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.

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IPC Meeting in Brussels

The Investment Performance Council (IPC) held its spring meeting in Brussels earlier this month. And, although it ended a bit earlier than usual, a great deal was accomplished. I'll share with you what I believe are some of the highlights from that session.

A new CVG

First, we approved the Country Version of GIPS® (CVG) for South Africa. I don't know about you, but I think it's pretty impressive the way the Global Investment Performance Standards are being adopted throughout the world. As we know, the presentation standards began in the United States, but soon moved into Canada, and throughout Europe. AIMR's important initiative to develop global standards resulted in GIPS, which has been welcomed by many European nations, including a Translated Version of GIPS (TG) in Poland! The standards have made their way to Japan, and into Australia and New Zealand. And now, to the southern most tip of Africa. And a CVG is being developed in Egypt – yet another part of the world. We should all be excited by the progress that's been made in a very short time.

Leverage & Derivatives

A significant discussion centered around the Leverage & Derivatives Subcommittee's work. As you may know, this subcommittee put forward a proposed standard some time ago. It met with some criticism from the industry, and was brought back to the subcommittee to reconsider and reflect upon.

In Brussels, the IPC decided three things:

#1 – for the immediate future, the Leverage & Derivatives Subcommittee should prepare a *guidance statement*, not a standard, for leverage and derivatives. While even I objected to some of the proposed aspects of the draft standards, much of what was developed by this group was excellent – *e.g.,* some great calculations were put forward. So, the subcommittee is to carve out of the initial draft the requisite components to form a guidance statement. I'm sure that such a document will be well received by the industry.

#2 – the area of the draft standards that received the greatest criticism dealt with the mandate for reporting both Value at Risk (VaR) and Tracking Error. I objected because (a) it was totally contrary to the way the standards had previously been developed to mandate a specific measure. Every manager should be entitled to the freedom to decide what measure(s) they should employ. And, (b) I believe that most money managers don't have the tools (software) to calculate VaR. The additional cost could be significant and unjustified.

However, the IPC recognizes that risk is an important area.[1] Therefore,

[1] At the session I suggested that we make risk a mandatory disclosure in 2010. Since it's too late to add this to "Gold" GIPS, I will make this a recommendation in my written response to the draft.

a Risk subcommittee will be created to delve into this area in greater detail.

#3 – the original draft of the Leverage & Derivatives standards touched on extreme users of these products, which translates into Hedge Funds. At present, the standards don't speak to these products. Therefore, the IPC decided to create a new subcommittee to focus on Hedge Funds.

I think this is a fantastic idea. In the winter issue of *The Journal of Performance Measurement®*, our interview guest, Mark Anson (CIO for the California Public Employees Retirement System – CalPERS), stated that he'd like to see such standards developed, and I'm sure many others feel the same way.

So, hopefully much new and welcome development should be forthcoming from these subcommittees.

Date changes for new standards

While "Gold" GIPS has been in development, various IPC subcommittees have been busy working on new standards. One of these, Advertising, was scheduled to go into effect this June, while three others (Private Equity, Real Estate, and Fees) were set for 1 January 2005. The IPC decided to shift the effective dates for these four new standards to 1 January 2006, to coincide with the effective date for "Gold" GIPS. This was done for a couple reasons.

First, to avoid confusion. By aligning the dates, we will hopefully make the transition to all of these items easier for firms to handle.[2]

And second, to save time and money for the various countries who have CVGs. One of the requirements of a CVG is that the sponsor agrees to adopt any changes that are made to GIPS. Since, for example, the AIMR-PPS® has standards for Private Equity, Real Estate, and Advertising, we would be obligated to remove our requirements and replace them with what's in GIPS. We are saved that time and expense for now, and can incorporate these changes at the same time we bring in the changes for "Gold" GIPS.

Reporting as well as presenting?

A suggestion was made at the meeting to broaden the standards to include client reporting. This was suggested as a way to enhance the awareness of GIPS throughout the industry, by reminding clients that their manager claims compliance.[3]

The reporting could include an annual statement of the client's return, vis-à-vis the return of the composite that the account is in, along with an explanation as to why the account is below or above the average.

[2] Even though the effective dates have shifted, firms may adopt the standards in advance of these dates.

[3] As a group, we recognize that GIPS is not as well known or accepted as we would like, and we are searching for ways to promote it. This idea was one of the suggestions that arose.

My reaction to this idea was somewhat negative. First, it means that you're going to make roughly half of your clients angry, since half will likely be below the average.[4] Why do this?

And, require firms to *explain* the reasons why the account is above or below? Again, why?

And, what software exists today that supports such reporting? I suspect this would require additional development and expense for many firms.

The notion of expanding the scope of the standards to the area of reporting would be an unwelcome change, in my opinion. Hopefully, we won't see this come to pass.[5]

"Gold" GIPS is here!

After much anticipation, the draft of the new version of GIPS is upon us. One of the things we discussed in Brussels is whether or not to keep the name "Gold" GIPS. Concerns included: (a) would some firms believe that there are two standards – GIPS and Gold GIPS – and that they would have a choice as to which to comply with? And, (b) would the next version have to be "Platinum," and then "Diamond," or the like?

"Gold" GIPS is not a "thing." It's a *process* – the process to bring us to a single, universally accepted standard for performance presentation. This won't happen in 2006, and may not happen in 2010, either. But, it will hopefully eventually occur, as GIPS is expanded to encompass those areas that have previously been missing and which distinguish it from the various CVGs. For example, the AIMR-PPS has Real Estate, Private Equity, and Advertising standards. With the introduction of these new standards from GIPS, the differences between the AIMR-PPS and GIPS diminish.

While I have been guilty of not putting the quotation marks around the word, Gold, this is technically the way it's been presented by the Country Standards Subcommittee of the IPC, which was responsible for developing the draft. This is intended to be a new version of GIPS, with other versions coming every five years or so.

A huge difference between GIPS and the AIMR-PPS is that the public is invited to comment. When, for example, the 1997 version of the AIMR-PPS was introduced, it was done without any public comment period.

[4] Since the composite return is an *asset weighted* average, rather than an *equally weighted* average, we can't guarantee that exactly half of the returns will be above and half below, but it should be pretty close.

[5] Clients always have the opportunity to ask their manager for a copy of the presentation for the composite that their account is in. But to mandate this reporting would be a mistake.

But now, any new guidance statement, standard or change requires a public comment period. And it's also upon us and will remain open until 1 August 2004.

This month, we hosted a series of luncheons (New York, Chicago, Boston, San Francisco, and Los Angeles) to begin to educate people about what's in this new version and explain how it will impact the AIMR-PPS. As a CVG, the AIMR-PPS must adopt any change that is introduced in GIPS, which means that any manager that claims compliance with the AIMR-PPS must be prepared to adopt these new changes.

Unfortunately, there's a tremendous amount of ignorance about the differences between CVGs and GIPS. For example, in our 2002 survey we asked North American managers if they comply with the AIMR-PPS to which almost 78% said "yes." We also asked them if they comply with GIPS, and got a response of only 47% saying "yes." But how can this be? If anything, there should be more saying "yes" to GIPS than to the PPS, as *anyone who complies with the AIMR-PPS also complies with GIPS.*[6]

Given this lack of awareness, we felt it was critically important to alert firms of the proposed changes and educate them about the impact they may have upon them. We will continue with this education process in the pages of this newsletter: in the coming months, we will touch on some of the more significant aspects of "Gold" GIPS, and offer editorial commentary.

You are encouraged to visit the AIMR website (www.AIMR.org), and get a copy of the draft. Review it and consider whether or not you support what's there. If you do, then let the IPC know it. But, if you don't, it's even more important that you voice your opinion. If your company has a policy which prohibits its name being associated with your comments, you can ask that your identity be held confidential, and your remarks will be flagged as "anonymous."

This is the first major change to the global standards since they were introduced. It's important that you take the time and become familiar with them. Please do so. You only have until 1 August 2004 to make your thoughts known.

[6] The inverse (that is, that anyone who complies with GIPS complies with the AIMR-PPS) is not necessarily true, as the PPS has requirements beyond GIPS, most notably the requirement for ten years of compliant history

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.
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UPCOMING TRAINING DATES

INTRODUCTION TO PERFORMANCE MEASUREMENT

LOCATION	**DATES**
Chicago, IL	April 19 - 20, 2004
San Francisco, CA	May 4 - 5, 2004
New York, NY	September 20 - 21, 2004
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2004
Performance Measurement Forum Schedule

San Francisco, CA	**May 6 - 7, 2004**
Edinburgh, Scotland	**June 9 - 10, 2004**
Madrid, Spain	**November 10 - 11, 2004**
Orlando, FL	**December 9 - 10, 2004**