

# The WM Company

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Dear Sirs,

## **GIPS Guidance Statement – Composite Definition**

The WM Company is pleased to have the opportunity to respond to the Association for Investment Management and Research on the Guidance Statement for Composite Definition. We agree with all the principals of the Guidance Statement with the exception of the points raised below.

### **Discretion**

*“For example, if a client requests that the firm not purchase any tobacco stocks in their portfolio, the firm should first consider if this restriction will hinder the implementation of the intended strategy. If so, the firm could classify this portfolio (and all portfolios with this restriction) as non-discretionary or could choose to create a composite for portfolios with tobacco restrictions.”*

This paragraph states a firm that cannot implement its intended strategy for a particular portfolio can classify it as non-discretionary or enter it into a composite for portfolios with like restrictions.

Our contention is that if a portfolio has client imposed restrictions and these prevent the implementation of the firm’s intended strategy, then the only option available should be to classify the portfolio as non-discretionary and exclude it from entering any composite.

A firm should not be allowed to enter such a portfolio into any composite. We therefore recommend that the following wording should be adopted.

*“For example, if a client requests that the firm not purchase any tobacco stocks in their portfolio, the firm should first consider if this restriction will hinder the implementation of the intended strategy for that portfolio. If so, the firm should classify the portfolio as non-discretionary.”*

### **Discretion**

*“In the case of client restricted securities (e.g. low-cost basis stocks, held to maturity securities, etc.), the firm may choose to classify the restricted portion of the portfolio as non-discretionary (also referred to as “un-managed” or “un-suspended”) and keep the remaining discretionary portion of the portfolio in the composite, provided the remaining portion is representative of the composite’s strategy.”*

The practice of ring-fencing certain securities and excluding them from a portfolio is not common in the UK. However if this practice is to be adopted in GIPS, then the question of cash allocation should be considered.

In effect the situation above can be thought of as a reverse carve-out". Therefore it is our belief that cash should be allocated to the discretionary and non-discretionary sections of the portfolio in a similar way to the allocation of cash when a carve-out is constructed.

We recommend that the wording of the Guidance Statement be amended to reflect that cash must be allocated to the discretionary / non-discretionary sections of a portfolio.

#### **Minimum Asset Level**

*"Firms must not market a composite to a prospective client with assets below the composite's minimum asset level."*

It is our contention that this sentence be removed from the Guidance Statement. Due to GIPS disclosure requirements any composite with a minimum asset level would have this clearly stated in the composite presentation. Therefore a potential client whose assets are below the minimum level would immediately be able to deduce that their portfolio would not be included within that composite and therefore that the relevance of the presentation would be reduced.

If the sentence were to be kept, it would be clearer to the reader by substituting "whose assets are" in place of "With assets"~ The sentence would then read:

*"Firms must not market a composite to a prospective client whose assets are below the composite's minimum asset level."*

#### **Minimum Asset Level**

*"Portfolios below the minimum must represent a small percentage of the composite assets and thus, should not have a material impact on the asset-weighted composite return."*

It is our belief that this sentence should be removed from the Guidance Statement.

If a minimum asset level is set properly and with due regard to the reasons for this provision, any portfolio below the minimum is non-discretionary and therefore excluded from inclusion in any firm composite. Non-discretionary portfolios do not come under the remit of GIPS. Therefore the number of non-discretionary portfolios below the minimum level and their potential impact on the composite return is irrelevant.

Yours faithfully

**The WM Company – GIPS Verification Department**