

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

2nd August 2004

Proposed Revisions to the GIPS Standards

Dear Sir / Madam,

PricewaterhouseCoopers wishes to thank the CFA Institute for this opportunity to comment on the proposed revisions to the GIPS Standards (“Gold” GIPS). We welcome the efforts of the CFA Institute to continuously develop the GIPS standards and its commitment to fair representation and full disclosure.

Our comments are provided in the attached appendix to this letter. If you wish to discuss these points further, please contact Kelvin Laing-Williams in London at +44 (20) 7804 1707 or Peter McNamara in New York at (646) 471 8743.

Yours sincerely,

PricewaterhouseCoopers LLP

Appendix: PwC Comments on the Proposed Revisions to the GIPS Standards (“Gold” GIPS)

General comments

We fully support the efforts of the CFA Institute to continuously develop the GIPS standards by revising and expanding the Standards and providing further elaborations with respect to their scope and contents. However, we would like to present the following items for your consideration.

Promotion of GIPS

The CFA Institute has been successful in educating traditional investment managers on GIPS compliance. However, there are still areas within the industry where GIPS awareness could be increased. Historically, an obvious target of such promotion has been the investment firms themselves and to some extent the pension plan consultants. In addition to these parties we believe that additional resources should be directed at others in the investment management industry, including the alternative asset class investment managers, plan sponsors and pension plan trustees. At the other end of the spectrum, the time may be right to also consider the feasibility of targeting specific client segments such as high net worth investors.

As we continue to move towards one global standard, we fully support the CFA Institute promoting the GIPS standards more actively among those parties that should have an interest in the Standards. Through such value-based promotion, such groups will become aware of the benefits that GIPS compliance brings to both themselves and their asset managers. In addition, this will help to achieve a practical, client-demand-oriented evolution of the Standards.

Evolution of GIPS

We believe that the Standards should continue to evolve as a principle-based framework and avoid becoming overly prescriptive. On this we have two observations:

a) While the GIPS are becoming more detailed in certain areas, in other areas they still provide little or even no specific guidance (e.g. application of GIPS for hedge-fund managers, guidance on measurement and presentation of risk measures). We believe care must be exercised to ensure all areas of GIPS have consistent levels of detail and precision applied and that the impact of provisions in the Standards in terms of their significance and effect on performance presentations is always borne in mind.

b) The Summary of Proposed Revisions to the GIPS Standards (page 3) under the New Provisions, 7th bullet point reads: “Must *abide* by guidance and interpretations, including the GIPS Handbook”. At the same time, principle FC.A.10 says that firms just must “*understand* all the requirements and recommendations of the GIPS standards”

- a. Firstly, we suggest that principle FC.A.10 be re-worded to explicitly emphasize that firms must abide by guidance and interpretations.
- b. Secondly, “GIPS guidance and interpretation” needs further clarification. We believe that firms should be required to abide only by those interpretations which relate to the investment industry in general and have been embodied in Guidance Statements. Whilst we believe the Q&As can provide useful reference material,

the circumstances of each case can make interpretation of these to a broader based audience inappropriate. In addition, these Q&As have not been subject to public comment or ratification by the IPC. We therefore do not believe that Q&As should be considered to form part of “GIPS interpretation” that firms are required to abide by. Including the Q&As as an effective extension of GIPS makes compliance with the standards unwieldy and lacking in transparency.

- c. Even if the Q&As are only to be used as reference material, we note that there are currently GIPS Q&As and AIMR-PPS Q&As, some of which are outdated. We believe that the AIMR-PPS Q&As should be reviewed, approved or superseded and moved over to GIPS Q&A status.

Language of the Standards

While the language of the Standards appears to be straightforward and comprehensible, we see room for improvement with respect to a clear distinction between requirements and recommendations in terms of their wording (‘must’ vs. ‘should’). In some cases, these words are not used consistently (refer also to our specific comments regarding various typo and structure errors on the last page of this appendix).

Specific comments

The Revised GIPS introduce both new provisions and incorporate provisions already included in the various GIPS Guidance Statements adopted.

For the sake of clarity, it would be helpful to provide an overview of all existing GIPS Guidance Statements and interpretations and their reconciliation to the “Gold” GIPS in terms of which Guidance Statement / interpretation remains a separate guidance and which is integrated in the “Gold” GIPS.

1. 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?

We support the requirement for firms to provide a compliant presentation to all prospective clients.

2. 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?

We support the requirement for firms to provide a list and description of composites to any prospective client. The term “prospective client” maybe interpreted differently across geographies and therefore a definition in the glossary might be helpful.

3. 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 support the recommendation and believe it should be a requirement and be extended to proclaim a general principle that firms must not knowingly market composites which are not appropriate for these particular clients for any reasons (size of the potential client portfolio, specific client investment preferences, etc.).

4. 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 support this requirement.

5. 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)?

This prospective requirement is already incorporated in the Guidance Statement on Calculation Methodology (which is already in effect) which we support.

There appears to be an inconsistency in this question, mentioning beginning 2005 as the effective date, while as the Revised GIPS propose this requirement from 1.1.2006 (see 2.A.8).

6. 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?

While we support realistic re-assessments of feasibility of future GIPS provisions by the industry (e.g. accrual accounting for dividends), we believe that postponements of the future GIPS provisions should be avoided as this practice may pose a potential credibility issue. Deadline extensions should generally only be granted if the IT technology is not sufficiently developed to support the future requirement.

As far as this particular postponement of treatment of carve-outs is concerned, our experience shows that some investment managers have either undertaken efforts to comply with this requirement as of 1.1.2005, or have declined to or stopped using carve outs within a GIPS compliant framework, since they were aware that they would no longer be able to comply after this deadline. Therefore, we are of the view that the extension of this deadline may undermine the Standards' quality in the eyes of some investment managers. In addition, the initial deadline has been known for a long time and was confirmed in the first draft of the Guidance Statement on the Treatment of Carve-Outs (as released for comment in 2002).

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

We understand this effectively means mandatory application of the "true" Time-Weighted Return methodology starting from 2010. We support this objective in principle and the results of our recent survey show that majority of investment managers believe that they should be able to implement this requirement by 2010. While achieving this objective is desirable, it will require considerable

investment in the IT area and may pose a significant issue for many institutions. We suggest that this requirement be made subject to an additional revision as the deadline approaches, taking into consideration the current level of the IT technology available to support it.

We also recommend the IPC to explicitly refer here to the Guidance Statement on Calculation Methodology (in effect since 1 June 2004), which provides a detailed guidance with respect to the “true” Time-Weighted Return methodology.

8. 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 support the proposed requirements.

Other matters

Application of GIPS

Paragraph 10 f on page 8 reads: “GIPS apply to the presentation of investment performance of assets managed on behalf of a third party.” We suggest extending this definition to cover proprietary assets as well, provided that they are managed on a fee-paying basis similar to third-party assets.

Maximising transparency

Paragraph 10 g on page 8, last sentence, reads: “...To fully explain the performance included in a presentation, firms are encouraged to present all relevant supplemental information”. We suggest extending this statement to say that firms are encouraged to present all relevant supplemental **and additional** information, to make it consistent with terminology used in the Guidance Statement on the Use of Supplemental Information.

Presentation of historical performance track-record

Paragraph 13 b on page 9, last sentence, reads: “For example, after a firm presents five years of compliant history, the firm must add an additional year of performance each year so that after five years of claiming compliance, the firm presents a ten year performance record”. We suggest re-wording this to say that “...the firm must add an additional year of performance each year so that after five years of claiming compliance, the firm presents **at least** a ten year performance record”. We believe that firms should not be prevented from presenting a performance record of more than ten years, if they wish to. The same should be added to principle 5.A.1 (a).

Definition of the Firm

According to the Revised GIPS, the definition of the firm is no longer permitted as:

1. an entity registered with the appropriate national regulatory authority overseeing the entity's investment management activities;
2. all assets managed to one or more base currencies (this option will no longer be allowed starting from 2005 anyway).

As a result, according to the new proposal, the firm can only be defined as an investment firm, subsidiary, or division held out to clients or potential clients as a distinct business entity.

This is a significant modification to the Guidance Statement on the Definition of the Firm (effective since 1 April 2002) where the first option was allowed going forward. The Standards must clarify whether firms already defining themselves under the first option will have to revise their definition of the firm, or whether there will be some sort of "grandfathering". If there is no "grandfathering", an appropriate transition period should be granted to such firms to adopt the new requirement.

Additional guidance would also be desirable with respect to situations where one firm may be held out separately but the investment process may not be functionally separated from another area. For instance, situations may arise where the same managers manage investment portfolios in two areas, but may not be dual employees of more than one legal entity or division.

Accounting conventions

The requirement to use the trade-date accounting principle is clarified in the Revised GIPS. As of 1.1.2005, firms must recognize the asset or liability on the date the transaction is entered into (according to GIPS Glossary in Appendix C). In some countries (e.g. in Europe) a so-called "booking date" principle is often applied (i.e. transactions are booked with an up to T+3 day delay after the trade date for the data processing reasons). We expect the IPC to address this question whether such practice still corresponds in substance to the trade date principle.

Disclosure on use of sub-advisors

The Revised GIPS (4.A.22) state that the firm must disclose any discretionary use of a sub-advisor(s). Please clarify the scope and extent of this disclosure (e.g. whether individual sub-advisors must be named, etc.). We believe that simply stating that sub-advisor is employed by the firm for a particular strategy would be sufficient for the purpose of this disclosure.

Mergers and acquisitions

Principle 5.A.5 states that "if a compliant firm acquires or is acquired by a non-compliant firm, the firms have one year to bring the non-compliant firm's acquired composites into compliance". We suggest to modify this provision to read "If a compliant firm acquires or is acquired by a **compliant** or a non-compliant firm, the firms have one year to bring the **applicable** non-compliant firm's acquired composites into compliance.", as not all composites may survive the merger in terms of the investment process.

Presentation and reporting recommendations

Paragraph 5.B.1 lists those items which should be included in the composite presentation or disclosed as *supplemental* information. We see the following issues in this respect:

- as these items are recommended, the word “supplemental” should be changed to “additional” (to be consistent with the Guidance Statement on the Use of Supplemental Information),
- removal of cumulative and equal weighted returns as recommended items (5.B.1 “b” and “c”) may pose a problem for companies who currently show these statistics but may be forced to label them as supplemental information.

We believe that GIPS should explicitly state that any additional presented statistics, which can be directly derived from the data presented in a compliant composite report (such as cumulative or annualised returns), are considered additional and not supplemental information.

Verification

As of 2010, an independent verification by a third party is proposed to become mandatory. Firms will have until 31 December 2011 to complete the initial verification. However, we see a need for the following further clarifications:

- the Revised GIPS do not clearly elaborate at what interval the verification must be performed (annually, at least once in two years, etc);
- it should be clarified whether the one year period only applies for the initial verification (for firms not previously verified) or will all firms only have one year to complete the verification in subsequent years in order to claim compliance;
- additional elaboration on the term “third party” should be provided.

In Section C “Detailed Examinations of Investment Performance Presentations” it states: “Separate from a GIPS verification, an investment management firm may choose to have a further, more extensive, specifically focused examination (or performance audit) of a specific composite presentation”. For the sake of consistency with the current terminology, we suggest to add “...specifically focused *performance* examination (or performance audit)...”.

Disclosure of calculation methods

The Revised GIPS state in 4.A.21 “The firm must disclose that the portfolio, composite, and benchmark calculation methods and valuation sources are available upon request” (this new requirement replaces current recommendations 4.B.1 and 4.B.2).

As this information is essential for understanding a performance presentation we believe that the current recommendations 4.B.1 and 4.B.2 should remain in the “Gold” GIPS, in addition to the proposed requirement 4.A.21.

Changes in calculation methodology

The Revised GIPS state in 4.B.7 “The firm *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 that in case of a material impact on composite performance, such matters *must* be disclosed, especially if the changes in methodology are applied retroactively.

Performance results of a past firm

The Revised GIPS state in 5.A.4: “Performance results of a past firm or affiliation *must* be linked to or used to represent the historical record of a new firm or new affiliation if:

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

The current GIPS (5.A.4) state: “Performance results of a past firm or affiliation *can only* be linked to or used to represent the historical record of a new firm or new affiliation if

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

We believe that this proposed modification is significant and must be shown with greater prominence in the Summary of Proposed Revisions. Reference should be made to the Guidance Statement on Performance Record Portability. All other GIPS requirements should be consistent with this Guidance Statement.

Disclosure of percentage of composites invested outside of benchmark

The Revised GIPS state in 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”.

We believe that disclosing a percentage of such off-benchmark investments requires considerable calculation efforts and interpretation of what is considered a benchmark sector may be subjective. Furthermore information given only for the most recent period may not be representative of the position over time. In addition, off-benchmarks investments may be a part of short-term tactical investment decisions, disclosure of which would not add much value in terms of a strategic asset allocation of a composite. We suggest that this provision be re-worded to require at a minimum qualitative (rather than quantitative) disclosure of any tactical investment deviations from the benchmark investment universe.

If this disclosure requirement is retained we recommend clarity as what is meant by a “composite managed against a benchmark” is given, e.g. is this only required for enhanced index products?

Disclosure regarding inconsistencies in the exchange rates

The Revised GIPS state in 4.A.11 “The firm must disclose and describe any known inconsistencies in the exchange rates used among the portfolios within a composite and between the composite and the benchmark”.

For the sake of completeness, this disclosure should be extended to cover any possible inconsistencies in valuation data between portfolios themselves and/or composite benchmarks and not only with respect to exchange rates. Otherwise, we believe that this disclosure in the proposed wording should be removed completely.

Real Estate

1) Third paragraph on page 24 states: “If a portfolio includes a mix of Private Equity Real Estate and other investment that are not equity real estate, then these requirements and recommendations only apply to the Private Equity Real Estate portion of the portfolio and the GIPS carve-out provisions (Sec II.3.A.7) must also be applied”.

We believe that in such cases the GIPS carve-out provisions should be recommended but not required to apply. Firms should not be forced to build carve-outs.

2) Paragraph 6.A.2 states that the first external valuation must be completed by 31 December 2007. We believe that due to proposed postponement of the effective date of the Real Estate Provisions to 1.1.2006, the deadline in requirement 6.A.2 should be changed to 31 December 2008 (to accommodate the proposed minimum period of thirty-six months).

3) At the present time, the GIPS Private Equity Provisions require performance reporting using money-weighted internal rate of return measures whereas the Real Estate Provisions require time weighted measures. The premise for the Private Equity Provisions requiring a money-weighted IRR appears to be based on the fact that investors do not control cash flows in closed-end private equity funds, and accordingly, a money-weighted internal rate of return will be most meaningful to the investor.

By some estimates, the U.S. institutional real estate investment industry has approximately \$150 billion currently invested in real estate funds. Of that amount, an estimated \$30 billion (20%) is held in open-end funds with the remainder in closed-end and separate account arrangements. Accordingly, it would appear that a potential inconsistency exists with regard to the Real Estate Provisions which require time-weighted returns for all funds, when, based on the premise found in the Private Equity Provisions, money-weighted IRR returns are more meaningful for 80% of the investors in the industry. While this debate has been ongoing in the real estate industry for many years, and there are good overall arguments for both money-weighted and time-weighted measures, we do not attempt to question the need for time-weighted returns in the real estate investment industry. Simply, it would appear that equal if not greater emphasis should be placed on money-weighted returns for the real estate asset class based on the meaningfulness of the measure and the nature of the investment vehicles in the industry.

Various other typo and structure errors

- page 8: paragraph 10 b should read: “GIPS require managers to include all actual fee-paying, discretionary portfolios in composites defined according to similar strategy and/or investment objectives and require firms to *initially* show GIPS compliant history for a minimum of 5 years, or since inception of the firm or composite if in existence less than 5 years.” It should also be mentioned that after presenting of at least 5 years of compliant track record the firm would add another year of performance every year going forward.
- page 17: “2.A.7 If the firm sets a minimum asset level for portfolios to be included in a composite, no portfolios below that asset level can be included in that composite”. This provision belongs to section “Composite Construction” rather than to “Calculation Methodology”
- page 17:”2.A.8. For periods beginning 1 January 2006, the firm must calculate composites performance by asset weighting the member portfolio returns at least monthly”. It should be explicitly made clear that this does not refer to real estate portfolios as separate Real Estate Provisions apply.
- page 17: “2.A.3 moved and combined with 1.A.7”. Should read “2.A.3 moved and combined with 1.A.5”
- page 19: “4.A.5....The firm *should* not market a composite to a prospective client with assets less than the composite’s minimum asset level.” If this is a recommendation (should) then it must be placed under 4.B.X.
- page 19:”4.A.7. If applicable, the firm must disclose the presence, use, and extent of leverage or derivatives including as description¹ of the use, frequency, and characteristics of the instrument sufficient to identify risks”. The superscript should be changed to 3.
- page 21: “4.B.1 replaced by 4.A.17” should read “4.B.1 replaced by 4.A.21”
- page 21: “4.B.2 replaced by 4.A.17” should read “4.B.2 replaced by 4.A.21”
- page 21: “4.B.3 replaced by 4.A.19” should read “4.B.3 replaced by 4.A.16”
- page 21: “4.B.4 replaced by 4.A.19”. It appears to be fully removed but not replaced by 4.A.19
- page 21: “4.B.5 replaced by 4.A.21” should read “4.B.5 replaced by 4.A.23”
- page 23: “5.B.1 (e) moved to Disclosures – 4.A.20” should read “5.B.1 (e) moved to Disclosures – 4.A.11”
- page 34: sample composite presentation still features Total Firm Assets, which is not consistent with the proposed amendment to remove this statistic. In addition, in Note 6 the following should be inserted: “A complete list *and description* of firm composites...”.