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CFA Institute
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Reference: Guidance Statement on Wrap Fee/SMA Performance
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Dear PPS Committee:

Thank you for this opportunity to share my views on the PPS standards on Separately Managed Accounts. My firm, Kayne Anderson Rudnick Investment Management, is unusual in that approximately two-thirds of our assets under management are from broker referred or “wrap” programs. This means these proposed new standards have a significant impact on my firm.

Your invitation to comment asked six direct questions. Allow me to answer each in turn:

1. Do you support...? I strongly support useable standards for the wrap business that reflect the unique economic, operational, and cultural dynamics of this important segment of the US capital markets. CFAI through its introduction and championing of AIMR PPS is especially well-placed to lead the effort for a useful consensus on the measurement of wrap returns.

2. Do you think that firms will be able to meet the recordkeeping requirements? No, the sub-advisory “wrap” business practice is for the recordkeeping to be the sole responsibility of the broker-sponsor. This implies that the records are not and have never been resident with the asset manager. While one can argue that future data might be “able to be captured” at considerable additional expense, retrieving past data is extremely problematic.

3. Do you agree with... the “double hit” of transactional expenses...? It is difficult to be enthusiastic about any compromise solution that systematically tends to

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show “wrap” results as inferior. This is the case when the same product with the same fundamental, underlying economic returns is compared in wrap and non-wrap formats. With this standard the former underperforms even though the two records are the same. That said, I have no great insight as to a better alternative. I would argue for more freedom in presentation as long as there is a reasonable basis for the calculation that is fully disclosed and discussed.

4. Do you support the 1 January 2006 effective date...? Given the need to change systems and procedures and to work closely with the sponsor partners, I believe that additional time is useful. The need to work out the difficulties inherent in any new standard requires adequate time. The procedures to capture the data in sub-advisory relationships is not only a new economic¹ burden, but also requires a new level of communication between the asset manager and the broker-sponsor. Additional time can be used to find effective and efficient ways to have a smooth and accurate implementation of the standards.

5. Should CFAI consider other methods...? One possible alteration is to allow the reporting of pre-wrap fee results as gross results. Another is to allow a firm to report both total assets under management and its AIMR compliant sub-firm assets under management. Being particularistic, the total AUM at this firm is ten billion; the non-wrap fully AIMR backed-up with in-house records is only three billion. It is not disingenuous to say that the firm has 11 figures under management and portrays its results appropriately.

6. Do you agree with the applications....? Waiting five years for a track record for existing but historically poorly documented wrap relationships seems too long. Why not two years? I have already commented above on some of the other questions.

¹ I must take umbrage at the remark on page nine, “cost must not be considered an excuse for the ability of a firm to obtain records.” An asset management firm is an economic entity; as such it always must consider cost. Additional cost is not an excuse; it is a reason. One can argue that the imposition of additional cost is an attempt to create barriers to entry into this market segment. There is already “buzz” in the press that some firms are exiting this segment due to its increasingly difficult economics. Additional cost prohibits small firms from bringing innovative new products to this market segment; it also reinforces the operational leverage of the large established firms.

In closing I would like to iterate my appreciation of CFAI and the IPC for taking on this thankless task. The “wrap” broker-sponsor market segment is different than the institutional market. The latter is the prototype for the GIPS standard. The institutional market has different pricing, operational, accounting, and execution methods. To make these institutional standards applicable to the esoteric wrap business is a difficult challenge.

Best Regards,

George Allen Weber CFA