

The Ernst & Young (South Africa) GIPS Discussion Group response to the IPC invitation to comment on proposals to add the Guidance Statement on the Treatment of Carve-Outs

1. Introduction

- 1.1 The South African practice of Ernst & Young launched the GIPS Discussion Group earlier this year. Members of the group include investment managers who are currently implementing the standards. They are at different stages of their implementation projects – some are close to completion and others are at the start. It is the intention of the group to comment on all proposals on GIPS open to the public for comment issued by the IPC and AIMR.
- 1.2 The response of the discussion group to the IPC invitation to comment on the Guidance Statement on the Treatment of Carve-Outs follows. Please note that this is not the response of Ernst & Young.

2. Do you agree with the principles established in the Guidance Statement?

- 2.1 Yes, we believe the principles established in the Guidance Statement are sound and support the aims of GIPS. We have some specific comments about the Guidance Statement, which we have set out below.

3. Are there other cash allocation methods that should be allowed prior to 1 January 2005?

- 3.1 Carve-outs are most commonly created in South Africa when an investment manager is asked to pitch for a specialist mandate that in the past has been managed as part of a broader portfolio. The manager typically carves out necessary information from the broader portfolios for the specific mandate. It is unusual for a manager to use carve-outs in the normal course of events. Consequently in most cases, the bulk of the information is created retrospectively.
- 3.2 The allocation of cash as proposed by the *Beginning of Period Allocation* implies that the allocation can be done only on a prospective basis. Considering the fact that the requests are usually as set out in 3.1 above, we believe that the principle can be applied retrospectively but using beginning of period weightings.
- 3.3 We recommend that the Guidance Statement include a requirement to apply an allocation methodology consistently. Unless this is specifically included, we consider that there may be opportunities for managers to change the methodology to improve performance information. Clearly this conflicts with the objectives of GIPS.
- 3.4 We do not believe there are other methodologies to consider.

4. Do you agree with the principles relating to the treatment of fees?

- 4.1 We support the principle relating to the treatment of fees.

5. Do you agree that if a firm creates a carve-out ”then all similar portfolio segments managed to that strategy should also be carved out and included in the composite”?

5.1 In order to avoid “cherry picking”, as the composite construction principles aim to achieve, the statement set out above is required. Consequently we agree, although the administration may be onerous.

6. Methods for allocating cash after 1 January 2005.

6.1 It should be understood that where a portfolio is managed and accounted for by way of sub-portfolios, the main portfolio must consist solely of the sub-portfolios and should not include any other assets. The basis of allocating new inflows into the main portfolio amongst the sub-portfolios should be consistently applied. We suggest that these principles be included in the “sub-portfolio” methodology.

6.2 Other than our comments set out in 6.1 above, we consider the methods to be understandable and complete.

7. Do you agree with the proposal that this guidance should only be applied on a forward-looking basis (i.e. not retroactively)?

7.1 As set out in 3.1 above, performance information on certain asset classes or sectors of the same class are most commonly requested for past periods. The Guidance should be applicable to circumstances of special requests. Where no information is normally maintained that would require carve-outs, managers should be able to apply the principles retrospectively. Where the information is normally maintained, we are satisfied that the principles should be applied only on a forward-looking basis.

8. Do you agree with the proposed Effective Date?

8.1 We consider the effective date of 1 January 2003 to be acceptable.