

Response to Investment Performance Council of CFA Institute (previously Association for Investment Management and Research) on Revising the GIPS Standards (“Gold” GIPS)

General Comments

1. Do you support AIMR’s effort to revise and expand the GIPS standards?

Generally, yes, and in particular where the proposed standards eliminate a previous lack of clarity in some areas, eg providing a compliant presentation to all prospects and the requirement to re-value funds with large cash flows. I do, however, have serious concerns about the increased requirements and disclosures and the negative impact these will have both on investment managers already in compliance/wishing to comply and the users of the information (see below for more detail). The purpose of the standards is to “facilitate a dialogue between investment managers and their prospective clients”, not try to answer all potential questions on the presentation.

2. Do you agree with the evolution process for the GIPS standards as outlined above?

Partially, yes. However, why wasn’t the opportunity taken to incorporate the Guidance Statement on Supplemental Information at the same time, given that managers are “encouraged to present all relevant supplemental information” as part of the goal of full disclosure and fair representation (Introduction, Overview 10.g)? I am also disappointed that agreement on requirements for leverage and derivatives could not be achieved in time for the release of GIPS “Gold” as this suggests forthcoming (“during 2004”) new requirements in addition to those now proposed. However, at least the majority of the Guidance Statements have been incorporated.

I also feel disappointment that the CFA Institute hasn’t more rigorously tackled the issue of CVG’s and some countries’ preference for these over GIPS. A goal should be set for when these will be eradicated in favour of a truly global standard.

3. Is the language of the Standards straightforward and comprehensible? If not, how can it be improved?

Generally, yes, however some areas are still too vague and woolly, eg the “true” (?) Time-Weighted Rate of Return calculation stipulated (2.A.2); the requirement to disclose “any events” (?) which help to interpret the performance record (4.A.23); the recommendation to include sundry composite-level risk measures (all, some, which?) (5.B.2); the recommendation to present additional performance-related information (all, some, which?) (5.B.4), and the absence of a requirement to disclose “where leverage/derivatives do not have a material (?) effect on returns (Appendix B, B9). These areas require more specifics and greater clarity and guidance, to reduce the burden of compliance and ensure a consistent approach by managers.

4. What modifications, if any, should be made to this proposal?

See above and additional comments below.

5. Do you agree with the numbering and format of the proposed revised GIPS standards?

Generally, yes, although I think the document could be less repetitive.

6. Should AIMR consider any other methods for meeting the objectives of evolving the GIPS standards?

Release proposed standards for leverage/derivatives asap so these can be absorbed into GIPS Gold and ensure, wherever possible, equality of treatment of different asset classes. Currently, requirements for property are significantly different to the main body of the standards, which runs contrary to my perceived aim of GIPS (see below).

Specific Comments

1. Is the new requirement that mandates firms to provide a compliant presentation to all prospective clients too onerous a burden for firms claiming compliance with the GIPS standards?

No. I am pleased that this requirement has been clarified.

2. Is the new requirement that mandates firms to provide a list and description of composites to any prospective client that makes such a request too onerous a burden for firms claiming compliance with the GIPS standards?

Probably not, although this depends on the nature of the required "description". We need more clarification on this.

3. Do you agree with the new recommendation that states the firms should not market a composite to a prospective client with assets less than the composite's minimum asset level?

No. If a composite of the appropriate mandate with a minimum asset level higher than the prospective client's assets is all the investment management company has, I feel that this information is better than nothing. An appropriate disclosure should be made.

4. Do you agree with the new requirement that mandates firms to be prepared to provide a compliant presentation for any composite on the firm's list of composites to a prospective client that makes such a request?

Yes.

5. Do you agree with the new requirement that requires firms to calculate composite performance by asset-weighting the member portfolio returns at least monthly (beginning 2005)?

Yes.

6. Do you agree that the effective date should be moved from 2005 to 2010 for the requirement that stipulates a carve-out return be managed separately with its own cash balance?

No. I strongly feel that this deadline should not be allowed to slip as this sends the wrong message regarding the rigour of the standards. It might also make managers disinclined to meet future deadlines, in the hope that they too might be extended.

7. Is it reasonable for the GIPS standards to require firms beginning 2010 to value portfolios on the date of any external cash flow?

Yes, however clarification of “any external cash flow” would be appreciated, eg does the receipt of interest income constitute “external” cash?

8. Should the GIPS standards require firms to retroactively disclose the following when carve-out segments are used?
(a) a list of the underlying composites from which the carve-out was drawn

No, I can't think that this information is particularly useful to prospects

and

(b) the percentage of the composite that is composed of carve-outs

Yes, I think this data is useful as it would immediately highlight how dependent the composite is on carve-out data. However, to be truly useful, the data would need to be provided at each year end, which could be overly burdensome. A compromise would be to include the data ongoing but not retrospectively.

General Response

In addition, I would like to make the following points:

1. The addition of since inception performance for the firm or composite (Introduction, Scope 13a) is good;
2. Why has the date for accrual accounting been put back from 2005 to 2010? As per my point above re. carve-outs, I think this has a detrimental impact on the validity and robustness of the standards;
3. Some of the requirements are excessively burdensome, which will create an uneven playing field between management companies with varying degrees of financial and human resources. For example:

1.B.2 and 2.A.9: for net of fees returns investment management fees should be accrued, and estimated trading expenses and investment management fees are not permitted. For funds where price performance is used, it may not be possible to apply actual fees if a sliding scale exists. In these circumstances, the widest band fee would probably be used as an estimate, which is reasonable. I suggest that this part of the recommendation/requirement be dropped but that relating to estimated trading expenses remain.

4.A.9: If using indices that are net of taxes, the firm must disclose the tax basis of the composite versus the benchmark. This is impracticable for composites of multi-asset funds or those with mixed tax statuses. I suggest that this be dropped.

4.A.10: For composites managed against a benchmark, the firm must disclose the percentage of the composites invested in countries, regions or sectors not included in the benchmark for the most recent period. I think a disclosure regarding a substantial (more than 5%?) off-benchmark bet is sufficient.

4.A.17: If a composite contains portfolios with Bundled Fees, the firm must disclose for each annual period shown the percentage of composite assets that are Bundled Fee portfolios. I think a disclosure to the effect that bundled fee portfolios are included, and what fees are bundled, is sufficient.

4.B.7: The firm should disclose when a change in a calculation methodology or valuation source results in a material impact on the performance of a composite return. I don't think this will be workable as such a change will normally be caused by a system switch or upgrade, where it will not be possible to compare the new calculation/source with what would have been before, in order to measure the materiality of the difference! I suggest that this be dropped.

5.A.7: If the firm changes the benchmark that is used for a given composite in the performance presentation, the firm must disclose both the date and the reasons for the change. If a custom benchmark or combination of multiple benchmarks is used, the firm must describe the benchmark creation and re-balancing process. I think a disclosure with the date and nature of the change is sufficient. The remainder of the requirement should be dropped as it will lead to excessively long disclosures.

5.A.8: If a composite contains any non-fee-paying portfolios, the firm must disclose, as of the end of each annual period, the percentage of the composite assets represented by the non-fee-paying portfolios. I think this is unnecessary and overly burdensome.

5.B.1: include composite performance gross of investment management fees and administrative fees and before taxes. Currently, I imagine most managers present performance either gross or net of fees with a benchmark on the same basis. I don't think they should be required to show both and there will be implications for benchmarks where net/gross of fees data is not readily available.

5.B.4: recommended to present composite-level country and sector weightings. I don't think this will be possible for most managers without buying additional software.

Finally, I agree that the ultimate aim of GIPS should be to have all managers both compliant and verified, however I am concerned that making verification compulsory will result in managers "switching off" from the compliance process due to the additional cost. Market forces in individual areas will determine whether managers require verification or not.

In addition, I believe the following proposals are retrograde steps:

3.A.1: non-discretionary portfolios must not be included in a firm's composites. It is probably correct that discretionary and non-discretionary portfolios should not be mixed in a composite, however I see no problem with managers having separate composites of non-discretionary portfolios, as long as a disclosure denotes this.

No longer need to include total firm assets on presentation. I think this is a key data item which should be continued. The information is required anyway, in order to continue to calculate composite assets as a percentage of total firm assets.

Real Estate

The following requirements and recommendations are proposed for real estate performance presentations, which are over and above those for “more standard” asset classes. I propose that they be dropped in the interests of maintaining consistency between investment types:

6.A.3: calculation methodology, firm’s description of discretion, valuation methods and procedures, source of the valuation, percent of composite assets valued externally, frequency of external valuation.

(With the exception of the penultimate point, which I think is unnecessary, these disclosures should be incorporated into a firm’s policies and procedures for GIPS compliance, as they are for other asset classes, rather than included on the presentation itself.)

6.A.4 and 6.B.5: income and capital appreciation returns for fund and benchmark in addition to total return.

6.B.7: gross and net of fees performance, and “additional useful information” – see my points re. other asset classes above.

Anne Marie French
Performance Measurement Services Manager
Britannic Asset Management
Glasgow, UK