



September 24, 2001

Professional Standards and Advocacy
AIMR
P.O. Box 3668
Charlottesville, VA 22903

Dear Sir or Madame:

Thank you for allowing us to comment on the proposed Guidance Statement on the Treatment of Significant Cash Flows (Guidance Statement). Our comments are as follows:

1. We believe that the use of Temporary New Accounts is the best method for dealing with portfolios that have significant cash flows. However, we acknowledge that many firms wish to have an alternative method for handling portfolios with significant cash flows. We support a strict set of rules that a firm must adopt if they wish to follow such a policy, with a focus on required, consistent application and full disclosure of policies and the impact on composites.
2. One of the key concepts of the Guidance Statement is the use of a Grace Period. The Grace Period is defined as the length of time a new portfolio is allowed to be excluded from the appropriate composite, to allow the firm to fully implement the intended strategy. The Guidance Statement states that a firm that excludes portfolios from a composite due to a significant cash flow must treat the account as equivalent to a new portfolio, and re-include it in the composite in accordance with the composite's established Grace Period.

We believe that a new portfolio is different from a portfolio that has experienced a significant cash flow, and thus should not be treated in the same manner. A new portfolio will typically start with 100% cash, or a portfolio of securities that may need to be completely changed. Time is needed to invest the entire portfolio, and a Grace Period allows a firm to invest the portfolio in the intended style. In contrast, a portfolio with a significant cash flow is already invested in the style. For a certain period, the portfolio will be impacted by the significant cash flow, resulting in a temporary non-fully discretionary status. However, the time period needed to handle the significant cash flow is typically much shorter than that needed to invest a new portfolio. Following the Grace Period re-inclusion rule may result in excluding the portfolio for longer periods than is necessary to not impact the composite.

For example, let's assume that the Equity Composite includes new portfolios after the first full month under management. On August 5, ABC Portfolio, a member

of the Equity Composite, experiences a significant cash flow, and is removed from the Equity Composite for the month of August. Following the Grace Period, ABC Portfolio would also be excluded from the Equity Composite for the month of September, and would not be re-included until October. More than likely, the month of September's performance would not be impacted by the August 5th cash flow. This situation would be even more exclusionary if a firm's inclusion rule for new portfolios was after a longer time period than one month.

We would rather see a firm re-include a portfolio as soon as possible, and minimize the amount of time it is excluded from the composite. We suggest that the Guidance Statement be changed to allow a firm to exclude a portfolio only for the period in which the significant cash flow occurred.

3. We believe that the Guidance Statement should explicitly state that a firm must implement this policy firmwide, but then may choose criteria for each composite. If a firm is allowed to apply this Guidance Statement to selective composites, perhaps based on the liquidity of the asset classes, the firm would need to continually assess which asset classes are considered non-liquid. As a result, there may be a lack of consistency in applying the Guidance Statement to a specific composite due to changing market conditions. Additionally, firmwide implementation would prevent selective use of this policy, which may be misleading to a reader of several compliant presentations from one firm.
4. Firms should be aware that by implementing this policy they risk losing a small composite's linked history. For example, if a composite includes only 2 portfolios, and both portfolios experience significant cash flows in the same month, the history of the composite would stop, and could not be linked to the performance of the composite once the portfolios are re-included in the composite. This is even more of a risk for composites that are composed of only one portfolio.
5. Under the heading "Documentation", 5 items are listed that must be tracked for each portfolio that experiences a significant cash flow. Item number 5 is "the amount of the cash flow as a percentage of the most recent composite market value." We suggest removing this requirement, as it has no bearing on the temporary removal of a portfolio. The information would also not be useful, and might be misleading, as the cash flow may be a very significant percentage of the portfolio, but a completely insignificant percentage of the composite, if the composite is very large and the portfolio is very small.
6. Under the heading "Disclosures", 4 items are required to be disclosed. It continues to say "In addition, upon request, the firm must disclose to clients the number of times portfolios were removed in a given period,..." We suggest two changes. First, a reader of the presentation would not know that additional information about portfolios with significant cash flows is available, therefore a firm should be required to disclose that additional information about the treatment

of portfolios with significant cash flows is available upon request. Secondly, the sentence states that the firm must disclose “to clients”... We believe the words “to clients” should be removed, to clearly indicate that such information must be made available to any reader that requests such information.

7. We suggest an implementation date of 1/1/02. By choosing a standard date for all firms, readers of compliant presentations would have a better basis for comparability.

Again, thank you for the opportunity to comment.

Sincerely,

Karyn D. Vincent, CFA
CAPS, Inc.