

The UK Investment Performance Committee (UKIPC) response to the Investment Performance Council (IPC) of the CFA Institute's¹ invitation to comment on proposals regarding revisions to the Global Investment Performance Standards (GIPS[®])

Foreword

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.

The UKIPC has adopted a country version 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.

In autumn 2001 the Investment Performance Council (IPC) of the CFA Institute endorsed UKIPS as a country version of GIPS.

The UKIPC is pleased to be asked to comment on the proposals from the IPC regarding revisions to the GIPS to 'gold' status.

Overview

The UKIPC is in broad agreement with what the IPC is trying to achieve, particularly in terms of the principles that it seeks to embrace within the enhanced 'gold' version of GIPS. However, it has a number of concerns which are outlined in this document.

The Committee is of the opinion that the status of the Standards may be jeopardised if there is an attempt to broaden their remit too far. Their strength lies in their emphasis on good business practice, on principles of integrity, openness and honesty. Yet there is a danger that they may be becoming too narrowly focused and overly prescriptive. Furthermore some significant slippage in the drafting seems to have emerged.

The Committee is concerned that the outcome may be to prevent investors and investment management companies from making use of the Standards. Furthermore, over-elaboration in this version of the Standards may well endanger their take-up. The Committee has on a number of occasions been alerted to the rising costs attached to installing and maintaining the Standards.

¹ On 9 May 2004 the Members of the Association for Investment Management and Research (AIMR) changed their organisation's name to the CFA Institute.

Clarity is essential and guidance important. It would be helpful if what is 'required' could be stated as such. If what is 'recommended' is likely to become a requirement in the course of time it would be useful if that too could be made clear. The term 'encouragement' is also used in places, but is open to interpretation. If the potential for ambiguity could be reduced, it is felt that the spirit of the requirements would be less vulnerable to misinterpretation or misunderstanding and would send a clearer message to users.

1. Do you support the CFA Institute's effort to revise and expand the GIPS Standards?

- 1.1 Yes. The Committee strongly believes in their importance and feels that it is appropriate to update, extend and improve the Standards; however, the proposals, and the way in which they have been presented, do give rise to concerns.
- 1.2 There appears to be significant duplication and repetition in the proposed drafting, resulting in a document that is in danger of becoming too long and unnecessarily cumbersome. A concise, more succinctly worded document would be more useful and less vulnerable to possible misinterpretation.
- 1.3 The Committee is concerned that loopholes may be emerging e.g. it is unclear whether a firm is permitted to present its track record, explaining why its figures are not compliant, even when it does not have a compliant composite within the specific product area.

2. Do you agree with the evolution process for the GIPS Standards as outlined?

- 2.1 The Committee supports and agrees with the evolution process for the GIPS Standards as outlined, however, it has specific concerns which are detailed in this response.

3. Is the language of the Standards straightforward and comprehensible? If not, how can it be improved?

- 3.1 The Committee feels that there is scope to remove some items which have been repeated; also to improve the clarity of the wording in the document. This should help to negate potential ambiguity. Details are provided in subsequent answers.

4. What modifications, if any, should be made to this proposal?

- 4.1 In principle, the Committee supports what the IPC is trying to achieve - however, it does have some significant reservations. It is felt that the scope of the Standards is potentially falling prey to 'regulatory creep';

also the degree of detail to which the IPC appears to give thought, suggests that in places it may be becoming overly prescriptive.

- 4.2 It is felt that having a number of implementation dates may give rise to confusion. Although it is helpful that the IPC has moved to change some of them - to 1 January 2006 - the Committee suggests that a document identifying the relevant approval dates set for adoption for each section of the standards would prove invaluable.
- 4.3 The Committee wishes to express its severe disappointment that, although signalled for amendment in the current guidance statements, carve-outs are now to be allowed until 2010. The Committee feels that the shift in stance muddies any clear differentiation between those firms that have prepared and complied and those that have failed to make the necessary effort. It is believed that this action may serve to undermine the Standard in the eyes of existing supporters and provides adequate reason to those as yet undecided, not to commit to it.
- 4.4 The Committee recognises that local business culture and practice will vary from country to country. It also appreciates that new business models - for example hedge funds - may find it difficult to conform to requirements that were not designed with them in mind. Nevertheless, it is wary of potential press criticism and the inherent damaging effect on the reputation of GIPS if there is a perception that existing standards are to be allowed to slip and earlier improvement plans deferred. The UKIPC urgently requests that the IPC revisit its reasons for delaying the more restricted form of carve-outs, and reconsiders its decision.
- 4.5 Gross returns have become the industry standard method of presenting investment performance numbers to institutional investors. Figures may also be shown on a 'net of fee' basis, but they are invariably always shown 'gross of fee' returns. The Committee is of the opinion that the proposed revised Standard fails to make clear what is recognised and required in order to uphold industry best practice; and runs the risk of weakening its value accordingly. The Committee asks that the IPC take the lead and consider making the necessary amendment.
- 4.6 Furthermore, whilst it is acknowledged that the basis referred to in 4.5 above is likely to be more appropriate to institutional rather than retail business, it is felt that if 'gross of fee' returns is made the default, others will still retain the option of providing 'net of fee' figures as well. The Committee requests a clearer explanation of the precise requirements for disclosure purposes, especially in cases when retail and institutional funds are used in combination within one composite.
- 4.7 The Committee is very concerned by the apparent looseness of the proposed arrangements for the introduction of verification. It requests the deletion of the paragraph in section III on page 28 "*During the next GIPS revision cycle, currently planned for an effective date of 1 January 2010, a reassessment will be performed to ensure the effective date of 1 January 2010 is still appropriate in light of market conditions.*" To delay the introduction of mandatory verification until 2010 may be an acceptable compromise; however, to imply that this may be extended is not.

5. Do you agree with the numbering and format of the proposed revised GIPS Standards?

5.1 The Committee believes that if the duplication point referred to in 1.2 can be addressed, this will work well.

6. Should the IPC consider any other methods for meeting the objectives of evolving the GIPS Standards?

6.1 When formulating its objectives for evolving the Standards the UKIPC feels that it might be better if the IPC perhaps concentrated on issues of principle rather than matters of detail. It believes that more might be achieved by emphasising the fundamentals and addressing the gaps in the existing Standards than by broadening their remit.

6.2 The Committee is of the opinion that greater awareness of GIPS, borne out of enhanced promotion, would give rise to a more practical, client-demand-led evolution of the Standards.

7. Specific comments:

7.1 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?

7.1.1 In theory this requirement seems acceptable, but there may be difficulties in putting it into practice. It is not possible to produce a track record if the precise portfolio asked for by the client does not currently exist. This seems to imply that a compliant firm may not develop new product lines. What should the company do? The Committee requests guidance as to the IPC's intention behind this requirement.

7.2 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?

7.2.1 The Committee believes that this embraces the spirit of openness attendant in GIPS and as such is a good idea and therefore a reasonable requirement.

7.3 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?

7.3.1 The Committee agrees with this recommendation, but requests further clarification. For example: what would be acceptable under the standard in a case where the company's composites' minimum asset level was above that of the suggested new mandate? Would this bar the presentation of composite figures, perhaps under the heading of supplementary information?

7.4 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?

7.4.1 Although in many respects this is close to Question 7.2 it is felt that the time frame given is reasonable for delivery and this is clearly a demand-led issue.

7.5 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)?

7.5.1 The Committee is supportive and agrees with this requirement.

7.6 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?

7.6.1 No. The Committee strongly disagrees with the date having been moved from 2005 to 2010. The original date has been known for a long time. Members of the Committee fully recognise that companies in emerging markets might find it difficult to comply with such requirements within the 2005 time-frame, but were curious as to why the IPC should propose a delay for *Gold* GIPS when so much prior warning of the implementation of this requirement had been given. The Committee is concerned by this precedent and fears that other important initiatives could equally easily be deferred. The Committee wants to understand precisely why the IPC should have apparently opted to weaken the value of the Standards. Relevant points already made in item 4.3 above are repeated in 7.6.2 below.

7.6.2 *The Committee wishes to express its severe disappointment that, although signalled for amendment in the current guidance statements, carve-outs are now to be allowed until 2010. The Committee feels that the shift in stance muddies any clear differentiation between those firms that have prepared and complied and those that have failed to make the necessary*

effort. It is believed that this action may serve to undermine the Standard in the eyes of existing supporters and provides adequate reason to those as yet undecided, not to commit to it. The Committee urgently requests that the IPC revisit its reasons for delaying the banning of carve-outs, and reconsiders its decision.

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

7.7.1 The Committee was of the opinion that 2010 was a reasonable date. However, it was concerned by the use in the question of the word “any”, which it was felt, introduced an element of ambiguity. Clarification is sought.

7.7.2 Further guidance is needed in terms of the different accounting methods used and the subsequent implications – in respect of dividends in particular. Such items should be added to the glossary.

7.8 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**

7.8.1 The Committee thinks that this is entirely reasonable, subject to their concerns on what will happen to carve-outs. If the less restrictive form is allowed to continue, it is felt that more informative disclosure of their potential inaccuracies would be required.

8. Additional observations re the Comparison Matrix – Proposed v Existing GIPS Standards taken in order:

1. A.8 / 1.B.3 Accrual accounting of dividends – this is not a major issue, for the UK as it is already adhering to an accrual accounting basis. The Committee accepted that this might prove difficult for emerging markets, but felt that the delay in implementation was in danger of conveying a poor impression of the robustness of the Standards.

1.A.4 Consistent valuation dates – this is provided according to the requirements of the client. The wording is potentially ambiguous e.g. should this be calendar month end or last business day? What about timing differences re valuations for global portfolios? A consistent policy may not always be feasible for composites.

3. A.7 Carve-out returns – see items 4.3 and 7.6.1 and 7.6.2 above.

No reference - Mandatory verification – the UK seeks to see this in place by 2010 at the latest, but is worried that ‘slippage’ may subsequently affect this requirement too. (Please also refer to 4.7). The wording in the comparison matrix is much stronger than that on page 28 of the *Gold GIPS* proposal, which could be interpreted as an opportunity for further delay.

2.B.3 Significant cash flows – clarification is sought as to how temporary new accounts would work in practice. Further clarification is sought on how to interpret the term ‘significant’.

Fundamentals of Compliance – barring the comments immediately below, the Committee wishes to express its full support of the insertion of this section.

FC.A.3 Other fundamental concepts – is open to misinterpretation and may therefore need re-wording. The words in brackets, (*As long as a prospective client has received a compliant presentation within the previous 12 months, the firm can present the prospect with interim performance information.*), is in danger of going against the spirit of GIPS. The implication is that there is scope to ‘cherry-pick’ performance data.

FC.A.14 is too open and may be interpreted as allowing the presentation of client numbers in a way that does not meet GIPS disclosure requirements. The Committee believes that this was not the IPC’s intention.

1.A.6 Input data – Accrual Accounting should stay at 2005. It potentially represents an all-embracing systems get-out clause and creates a poor impression of the integrity of the Standards.

1.A.7 Input data – this should be related to 1.A.4 with consistent wording, otherwise it is open to misinterpretation.

2.A.2 Calculation methodology – What is the meaning of the word ‘true’? What are the implications?

2.A.10 Calculation methodology – The wording needs clarification. We propose that the wording should be revised to read: “*When calculating the ‘gross of fees’ or ‘net of fees’ return for a composite containing both:*
a) *portfolios where the direct Trading Expenses cannot be identified and segregated from a Bundled Fee, and*
b) *portfolios where the direct Trading Expenses can be identified*

GIPS Calculation Methodology Requirement (shown in 2.A.9) must be met for those portfolios of type a).”

2.A.8 and 2.A.4 – Calculation methodology — The terminology here is perhaps inconsistent and there is some repetition and overlap.

2.A.10 Calculation methodology – We suspect that this may be a cut and paste error repeated from the previous page.

2.A.11 Calculation methodology – The Committee enquired whether there was a particular reason for the change.

3.B.3 Composite construction – This would not be needed if there were no delay in respect of carve-outs

4.A.10 Disclosures – There are ongoing concerns in respect of this point – the Committee is of the opinion that it would be better to require a disclosure of any investments in countries, regions or sectors not included in the benchmark that amounted to more than say 5 or 10% of the composite. This way, portfolios that were significantly different from the benchmark could be readily identified, whilst the process itself would not be unduly burdensome to those that had only small off-benchmark positions.

5.A.8 Disclosures – Is there a reason for a shift in this section?

5.B.1 The proposed removal of sections (b) and (c) is questioned. The Committee believes them to be relevant and therefore that they should be retained. These items should also be included in the glossary.

4.A.23 Disclosures – Does this refer to ‘any’ personnel changes - those running the business, responsible for the investment function, running the portfolio – are there to be parameters?

4.B.6 Disclosures – the terms, ‘recommended’, ‘required’, ‘encouraged’, ‘urged’, ‘strongly encouraged’ may have different practical implications and clarification would be appreciated. It may be appropriate to establish a glossary of terms in order to ensure consistent word usage.

Presentation and reporting recommendations – The Committee is supportive of the use of risk measures and feels that they are important. However, it believes that they should be appropriate to and representative of client requirements and this may not necessarily be with the inclusion of VaR.

In conclusion, the UKIPC points to its main concern. It appears that the CFA Institute may be shifting its stance from one of broad principle to detail. In this respect the Committee was unsure as to which might be the driving force - the CFA Institute or GIPS.

UK Investment Performance Committee
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