

VIA FEDERAL EXPRESS
AND EMAIL standardsetting@aimr.org

October 28, 2002

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

ATTN: AIMR-PPS Implementation Committee

Dear Committee Members:

We are writing this letter in response to the Proposed Guidance Statement on Wrap Fee Performance that you recently issued. First of all, we would like to express our overall support of what the Committee is trying to accomplish with these proposed guidelines. We believe it is important to ensure that a client and/or prospective client receive performance information that clearly and fairly represents the wrap fee product. **That said, we have carefully reviewed the proposed statement and considered its implications to our firm. Our conclusion is that compliance with its provisions would create a significant and unnecessary additional burden for investment advisers such as ourselves in terms of infrastructure, personnel and, as a result, cost. It would likely render participation in certain wrap programs financially untenable. Further, we do not think that the provisions are necessary in order to present performance fairly and clearly to clients. We strongly urge the Committee to reconsider and amend its proposed guidelines.**

BACKGROUND

Roger Engemann & Associates, Inc. (“REA”) is a federally registered investment adviser, has been in business since 1969 and currently manages over 14,000 accounts with approximately \$3.9 billion under management. Of those 14,000 plus accounts, a little over 13,000 of them are in various wrap programs. REA has been participating in the wrap business since the mid-1980s. Since 2000, REA has maintained separate non-wrap and wrap fee composites. Prior to 2000, REA maintained a composite that included both wrap and non-wrap accounts. All our composites are prepared and presented in compliance with the Performance Presentation Standards of AIMR, the U.S. and Canadian version of the Global Investment Performance Standards (GIPS), and verified quarterly by a well respected independent auditing firm.

COMMENTS

1. **Definition of Firm:** In considering how a firm defines itself, under section 1, page 6, you state that a firm should consider some potential disadvantages when defining the entire organization as the firm. Some of the disadvantages you list are that: “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)”.

It would be impossible for the investment management firm to ensure that the performance provided by the wrap fee sponsor meets the requirements of the AIMR Standards for the following reason: In most cases, the client has a contractual relationship with the wrap sponsor and not the investment management firm. The wrap client appoints the investment management firm to manage their assets through the contract the client executes with the wrap sponsor. The investment management firm has a pre-executed sub-advisory agreement with the wrap sponsor, which outlines the terms of how the investment management firm will perform its services to the wrap client. Because of the structure of these contractual arrangements, the investment management firm has no authority over the standards the wrap sponsor uses in calculating the performance it provides to the wrap client. Nor is the investment management firm always privy to the performance results that the wrap sponsors send to each individual client. The investment management firm can, however, ensure that the performance that it calculates and provides to the wrap sponsor meets the requirements of the AIMR Standards.

As for the firm maintaining separate/duplicate records, in cases where the client accounts are traded and maintained on the wrap sponsor’s portfolio management system and not the investment management firm’s system, the investment management firm receives a lower overall fee since the wrap sponsor has contractually taken on the responsibility of reporting, reconciling and billing the wrap client. Therefore, requiring the investment management firm to maintain separate/duplicate records would force the investment management firm to bear the burden of an enormous amount of additional expenses. In addition, some wrap sponsors do not provide the investment management firm with access to the individual wrap client account records, which would make it impossible for an investment management firm to obtain records on existing and new wrap clients in those programs.

The Committee might want to consider that for purposes of compliance with the AIMR-PPS standards, an investment management firm be allowed to define the entire organization as the firm if, in addition to the other requirements:

- Both the non-wrap fee and wrap fee portfolios are included in the firm’s total discretionary assets under management, and
- The firm discloses in their wrap composite (which would consist of all wrap accounts maintained on the manager’s portfolio management system) the dollar amount of wrap assets not included in the composite and the reason for the exclusion of the assets (e.g. does not maintain the books and records required by the SEC to calculate and substantiate performance).

We believe the added disclosure would ensure fair presentation to the client, eliminate the concern of possible “cherry picking” since the firm must include all wrap accounts in their composite for which they maintain the books and records, and remain consistent with your statement in the guidelines under “Underlying Records”, which states that lack of records is not an acceptable reason to exclude the wrap fee division of the firm when defining the firm. This should also allow the investment management firm to continue to satisfy the long-standing position taken by the SEC that prohibits an investment adviser from publishing the performance of accounts if it does not maintain the substantiating books and records for those accounts.

2. **Underlying Records:** You state on page 7: “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 take the 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.”

First of all, the investment management firm does NOT outsource the marketing and performance reporting functions to the wrap sponsor. In point of fact, those functions contractually never belong to the investment management firm and are always the responsibility of the wrap sponsor. The only function that is outsourced to the investment management firm is the management of client assets and this function is outsourced by the wrap sponsor. In addition, as stated above, “shadow accounting” would place the burden of cost directly on the investment management firm, which was not contemplated when they originally negotiated their fees and entered into the sub-advisory contracts with wrap sponsors. Some firms, such as REA, have been in these wrap programs for many years and have thousands of accounts that are traded and maintained outside of their portfolio management system. It would be nearly impossible to re-create past records for current and terminated clients in the investment management firm’s system, which would be necessary if investment management firms were forced to maintain shadow accounting.

In the “Guiding Principles” section on page 5, you state that investment management firms are required to comply with all applicable local laws or regulations, including the laws and regulations relating to record keeping. In the case of REA, since we are a federally registered investment adviser, we are required to comply with the rules and regulations mandated by the SEC. As stated above, the SEC prohibits an investment adviser from publishing the performance of accounts if it does not maintain the underlying books and records to substantiate the performance. Therefore, REA, along with other federally registered investment advisers, would not be able to remain in compliance with the SEC rules if it used the performance calculated and reported by the wrap sponsor, notwithstanding the fact that the wrap sponsor’s performance was AIMR compliant, without books and records to substantiate the performance. And because the wrap contracts are between the wrap sponsor and the wrap client, and given the proprietary

stance many wrap sponsors take regarding client information, obtaining an agreement with the wrap sponsor to secure access to the underlying records may not be possible.

Again, we believe that if certain disclosures were made as outlined above, the client receiving the composite information from the investment management firm would have a fair representation of the investment management firm's performance.

It appears to us that the proposed Guidance Statement on Wrap Fee Performance prepared by the Committee erroneously carries the assumption that the investment management firm has control over the clients' accounts and can dictate what performance wrap sponsors present to wrap clients and how such performance is calculated. This assumption is inaccurate. We completely agree that an investment management firm must make every effort to ensure that each client, be it wrap or non-wrap, who is presented with composite information calculated by the investment management firm, receive a fair and accurate picture of the firm's performance. We also believe this to be true for every wrap sponsor, which usually are firms dually registered as a broker/dealer and investment adviser. Therefore, in the final adopted version of the Guidance Statement on Wrap Fee Performance, we recommend that the Committee should clearly distinguish between the compliance requirements for the investment management firm that manages the client's assets and the wrap sponsor that reports and calculates the wrap program performance.

In closing, we would just like to reiterate our continued support of what the Committee is trying to accomplish.

Sincerely,

Roger Engemann, CFA & President

Gretchen Lash, CFA & Chief Investment Officer

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