

July 11, 2005

Mr. James Hollis  
Chair  
Investment Performance Council  
CFA Institute  
560 Ray C. Hunt Drive  
Charlottesville, VA 22903

Dear Jamie:

The Money Management Institute is thankful for your willingness to receive additional comments on the IPC's wrap fee/Separately Managed Account (SMA) Provisions and Guidance for the GIPS Standards prior to its submission to the CFA Institute's Board of Governors. MMI applauds the IPC for incorporating many of the comments we submitted to the IPC on the proposed wrap fee/SMA Guidance Statement. However, we believe that there are several areas to be further addressed to enable investment firms claiming AIMR-PPS/GIPS compliance to manage wrap fee/SMA portfolios. We suspect that some of MMI's recommendations are the result of drafting inconsistencies, not the result of fundamental disagreements. However, we are concerned that some are the result of the IPC's desire to require investment firms that manage wrap fee/SMA portfolios to comply with more burdensome requirements than other investment firms. Attached is a clean and black lined copy of our suggested changes. Specifically our changes relate to four different areas as explained below.

**Firm Definition** – In several areas of the Guidance Statement, the IPC makes it mandatory that an investment firm to define itself as a division, the division must have “autonomy over the investment decision-making process”. (see p. 5 “Definition of Firm” first paragraph, p. 14 Question 5 first paragraph) The language MMI submitted included the phrase “should have” which is word for word identical to the IPC's *Guidance Statement on Definition of the Firm*.<sup>1</sup> We are concerned that the IPC is creating a higher standard for an investment firm that manages wrap fee/SMA portfolios to define itself into one or more divisions than other investment firms that do not manage wrap fee/SMA portfolios. We

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<sup>1</sup> The IPC rejected the notion that a firm that holds itself as a separate entity yet does not maintain its own distinct investment process may not be defined as a firm. The IPC's proposed Firm Definition Guidance Statement initially had a guiding principle that required the firm to be a “distinct entity with its own distinct investment process.” See Firm Definition Guidance Statement (Adopting Release), p. 4. The IPC ultimately removed this principle in response to commenters' opposition to the principle.

hope that this is an oversight by the IPC since the mandatory requirement that a “division” have an autonomous investment decision-making process is inconsistent with the IPC’s response to Question 5 in the Guidance Statement. Question 5 states “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.”

**Net-of-Fees Performance Presentation to Wrap Fee/SMA Clients** - Proposed Standard 8.A.5. second bullet requires that if a sponsor-specific composite presentation does not include performance net of the entire wrap fee, then the firm must disclose that the named sponsor-specific presentation is only for the use of the named wrap fee/SMA sponsor (also discussed on p. 10 “*Wrap Fee/SMA Results for Existing Wrap Fee/SMA Sponsors For the Purpose of Generating Additional Business ...*” second paragraph.) This is not consistent with the Guidance Statement’s discussion on page 6 which permits the presentation of a wrap fee/SMA composite to clients other than wrap fee/SMA prospects, to be presented net-of-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. It is our recommendation that either the language included on page 6 be incorporated into proposed Standard 8.A.5 or Standard 8.A.5 be clarified that the required disclosure restriction on performance use be applicable only when delivered by the wrap fee/SMA sponsor to prospective wrap fee/SMA clients. This is important, since numerous wrap fee/SMA sponsors collect performance information to be presented by the wrap fee/SMA sponsor to prospective clients that are interested in retaining the investment firm for non-wrap fee/SMA portfolio investment management.

**Shadow Accounting** – MMI disagrees with the definition of “shadow accounting” set forth in footnote 2. What is disturbing is that the definition espoused by the IPC has never been open for industry comment or been discussed with the MMI whose members actually perform shadow accounting. We believe that the MMI’s description is appropriate. Ultimately, each firm will need to determine what are appropriate records to shadow when the firm opts to engage in shadow accounting to comply with AIMR-PPS/GIPS. The IPC should not through a footnote establish an indirect standard of appropriate “shadowed” records.

**Records** – MMI believes that the IPC’s position concerning the inability to obtain or have access to supporting records from wrap fee/SMA sponsors, despite Question 6 guidance, will force many investment firms that are unable to create a wrap fee/SMA division that does not claim AIMR-PPS/GIPS compliance to drop all claim of AIMR-PPS/GIPS compliance. The position taken by the IPC is draconian since it enables a wrap fee/SMA sponsor, refusing to deliver or give access to, performance records to determine whether an investment firm that manages wrap fee/SMA portfolios may claim AIMR-PPS/GIPS compliance. Numerous wrap fee/SMA sponsors will not give, or give access to, records that support wrap fee/SMA portfolios performance. In addition, because of the number of wrap fee/SMA portfolios typically managed by an investment firm, the cost of shadow accounting is un-economical in light of the small fees investment firms are paid for managing wrap fee/SMA portfolios. Furthermore, it is *impossible* for many firms now claiming AIMR-PPS/GIPS compliance to achieve shadow accounting capabilities by the January 1, 2006 effective date. Investment firms will not be able to obtain, install and test

required systems, hire appropriate staff, and compliance test within the less than five month period given by the IPC to implement shadow accounting. MMI's approach is reasonable and virtually identical to the CFA Institute's current position concerning lost records. The CFA Institute currently permits an investment firm to continue its claim of AIMR-PPS compliance when underlying data substantiating performance is not available due to extreme circumstances beyond the investment firm's control and such circumstances are not the result of: (i) lack of investment in appropriate systems to evaluate or re-create the performance calculation; (ii) financial costs of locating or recreating the data; (iii) an intent to improve one or more account's performance; and (iv) the absence of such records is disclosed. MMI's proposal is consistent with their requirements, and obligates the investment firm to use all reasonable efforts to obtain the records with cost not a factor. MMI requests that the CFA Institute restore its proposed language to the Guidance Statement.<sup>2</sup>

**Effective Date** – A January 1, 2006 effective date is unreasonable and shows the continuing lack of understanding by the IPC of the complexity of the wrap fee/SMA business as it relates to performance. The CFA Institute staff's reason for not delaying the effective date is fallacious. MMI is told that the January 1<sup>st</sup> effective date cannot be delayed because it is tied to the effective date of the adoption of "Gold" GIPS. However, other CFA Institute Guidance Statements have been delayed and effective way beyond January 1<sup>st</sup>. The CFA Institute has recently delayed, in response to industry comments, the effective date of both the treatment of cash flows and mandatory verification to January 1, 2010 or later. This is another example of the IPC treating investment firms that manage wrap fee/SMA portfolios differently from other investment firms. As we have repeatedly told the IPC, the MMI is working on an industry wide effort to standardize, systematize and streamline recordkeeping and other important aspects of the wrap fee/SMA industry that will solve many of the issues raised by MMI and others with the IPC. MMI requested that the effective date be delayed until at least 2008, and preferably 2010, as the CFA Institute has done for cash flows and mandatory verification.

Until the issues raised in this letter can be addressed through cooperation, communication and dialogue, MMI cannot and will not support and will both privately and publicly oppose the CFA Institute's investment performance efforts. MMI is willing to continue to cooperate and work for the betterment of the investment profession, but it will not continue this approach if the IPC and CFA Institute continue their process of imposing more

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<sup>2</sup> The CFA Institute recognizes that there may be situations where a firm does not have the underlying data to support the performance and that such absence of records should not prevent a firm from claiming AIMR-PPS compliance. The CFA Institute states that the *only* reason a firm can use as a basis for not fully complying with the Standards is "the absence of underlying records." (AIMR-PPS Q&A, Question: "Our bank was very close to completing a lengthy..."[Source: AIMR List of 75 Questions and Answers, 1994], AIMR-PPS Q&A Database [available at: <http://www.cfainstitute.org/programs/standards/pps/faqs/>]). In addition, the CFA Institute clearly states that "if a firm does not have records to substantiate performance after 1993 or 1994 [the AIMR-PPS effective dates], it could come into compliance if the lack of records is disclosed."

restrictive performance requirements on investment firms that manage wrap fee/SMA portfolios differently than other investment firms.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Janet Mariconti". The signature is written in a cursive, flowing style.

Janet Mariconti

Chair, CFA Institute Liaison Committee

Cc:

Alecia L. Licata, Director, Investment Performance Standards, CFA Centre for Financial Market Integrity

Jeff Diermeier, CFA, President and CEO, CFA Institute