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December 28, 2004

CFA Institute
CFA Centre for Financial Market Integrity
Reference: Guidance Statement on Wrap Fee/SMA Performance
P.O. Box 3688
Charlottesville, Virginia 29903

RE: GIPS Guidance Statement on Wrap Fee/Separately Managed Account Performance

Ladies and Gentlemen:

Flippin, Bruce & Porter, Inc. is pleased to have the opportunity to comment on the above-referenced Guidance Statement. Flippin, Bruce & Porter (FBP) claims compliance with the AIMR-PPS Standards, the US and Canadian version of GIPS and would be subject to said guidance, if adopted. FBP has existing relationships with a number of SMA sponsors and has a vested interest in the adoption of a meaningful, relevant and attainable standard for calculating and presenting SMA performance.

FBP observes that this guidance appears to address the identical issue that was undertaken by the AIMR Performance Presentation Standards Implementation Committee of the Association for Investment Management and Research in its Guidance Statement on Wrap Fee Performance, issued for comment mid-2002. While addressing several nuances raised in the 2002 comment letters, the current guidance fails to address in a constructive way the larger issues, to which almost universally the comment letters of 2002 pointed. Our substantive concerns with the current guidance are as follow:

- The guidance requires firms wishing to include both non-SMA and SMA assets in its assets under management to “be sure that the performance provided to the investment management firm by the SMA sponsor meets the requirements of the Standards or the firm must maintain separate/duplicate records at the firm level (which meet the requirements of the standards).” As was often mentioned in the 2002 comment letters, firms rarely have the leverage to make demands of SMA sponsors who jealously and understandably safeguard their client information. Because of these realities, this requirement is tantamount to requiring that the managers of the SMA accounts install “shadow accounting” systems to comply, a direct cost which will negatively impact the managers’ already lower –margin SMA business. As if to counter objections before they might arise, the guidance states “cost must not be considered an excuse for the ability of a firm to obtain records.” Firms acting in their best interest will weigh the benefit of maintaining compliance with the Standards

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against the cost of doing so. These costs include the direct costs just mentioned as well as the more subtle costs of unintended consequences. One such example is the cost of losing current institutional clients. In order to avoid the direct cost of shadow accounting, managers are thereby motivated to 'redefine' their firms to exclude SMA assets. Such a re-definition could result in a loss of current institutional business and reduced new business opportunities since many institutional clients (and their consultants) require a certain minimum level of assets under management as a condition of maintaining or awarding mandates. This too has a margin impact. FBP suggests that the IPC allow firms which 'redefine' themselves to disclose as supplemental information their total assets under management, including their SMA assets, to alleviate this unintended consequence.

- With respect to the guidance's requirement that firms show returns net of fees when marketing to SMA sponsors, we respect the IPC's position that a net-of-fees presentation is generally conservative and reduces confusion given the development of various SMA fee structures. However, SMA sponsors are highly sophisticated organizations, well prepared to distill a net-of-fees presentation from its gross of fees counterpart in evaluating the manager. The risk that such sophisticated sponsors would be misled by a gross-of-fees performance is frankly minimal. In fact, our observation is that among SMA sponsors, the gross-of-fees presentation provides a *more* equalized basis for evaluating a manager's true investment performance unclouded by fee/cost structures.
- Similarly, the requirement that the firm maintain a 'super' composite of all accounts across all SMA programs would appear to have little benefit to a sophisticated SMA sponsor, owing to the disparity in fees charged across programs. With respect to this 'super' composite, the guidance is not clear whether the firm would be allowed to aggregate the *composite* performance of each program into the 'super' composite or whether the manager would be required to look to the individual accounts within each composite and aggregate the performance at this granular level. If the latter should be the intent of the guidance, FBP believes that, short of retrieving such information through a shadow accounting system, firms would face a logistical nightmare in maintaining such a composite. Such a process would also detract from timely performance disclosure. The manager is thus, once again, forced into the only viable option of costly shadow accounting or the unintended consequence referred to earlier. FBP appreciates that the IPC's motivation behind incorporating this requirement is to ensure that firms be precluded from "cherry-picking" the performance of their best performing programs. However, we believe that the same objective can be achieved by requiring firms to present the composite performance, (separately) of all their existing SMA programs (i.e. full disclosure of each existing program to a prospective sponsor). The benefits of such an approach are two-fold; the prospective sponsor benefits from a truer picture of the manager's ability to manage investments and

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programs while the manager avoids the frictional costs of maintaining a 'super' composite.

- A potentially problematic situation arises in connection with this style-defined, 'super' composite. While it is within the manager's ability to control the dissemination of performance to prospective sponsors and clients when representatives of the firm engage in marketing, managers market predominantly to sponsors and their financial consultants. It is the sponsors and their staff of financial consultants who undertake the marketing to prospective clients. Typically, these sponsors prepare a "profile" of the manager, which includes the composite presentation of that manager's performance on behalf of the sponsor's clients. The manager has minimal involvement in the preparation or use of these profiles except to review them for accuracy to the extent permitted by the sponsors (more specifically, the sponsor's compliance department). It is unlikely that sponsors will voluntarily agree to adhere to the requirements of the guidance by marketing the manager-supplied, style-defined 'super' composite performance if they themselves elect not to claim compliance. Once again, the cost of unintended consequence is to place managers in the difficult position of having to decide whether to turn down business from non-complying sponsors (those which do not present the manager's 'super' composite) or re-define the firm thereby jeopardizing the manager's institutional business.

On behalf of all the principals and associates of Flippin, Bruce & Porter, we appreciate this opportunity to share our observations concerning the Guidance Statement. It is our hope that the IPC reconsiders its guidance by weighing the realities of the investment management 'distribution' system and the costs (both direct and consequential) of compliance in achieving the underlying principle of fair representation and full disclosure, a principle to which our firm remains deeply committed.

Sincerely,

John T. Bruce, CFA
Principal and Founder
Flippin, Bruce & Porter, Inc.