

Emilio Maffi's response to the Investment Performance Council (IPC) of the Association for Investment Management and Research (AIMR) invitation to comment on proposed Guidance Statement regarding Calculation Methodologies to apply when calculating investment performance in accordance to Global Investment Performance Standards (GIPS).

⊙ **Foreword**

I work for a Big Four Firm that is leader in its country in verification activity on Management Firms who claim compliance with GIPS; we attested compliance with GIPS of six Management Firms on a total number of nine compliant Firms in Italy (based on our acquaintances).

I'm pleased to comment on proposals from the IPC Subcommittee to add provisions to address the impact of calculation methodologies on investment performance and I have set out my response to the specific questions below.

⊙ **Do you agree with the principles established in the Guidance Statement?**

I agree with the principles, also because I think that these provisions have already been stated in GIP Standards.

In fact, GIPS 2.A.2 states that:

- «Actual valuations at the time of external cash flows will likely be required for periods beginning January 1st, 2010.», i.e. the only method that can really be called “time- weighted” (I would better define it “True Time Weighted” to distinguish it from the others) will be compulsory only from 1st January 2010;
- «Time-weighted rates of return that adjust for daily-weighted cash flows must be used for periods beginning January 1st, 2005.», i.e. from 1st January 2005 will be compulsory to utilize a method that considers the timing of external cash flows (e.g. *Modified Dietz Method* or *IRR Modified Method*);
- «Time-weighted rates of return that adjust for cash flows must be used.», i.e. for initial implementation of GIPS is permitted to utilize a simplified method, provided that at least it sterilizes performances from cash flows impacts (e.g. *Original Dietz Method*).

I'm sure that this approach will determine a tough attack to IPC from academics because to be precise the methods that GIPS accept until 2009 can't be called “Time Weighted Rate of Return Methods”; nevertheless, I think that IPC's focal aim is to pursue an adoption of GIPS as diffused as possible and this goal can be achieved only permitting an initial simplification of Standards' basic requirements (provided that the method that Firm applies in calculating its performance is clearly reported in its presentation).

For this reason, IPC chose to permit also a quarterly valuation of portfolios up to 1st January 2001 and a monthly one up to 1st January 2010 (being aware that hereon calculation methods couldn't have been so precise in determining Firm's performances), besides it decided to require accrual accounting for dividends and trade-date accounting only from 1st January 2005; nonetheless, there's no prohibition to Firms (on the contrary, this would be welcome) in anticipating these dates, being a

more accurate calculation methodology a strong enhancement for Firm's presentation when clients have to choose between a pool of GIPS compliant asset managers. Finally, it would maybe be better that the Guidance Statement redefines the proposed methods to silent academics' complaints; as reported before, I propose to define as "True Time Weighted" the method that will be compulsory from 1st January 2010, while the other methods should be defined as "Approximations of Time Weighted" (by the way, as already contained in Proposed Guidance's spirit).

⊙ **Are all areas of rate of return and asset-weighted composite calculation sufficiently covered in this Guidance Statement?**

In my opinion, Guidance's purpose isn't to enumerate all possible calculation methodologies, but to state some guide principles to apply when calculating performance according to GIPS; I think these principles are clearly reported inside the Guidance Statement.

I think that if a Firm would decide to adopt a different methodology this wouldn't be an obstacle in claiming compliance, provided that this methodology is applied according to GIPS' spirit of fair representation and is clearly reported and explained inside Firm's presentation.

⊙ **Are there other areas of calculation methodology that should be addressed in this Guidance Statement?**

I think that the Guidance should better focus the item of cash flows timing; in fact, Guidance's actual formulation cites it only when approaching *Modified Dietz Method*, but this a problem that is crossly in all calculation methodologies that face cash flows timing.

Nonetheless, I agree with Guidance's provision that each Firm has to establish a policy, according to when portfolio manager indeed register the availability/unavailability of occurred cash flows, and treat cash flows consistently.

⊙ **It is reasonable to expect that firms will be able to value portfolios at the time of any external cash flow beginning 1st January 2010 (excluding real estate, venture capital, and private equity)?**

I think that this date is reasonable according to IPC's aim of reaching a diffusion of GIPS as large as possible within Asset Management Firms.

In fact, I think that anticipating this date could cause a lesser number of Firms adopting GIPS as daily valuation of portfolios (even if favorable before 1st January 2010) is at the moment, at least in Italy (except for Mutual Funds), a problematic item due to IT restrictions.

Moreover, I think that a softer requirements from GIPS (i.e. permitting for some years a calculation methodology less accurate than True Time Weighted) should spur a larger number of Firms to adopt them; besides, it's important to remind that when a Firm adopts GIPS for the first time it has to present ten years of GIPS compliant data series and therefore it would be practically impossible for the Firm to recalculate a daily valuation of portfolios for the years when this valuation wasn't applied (i.e. this would imply a large delay in Firm's possibility of claiming GIPS compliance).

⊙ **Do you agree with the proposed Effective Date? If not, when should the guidance become effective?**

I agree with the proposed Effective Date even if I think that the provisions of this Guidance Statement are already contained in the Standards; in fact, GIPS 2.A.2 requires Firms to apply minimally the same methods (*Original Dietz Method* up to 1st January 2005 and *Modified Dietz Method / IRR Modified Method* up to 1st January 2010) proposed in this Guidance Statement.

⊙ **Additional comment**

I've not been able to recalculate the figures of portfolios' monthly returns reported in the example that the Guidance proposes inside asset-weighting section; my figures are 11.37% (instead of reported 11.32%) for Portfolio 1 and 8.30% (instead of reported 8.26%) for Portfolio 2.

Anyway, I have to point out that the Guidance should be more accurate in presenting its numeric examples; in fact, I think that it could be misleading for the reader to find a geometric linking of periodic performances expressed as the Guidance does (example 2 proposed inside rate-of-return section):

- first sub-periodic performance 0.79% and second sub-periodic performance 2.13%, monthly performance 2.92% (calculated rounding figures at tenth of percentage points: $1.008 \times 1.021 - 1$) instead of 2.94% (2.93% considering all decimal fractions);
- first sub-periodic performance 1.74% and second sub-periodic performance 0.88%, monthly performance 2.62% (calculated rounding figures at tenth of percentage points: $1.018 \times 1.009 - 1$) instead of 2.64%;
- first monthly performance 1.80%, second monthly performance 2.92% and third monthly performance 2.62%, quarterly performance 7.48% (calculated rounding figures at tenth of percentage points: $1.018 \times 1.029 \times 1.026 - 1$) instead of 7.56% (7.55% considering all decimal fractions of sub-periodic figures).

Rounding figures at tenth of percentage points would amplify the inaccuracy (already provoked by permitting simplifications in calculation methodologies) of annual performance figure; I think that IPC, after correcting Guidance's figures reported as examples, should state that a minimum of hundredth of percentage points rounding is required in geometric linking of sub-periodic figures.

I'm glad to have taken part in the discussion about this Guidance Statement on GIPS Standards and I hope that my comments will be taken in consideration.

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