

PERFORMANCE PERSPECTIVES

with David Spaulding



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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, our focus is on the money management industry.

Our involvement with the industry isn't limited to consulting. We're actively involved as members of the CFA Institute (formerly 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

QUALITY OF VERIFICATIONS

When I teach the GIPS® courses for the CFA Institute or the GIPS part of our *Introduction to Performance Measurement* class, I often discuss the need for money management firms to do a proper job of *due diligence* when selecting a verifier. Unfortunately, this isn't always the case.

What questions should you ask a verification candidate? The CFA Institute's website provides a PDF file with some (see www.cfainstitute.org/centre/ips/ipsresources.html). When a verifier lets you know that they want to "make this as easy as possible for you" and that they "don't worry about non-marketed composites," that, to me, is a sign of a verifier who is probably not going to do an adequate job. However, because the pressure is on many firms to be able to (a) state that they're compliant and (b) that they've been verified, they may select a verifier who will be less demanding and less costly. But, as the saying goes, "you get what you pay for."

After a recent class for the CFA Institute, a student mentioned that their verifier prepares their presentation materials for them. I was a bit surprised since we had encountered a similar situation with this same verifier about 18 months earlier and had thought they had mended their ways.¹ The *Verifier Independence Guidance Statement* is pretty clear on this: "Examples of services that, if performed by the verifier, create or may create an independence issue include:...Preparing compliant presentations."² And under "Required Verification Procedures," the standards state "Verifiers must review a sample of composite presentations to ensure that the presentations include the information and disclosures required by the GIPS standards."³ If a verifier prepares the presentations, won't this review mean they're *checking their own work*?

When this first surfaced in 2005, I sent the following e-mail to the GIPS Help Desk:

I was wondering if you agree with me that the following case is one where the verifier has crossed the line of independence:

I visited a client last Friday to discuss software requirements, including support for AIMR-PPS® compliance. I asked if they would like a system that would prepare their disclosure materials for them and they said no, since their verifier did this. I was a bit stunned by this, and asked for clarification, at which point they handed me their composite materials (presentation & disclosures) and said that the verifier prepares these materials - they simply give them the return information. And sure enough, these documents are signed at the bottom by the verifier — their entire presentation.

1 I should also mention that the materials the verifier prepared were incomplete!

2 *GIPS Handbook*, Second Edition, 2006: pages 251-252.

3 *GIPS Standards*, February 2005: page 25.

The Journal of Performance Measurement®:

UPCOMING ARTICLES

Single Currency Return Attribution

– *Bob Kopprasch, Ph.D.,
Gijs Treimanis*

Morningstar® Investor Return: Capturing the Collective Investor Experience

– *Catherine Sanders,
Julie Austin, CFA, and
Michelle Swartzentruber*

Fixed Income Attribution with Minimum Raw Material

– *Andrew Colin, Ph.D.*

Risk-Adjusted Performance Attribution Based on the Information Ratio

– *Jose Menchero, Ph.D., CFA*

Fixed Income Attribution: A Unified Framework Part 2

– *Bernard Murira, CFA and
Hector Sierra, Ph.D., CFA*

The Journal Interview

– *Todd Juillerat, CFA, Invesco*

So, isn't this a case where the verifier is no longer independent, for what are they going to check? Their own work?

Please comment, as I need to report back to my client. Thank you!

Their response:

Hi Dave,

Based on the recent discussion on the Verifier Independence Guidance Statement at the Interpretations Subcommittee call, you might tell your client that a verifier is not independent when they verify their own work.

Hopefully the final Guidance Statement will be adopted by the IPC and posted to the website before year-end.

Thanks.

Is that clear enough?

In addition, the student mentioned that they had been told not to worry about their “non-marketed composites.” So, instead of having 40 or so composite presentations, they have less than ten. When I asked her how long it would take to prepare a presentation for the non-marketed composites, she couldn’t estimate this. To me, this is a huge problem.

There should be certain telltale signs that clients should look for when selecting a verifier. If the verifier is preparing the materials, while this may sound like a great benefit, it’s an independence issue which should signal that the verifier is not as familiar with the standards as they need to be. Also, whenever a verifier gives a hint that they “don’t have to bother with non-marketed composites,” we have yet another problem.

While I understand the appeal of a firm that (a) charges less and (b) doesn’t require as much from their clients, consider these two scenarios:

- You need to get a physical done. One doctor charges you \$1,000 and does blood work, an EKG, and loads of other tests. A second doctor will charge you just \$100 and provide a cursory review, usually telling you that you’re “doing just fine.” Which do you choose?
- The front page of the March 19, 2007 Wall Street Journal has an article “Behind Crashes Abroad, Ill-Regulated Airlines.” The article states “The root of the problem is ‘flags of convenience,’ or countries – mainly in Africa and the former Soviet Union – that register carriers without properly regulating them.”

While one might argue that to compare a GIPS verification to either a physical or airline safety is a bit of hyperbole, I suspect you get my point.

One would think that the new SEC rules regarding compliance officers shouldering personal liability would be sufficient to make firms less likely to take shortcuts. But we had a case not long ago where we found the firm not to be in compliance but their compliance officer was comfortable continuing to claim compliance!

If a firm is selling to the institutional marketplace, compliance is a virtual requirement. Often, however, getting the non-institutional accounts into compliance is quite a chore. So, any shortcuts are often seen as a God-send.

I expect that this will require either the SEC finding firms out-of-compliance for their failure to have materials for all of their composites or for someone to file a lawsuit against their verifier for providing misleading guidance. Until this happens, a lot of firms will *take the easy approach* and allow substandard work by non-independent firms to do their verification.

The Spaulding Group (TSG) can address any of these common problem areas

Types of Assignments

General Performance Measurement Issues

TSG assists firms in evaluating the broader areas of performance to include calculations (which to use and when), reporting (for internal use, for prospects, and for clients), systems issues, and other areas.

Verification/Certification

We also offer GIPS® verification, and if you are not claiming compliance but need your numbers certified, we can assist with that as well.

GIPS Compliance

Many firms need assistance understanding the GIPS standards and determining whether they should comply. Also, many need help developing a strategy to become compliant or remain compliant. Often, in just a day or two, TSG can help you address the opportunities, benefits, and tasks to be tackled in order to comply.

System Design

TSG can support you in the design and development of your performance system. We can also assist in documentation and testing.

Software Searches

TSG can help you decide which software product best meets your firm's needs, and we also support the implementation process.

Operational/Control Issues

TSG can assist you in dealing with a host of operational challenges including data integrity, reconciliation, policies and procedures, and much more.

VERIFYING THE VERIFIERS

I know there has been talk about *verifying the verifiers*. I believe I actually coined this term in 1992. We had just began to offer verifications and were constantly running into situations where prospects were telling us things that our competition had been saying, which we knew to be untrue. When I approached Sue Martin, who at that time was responsible for the AIMR-PPS®, she acknowledged that there was a problem. However, AIMR was not in a position to police the verifiers. Consequently, anyone could “hang up a shingle” and offer verification services.

Sixteen years later, we still have problems. But how do we “verify the verifiers”?

Someone suggested that we create a central database where firms could communicate issues they had encountered. In spite of my apparent solicitation of a lawsuit above, I generally try to avoid litigation. And I think this is one of the challenges the industry faces: if we were, for example, to have a central repository for reporting violations and problems, no doubt some verifier would file a suit. Also, not many money management firms are interested in saying that their verifier has done a shoddy job, as it will reflect upon them.

Perhaps the GIPS Verification Subcommittee will come up with something...let's hope so! If you have any ideas, please let us know.

CONGRATULATIONS JONATHAN!

We just learned that Jonathan Boersma has been named the director in charge of GIPS for the CFA Institute. We've known Jonathan for a long time and are confident that he will do a great job in this increasingly challenging position. And, we wish him much success!

CONGRATULATIONS TO #1 CIPM!

We just learned who is receiving the CIPM certificate with the #1 on it. In case you didn't know this, all certificates are numbered sequentially. When I got mine, I presumed that they were being done alphabetically (mine is #75). But we have now learned that they were awarded based on the order an individual took and passed the Expert exam. And so, #1 is being awarded to the first person who passed Expert. And who was this? Douglas Lempereur of Franklin Templeton. Not only did Douglas pass the CIPM, he is already a CFA and also recently passed the Financial Risk Manager Exam (FRM) which is offered by the Global Association of Risk Professionals (GARP). The string of characters following his name is growing geometrically! Congratulations, Douglas!

KEEP THOSE CARDS & LETTERS COMING

We appreciate the occasional e-mail we get regarding our newsletter. Occasionally, we hear positive feedback while at other times, we hear opposition to what we suggest. That's fine. We can take it. And more important, we encourage the dialogue. We see this newsletter as one way to communicate ideas and want to hear your thoughts.

THE SPAULDING GROUP'S 2007 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
April 16-17	Introduction to Performance Measurement Training	San Francisco, CA (USA)
April 18-19	Performance Measurement Attribution Training	San Francisco, CA (USA)
April 26-27	Performance Measurement Forum	New Orleans, LA (USA)
May 8-9	Introduction to Performance Measurement Training	Chicago, IL (USA)
May 10-11	Performance Measurement Attribution Training	Chicago, IL (USA)
May 15-16	PMAR Conference	Philadelphia, PA (USA)
June 4-5	Advanced Performance Measurement Training	New Brunswick, NJ (USA)
June 14-15	Performance Measurement Forum	Helsinki, Finland
July 23-27	Investment Performance Measurement Boot Camp	New Brunswick, NJ (USA)
August 20-21	CIPM Principles Exam Preparation	Boston, MA (USA)
August 22-24	CIPM Expert Exam Preparation	Boston, MA (USA)
August 27-28	CIPM Principles Exam Preparation	Los Angeles, CA (USA)
August 29-31	CIPM Expert Exam Preparation	Los Angeles, CA (USA)
September 17-18	Introduction to Performance Measurement Training	Los Angeles, CA (USA)
October 8-9	Introduction to Performance Measurement Training	Boston, MA (USA)
October 10-11	Performance Measurement Attribution Training	Boston, MA (USA)
October 15-16	Advanced Performance Measurement Training	San Francisco, CA (USA)
October 23-24	Introduction to Performance Measurement Training	New York, NY (USA)
October 25-26	Performance Measurement Attribution Training	New York, NY (USA)
November 8-9	Performance Measurement Forum	Athens, Greece
November 29-30	Performance Measurement Forum	Orlando, FL (USA)
December 3-4	Introduction to Performance Measurement Training	New Brunswick, NJ (USA)
December 5-6	Performance Measurement Attribution Training	New Brunswick, NJ (USA)

*For Additional information on any of our 2007 events,
please contact Christopher Spaulding at 732-873-5700*

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Fifth Annual International

PMAR

Performance Measurement,
Attribution & Risk

Conference

May 15th - 16th, 2007

TRAINING...

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INTRODUCTION TO PERFORMANCE MEASUREMENT

A unique introduction to Performance Measurement specially designed for those individuals who require a solid grounding in all aspects of performance measurement. The Spaulding Group, Inc. invites you to attend Introduction to Performance Measurement on these dates:

April 16-17, 2007 – San Francisco, CA

May 8-9, 2007 – Chicago, IL

September 17-18, 2007 – Los Angeles, CA

October 8-9, 2007 – Boston, MA

October 23-24, 2007 – New York, NY

December 3-4, 2007 – New Brunswick, NJ

15 CPE & 12 PD Credits upon course completion

The Spaulding Group is registered with CFA Institute as an Approved Provider of professional development programs. This program is eligible for 12 PD credit hours as granted by CFA Institute.



PERFORMANCE MEASUREMENT ATTRIBUTION

Two full days devoted to this increasingly important topic. The Spaulding Group, Inc. invites you to attend Performance Measurement Attribution on these dates:

April 18-19, 2007 – San Francisco, CA

May 10-11, 2007 – Chicago, IL

October 10-11, 2007 – Boston, MA

October 25-26, 2007 – New York, NY

December 5-6, 2007 – New Brunswick, NJ

15 CPE & 12 PD Credits upon course completion

The Spaulding Group is registered with CFA Institute as an Approved Provider of professional development programs. This program is eligible for 10 PD credit hours as granted by CFA Institute.



ADVANCE PERFORMANCE MEASUREMENT

June 4-5, 2007 – New Brunswick, NJ

October 15-16, 2007 – San Francisco, CA

IN-HOUSE TRAINING

The Spaulding Group has offered in-house training to our clients since 1995. Beginning in 1998, we formalized our training, first with our Introduction to Performance Measurement class and later with our Performance Measurement Attribution class. We now also offer training for the CIPM program. To date, over 1,500 individuals have participated in our training programs, with numbers increasing monthly.

We were quite pleased when so many firms asked us to continue to provide in-house training. This saves our clients the cost transporting their staff to our training location and limits their time away from the office. And, because we discount the tuition for in-house training, it saves them even more! We can teach the same class we conduct to the general market, or we can develop a class that's suited specifically to meet your needs.

The two-day introductory class is based on David Spaulding's book, Measuring Investment Performance (McGraw-Hill, 1997). The attribution class draws from David's second book Investment Performance Attribution (McGraw-Hill, 2003). The two-day Advanced Performance Measurement Class combines elements from both classes and expands on them.