

# Performance Perspectives

## with Dave 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, 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](mailto:CSpaulding@SpauldingGrp.com).

<http://www.SpauldingGrp.com>

### **Welcome!**

We've been talking about introducing an electronic newsletter for about a year, and it's finally here! It's not that I don't have anything to say – I'm never shy. But, finding the time to put this together has been a challenge, especially when I have two jobs, (to learn about my second job, visit <http://www.northbrunswickonline.com/Index/mayor.htm>). (Oh, by the way, my term ends December 31 – I guess I'll have to find something else to occupy my time – I shouldn't have too much trouble).

After some pressure from my staff, I've finally taken the time to do this. This isn't our first newsletter, however. When we started the firm in 1990, we introduced one. We produced about eight issues, as I recall. This was followed by a client-only publication, of which about a half-dozen issues were circulated. We're hoping that this will be a continuing communication piece, as the dynamics of the industry warrant it.

We will attempt to provide you with some insights into what's going on in the industry, some of my perspectives on these events, as well as a little bit about our firm. We hope you find what we share of interest. As always, your thoughts and comments are invited. Feel free to e-mail me at [DSpaulding@SpauldingGrp.com](mailto:DSpaulding@SpauldingGrp.com).

### **The Presentation Standards**

Much is taking place in the world of the AIMR Performance Presentation Standards (AIMR-PPS®) and the Global Investment Performance Standards (GIPS®).

#### E-mail Alert List

First, if you haven't signed up for the standards' e-mail alert list, you should. There's no cost and this way you're sent an e-mail whenever there's something of note added to the AIMR site. To do this, simply

#### Guidance Statements

Second, if you haven't noticed, quite a number of new guidance statements have been introduced over the past year. What's a "guidance statement"? It's a fairly detailed explanation of a concept or process involving the standards. For example, "composite." For many people, especially those new to the standards, understanding *what* a composite is, *how* they are to be used, what *types* of composites one might have, etc. can be a challenge. If you're going to rely solely on what's in the standards, you're going to have to be pretty creative as there's not much there. So, the Investment Performance Council's (IPC) Interpretations Subcommittee created a guidance statement that goes into quite a bit of depth.

## The Ten Commandments of Performance Measurement

by David Spaulding

### THOU SHALT....

- I – CALCULATE TIME-WEIGHTED PORTFOLIO RETURNS**
- II – TREAT CASH FLOWS OF 10% OR MORE AS “LARGE”**
- III – NOT ANNUALIZE FOR PERIODS LESS THAN ONE YEAR**
- IV – USE APPROPRIATE BENCHMARKS**
- V – INCLUDE RISK MEASURERS**
- VI – HANDLE CASH FLOWS PROPERLY**
- VII – SUPPORT THE PERFORMANCE PRESENTATION STANDARDS**
- VIII – CALCULATE ATTRIBUTION**
- IX – AVOID SPREADSHEETS FOR PERFORMANCE SYSTEMS**
- X – TREAT PERFORMANCE MEASUREMENT AS A PROFESSION**

These *commandments* are excerpted from an article by David Spaulding which was published in the Fall 2001 issue of *The Journal of Performance Measurement*®. To access the entire article or *The Journal*, please visit our website at

<http://www.SpauldingGrp.com>

### Gold GIPS

The first version of GIPS was introduced in 1999. Since that time, a few changes have been introduced, but not many. For example, you now have the ability to temporarily remove portfolios from composites in the event of large cash flows. This was a significant and welcome change to the standards. To learn more, visit [http://www.aimr.org/pdf/standards/cashflow\\_adopt.pdf](http://www.aimr.org/pdf/standards/cashflow_adopt.pdf).

Rather than continue to add changes on a regular basis, which could create a great deal of confusion, the IPC decided to minimize changes, except on a 5-year cycle when major changes will occur. The first such date for this is coming up: 2005. And what's specially noteworthy about this date is that the revised standards will be called "Gold GIPS." Now, what do we mean by Gold GIPS? Essentially, it's the initial attempt to come up with a set of standards which will begin to eliminate the differences between the various country versions of GIPS (CVG; as you may know, the AIMR-PPS is a CVG for the United States and Canada. To avoid having lots of subtle differences between the various country versions, the idea is to slowly migrate to a single standard (GIPS) which will include everything anyone needs. Granted, there may be some regulatory issues within some countries which impact what's in GIPS, so the prospect that we'll cover 100% is unlikely, but at least we can eliminate as much as possible.

The plan is that in early 2004, the IPC will issue a draft of Gold GIPS. The industry will then have six months to review it and comment. You are strongly encouraged to do so. You may find some things which you find objectionable. Or, you may want to add or change something. Voice your opinion! Be heard! It's important.

The 1999 version of GIPS anticipated a few changes to take place in 2005 and 2010. For example:

- Going from allowing mid-point treatment of cash flows (e.g., the use of the "Original Dietz formula) to a requirement for at least day-weighting cash flows in 2005
- A requirement to revalue portfolios whenever a cash flow occurs (this is essentially daily performance, although some may argue that it's technically not; we think it's close enough to call it daily) in 2010.
- A requirement to accrue for dividends in 2005.
- A requirement to use trade-date accounting in 2005.
- The elimination of the ability to allocate cash to carve-outs in 2005.
- A possibility of having mandatory verification on/about 2005.

I'll share with you some of my concerns about these proposed changes:

- Going to day-weighting: I agree with this change. Makes sense.
- Revaluing Portfolios: It's too early. While firms in North America and much of Europe can do this, there are many areas where this will be a challenge. Also, I'm concerned that there are still many security types for which daily valuations are not very accurate, so such a requirement doesn't make sense in some cases. I suggest a delay to 2015 and even then, the possibility that there will be certain asset classes which will be exempt from this requirement.
- Requirement for accruals: It's too soon. Again, while many firms in North America and Europe will have little difficulty to implement this, there are others who can't. So, a delay is needed – perhaps to 2010.
- Trade-date Accounting: Same comments as for accruals. Wait until 2010.
- Elimination of Cash Flow Allocation Option for Carve-outs: I have never supported this option and feel that there should be an exemption for firms that are using a domestic balanced

portfolio (e.g., U.S. fixed income and equities). The argument that the carved-out portions aren't representative of single-asset portfolios may be right in some cases, but in most cases I think they are. At the minimum, the date should be shifted to 2010. Ideally, the requirement will be reworded.

- **Mandatory Verification:** I don't support this. Let the market decide if verification is required. Don't put another financial burden on money management firms.

The IPC's Country Standards Subcommittee (CSSC) is responsible for putting Gold GIPS together. They're currently obtaining input from various parties, including the various other IPC subcommittees and the regional committees (e.g., the AIMR-PPS Implementation Committee and the EIPC - European Investment Performance Committee). The CSSC is considering modifying some of these planned changes. We'll have to wait until the Gold GIPS is published to see exactly what's planned. But again, please review and comment! Even if you want to say "I agree with everything," your opinion will count. And, if you disagree with some of the proposed changes (as I do), please let the IPC know.

## **Leverage and Derivatives**

The IPC's Leverage and Derivatives Subcommittee recently published proposed standards (see [http://www.aimr.org/pdf/standards/cashflow\\_adopt.pdf](http://www.aimr.org/pdf/standards/cashflow_adopt.pdf)). This proposal is pretty extensive in that it defines what leverage is, requires certain risk measures (e.g., Value at Risk and Tracking Error), and makes other requirements on any firm that uses leverage and/or derivatives. I was the first to comment on this proposal, as I found some things rather objectionable. Other individuals and groups also commented (to see the comments, visit [http://www.aimr.org/standards/issues/ld\\_comments.html](http://www.aimr.org/standards/issues/ld_comments.html)). Although the comment period has officially ended, it's important to be familiar with what was proposed and to monitor how this committee and the IPC responds to the feedback that is received, especially if you may be subject to these changes.

Presentations to all participants. We've already set the date for PMAR 2004 (May 17-18, 2004), so please mark your calendar and plan to be there!

There's a weekly television news program in the States called "The McLouglin Group." I always enjoyed watching it. When I started the firm, I decided to name it "The Spaulding Group," partially as a result of this show. Over the past few months, it is appearing as if the firm is becoming a "Group of Spauldings," as both of my sons have joined us: Christopher (Chris) is our Director of Sales and Douglas (Doug) is now responsible for the production of *The Journal of Performance Measurement*. My wife, Betty, was a bit anxious about the three of us working together, but so far it's going very well.

You may have noticed that we introduced a new logo to represent our firm's breadth of services.

We believe that this logo summarizes our offerings in an attractive and meaningful way. We hope you agree.



In 1992, as the AIMR standards were about to go into effect, we announced that we were going to do verifications. Well, since we were getting more requests to help firms become compliant rather than verify their compliance, we decided to back out of this area. After a great deal of discussion and reflection, we recently decided to re-enter the world of verification. This is one of our newest offerings and we are hopeful that we will be able to grow it, not only in North America but in Europe and elsewhere. To learn more contact Chris Spaulding at [CSpaulding@SpauldingGrp.com](mailto:CSpaulding@SpauldingGrp.com).

## **TSG News**

This past May we held our first conference: PMAR™ (Performance Measurement, Attribution and Risk Conference). The feedback from our attendees, speakers, and cosponsors was extremely positive. We will shortly publish conference proceedings and distribute them, along with audio CDs and CDs of the

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>	<u>VENUE</u>
New York, NY Cape Town, South Africa	September 9 -10, 2003 September 29 - 30, 2003	DoubleTree, NYC Deloitte & Touche 11 Landsdowne Road Cape Town, South Africa
Boston, MA San Diego, CA	October 28 - 29, 2003 December 16 - 17, 2003	Boston Sheraton TBA

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

### PERFORMANCE MEASUREMENT ATTRIBUTION

New York, NY Geneva, Switzerland Cape Town, South Africa	September 11 -12, 2003 September 18 - 19, 2003 October 1 -2 , 2003	DoubleTree, NYC Intercontinental, Geneva Deloitte & Touche 11 Landsdowne Road Cape Town, South Africa
Boston, MA San Diego, CA	October 30 - 31, 2003 December 18 - 19, 2003	Boston Sheraton TBA

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

These programs may qualify for AIMR Professional Development credit. If you are an AIMR member, please refer to the AIMR Web site to determine whether this program meets the criteria for AIMR PDP credit, to calculate credit hours, and to verify documentation requirements.  
([www.aimr.org/memberservices/continuinged/ceprogram](http://www.aimr.org/memberservices/continuinged/ceprogram))

## 2003

### Performance Measurement Forum Schedule

**March 20-21, 2003 - San Francisco, CA**  
**June 11-12, 2003 - Warsaw, Poland**  
**November 12-13, 2003 - Lisbon, Portugal**  
**December 8-9, 2003 - New York, NY**

