



THE MONEY MANAGEMENT INSTITUTE

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December 23, 2004

James E. Hollis III, Chair of the Investment Performance Council
Ms. Karyn Vincent, Chair of the AIMR—PPS Implementation Committee
c/o CFA Institute
CFA Centre for Financial Market Integrity
P.O. Box 3668
Charlottesville, VA 22903

Re: Guidance Statement on Wrap Fee/SMA Performance

Dear Jamie and Karyn:

The Money Management Institute (“MMI”)¹ appreciates the opportunity to comment on the Guidance Statement on Wrap Fee/Separately Managed Account (“SMA”) Performance that the CFA Institute (“CFA Institute”) recently proposed (the “Proposed Statement”). The MMI applauds the CFA Institute’s cooperative approach with the industry and substantial effort in this area. It is apparent that the CFA Institute listened to and incorporated prior industry comments in the Proposed Statement. However, the MMI strongly feels there are remaining areas of concern as outlined in this letter that need to be addressed to enable many investment firms to continue their claim of compliance with the Association for Investment Management and Research (“AIMR”) Performance Presentation Standards (“AIMR-PPS” or “Standards”) while still participating in SMA programs.

1. Do you support CFA Institute’s effort to develop guidance for the calculation and presentation of wrap fee/SMA portfolios as outlined?

The MMI supports the CFA Institute’s efforts to develop guidance for the calculation and presentation of wrap fee/SMA portfolios. Indeed, the MMI has welcomed opportunities to meet with CFA Institute personnel to discuss different concerns in this area. Although substantial progress has been made with respect to guidance, the MMI believes serious concerns still exist as described below.

¹ The MMI is the association for the Separately Managed Account (“SMA”) industry. SMAs are individually managed accounts in programs pursuant to which clients pay a program sponsor a single, all-inclusive fee covering multiple services such as investment management, consulting, brokerage and custody. The MMI’s membership includes the leading money manager firms and most major SMA program sponsor firms. The MMI estimates that the SMA industry had approximately \$535 billion in assets under management as of September 30, 2004, with an average account size of \$265,307. The MMI estimates that there were approximately three million SMAs for individual investors at that date.

Definition of Firm

The MMI seeks clarification with respect to the Proposed Statement's section on "Definition of Firm" in light of publicly made comments by, and private conversations with, CFA Institute personnel that indicate a lesser standard for investment firms that claim AIMR-PPS compliance ("Firms") that participate in SMA programs than is currently set forth in the Investment Performance Council ("IPC") Guidance Statement on Definition of the Firm.² The informal guidance suggests that, with respect to SMA programs, an investment management firm may define itself by the product it offers (i.e., SMAs) rather than the manner in which a firm holds itself out to the public as a distinct business entity.

The Standards specifically state that an investment management firm claiming AIMR-PPS compliance may define itself for investment performance purposes as: (i) an entity registered with an appropriate national regulatory authority; (ii) a firm, subsidiary or division that holds itself out to clients or potential clients as a distinct business unit; or (iii) until January 1, 2005, all assets managed to one or more base currencies (for firms managing global assets).³ The Firm Definition Guidance Statement recommends that a compliant firm adopt the broadest, most meaningful definition of the firm, and consider how the public views it.⁴ In order for a firm to rely on the Firm Definition Guidance Statement, the Firm must:

- be organizationally and functionally segregated from other units, divisions, departments or offices;
- retain discretion over the assets it manages and should have autonomy over the investment decision-making process; and
- hold itself out to the public as a separate firm.

Whether a business entity is "separate and distinct," and deemed to be held out to the public as a separate firm may be determined by considering factors such as whether the business entity is a legal entity, has a distinct market or client type, or whether it uses a separate and distinct investment process.⁵ It does not state that the firm can be a separate business entity if it has a distinct product. The MMI encourages the CFA Institute to clarify whether a Firm may consider itself a separate business entity for AIMR-PPS firm definition purposes solely based on managing a distinct business product such as SMAs. MMI supports such a clarification.

Composite Construction

The MMI is greatly concerned about composite construction and the delivery of performance information as set forth in the Proposed Statement. Currently, certain SMA

² Investment Performance Council (IPC) Guidance Statement on Definition of the Firm, April, 2002 ("Firm Definition Guidance Statement").

³ AIMR-PPS, I.C.12, Scope.

⁴ Firm Definition Guidance Statement, p. 2.

⁵ Firm Definition Guidance Statement, p. 2.

program sponsors refuse to allow or prohibit Firms from including in their composites the performance of accounts representing the same strategy of other competitor SMA programs. At the same time, certain SMA program sponsors contractually require Firms to prepare or deliver performance material and attend presentations with SMA program sponsors' potential clients. By adopting the approach set forth in the Proposed Statement whereby Firms must deliver to potential SMA program clients one or more AIMR-PPS compliant composite that includes all SMA program accounts managed to the same strategy, the CFA Institute essentially is forcing Firms to either: (1) violate AIMR-PPS or (2) terminate existing SMA relationships and/or avoid potential SMA relationships. The CFA Institute's position in the Proposed Statement places Firms in an untenable position with respect to AIMR-PPS compliance – comply, stop compliance, or redefine the Firm.

The MMI repeats its previous recommendation that the CFA Institute adopt an approach, described below, that takes into consideration the practical workings of the SMA marketplace while still adhering to the basic ethical principles of AIMR-PPS.

The MMI supports the CFA Institute's position that the Firm delivers an AIMR-PPS compliant composite presentation to SMA program sponsors. The MMI does not support making this requirement applicable to SMA program clients. In the alternative, the MMI believes, as described below, that a workable approach is for Firms to be required to: (i) deliver to SMA program clients a Sponsor specific composite that includes the performance of accounts managed by the Firm for investors in a particular SMA program in the same strategy ("Sponsor Specific Composite"); and (ii) offer to deliver to SMA program clients a composite that groups all SMA portfolios according to the same investment style or strategy, regardless of the SMA program sponsor ("Style Composite").

As noted above, the MMI is aware of numerous SMA program sponsors prohibiting a firm from providing to SMA program clients the Firm's AIMR-PPS compliant performance that includes accounts managed in the same strategies for unrelated SMA programs. The MMI is supportive of each SMA program client having an opportunity to receive a Firm AIMR-PPS compliant composite within the confines imposed on Firms by SMA program sponsors. To address the restriction imposed on Firms by SMA program sponsors that prohibit a Firm from presenting a Style Composite to SMA program clients, the MMI believes that a Firm must be permitted to make available to SMA program clients a Style Composite presentation prior to, or contemporaneously with, the Firm commencing managing client assets. This can be accomplished by the Firm either including: (i) a legend within a Firm's documents legally required to be delivered to the SMA program client prior to the Firm managing the client's assets; or (ii) with the approval of the SMA program sponsor included as part of the Sponsor Specific Program performance material a legend as to how the SMA program client may receive a complete list and description of the Firm's composites and/or performance presentation that adheres to the Standards (e.g., web site, email, phone number). This approach enables an investor to obtain an AIMR-PPS compliant composite presentation that includes all accounts managed to the same strategy for all SMA programs prior to or in conjunction with entering into the investment management relationship with the Firm and is consistent with the AIMR-PPS and GIPS Advertising Guidelines.

2. Do you think firms will be able to meet the recordkeeping requirements as specified?

The MMI is significantly concerned about the recordkeeping requirements as specified in the Proposed Statement. To date, we are unaware of any SMA Sponsor agreeing to represent that they maintain records required by a Firm to claim AIMR-PPS compliance. We propose that Firms that manage SMA program assets should be able to rely upon the following to meet the Standards' recordkeeping requirements: (i) records maintained by the Firm directly or through "shadow accounting"⁶; (ii) records maintained by a third party, including the SMA program sponsor, through which the Firm has access or receives written representation that the records are maintained in accordance with CFA Institute requirements *so long as* ample industry time is given by the CFA Institute for the MMI and SMA sponsors to agree on a common reporting platform⁷; or (iii) performance is reported directly to the Firm by the SMA program sponsor consistent with our response to Question 5 below. For purposes of this letter, MMI is not expressing its view on the recordkeeping requirements imposed on its members by U.S. Securities Laws and Regulations. However, we note that the recordkeeping obligations imposed on Firms participating in SMA programs by the CFA Institute are more onerous than the U.S. SEC.

Due in large part to recordkeeping concerns, the MMI strongly believes the effective date of the Proposed Statement should be extended to be no earlier than 2008, preferably 2010. Certain SMA program sponsors may not be amenable to or capable of taking responsibility for the records or making them available to investment management firms in time to enable firm compliance with the proposed effective date. In addition, it will take virtually all SMA program sponsors significant time and expense to update their recordkeeping systems to be consistent with CFA Institute proposed recordkeeping requirements, *if they choose to do so*. It will also be difficult for all Firm's that manage SMA program assets to conform the Firm's AIMR-PPS policies and procedures with each Sponsor's procedures related to performance calculation and presentation (e.g., cash flow policies, account inclusion and exclusion practices, etc.). As a practical matter, 2005 budgets of Firms and sponsors are finalized with the possibility of adequate funding occurring at the earliest in 2006. Significantly greater costs are related to implementing "shadow accounting", again with little chance of obtaining the required budget until 2006, if then. In addition, to accommodate the recordkeeping requirements, many within the industry rely on the same portfolio accounting service provider (i.e., APL) and a rush of implementations to "shadow accounting" will, most likely, prove to be beyond the capacity of software companies and make it impossible to comply with the proposed effective date.

⁶ "Shadow accounting" is viewed in the investment management industry as maintaining investment performance records for each account that enable an investment management firm to determine beginning and end of reporting period values and cash flows. Shadow accounting is prohibitively expensive for many Firms to use as the cost increases as additional accounts are added to each SMA program. The SMA business is a "low margin", highly competitive business requiring Firms to avoid costly expenses when participating in SMA programs.

⁷ The MMI is working closely with DTCC and NSCC, both widely used book-entry settlement and record keeping entities for the securities/brokerage and mutual fund industries, respectively, on developing a single platform to be used by all participants in SMA programs to create, in part, transparency of records, and consistency of reporting. Phase one is complete. The design of phase two is under development. The most optimistic date for implementation is late 2006.

Accordingly, MMI encourages the CFA Institute to delay any effective date to the earliest of 2008, with a preferred implementation date of 2010 consistent with the effective date of numerous other provisions of GIPS (e.g. mandatory verification, accrual of dividends, etc.)

3. Do you agree with the proposed treatment for a “double hit” of transaction expenses (when creating a simulated wrap fee performance record)?

Although it would prefer not to have a “double hit”, the MMI realizes that it is extremely difficult to “unbundle” the different expenses and, as such, understands that it is preferable to understate performance with the appropriate footnotes, rather than overstate performance.

4. Do you support the 1 January 2006 effective date of the proposed Guidance Statement for Wrap Fee/SMA Performance?

As referenced in the response to Question 2 above, the MMI strongly recommends that the effective date for a revised version of the Proposed Statement should be no earlier than 2008, with a preferred effective date of 2010.

5. Should CFA Institute and the IPC consider any other methods for meeting the objectives of clarifying the application of the GIPS standards to wrap fee/SMA portfolios as set forth above?

The MMI urges the CFA Institute to consider the following alternative approach for SMAs that logically follows from the CFA Institute’s guidance with respect to its treatment of composite dispersion for SMAs in the Proposed Statement.

The Proposed Statement states that for the purpose of calculating a measure of dispersion of individual component returns around the aggregate composite return, the Firm may view the aggregate performance information reported by a SMA program sponsor as a single portfolio and therefore, a measure of dispersion is not necessary or relevant (under the five or fewer portfolios rule).

The MMI believes that the treatment of an SMA program sponsor’s aggregated performance as a single portfolio for dispersion is similar to the Investment Performance Council’s guidance for pooled funds. The MMI urges the CFA Institute to extend this “pooled fund” approach for SMA dispersion more broadly to SMAs generally. Pooled funds, including mutual funds, unit investment trusts, hedge funds and other pooled vehicles may be treated as separate composites, even if a cloned fund exists, or combined with other portfolios into one or more composites of the same strategy.⁸ In addition, a Firm may rely on the performance provided by the pooled fund without need to maintain the underlying records that support the performance record of the pooled vehicle.⁹ In certain situations, especially in relation to hedge funds and other private pooled investment vehicles, there is no requirement that the performance issued by the hedge fund be audited or the underlying portfolio be transparent. In actuality, the Firm takes the performance

⁸ Investment Performance Council (IPC) Guidance Statement on Composite Definition, p.8; AIMR Performance Presentation Standards Handbook, 1997, p.29.

⁹ See footnote 8.

number on face value. For performance reporting purposes, SMAs are similar to pooled funds. The sponsor, similar to a manager of managers, selects the Firms that participate in the SMA program, the SMA sponsor maintains records, and each SMA program reports to each Firm their historical performance. This is very similar to how a manager of managers or fund of hedge funds operates. We see no reason that similar treatment cannot be applied to SMAs. If the CFA Institute expanded its position concerning composite dispersion to all aspects of SMAs, the difficulties the Proposed Statement poses to the industry discussed in this letter would be eliminated and could be effective on the CFA Institute's proposed January 1, 2006. Finally, a Firm would not be compelled to redefine itself simply due to it participating in SMA programs.

6. Do you agree with the application questions and responses provided?

The MMI believes that these questions and responses will need to be changed in light of the CFA Institute's response to industry comments.

7. Other comments on the proposed Statement.

Not at this time.

* * *

The MMI continues to be open to meet with CFA Institute representatives and further our joint objectives to produce reasonable and clear guidance relating to SMAs. To the extent that the Proposed Statement does not accommodate the concerns described in this letter, the MMI fears that many investment management firms will be compelled to denounce their claim of AIMR-PPS compliance or redefine the Firm at extensive cost and confusion to both clients and the industry - a result the MMI believes all want to avoid.

Sincerely yours,

Janet L. Mariconti
Chair, MMI Committee on CFA Institute Liaison

cc: CFA Institute Board of Governors
Investment Performance Council
Christopher L. Davis, MMI Executive Director