” that includes all equity portfolios. The firm may then create a subset Small Cap Composite composed of portfolios included in the Total Equity Composite that use a small cap benchmark. We suggest that a firm be required to disclose if a composite is a “subset” of a larger composite as part of the composite definition.

Again, thank you for the opportunity to comment.

Sincerely,

Karyn D. Vincent, CFA
CAPS, Inc.