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## INTEROFFICE MEMORANDUM

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**TO:** CFA INSTITUTE  
**FROM:** ANN PUTALLAZ, V.P. & DIRECTOR OF DATA & COMMUNICATION SERVICES, MUNDER CAPITAL MANAGEMENT  
**SUBJECT:** COMMENTS ON PROPOSED GIPS STANDARDS  
**DATE:** 8/3/2004

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### **General Comments**

We support the revision and expansion of the GIPS standards, and agree with most of the changes. However, we hope that the number of required disclosures will be monitored closely. At some point, the quantity of disclosures may become overwhelming to the reader and important information will be diminished rather than highlighted.

### **Specific Comments**

The following are our comments on the proposed GIPS standards.

#### **Proposed Effective Date**

There is some question as to whether the 1 January 2006 effective date applies to the date the presentation materials are prepared, the date the presentation is made to the client, or the date of the performance results included in the presentation. We suggest that the Standards clearly indicate that the effective date applies to all presentation materials prepared on or after 1 January 2006.

#### **1.A.3**

**For periods prior to 1 January 2001, portfolios must be valued at least quarterly. For periods between 1 January 2001 and 1 January 2010, portfolios must be valued at least monthly. For periods beginning 1 January 2010, the firm will be required to value portfolios on the date of any external cash flow.**

We have no objection to this provision from a conceptual point of view. However, to implement this would require a very significant cost increase because of the need to price fixed income securities daily. In addition, there would be significant time involved in verifying daily fixed income pricing. We would therefore suggest that this be a recommendation rather than a requirement.

A second point is that daily pricing in the case of a small external cash flow (e.g. less than 10%) generally has a negligible impact on returns. We would recommend that the provision call for valuation of a portfolio on the date of an external cash flow of 10% or more.

#### **1.A.6**

**For periods beginning 1 January 2010, Accrual Accounting must be used for dividends (as of dividend ex date).**

We are planning on implementing accrual accounting at some point within the next year or so, so we would not have any difficulty in meeting this requirement. However, if there are firms that would find this requirement burdensome, we would suggest that this be made a recommendation rather than a requirement, since the impact on performance should be relatively minor.

#### **2.A.2**

**Time-weighted rates of return that adjust for cash flows must be used. Periodic returns must be geometrically linked. Approximated time-weighted rates of return that adjust for daily-weighted cash flows must be used for periods beginning 1 January 2005. The firm must use a “true” Time-Weighted Rate of Return calculation method for periods beginning 1 January 2010.**

We agree that the implementation of 2.A.2 would result in more accurate returns. Our reading of this provision is that using a modified Dietz formula satisfies the requirement effective on 1 January 2005, and we have no problem with that deadline.

The requirement for 1 January 2010 would be a large undertaking for our firm. We currently cannot daily post a fixed income portfolio. First, there is a problem with the methodology that our trade accounting system uses for the daily posting of fixed income portfolios. Second, daily pricing for fixed income securities would require a significant increase in cost and in the time involved in verifying fixed income pricing on a daily basis. Therefore, it will be difficult to meet the requirement for 1 January 2010.

Perhaps the methodology required by 1 January 2010 could involve re-pricing when there is an external cash flow of 10% or greater, with the current provision being moved to a recommendation.

#### **2.A.6**

**All returns must be calculated after the deduction of the actual Trading Expenses incurred during the period. Estimated Trading Expenses are not permitted.**

We agree that this should generally be the case. However, we believe that an exception should be made for bundled fee accounts. Please see our response to 2.A.9 and 2.A. 10.

#### **2.A.9**

**If the actual direct Trading Expenses cannot be identified and segregated from a Bundled Fee:**

- a) **When calculating Gross-Of-Fees returns, returns must be reduced by the entire Bundled Fee, or the portion of the Bundled Fee that includes the direct Trading Expenses. Estimated Trading Expenses are not permitted.**
- b) **When calculating Net of Fees returns, returns must be reduced by the entire Bundled Fee, or the portion of the Bundled Fee that includes the direct Trading Expenses and the Investment Management Fee. Estimated Trading Expenses and Investment Management Fees are not allowed.**

In our experience, it is not possible to obtain actual trading expenses from bundled fee program sponsors. Our reading of 2.A.9 is that the entire bundled fee would therefore have to be deducted from gross-of-fee returns.

We believe that when a composite includes only bundled fee accounts, the most accurate portrayal of performance would result from the reporting of gross returns without having to deduct trading expenses. Otherwise, the prospect is likely to be presented with identical gross and net returns. The fact that gross returns are calculated prior to the deduction of trading expenses would be a required disclosure.

A second methodology would be to allow trading expenses to be estimated, with a required disclosure of the estimated expenses and how the estimates were derived. We view this as less desirable, since differences in the methodology used for estimating trading expenses, as well as differences in accuracy, would make it more difficult to get a true comparison of gross returns from one investment manager to another.

#### **2.A.10**

**If a composite contains both portfolios where the actual direct Trading Expenses cannot be identified and segregated from a Bundled Fee and portfolios where the direct Trading Expenses can be identified, GIPS Calculation Methodology Requirement 2.A.9 (above) must be met for those portfolios where the direct Trading Expenses cannot be identified and segregated from a Bundled Fee when calculating the composite Gross-Of-Fees or Net-Of-Fees return.**

We are concerned that this methodology would not result in an accurate portrayal of performance. When a composite includes accounts where trading expenses can be identified, as well as accounts where these expenses are not known, we would advocate the use of estimated trading expenses for those accounts where the actual

expenses cannot be identified. The fact that trading fees were estimated for some accounts in the composite, the estimate used and the basis for the estimate would be a required disclosure.

#### **2.A.7**

**If a firm sets a minimum asset level for portfolios to be included in a composite, no portfolios below that asset level may be included in that composite.**

We agree with this provision in principle. However, in an effort to reduce the frequency with which portfolios might enter or leave a composite, firms may have established a written policy that allows portfolios that fall below the minimum (yet remain above a defined floor) to remain in the composite for a specified period of time. We would hope that the wording of this provision would not preclude such a policy.

#### **4.A.2**

**[Total firm assets for each period were removed as a required disclosure, since the IPC believes the information is easily derived from other data.]**

We believe that total firm assets should be a recommended disclosure, so that firms who wish to include that data can do so without a “supplemental” label.

#### **4.A.6.**

**The firm must disclose the currency used to express performance.**

It is usually clear from the presentation what currency is used to express performance. In an effort to avoid unnecessary disclosures, we believe this disclosure should be required only if the currency used is different from the currency in the composite presentation.

#### **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.**

It is assumed that active managers will have some degree of benchmark risk. We feel that this provision is unnecessary for active managers, and should be required (if at all) only of passive managers.

#### **4.A.21**

**Firms must disclose that the portfolio, composite and benchmark calculation methods and valuation sources are available upon request.**

We recommend that this disclosure be eliminated. The list of required disclosures is already quite lengthy. Disclosures that are less essential simply reduce the weight of

truly important disclosures. Clients/consultants who are knowledgeable enough to be interested in this information will ask for it without prompting.

#### **4.A.23**

**The firm must disclose any events (such as ownership or personnel changes, significant deviations between annual and interim performance records) which help a prospective client interpret the performance record.**

It is currently unclear as to whether this should be applied retrospectively or prospectively. We would suggest that this be applied prospectively. We also wonder if such disclosures would have to be presented indefinitely or for a period of time. A change that was significant at a point in time may become inconsequential after some time has elapsed, and the disclosure will no longer add value.

#### **4.A.28**

**Firms must list “discontinued” composites on the firm’s list of composites for at least five years after discontinuation.**

While we do not have strong objections to this provision, we believe that it is more appropriate to present a list that accurately portrays a firm’s current offerings.

#### **4.B.7**

**Firms should disclose when a change in a calculation methodology or valuation source results in a material impact on the performance of a composite return.**

We believe this provision will be hard to apply. Firms may have very different views on what is “material”, and determining the impact of a change on historical returns could be difficult. Our recommendation would be to delete the provision. If it is felt that a provision such as this should be included, we would suggest that it be reworded to state that changes in calculation methodology or valuation should be disclosed for a specified period of time (e.g. one year) after the implementation of a change.

#### **5.A.1.d**

**The following items must be reported: A measure of dispersion of individual portfolio returns for each annual period**

We agree that measuring dispersion of individual portfolio returns on an annual basis is generally the most accurate methodology and should be the most frequently used. However, there are cases where an annual measure may not result in the truest portrayal of dispersion. For that reason, we believe that investment managers should have flexibility in choosing the frequency of the dispersion measure, as long as the methodology is fully disclosed.

#### **5.A.4**

**Performance results of a past firm or affiliation must be linked or used to represent the historical record of a new firm or new affiliation if:**

- **a change only in firm ownership or name occurs, or**
- **the firm has all of the supporting performance records to calculate the performance, substantially all the assets included in the composites transferred to the new firm, and the investment decision-making process remains substantially unchanged.**

We were puzzled by the change in emphasis of this provision. The previous version emphasized that results could only be linked if certain provisions were met. The current version sounds as though linking is required under most circumstances. We believe that linking returns will often prove to be inappropriate, and recommend that the former emphasis be retained.

If only a few accounts follow the manager, rather than the majority of assets, it is not clear why their performance could not be used by the manager in his/her new position, assuming that the other conditions were met.

#### **5.A.5**

**If a compliant firm acquires or is acquired by a non-compliant firm, the firms have on year to bring the non-compliant firm's acquired composites into compliance.**

First, it seems to us that the task of bringing a firm into compliance goes beyond the composites to touch many other aspects of the firm, so we are puzzled by the focus on composites alone. We also believe that more guidance is needed here. If the non-compliant firm cannot be brought into compliance retrospectively (e.g. lack of adequate documentation) does this mean that the compliant firm will no longer be able to claim compliance? There should be a provision for such a situation – e.g. the non-compliant firm becomes compliant as far back as possible and does not advertise non-compliant composites. There should be some way for the firm that is compliant to remain so.

#### **5.A.6**

**If a composite is formed using single asset carve-outs from multiple asset class composites the presentation must include the following:**

- **a list of the underlying composites from which the carve-out was drawn, and**
- **the percentage of the composite that is composed of carve-outs**

**As of January 2006, the firm must disclose this information for each period (retrospectively and going forward).**

To balance full disclosure with practicality, we recommend that prospective information be required and retrospective information be recommended.

### **5.B.1**

**The following items should be included in the composite presentation or disclosed as supplemental information:**

- a) composite performance of gross of Investment Management Fees and Administrative Fees and before taxes (except for non-reclaimable withholding taxes)**
- b) removed (cumulative returns for composite and benchmarks for all periods)**
- c) removed (equal-weighted means and median returns for each composite)**
- d) The firm is recommended to present the volatility over time of the aggregate composite return and benchmark return.**

We find the wording here confusing. If the intent is to recommend that the following items be included (gross performance and volatility of the aggregate composite return and benchmark return), then they should be considered additional information and not have to be labeled as supplemental items.

Also, we question the removal of 5.B.1. b and c. They seem important enough to warrant a recommendation for their inclusion.

### **5.B.4.**

**The firm is recommended to present the following additional performance-related information:**

- a) Graphs and charts presenting specific information required or recommended under the GIPS standards**
- b) Returns for quarterly and/or shorter time periods**
- c) Annualized composite and benchmark returns for periods greater than 12 months**
- d) Composite-level country and sector weightings**

We have no problem with these recommendations. However, as noted in the response to 5.B.1. above, we believe that additional items should be added to the recommended list.

### **Verification**

We support the adoption of mandatory verification by 1 January 2010. We believe that mandatory verification will help to ensure that areas of confusion are identified and dealt with in a consistent and professional manner. While a firm may have one or more staff members who are truly AIMR-PPS/GIPS experts, a verification requirement will help to ensure that a firm's AIMR-PPS processes are reviewed by a third party, helping to prevent misinterpretations of the GIPS standards from becoming embedded in a firm's composite construction and presentation methodologies.