



Performance Perspectives

with David Spaulding

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Since 1990, The Spaulding Group has had an increasing presence in the money management industry. Unlike most consulting firms that support a variety of industries, we focus on the money management industry.

Our involvement with the industry isn't limited to consulting. We're actively involved as members of the CFA Institute (formerly AIMR), the New York Society of Security Analysts (NYSSA), and other industry groups. Our president and founder regularly speaks at and/or chairs industry conferences and is a frequent author and source of information to various industry publications.

Our clients appreciate our industry focus. We understand their business, their needs, and the opportunities to make them more efficient and competitive.

For additional information about The Spaulding Group and our services, please visit our web site or contact Chris Spaulding at CSpaulding@SpauldingGrp.com

<http://www.SpauldingGrp.com>

New Guidance Statements (continued)

In the November issue, we mentioned that there are five new guidance statements available for public comment (see (http://www.cfainstitute.org/standards/pps/gips_status.html)). And, we touched on two of these: verification and leverage & derivatives. Now, we'll touch briefly on the remaining three.

Draft Guidance Statement – SMA/Wrap Fees

First, a brief explanation: SMA = Separately Managed Account. This is the term that the wrap fee industry apparently prefers over the term, wrap fee. There will no doubt be some confusion, however, as not all separately managed accounts are wrap fees. Never the less, this guidance addresses those accounts where the fees are bundled, and where these fees can include any combination of management, transaction, custody, and other administrative fees. Also, in this program, the manager typically does not have a direct relationship with the client – rather, the program sponsor handles this. One such type of fee is called an “All-In-One” fee, which some European countries have. This guidance doesn't apply to those but rather to wrap fee programs.

Roughly two years ago, the AIMR-PPS[®] Implementation Committee offered guidance on wrap fees. It was met with a rather painful response from the industry (over 60 responses were received). The MMI (Money Management Institute), which is a membership group of wrap fee sponsors and managers, led the criticism of what was offered. The general sentiment seemed to be that what was proposed was neither achievable nor realistic.

The sad truth is that many programs do not provide their managers with the details of the underlying accounts, thus making the ability for these managers to have the requisite details for compliance with the AIMR-PPS and/or GIPS[®] difficult, if not impossible. One attraction of these programs to managers is the volume of assets that they can bring to the manager, without the extensive administrative overhead. The fees they receive may be lower than what they would typically charge, but this is offset by the reduced costs. If the sponsor doesn't provide the details, the manager might “shadow” the accounts. However, this now introduces a significant cost, making the justification for their participation in the program questionable.

Upon reading the outpouring of critical comments, the committee decided to revisit this topic. We spent close to two years reworking the document.

Now, you might ask, “so why didn't the AIMR-PPS Implementation Committee

once again send it out for comment?” Good question. There are at least three reasons for this. First, we’re moving towards *convergence* with the GIPS standards. Therefore, we want to reduce the differences between the AIMR-PPS, which is a *country version of GIPS* and GIPS itself. Second, if we had submitted it on our own, we would still require the approval of the Investment Performance Council (IPC), so there is reason to start off with their *de facto* backing, through the release of this document. And finally, North America is no longer the only place where such programs are offered. We understand that Japan and the UK are now offering wrap fee programs, so this is a potential global issue. Thus, making it part of GIPS makes a lot of sense.

This guidance relaxes some of the previous requirements. One option is to view the *sponsor* as the client. This would allow the firm to have a *single account*, which would represent the entirety of accounts within the style for that sponsor. The firm could rely upon the sponsor’s stated return for the manager. The firm needs to insure that what’s provided meet the rules of the presentation standards however. Also, you might want to insure that your compliance officer is comfortable that this will meet the requirements of the SEC.

One potentially controversial aspect of this guidance is the allowance for firms to have non-compliant information pre-January 2006. The AIMR-PPS originally required compliance as-of 1 July 1995,¹ this is a pretty significant shift. The committee basically realized that having the details has been virtually impossible for many firms who want to include their wrap fee accounts within their firm definition. It also states that effective January 2006, firms have to have the details.

The reality is that many firms may opt in the end to exclude the wrap fee accounts from their firm definition, since they’re permitted to present the institutional returns (which are often what is used to initially promote their performance to potential wrap fee program sponsors) as supplemental information, they aren’t losing that much by taking this action.

If this guidance applies to you, make sure you review it. We’re hopeful that this will be much more warmly received by the industry. You only have a few more days to comment on this, however, as the public comment period ends 31 December 2004.

Draft Guidance Statement – Record Keeping

While the U.S. Securities & Exchange Commission has been generally pretty good about laying out what a manager is required to keep to support their stated returns, this isn’t true everywhere. So, the IPC’s Interpretations Subcommittee developed this guidance to assist firms in deciding what records are needed.

Although we’re often tempted to believe what is written down, we have all come to realize that it’s not always accurate. A manager should be able to substantiate what they report. But what do they need?

One might think that their computer records are satisfactory. But, these records are, in essence, self-developed. We would want to see records from independent, third parties. For example, brokerage and/or custodial statements. These can be hard copy or electronic. Other records may also be required, such as portfolio lists, transaction report, outstanding trade reports, corporate action reports, income reports, accrued income reports, tax reclaim reports, and fee information.

This guidance should be very helpful for GIPS compliant firms to develop Policies & Procedures for record keeping, as well as to insure they have everything they require.

This document, too, is open to public comment for only a few more days: 31 December 2004.

Draft Guidance Statement – Error Correction

This document, like the Record Keeping guidance, is helpful for firms to develop policies and procedures. The earlier

¹ See AIMR Performance Presentation Standard Handbook, Second Edition (1997), page 4.

work done by the Performance Measurement Forum² and published in *The Journal of Performance Measurement*³ was the initial basis for this document. The article addressed both portfolio- and composite-level return information, while the guidance is limited to composites.

The key goal is for firms to develop policies and procedures for defining *when* they will

- a. go back and adjust returns
- b. notify recipients of reports with corrected returns

when they discover problems with previously calculated and/or reported figures.

And, a key aspect of this is the issue of *materiality*. How *material* must a change be to go through this exercise? We recognized that materiality can vary, from asset class to asset class. Therefore, some thought is required.

Please take the time to review this document and see how it can help you develop your P&P on it. You have until 28 February 2005 to comment.

Performance Attribution Survey

We have recently completed our second survey on performance attribution. The results have been compiled and the report will shortly be at the printers. Next month, we will hold two luncheons to present the results (London - 18 January; NYC - 21 January). We thank our cosponsors (**Russell/Mellon Analytical Services, StatPro, Eagle Investment Systems, ORTEC, Financial Models, Wilshire Analytics, and First Rate Investment Systems**) for their support.

In our next issue, we'll touch on some of the key findings. If you'd like a copy of the report, please contact Sue Kneller (SKneller@SpauldingGrp.com) for information.

² The Performance Measurement Forum is a membership group, organized by The Spaulding Group, which meets twice a year in North America and twice a year in Europe. For information, contact Patrick Fowler. (PFowler@SpauldingGrp.com).

³ See "Adjustments to Prior Period Returns," by David Spaulding and Stefan Illmer, Summer 2003, pages 11-18.

This newsletter is produced by TSG Publications. It is written and edited by Dave Spaulding. The opinions expressed are his and are a result of his own industry experience. Content layout by Sabina T. Hastings.

Internet Spam

I don't know about you, but my volume of spam has grown to a point of being completely unbearable. I was getting 150-200 such messages on a daily basis. These messages, many suggesting that a particular physical aspect of my body needed adjustments and others implying that since I'm now over 50, I need a drug to aid me with a particular activity, were just too much for me to handle.

I tried multiple times to get my ISP (Internet Service Provider) to enhance their screening facility, but to no end.

Brian Rom of Investment Technologies turned me onto ChoiceMail by Digiportal (<http://www.digiportal.com/>). It keys off of a *white list*, which is a list of e-mail addresses you've indicated you're willing to accept messages from. This list can be simply your e-mail directory, which can be fairly easily transferred to the software.

So, you ask, what if someone e-mails you that is not on the list? Well, the message is stopped and the sender is asked to respond to a brief inquiry, which is then transmitted to you for approval, the idea being that spam generators won't be able to respond to such a request, and will therefore fail.

I installed a test version just a week ago. Roughly a half dozen e-mails have come in that needed me to bless before actually hitting my inbox. But, the spam is gone! Completely!

If you're experiencing any degree of spam that you feel is uncomfortable, perhaps you'll want to consider this software.



On behalf of my associates, we wish you a Merry Christmas, Happy Holidays, and a wonderful New Year!

UPCOMING TRAINING DATES

INTRODUCTION TO PERFORMANCE MEASUREMENT

<u>LOCATION</u>	<u>DATES</u>
Chicago, IL	January 11 - 12, 2005
New York City, NY	January 24 - 25, 2005
Sydney, AU	February 24 - 25, 2005
Boston, MA	March 8 - 9, 2005
San Francisco, CA	April 19 - 20, 2005

Receive 15 CPE Credits for attending this Two-day class!

PERFORMANCE MEASUREMENT ATTRIBUTION

<u>LOCATION</u>	<u>DATES</u>
Chicago, IL	January 13- 14, 2005
New York City, NY	January 26 - 27, 2005
Boston, MA	March 10 - 11, 2005
San Francisco, CA	April 21 - 22, 2005

Receive 11 CPE Credits for attending this One and a Half day class!

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