June 3, 2009

Re: GIPS 2010 Exposure Draft

Dear Members of the GIPS Executive Committee:

I greatly appreciate this opportunity to comment on the proposed changes to the Global Investment Performance Standards (GIPS®). Thank you for your contributions to the industry. I know that many, many hours went into this document and congratulate you for your efforts.

The proposed changes far exceed what I would have expected for a document which has existed since the 1990s. In several instances the changes make compliance more difficult, complex, and costly, thus creating a challenge for many firms, especially during our current economic times. And while the economy was much better when these changes were crafted, the committee should be ever mindful of the impact the changes will have on the organizations that have adopted them.

As I always do, I will be candid in my remarks. You will see (and perhaps have already seen through my newsletter) that I find much of what is contained in the document objectionable. But there is also much that I agree with. I hope that my words are not taken in an offensive manner for that is not my intent. I consider you to be friends and colleagues who I respect greatly. Few recognize the many, many hours that go into this effort, which is unfortunate. And while we might disagree about various items, know that I hold you all in high esteem.

Items slotted to go into effect 1 January 2010

While you haven't specifically requested comments on what will soon be a set of new requirements. I'd like to take this opportunity to never-the-less express my thoughts on a couple items.

<u>Elimination of the ability to allocate cash for carve-outs</u>

As you know, I was a member of the predecessor organization (Investment Performance Council (IPC)) that worked on the current edition of the standards. The original target effective date was 1 January 2005; however, because of the monumental amount of work that had to be done, we shifted it to 1 January 2006. The first edition of the standards had a few items that were set to go into effect 1 January 2005: one of these was the elimination of the ability for firms to allocate cash for carve-outs. However, because of the vast amount of opposition to this planned change, we shifted the effective date to 1 January 2010. So we established a precedent whereby we could shift a change that was taking place in advance of the effective date of the next edition.

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If you check my remarks on the earlier draft you will see that I (a) also opposed this change to carve-outs[1] and (b) favored extending the effective date indefinitely, not just for five years. Because of the actions taken at that time, I (and I'm sure others) fully expected to have the opportunity to once again comment on this item in the hopes that it would be shifted again. The EC chose, however, not to solicit such comments, in spite of the precedent that had been established. This was unfortunate as there are many firms that still oppose this change. I'm aware of a few firms that have decided to discontinue their compliance with the standards simply because of this item and many others who are struggling in trying to find a realistic way to continue with carve-outs while managing cash separately.

Error correction guidance

As I suspect you are also aware, I was on the Interpretations Subcommittee that worked on the original draft for the Error Correction Guidance Statement.[2] This document was originally slated to go into effect several years ago, however during the transition from the IPC structure to the EC, it was delayed for some reason.

The new Interpretations Subcommittee apparently decided to reconsider various aspects of this document. The resulting document went into effect last year. It included a requirement that firms disclose any material changes to a composite for a period of at least one year.

There are numerous reasons why I object to this. I will save my specific objections to the change until later in this document (see 4.A.28 on page 10).

- There had been another precedent that when, as a result of feedback from the public, a draft document undergoes material changes, a subsequent review will be conducted, allowing the public the opportunity to comment once again before the document goes into effect.
- This document contains a requirement. I was told it revised a recommendation from the original document. However, I don't see it that way. The item in question appears on the very last page in a response to a question. I don't recall ever having seen this but no doubt did; but, at the time it obviously didn't strike me as being exceptionally noxious. What is troubling in looking back is that there is absolutely no basis for the response as there is nothing to support it within the corpus of the document itself. And while compliant firms are obligated to adhere to Q&As, one would expect that they be based on something within a document rather than something that is totally dreamed up.
- I was under the impression that the EC had agreed not to introduce requirements within a

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[1] I will not bother to express my reasons here, as they haven't changed and have been previously documented

[2] As I recall, I actually wrote the first draft of the document, which was based on an article that Stefan Illmer and I wrote for *The Journal of Performance Measurement*.

guidance statement; these documents are to provide guidance on existing requirements. The introduction of a requirement here therefore runs in conflict with this belief: and so, either I was mistaken or the EC decided to make an exception. The result that many firms are unaware of this change since it was encompassed within a guidance statement which would easily have been overlooked.[3]

- The introduction of a requirement following the distribution of a draft surely constitutes a material change. This document should have therefore been distributed for a second review. However, the EC apparently decided to introduce a new requirement without soliciting feedback and to make the change effective in such a way that no change could be made. Perhaps this was done because it had taken so long for the document to be finalized that it was rushed through. Such action is especially troubling for it suggests that the EC will take such action in the future, thus avoiding the need to hear comments from the public. I would hope that this was seen as a mistake and that such an event will not occur again. I encourage the EC to reconsider this action and immediately withdraw the current guidance document and resubmit it to the public for comment so that the change will not take effect at the beginning of next year. Otherwise, you will no doubt hear criticism of the associated change that now appears in the new edition, thus having to consider eliminating it for 1 January 2011 while the requirement has already existed.

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Note that I won't comment on everything as a great deal is being changed. However, you can assume that in the absence of a comment that I either (a) agree or (b) simply don't have an opinion.

0.A.2. FIRMS MUST be defined as an investment firm, subsidiary, or division held out to clients or PROSPECTIVE CLIENTS as a DISTINCT BUSINESS ENTITY.

The change to "fair value" is not an insignificant one and worthy of discussion. While the hierarchy that's provided is helpful, the impact on the industry's ability to respond is one that's unclear to me. Note that the footnote applies to this paragraph and it's a bit ambiguous.

0.A.5. Changes in a FIRM'S organization MUST NOT lead to alteration of historical COMPOSITE performance.

Throughout the document we find a switch from "cannot" (or as in this case, "are not permitted") to "must not." My guess is that the EC feels that "must not" carries more weight. While this is perhaps debatable, I have no objection to the wording switch.

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[3] While one might argue that compliant firms are obligated to abide by guidance statements and therefore should have reviewed this document when it was released, the onus on communicating new requirements in an effective and clear manner lies with the EC.

0.A.6. FIRMS MUST document their policies and procedures used in establishing and maintaining compliance with GIPS standards.

Wording has been improved.

0.A.7. Once a FIRM has met all applicable REQUIREMENTS of the GIPS standards, the FIRM MUST use one of the following compliance statements to indicate that the FIRM is in compliance with the GIPS standards. The compliance statement MUST remain in a single paragraph.

I support the change. It's a good compromise to "mandatory verification, which to me is an anathema. I disagree, however, with the need for two versions where the firm has been verified. The use of two years as the rule for "stale" is arbitrary. Example: Firm A shows ten years of performance (2000-2009) and had the first eight years verified. By your definition they would be "stale." Firm B also has ten years (2000-2009) but was only verified for a single year (2009). By your definition they are "current." I would think that a reviewer of these materials might place greater weight on the firm that had eight of their ten years done, even though they haven't had the last two, as compared with the one that only had a single year done. Since firms must show the period they were verified for, I suggest only having one version (for firms that have been verified).

0.A.9. Statements referring to the calculation methodology used in a performance presentation as being "in accordance", "in compliance", or "consistent" with the Global Investment Performance Standards, or similar statements are prohibited.

This document should comply with American-English (not UK-English) grammar and notation, meaning the commas should be within the closed quote.

In addition, what is the definition of "statement"? If you check out www.dictionary.com, you will find "a communication or declaration in speech or writing, setting forth facts, particulars, etc." Is this paragraph intended only for *written* statements or also *verbal*? I suspect only the former. If I am in a meeting with a prospect and they ask me "okay, so you're not compliant; but are your calculations in compliance" I suspect I am permitted to answer "yes." Likewise, in response to RFPs, if such a question is asked, I think there is a precedence that allows me to respond. And so, even "written" has some exceptions. I know that all of this is quite complex and you don't need more *wrenches* thrown into *the works,* but I can see how this might be a bit ambiguous. Sorry.

0.A.10 Statements referring to the performance of a single, existing client PORTFOLIO as being "calculated in accordance with the Global Investment Performance Standards" are prohibited except when a GIPS-compliant FIRM reports the performance of an individual client's PORTFOLIO to that client.

I would like to see this paragraph removed. There is no need to report such a statement to an existing client, as GIPS deals with marketing to prospective clients. If the firm is calculating a return for an individual portfolio, the fact that the formula is one that is permitted by GIPS is not relevant to the presentation.

0.A.11. FIRMS MUST make every reasonable effort to provide a COMPLIANT PRESENTATION to all PROSPECTIVE CLIENTS. FIRMS MUST NOT choose to whom they want to present compliant performance, As long as a PROSPECTIVE CLIENT has received a COMPLIANT PRESENTATION within the previous 12 months, the FIRM has met this REQUIREMENT.

Shouldn't the wording indicate that the compliant statement must be for the composite associated with the strategy they're considering?

0.A.12. FIRMS MUST provide a complete list and description of the FIRM'S COMPOSITES to any existing or PROSPECTIVE CLIENT that makes such a request. FIRMS MUST list closed COMPOSITES on the FIRM'S list of COMPOSITES for at least 5 years after closure.

I oppose the inclusion of the word "existing" with the words "Prospective Client." for two reasons: first, it's an attempt to broaden the standards to deal with client reporting, which I object to; second, the definition of "prospective client" includes "existing clients," and therefore to use the extra words is redundant, and therefore superfluous and unnecessary.

Regarding the "list and description," (which obviously appears elsewhere in the standards): I believe that a firm should be able to state that they have XX single account composites, whose descriptions are available upon request. I.e., that a firm can actually have TWO lists: the first would exclude single account composites, especially where there are many, many such items and second, a list that includes these. The only drawback, of course, is that you're disclosing that they are single accounts in the composites. However, if the firm is willing to do this, what's the harm? I hope the committee will look favorably upon this suggestion.

0.A.16 FIRMS MUST comply with all applicable laws and regulations regarding the calculation and reporting of returns.

I object to this new requirement. Of course we want firms to abide by the law. However, if the SEC conducts an examination and finds a discrepancy, that doesn't necessarily mean it ties directly to the firm's compliance with GIPS. The firm may have published an advertisement that is in conflict with the SEC's rules. But what does that have to do with GIPS compliance? And if such a problem occurs, does that mean the firm is therefore out of compliance with GIPS? And if so, for how long? This additional language serves no purpose but will only add confusion where there's already too much.

0.B.2. FIRMS SHOULD provide to each existing client, on an annual basis, a COMPLIANT PRESENTATION for the COMPOSITE(S) in which the client's PORTFOLIO is included.

In the strongest terms possible, I OPPOSE this. The standards are for prospective, not existing clients.[4] To recommend that firms provide clients with reports is moving towards the slippery slope of (a) making it a requirement and (b) adding further requirements for existing clients. The idea is fraught with problems, not the least being the added costs, headaches, challenges, etc. to take this on. I'm aware of no firm that does this today and even if there were firms, they are in the minority. Clients can always ask for these statements; no need to have this here. Recommendations are supposed to be "best practices." Perhaps the EC should define what is meant by this. One would expect that it refers to a host of firms that currently practice such procedures; however, I'm unaware that very few if any at all do this today. In fact, I'm aware of a firm that tried it and immediately stopped because of the headaches and costs that resulted from it. The standards are for *prospective* clients, not *existing* clients. This recommendation should be removed.

0.B.3. FIRMS SHOULD comply with the RECOMMENDATIONS of the GIPS standards, including RECOMMENDATIONS included in any updated information. Guidance Statements, interpretations. Questions & Answers (Q&As). and clarifications published by CFA Institute and the GIPS Executive Committee, which will be made available via the GIPS website (www.gipsstandards.org). as well as the GIPS Handbook.

Suggest that you change "should" to "are encouraged to."

1.A.2. For periods beginning on or after 1 January 2011. PORTFOLIOS MUST be valued at FAIR VALUE in accordance with the GIPS Valuation Principles in Appendix D

Again, this switch to fair value isn't a subtle one and I'd like to hear what others think the impact might be. Also, again, the footnote is confusing.

1.A.3. FIRMS MUST value PORTFOLIOS in accordance with the COMPOSITE specific valuation policy. PORTFOLIOS MUST be valued: a) At least monthly. b) On the date of all LARGE CASH FLOWS. c) No more frequently than required by the valuation policy.

I'm okay with this. However, there's the possibility of confusion as some may wonder how this applies to RE & PE, which it doesn't. In addition, the wording looks like a multiple choice test. Also, should define VALUATION POLICY

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[4] Except in the case where an existing client has become a prospective client, as per the definition in the glossary.

1.A.4. For periods beginning on or after 1 January 20 1 0, FIRMS MUST value PORTFOLIOS as of the calendar month-end or the last business day of the month.

I prefer the old wording; it's clearer

1.A.5. For periods beginning on or after 1 January 2005, FIRMS MUST use TRADE DATE ACCOUNTING.

I prefer the old wording; it's clearer.

1.A.6. ACCRUAL ACCOUNTING MUST be used for fixed-income securities and all other investments that accrue interest income. The FAIR VALUE of fixed-income securities MUST include accrued income.

Again, unsure about "fair value"

1.A.7. For periods beginning on or after I January 2006, COMPOSITES MUST have consistent beginning and ending annual valuation dates. Unless the COMPOSITE is reported on a non-calendar fiscal year, the beginning and ending valuation dates MUST be at calendar year-end (or on the last business day of the year).

I prefer the old wording; it's clearer.

2.A.1. TOTAL RETURNSMUST [sic] be used.

Typo (need a space); glad to see someone was listening (no need for the previous redundant reference to income, since "Total Return" includes income!)

2.A.2. TIME-WEIGHTED RATES OF RETURN that adjust for EXTERNAL CASH FLOWS MUST be used. Periodic returns MUST be geometrically LINKED. EXTERNAL CASH FLOWS MUST be treated in a consistent manner with the FIRM'S documented, COMPOSITE-specific policy. FIRMS MUST define LARGE CASH FLOW for each COMPOSITE to determine when the PORTFOLIOS in that COMPOSITE are to be revalued for calculating performance.

Suggest always appending "CASH FLOW" with "EXTERNAL," so as to avoid confusion, since there can also be internal cash flows which are not dealt with in the standards.

3.A.1. All actual, discretionary PORTFOLIOS MUST be included in at least one COMPOSITE. Nondiscretionary PORTFOLIOS MUST NOT be included in a FIRM'S COMPOSITES

Yes, I agree with including non-fee paying accounts. Today firms have the option and many only include a few; this might suggest some gaming, therefore to require that all be included is fine.

NOTE: I'd like to see the wording changed to "GIPS discretionary" in order to emphasize that the "discretion" relates to GIPS. The word "discretion" is often confusing since it's used in a broader context. By prefixing it with "GIPS," we will reduce this confusion.

3.A.3. COMPOSITES MUST include new PORTFOLIOS on a timely and consistent basis after the PORTFOLIO comes under management.

I prefer the old wording; it's clearer.

3.A.8. If a FIRM sets a minimum asset level for PORTFOLIOS to be included in a COMPOSITE, FIRMS MUST NOT include PORTFOLIOS below that asset level in that COMPOSITE. Any changes to a COMPOSITE-specific minimum asset level MUST NOT be applied retroactively.

Actually, elsewhere (in the guidance) it indicates the ability to establish a range and have flexibility in dealing with the minimum. This wording (and the original) is much more strict, which runs contrary to the guidance. This wording should be similarly flexible and not so strict. The current wording, when compared with what's written elsewhere, causes confusion.

3.A.9. FIRMS MUST NOT present a COMPOSITE to a PROSPECTIVE CLIENT known to have a PORTFOLIO with assets less than the COMPOSITE'S minimum asset level.

The question in the exposure draft is misleading ("Do you agree with changing 3.A.9 from a recommendation to a requirement.") It ISN'T a recommendation today. The current wording is: 3.B.3 Firms should not market a composite to a prospective client who has assets less than the composite's minimum asset level.

I STRONGLY oppose this change.

What is a firm to provide such a client, a representative account? I think this change should be withdrawn.

I am okay with the recommendation that currently exists ("3.B.3 Firms should not market a composite to a prospective client who has assets less than the composite's minimum asset level"), but it doesn't preclude the possibility that the firm will take on smaller clients as a concession to existing clients or for other reasons.

If you TRULY want to make the current recommendation a requirement, then do that: "Firms MUST NOT market a composite ..." I will support this.

3.B.1. To remove the effect of a SIGNIFICANT CASH FLOW, FIRMS SHOULD use TEMPORARY NEW ACCOUNTS

I'd like to see the reference to temporary account removed. The implementation of temporary accounts is quite difficult and the ability to remove accounts in the event of significant flows solves the problem. Very few firms do this. The significant cash flow option serves quite well. To suggest that this is "best practice" is debatable.

4.A.5. FIRMS MUST disclose the presence, use, and extent of leverage, derivatives, and/or short positions, if material, including a description of the frequency, of use and characteristics of the instruments sufficient to identify risks.

While I do not see a reason to add short positions (in my opinion it's part of the "fear" that shorts are causing many of the problems), I don't object if most folks are okay with this.

4.A.7. FIRMS MUST disclose relevant details of the treatment of withholding tax on dividends, interest income, and capital gains, if material. FIRMS MUST also disclose if BENCHMARK returns are net of withholding tax.

I support this change.

4.A.10. For any performance presented for periods prior to 1 January 2000 that does not comply with the GIPS standards, FIRMS MUST disclose the period of non-compliance.

I don't support this change and prefer the current wording. Firms should be prepared to explain what the basis is for the period not being compliant.

4.A.11. For periods beginning prior to 1 January 2010, if CARVE-OUTS are included in a COMPOSITE. FIRMS MUST disclose the policy used to allocate cash to CARVE-OUTS.

Someone apparently decided that "For periods prior to 1 January 2010" isn't clear, so they made it "For periods beginning prior to 1 January 2010." I think this is clumsy and confusing and should be dropped wherever it appears (e.g., also from the footnotes previously noted).

4.A.17. FIRMS MUST disclose that information regarding policies for valuing PORTFOLIOS, calculating and reporting returns, and preparing COMPLIANT PRESENTATIONS is available upon request.

I suggest striking the words "and preparing compliant presentations." Such details don't need to be disclosed.

4.A.19 FIRMS MUST disclose all significant events that would help a PROSPECTIVE CLIENT interpret the performance record.

Coming up with a date to stop reporting these can be difficult, but I think five years should probably suffice.

4.A.20 FIRMS MUST disclose the COMPOSITE DESCRIPTION which must include sufficient information to allow a PROSPECTIVE CLIENT to understand the key characteristics of the COMPOSITE strategy; including risk.

> I disagree with having the "key characteristics and risks" included. More work and it's subjective. In the U.S. the SEC wanted to require disclosure of risks and concluded that this is very difficult. To describe risks is highly subjective.

4.A.21. If a FIRM is redefined, the FIRM MUST disclose the date, nature, and reason for the redefinition.

> I suggest striking the word "nature." This word is highly ambiguous and I doubt if two people at random would agree on what it means. The current wording is sufficient.
>
> As for timing, I'd think indefinite, except perhaps at the point where the firm is no longer showing records for the prior definition, in which case it would no longer be applicable.

4.A.22. If a FIRM has redefined a COMPOSITE, the FIRM MUST disclose the date, nature. and reason for the change. Changes to COMPOSITE DEFINITIONS MUST NOT be applied retroactively.

> I see that the word "nature" is here, too. I'd strike it.
>
> As for timing, I'd say indefinite (i.e., no termination), except, perhaps, when the period for which the change occurred is no longer displayed, in which case it wouldn't be relevant.

4.A.23 FIRMS MUST disclose any changes to the name of a COMPOSITE.

> This change should be required to be shown for a period of three years.

4.A.27 If the FIRM has adopted a SIGNIFICANT CASH FLOW policy for a specific COMPOSITE, then the FIRM MUST disclose how the FIRM defines a SIGNIFICANT CASH FLOW for that COMPOSITE, [sic] and for which period(s).

> The absence of this requirement was clearly an oversight of the IPC; this requirement always existed but was imbedded in the guidance statement. Glad that it's included where it belongs. (NOTE: need to remove the comma before the word "and")

4.A.28. FIRMS MUST disclose, for a minimum of 12 months, any change to the COMPLIANT PRESENTATION due to a correction of a material error

> As noted earlier, I disagree with this requirement. If an error is corrected, why tell people who

are NOW getting it? If the firm has a policy that calls for them to communicate errors to individuals that previously got a report (with the error), that's great! But to require ongoing communication of errors is unnecessary and just more work and disclosures. People make mistakes; the firm found one and corrected it. They've done their penance.

I realize that this change is here because of the introduction of the E&C guidance statement last year. However, the public wasn't afforded the opportunity to comment on it and the associated requirement for this disclosure. In my opinion this wasn't handled properly and should be corrected.

4.A.29. FIRMS MUST disclose the 3 year annualized EX-POST STANDARD DEVIATION fusing a minimum of monthly periods) for the COMPOSITE and for the BENCHMARK as of the most recent annual period presented. The PERIODICITY of the COMPOSITE MUST be identical to the PERIODICITY of the BENCHMARK when calculating EX-POST STANDARD DEVIATION.

Risk is a very challenging area, as everyone knows. There is no universally accepted definition of risk or way to calculate risk. Our research has shown that most firms use standard deviation as a risk measure. However, there are many who feel that it's a measure of volatility, not risk. But, it's easy to calculate and compare. I'm concerned with annualized standard deviation, however.[5] An alternative that might be better accepted would be to require firms simply to show A risk measure (or risk-adjusted return measure) and suggest possible ones to use. Comparability isn't possible, I'll grant you that, but at least there's some flexibility. But, in reality, I don't object to this and if the committee feels that this is appropriate, I will support this.

Note: this statistic should be for every period, not just the most recent.

5.A.1. The following items MUST be included in each COMPLIANT PRESENTATION:

At least 5 years of annual performance (or a record for the period since FIRM or COMPOSITE inception if the FIRM or COMPOSITE has been in existence less than 5 years) that meets the REQUIREMENTS of the GIPS standards; after presenting 5 years of annual performance, the FIRM MUST present additional annual performance up to a minimum of 10 years. (For example, after a FIRM presents a minimum 5 years of compliant history, the FIRM MUST add an additional year of performance each year so that after 5 years of claiming compliance, the FIRM presents a minimum 10-year performance record.)

Glad to see that clarity has been added for partial years; this should be at the front and back-end, so some additional wording is probably in order. Suggested Change: in addition to firm assets require composite assets and make the reporting of the percent composite assets represent of the

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[5] I am in the process of doing some research on annualized standard deviation and will be happy to provide you a copy of the results.

total firm assets optional. To derive the firm assets if the percent is shown can be quite difficult (if not impossible), so to be more accurate, the asset amount should be shown

5.A.1.c The number of PORTFOLIOS and amount of assets in the COMPOSITE, and either the percentage of the TOTAL FIRM ASSETS represented by the COMPOSITE or the amount of TOTAL FIRM ASSETS at the end of each annual period. If the COMPOSITE contains 5 PORTFOLIOS or less, the number of PORTFOLIOS is not REQUIRED.

I suggest requiring both firm and composite assets and not allow percent of firm assets. My reason is that one can always derive the accurate percentage if we know firm and composite assets; however, if we have composite assets and percentage we may not be able to accurately derive firm assets due to rounding. It's more accurate to require what I propose.

5.A.2. FIRMS may LINK non-GIPS-compliant returns to their compliant history so long as the FIRMS meet the disclosure REQUIREMENTS for noncompliant performance and only compliant returns are presented for periods after 1 January 2000.

Model, back-tested, and other non-actual returns are "non-GIPS-compliant" returns. This statement says that a firm can link "non-GIPS-compliant" returns to their compliant history. I know what the committee means, but to avoid confusion perhaps some additional clarity is in order.

5.A.4.ii The decision-making process remains substantially intact and independent within the new FIRM, and

I prefer the current wording. It's clearer.

5.A.4.c. In addition to 5.A.4.a and 5.A.1.b, when one FIRM joins an existing FIRM, performance of COMPOSITES from both FIRMS MUST be linked to the ongoing returns if substantially all the assets from the past FIRM'S COMPOSITE transfer to the new FIRM.

We have been waiting for quite some time to learn what this exactly means. When I was on the Interpretations Subcommittee we debated it: there were two different views[6]. I would hope that guidance would be forthcoming as there's confusion.

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[6] Some argued that "compliance" means what the word means, "compliance." That is, five years (or since inception) of returns. Others felt that it meant since the point when the merger occurs. I think the former is correct and that the latter is a leap. Yes it makes mergers more complex, but compliance is complex. The acquiring firm can always keep the new entity outside its firm definition until they have five years of compliant records.

5.A.5. For periods beginning on or after 1 January 2006 and ending prior to 1 January 2011. if a COMPOSITE includes CARVE-OUTS, the COMPLIANT PRESENTATION MUST include the percentage of the COMPOSITE assets that is composed of CARVE-OUTS

Firms should CONTINUE to disclose this. Carve-outs haven't gone away, just the ability to allocate cash. I think the information has value and should remain.

5.A.6.b If the FIRM changes the BENCHMARK, the FIRM MUST disclose the date, nature, and reason(s) for the change.

Please strike "nature." It's not that I'm not a nature lover, it's that the word here is ambiguous. If you want to define it, then perhaps it could stay, but to assume that people agree on a definition would be an error.

5.A.8. For periods beginning on or after 1 January 2011. if a COMPOSITE contains any PROPRIETARY ASSETS, the FIRM MUST present, as of the end of each annual period, the percentage of the COMPOSITE assets represented by the PROPRIETARY ASSETS.

NO NO NO!!! I find this highly objectionable. Firms often "seed" new ideas; to require that this information be made public serves no purpose and runs the risk of firms divulging proprietary ideas that they're testing. NO NO NO!!!

In addition, as the term "Proprietary Assets" is defined, to include assets of firm management, such a disclosure will be an accounting nightmare. Imagine if the firm's management is invested in various mutual funds, private partnerships, etc. The will be obliged to track these details so they can report them. Why? This will be extremely burdensome and will not improve the information provided to prospects.

6.A.2. REAL ESTATE investments MUST be valued by an independent external PROFESSIONALLY DESIGNATED, CERTIFIED, OR LICENSED COMMERCIAL PROPERTY VALUER/APPRAISER at least once every 36 months. For periods beginning on or after 1 January 2012. REAL ESTATE investments MUST be valued by an independent external PROFESSIONALLY DESIGNATED. CERTIFIED. OR LICENSED COMMERCIAL PROPERTY VALUER/APPRAISER at least once every 12 months. In markets where neither professionally designated nor appropriately sanctioned valuers or appraisers are available and valuers or appraisers from other countries bearing such credentials do not commonly operate, then the FIRM MUST take necessary steps to ensure that only well-qualified independent property valuers or appraisers are used.

Requiring annual valuation by external parties will add costs, which may discourage firms from complying. Unclear to me why this change is being proposed. I'd like to hear input from the RE sector. I am concerned that many real estate firms will "opt out" of compliance because of this added cost.

6.A.6. The annualized since inception INTERNAL RATE OF RETURN (SI-IRR) must be calculated using the period-end valuation of the COMPOSITE as a terminal value. For periods beginning on or after 1 January 2011. SI-IRR MUST be calculated using daily cash flows.

Good to require SI-IRR, BUT this requirement should be simply made on a BROAD basis: "If the manager controls the external cash flows, SI-IRR is required." In these cases, TWRR has no value and shouldn't be required nor recommended. In all due respect to those who claim that the requirement for IRR has nothing to do with who controls the cash flows (for which there is no independent document (other than things they've written themselves) which support this), there are a massive amount of references to the contrary. And so, if we require SI-IRR for private equity managers because they control the flows, but do not require TWRR, why then would we require TWRR for direct real estate managers who control the flow when we have obviously acknowledged that it isn't needed? In addition, much benefit would result from simply stating that SI-IRR is to be used WHENEVER the manager controls the flows.

7.A.4 For periods beginning on or after 1 January 2011, the annualized SI-IRR MUST be calculated using daily cash flows, and the period-end valuation of the COMPOSITE as a terminal value. Stock DISTRIBUTIONS MUST be included as cash flows and MUST be valued at the time of DISTRIBUTION.

I don't see the justification to require daily treatment of flows as it only complicates the IRR; monthly grouping of flows should continue to be permitted.

8.A.6. When FIRMS present COMPOSITE performance to an existing WRAP FEE/SMA sponsor, which includes only that sponsor's WRAP FEE/SMA PORTFOLIOS (resulting in a "sponsor-specific COMPOSITE"): - FIRMS MUST disclose the name of the WRAP FEE/SMA sponsor represented by the sponsor-specific composite; and - If the sponsor-specific COMPOSITE COMPLIANT PRESENTATION is intended for the purpose of generating WRAP FEE/SMA business and does not include performance net of the entire WRAP FEE, the COMPLIANT PRESENTATION MUST disclose that the named sponsor-specific COMPLIANT PRESENTATION is only for the use of the named WRAP FEE/SMA sponsor.

This provision should remain.

Yes, firms should be permitted to show sponsor- or style-specific presentations.

Verification Section

I agree with the bulk of what is shown. I do not support including provisions regarding 0.A.16 (see my earlier comments). As for 0.A.17, I believe that this is already part of verification, to at least some extent. However, to extend the verification requirements to include it might (a) result in increased costs and (b) put verifiers at greater risk. Therefore, I do not support having the

verification language reference either of these paragraphs.

As for verification itself, MUCH more guidance is needed. Verifier independence seems to be ignored by various firms. In some cases verifiers prepare "templates" of policies and procedures for their clients: to me, this is highly risky as it moves them quickly to a *slippery slope* where they may end up *verifying their own work*. And while I'm aware that some verifiers haven't objected in the past to doing this (in the case where verifiers prepare the client's actual presentation materials as an "added service"), there has to be a point where the EC says "enough!"

The GIPS standards provide a "level playing field" for managers but fail to for verifiers. It needs to.

Appendix C - Advertising Guidelines

I support these changes, except where they relate to comments made earlier (e.g., regarding "stale" verifications).

Note: the removal of after-tax standards, while understandable, creates issues that need to be addressed. While I favor the continued use of these standards, I understand the committee's preference to avoid country-specific guidance. However, there should be exceptions made and this is clearly one that could continue to be employed. But, if the removal remains than guidance should be available regarding the use of after-tax composites, as their prohibition would, I would hope, not be promulgated. And therefore such guidance should include a requirement that the methodology employed to derive after-tax returns be disclosed, either within the corpus of the presentation or as an additional disclosure. For U.S. firms, perhaps the USIPC can suggest that they continue to abide by the provisions that currently exist.

App. A.7 What if the verifier cannot rely on the work of another verifier? What if the prior verifier did a poor job and didn't notice that their client wasn't actually compliant!?!?! Guidance is needed.

App. D.2 "Current obligations relating to fair value"? No comprende.

App. D.6 Further discussion is in order, though I think the order is reasonable.

Glossary

Discretion: There should be a distinction between "legal" discretion (i.e., where a client grants the manager the right to trade on their behalf) and "GIPS" discretion (i.e., those cases where client restrictions cause a legally discretionary account to be non-discretionary for GIPS purposes). I would prefer that any time the word "discretion" is used, we would qualify it by seeing "GIPS discretion," so as to distinguish it from "legal discretion." This is OFTEN confusing to firms. So,

such emphasis (or at least a definition) would help.

Standard Deviation The wording provided relates only to standard deviation as a measure of dispersion; since it is also being proposed as a risk measure, a definition relating to this use should be included (e.g., Standard deviation is a measure of volatility, which is based on the assumption of a normal (i.e., Gaussian or bell-shaped) curve."

Prospective Client: I OBJECT to the reference of being "above the composite minimum" (what is someone if they're below? Kind of silly, yes). I think that some clarity is needed to exclude mutual fund customers and others who deal with an omnibus type arrangement. Since the definition CLEARLY includes "Existing clients," there is NO REASON to emphasize "existing clients" elsewhere in the document.

Link, "2)": YES, I agree ... This has always been my interpretation. Glad it's included :-). However, there's a typo in the formula for mathematical linking ... Two too many closed parentheses. Also, it has the word "LINKED," which suggests that this term is in the glossary (odd that it would be part of the definition for link) but it isn't, and therefore shouldn't be capitalized. In addition, I would change "two pieces of information can be linked" to "two pieces of information could be seen as being linked." I'm concerned that saying "can be linked" gives permission, when there are times when it's not permitted.

<u>Need definitions for:</u>

Valuation Policy
Best Practice
Discontinued composite; what if there are accounts earmarked for it but are below the minimum; does this make them discontinued?

<u>Need guidance for</u>:

Fund-of-funds. Fund-of-fund managers can comply with the standards, but there is no guidance here. Take, for example, a private equity fund-of-fund manager: what standards do they abide by? THEY don't control the cash flows, the managers they pick do, so do they show TWRR? Because this industry expects to see since inception IRR, I would expect this to be used here, too, but there is no guidance.

Investment Consultants. I would argue that the standards should be able to apply to investment consultants, too. They are engaged in asset allocation and manager selection, which is quite similar to a fund-of-fund manager. Granted, in some cases they are making recommendations, but there is still room to expand the standards into this arena.

Overlays: The standards don't speak to overlays. Overlays deal with exposure, not real market

values. Many overlay managers believe they can't comply with GIPS because of this difference. I would like to see the standards speak specifically to overlays and have exposure take the place of market value.

Again, thank you for allowing me the opportunity to comment. I look forward to the finalized version.

Sincerely,

David Spaulding, CIPM
President

June 23, 2009

Re: GIPS 2010 Exposure Draft

Dear Members of the GIPS Executive Committee:

I want to again thank you for the opportunity to comment on the proposed changes to the GIPS® standards. Since I sent my earlier comments in on June 3 I have struggled with the issue of standard deviation as a risk measure (as is proposed in ¶4.A.29). I have been working on a paper for a class I'm taking and the subject happens to be annualized standard deviation. As a result of my research, coupled with my prior concerns, I have now concluded that I must voice opposition to the use of standard deviation as a risk measure. Some of what I've included below comes from my paper.

To briefly summarize what I've shown below, the issues are:

- the appropriateness of standard deviation as a risk measure
- the measure's underlying assumption that distributions are normal.

Value of standard deviation as a risk measure

Our definition of risk has a lot to do with how we measure it (Arnott and Bernstein (1988)). The use of standard deviation as a risk measure dates to the early 1950s (Markowitz (1952)). Historically, the major concern of plan sponsors has been the variability of fund assets (Arnott and Bernstein (1988)). But, is this correct?

The simplicity and convenience of variability contributed to its success. It was an expression of the pension fund culture that variability (or, more specifically, standard deviation) was the preferred measure (Arnott and Bernstein (1988)). Is there any doubt why Sharpe used it as his risk measure, (Sharpe (1966)) which was later used for tracking error? (Treynor and Black (1973)) As Arnott and Bernstein (1988) pointed out, risk elimination doesn't address variability but rather the risk of having inadequate assets to meet obligations; this is the "rational definition" of risk.

The appropriateness of standard deviation has been challenged from several perspectives:

- whether volatility (variability) is a valid measure of risk
- the treatment of the above and below the mean returns equally
- the assumption of normality of the distribution.

In spite of the prevalence in use of standard deviation as a risk measure, its appropriateness has

frequently been challenged (Sortino (2004), Arnott and Bernstein (1988)). The first question deals with whether or not a measure of volatility is appropriate at all? That is, can risk be defined as volatility? In challenging this notion Biggs (2006) posed the question, "[a]s an investor in hedge funds, what would you rather have over five years? A very choppy 20% to 25% compound or a steady 10% to 12%?"

As Eling (2008) put it, "standard deviation involves both positive and negative deviations of return from its expected value, which is not the general understanding of risk." Benson, Gray, Kalotay and Qui (2008) cited Leland (1999) who pointed out how Markowitz used standard deviation as his risk measure, which resulted in "placing equal emphasis on return deviations below *and above* the mean. As such, a risk-averse investor in Markowitz's mean-variance world views downside and upside variance with equal distaste."

Because of the equal treatment of above and below average returns, an alternative approach of focusing solely on the returns below average (or arguably, the returns below the client's minimum acceptable return) is deemed preferable (Rom and Ferguson (2002a, Rom and Ferguson (2002b, Rom and Ferguson (1997/1998), Sortino and Forsey (1996, Sortino and van der Meer (1991), Ang, Chen and Yuhang (2006)).

Normal or not normal

The standard deviation assumes a normal distribution. But are returns normally distributed? Anson (2002) demonstrated how the S&P 500 can fail in this regard. And de Silva, Sapra and Thorley (2001) showed how U.S. mutual fund returns are often far from being normally distributed. Others, too have questioned the notion that stock returns are normally distributed, occasionally referencing the extreme values that are often found (Assaf (2009), Jansen and de Vries (1991), Longin (1996, Longin (2001)).

Interestingly, Wander and D'Vari (2003) feel that "[m]ore data, all else equal, is better than less," while Rom and Ferguson (2001) found the opposite in their research. Our data, too, suggests that more will result in a less normally distributed distribution. Perhaps in support of the notion that more is better, with smaller samples the impact of extreme returns might cause an even less normally looking distribution, but this would depend on the timeframe being reviewed.

While Wander and D'Vari (2003) feel that the faulty assumption of normality means that "bad events may occur much more frequently than expected," and thus possibly invalidate the measure's value, Eling and Schuhmacher (2007) showed that this wasn't necessarily a problem with the Sharpe ratio, which uses standard deviation as its risk measure and therefore also relies on the assumption of a normally distributed distribution. They found that the ratio still worked quite effectively in gauging risk.

I also question the use of an annualized version of standard deviation, as it doesn't lend itself to being interpreted as a non-annualized version does, other than for comparison purposes (this is the gist of my paper, which I am currently pursuing).

Sorry that I wasn't as committed to this in my earlier submission. Again, thanks for the opportunity to express my thoughts.

Sincerely,

David Spaulding, CIPM

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