



October 31, 2002

Association for Investment Management and Research  
Reference: AIMR-PPS standards – Wrap Fees  
P.O. Box 3668  
Charlottesville, VA 22903

*Re: Proposed Guidance Statement on Wrap Fee Performance*

Ladies and Gentlemen:

The Investment Counsel Association of America<sup>1</sup> appreciates the opportunity to comment on the Association for Investment Management and Research's (AIMR) proposed Guidance Statement On Wrap Fee Performance. We commend AIMR for attempting to clarify an area that has generated much confusion. However, we have the following specific comments and concerns and generally conclude that investment managers in the wrap fee business cannot reasonably implement many of the proposed requirements.

**1. Guiding Principles**

The Guidance Statement states that “because the wrap fee itself may be difficult to segregate into its component parts, the AIMR-PPS standards require the presentation of wrap fee performance to prospective wrap fee clients after the deduction of the entire wrap fee.” There are two principal problems with the underlying assumptions in this statement. First, managers typically have access only to information regarding their management fees and are not in a position to perform the required calculation. Second, managers typically do not prepare performance presentations for the benefit of prospective wrap fee clients; sponsors usually prefer to perform that task themselves. In fact, contracts between sponsors and managers typically mandate that the sponsor is responsible for client reporting. Managers generally have little to no contact with wrap fee clients with respect to marketing and portfolio and performance reporting and are usually restricted in that regard.

Managers are customarily required to prepare portfolio and performance reports for the benefit of the sponsor so that sponsors have a basis for evaluating prospective and incumbent managers. In order to evaluate managers on an equal footing, sponsors want and need to have the gross-of-fees performance calculation from the manager. Using this

---

<sup>1</sup> 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 about 300 federally registered advisory firms that collectively manage in excess of \$3 trillion for a wide variety of individual and institutional clients. For more information about the Association, please see our web site at [www.icaa.org](http://www.icaa.org).

information, sponsors can then calculate performance according to their own methodology to be presented to wrap fee clients. A gross-of-fee calculation by the manager is appropriate because sponsors are highly sophisticated and capable of asking questions about fees and the potential effect on portfolio performance. The sponsors have the opportunity to do so because this information is generally provided in a one-on-one setting to sophisticated sponsor due diligence or research teams responsible for assessing all aspects of a manager's performance, including investment performance.

## **2. Definition of Firm**

The Guidance Statement describes three options for defining the firm: (a) define the entire organization as the firm, (b) define the non-wrap fee division as a firm, or (c) define the wrap fee division as a firm. For firms that already have well-established wrap fee products, these definitional possibilities do not pose a problem and can be implemented without great difficulty. However, for firms wanting to implement new wrap products, these definitions are impractical and make it exceedingly difficult to claim compliance with the AIMR-PPS standards.

Although the Guidance Statement offers three definitional options, in reality only the first is feasible for new wrap products and even that option would be difficult to implement. The third option simply does not work because there would be no wrap product to define as the firm. The second option is impractical because it allows firms to show institutional performance only as supplemental information. If the firm is presenting a new product in which there is no performance to present, then there would be nothing to supplement and, therefore, the firm would not be able to show any performance at all.

If a firm chooses to define the entire organization as the firm, then the Guidance Statement warns that "firms must be sure that the performance provided by the wrap fee sponsor meets the requirements of the Standards or the firm must maintain separate/duplicate records at the firm level." This cautionary statement overlooks several very important facts. First, the sponsor generally has the contractual relationship with the end client; the managers generally do not contract with clients but enter into contracts directly with the sponsors only. Most sponsors take responsibility for calculating and providing performance information to their clients and, in fact, require that their own calculations be used in the marketing of this product.

Second, sponsors typically are not or cannot be in compliance with the AIMR-PPS standards. It would be unreasonable and presumptuous for a manager to demand that a sponsor follow standards that are strictly voluntary. Moreover, managers do not have sufficient leverage in these relationships to require sponsors to do so. As a result, it is unreasonable for AIMR to place the burden on the manager of ensuring that the sponsor's performance calculations adhere to the methodology mandated by AIMR standards.

Third, this Guidance Statement places managers in an untenable position of being required to verify third-party performance calculations without having the authority or ability in many cases to analyze the underlying performance calculation methodologies of wrap fee sponsors.

### **3. Underlying Records**

The Guidance Statement acknowledges that investment managers “do not maintain or have access to the data necessary to substantiate performance” in order to satisfy Standard 1.A.1 of the AIMR-PPS standards, which state: “All data and information necessary to support the firm’s performance presentation and to perform the required calculations must be captured and maintained.” As a solution, the Guidance Statement offers two options for satisfying this requirement. Firms may use “shadow accounting” or the firm may rely on the performance reported by the wrap fee sponsor so long as the firm satisfies itself that the sponsor meets the requirements of the Standard and, if necessary, obtains an agreement with the sponsor to secure access to the underlying records.

We believe that it is unrealistic to use either of the recommended options because they are extremely difficult, if not impossible, to implement. From a business practice viewpoint, shadow accounting would not make sense because it is prohibitively expensive to reconcile the literally thousands of accounts within the numerous wrap fee programs in which a manager may participate. Managers would be required to duplicate recordkeeping that sponsors have contractually agreed to perform and for which they are compensated. Managers are usually paid less for managing wrap fee accounts than institutional accounts to reflect this division of responsibilities. Moreover, even assuming a manager was willing to incur the expense of shadow accounting, for those firms that already have well-established wrap fee products, obtaining records from the sponsors to shadow account for historical periods will not be possible and is unreasonable given the long-standing contractual division of these responsibilities among the managers and sponsors. Many sponsors do not and have not employed AIMR standards. Given the fact that most wrap fee sponsors have the contractual responsibility for performance reporting to clients, managers with well-established wrap fee products will not have access to sufficient data from sponsors required to comply with the AIMR standards. In many instances, 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.<sup>2</sup>

---

<sup>2</sup> Deloitte & Touche prepared a White Paper in August 2002 that was commissioned by The Money Management Institute titled “Operational Interfaces in the Separately Managed Account Industry.” The White Paper concluded that systems currently being used in wrap fee programs did not have the capacity to import and export large amounts of information. The White Paper also concluded that “the lack of standardized procedures and data protocols in the industry combined with varying sponsor platforms, low levels of connectivity and closed architecture systems has made the reconciliation process a significant challenge.”

The second option of relying on the performance records of the wrap fee sponsor also is unreasonable because sponsors generally do not provide managers with access to individual account information that is necessary to do performance calculations. This information is guarded as a valuable asset of the sponsor and managers generally are not in a position to negotiate access. Even when the sponsor does provide account information, these reports are often incomplete and not timely. Sponsors generally are not willing or are unable to provide regular electronic data feeds with trade and income information that are necessary to make accurate performance calculations. For example, in dealing with transactions when the client withdraws cash from his or her account, the manager might account for that withdrawal immediately, while the sponsor might not account for the withdrawal until the cash actually left the custodial account. Moreover, as stated above, many sponsors do not follow AIMR standards and managers do not have sufficient leverage in these relationships to require sponsors to do so. 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 AIMR-PPS standards, particularly without access to adequate information.

#### **4. Presenting Wrap Fee Performance**

The Guidance Statement states that “The sponsor will provide the performance results supplied by the investment management firm to wrap fee prospects. Generally, the prospects will not receive the performance in a typical ‘one-on-one’ presentation setting with the ability to ask questions of the investment management firm.” This statement correctly acknowledges that it is the sponsor, and not the manager, that is responsible for providing the client with information. However, this provision implies that the manager has some degree of control over what information the sponsor provides and how the information is provided. On the contrary, the manager commonly has no control over how or what information the sponsor disseminates. The Guidance Statement also assumes that because a representative of the manager is not available that the client does not have an opportunity to ask questions. However, such presentations typically are made by a registered representative of the sponsor who explains the performance data in a one-on-one setting in which the client has the opportunity to ask questions.

The Guidance Statement proposes that “[f]irms can present wrap fee sponsors with gross-of-fees performance only for the use of the sponsor, provided that prior to presenting the firm’s performance to a prospective wrap fee client the wrap fee is deducted (resulting in net-of-fees performance).” Once again, the Guidance Statement incorrectly assumes that the manager has the ability to dictate to the sponsor how performance information ought to be presented to clients. The Guidance Statement also places a burden of responsibility on the manager to monitor the sponsor’s actions, which does not make sense contractually or practically and is inconsistent with the long-standing division of responsibilities and fees associated with a typical sponsor-manager relationship. The sponsor may choose not to show the gross performance that the manager provided and instead may calculate performance independently and present that (either net and/or gross) to the client.

The Guidance Statement requires managers to “group wrap fee portfolios in a composite according to the same investment style or strategy, regardless of the sponsor.” The ability to comply with this statement depends on whether managers can obtain consistent information from each sponsor. As more fully discussed above, there are enough differences between the portfolio accounting systems that sponsors use, the amount of access to information they provide, the fee structures, and general differences within strategies that the overall performance would be distorted.

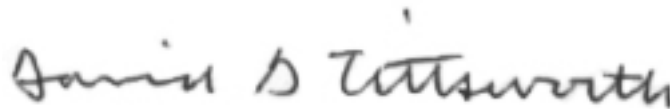
## 5. Conclusion

The ICAA believes that the Guidance Statement does not adequately account for the realities of the typical relationship between managers and sponsors in wrap fee programs and therefore does not make practical business sense. Further, because AIMR-compliant presentations are neither required by sponsors nor presented to wrap-fee clients, the cost of complying with the Guidance Statement would far outweigh the benefits to investors. Given the significant issues with the Guidance Statement as proposed and the complexity of wrap fee programs, we suggest that AIMR postpone implementation of the Guidance Statement and study these issues further.

...

We thank you for the opportunity to comment on the Guidance Statement on Wrap Fee Performance and we welcome your questions about our views. Please do not hesitate to contact me if you need additional information.

Sincerely,



DAVID G. TITTSWORTH  
Executive Director

cc: The Honorable Harvey L. Pitt  
The Honorable Cynthia A. Glassman  
The Honorable Harvey J. Goldschmid  
The Honorable Paul S. Atkins  
The Honorable Roel C. Campos  
Paul F. Roye  
Robert E. Plaze