

CFA Institute

Professional Standards & Advocacy Department
Reference: "Gold" GIPS Standards
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Zurich, July 30, 2004

Re: Ernst & Young comments on the proposed "Gold" GIPS Standards

Dear Madam/Sir,

We would like to thank the CFA Institute for the opportunity to comment on the proposed "gold" GIPS standards. The "gold" GIPS Standards are a significant improvement and represent a further step towards acceptance as the global industry reference and standard for investment performance presentation.

Please find enclosed the response of Ernst & Young Ltd, with comments and suggestions, on the proposed "gold" GIPS Standards.

If you wish to discuss any of our points further, please contact Frank Schmidt (tel. +41 58 286 3388, email: frank.schmidt@ch.ey.com) or Eugene Skrynnyk (tel. +41 58 286 6487, email: eugene.skrynnyk@ch.ey.com) in Switzerland.

Yours sincerely
Ernst & Young Ltd



Frank Schmidt



Eugene Skrynnyk

*General Comments (as requested)***Do you support CFA Institute's effort to revise and expand the GIPS standards?**

We fully support CFA Institute's effort to revise and improve the GIPS standards.

Do you agree with the evolution process for the GIPS standards?

We agree with the evolution process. One important aspect that we would like to point out and on which the CFA Institute has already taken the necessary step, is that it is important and preferable for firms to have a consistent effective date, both for the recently adopted new guidance statements and provisions, as well as for the "gold" GIPS standards. This ensures a timely and effective target adoption date for firms in the industry, rather than a continuous introduction of new requirements that firms need to implement and meet every one or two years. The definition of a fixed time schedule for introducing changes to GIPS in the future will also aid firms in implementing any necessary changes on time and without confusion as to the effective date of the individual changes.

Is the language of the Standards straightforward and comprehensible?

Overall, the language of the Standards is straightforward and comprehensible. There are however, several areas where we feel further clarifications or definitions are necessary. Please refer to the other specific comments at the end of this document.

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

See other specific comments at the end of this document.

Do you agree with the numbering and format?

Overall, we agree with the outlined numbering and format. Three minor suggestions include:

- The numbering of the 'Fundamentals of Compliance' section (i.e. FC.x.x) should be changed to 0.x.x.
- For the 'Fundamentals of Compliance', the 'Real Estate' and the 'Private Equity' sections, the formatting (or positioning) of Requirements and Recommendations is different from the existing sections. For example: the 'Fundamentals of Compliance' section starts with all the Requirements (Definition of the Firm, Document Policies and Procedures) only to then add the Recommendations for Definition of the Firm. Within the current layout (section 1 to 5) this is dealt with differently in that the Recommendations for each section immediately follow the Requirements. The layout should be kept consistent throughout the standards and the currently used layout should be kept for the new sections of the standards as well. The reason for this is that if requirements and recommendations are not kept within one 'unit', the temptation is to 'skip' the recommendation sections of the standards (purely because they are 'Recommendations' – whereas they should be read attentively as they represent not only best practice but also future 'Requirements').

- The Provisions and Guidelines guidance documents should be included in the same section of the GIPS standards. At the moment, Real Estate and Private Equity Provisions are included in Section II, while the Advertising Guidelines are in Appendix B of the “gold” GIPS standards.

Should CFA Institute consider any other methods for meeting the objectives of evolving the GIPS standards?

With respect to the GIPS evolution plan, we believe that the CFA Institute has put in place a very well structured and coordinated development and implementation strategy for the evolution of the GIPS standards.

Two important points should be taken into consideration. First, there is the question if the GIPS standards should be translated (e.g., three official languages or just translations in certain countries). As we see it, some countries are comfortable with having just an English version, while others prefer a translation of GIPS. A translation of GIPS could be important for the local acceptance of GIPS. Second, there is the issue whether the local brand and/or sponsor name will be allowed to remain or not. In our view, the presence of a local sponsoring organization is critical to the ongoing effective implementation and success of GIPS. Both of the points are important aspects that should not be neglected and which CFA Institute has to objectively decide on based on the feedback from country sponsors. As an example, the GIPS standards could state that the name of a translated version of GIPS or a country version of GIPS can always incorporate the name of the sponsoring organization. This becomes even more important when the local standards were established under that name in the past and the standards have been already well known and recognized in the local market.

Specific Comments (as requested)

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?

Firms claiming compliance with the Standards must be able to provide a compliant presentation to substantiate that claim. The introduction of the new requirement serves to reinforce that position. We also recommend the CFA Institute to provide a definition of the term ‘prospective client’ so that there is no misunderstanding and/or too broad or narrow interpretation of ‘prospective client’.

Also important to note is that there are some firms that are already compliant with the standards, but for various reasons have chosen not to make this information public as yet. What is expected or required from firms under such circumstances?

Please note that the remark regarding the definition of ‘prospective client’ is not repeated again in this document, and applies to all references of ‘prospective client’ that follow.

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?

Firms claiming compliance with the Standards must be able to provide a list and description of composites to any party. The introduction of the new requirement serves to reinforce that position. See also the previous comment.

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

We believe firms should use their professional judgment whether a composite is representative or not for a particular prospective client. We see no problem in including this as a recommendation. Any future change from recommendation to requirement should be carefully considered though.

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?

We believe that compliant firms should already be in a position today to provide compliant presentations for any of the firm's composites. We believe that the standards already implicitly mandate this fact and we fully agree and welcome the inclusion of this requirement.

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)?

Our experience shows that firms have already implemented the asset-weighted method for composite performance calculation. Therefore, we believe this new requirement is appropriate and is no burden at all for firms to implement.

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?

We agree that moving forward the effective date to 2010 will allow firms the necessary additional time to find a solution and/or upgrade IT systems. However, we strongly believe that this requirement must not be postponed any further. One concern here is that this may send the message that previously established and communicated in advance deadlines may be extended. To ensure the credibility of the GIPS standards, postponements must not re-occur, since such actions may conflict with the stated aim of having 'a more rigorous standard'. Also to keep in mind is that firms that did not take steps to meet the requirements in the first place, may have taken the 'easy route', while those firms that have implemented the necessary steps, may have been put at a disadvantage.

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

We agree with the requirement. It is already evident in the industry that a number of firms in many countries already value portfolios at the time a cash flow occurs and also use the daily valuation performance calculation method. Important to note however, is that in some countries the requirement to revalue portfolios for all cash flows (by 2010) may be too onerous for many managers and will require significant IT expenditures.

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, and**
- (b) the percentage of the composite that is composed of carve-outs.**

We believe the Standards must not require such retroactive presentation of historical information. The above could be incorporated as a recommendation in the Standards.

Other Comments (as viewed appropriate by Ernst & Young)

The following are additional points that we would like to bring to the attention of the CFA Institute:

- GIPS disclosure 4.A.10 requires firms to disclose the percentage of composite assets invested in regions or countries not included in the benchmark. This has always been a contentious issue for firms as the effort and the potential cost of implementing this requirement can be quite substantial to arrive at, in our view, sometimes not significant results (i.e. < 0.5%). We believe it may be worthwhile to consider a clarification regarding the significance level for this disclosure. We also agree with a possible provision that provides the prospect with information about risks in the strategy that are not reflected in the benchmark in order to enable the prospect to assess the performance track record. Neither the current nor the proposed provision addresses this point.
- GIPS requirement 5.A.7 requires the presentation of total return benchmarks. We believe it necessary to clarify whether price indices are also allowed, particularly in situations when no total return benchmarks are available.
- The GIPS Standards focus on potential or prospective clients and do not address the issue of reporting to existing clients. The area of existing clients is also an important topic and we believe it would be appropriate to provide interpretations on this subject as well, either in the proposed Standards or in a separate guidance statement. Key questions include: a) what is and what is not allowed in terms of presentation of investment performance figures; b) does a full composite presentation, including disclosures, have to be included in the reporting to an existing client when a firm mentions or makes reference to GIPS compliance; c) can a firm state in its reporting(s) to existing clients that the individual performance of the portfolio meets the requirements of the standards, i.e. is “calculated in accordance with GIPS” (as stated in FC.A.14). Within the context of normal client/manager communications, our view is that the use of customized presentations or the presentation of single account return information should not be prohibited.

- With regards to removing the total firm assets disclosure requirement, additional clarification should be provided if the continued presentation of such information would be considered as a recommendation or as supplemental information. We suggest to leave this requirement or, at most, to ‘downgrade’ it to a recommendation. The removal of total firm assets from composite report(s) may have cost consequences for some firms, and this may be alleviated by ‘downgrading’ the disclosure requirement to a recommendation.
- Mandatory verification will be required effective January 1, 2010. The proposed standards do not address the frequency of verification. This requirement should be clarified, considering that some compliant firms in the industry choose not to be verified on a yearly basis. It is also not quite clear what will happen in the instance that a firm does not meet this requirement; as we understand it, firms will not be able to claim compliance and/or comply unless they are verified. Finally, the earlier mentioned consideration with respect to postponing or extending any deadlines should be taken into account by the CFA Institute as well.
- Based upon the existing standards and guidance documents to date, the clarification of trade date accounting is not apparent and trade date accounting is not defined or clarified in its entirety. We suggest that such information be provided.
- With respect to the requirement on the use of accrual accounting for dividends (1.A.6), a clear definition is necessary. It should be defined what exactly is expected and required of firms in order to meet requirement 1.A.6.
- With respect to recommendations 1.B.2 and 2.B.1, the meaning of the word ‘accrue’ is not clear and should be clarified.
- For requirement 2.A.2, the term ‘true’ time-weighted rate of return may be interpreted broadly. For example, what is the applicable requirement regarding the valuation of the portfolio when a cash flow occurs: at the beginning of the day, or at the moment the cash flow occurs? If the latter is required, it’s possible that a portfolio has to be valued several times in one day. Most performance measurement systems do not have such functionality. The definition, as relevant to the GIPS standards, should be clarified, i.e., the word ‘true’ deleted, and a definition of Time-Weighted Rate of Return added to the Glossary in the Standards. With respect to requirement 2.A.4, we believe that once a firm has chosen the appropriate composite return calculation method, that method should be applied consistently. Therefore, we propose to incorporate the word ‘consistently’ into the requirement.
- Additional clarification should be provided on composite construction, specifically on retroactive creation of composites, redefinition of composites, as well as error corrections relating to composite classification.
- Requirement 4.A.23 requires disclosure of any events that help a prospective client interpret the performance record. Considering that the requirement cannot be objectively verified in terms of compliance, we believe it is appropriate to split this requirement into two parts: a) a requirement that lists a set of events that must be disclosed if they occur; and b) a recommendation for the disclosure of any other events that may be of relevance to a prospective client.
- Requirements 1.A.7 and 1.A.8 are in our view either not compatible or require further clarification. Requirement 1.A.8 states that portfolios must be valued as of calendar month-end, which implies that composites will be valued as of calendar month-end. In our opinion, the

wording in the brackets at the end of requirement 1.A.7 – allowing valuation as at last business day of the year – should consequently be removed. Further clarification is necessary to ensure that both of these requirements are consistent.

- The disclosure of non fee paying accounts-5.A.8, should be expanded to also include disclosure of affiliated accounts that may be included in composites. Currently, managers may avoid disclosure of related party money under management by charging a nominal fee.
- In the CFA Institute ‘Comparison Matrix – Comparison of the Proposed v. Existing GIPS Standards’ the effective dates need to be updated and/or clarified where applicable. For example, effective dates of the Private Equity Provisions and the GIPS Advertising Guidelines.
- ‘APPENDIX A-SAMPLE PRESENTATIONS’ of the Standards contains a composite presentation example (page 33). Following the outcome of the final changes, this section will need to be updated appropriately. [(Currently, the total firm assets are still presented in the presentation, considering that this requirement is expected to be removed. Also, the currency of the report should be checked, as Note 3 refers to DEM whereas the composite value column refers to EUR (with data pre 1999)].
- In the ‘REAL ESTATE’ section, requirement 6.A.3.(a), last line of the paragraph, the wording “(check Peter’s last e-mail on accrual)” should be removed since this does not seem to be relevant within the context.