

UK Investment Performance Committee (UKIPC) response to the Investment Performance Council (IPC) invitation to comment on GIPS guidance statement on composite definition

1 Foreword

The UKIPC represents both investors, data producers, fund managers and consultants in the United Kingdom and is a strong supporter for better, clearer and fairer reporting across the industry worldwide. The UKIPC is therefore pleased to be able to respond to this draft guidance statement on composite definition.

2 Opening comments

2.1 Composite definition is a fundamental part of the GIPS compliance process. The draft draws attention to a number of issues that should be borne in mind when drawing up composites and, when agreed will remove areas of ambiguity in this important process.

2.2 The UKIPC is pleased that the draft reinforces the important point that composite definitions, the definition of discretion and the criteria and method used to include or exclude portfolios should be documented and consistent.

3 Guiding principles

3.1 The draft discusses the important area of discretion, as technically firms may exclude funds that they define as non-discretionary from their GIPS process. The UKIPC suggests that the definition of discretion should be oriented toward keeping those funds that qualify as non-discretionary to an absolute minimum. Even possibly prescribing a maximum proportion of assets that can be defined as non-discretionary as obviously, if a firm were earning a fee for managing a portfolio, it would follow that there must be some element of discretion being exercised.

3.2 The draft discusses degrees of discretion and states that firms may consider classifying portfolios with certain restrictions into a separate composite. It is suggested that this statement should read “*should where possible*” rather than “*may*” reducing the opportunity for individual interpretation or choice.

3.3 The draft discusses the opportunity to exclude elements of portfolios that are non-discretionary, and seeks comments on this issue. The UKIPC view is that it would be simpler to introduce a solution that discretion should be applied to the whole account and not selective parts of the account and therefore exclusion of elements should not be allowed.

4 Minimum Asset level

4.1 There are several important and useful clarifications made in this section of the draft.

4.2 Firstly, “*Firms may establish a minimum asset level for a composite to identify portfolios that are too small to be representative of the intended strategy*”. Does this imply that this is the only reason for establishing a composite minimum, and therefore does this claim have to be verified in some way? In some cases firms have defined minimum asset levels for composites for convenience and to reduce the data gathering exercise, surely this statement changes that basis and therefore has implications for compliant firms.

4.3 Secondly, “*Firms must not market a composite to a prospective client with assets below the composite minimum asset level*”. This is a difficult point to verify, and implies either the need for a composite of portfolios below the minimum asset level or the idea of marketing without a composite! Given the previous statement as well, it is unlikely that marketers would distinguish in practice between prospective clients who fall below the asset minimum of the composite, and they will certainly not be happy to admit that below the asset minimum the portfolio may not be representative of the strategy.

4.4 Thirdly, “Portfolios below the minimum must represent a small percentage of the composite assets and thus, should not have a material impact on the asset-weighted composite return.” What would we define as material? This sentence also reinforces the idea that the data for these portfolios must be gathered and calculated alongside the main composite data.

UKIPC suggests that for items 4.2 – 4.4, it may be helpful for the interpretations committee to consult more widely on the possible implications of these changes (probably via the verifiers) to assess the effect.

4.5 UKIPC agrees with the basis for each of these important statements which serve to clarify this whole area of minimum asset levels but believes that there may be issues where minimum levels have been used differently by firms who are undergoing or have already undergone the compliance process. This may present a significant issue to larger firms who may have a long tail of small portfolios for each strategy managed, for private clients or charities, where they have not gathered the data but where these portfolios fall within the firm definition.

4.6 The draft logically refers to the need for documentation of policy relating to treatment of portfolios crossing the minimum asset level and consistency in its application. It is unlikely however that a portfolio would ever be removed from a composite due to market movements given that the guidelines would need to change or the client would have to confirm that the firm considers it too small to implement the composite strategy.

5 Composite definition

- 5.1 The draft goes on to reinforce the idea of a creating a structured process for assigning composites and the portfolios within them. The section on Composite definition is valuable in documenting the principles to be applied, and are largely consistent with those principles required by verifiers.
- 5.2 An important point that needs highlighting is the idea that “Discontinued composites must remain on the firm’s list of composites for at least five years after discontinuation”.

6 Composite definition criteria

UKIPC is unsure why this section has been included but it is worth noting, that composite criteria are more likely to work on a matrix basis within levels of the hierarchy shown in order to ensure that composites are most closely geared to the strategy that a prospective client requires. This section is useful however in suggesting examples of composites that would be valid.

7 Constraints/Guidelines

- 7.1 Where derivatives, hedging and or leverage is used by a portfolio, the guidance still allows the firm to decide whether to split out these portfolios from a composite. The guidance could possibly be more prescriptive here or introduce the idea of materiality for the verifier to investigate whether this should be done.
- 7.2 There is an important point of clarification under measurement periods that helps to overcome some of the issues related to certain pooled funds that price weekly instead of monthly. The guidance insists that these portfolios are split into separate composites in order to ensure that valuation or performance is not extrapolated from the weekly returns, and overcomes a significant issue posed to those houses who have several of these portfolios.

8 Additional considerations

- 8.1 The guidance on the use of inception date as a criteria for composites is useful, but may be made more prescriptive as there are only a handful of circumstances where inception date could be validly used as a composite criteria, and even in these cases it is arguable that if inception date is inherent to the strategy, that these performance numbers are not valid for marketing purposes.
- 8.2 It is suggested that the last sentence of the guidance for multiple offices should refer to location but not group.
- 8.3 The section on dispersion, possibly could be tightened up and tied in with guiding principle number 5 which states that “portfolios with different investment strategies

or objectives” cannot be included in the same composite as this composite is meaningless. Composite dispersion is a good indicator of how meaningful a composite is in displaying the performance of a particular firm. It would be helpful to have a measure of dispersion prescribed; perhaps quartile breaks or standard deviation within composite.

9 Conclusion

- 9.1 The UKIPC believes that the draft document contains a valuable clarification of the principles that should be adhered to in determining composite definition and criteria.
- 9.2 However, the Committee considers that the proposed implementation date of 1 April 2002 may pose a problem given that certain firms may have to change their composites to reflect the new guidelines. A date of 31 December 2002 is suggested.

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