G·I·P·S

Global Investment Performance Standards

Guidance Statement on Wrap Fee/Separately Managed Accounts (SMA) Portfolios

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www.gipsstandards.org

8.A. Wrap Fee/SMA Performance Presentation and Reporting – Requirements

The following are additional requirements for firms to follow when presenting wrap fee/SMA performance to prospective wrap fee/SMA sponsors or wrap fee/SMA client prospects ("wrap fee/SMA prospect") and existing wrap fee/SMA sponsors or existing wrap fee/SMA clients ("wrap fee/SMA client") in compliance with the GIPS standards ("Standards").

8.A.1. For all wrap fee/SMA composite presentations that include periods prior to the composite containing an actual wrap fee/SMA portfolio, the firm must disclose, for each period presented, that the composite does not contain actual wrap fee/SMA portfolios (i.e., that 0% or none of the composite portfolios/assets are wrap fee/SMA portfolios).

8.A.2. The firm must include the performance record of actual wrap fee/SMA portfolios in appropriate composites in accordance with the firm's established portfolio inclusion policies. Once established, these composites (containing actual wrap fee/SMA portfolios) must be used in the firm's presentation to wrap fee/SMA prospects.

8.A.3. When firms present performance to a wrap fee/SMA prospect, the composite presented must include the performance of all appropriate, actual wrap fee/SMA portfolios, if any, managed with similar investment objectives and/or strategies, regardless of the wrap fee/SMA sponsor (resulting in a "style-defined composite").

8.A.4. When firms present performance to a wrap fee/SMA prospect, performance must be shown net of the entire wrap fee.

8.A.5. When firms present composite performance to an existing wrap fee/SMA sponsor, which includes only that sponsor's wrap fee/SMA portfolios (resulting in a "sponsor-specific composite"):

- Firms must disclose the name of the wrap fee/SMA sponsor represented by the sponsor-specific composite; and
- If the sponsor-specific composite presentation is intended for the purpose of generating wrap-fee business and does not include performance net of the entire wrap fee, the presentation must disclose that the named sponsor-specific presentation is only for the use of the named wrap fee/SMA sponsor.

Introduction

The purpose of the GIPS standards is to create performance presentations that allow for greater comparability of returns and increase the transparency of information provided to prospective clients. While it is impossible to develop standards that cover every situation, the GIPS standards provide a general framework that can be applied to many different circumstances. It is important to remember the underlying principles of the Standards: fair representation and full disclosure.

In order to provide prospective clients with a variety of investment options, investment management firms offer different types of investment products/services as well as fee structures.

One of these structures offers clients the ability to "bundle" one or more fees incurred during the management of a portfolio (i.e., bundled fees). Bundled fees can include any combination of management, trading, custody, and other administrative fees. Two specific examples of bundled fees are the Wrap Fee and the All-In Fee (see Appendix B for definitions of these terms). Wrap fee/SMA[1] portfolios are unique and significantly different from traditional brokerage or investment management relationships and, as a result, additional guidance is necessary for firms managing wrap fee/SMA portfolios on how to apply the GIPS standards.

Application of the GIPS standards to Wrap Fee/SMA Portfolios

A number of complex issues relating to achieving fair representation and full disclosure exist for a wrap fee/SMA investment manager to calculate, maintain, and present performance results in compliance with the GIPS standards. These issues result in several challenges, which include:

- A single fee is charged by a "sponsor" for several combined services (e.g., advisory, trading, custody, and other services).
    - The investment management firm typically has no involvement in or knowledge of the total fee that is charged by the wrap fee/SMA sponsor to individual wrap fee/SMA clients. The investment management firm typically has knowledge of only the fees it receives for its investment management services.
    - The GIPS standards require investment management firms to deduct trading expenses from all performance. Because the total fee charged to wrap fee/SMA portfolios is determined by the sponsor, a wrap fee is difficult, if not impossible, for the investment management firm to separate into parts in order to identify which portion is attributable to a specific service (e.g., 20% of the wrap fee is attributable to custody fees, 60% of the wrap fee is attributable to management fees, 5% is attributable to trading costs, 5% is attributable to client reporting, etc.).

- The investment management firm typically does not have a direct relationship with the end user of its wrap fee/SMA investment management services, although these portfolios are considered discretionary assets of the investment management firm. Instead, multiple parties (at least an investment management firm, a broker or sponsor, and an end user) are involved in this business model, with the wrap fee/SMA sponsor serving as the intermediary between the investment management firm and the end user of the investment services.
    - Investment management firms must have records to support performance presented to satisfy law and regulations as well as the requirements of the GIPS standards; however, wrap fee/SMA sponsors typically maintain underlying portfolio records and investment management firms may not have access to those records.
    - The investment management firm provides investment performance presentations to wrap fee/SMA sponsors which may or may not be used by the wrap fee/SMA sponsor for presenting to wrap fee/SMA prospects.
    - The investment management firm provides investment performance and other information to prospective wrap fee/SMA sponsors that is used by the sponsor to evaluate the investment management firm. The wrap fee/SMA sponsor typically

[1] For purposes of this guidance, the combined term "wrap fee/SMA" is used to describe these relationships and portfolios.

requires specific information from the investment management firm that may or may not comply with the GIPS standards.

Scope of Guidance Statement on Wrap Fee/SMA Performance

This Guidance Statement clarifies and interprets the broader GIPS provisions, specifically addressed from the perspective of the wrap fee/SMA investment management firm, and is applicable to those GIPS-compliant investment management firms which have discretionary portfolio management responsibility for wrap fee/SMA portfolios. This Guidance Statement is <u>not</u> applicable to those investment management firms that provide model portfolios to wrap fee/SMA sponsors, but have no discretionary portfolio management responsibility for individual wrap fee/SMA portfolios. Similarly, an overlay manager in a Multiple Strategy Portfolio (MSP) may also be excluded from this Guidance Statement <u>if</u> they do not have discretionary management. This Guidance Statement is only applicable to those firms that manage wrap fee/SMA portfolios; it is not applicable to those firms that manage portfolios defined as other types of Bundled Fee portfolios. (See Appendix B.)

While there are different types of wrap fee/SMA structures, this guidance is applicable to all wrap fee/SMA portfolios where the fees are bundled and the wrap fee/SMA sponsor serves as an intermediary between the investment management firm and the end user of the investment services. This guidance does not impose any specific, additional requirements for an investment management firm to monitor the use of their performance information once it has been provided to a third party; however, as in all situations where the performance information of the investment management firm is distributed by a third party, the firm should take appropriate measures to ensure that their performance is not misrepresented or used in a misleading fashion.

Key GIPS Provisions Specifically Applicable to Wrap Fee/SMA Performance

1.A. Input Data- Requirements

1.A.1. All data and information necessary to support a firm's performance presentation and to perform the required calculations must be captured and maintained.

2.A. Calculation Methodology- Requirements

2.A.5. All returns must be calculated after the deduction of the actual trading expenses incurred during the period. Estimated trading expenses are not permitted.

2.A.7. If the actual direct trading expenses cannot be identified and segregated from a bundled fee:

a. when calculating <u>Gross-Of-Fees Returns</u>, returns must be reduced by the entire Bundled Fee or the portion of the Bundled Fee that includes the direct Trading Expenses. The use of estimated trading expenses is not permitted.
b. when calculating <u>Net-Of-Fees Returns</u>, returns must be reduced by the entire bundled fee or the portion of the Bundled Fee that includes the direct Trading Expenses and the Investment Management Fee. The use of estimated trading expenses is not permitted.

3.A. Composite Construction - Requirements

3.A.2 Composites must be defined according to similar investment objectives and/or strategies. The full composite definition must be made available upon request.

4.A. Disclosures- Requirements

4.A.6. Firms must clearly label returns as Gross-Of-Fees or Net-Of-Fees.

4.A.12. Firms must disclose the fee schedule appropriate to the presentation.

4.A.13. If a composite contains portfolios with bundled fees, firms must disclose for each annual period shown the percentage of composite assets that is bundled fee portfolios.

4.A.14. If a composite contains portfolios with Bundled Fees, firms must disclose the various types of fees that are included in the bundled fee.

4.A.15. When presenting gross-of-fees returns, firms must disclose if any other fees are deducted in addition to the direct trading expenses.

4.A.16. When presenting net-of-fees returns, firms must disclose if any other fees are deducted in addition to the investment management fee and direct trading expenses.

Guiding Principles

It is important for investment management firms managing wrap fee/SMA portfolios to consider the following guiding principles when determining the manner in which to apply the GIPS standards to wrap fee/SMA portfolios:

- As specified in the GIPS standards (Introduction I.D.10.i.), firms are required to comply with all applicable local laws or regulations. This includes the laws and regulations relating to record keeping (e.g., having records to substantiate the performance record), which can be difficult to satisfy for some wrap fee/SMA investment management firms.

- The GIPS standards require the presentation of performance after the deduction of actual trading expenses. The wrap fee itself may be difficult to segregate into its component parts; however, the GIPS standards require the presentation of performance after the deduction of the actual trading expenses.

- Firms may wish to calculate performance history for presentation to wrap fee/SMA prospects using the gross-of-fees performance results for non-wrap fee/SMA portfolios managed to the same strategy reduced by the highest wrap fee applicable to that product. This performance history can be presented in compliance with the Standards since the performance of the investment strategy presented is based on actual assets under the firm's management and satisfies the underlying principles of fair representation and full disclosure.

- The firm must not exclude the performance of actual wrap fee/SMA portfolios when presenting performance to wrap fee/SMA prospects.

Definition of Firm

For purposes of claiming compliance, the GIPS standards define a firm as an investment firm, subsidiary or division held out to the public (clients or potential clients) as a distinct business entity. This 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. Possible criteria that can be used to determine this include:

- Being a legal entity,
- Having a distinct market or client type (e.g., institutional, retail, private client, etc.),
- Using a separate and distinct investment process

Organizations that have both a non-wrap fee/SMA division (e.g., institutional, private client, mutual fund, etc.) and a wrap fee/SMA division should examine the alternatives for defining the firm according to the above definition. These alternatives apply both to organizations that are just entering into the investment management industry as well as to those that are simply expanding their operations to now incorporate wrap fee/SMA products.

There are benefits and drawbacks that must be considered for each alternative definition. Possible scenarios include:

1. *Define the Entire Organization as the Firm and the Firm Claims Compliance with the GIPS standards, or*
2. *Define the Divisions Separately with either*
   (a) The Non-Wrap Fee/SMA Division and the Wrap-Fee /SMA Division are Defined as Separate Firms, and both claim compliance with the Standards, or
   (b) The Non-Wrap Fee/SMA Division and the Wrap-Fee /SMA Division are Defined as Separate Firms, and only one division claims compliance with the Standards

1. *Define the Entire Organization as the Firm and the Firm Claims Compliance with the GIPS standards*

The Standards recommend that investment management firms adopt the broadest, most meaningful definition of the firm. If both the wrap fee/SMA and non-wrap fee/SMA divisions are held out to the public as one entity, in order to meet the objectives of fair representation and full disclosure, it is recommended that the entire organization, including both non-wrap fee/SMA and wrap fee/SMA divisions, be defined as the as the firm for purposes of compliance. The organization will likely benefit from this broad definition, since:

- Both the non-wrap fee/SMA and wrap fee/SMA portfolios are included in and increase the firm's total assets under management.
- The firm has the option to combine wrap fee/SMA and non-wrap fee/SMA portfolios managed to similar investment objectives and/or strategies in the same composite provided additional required calculations and disclosures are made.
- Prior to the firm acquiring actual wrap fee/SMA portfolios, the firm can use the historical, non-wrap fee/SMA gross-of-fees performance history, adjusted to deduct the highest total

wrap fee charged to the end user by the wrap fee/SMA sponsor, in order to calculate a wrap fee/SMA performance history.

However, the firm should also consider the following potential disadvantage of defining the entire organization as the firm: If the firm includes wrap fee/SMA portfolios in a composite that is presented to clients other than wrap fee/SMA prospects or wrap fee/SMA clients, the firm must deduct the entire wrap fee from the performance of the wrap fee/SMA portfolios, unless the firm is able to identify and deduct either actual trading expenses charged to wrap fee/SMA portfolios or the portion of the wrap fee that includes actual trading expenses charged to wrap fee/SMA portfolios.

2. *Define the Divisions Separately*

Organizations that choose to hold the divisions out to the public as separate and distinct entities must define the divisions as separate firms for purposes of compliance. The claim of compliance with the Standards may be made solely by either division or both divisions may make the claim of compliance independent of the other. Firms claiming compliance with the Standards may not show assets or performance of another firm except as supplemental information to an appropriate compliant presentation of the firm.

It is possible that the divisions of an organization may not be organizationally and functionally separate or independent of each other, but because:

- their operations and functions are distinct within the organization, and
- the divisions are held out to the public as distinct entities,

the organization would be permitted to define one or both of the divisions as separate firms for purposes of compliance.

Underlying Records

Firms have options for satisfying GIPS provision 1.A.1. *"All data and information necessary to support a firm's performance presentation and to perform the required calculations must be captured and maintained."*

Some firms do not maintain or have access to the data necessary to substantiate portfolio-level performance. In order to satisfy the requirement of the GIPS standards, firms may choose to:

- Place reliance on the performance calculated and reported by the wrap fee/SMA sponsor. This can be done on either the aggregate level, effectively viewing the wrap fee/SMA sponsor as a single portfolio, or on the underlying wrap fee/SMA portfolio level. When relying on information provided by a third party (in this instance the wrap fee/SMA sponsor), the firm claiming compliance with the Standards must take the necessary steps to satisfy that the information provided by the wrap fee/SMA sponsor can be relied on to meet the requirements of the Standards.

- Utilize "shadow accounting"[2] to track the wrap fee/SMA portfolios on their in-house performance measurement systems.
- Exclude the wrap fee/SMA division from the definition of the firm (see above).

A firm claiming compliance with the Standards is responsible for its claim of compliance and is responsible, as well, for reporting information in compliance with the Standards to prospective clients. The firm must be sure that the performance provided by the wrap fee/SMA sponsor can be used by the firm to satisfy the requirements of the GIPS standards or the firm must maintain separate/duplicate records at the firm level (which meet the requirements of the Standards). Further, if the firm undertakes the verification process, the wrap fee/SMA portfolios are subject to the same level of testing as all other portfolios within the firm.

For periods beginning 1 January 2006, the firm must maintain or have access to supporting records for all portfolios included in a composite. The lack of records is not a reason to classify these portfolios as non-discretionary.

Constructing and Maintaining Composites for Wrap Fee/SMA Portfolios

While the same investment strategy can be employed by the investment management firm for wrap fee/SMA and non-wrap fee/SMA portfolios, the delivery of information about the strategy to the end user is what distinguishes wrap fee/SMA portfolios and necessitates additional guidance for creating and maintaining composites that include wrap fee/SMA portfolios.

In order for a firm claiming compliance with the GIPS standards to present results for a specific strategy to wrap fee/SMA prospects that the firm historically managed for <u>only</u> non-wrap fee/SMA portfolios, the firm must satisfy the following:

(1) the firm definition must include both the wrap fee/SMA and non-wrap fee/SMA assets,
(2) there were no wrap fee/SMA portfolios under management for the particular strategy during the time periods for which the firm compiles the wrap fee/SMA performance using <u>only</u> non-wrap fee/SMA portfolios, and
(3) for all wrap fee/SMA composite presentations that include periods prior to the composite containing an <u>actual</u> wrap fee/SMA portfolio, the firm must disclose, for each period presented, that the composite does not contain actual wrap fee/SMA portfolios (i.e., that 0% or none of the composite portfolios/assets are wrap fee/SMA portfolios). This disclosure will be used by the firm prior to the implementation of GIPS provision 4.A.13., which will be required once the composite contains a wrap fee/SMA portfolio.

The firm may calculate a wrap fee/SMA performance history for a specific strategy by using that strategy's gross-of-fees, non-wrap fee/SMA composite history reduced by the highest total wrap fee charged to the client (end user) by the wrap fee/SMA sponsor for the strategy (product), resulting in net-of-fees wrap fee/SMA performance.

It is up to the firm to determine the appropriate highest wrap fee to deduct. This highest wrap fee should be obtained from the prospective wrap fee/SMA sponsor and should be comparable for

[2] "Shadow accounting" is considered the process of maintaining investment performance records for each account that enables an investment management firm to determine beginning and end of reporting period values and cash flows.

the investment style or strategy of the wrap fee/SMA composite. “Pure” gross-of-fees performance (i.e., gross of all expenses, including trading expenses) is only permitted as supplemental information to a compliant presentation. It is recognized that when starting with the gross-of-fees, non-wrap fee/SMA composite history, the gross-of-fees performance already reflects the deduction of actual trading expenses incurred. By then reducing the composite performance by the highest total wrap fee, which includes a portion attributable to trading expenses, performance will reflect the deduction of trading expenses two times (actual and portion of highest wrap fee). If the firm can identify the portion of the highest total wrap fee attributable to trading expenses, the firm may first calculate performance reflecting the deduction of both actual trading expenses and the highest wrap fee; the firm may then increase this result by the identifiable portion of the wrap fee attributable to trading expenses in order to compute a net-of-fees return.

Beyond building an initial track record for presentation to wrap fee/SMA prospects, the investment management firm must consider whether it will revise its wrap fee/SMA composite history as it accumulates an actual wrap fee/SMA performance record. Once a firm acquires one or more wrap fee/SMA portfolios for management, the firm must include the performance of the actual wrap fee/SMA portfolio(s) in an appropriate composite in accordance with the firm’s established portfolio inclusion policies. The firm must determine if it will combine wrap fee/SMA portfolios in a composite with non-wrap fee/SMA portfolios with the same strategy, or if it will have separate composites for non-wrap fee/SMA portfolios.

The firm has three options to consider:

1. Keep the calculated history, redefine the composite to include only actual wrap fee/SMA portfolios going forward, and include relevant disclosures;
2. Continue to include the ongoing performance of the non-wrap fee/SMA portfolios and combine this with actual wrap fee/SMA portfolios; or,
3. Create a new composite to represent only actual wrap fee/SMA portfolios. The new composite will reflect a recent composite creation date. The non-wrap fee/SMA calculated composite will be discontinued, and must be shown as a discontinued composite on the firm’s list of composites for at least five years after discontinuation.

The firm must not exclude the performance of actual wrap fee/SMA portfolios from the appropriate composite(s). When presenting wrap fee/SMA performance to wrap fee/SMA prospects, the firm must choose one of the three options listed above.

Firms must not redefine a composite on a retroactive basis, according to the ***Guidance Statement on Composite Definition***. Once the firm includes non-wrap fee/SMA portfolios in the wrap fee/SMA composite history, the firm must not retroactively strip those portfolios out of the composite in order to create a “Wrap Fee/SMA Only” composite history.

Performance Presentation

Depending on the recipient of the presentation, the Standards have different requirements for presenting wrap fee/SMA performance results. Specifically, most wrap fee/SMA sponsors need different statistics and disclosures than retail investors. These differences result in separate requirements depending on the audience being presented the composite results. The investment management firm may provide its performance to wrap fee/SMA prospects to generate new business or may provide its performance to existing wrap fee/SMA sponsors to generate additional business.

Wrap Fee/SMA Results for Wrap Fee/SMA Prospects (the 1st time the firm presents performance to a wrap fee/SMA prospect to obtain new business)
When presenting performance to a wrap fee/SMA prospect, performance must be shown net-of-fees (i.e., the entire wrap fee). Firms may also present gross-of fees and/or "pure" gross-of-fees returns as additional and/or supplemental information[3].

The GIPS standards require firms to define composites according to similar investment objectives and/or strategies. In order to facilitate the comparability of performance results and prevent firms from cherry-picking their best performing portfolios for presentation, investment management firms must group all appropriate wrap fee/SMA portfolios in a composite according to the same investment style or strategy (creating a style-defined composite) regardless of the wrap fee/SMA sponsor.[4] If the firm has no actual wrap fee/SMA portfolios under management for the specified strategy, this style-defined composite will be composed of only non-wrap fee/SMA portfolios managed to the specified strategy, using the gross-of-fees performance results reduced by the highest wrap fee applicable to that strategy.

Once the firm has actual wrap fee/SMA portfolios under management, the firm has two options for composite construction.

1. If the firm chooses to define its composites to include only actual wrap fee/SMA portfolios going forward, the style-defined composite will consist of portfolios from all wrap fee/SMA sponsors that are managed to the specified strategy.

2. If the firm chooses to continue to combine the ongoing performance of the non-wrap fee/SMA portfolios and actual wrap fee/SMA portfolios in the same composite, the style-defined composite will consist of the continuing non-wrap fee/SMA portfolios as well as all wrap fee/SMA portfolios managed to the specified strategy, regardless of the wrap fee/SMA sponsor.

Regardless of the firm's composite construction choice, this style-defined composite must be presented to wrap fee/SMA prospects in order to demonstrate a full and fair picture of the firm's ability to manage wrap fee/SMA portfolios in the defined style. Firms may choose to present additional and/or supplemental information demonstrating the firm's ability to manage portfolios for a specific wrap fee/SMA sponsor or group of wrap fee/SMA sponsors.

When an investment management firm that claims compliance with the GIPS standards prepares a performance report to be provided to prospective wrap fee/SMA clients (either directly by the investment management firm or through the wrap fee/SMA sponsor) performance must be

[3] See the ***Guidance Statement on the Use of Supplemental Information*** at www.cfainstitute.org/standards.
[4] The Standards require firms to include all fee-paying discretionary portfolios in at least one composite. In this way, firms cannot "cherry-pick" their best performing portfolios to present to prospective clients.

prepared net-of-fees reflecting the actual wrap fee or the highest wrap fee charged to clients by the wrap fee/SMA sponsor. The investment management firm may prepare additional information as requested by the wrap fee/SMA sponsor consistent with the ethical principles of the Standards.

Wrap Fee/SMA Results for Existing Wrap Fee/SMA Sponsors For the Purpose of Generating Additional Business (once an agreement is established with a wrap fee/SMA sponsor)
When reporting performance to an **existing** wrap fee/SMA sponsor for the purpose of generating additional investment management business, the firm may choose whether to show returns on a gross-of-fees or net-of-fees basis. (Firms may also present "pure" gross-of-fees returns as supplemental information.) However, as described above, all presentations that are prepared by the investment management firm and will be provided to **prospective** wrap fee/SMA clients must be presented net-of-fees reflecting the actual wrap fee or the highest wrap fee charged to clients by the wrap fee/SMA sponsor.

When an investment management firm is reporting the performance of a wrap fee/SMA program to an existing wrap fee/SMA sponsor, there is a need to report how the firm has performed managing a particular program or "product" for that individual wrap fee/SMA sponsor. The investment management firm may report the performance of the composite that includes only the portfolios managed for that wrap fee/SMA sponsor. Similar to the concept of existing client reporting, an investment management firm may choose to create a smaller "composite" consisting only of the portfolios managed for the wrap fee/SMA sponsor in order to present to that sponsor the performance of their own wrap fee/SMA product. Provided all the requirements of the Standards are met on a firm-wide basis, the sponsor-specific "composite" presentation may include the claim of compliance. The investment management firm must reflect the name of the existing wrap fee/SMA sponsor in the sponsor-specific compliant presentation. Further, if the presentation does not include net-of-fees returns, the investment management firm must include a prominent disclosure stating that the sponsor-specific composite presentation is only for the use of the named wrap fee/SMA sponsor.

The Use of Aggregate Information
The use of aggregate information for performance and performance-related reporting purposes is permitted. A firm may choose to rely on and report aggregate information obtained from the wrap fee/SMA sponsor, effectively viewing the sponsor as a single portfolio. For example, at year-end, if a firm is managing 1,000 underlying wrap fee/SMA portfolios for one sponsor, and the firm effectively views the sponsor as a single portfolio, the firm may choose to report "1" or "≤5" for the number of portfolios in the composite. The Standards provide that the firm is not required to disclose the number of portfolios if there are five or fewer portfolios in the (wrap fee/SMA) composite.

Alternatively, the firm may chose to rely on the underlying portfolios of each sponsor, and the performance and performance-related information presented will reflect the individual wrap fee/SMA portfolios (end users). Using the example above, the firm will report "1000" for the number of portfolios in the composite.

Calculating Gross-of-Fee and Net-of-Fee Returns for Wrap Fee/SMA Composites

The Standards require that performance is to be calculated net of actual trading expenses. For wrap fee/SMA portfolios, this concept is not so easily applied, because the wrap fee itself may be difficult, if not impossible, to segregate into its component parts. In some cases, the actual fees charged to each wrap fee/SMA portfolio are not available. See examples of calculations in Appendix C.

Calculating Performance For Composites That Include Wrap Fee/SMA Portfolios To Be Presented To a Wrap Fee/SMA Prospect (the 1st time performance is shown to obtain new business)

When calculating performance to be presented to a wrap fee/SMA prospect, performance must be reduced by the entire wrap fee in order to compute a net-of-fees return. This reduction is applicable to all wrap fee/SMA portfolios in the composite as well as any non-wrap fee/SMA portfolios in the composite. The net-of-fees requirement for *Wrap Fee/SMA Prospect*s is applicable regardless of whether the firm can determine the portion of the wrap fee that includes trading expenses.

Calculating Performance For Composites That Include Wrap Fee/SMA Portfolios To Be Presented To Existing Wrap Fee/SMA Sponsors For the Purpose of Generating Additional Business (once an agreement is established with a wrap fee/SMA sponsor)

When calculating performance to be presented to an existing wrap fee/SMA sponsor, performance can be calculated (and presented) either gross- or net-of-fees. These calculations can be difficult to compute for wrap fee/SMA portfolios because the wrap fee cannot be broken into its components.

Therefore, in cases where the trading expenses cannot be identified and segregated from a total wrap fee, either the entire wrap fee or the portion of the wrap fee containing the trading expenses must reduce the gross-of-fees and net-of-fees returns. In these cases, custody and other administrative fees might be included in (reduce) the gross-of-fees and net-of-fees returns. Firms may find that the gross-of-fees return is equal to the net-of-fees return.

If firms can identify these other fees and expenses, firms are permitted to add back any fees and expenses except for the trading expenses for gross-of-fees returns and any may add back any fees and expenses except for the trading expenses and investment management fees for net-of-fees returns.

In order to assist prospective clients and their understanding of the fees charged in these situations, when presenting gross-of-fees returns, firms must disclose if other fees are deducted in addition to the direct trading expenses. When presenting net-of-fees returns, firms must disclose if any other fees are deducted in addition to the investment management fee and trading expenses.

Calculating an Internal Risk Measure for a Wrap Fee/SMA Composite

The GIPS standards require all presentations to include a measure of dispersion of portfolio returns, considering only those portfolios that have been included in the composite for the full year. Firms are encouraged to maintain the individual (end user) portfolio-level returns, which will facilitate the computation of the required measure of dispersion (and number of portfolios within the composite).

An investment management firm may choose to view the aggregate performance information reported by a wrap fee/SMA sponsor as a single portfolio. This measure of dispersion considers the sponsor-level returns, not the portfolio-level returns that are consolidated in the sponsor-level returns. The Standards provide that the firm is not required to disclose a measure of composite dispersion if there are five or fewer portfolios in the (wrap fee/SMA) composite.

Supplemental/Additional Information

The GIPS standards recommend that firms present information that supplements the required compliant presentation that will assist clients to interpret the record. With regard to presenting wrap fee/SMA performance to wrap fee/SMA prospects, firms are required to show net-of-fees performance results; however, they are permitted to show "additional information" in the form of gross-of-fees results (i.e., reduced by trading expenses) as well as "supplemental information" in the form of "pure" gross-of-fees results (i.e., gross of all expenses, including trading expenses). See the Guidance Statement on the Use of Supplemental Information as well as the sample presentations provided in Appendix A.

Effective Date

The Effective Date of this Guidance Statement is 1 January 2006. Firms currently coming into compliance are encouraged to apply this guidance to all periods. Firms are also encouraged to apply this guidance prior to the effective date; however, this guidance must be applied for all performance periods beginning 1 January 2006.

For periods prior to the effective date of 1 January 2006, the firm may link non-compliant performance 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. As with all aspects of complying with the GIPS standards, a firm must meet any regulatory requirements, including those related to recordkeeping.

Applications

1. *The Standards require the disclosure of a fee schedule that is appropriate to the presentation. As an investment management firm managing wrap fee/SMA portfolios, we maintain a fee schedule that is between us and the SMA sponsor. The SMA sponsor has a fee schedule that is between the SMA sponsor and the end client. Which fee schedule should be presented?*

In all instances, if the composite presentation will or may be presented to a prospective client that is an end user of investment management services, the appropriate fee schedule to present is the one that reflects the total wrap fee that will be charged by the SMA sponsor to the end user.

If the composite presentation is provided only to a prospective SMA sponsor (and will not be used to market to an end user), the fee schedule may reflect the investment management firm's portion of the total wrap fee (the fee schedule between the investment management firm and the SMA sponsor). Additional information about other fee schedules may be presented as supplemental information.

2. *When reporting performance to a specific wrap fee/SMA sponsor with whom our firm has entered into a sponsor agreement, we report the performance of that sponsor's portfolios (managed to the same strategy) since the inception of our relationship with the sponsor in a composite. May we link the performance of the sponsor-specific results to our historical, style-defined wrap fee/SMA composite track record, which includes the combined historical performance of all wrap fee/SMA portfolios managed in the same style, regardless of sponsor?*

Yes, sponsor-specific wrap fee/SMA composite results may be linked to the historical performance of a style-defined composite (which could also include the performance of non-wrap fee/SMA portfolios managed in the same style reduced by the highest total wrap fee).

3. *When reporting performance to a wrap fee/ SMA prospect, may we present sponsor-specific composite performance from an existing wrap fee/SMA sponsor?*

When presenting performance to a wrap fee/SMA prospect, the firm must present a style-defined composite in order to demonstrate a full and fair picture of the firm's ability to manage all wrap fee/SMA portfolios in the defined style. Firms may choose to present additional and/or supplemental information demonstrating the firm's ability to manage portfolios for a specific wrap fee/SMA sponsor or group of wrap fee/SMA sponsors.

4. *Does this guidance mean we have to control how a wrap fee/SMA sponsor uses our firm's presentations? What if the sponsor delivers our sponsor-specific wrap fee/SMA gross-of-fees composite performance to a wrap fee/SMA prospect?*

No; this guidance does not impose any specific, additional requirements for an investment management firm to monitor the use of their performance information once it has been provided to the wrap fee/SMA sponsor; however, as in all situations where the performance information of the investment management firm is distributed by a third party, the firm should take appropriate measures to ensure that their performance is not misrepresented or used in a misleading fashion.

5. *Our firm manages both institutional and SMA portfolios. As of 1 January 2000, we began to claim compliance with the GIPS standards for our institutional portfolios. Given the guidance provided for wrap fee/SMA portfolios, we do not believe we can currently meet the requirements of the GIPS standards for our wrap fee/SMA portfolios. Can we continue to exclude our wrap fee/SMA portfolios from our GIPS-compliant firm, so we may continue to claim compliance for our institutional portfolios?*

The answer depends on how the firm holds itself out to the public. For purposes of claiming compliance, the GIPS standards define a firm as an investment firm, subsidiary or division held out to the public (clients or potential clients) as a distinct business entity. This entity is a unit, division, department, or office that is organizationally and functionally segregated from other units, divisions, departments, or offices and retains discretion over the assets it manages and should have autonomy over the investment decision-making process. Possible criteria that can be used to determine this include:

- Being a legal entity,
- Having a distinct market or client type (e.g., institutional, retail, private client, etc.),
- Using a separate and distinct investment process

In the situation described, provided the non-wrap fee/SMA division satisfies the definition of the firm guidance above, it is possible for the organization to separately define its institutional division as a distinct business entity that excludes its wrap fee/SMA division from its claim of compliance. This would not automatically jeopardize the organization's claim of compliance with the GIPS standards. If the non-wrap/SMA (institutional) portfolio managers also manage the wrap fee/SMA portfolios, this structure would not necessarily prevent the firms from being separately defined. The firm should consider that it may not show performance from the wrap fee/SMA division (except as supplemental information to its institutional track record). For more information on supplemental information, please review the *Guidance Statement on the Use of Supplemental Information*.

6. *We manage SMA portfolios for approximately 45 SMA sponsors. We are able to maintain satisfactory supporting records for 44 of those 45 SMA sponsors. For one SMA sponsor, we are not able to obtain what we consider to be adequate supporting records. We intend to exclude them from our firm's assets and definition of the firm, and claim compliance for the remainder of our SMA business (the other 44 SMA sponsors). Can we do so?*

The concept of compliance with the GIPS standards must be applied on a firm-wide basis. While there is some flexibility in defining a firm, an organization may not choose to exclude a portion of its assets from its firm definition simply because it cannot satisfy the recordkeeping requirements of the Standards.

That said, one troublesome wrap fee/SMA sponsor would not, in all cases, prevent the firm from claiming compliance. The firm should consider the records that are available for that wrap fee/SMA program and assess whether the firm can place reliance on the records that are maintained. In many instances, some records are available for all portfolios – such as trading records and summary information – regardless of wrap fee/SMA sponsor. Acknowledging that the level of detail may not be ideally what the firm would like to have, the firm may be able to determine that the minimal records available are enough to satisfy the firm's recordkeeping requirements, enabling it to meet the GIPS standards.

7. *Our firm currently manages wrap fee/SMA accounts. We will not be able to comply with the GIPS standards for SMA portfolios as of 1 January 2006. We believe we will be able to comply with GIPS for our SMA portfolios as of 1 January 2008. Can we begin to claim compliance with GIPS for our SMA portfolios as of 1 January 2008?*

Firms that manage SMA portfolios and wish to claim compliance with the GIPS standards must comply with the GIPS standards as of 1 January 2006, at a minimum. If the investment management firm is not able to claim compliance as of this date, they must wait until they have a minimum 5-year track record which complies with the GIPS requirements before claiming compliance.

8. *We manage small cap portfolios for three sponsors, using the same strategy. We place reliance on each sponsors' aggregate information effectively viewing each sponsor as a single portfolio. When reporting performance of the style-defined composite, how should we report number of accounts and the measure of internal dispersion?*

If the firm is relying on the three sponsors' aggregate information for disclosure and performance reporting purposes, the number of accounts could be reported either as 3 or five or fewer (≤ 5). The firm could report a measure of dispersion using the annual returns from each of the three sponsors, or could choose to not present the disclosure and report five or fewer portfolios (≤ 5) in the composite.

9. *I would like to present gross-of-fees returns for a sponsor-specific composite which contains only actual wrap fee/SMA portfolios to an existing wrap fee/SMA sponsor. I know the entire wrap fee (150 Basis Points) as well as the investment management fee (50 Basis Points) that is included in the wrap fee. This leaves the "portion of the bundled fee containing trading expenses" equal to 100 Basis Points. Can I add back the 50 basis points (investment management portion of the total wrap fee) to calculate a more accurate gross-of-fees return?*

The guidance provides that when calculating gross-of-fees performance for composites that include wrap fee/SMA portfolios to be presented only to existing wrap fee/SMA clients, firms may add back any fees and expenses they can identify within the wrap fee except for the trading expenses. When presenting gross-of-fees returns, the GIPS standards require firms to disclose if other fees are deducted in addition to the trading expenses. (See GIPS provision 4.A.15.) The investment management firm must also reflect the name of the existing wrap fee/SMA sponsor in the sponsor-specific compliant presentation. Further, if the presentation does not include net-of-fees returns, the investment management firm must include a prominent disclosure stating that the sponsor-specific composite presentation is only for the use of the named wrap fee/SMA sponsor.

In this situation, the firm should start with a net-of-fees performance return (which reflects or is reduced by the total wrap fee of 150 basis points). Because 50 basis points of the total 150 basis point wrap fee are attributable to the investment management fee, the remaining 100 basis points includes among other expenses, those directly attributable to trading expenses. The firm may add back the 50 basis point investment management fee to the net-of-fees performance results to compute a gross-of-fees performance return.

APPENDIX A

Sample 6 Investments
Large Cap SMA Composite
January 1, 1993 through December 31, 2003

					As of December 31			
Year	Net Return (%)	"Pure" Gross Return* (%)	XYZ Index Return (%)	Internal Dispersion (%)	Number of Portfolios	Composite Assets ($ millions)	% of Firm Assets (%)	% of SMA portfolios
2003	13.89	16.42	15.99	0.7	1,834	2,125	14	100
2002	-16.77	-14.22	-21.51	1.1	1,730	2,130	15	100
2001	-12.00	-9.45	-11.71	1.0	1,631	2,141	14	100
2000	4.59	7.12	6.08	1.2	1,532	2,127	14	100
1999	11.63	14.22	12.75	0.9	1,428	2,116	11	100
1998	14.45	17.01	14.68	0.8	35	1,115	12	0
1997	25.48	28.02	29.98	1.0	32	1,110	13	0
1996	20.47	23.00	21.99	1.1	26	990	12	0
1995	38.39	41.01	37.01	0.9	24	975	15	0
1994	-2.67	-0.11	-0.62	0.8	18	870	14	0
1993	16.47	19.02	18.64	0.7	17	766	16	0

* - Beginning January 1, 1999, "pure" gross-of-fees returns do not reflect the deduction of any expenses, including trading costs. "Pure" gross-of-fees returns are supplemental to net returns. See note 3.

Sample 6 Investments has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®).

1. Sample 6 Investments is an independent investment advisor registered under the Investment Advisers Act of 1940.

2. Beginning January 1, 1999, the Large Cap SMA Composite (Composite) includes all separately managed (wrap) portfolios benchmarked to the XYZ Index. Performance results from 1993 through 1998 are those of the Large Cap Institutional Composite. The Composite was created in December 1998. A complete list and description of firm composites is available upon request.

3. Portfolio returns are calculated monthly, using the Modified Dietz method. Portfolios are revalued for any cash flow that exceeds 10% of the portfolio's market value. Pure gross returns from 1999 through 2003 do not reflect the deduction of any trading costs, fees or expenses. "Pure" gross returns from 1993 through 1998 reflect the deduction of trading costs. The SMA fee includes all charges for trading costs, portfolio management, custody, and other administrative fees. Net returns are calculated by subtracting the highest applicable SMA fee (2.50% on an annual basis, or 0.625% quarterly) on a quarterly basis from the gross Composite quarterly return. Monthly Composite returns are calculated by weighting each account's monthly return by its relative beginning market value. All returns are expressed in U.S. dollars. Additional information regarding policies for calculating and reporting returns is available upon request.

4. The XYZ Index returns are provided to represent the investment environment existing during the time periods shown. For comparison purposes, the index is fully invested and includes the reinvestment of income. The returns for the index do not include any trading costs, management fees or other costs.

5. The dispersion of annual returns is measured by the equal weighted standard deviation of portfolio returns represented within the Composite for the full year.

6. Past performance is not an indicator of future results. The standard fee schedule in effect is as follows: 2.50% on total assets.

Supplemental Information

Year	"Pure" Gross Return (%)	Net Return (%) Assuming 3% SMA Fees	Net Return (%) Assuming 2% SMA Fees
2003	16.42	13.45	14.39
2002	-14.22	-17.20	-16.19
2001	-9.45	-12.47	-11.44
2000	7.12	4.02	5.12
1999	14.22	11.11	12.12
1998	17.01	13.98	14.99
1997	28.02	24.95	26.03
1996	23.00	20.01	20.99
1995	41.01	37.99	39.02
1994	-0.11	-3.21	-2.10
1993	19.02	16.01	17.00

Sample 7 Asset Management Company
Small Cap SMA Composite
January 1, 1993 through December 31, 2004

Year	Net Return (%)	Small-Cap Index Return (%)	Internal Dispersion (%)	As of December 31: Number of Portfolios	Composite Assets ($ millions)	% of Firm Assets (%)	% of SMA portfolios
2004	10.0	8.9	0.8	583	1432	17	100
2003	-8.9	-15.4	0.7	573	1324	14	100
2002	6.7	7.6	1.1	563	1243	15	100
2001	-4.5	3.5	1.0	553	976	14	100
2000	11.0	2.6	1.2	503	890	14	100
1999	14.6	14.9	0.9	433	789	11	50
1998	-3.7	-7.3	0.8	333	654	12	40
1997	14.6	10.9	1.0	233	633	13	30
1996	19.1	14.3	1.1	133	300	12	25
1995	2.3	3.7	0.9	23	162	15	20
1994	-1.6	0.7	0.8	13	120	14	0
1993	12.7	13.4	0.7	3	25	16	0

Sample 7 Asset Management Company has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®).

1. Sample 7 Asset Management Company is an independent investment advisor registered under the Investment Advisers Act of 1940.

2. Beginning January 1, 2000, the Small Cap SMA Composite (Composite) includes all separately managed (wrap) portfolios benchmarked to the XYZ Index and sponsored by Sparky Sponsor, Inc. Performance results from 1995 through 1999 are those of Sample 7's Small Cap Institutional Composite and small-cap wrap portfolios managed for Sparky Sponsor. Performance results from 1993 and 1994 are the Small Cap Institutional Composite. The Composite was created in August, 2000. A complete list and description of firm composites is available upon request.

3. Portfolio returns are calculated monthly, using the Modified Dietz method. Portfolios are revalued for any cash flow that exceeds 10% of the portfolio's market value. The SMA fee includes all charges for trading costs, portfolio management, custody, and other administrative fees. Net returns are calculated by subtracting the highest applicable SMA fee (2.50% on an annual basis, or 0.625% quarterly) on a quarterly basis from the gross quarterly return. Monthly Composite returns are calculated by weighting each account's monthly return by its relative beginning market value. All returns are expressed in U.S. dollars. Additional information regarding policies for calculating and reporting returns is available upon request.

4. The XYZ Index returns are provided to represent the investment environment existing during the time periods shown. For comparison purposes, the index is fully invested and includes the reinvestment of income. The returns for the index do not include any trading costs, management fees or other costs.

5. The dispersion of annual returns is measured by the equal weighted standard deviation of portfolio returns represented within the Composite for the full year.

6. Past performance is not an indicator of future results. The standard fee schedule in effect is as follows: 2.50% on total assets.

APPENDIX B

Excerpt from GIPS Glossary:

Bundled Fee — a fee that combines multiple fees into one "bundled" fee. Bundled Fees can include any combination of management, transaction, Custody, and other Administrative Fees. Two specific examples of Bundled Fees are the wrap fee and the all-in fee.

All-in Fee — Due to the universal banking system in some countries, asset management, brokerage, and Custody are often part of the same company. This allows banks to offer a variety of choices to customers regarding how the fee will be charged. Customers are offered numerous different fee models in which fees may be bundled together or charged separately. All-in fees can include any combination of Investment Management, Trading Expenses, Custody, and other Administrative Fees.

Wrap Fee — Wrap fees are specific to a particular investment product. The U.S. Securities and Exchange Commission (SEC) defines a wrap fee account (more commonly known as a Separately Managed Account) as "any advisory program under which a specified fee or fees not based upon transactions in a client's account is charged for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and execution of client transactions". A typical separately managed account has a contract or contracts (and fee) involving a sponsor (usually a broker or independent provider) acting as the investment advisor, an investment management firm typically as the subadvisor, other services (custody, consulting, reporting, performance, manager selection, monitoring, and execution of trades), distributor, and the client (brokerage customer). Wrap fees can be all-inclusive, asset-based fees (which may include any combination of management, transaction, custody, and other Administrative Fees).

APPENDIX C

Examples of Gross-of-Fees and Net-of-Fees Calculations

Non-Wrap	**Presenting to Current Wrap Fee/SMA Sponsors and Clients (Can and choose to unbundle wrap fee)**	**Presenting to Prospective Wrap Fee/SMA Sponsors and Clients**
Return on Assets	Return on Assets ("Pure Gross")**	Return on Assets ("Pure Gross")**
- Trading Expenses	- Portion of Wrap Fee that includes Trading Expenses that can be segregated	
Gross-Of-Fees Return	**Gross-Of-Fees Return**	- Highest Wrap Fee Or - Actual Wrap Fee
- Investment Management Fee	- Portion of Wrap Fee that includes IM Fee that can be segregated	
Net-Of-Fees Return	**Net-Of-Fees Return**	
- Administrative Fee	- Remaining portion of wrap fee (if any)	
Client Return*	Client Return*	**Gross-Of-Fees Return** **and** **Net-Of-Fees Return** and Client Return *

*** The Client Return is not required by the GIPS standards and is presented here as additional information that may be helpful for existing clients.**

**** While the "pure gross" return is not required or recommended by the GIPS standards, it can be shown as supplemental information.**