

CFA Institute
CFA Centre for Financial Market Integrity
Reference: Guidance Statement on Wrap Fee/SMA Performance
PO Box 3668
Charlottesville, Virginia 22903
E-mail: standardsetting@cfainstitute.org

December 27, 2004

Proposed Guidance Statement on Wrap Fee/SMA Performance

Dear Sir/Madam,

PricewaterhouseCoopers wishes to thank the CFA Institute for this opportunity to comment on the proposed Guidance Statement on Wrap Fee/Separately Managed Account Performance. We welcome the efforts of the CFA Institute to continuously develop the GIPS standards and its commitment to fair representation and full disclosure. PwC strongly supports the release of additional guidance in this complicated area.

The SMA/Wrap arena is an important issue for many firms who have historically been subject to AIMR-PPS. A number of firms feel that they have done all they can in order to get access to the supporting records and it would be now so cost prohibitive to put together the historical underlying records that they could be forced to exit the SMA business all together. Other firms, for whatever reason, had not adequately paid enough attention to this area and have either been struggling to get into compliance historically or have been anxiously waiting on the sidelines to see how this issue will be resolved. In addition, there are firms that were able to get it right the first time through considerable cost and effort and so they presently adhere to both the wrap-fee account guidance contained in AIMR-PPS as well as the proposed GIPS guidance now open for public discussion. Needless to say there have also been some regulatory concerns along the way at those firms that may not have followed the original AIMR-PPS guidance as intended.

We hope that this proposed guidance receives the necessary industry feedback in order to foster global acceptance of the pertinent issues and solutions. We also hope that the industry trade groups, sponsors, investment management firms and other interested parties can continue to work together to improve system and recordkeeping capabilities down the road. Although the guidance will not necessarily solve every issue that has been raised by the SMA industry, it will provide everyone with more time to work out the infrastructure that will ultimately need to be put in place to make the recordkeeping aspect more efficient for everyone.

Our specific comments are as follows:

Introduction

We note that the term Separately Managed Account, although now often used in this area, can be rather confusing and consideration should be given to changing this terminology.

Guiding Principles

It cannot be emphasized enough that firms are required to comply with all applicable local law or regulation. In this Guidance Statement this is particularly important with respect to recordkeeping requirements. The ability to present and link performance without supporting records would likely not be deemed permissible under U.S. federal securities laws.

Definition of Firm

The Guidance statement on Definition of the Firm provides further guidance when a firm defines itself under option 2 “an investment firm, subsidiary or division held out to clients as a distinct business unit”.

More specifically , readers of that Guidance Statement will note that it specifically states that (underlined emphasis added) “A distinct business entity is a unit, division, department or office that is organizationally and functionally segregated from other units, divisions, departments or offices, retains discretion over the assets it manages and should have autonomy over the investment decision-making process.”

There needs to be further guidance on how to make a determination whether a specific division exists or not as this is often a critical area in the wrap/SMA arena and firms, attorneys and verifiers are put in an awkward position of subjectively making this determination. The determination often gets further complicated when there are dual employees within the organization that may manage both SMA and institutional accounts in the same manner. Similarly, some firms may even have the same employees handle the marketing and compliance functions for both their institutional and wrap/SMA products.

The proposal refers to the Definition of Firm Guidance Statement and states that you can consider defining the non-SMA division as the firm if it “meets one of the permissible definitions of the firm (e.g., holds the non-SMA fee division out to the public as a distinct entity). . . .” Although this language is technically correct, the guidance makes no such mention of the required organizational and functional segregation including consideration of dual employees and combined marketing. If the determination is made not to provide further guidance in this proposal, the wrap/SMA Guidance Statement should be expanded to at least mention that such a determination needs to be made. Otherwise, firms may misinterpret this guidance. If the IPC believes that such organization and functional segregation is not required then this should be clarified in writing as well.

In addition, we note that under option 2 (Define the Non-SMA FEE division as a Firm) the proposal states that “Similarly, the non-SMA firm performance cannot be shown to prospective SMA clients of the SMA division except as supplemental information”. We do not take exception to the disclosure of the non-SMA performance under these circumstances. However, we note that the Guidance Statement on supplemental information defines the term (underline emphasis added) “as any performance-related information included as part of a compliant performance presentation that supplements or enhances the required and/or recommended disclosure and presentation provisions of the GIPS standards”. The IPC may want to consider rewording the above text as it is likely that the SMA firm would not be compliant and hence could not have supplemental information by definition.

Underlying Records

We agree with the statements that “firms must exhaust all methods to gain, recreate, or obtain access to the performance records to substantiate portfolio returns” However, we believe that this point needs to be emphasized in additional places throughout the document. For example, the following statements should be clarified so as not to be taken out of context (underline emphasis added):

“For periods prior to 1 January 2006, the firm may link performance without the necessary records to support the figures to their ongoing performance record, provided the firm discloses the periods of non-compliance and explains how the presentation is not in compliance with the GIPS standards (i.e., the firm does not have the records to substantiate performance).”

“SMA firms will be able to link performance prior to 1 January 2006 to their ongoing performance record (with appropriate disclosure), regardless of whether the pre 2006 returns have the records to support the individual SMA portfolio returns.”

“To provide flexibility to SMA firms that historically did not maintain the records to substantiate performance, those firms do not have to wait until they are able to build a 5-year compliant track record in order to claim compliance with the GIPS Standards. Instead SMA firms will be able to link performance prior to 1 January 2006 to their ongoing performance record (with appropriate disclosure), regardless of whether the pre-2006 returns have the records to support the individual SMA portfolio returns.” As stated in the effective date section.

Also, please see responses to application questions numbered 1 and 4 on pages 14-15 of the proposal.

In addition, we believe that many firms in the U.S. will conclude that they cannot legally present pre 2006 performance without supporting records and hence will choose not to do so without such documentation. Of course they would still be able to present those pre 2006 periods they have support for. In such cases where performance is not presented, we believe that the existence of such prior performance must be disclosed as long as such disclosure is not deemed inappropriate for regulatory purposes. The purpose of this extra disclosure should be to alleviate potential cherry picking concerns.

Generally, we do not believe that unsupportable performance can be presented and linked to compliant performance.¹ This will create bad precedent under GIPS and is arguably inconsistent with the GIPS framework. If the IPC is going to allow the presentation of such performance, consideration should be given to presenting such information only as supplemental information and even then only subject to applicable regulatory requirements. This would be more consistent with both the current GIPS input data requirements (see GIPS requirement 1.A.1.) and the proposed GIPS recordkeeping Guidance Statement. We note that in the U.S. presenting unsupportable performance information would likely not be allowed under U.S. federal securities laws even if the data is presented as supplemental information.

The proposed guidance in the underlying records section states that “The use of aggregate level information obtained from the SMA sponsor is acceptable as long as this policy is fully disclosed.” It is not perfectly clear from this wording whether aggregate level information may be acceptable for periods before and/or after 1 January 2006. We believe that the whole notion of aggregate level data should be better defined and expanded upon as this would be useful for those firms not yet familiar with the topic and would help to clarify how this concept can or should be applied. This would also help to avoid an incorrect interpretation of this area. For example, we note that this section also states (underline emphasis added) that a) firms may choose to use “shadow accounting to track the SMA portfolios on their in-house performance measurement systems” b) as mentioned above, “firms must exhaust all methods to gain, recreate, or obtain access to the performance records to substantiate portfolio returns”, and c) “For periods beginning 1 January 2006, the firm must maintain or have access to supporting records for all portfolios included in a composite.” Given the concept of aggregate level information mentioned above, consideration should be given to clarifying the use of the term “portfolio”. Lastly, it should also be clarified as to whether it is optional whether a firm chooses to view the underlying records at the aggregate level. This may prove to be particularly important for those firms that do not have underlying individual account records for their sponsors’ underlying clients before 2006 and are assessing their options in terms of applying this guidance to the underlying records they do have.

Establishing an Initial SMA Track Record

The proposal states that gross of fee performance can only be used as supplemental information. This should be modified to indicate that this is with respect to “pure” gross of fee performance in order to be consistent with the terminology used in the supplemental/additional information section of the proposal.

¹ Generally speaking non supportable wrap/SMA performance should not be linked to compliant performance. The only exception to this that we could envision in GIPS is when such performance is deemed to be non compliant performance for periods prior to January 1, 2000 and the firm has 5 years of compliant history. This would then be consistent with current GIPS provisions (see GIPS Introduction Scope-item 13-c.)

Performance Presentation

SMA Results for Prospective Clients

We agree with the statement that “firms may choose to present additional/and or supplemental information demonstrating the firm’s ability to manage portfolios for a specific SMA sponsor or group of SMA sponsors.”

SMA Results for Current Clients

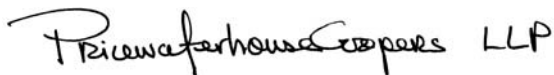
This section is related to client reporting and so arguably could be considered for deletion. We agree that firms can prepare and present sponsor specific performance to existing sponsor clients. We also understand that firms may be asked for a compliant presentation put together in such fashion. However, we do not believe that sponsor-specific performance should be called a “composite” but rather should be considered additional or supplemental information to a compliant presentation or simply part of routine client reporting. We also note that this allowance is inconsistent with the section above and such terminology can cause unnecessary confusion in the market place. Furthermore, we do not believe that this “composite” should contain the “claim of compliance” as such a claim could be misleading.

Effective Date

As we previously stated in the underlying records section above, the effective date language needs to be clarified as the books and records exemptions can only be applied once a firm has exhausted “all methods to gain, recreate or obtain access to the performance records” regardless of cost. To imply that this exemption is an option available to all firms that did not maintain the records could be misleading.

If you wish to discuss these points further, please contact Kelvin Laing-Williams in London at +44 (20) 7804 1707 or Peter McNamara in New York at (646) 471 8743.

Yours sincerely,



PricewaterhouseCoopers LLP