



Guiding Portfolio Strategies

McDONNELL INVESTMENT
MANAGEMENT, LLC

VIA E-MAIL AND REGULAR MAIL

October 30, 2002

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

Re: AIMR Proposed Guidance Statement on Wrap Fee Performance

Ladies and Gentlemen:

On behalf of ourselves, individually, and on behalf of McDonnell Investment Management, LLC, we are writing in response to the Association for Investment Management and Research's ("AIMR") proposed Guidance Statement On Wrap Fee Performance (the "Guidance Statement"). As CFAs and members of AIMR, we understand and support AIMR's efforts to clarify the AIMR-PPS requirements for the Separately Managed Account ("SMA") industry. However, we have significant concerns that many of the proposed requirements in the Guidance Statement cannot currently be implemented and enforced by managers within the SMA industry. Being participants in both the SMA market and the market for traditional institutional accounts, we believe the Guidance Statement does not adequately take into account the unique characteristics of the SMA industry, particularly the way in which SMA programs operate, the way they are marketed and the historical division of responsibilities (including recordkeeping responsibilities and performance reporting) among SMA sponsors and managers. *In our view, if AIMR is to be successful in achieving acceptance of these standards in the SMA industry, it is critical that AIMR understand and consider these differences fully before revising and finalizing the Guidance Statement.*

The Guidance Statement proposes that "Firms 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)." It also mandates that "firms must make every reasonable effort to be sure that the wrap fee performance shown to prospective wrap fee clients is shown net of the entire fee." First, SMA managers do not have access to sufficient information necessary to calculate the entire fee, but only have information regarding their own management fees. Second, the Guidance Statement incorrectly assumes that the manager has the ability to dictate the manner in which sponsors present performance information to clients. In the SMA industry sponsors (not managers) prepare performance presentations for the SMA clients. The division of this responsibility (as well as all client reporting) is customarily required by the contract between the SMA sponsor and manager. SMA managers prepare reports provided to sponsors on a "one-on-

one” basis. As part of those reports, gross-of-fee performance calculations are typically requested by sponsors to allow them to evaluate managers on an “equal” basis. Sponsors calculate performance independently according to their own methodology which is presented (either gross or net) by them to SMA clients.

We believe strongly that AIMR needs to recognize the fundamental distinctions discussed above and further recognize that the Guidance Statement is overly broad in that it will require SMA managers to become the de facto auditors and regulators of SMA sponsor performance. Any such requirement would be contrary to the contractual relationship between SMA sponsor and manager and is inconsistent with the long-standing division of responsibilities and fees associated with a typical sponsor-manager relationship. ***We urge AIMR to focus the AIMR-PPS standards as they would apply to SMA managers solely on the performance presentations that are prepared by the SMA managers and presented to SMA sponsors.*** In our view, the provision of “gross-of-fee” performance to sponsors is proper under the circumstances described above as sponsors (who are acting in a consultant role) are very sophisticated and have significant resources devoted to analysis of performance of SMA managers and have substantial business leverage with the SMA managers regarding management fees. To the extent “net-of-fee” performance may be required to be provided to SMA sponsors, we believe that such calculation by SMA managers deduct only the management fee.

In addition, ***the nature of performance reporting for SMA clients discussed above warrants AIMR to continue to permit certain other exceptions and/or exclusions in its presentation standards, subject to appropriate disclosure.*** For example, consistent with the position of the staff of the Securities and Exchange Commission, it should be acceptable for SMA sponsors to use gross-of-fee performance to be presented to SMA clients together with net performance, assuming they are of equal prominence. Further, AIMR should clarify that linking by SMA managers or sponsors of SMA performance with earlier performance for similarly managed institutional accounts is appropriate under certain circumstances and with adequate disclosures. Additionally, AIMR should permit SMA managers to present sponsor-specific performance to prospective SMA sponsors, subject to appropriate disclosure. The ability of an SMA manager to comply with the Guidance Statement’s requirement to “group wrap fee portfolios in a composite according to the same investment style or strategy, regardless of the sponsor,” will be difficult due the fact that SMA managers will not be in a position to obtain consistent information from each SMA sponsor. Given the many differences among the systems that sponsors use, the information sponsors provide, the fee structures, and general differences within strategies, the overall performance would likely be distorted.

The Guidance Statement also states that if a firm chooses to define the entire organization as the firm, the firm must either ensure that the SMA sponsor’s performance meets the AIMR-PPS requirements or maintain separate/duplicate records at the firm level. While the Guidance Statement acknowledges the fact that SMA managers “do not maintain or have access to the data necessary to substantiate performance,” the alternatives suggested in the Guidance Statement are impractical, and extremely difficult, if not impossible, to satisfy, particularly in the case of being required to ensure the Guidance Statement standards on a retroactive basis. ***We believe that any new standards be applied prospectively only to grandfather the practices of SMA managers who may be deemed to be complying with the existing interpretations and understandings of the AIMR-PPS standards to ensure they are not forced out of compliance because they have no ability to retroactively gain access to the required records.***

Shadow accounting is very costly due to the necessity of reconciling the thousands of accounts spread across the many SMA programs in which SMA managers participate. In recognition of the fact that both the recordkeeping responsibilities and compensation associated with it have been contractually assigned to the SMA sponsor, SMA managers are usually paid less for managing SMA accounts than institutional accounts. ***Even if an SMA manager is willing to incur the expense of shadow accounting, obtaining records from the sponsors to shadow account for historical periods will be extremely difficult, if not impossible.*** Given the significant growth of the SMA industry, the continuing lack of connectivity and flexibility of the underlying SMA sponsor systems supporting it, as well as the absence of any incentive on the part of SMA sponsors to provide the necessary information, the ability of an SMA manager to obtain the required historical data to retroactively shadow account will be significantly impaired. To the extent shadow accounting might be recommended prospectively, we recommend AIMR establish minimum standards for such shadow accounting. We believe that the use of month-end account values and cash flows is an appropriate threshold for calculating performance in the SMA industry. To facilitate this, AIMR should exempt SMAs from the time-weighting requirement for daily cash flows which is to be required in 2005. Given the recordkeeping and shadow accounting difficulties, as well as the relatively small average account size for the thousands of SMAs, daily cash flow accounting for performance calculation purposes adds unnecessary complexity and difficulty to already burdened legacy systems and provides little or no added benefit to the current assumed-mid-month approach to cash flows.

Additionally, ***relying on the performance records of the SMA sponsor is not practicable because SMA sponsors do not provide SMA managers with access to individual account information that is necessary to calculate performance.*** Sponsors generally are not willing to, or are unable to, provide regular electronic data feeds with trade and income information that are necessary to accurately make performance calculations. Additionally, because SMA sponsors do not follow AIMR standards and SMA managers do not have sufficient business leverage in these relationships to require sponsors to do so, it is unreasonable for AIMR 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.

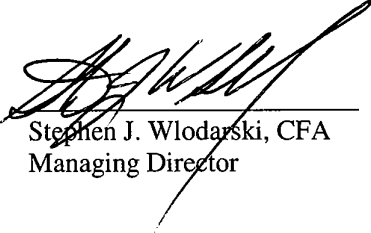
Finally, we do not believe a July 1, 2003 effective date for the Guidance Statement is reasonable in light of the significant concerns discussed above. ***We suggest that AIMR postpone implementation of the proposed standards to facilitate a significantly revised Guidance Statement which affords both SMA managers and sponsors a forum to contribute to standards better suited to the SMA industry and that such a revised Guidance Statement should become effective no earlier than 18 months following its adoption by AIMR.***

In summary, we believe that performance calculation standards for the SMA industry should be clarified. However, we conclude that compliance with the standards proposed by AIMR in this area are not within the exclusive control of the SMA managers. Absent full cooperation and standardization within the SMA industry (in particular SMA sponsors) to meet these voluntary standards as proposed in the Guidance Statement, SMA managers will not be in a position to comply despite any reasonable efforts to do so. Further, any approach to this issue should acknowledge and take into consideration the unique characteristics of the SMA industry, including the long-standing relationship and division of responsibilities among SMA sponsors and managers. Because managers have not historically been involved in performance calculation reporting for SMA clients, we recommend that any new standards imposed by AIMR on SMA managers be implemented prospectively only. Any new standards should grandfather the existing practices of SMA managers who may be deemed to be complying with the existing interpretations and understandings of the AIMR-PPS standards. To mandate retroactive

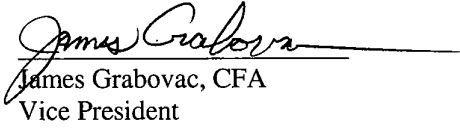
compliance of the proposed standards ignores the practical impossibility of an SMA manager effectively meeting such standards. Moreover, the effectiveness of any revised Guidance Statement should be no earlier than 18 months following its adoption by AIMR, and would occur only after its thoughtful consideration of the views and comments of SMA industry participants.

We appreciate the opportunity to comment on the Guidance Statement and would be happy to discuss our comments with you. Please do not hesitate to contact Stephen J. Wlodarski if you need additional information or clarification at (630) 684-8600.

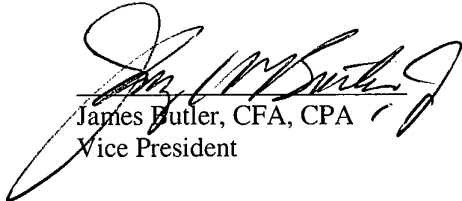
Sincerely,



Stephen J. Wlodarski, CFA
Managing Director



James Grabovac, CFA
Vice President



James Butler, CFA, CPA
Vice President