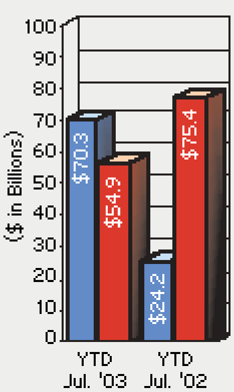
AT A GLANCE

Equity Funds 2003 YTD Net Flows Up $46B From 2002



Compared to the first seven months of 2002, equity funds have gained significant sales traction, while bond funds have slipped. More importantly, 2003 total net flows are up more than $46 billion through the same time period in 2002.

Source: Financial Research Corp.

AIMR Reluctant to Ease Standards for SMAs

March 22, 2004

The standoff between SMAs and AIMR is sort of like Groucho Marx' famous quote that if it was a club that would let him in, he wouldn't want to join it.

AllianceBernstein, Lord, Abbett, Prudential Investments and a number of other large separately managed account (SMA) investment firms represented by the Money Management Institute have asked the Association for Investment Management and Research (AIMR) to relax some of its institutional performance guidelines for the separately managed account industry. AIMR is reluctant to ease its SMA guidelines, and a growing number of people in the industry think that should it do so, it would ultimately do it no good.

With only a few months until the tentative June release date for its second proposed guidelines for the rapidly growing separately managed account industry, AIMR is still reluctant to end the standoff by bending its longstanding institutional rules for the rapidly growing SMA industry.

"AIMR is trying to keep the standards high in terms of not allowing investment managers not to treat the SMA in a different light than any other account that asset managers may manage," said Gregory Turk, an associate for performance standards at AIMR. "If we allow some special treatment of SMAs, it opens a Pandora's box for other products to gain leniency."

But some hope a breakthrough in the stalemate may stem from newly proposed international reporting guidelines that encompass both institutional and SMA reporting standards. Throughout a nearly five-year dialogue between AIMR and MMI, asset managers have cited vast differences between the distribution models of multi-million dollar institutional portfolios and SMAs as the basis of an argument for separate performance reporting guidelines.

Responding to AIMR's first set of proposed SMA guidelines in late 2002, MMI zeroed in on the fact that maintaining daily net asset values for thousands of smaller accounts is further complicated because third-party distributors, also known as sponsors, often control access to vital trade records, establish fees and independently distribute sales literature to individual investors. AIMR quickly acknowledged that it had more to learn about SMAs and subsequently withdrew its proposal for further consideration.

Once again, last fall, MMI, through its AIMR Liaison Committee, appealed to the investment management organization to find a compromise that recognizes the near stranglehold of information at the sponsor level (see MME 9/1/03).

"With regard to why it's easier for SMA managers to report performance for institutional clients," Scott Sipple, managing director in charge of separate accounts at Alliance Bernstein and a member of the AIMR Liaison Committee, told MME, "it really has much more to do with the issue of us being able to get information the way the sponsors want it prepared."

Gordian Knot

Nearly 18 months since the latest round of discussions began, both sides appear no closer to untying the Gordian knot intersecting privately managed assets for institutional investors and the high-net-worth and mass-affluent individual marketplaces. Some asset managers fear that failure to find common ground on the matter may lead to a difficult choice of jettisoning their SMA businesses or going without AIMR compliance, an all-or-nothing proposition for investment firms with multiple lines of business. Because profit margins are fatter for institutional accounts than SMAs, some firms may consider the former option.

"If they went to these standards, it may force managed account providers to not get AIMR certification," Sipple said, in a recent interview. "What we're saying is, Let's look rationally, work

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cooperatively and avoid staring into that abyss.'"

Both sides are quick to characterize the ongoing negotiations as amicable. AIMR, which is reluctant to alienate its constituents by setting an unattainable bar for SMA performance measurement, acknowledges special challenges posed by close relationships between asset managers and sponsor firms, such as Morgan Stanley and Smith Barney.

"In our mind, the solution has been easy. The sponsor has to provide the investment manager with all the details, such as the transaction costs," Turk said. "Unfortunately, the power in the equation is the sponsor, who sets up the relationship, so the investment manager is getting squeezed."

Asset managers are equally sympathetic to AIMR's challenge for maintaining high standards for full disclosure and fair reporting of managed assets in a rapidly changing global marketplace. In addition, MMI rejects the notion that any compromises in AIMR's forthcoming SMA guidelines may amount to a relaxation of standards and subsequently dumb down the group's "Good Housekeeping" seal of approval.

"I don't know if it's a relaxation of standards so much as a modification to adapt to the needs of the separate account space," said Janet Mariconti, a senior vice president at Prudential Investments, a division of Prudential Financial. Mariconti is also chairman of MMI's AIMR Liaison Committee.

MMI and other asset managers are pinning their hopes for an equitable compromise on educating AIMR officials about the nuances of the SMA space. "They [AIMR] know a lot about the investment management business, but we together are bringing up their knowledge of the SMA business," said Mark Pennington, director of managed accounts at Lord, Abbett and a member of MMI's AIMR Liaison Committee. "It's one thing if you're running 100 institutional accounts that have an average size of at least $100 million. It's another thing if you're running $18 billion in 63,000 separate accounts," Pennington said.

MMI members have also raised concerns about grandfathering shadow recordkeeping systems, independent accounting programs designed to duplicate sponsors' order books. These shadow accounts were established after AIMR came out with its proposed SMA guideline updates in 2002. Manually updating the shadow accounting system is extremely cost prohibitive, according to an asset management official, who requested to remain anonymous. AIMR is unlikely to grant the request because its guidelines requiring shadow accounts date back to 1993, the official said.

Although the two sides are still in disagreement about some recordkeeping issues, AIMR's proposed Global Investment Performance Standards, or Gold GIPS, released in January may provide some avenue for harmonizing institutional and SMA fee disclosure practices. Alecia Licata, vice president of investment performance standards at AIMR, noted similarities between bundled fee programs, known among some Swiss financial institutions as "all-in" fees, and wrap account programs currently exploding in North America.

"SMAs are becoming more popular and at the same time, the AIMR standards, which are driven by global standards, are growing and evolving," Licata said. "While the separately managed account is unique to the U.S., the concept of a wrapped fee is not."

As an example, AIMR performance standards require asset managers to show fees net of transaction costs rather than merely netting out investment advisory fees. MMI prefers to report gross fees without unbundling transaction and proprietary costs, Licata said, because the expenses vary among different sponsors. Gold GIPs, now under consideration by 24 countries, may provide new alternatives, such as allowing asset managers to disclose estimated fees, which are average figures for industry expenses, she said.

"The Gold GIPS talk is about bundled fees, which are applicable in the wrap area," she noted, adding that these are among other potential changes coming down the pike in the ways that SMAs are handled.

Eric Baum is a freelance writer living in Moscow. He was a senior reporter for Institutional Investor, has been published in The New York Times and Forbes and has worked as a registered rep for John Hancock Securities. He can be reached at edbaum@aol.com.

http://www.thomsonmedia.com http://www.mmexecutive.com

Eric Baum