

INVESTMENT PERFORMANCE COUNCIL ADOPTION OF THE GUIDANCE STATEMENT ON PERFORMANCE RECORD PORTABILITY

SUMMARY: In November 2000, the Association for Investment Management and Research (AIMR) released for public comment the proposed Guidance Statement on Performance Record Portability.

The Guidance Statement on Performance Record Portability provides clarification to the Global Investment Performance Standards™ (GIPS™) relating to when an investment manager can bring a historical performance record with them to a new or merged firm.

ADDITIONAL INFORMATION: For further information on the Guidance Statement on Performance Record Portability, contact AIMR's Professional Standards and Advocacy department via facsimile at 804-951-5320, via e-mail at gips-info@aimr.org, or at 560 Ray C. Hunt Drive, P.O. Box 3668, Charlottesville, VA 22903-3668.

I. PURPOSE OF GUIDANCE STATEMENTS

Guidance Statements are developed to respond to questions that raise new and novel issues that are beyond the scope of the simple application of the Standards and/or require additional interpretation and clarification. They incorporate all of the applicable existing interpretations that have been published on a subject in an effort to consolidate all related information and add clarification.

II. SUMMARY OF COMMENTS

In general, most of the comments received during the public comment period were in support of the objectives of the Guidance Statement. Below is a summary of the comments received along with the changes generated by the comments. The firm or individual making each comment is indicated using the following abbreviations:

Abbott: Lesley Abbot, WM Company

Hart: Michael Hart

Koutsoumbelas: Gus Koutsoumbelas, Pershing

PwC: Peter McNamara and Kelvin Laing-Williams, PricewaterhouseCoopers

SPECIFIC COMMENTS ON THE PROPOSED GUIDANCE STATEMENT ON PERFORMANCE RECORD PORTABILITY

The original proposal states that “Performance is the record of the firm, not of the individual”. It outlined three exceptions where performance earned at the previous firm could be linked to the ongoing results at a new affiliation. Below are comments on the Guidance Statement as well as specific comments on the three exceptions.

1. Comments on the Guidance Statement

The original proposal included three exceptions where performance earned at the previous firm could be linked to the ongoing results at a new affiliation. However, in actuality, exceptions “a” and “b” are very similar, separated by only one provision that is applicable to the combination of firms. When one firm (Firm A) joins another firm (Firm B), the composite performance from Firm A can only be linked to the ongoing results at Firm B if substantially all the assets from Firm A’s composite come over to Firm B. The original structure of the Guidance Statement was modified to reflect that there are four basic rules of performance portability and highlighted the additional requirement that must be satisfied in order to link the performance when one firm joins another firm.

Revision: *Combine items ‘a’ and ‘b’ to provide consistency and add clarity.*

Comment: The portability guidelines should allow individuals who have been put at a competitive disadvantage due to a merger or acquisition to be able to market their performance history. (Hart)

The Guidance Statement as proposed includes as much flexibility as possible while keeping with spirit and principles of the GIPS standards.

Revision: *None. No modifications to the Guidance Statement as proposed.*

Comment: As portability is such a complex area with numerous legal implications, the Guidance Statement should reiterate that firms must adhere to all applicable laws and regulations. Hence, firms should first meet the applicable regulatory aspects of portability before they look to adhere with the Portability Guidance Statement. (PwC)

As stated in the GIPS standards (Section I.10.i.), firms must comply with all applicable laws and regulations. In cases where local laws or regulations conflict with the Standards, the firm should abide by the local law or regulation and disclose how the local law or regulation conflict with GIPS. Because of the complexity of portability, firms should be reminded to look to law or regulation in addition to the guidance issued on compliance with GIPS standards.

Revision: *Add a sentence to the introductory section to remind firms to comply with all applicable laws and regulations.*

2. Comments on Exception “a”

Exception “a” of the original proposal presents the situation when a manager or group of managers join a new firm. It lays out the requirements that must be met in order for the manager to be able to link historic performance records to the on-going performance at the new firm.

{Note: In an effort to more clearly reflect the fundamental rules of portability, exceptions “a” and “b” from the original proposal were combined.}

Comment: The term “substantially all” can expose subjective interpretation in attempting to decipher and quantify essential elements. How can AIMR set forth an objective criterion that clearly defines, either qualitatively or quantitatively, the meaning of the term “substantially all”? Does acquiring a part that is greater than 50 percent, or greater than 80 percent, or greater than 90 percent satisfy a conscientious, good-faith commitment to adhere to the spirit of the AIMR-PPS standards?

The term “approximately,” an inconclusive phrase when standing alone can provide a clearer understanding when referring to quantity. This word has the same interpretation as the term “more or less” with respect to quantity. The utterance “approximately” conjures a perceived notion of encompassing practically the whole of a unit, while the expression “substantial” can reflect any amount in quantity from a whole to greater than half. Therefore, I recommend that you change the phrase “substantially all” to “approximately all” in both sections a and b. (Koutsoumbelas)

The GIPS standards reference the term “substantially all” in provision II.5.A.4.b. The Standards were purposefully non-prescriptive in their assignment of this term in an effort to broadly encompass the many potential situations that can occur in light of business combinations and segregations.

Revision: None. Retain the use of the term “substantially all”.

Comment: We believe that if a new firm has documents supporting the reported performance, there is no need to disclose in the presentation the “availability of the performance records from the new manager’s old firm”. Further, exception “a” also requires that the new firm must provide the performance records when requested. This requirement should either be deleted or clarified to indicate what type of performance records must be supplied and to whom. It is unclear whether a performance presentation from the old firm would suffice. If the new firm has proper supporting records for the old firm performance, it is not clear why the new firm would need to share “the performance records” to any potential investor that asks for them. (PwC)

Firms must maintain the supporting documents for any performance that it presents (other than as supplemental information). The requirements should be no different for performance earned at a prior firm. The intent of the disclosure is to make investors aware that a portion of the performance history was generated at a prior firm.

Revision: *Revise the disclosure to require that firms disclose the linking of returns from the old firm to those earned at the new firm and remove the requirement to make records available.*

3. Comments on Exception “b”

The second exception, “b”, in the original proposal presents the situation when two firms join as a result of a merger or acquisition. It outlines certain rules that must be met in order for the performance history of one of the firms to be linked to the on-going performance of the new combined firm.

{Note: In an effort to more clearly reflect the fundamental rules of portability, exceptions “a” and “b” from the original proposal were combined.}

Comment: In an effort to clarify exception “b”, I recommend that you use terminology such as "Firm A", "Firm B" and "Firm AB" instead of "new/existing/merged firms" to assist identifying the individual and merged "firms". (Abbott)

Revision: *Add fictional designations to provide additional clarity.*

Comment: Exception “b” states, “If the staff of the two merged firms are combined and the decision making is shared (and thus changed), the performance records of the acquired firm should be presented as supplemental information and may not be linked to the ongoing results.” “May not” should be changed to “must not” as “must not” is more definitive.

The use of “may not” could be construed as meaning that the performance record does not have to be linked, but could do so if the firm so chooses. The intent of this statement is to prohibit a firm from linking the performance records of the acquired firm to the ongoing results at the new affiliation.

Revision: *Modify to state that the performance records of the acquired firm should be presented as supplemental information and must not be linked to the ongoing results.”*

Comment: The text of exception “b” should be expanded to indicate whether all the portability requirements such as the staff and decision making process remaining intact and independent within the firm still need to be met in the case of merged composites (e.g.

surviving and non-surviving composites) or whether these requirements are not applicable. (PwC)

Revision: *Clearly outline the four rules that apply to all situations when determining performance record portability. Also, expand the section on surviving and non-surviving composites with examples.*

Comment: The proposed guidance statement requires that “the records of “non-surviving” composites must be made available on request”. This implies that the firm must construct composites for all the non-surviving strategies for the period up to the merger (i.e. Firm A’s fixed income strategies and Firm B’s equity strategies) despite the fact these strategies are not continued in the new firm and therefore do not present potential investors/consultants with an indicative track record for the investment process they are evaluating. Firms should not be required to produce performance records for non-surviving composites. (PwC)

The issue of discontinued strategies is a potential topic for a future Guidance Statement. The intention of this Guidance Statement, however, is to focus on the issues surrounding the portability of performance results.

Revision: *Modify the Guidance Statement to state that firms should make the performance of non-surviving composites available upon request.*

INVESTMENT PERFORMANCE COUNCIL (IPC)

Guidance Statement on Performance Record Portability

In the current global market for merger, acquisition, and consolidation of investment management firms, past performance records are increasingly valuable assets for their owners. But historical records are the result of many factors (e.g., people, process, discipline, and strategy) that may not be easily transferred to a new entity and still warrant having the same label as the old entity. The applicability and integrity of the performance record is only as good as the ongoing integrity of the strategy and all the contributing factors. Portability of performance records is a very important area that should be clarified within the Global Investment Performance Standards (GIPS®). In addition, because the legal issues and requirements surrounding portability can be particularly complex, firms are reminded that, under the GIPS standards, they must comply with all applicable laws and regulations regarding portability before applying this Guidance Statement.

Performance is the record of the firm, not of the individual. In most cases, with the exceptions noted in “a” and “b” below, performance results of a prior firm must not be used to represent the historical record of a new affiliation or a newly formed entity. Using the performance data from a prior firm or affiliation as supplemental information is permitted as long as the past record is identified clearly as such and is not linked to the results of the new affiliation. If the provisions for portability are met, then it is possible for multiple firms to claim the same performance history as their own.

Changes in a firm's organization should not lead to alteration of composite results. Therefore, composites must include all accounts managed by a member of a firm, even if the individual responsible for the past results is no longer with the firm, and composites should not include portfolios managed by members of the firm before they joined the firm.

The “firm” is consistently defined by the GIPS standards in Section I.12. “Firm” mergers can happen within an affiliated group and this guidance statement will apply to such situations. As Section II.5.A.5. of the GIPS standards reads, “If a compliant firm acquires or is acquired by a non-compliant firm, the firms have one year to bring the non-compliant firm’s assets into compliance.” However, the important determinant of allowable performance record portability is not a firm’s former compliance with GIPS standards but whether the acquiring firm continues the original strategy that defined the composite with all of its continuing factors.

Performance data from a prior firm may be used, with the proper disclosures, as supplemental information. Unless the provisions listed under items ‘a’ and ‘b’ are met, this supplemental information must not be linked to the ongoing performance of the new firm. The key issue is the linking of prior performance results to the ongoing performance record at the new affiliation.

- a. **When a manager, group of managers, or an entire firm joins a new firm, a composite’s past performance may be linked with the ongoing results of the new firm only if all of the following conditions are true for that composite:**

- Substantially all the investment decision makers are employed by the new firm (i.e., research department, portfolio managers, and other relevant staff),
- The staff and decision-making process remain intact and independent within the new firm,
- The new firm discloses that the performance results from the old firm are linked to the performance record of the new firm, and
- The new firm has records that document and support the reported performance.

In addition to the above four rules, when one firm (Firm A) joins an existing firm (Firm B), performance from one of Firm A's composites can be linked to the ongoing results of Firm B only if:

- Substantially all the assets from Firm A's composite transfer over to Firm B.

Most cases will not meet all of the above requirements, in which case the past performance record of the former firm cannot be linked to the ongoing performance record at the new firm. However, the past performance record may be presented as supplemental information when relevant.

In the case where two firms join and two composites are to be merged, the new firm must first determine if there is a "surviving" composite. A "surviving" composite is the composite that represents the continuity of investment strategy, process, and personnel. In order to be a "surviving" composite, the staff and decision-making process of the composite must remain intact and independent at the new firm.

If the firm identifies a "surviving" composite, its performance history can be presented and linked to the ongoing performance of the merged composite. It is recommended that the performance of the "non-surviving" composite be made available as supplemental information upon request. For example, as a result of a merger, two composites ("C" and "D") are combined in a merged composite "CD". If the firm is able to satisfy all the rules of portability and determines that composite "C" is the "surviving" composite, then the performance history from composite "C" may be linked to the on-going record of composite "CD". Although the assets from composite "D" are included in composite "CD", the performance history of composite "D" are not linked to the ongoing record of composite "CD" but should be made available upon request.

If the firm determines that neither composite maintains all the elements of continuity, then there has not been a merger of composites and neither historic performance record can be linked to the ongoing composite performance record, but it is recommended that both of the "non-surviving" composites be presented as supplemental information. For example, if the staff of two firms are combined into one and the investment decision-making process is shared (and thus changed), the historical performance records of both of the non-surviving composites should be presented as supplemental information and must not be linked to the ongoing results of the new composite.

- b. **If the presenting firm is a "manager of managers"**, and is hired by its clients because of the presenting firm's manager selection skills and the firm maintains discretion of the underlying assets (has the control to hire or fire the sub-advisor), the firm must include those assets in the total firm assets and present the performance of the underlying assets in the presenting firm's composites. Similarly, if the presenting firm replaces one sub-advisor with another, the presenting firm must include within the same composite the performance of the assets assigned to the new firm going forward and leave the results from the former firm unchanged.

If the presenting firm does not have discretion of the underlying assets managed by the sub-advisor, then the performance record of the underlying assets must not be included in the presenting firm's performance composites.

Firms should keep in mind that this Guidance Statement falls under the over-riding principles of the GIPS standards: fair representation and full disclosure. Firms are encouraged to disclose any significant events within the firm (such as changes in the personnel responsible for investment management) that would help a current or prospective client interpret the performance record.