

Professional Standards and Advocacy
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A.170.1/SH

Comments on the IPC Guidance Statements on the Treatment of Carve-Outs

Dear Madam, Dear Sir

On behalf of our Performance Standard experts, please accept our thanks for giving us the occasion to comment on the proposed guidance statements.

Do you agree with the principles established in the Guidance Statement?

Basically we support the principles established in the Guidance Statement. We have two reservations and suggestions for modifications:

1. The rationale behind the requirement to include cash in total returns is reasonable. However, this rule may not be applicable in situations where the investment strategy does not foresee any cash positions at all; for instance when a prospective client wants its funds to be fully invested at all times cash would constitute but a very small temporary and residual position. We therefore suggest the following modification: ***“the carve-out should (after 1.1.2005 must) have its own cash unless the asset allocation of the composite does not foresee cash positions.”***
2. “Separate management” is the fulcrum of the Guidance Statement. A clear definition and description of what separate management means should be given to avoid future misuse.

Separate management normally means that the management of different asset classes is split among several fund managers. This is the case when, for instance, with a balanced mandate each portfolio managers of equities and fixed income has full discretion over its asset class and these classes are managed separately. In this case carve-outs can be created easily. In some organizations, however, it may not be easy to identify the unit with full discretion over an asset class. Take for instance the case of a separate equity and a fixed income research department each producing its own recommendations but with a common and central-

ized portfolio manager who implements their policies. He would hardly allow the creation of carve-outs, as the management discretion is shared by all three departments.

Are there other cash allocation methods that should be allowed prior to 1 January 2005?

We believe that generally any method of cash allocation should be allowed provided that it is reasonable and properly disclosed.

The difference between the two methods described in the Guidance Statement is not clear. Method 2 seems to be a particular example of the more comprehensive method 1. We therefore suggest improving the wording describing the two methods and attaching an example to each so as to illustrate the exact meaning.

Furthermore the Guidance Statements should distinguish between cash and short-term investments. In some mandates, cash is an independent asset class (e.g. some balanced mandates), whereas in others, it is a pure residual position. For portfolios with short-term tactical or strategic allocation, it seems questionable whether it makes sense at all allocating cash returns based on one of the two methods suggested in the proposed Guidance Statement, as cash becomes a distinct asset class in this case, with a return that must be considered as one of the equity or bond portion. Only the portion of "cash on sight" used for portfolio treasury purposes should be allocated to other asset classes.

Do you agree with the principle relating to the treatment of fees?

Yes, we agree with it.

Only the actual fee should be split among carve-outs when presenting net-of-fees portfolios. The fee splits should be representative of their asset class. This statement should not contradict the future Fees Provisions.

Do you agree that if a firm creates a carve-out, "then all similar portfolio segments managed to that strategy should also be carved-out and included in the composite"?

Yes, we agree with it.

There are three proposed methods for properly accounting for the cash position for periods after 1 January 2005. Are these methods understandable and complete? Are there any other appropriate methods?

As mentioned above, for a portfolio with a tactical or strategic cash allocation (e.g. balanced mandates), cash becomes an asset class and only the return of the portion of residual cash should be accounted for separately.

The methodology suggested for the period 2005 onwards is more accurate than cash allocation. However, we believe that the allocation of cash returns as authorised prior to January 1, 2005 should not be prohibited.

Even when a multi-asset-class client is managed with segregated portfolios, these are often not isolated from each other and funds flow between them to allow centralised cash management.

In practice, for efficiency reasons and in the client's best interest, residual cash balances from segregated sub-portfolios are often consolidated and converted into the portfolio's base currency in order to reach a critical mass allowing a short-term placement. Therefore, even with asset classes managed in separated portfolios with individual cash accounts, the use of the allocation method might be necessary to allocate cash returns.

We therefore suggest that the use of separated portfolios for cash management be a recommendation only.

Do you agree with the proposal that this guidance should only be applied on a forward-looking basis (i.e., not retroactively)?

Yes, we support this proposal.

Do you agree with the proposed Effective Date? If not, when should the guidance become effective?

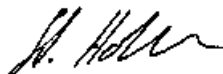
Yes, we agree with the proposed effective date.

We are grateful for having had the opportunity to comment on the proposed provisions and guidance and we hope that our comments will be taken into consideration.

Yours sincerely,

SWISS BANKERS ASSOCIATION

Swiss Performance Presentation Standards



St. Hoffmann