December 30, 2004

Via E-mail

CFA Institute
CFA Centre for Financial Market Integrity
Reference: Guidance Statement on Wrap Fee/SMA Performance
P.O. Box 3668
Charlottesville, VA 22903

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

Ladies and Gentlemen:

The Investment Counsel Association of America[1] appreciates the opportunity to comment on the CFA Institute's (Institute) and Investment Performance Council's proposed Guidance Statement on Wrap Fee/Separately Managed Account Performance (the Statement).[2] We commend the Institute for re-proposing and attempting to clarify the Institute's wrap fee/SMA performance guidance for the GIPS standards[3] and for giving interested parties an opportunity to comment on these important issues. We remain concerned, however, that many of the key issues we raised in our comment letter in 2002 have not been addressed.[4] We incorporate that letter by reference and focus here only on two critical issues – the recordkeeping requirements and the proposed compliance date. We respectfully submit that advisers will not be able to comply with the recordkeeping requirements and certainly not by the compliance date.

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[1] The Investment Counsel Association of America, Inc. is a not-for-profit organization that represents the interests of SEC-registered investment advisory firms. Founded in 1937, the ICAA's membership today consists of more than 350 federally registered advisory firms that collectively manage in excess of $4 trillion for a wide variety of individual and institutional clients. Additional information about the ICAA is available on our web site: www.icaa.org.

[2] The Statement is available at http://www.cfainstitute.org/standards/pdf/SMA_Wrap_Fees.pdf. The Statement would apply to investment management firms that claim AIMR-PPS or GIPS compliance and are discretionary portfolio managers of wrap fee/SMA portfolios.

[3] The Statement follows a previous Guidance Statement on Wrap Fee Performance proposed by the Institute (formerly AIMR) in June 2002 for the AIMR-PPS standards (2002 Statement), available at http://www.cfainstitute.org/standards/pdf/wrapfee.pdf.

[4] See *ICAA Comment Letter to AIMR Re: Proposed Guidance Statement on Wrap Fee Performance* (Oct. 31, 2002) (2002 letter), available at http://www.icaa.org/public/letters/compendiums/letterscompendium-2002.pdf.

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Underlying Records

We appreciate the Institute's acknowledgement that many investment management firms may not be able to gain access to the records necessary to substantiate performance on a retroactive basis (for periods before January 1, 2006, the effective date of the Statement). We are also pleased the Institute has not required managers that did not maintain the records to wait until they are able to build a five-year compliant track record with supporting records in order to claim compliance with the GIPS standards. However, we remain concerned about the three "options" the Institute has identified to satisfy the proposed GIPS standard for underlying records for wrap fee/SMA portfolios.

GIPS Standard 1.A.1 requires that: "All data and information necessary to support a firm's performance presentation and to perform the required calculations must be captured and maintained." The Statement interprets this to mean managers must maintain or have access to supporting records for all portfolios included in a composite. The Statement notes that many managers do not maintain or have access to the data necessary to substantiate performance. As a solution, the Statement provides three options to satisfy this requirement. First, managers could place reliance on the performance calculated and reported by the sponsor, provided the manager takes the necessary steps to satisfy itself that the information provided by the sponsor meets the requirements of the AIMR-PPS or GIPS standards and, as necessary, obtains an agreement with the sponsor to secure access to the underlying records. Second, managers could use a "shadow accounting" system to track the SMA portfolios on their in-house performance measurement systems. Third, managers could exclude the SMA division from the definition of firm.[5] For reasons we discussed in our 2002 letter, we believe that it is unrealistic to use any of the recommended options because they are extremely difficult, if not impossible, to implement.[6] Further, some managers may be forced to stop managing wrap fee/SMA programs rather than maintain the proposed AIMR-PPS or GIPS recordkeeping requirements for these programs.

We believe the first option of relying on the performance calculated and reported by the sponsors is unreasonable because sponsors generally do not provide managers with access to individual account information that may be necessary for the manager to satisfy itself regarding the sponsors' performance calculations. The Statement notes that all managers "must exhaust all methods to gain, recreate, or obtain access to the performance records to substantiate portfolio returns. Cost must not be considered an excuse for the ability of a firm to obtain records." These assertions reflect a misunderstanding of the nature of the relationship between the sponsor and the manager. Cost alone is not the prohibitive factor. Sponsors guard this information as a valuable asset, and managers do not have the leverage to negotiate access. Moreover, sponsors generally continue to be unwilling or unable to provide regular electronic data feeds with trade and other information that are necessary to make accurate performance calculations. Further, many sponsors do not follow GIPS standards, and managers do not have sufficient power in these relationships to require sponsors to do so.

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[5] Under the GIPS standards, a firm may define itself as an investment firm, subsidiary, or division held out to clients or potential clients as a distinct business unit (*e.g.*, a subsidiary firm or distinct business unit managing private client assets may claim GIPS compliance for itself without its parent organization being in compliance).

[6] *Supra* n.4.

As a result, it is unreasonable to place the burden on the manager of assessing whether the sponsor's performance calculations are compliant with the GIPS standards, particularly without access to adequate information.

We believe the second option, shadow accounting, is beyond what is technologically feasible at present. As we mentioned in our previous comment letter, shadow accounting makes little sense economically and practically because it will be prohibitively expensive and time-consuming to manually reconcile the literally thousands of accounts within the numerous wrap fee/SMA programs in which a manager may participate. Managers will be forced to face very expensive upgrading systems in order to interface with sponsors' information and trading systems, which are often incompatible with the managers' systems. Manual back-office reconciliations are simply not an option for managers with large volumes of trades in SMAs without significantly increasing resources, employees, and expenses. Further, many sponsors are reluctant to open their proprietary systems to managers. In addition, managers that implement a shadow accounting system may not even have access to sufficient data from sponsors required to comply with the standards. A manager's good faith attempt to obtain the required data to perform shadow accounting has been, and will continue to be, frustrated by the state of the systems in the wrap fee industry and the lack of connectivity among wrap fee sponsors and managers.

Finally, the third option, redefining the firm to exclude the SMA division from the definition of the firm, will not work for firms wanting to implement new wrap products. Although this option is potentially workable for managers that already have well-established wrap fee/SMA products, implementation will be burdensome and time-consuming. A manager that chooses to redefine the firm to exclude the SMA division will incur considerable expenses in employee time and firm resources to recalculate the firm's assets under management, restructure the firm's composites, and rebrand the firm and the SMA division. In addition, managers would not be permitted to show performance from the SMA division except as supplemental information. Further, the non-SMA firm performance may not be shown to prospective SMA clients of the SMA division except as supplemental information. These restrictions present significant drawbacks to redefining the firms to exclude the SMA division.

Compliance Period

We are concerned that the Statement proposes an impractical and burdensome implementation period for managers to comply with the requirements. In light of the proposed adoption date of June 2005, managers will have approximately six months to implement the Statement's requirements. A manager that chooses to rely on the sponsor or to implement shadow accounting systems must have adequate time to amend any contractual agreements with sponsors to reflect these new requirements in the Statement and conduct additional due diligence on the sponsors. Furthermore, a manager that chooses to implement a shadow accounting system will require sufficient time to develop technological interfaces with SMA sponsors in order to automate trade communications and back-office reconciliations. As mentioned above, a manager that chooses to redefine the firm to exclude the SMA division must recalculate the firm's assets under management, restructure the firm's composites, rebrand the firm and the SMA division, and implement new marketing efforts – all of which will require considerable time and firm resources to implement.

Equally troublesome is the proposed requirement that if a manager cannot meet the January 1, 2006 compliance date, it must wait until it has a minimum five-year track record that complies with GIPS before claiming compliance. We believe this requirement unfairly and unjustly penalizes managers that seek to implement a shadow accounting system, given the complexities of having to develop the systems to interface with every SMA sponsor for which the firms manage wrap fee/SMA programs. Managers require more than the proposed implementation period of six months to adjust their operational and technical systems to meet the underlying record requirements. Managers should not be penalized an additional number of years for working toward a solution of GIPS compliance. Accordingly, for all the reasons discussed above, we request that the compliance period be extended for at least two years from the date of the Statement's adoption.

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We appreciate the opportunity to comment on the Institute's Guidance Statement on Wrap Fee/Separately Managed Account Performance, and we would be pleased to work with you further on these issues. Please do not hesitate to contact the undersigned or Karen L. Barr, ICAA General Counsel, if we may provide additional information or clarification with respect to our comments.

Sincerely,

Monique S. Botkin
Counsel