



To: Dwight D. Churchill, Chair, AIMR Board of Governors  
AIMR Board of Governors  
*Financial Analysts Journal*

From: Bruce I. Jacobs, Ph.D.  
Member, AIMR  
Principal, Jacobs Levy Equity Management

In re: Letter to the Editor Submission to *Financial Analysts Journal*

Date: November 21, 2002

In June 2001, I submitted a letter to H. Gifford Fong, then *Financial Analysts Journal (FAJ)* Editor, which corrected certain misstatements about securities law made by Book Review Editor Martin Fridson in his piece "Postscript: Reviewer's Response" (*FAJ*, May/June 2001). Editor Fong, with the involvement of AIMR Senior Vice President Katrina Sherrerd,<sup>1</sup> declined to publish my June 2001 letter, saying that sufficient space had already been devoted to the subject. It should be noted that the subject involves portfolio insurance products. As Gifford Fong Associates sold such products, and appears to have violated legal disclosure standards in its marketing of them,<sup>2</sup> Editor Fong's decision not to pursue the subject might be construed as a result of conflicted interest. Furthermore, newly named Editor Robert Arnott, while with Salomon Brothers and TSA Capital Management in the 1980s, was involved with portfolio insurance (see also his article with Roger Clarke in the November/December 1987 issue of *FAJ*); this involvement may be perceived as a conflict of interest that would disqualify him from vetting the enclosed Letter to the Editor.<sup>3</sup>

I am therefore submitting the enclosed Letter to the Editor to you, as a representative of AIMR and the *FAJ*. The enclosed letter updates the June 2001 letter to reflect subsequent events. Like the earlier letter, this one corrects the misstatements of securities law. It also points to a conflict-of-interest problem at *FAJ*, where an editorial board member with financial interests in a product was allowed to influence coverage of that product in the pages of *FAJ*. As these issues involve *FAJ* governance and, ultimately, AIMR governance, they should be of interest to you.

At the time I wrote the previous letter, I found it troubling that Editor Fong decided to truncate the discussion at what I think you (upon reading the enclosed letter) will agree is a critical juncture. This decision left *FAJ* readers under the false impression that disclosure by investment managers is adequate so long as "sophisticated investors who know the right questions to ask" would not be misled. *FAJ* has done nothing to date to correct the record. It is important that AIMR members understand that *caveat emptor* is not the correct standard for investment advisory disclosure. Rather, securities law and AIMR standards mandate *full disclosure*. That is, the onus is not on the prospective client "to ask the right questions," but rather on the investment advisor to disclose the investment risks.

While Editor Fong decided that this correction was not worth publishing, *Pensions & Investments* decided otherwise. *P&I* published two pieces that investigated the goings-on behind the scenes. I was quite disturbed to read there that a member of the *FAJ* Editorial Board with direct financial interests in portfolio insurance was allowed to influence coverage of that product in the pages of *FAJ*.

It is my understanding that AIMR and *FAJ* are striving for "best practice" in the area of conflicts of interest. In that regard, it may be useful to see how other professional journals have handled disclosure to their readership of violations of conflict-of-interest standards. I recommend the following: the "Correction" regarding "Pertussis Vaccine Encephalopathy" in the *Journal of the American Medical Association (JAMA)* (April 25, 1990); the "Pertussis Vaccine Encephalopathy" letters and associated "Editorial Note" (*JAMA*, November 14, 1990); "Conflicts of Interest in the Publication of Science" (*JAMA*, July 10, 1991); "Editorials and Conflict of Interest" in the *New England Journal of Medicine (NEJM)* (October 3, 1996); "Authors' Conflicts of Interest: A Disclosure and Editors' Reply" (*NEJM*, November 18, 1999); "Disclosure of Authors' Conflicts of Interest: A Follow-Up" (*NEJM*, February 24, 2000); "Conflict of Interest: NEJM Admits Breaking its own Tough Rules" (*Science*, March 3, 2000); and "Disclosure of Authors' Conflicts of Interest--A Follow-Up" (*NEJM*, July 13, 2000). (For your convenience, I would be pleased to provide you copies of these pieces.)

In addition to publishing my letter, I think the *FAJ* should discuss this recent affair in the journal itself, much as the *NEJM* and *JAMA* have done as a matter of disclosure and transparency. This would clear the record and allow the *FAJ* to proceed with a clean slate.

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1. Ms. Sherrerd's opinion may be gathered from her statements to the *Wall Street Journal* (September 13, 2002), where she said that the reviewer "apparently got feedback from a number of people and revised his opinion." But this whole affair is not just a matter of opinion; rather, it is a matter of misstatements of law and violations of AIMR standards of conduct.
  2. At least one of Gifford Fong's articles (published in the March/April 1989 issue of *FAJ*) presents simulated results without disclosing model limitations. As the article is posted on the Gifford Fong Associates' website, it could be considered by the SEC as an

advertisement and, as such, would appear to violate federally mandated requirements as well as AIMR Standards of Professional Conduct governing the presentation of model results. (See also "An Open Letter to AIMR and *Financial Analysts Journal*," October 1, 2001, at <http://www.cimrbook.com/cimr/ethicalissues.html>). Furthermore, Gifford Fong Associates' ADV filings describe its portfolio insurance products with terms such as "guaranteed minimum" return and "insures a minimum return," which language and description would appear to be misleading and therefore a violation of securities law, as well as a violation of AIMR Standard of Professional Conduct IV(B.6), which "prohibits statements or implications that an investment is 'guaranteed' or that superior returns can be expected in the future based on the member repeating past successes."

3. While I have no reason to question Editor Arnett's professionalism and integrity or his ability to adjudicate this letter, in view of the long history of this matter and best ethical practice, he ought to be recused.

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