The UK Investment Performance Committee (UKIPC) response to the Investment Performance Council (IPC) of the Association for Investment Management and Research (AIMR) invitation to comment on Global Investment Performance Standards (GIPS) guidance statement addressing calculation methodology

1 Foreword

1.1 The UKIPC represents investors, data producers, fund managers and consultants in the United Kingdom. It fully supports the GIPS commitment to fair representation and full disclosure through transparent and unambiguous reporting across the global investment industry.

1.2 The UKIPC has without amendment adopted an edition of GIPS entitled “The UK Investment Performance Standard” (UKIPS). This standard is sponsored and endorsed by the Association of British Insurers, the Association of Consulting Actuaries, the Investment Management Association, the National Association of Pension Funds, the Society of Pension Consultants and the UK Society of Investment Professionals.

1.3 In autumn 2001 the IPC of the AIMR endorsed UKIPS as a country version of GIPS.

1.4 The UKIPC is pleased to be asked to comment on the guidance statement from the IPC Subcommittee addressing calculation methodology and has set out its response to the specific questions below.

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

2.1 It is still very much a moot point as to what is the value added of daily returns for the extra effort involved. The requirement to revalue more frequently can present problems for some instruments and, therefore, for total asset returns for multi asset portfolios. There is a concern about the possible mixing of methodologies for liquid/less liquid investments in the context of volatile markets. While daily time-weighted rates of return (TWR) is theoretically more accurate, it presents practical difficulties all of which impact accuracy, e.g. pricing, corporate actions, late trades.

2.2 However, the difficulties identified in paragraph 2.1 may not normally present practical problems unless returns are calculated in real time since it should be possible to make adjustments retrospectively.

2.3 It would also be worth clarifying whether the requirements actually mean intra day (i.e. any cashflow or significant cashflows in a day) or daily i.e. the end of each day.

2.4 UKIPC agrees that the accuracy of return calculations needs to be improved. Member experience is that the methodology used as standard by custodians and some external performance measurers can result in significant distortions, particularly for index funds, so more frequent re-valuations are to be encouraged. There is also a concern that there is too much emphasis on the Modified Dietz method, which is effectively a chain-linked series of Money–Weighted Returns, which presents problems when markets are volatile.

2.5 Perhaps the concept of significant cash flow could be considered, so only revalue if cash flow is greater than, say, 5% of fund.

3 Are all areas of rate of return and asset-weighted composite calculation sufficiently covered in this Guidance Statement?

3.1 Asset weighting of composites - (standard 2A4, page 11). UKIPC would prefer the upfront emphasis of this requirement to be put on the use of beginning of period weightings adjusted for cashflows, with beginning of period values also being acceptable.

3.2 Worked Examples - (pages 8&9). The examples shown use different data - it would be more helpful to see the impact on using the same data with different methodologies to illustrate the impact of moving to daily.

4 Are there other areas of calculation methodology that should be addressed in this Guidance Statement?

4.1 Accrual accounting - (standard 2A3, page 3). It would be helpful to clarify the preferred methodology for accruals. Common practice in the US is to add accrued income to the valuation (which assumes costless re-investment). The alternative method (commonly used in the UK for instance) is to report income on an accrued basis but not assume re-investment i.e. treat the income accrual as a disinvestment. This means that the value of income is not included in the fund for return purposes between ex dividend and pay date.

4.2 Correction of errors - (page 7, para 5). This section states it is "important to be able to correct for errors". Clarification is required on what this actually means. It acknowledges the problem but does it mean restating returns or physically recalculating the return correctly? An example might be if a manager felt it acceptable to re-issue figures, with say, a basis point adjustment applied at bottom line only, with a disclosure. The UKIPC suggests that the standard would require an actual calculation and believes that this should be specified.

5 Is it reasonable to expect that firms will be able to value portfolios at the time of any external cash flow beginning 1 January 2010 (excluding real estate, venture capital and private equity)?

5.1 The exclusion of real estate (RE), venture capital (VC) and private equity (PE) will cause issues. First, clarification is required as to whether this means RE / VC / PE vehicles or investments, or both? If these are excluded, there will be an impact on the Total Assets return calculation for balanced funds which invest in these categories due to a mixing of methodology.

5.2 The requirements are for a methodology to be used from a date, which presumably means for periods from that date. If, for example, a composite is created on January 2nd 2010 and that composite has a five year history does it have to use daily TWR? It states that the firm must be consistent as to the methodology used for a portfolio in a composite but the methodology has to be allowed to vary over time unless the standards are retrospective. This should perhaps be more clearly stated.

5.3 In terms of being reasonable to expect firms to comply, again, it would be sensible to clarify what the exact requirement is (daily or intra day). The view of UKIPS, in either case, is that it will be difficult for all to comply.

6 Do you agree with the proposed Effective Date? If not, when should the guidance become effective?

6.1 Yes, subject to comments above.

UK Investment Performance Committee

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