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Email: Standardsetting@aimr.org

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

To Whom It May Concern:

Our review of the proposed wrap fee guidelines indicate that AIMR has acknowledged only some of the major roadblocks implementation of the suggested guidelines pose to Investment Management firms and/or has not properly understood the contractual relationship between the investment management firms and the underlying Sponsors. In response to the “online .pdf file” soliciting input we have addressed specific areas of that 18-page document below.

**Page 6 – 1. Define The Entire Organization As The Firm** states in the second to last bullet point: **“The firm 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 (which meet the requirements of the Standards)”**. This requirement overlooks several key points:

- ❖ Generally speaking, contracts between the underlying Sponsor and the Investment Management firm assess responsibility to the program Sponsor (or its sub-contracted vendor) for all reporting to the end clients (including performance) **not** the Investment Manager.
- ❖ Many Sponsors not only take full responsibility for calculating and providing performance information to their brokers and clients (i.e., firm Profiles), both net and gross, but require that “their” numbers be used in the marketing of the product.
- ❖ We would assert that while Investment Managers do share a fiduciary responsibility for the investment decisions they make in client portfolios, it is the Sponsors who contractually obligate themselves to the end clients for, not only investment advice but, all the operational support (i.e., performance, statements, fee billing, etc.). The Investment Manager has no signed agreement with the end client.
- ❖ **Many** of the Sponsors (larger ones included) have chosen **not to** employ AIMR standards. The Investment Manager is not in a position to dictate to the Sponsor how they fulfill their contractual operation obligations to the clients.
- ❖ In all cases, it is the broker who provides or communicates performance to the end client, not the Investment Manager. Group presentations by Investment Managers are more often provided to groups of brokers as opposed to clients and/or prospects.

**Page 7 – Underlying Records** states in the first sentence: **“Lack of records is not an acceptable reason to exclude the wrap fee division from the definition of the firm.”** In the second paragraph it states: **“Because the**

**Investment Management firm has outsourced the marketing and performance reporting functions to the wrap sponsor, many firms do not maintain nor have access to the data necessary to substantiate performance. In order to satisfy the requirement of the Standards, firms may choose to utilize “shadow accounting” to track the wrap fee portfolios on their in-house performance measurement systems. Alternatively, firms may choose to place reliance on the performance calculated and reported by the wrap fee sponsor, provided the firm takes necessary steps to satisfy that the information provided by the wrap fee sponsor meets the requirements of the Standards and, if necessary, obtains an agreement with the wrap fee sponsor to secure access to the underlying records.”**

- ❖ We believe it is an erroneous assumption by AIMR to state that the Investment Managers have “outsourced” the marketing and reporting functions to the wrap Sponsors. Investment Managers have NO contractual relationship with the end client and in most of our relationships the Sponsors **claim** not only the right, but also the proprietary nature of their relationship with the client, to provide all communications and reports. Many Sponsors further require that the Investment Manager not have any direct contact with the client without their approval.
- ❖ To suggest that the Investment Managers utilize “shadow accounting” overlooks, again, that many Sponsors do not employ AIMR Standards, do not provide access to individual records, and/or that Investment Managers have the power and ability to mandate that they have access or to act as Auditors to the Sponsors’ operations.
- ❖ Where Investment Mangers employ portfolio models, it is reasonable to expect that the end performance results of both the Managers and the Sponsors be closely similar. But we believe to assert that Investment Managers should require access to sponsor records to access accuracy places the Investment Manager in the role of the Sponsor’s auditor. This is almost a complete role reversal to the actual contractual relationship, where it is the Sponsor whose due diligence team audits the performance of the Sponsor. It is more likely that the Sponsors “might” agree to provide the Sponsors with their audited results by their own external auditors.
- ❖ Investment Managers are not in the position to dictate to Sponsors what methodology they must use to calculate and report their performance.

**Page 10 – 4<sup>th</sup> paragraph** states that: **“In order to facilitate the comparability of performance results and prevent firms from cherry-picking their best performance portfolios for inclusion, Investment Management firms must group wrap fee portfolios in a composite according to the same investment style or strategy, regardless of the Sponsor. This style-defined composite must be presented to prospective wrap fee clients and sponsors in order to demonstrate a full and fair picture of the firm’s ability to manage wrap fee portfolios.”** Again, these Standards are overlooking some key points:

- ❖ Many of the individual Sponsors do not allow the use of Investment Manager calculated composite numbers to be marketed to their brokers, clients and/or prospects, instead insisting that “their” composite numbers must be used.
- ❖ Lumping all similar strategy accounts together regardless of Sponsor, overlooks that different Sponsors have different fee structures, and many programs have differences within strategies (i.e., use of dollar-cost averaging in one Sponsor but not another, limitations on use of cash, etc.). All these things would contribute to distorting the overall performance on a Sponsor to Sponsor basis.
- ❖ Not all Sponsors use the same accounting software – some are proprietary systems and it is questionable that the Sponsors would willingly grant this type of access.
- ❖ Suggesting that Investment Managers could employ the use of their own account management systems overlooks that not all outside vendors accept accounts within the minimum size range of wrap fee accounts or that the fees these companies would charge on such small accounts would negate any profitability to Investment Managers in running wrap fee accounts, who generally receive no more than .50 basis points and more often in the .45 to .40 range or less.

**Page 12 2.2 Answer** of the AIMR Guidance Statement states that, **“the firm is responsible for the presentation of performance results, whether the firm calculates the performance results or relies on a third party.”**

- ❖ The Standards falsely assume that the investment manager has it within its power to force the sponsor to:
  1. Allow it to use the numbers it calculates in presenting the product and ignores that many sponsors allow **only** their calculations to be used.
  2. Allow access to their systems for “shadow accounting” by the investment manager.
  3. Provide documentation so that the investment manager can audit their calculations.
  4. Be an AIMR compliant firm, when in many cases the sponsors are not AIMR compliant.
- ❖ The Standards don’t address the situation in which Investment Managers do not market with performance numbers in any of their materials.

While it may make sense to provide guidelines for those investment management firms who do attempt to prepare their own wrap fee composites, we do not believe it is reasonable to suggest that those who do not market using their own performance numbers should be compelled to do so, or compelled to attempt to exert control over the Sponsors who calculate them. Not only is this a duplication of the underlying Sponsor’s preparation of composites, this policy falsely assumes that Investment Managers are in a position to dictate to Sponsors. While we applaud the well meaning intent of applying AIMR Standards within the wrap fee community, we do not support guidelines, which seek to usurp the contractual relationship of responsibilities between the Sponsor and Investment Manager, create dissent between the Investment Manager and Sponsor, or which place the Investment Manager in the business of auditing other firms. Additionally, these proposals would be so costly to implement that it could easily price Investment Managers, who receive the smallest end of the overall fee, right out of the wrap fee business.

We would strongly urge the Association for Investment Management and Research to consider constructing a committee consisting of both Investment Managers and Sponsors to contribute to a solution of this matter and to postpone any hasty effective date of the existing proposal.

Sincerely,



Helene H. McElmurray  
Vice President