

PERFORMANCE PERSPECTIVES

with David Spaulding



VOLUME 8 – ISSUE 11

JULY 2011

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.

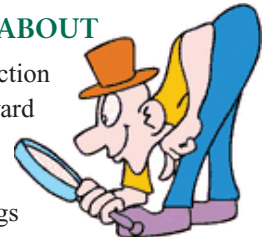
Our involvement with the industry isn't limited to consulting. We're actively involved as members of the CFA Institute (formerly AIMR), the New York Society of Security Analysts (NYSSA), and other industry groups. Our president and founder regularly speaks at and/or chairs industry conferences and is 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

A GUIDANCE STATEMENT YOU NEED TO CARE ABOUT

As we move through this year you probably noticed the introduction of a few revised guidance statements. Some have been put forward for public comment, while others haven't been. One that is out for comment deals with Performance Examinations, one of my favorite topics. And so, it's not surprising that I have a few things to say about this proposed revision.¹



The exposure draft specifically solicits comments to several questions; some of these are what I'll comment on here.

My biggest issue is the proposal for the verifier to request information from "independent external parties," meaning brokers or custodians. I find this suggestion a clear response to Bernie Madoff and his ilk, and the broader industry shouldn't suffer as a result. It puts the verifier in the form of a checker-for-fraud, which shouldn't be their role. This opens up huge potential risk/liability problems for the verifier, not to mention the added cost and complexity for the whole process. Three levels are offered:

- "preferable" to obtain from independent external parties
- "must make every reasonable effort" to obtain from independent external parties
- "must" obtain from independent external parties.

I am quite concerned with this language. Who can deny that getting information directly from a third party would be preferred? But the complexity of doing so, in light of the reality that by far, most asset managers don't commit fraud, outweighs the benefits. And while one might suggest that we ask the client to do the "leg work" on our behalf (to make it easier for the verifier), if they (the asset manager) is, in fact, committing fraud, surely they can pull off a ruse that would make us think that what they're providing as being ostensibly from an external party is actually self-generated. And so the most the client can do is make introductions and requests that these external parties respond to our requests. Can you imagine what a nightmare this might become?



In addition, we find a suggestion that the verifier verify the integrity of supplemental information. This, too, can and will create unnecessary additional costs. Examinations should deal with the required and recommended information, not supplemental. Such analysis could become quite challenging for the verifier, depending on what's included in this area.

Note: this guidance applies to asset managers as well as verification firms. And so, you should voice your opinion. The deadline for comments is August 31, 2011. Note that you can submit your comments anonymously. Whether you agree with my views or not, let your opinion be heard!

¹ See <http://tinyurl.com/65tedjl>.

The Journal of Performance Measurement®:

UPCOMING ARTICLES

**A New Measure for the
Investment Management
Industry: TIME & MONEY
WEIGHTED RETURN (TMWR)**
– Joe D'Alessandro

The Journal Interview
– Howard Marks

**Currency Hedged Benchmark
Replication: Challenges and
Improvements**
– Jordan Alexiev, Steve Fenty
and Jay Moore

**A New Empirical Method for
Yield Curve Attribution**
– Maria de Sousa Vieira

Portfolio Leverage Ratio
– David Asermely

**Structuring Family, Wealth,
Governance and Global
Family Entities: Basic
Requirements of Performing
Reporting for Meaningful
Interpretation of Results**
– Tania Nield and Douglas Rogers

I thought I'd share with you the comments I am sending to the CFA Institute regarding the proposed changes; I've included the questions here, as well as my responses (italicized).

1. Introduction- The GIPS standards make use of the terms “composite” and/or “composite presentation” when describing performance examinations. The proposed Guidance Statement indicates that both terms are to be viewed interchangeably as it is the composite, including its associated composite presentation, that is examined as part of a performance examination. Please indicate in your comments whether you agree or disagree with such an approach and provide specific alternatives if deemed necessary.

I think it's confusing to use the terms “composite” and “composite presentation” interchangeably: they mean two very different things, and to suddenly decide that they are interchangeable can cause much confusion. The alternative: use the right words within the appropriate context. If it means “a collection of accounts,” use “composite”; if it means the document that is given to prospects to represent the performance of said collection, use “presentation” or “composite presentation.”

2. Performance Examination Procedures-Portfolio Selection: The proposed Guidance Statement indicates that the verifier must obtain a list of all open (both new and existing) and closed portfolios for the firm for the period(s) under examination in order to test for proper portfolio inclusion and exclusion for a composite. Please indicate in your comments whether you agree or disagree. <emphasis in original>

I agree that lists of all open (and new and existing) and closed accounts need to be asked for, at the firm level. Our firm asks for this even with a verification, and given that a verification should proceed or be done concurrently with an examination, I would think the verifier should already have this material. But redundancy isn't always a bad thing.

3. Performance Examination Procedures-Portfolio Trade Processing: The proposed Guidance Statement indicates that sufficient procedures must be performed to determine that portfolio trading activity is supported by appropriate documentation such as custody statements, trade confirmations, and reconciliations. Do you believe it also needs to be indicated that:

- a. it is preferable that verifiers obtain appropriate documentation directly from independent external parties;
- b. verifiers must make every reasonable effort to obtain appropriate documentation directly from independent external parties; or
- c. verifiers must obtain appropriate documentation directly from independent external parties?



As for portfolio trading documentation:

- a. *No, it is not necessary to obtain from independent external parties. This would prove disruptive and in many cases very difficult. It would possibly also increase the costs of the examination. Let's not allow Bernie Madoff to cause us to go too crazy with our guidance.*
- b. *No, no need to get from external parties!*
- c. *Again, no on the idea of getting information from external parties. Let's make everyone suffer because of a few bad eggs.*

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.

4. Performance Examination Procedures-Existence and Ownership of Client Assets: The proposed Guidance Statement indicates sufficient procedures must be performed to determine that beginning- and end-of-performance measurement period portfolio positions are supported by sufficient documentation such as custody statements and custody reconciliations, and the verifier must make every reasonable effort to obtain these documents directly from independent external parties (e.g., custodian, broker). Similar to 3 above, do you believe that instead of the above language, that it needs to be indicated that:

- a. it is preferable that verifiers obtain appropriate documentation directly from independent external parties; or
- b. verifiers must obtain appropriate documentation directly from independent external parties?

There is no need to go to external third parties for documentation to attest to the ownership of assets. It is neither preferable, desirable, or anything close to okay to suggest that verifiers must now go to third parties to get these documents. This will only add to the complexity of this process.

5. Performance Examination Procedures-Compliant Composite Presentation Information and Disclosures: The proposed Guidance Statement indicates that when supplemental information is presented in the examined composite's compliant presentation, at a minimum, the verifier must ensure that the supplemental information is not false or misleading, and the supplemental information is clearly labeled and identified as supplemental information to a particular compliant presentation. Please provide feedback as to the responsibility of the verifier if supplemental information for the composite is presented outside of the compliant presentation being examined and if deemed appropriate, how this should be incorporated into the Guidance Statement.

I oppose the extension of examinations to include the review of supplemental information. This could "open up a can of worms" regarding what needs to be verified. There is no need to expand examinations further. I don't have a problem with the verifier confirming that the such information carries a label identifying it as "supplemental," but beyond that I am concerned.

In addition, the use of the term "identified as supplemental information to a particular compliant presentation" suggests that simply stating "Supplemental" or "Supplemental Information" might not be sufficient, but that some additional wording, tying the information to the presentation, is now needed. If this is the case, clarity is needed, along with examples. If not, then this wording should be simplified to avoid confusion.

Some additional comments:

Page 1 of the actual document, 4th paragraph, first sentence: "Verifiers conducting a performance examination generally comprise...that have a high degree of knowledge regarding the investment industry." This is a qualitative statement based solely on subjectivity and should not be included here. The GS should not give any statement regarding the qualifications of firms who conduct this work. We have seen enough cases where this isn't true, which therefore suggests that such an endorsement is neither appropriate, necessarily accurate, or justified. I also don't believe it's needed.



Upcoming webinar

Dave Spaulding will host a webinar on Monday, July 25 at 11:00AM EST to discuss Performance Examinations in much greater detail. Please sign up!²



INVESTMENT
PERFORMANCE
ANALYSIS
& RISK
MANAGEMENT

16 & 17
August 2011
Singapore

Asian funds
is expected to
grow by
70% by 2012

Click here
for the full insights ►►

I suggest rewording the sentence in the next paragraph that reads "Performance examinations are unlikely to become a requirement of the GIPS standards." Perhaps to "It is unlikely that performance examinations will become a requirement of the GIPS standards."

The term "principal verifier" is used; it should be defined.

On page 3 we find the word "all-inclusive." This seems to be unnecessary redundancy, since "inclusive" by itself should be sufficient. The emphasis of including the word "all" as an appendage is unnecessary. www.dictionary.com offers the following definitions:

*inclusive: including a great deal, or including everything concerned; comprehensive
all-inclusive: including everything; comprehensive*

WHY WE DON'T LIKE EXAMINATIONS

Perhaps we should support all of these proposed changes, because the result will likely be that more and more firms will simply stop having them done. And since our firm opposes them to begin with, this would be good news, at least to us.

Firms become compliant for marketing purposes.

Firms undergo verifications for marketing purposes.

But why do they have examinations done? Not for marketing purposes: that has been our findings. And so, the reasons tend to be based primarily on confusion or that "we've always had them done."

I have a lot more to say on this, and will at our upcoming [webinar](#).

FROM OUR READERS...

Andre Mirabelli commented on our June edition, regarding the proposal to have standards for client reporting:

David,

I would hope that professional organizations would come to support only those methodologies that cannot demonstratively be shown to lead to absurd results.

In my observations of performance measurement reporting, to my chagrin, this seemingly minimal requirement on methodologies is often breached.

That is why I fear "Standards," "Guidelines" and sanctioned "Best Practices."

I fear that an example showing that a methodology leads to an absurdity will not be enough to dissuade a committee from adopting the methodology.

Andre



² To register please contact Patrick Fowler (PFowler@SpauldingGrp.com; 732-873-5700). Note that the webinars are complementary for our verification clients and Performance Measurement Forum members; a nominal fee is charged for all others.

THE SPAULDING GROUP'S 2011 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
August 22-23, 2011	CIPM™ Principles Exam Preparation Class	New Brunswick, NJ (USA)
August 24-26, 2011	CIPM™ Expert Exam Preparation Class	New Brunswick, NJ (USA)
September 13-14, 2011	Fundamentals of Performance Measurement Training	San Francisco, CA (USA)
September 15-16, 2011	Performance Measurement Attribution Training	San Francisco, CA (USA)
October 11-12, 2011	Fundamentals of Performance Measurement Training	Chicago, IL (USA)
October 13-14, 2011	Performance Measurement Attribution Training	Chicago, IL (USA)
December 6-7, 2011	Fundamentals of Performance Measurement Training	New Brunswick, NJ (USA)
December 8-9, 2011	Performance Measurement Attribution Training	New Brunswick, NJ (USA)

For additional information on any of our 2011 events, please contact Christopher Spaulding at 732-873-5700

PERFORMANCEJOBS.COM

Visit PerformanceJobs.com and you'll see that we have several jobs posted. We're very excited with the initial interest this venture has caused and look forward to it becoming the major resource for individuals seeking employment as well as firms looking to hire. If you know of someone who is looking for a career in investment performance, please direct them to our site and encourage them to submit their resume today.

PERFORMANCEJOBS.COM

TRAINING...

Gain the Critical Knowledge Needed for Performance Measurement and Performance Attribution

TO REGISTER:

Phone: 1-732-873-5700

Fax: 1-732-873-3997

E-mail: info@SpauldingGrp.com



The Spaulding Group, Inc. is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be addressed to the National Registry of CPE Sponsors, 150 Fourth Avenue North, Suite 700, Nashville, TN 37219-2417. www.nasba.org

FUNDAMENTALS OF 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 Fundamentals of Performance Measurement on these dates:

September 13-14, 2011 – San Francisco, CA December 6-7, 2011 – New Brunswick, NJ
October 11-12, 2011 – Chicago, IL

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:

September 15-16, 2011 – San Francisco, CA December 8-9, 2011 – New Brunswick, NJ
October 13-14, 2011 – Chicago, IL

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.



IN-HOUSE TRAINING

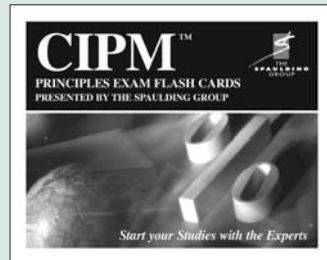
The Spaulding Group has offered in-house training to our clients since 1995. Beginning in 1998, we formalized our training, first with our Introduction to Performance Measurement class and later with our Performance Measurement Attribution class. We now also offer training for the CIPM program. To date, close to 3,000 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 of transporting their staff to our training location and limits their time away from the office. With the discounted 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).

UPDATED CIPM Principles and Expert Flash cards are now available on our web store. Please visit www.SpgShop.com today to order your set.

Our performance experts have created a study aid which can't be beat: **flash cards!** These handy cards will help you and your associates prepare for the upcoming CIPM Principles Exam. Unlike a computer-based study aid, you can take them anywhere to help you test your knowledge.



Benefits of Flash Cards:

- Work at your own pace
- Immediate feedback
- Strengthen and reinforce core CIPM principles

These cards are a **must have** for anyone preparing to take the CIPM Exams.