

Performance Perspectives

with Dave Spaulding

Volume 1- Issue 11
July 2004



An apology

I have to begin with an apology. If you're at all tired of hearing about the performance presentation standards, you won't enjoy this edition of our newsletter, as that's all we're addressing here. Sorry about that. There are loads of other things I want to comment on, but these topics seem somewhat more interesting at this time, and so that's what we've got this month.

What's in a name?

There are certain terms, which are clearly open to interpretation. For example, "composite." What is it? How do you create one? What criteria should you use? Recognizing that the term lacked a certain degree of clarity, the Investment Performance Council's Interpretations Subcommittee produced a Guidance Statement which provides a great deal of detail to assist anyone involved with the GIPS® or AIMR-PPS® standards.

But what about the term "Composite Creation Date." As you may know, this is a required disclosure for these standards. So what does it mean? To me, the term is pretty clear: the *date* that you *created* the *composite*. Often, we found that firms assigned the date that the first entry appeared, even though the composite was created recently (e.g., a firm creates their composite in 1998, with values going back 10 years (to 1988) and assign "1988" as the composite creation date. Wrong! After all, it wasn't *created* in 1988, was it?"

But, an interesting thing happened recently. As a result of a consulting assignment, I learned that the GIPS Handbook has an additional qualification for this date. If you look on "4-5.A.1 (f) Page 1," which is in the section with the tab "Standard 5 / Presentation and Reporting" we find "Standard 5.A.1 (f)" for "The composite creation date."

It starts off by saying "Firms are required to disclose the date on which the firm first grouped portfolios to create a composite." (emphasis added). This is what I said, right? But, you can't stop there. Keep reading and you'll find "...cannot be before the date when the firm first claims compliance with the Standards." What? Where did this come from?

I don't know about you, but I don't see how the date you start claiming compliance should be a constraint on the date you create a composite. I sent the following scenarios to a few folks for their thoughts:

Scenario #1

Firm A decides in 1994 to become compliant with the AIMR-PPS, and starts building its composites that year. Let's say that one of these composites (that they create in 1994) is their Large Cap Growth Composite. The following year, they're done their work and can now claim compliance (i.e., they start claiming compliance in 1995). In

Since 1990, The Spaulding Group has had an increasing presence in the money management industry. Unlike most consulting firms that support a variety of industries, we focus on the money management industry.

Our involvement with the industry isn't limited to consulting. We're actively involved as members of the Association for Investment Management & Research (AIMR), the New York Society of Security Analysts (NYSSA), and other industry groups. Our president and founder regularly speaks at and/or chairs industry conferences and is a frequent author and source of information to various industry publications.

Our clients appreciate our industry focus. We understand their business, their needs, and the opportunities to make them more efficient and competitive.

For additional information about The Spaulding Group and our services, please visit our web site or contact Chris Spaulding at CSpaulding@SpauldingGrp.com.

<http://www.SpauldingGrp.com>

1996, they get verified and the verifier has no issues with their claim.

Question: What is the composite creation date for their Large Cap Growth Composite?

1994
1995
1996

Scenario #2

Firm B created a composite for their Small Cap Value (SCV) strategy in 1984, long before the AIMR-PPS. It contains all of their accounts but is equal-weighted.

In 1993, they decide to become AIMR-PPS compliant, and that year switch their composite calculation methodology to asset weighting. They become compliant in 1993.

Their SCV composite has annual returns that go back to 1984, and include the required disclosure that the records prior to 1993 aren't in compliance because they're equal-weighted.

Question: What is the composite creation date for their Small Cap Value Composite?

1984
1993

Given that I take the term "composite creation date" literally, I figured that for the first scenario, the answer should be 1994, since that's the date they created the composite. BUT, since they didn't claim compliance until 1995, the answer is supposed to be 1995. For the second scenario, since the composite was created in 1984, I thought 1984 was correct. But no, since the firm did not claim compliance until 1993, they can't use the earlier date.

If you visit the AIMR (sorry, CFAI website), you'll see some Q&A regarding this topic. But there's no reference to a dependency on the date that the firm claims compliance. What we do see is a reference to "restatement" of composites. I interpreted this to mean, for example, if we create a composite several years before we claim compliance, but when we begin to comply, we go back and restate values, then we couldn't use our original date. Make sense? But in scenario 2, there is no restatement. The pre-1993 records remain as they were. So why would we not use the 1984 date?

At the present time, one could argue that they are not required to follow the GIPS Handbook. Why do I say this? Because if you look at "Gold" GIPS, there's a proposed new requirement on page 3 that reads: "Must abide by guidance and interpretations including the GIPS Handbook." If we were required to comply with the handbook today, there would be no need to have this listed as a new requirement. But whether you feel that you should or shouldn't comply with this book today or not, we still have to deal with this qualified view of "composite creation date."

I am currently trying to get clarity on this. As for the individuals to whom I sent the above scenarios, what did they respond? Two were aware of this "rule" in the handbook, and answered "1995, 1993" respectively. One of these said he disagreed with the rule. The third said that you could either say 1994 or 1995 for the first, and either 1984 or 1993 for the second (he must be a politician). And the fourth person said 1994, 1993. Confusing, right? I should mention that this group includes verifiers.

So, what I thought was an obvious term is hardly that. Hopefully, we'll get this issue clarified (I'm working on it).

A single global standard

Last month the IPC held its semi-annual conference call. This was a public session, so I'm permitted to share some of what was discussed.

The CSSC (Country Standards Subcommittee) is the group that's responsible for "Gold" GIPS. There were two major areas they addressed. First, the goal to eliminate the translated versions of GIPS or at least to discourage their creation. Where a country's native

language may not be English, but where English is commonly spoken, rather than create a translation of the standards, which is costly and time-consuming, these countries would be asked to consider adopting the English version (a summary document (not the whole standard), in the native language, could accompany GIPS). This idea isn't meant to offend non-English speaking countries by any means. It's simply aimed at reducing the workload and confusion. Apparently some countries are already moving in this direction, which is probably a good thing.

The other point was the statement that the original goal of the global committee was to have a single standard that was universally accepted. I.e., that there would be no country versions (e.g., no AIMR-PPS). And, that we assign a date today (2005, 2010, 2015) for each country version to aim at by which time they would be eliminated – to develop a plan to achieve this goal by the identified date. So far, we haven't come up with a date.

I'm a realist and don't see this happening any time soon, if ever. Even 2015 is probably a bit lofty. Why do I say this?

Just look at the AIMR-PPS. We have a 10-year requirement while GIPS only requires five years. And there's no requirement in "Gold" GIPS to move to a 10-year mandate. Unless we know that in the next version of GIPS (expected due date of around 2010) that such a requirement would be added, perhaps with an effective date of 2015, how can we agree to a date? And let's look at some of the other differences: the AIMR-PPS has provisions for after-tax – GIPS doesn't and it's unclear whether it will. Does this mean that the AIMR-PPS would drop this requirement? We'd have to in order to become 100% like GIPS. And, what about wrap fee accounts?

Would I support a global standard? Yes. Do I think it's realistic? No.

Other countries, too, have some unique requirements that would make such a shift difficult.

This is another topic that we'll have to wait to see what happens. I'll try to keep you informed.

New subcommittees

At the March IPC meeting in Brussels, we discussed adding two new subcommittees: hedge funds and risk. I am anxious for this to occur, as these two areas are worthy of development. However, this won't occur until after "Gold" GIPS is approved.

We also discussed adding a seat for software vendors to the IPC. Carl Bacon is the only software vendor on the subcommittee, and he holds the primary seat for verification. Carl is a great and knowledgeable expert on performance in general and the standards in particular. Given the critical role that software plays in compliance, a formal seat¹ for software would be a great

benefit. This won't happen, at the earliest, until after "Gold" GIPS is approved, either.

I'll keep you posted.

I'm lonely

For a while, my comment letter on "Gold" GIPS sat by itself on the CFA website. Today, it's joined by two others. But, I'm still lonely. Where is your letter? Surely you have an opinion.

I've previously voiced my opposition about some of the provisions (such as the requirements for mandatory verification, daily performance², and the elimination of the cash allocation option for carve-outs, all slotted for 2010). If you agree with the document in its entirety, your opinion is welcome. And, if you disagree with anything or have any comments what so ever, you're invited to comment. Just as we say in the States during election time, "your vote counts." Your opinion counts here, too. So please, send in your letter. Remember, you can have it shown as "anonymous," if this helps. And remember, you only have until August 1 to respond, so act today!

TSG Selected Again to Train for AIMR (CFAI)

I'm pleased to report that the CFA Institute recently selected our firm to once again offer training on the AIMR-PPS standards. AIMR sent out an RFP earlier this year, for the third time, and once again we were picked. We conduct this training as part of a consortium, which includes Herb Chain of Deloitte & Touche and Matt Forstenhausler of Ernst & Young. We've been doing this training for about five years now and I enjoy the classes immensely. Our schedule for the coming months is:

- October 14, 2004, in Chicago, IL to follow a conference on Private Equity
- October 26, 2004, in Vancouver, British Columbia (Canada) to precede the 8th Annual AIMR-PPS Conference
- February 17, 2005, in Stamford, CT to follow a conference on Hedge Funds.

This is a single-day class, which addresses the AIMR-PPS and GIPS. If you'd like more information, either contact us or the CFAI directly.

¹ Which actually means the opportunity for three seats: a primary and two alternates.

² More specifically, the requirement to revalue your portfolio for every cash flow.

This newsletter is produced by TSG Publications.
It is written and edited by Dave Spaulding. The
opinions expressed are his and are a result of his
own industry experience.
Content layout by Sabina T. Hastings.

UPCOMING TRAINING DATES

INTRODUCTION TO PERFORMANCE MEASUREMENT

<u>LOCATION</u>	<u>DATES</u>
New York, NY	September 27 - 28, 2004
Boston, MA	October 4 - 5, 2004
Los Angeles, CA	October 18 - 19, 2004

Receive 15 CPE Credits for attending this Two-day class!

PERFORMANCE MEASUREMENT ATTRIBUTION

<u>LOCATION</u>	<u>DATES</u>
New York, NY	September 29 - 30, 2004
Boston, MA	October 6 - 7, 2004
Los Angeles, CA	October 20 - 21, 2004

Receive 11 CPE Credits for attending this One and a Half day class!

These programs may qualify for CFA Institute Professional Development Program credit. If you are a CFAI member, please refer to the CFAI Web site to determine whether this program meets the criteria for CFAI PDP credit, to calculate credit hours, and to verify documentation requirements.

(www.cfainstitute.org/pdprogram)

2004

Performance Measurement Forum Schedule

Madrid, Spain	November 10 - 11, 2004
Orlando, FL	December 9 - 10, 2004

