

CFA Institute  
Professional Standards & Advocacy Department  
Re: “Gold” GIPS Standards  
P.O. Box 3668  
Charlottesville, Virginia 22903

Dear Sir or Madam:

Thank you for allowing us to comment on the draft of the “gold” GIPS® standards. We begin by applauding the effort to standardize investment performance reporting world-wide. With the ever-increasing globalization of the financial services industry, including asset management, and with diversification by economy as a key element of prudent diversification, achieving standardization of asset management operations, regulation and reporting is a critical objective for the efficiency of the global economy.

Nevertheless, that vital objective must be tempered by a realistic assessment of current practice in existing asset management environments, including North America, the area of concern to the AIMR-PPS® Implementation Committee. Requirements that would be expensive to implement will be a barrier to their adoption in an increasingly competitive asset management industry that must keep a sharp eye on expenses. The value of any new requirement must be easy to explain to an asset manager’s clients in order for the requirement to win quick acceptance and speedy implementation.

The Committee has limited its comments to a very few points with respect to which Committee members have a broad and deep consensus that a recommendation should be reconsidered. Our comments follow.

### **Mandatory Verification**

Above all, the Committee strenuously objects to the requirement of Mandatory Verification. The Committee’s objection has both a theoretical and a practical foundation.

#### *Theory*

CFA Institute is a professional association grounded in the belief that professionals can achieve meaningful self-regulation by voluntary, good faith efforts reinforced by marketplace pressures. While of course CFA Institute is deeply gratified that its efforts have been so widely successful that its performance standards have won the respect of securities regulators, and perhaps forestalled more extensive and costly government regulation, CFA Institute does not wish to abandon its roots in good-faith voluntarism. We believe that mandating verification is counter to the principle of good-faith voluntarism.

#### *Practice*

The Committee has also the following practical reasons for opposing making verification mandatory:

- the cost associated with verification;
- lack of qualified verification firms; and
- lack of understanding concerning what a verification is, and what it is not. (Too often we hear people refer to performance results being verified, when in fact verification provides no assurance on the results of a specific composite).

Cost is clearly the most important of these concerns. We believe that smaller firms, for whom the cost of verification could be overly burdensome, would be excluded from the “compliant” universe. The Committee fears that mandatory verification will lead to widespread withdrawal from the effort to claim compliance, to the detriment of investors in North America.

In conclusion, the marketplace should continue to determine whether verification is necessary or not.

### **Mandatory Revaluation on the Date of any External Cash Flow**

The Committee opposes a requirement for mandatory revaluation on the date of any external cash flow. We acknowledge that daily pricing produces the most accurate performance results. However, if a firm’s investment requirements do not require pricing all securities in order to meet a portfolio’s cash flow requirements, then requiring the firm to do so in order to claim compliance imposes additional costs for a small, if any, improvement in overall accuracy in reporting performance. Particularly for firms with significant fixed-income assets, such a requirement might tip the balance on the overall cost-effectiveness of claims of compliance.

Firms that do not wish to adopt a policy of daily pricing might be tempted to adopt a Significant Cash Flow policy for all cash flows, where accounts are removed from the composite for all cash flows, or to use Temporary New Accounts for all cash flows. While these approaches might be technically compliant, they would clearly not accord with the intent of those provisions. In any case, they would represent the kind of standards gamesmanship that the Committee believes that the standards should seek to discourage as much as possible.

If there is any requirement at all with respect to revaluation for cash flows, the very lowest level for which a required revaluation seems defensible is a cash flow of at least 5% of the composite’s beginning of the period assets.

### **Carve-Outs**

As to carve-outs, the Committee acknowledges that theoretical principles and practical considerations argue at cross-purposes. The theoretical considerations argue for their elimination. Managing an asset class that is simply one element of a mandate that includes other asset classes as well is not the same as managing a portfolio that consists solely of that asset class. Further, there can be good faith differences of view about the appropriateness of the standards used to disaggregate composite portfolios into “carve-outs,” that raise legitimate concerns about “cherry-picking.”

However, the practical considerations argue overwhelmingly for continuing to permit carve-outs, not only to the revised deadline of 2010, but as long as they are in widespread use in major investment markets.

Carve-outs, with allocated cash, are still widely used in the U.S market, particularly by firms that focus on high net worth clients. The Japanese market also widely uses carve-outs. Until there are changes in these major markets, there should be no ban on carve-outs.

### **Definition of the Firm**

The Committee opposes the proposal to delete independent registration with regulatory authorities as a basis for definition of the firm.

To the extent practical, “gold” GIPS should promote full disclosure of investment performance that a rational investor would find meaningful to making a decision on an investment manager. Definition of the firm should not be a way to segregate some investment performance of a single investment operation from other investment management performance by the same team. Where the same investment personnel manage two portfolios recognized as the same style (large cap growth; core fixed income) and included in the same “book of business,” it should not be possible to define firms such that the two portfolios end up in different composites. We believe that requiring a firm to explicitly define how the firm has been defined, if it has been defined based upon legal entity, would suffice. We believe that the “legal entity” distinction is less susceptible to manipulation than the “separately held out” distinction. The organizational costs of organizing and registering a legal entity are deterrents to abuse. “Separately held out” is a more subjective standard, one which some managers could achieve at very low cost, for the sole purpose of limiting disclosure.

### **Conclusion**

The Committee repeats its thanks for the ability to contribute its comments. We welcome the opportunity to discuss our comments with you.

Sincerely,  
AIMR-PPS Implementation Committee