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Today's Issue

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Managed Acct Standards Come Under Fire

By Thomas Coyle

Now that all the [comments](#) are in, the [CFA Institute](#)'s **Investment Performance Council** (IPC) seems to have won few converts in its latest attempt to set standards for reporting separately managed account (SMA) performance. Industry participants, especially managers, see the new guidelines as imprecise and unworkable. Observers from outside the U.S., meanwhile, accuse the Charlottesville, Va.-based CFA Institute – formerly the **Association for Investment Management and Research**, or AIMR – of bending globally applicable standards with “overly prescriptive guidance reflecting U.S. markets” alone.

An IPC member did not return calls by press time.

The comment period for the guidelines – issued late in October 2004 – ended last Wednesday after an extension from its original December 31, 2004 cutoff. Though most submissions took exception with parts of the guidelines, the IPC has only 15 comments to wade through this time. The last time it issued guidelines, in July 2002, it elicited 57 comments, most of them negative. Though the CFA Institute won't come out and say it, that reaction is widely thought to have sent the IPC back to the drawing board to emerge, over two years later, with the guidelines now on show.

Some of those who submitted comments in the latest round complain that the new guidelines still don't reflect the realities of the industry. The [Investment Counsel Association of America](#) (ICAA), a Washington, D.C.-based association for investment advisors, spells that out in the first paragraph of its comment. “We remain concerned that many of the key issues we raised in our comment letter in 2002 have not been addressed,” writes ICAA counsel **Monique Botkin**. [Northern Trust Value Investors](#), a West Palm Beach, Fla.-based asset management unit of [Northern Trust](#), goes further in suggesting that the new guidelines adhere too closely to the old. The body of its December 30, 2004 comment is a word-for-word reproduction of the letter it sent on October 22, 2002.

But most of the fresh comments acknowledge that the latest guidelines attempt to redress some of the points that vexed letter writers in 2002. The trouble is, they don't do it clearly or comprehensively enough, say critics.

The **Money Management Institute** (MMI), the Washington D.C.-based industry association for the SMA industry, seems to approve of the IPC's new "carve out" provision. That allows managers who find the performance standards too onerous to create separate "firms" to house their non-compliant managed account practices without endangering their compliance standing in the institutional space. But the MMI wants clarification on several important points. Does the carve-out provision require a manager's SMA business to "be organizationally and functionally segregated from other units," have autonomy over the "investment decision-making process," and "hold itself out to the public as a separate firm," or can it meet the IPC's definition of a separate firm "solely based on managing a distinct business product"?

Asset manager **Pimco Advisors** also wants the IPC to clarify its stance on carve-outs, calling for "more flexibility with regards to firm definitions and the ability of firms to use historical institutional composite performance [data] relating to the same investment strategy as the SMA product." Without that concession, write Pimco COO **Zinovia Spezakis** and performance and analytics manager **Sophie Wang**, it would be hard to launch new SMA products, since they're typically sold with reference to the performance of identical strategies on the institutional side.

In addition, the MMI questions the IPC's insistence that managers show clients and prospective clients performance composites "across SMA programs." In fact, writes **Janet Mariconti**, chair of the MMI's AIMR Liaison Committee and a senior v.p. with **Prudential Investments**, "Certain SMA program sponsors refuse to allow or prohibit [managers] from including in their composites the performance of accounts representing the same strategy of competitor SMA programs." To get around that, the MMI supports allowing managers to present prospective clients with information – a Web site address or telephone number – that shows composite information, and allowing them to do it before they actually start managing the client's money.

The MMI also sees folly in the IPC's requirement that managers get standards-compliant records from sponsors. "To date, we are unaware of any SMA sponsor agreeing to represent that they maintain records required by a [manager] to claim" compliance, writes Mariconti.

Instead, the MMI proposes that managers be able to perform "shadow recordkeeping" as a proxy for the information that the sponsor can't or won't share, and use the sponsor's records only if "they have written assurance" that the sponsor is in compliance. As an alternative, the MMI suggests that the IPC regard SMA records as it does those of "pooled funds" – mutual funds, unit investments trusts, hedge funds, for example. That way, SMAs could be treated as separate composites. "For performance reporting purposes, SMAS are similar to pooled funds," Mariconti writes. "The sponsor, similar to a manager of managers, selects the [management firms] that

participate in the SMA program, the SMA sponsor maintains records, and each SMA program reports to each [manager] their historical performance.”

Meanwhile several managers say that shadow accounting isn't a practical way for managers to replicate records that sponsors are reluctant or unable to share. “Shadow accounting is not feasible as investment managers are already operating under increasingly tighter margins and can not bear these costs on a profitable basis,” writes Northern Trust Value's COO **Melinda Mecca** .

A couple of program sponsors weighed in as well, zeroing in on the IPC's requirement that managers either show gross-of-fees performance that reflects trading costs or leave the entire bundled fee in its calculations. “We have begun conducting some research as to how we will identify exact transaction costs and apply it to gross-of-fee performance calculations,” write **Piper Jaffray** due diligence analysts **Eric Hayne** and **Matt Dmytryzyn** . But they concede that they might not be able to figure it out – and they doubt many other SMA sponsors will be able to either.

“This will likely result in all investment management firms showing the bundled fee” – a good 2.5% or more, putting gross-of-fee returns roughly on par with net-of-fee returns. “We don't believe this provides an accurate representation of gross performance.” **A.G. Edwards** makes a similar point about the difficulties sponsors – let alone managers – have in unbundling SMA fees.

Almost all comment letters want a push-out of the IPC's proposed effective date of January 1, 2006. Some want a year more; the MMI wants four years, but it will accept two. Writers say the delay is necessary, either for better industry-wide communication systems to come on line, or for individual managers to get their houses in order. Referring to the Herculean task of securing back-up data from all the SMA sponsors it deals with – assuming it *can* be got – Kayne Anderson Rudnick's **Amanda Mar** writes, “It is unrealistic to expect that all of the work can be completed in a year without taking significant risk of partial compliance and incomplete recordkeeping.”

Overseas observers, meanwhile, seem alarmed at what they view as the IPC's willingness to subvert global standards to the requirements of the U.S. marketplace. “The purpose of the guidance seems to be to help the SMA industry in the U.S. by softening” the rules, says an unsigned comment from the **Security Analysts Association of Japan** . That, the association complains, “may adversely affect practices in other local markets with different business circumstances.”

The **Swiss Bankers Association** takes a similarly hard line. Though it notes that SMAs “have some peculiarities,” it insists that “they share the vast majority of practices with classical institutional management.” So it supports the latest IPC guidance as “as correctly applying existing” investment

performance reporting standards to SMAs.

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