



Vincent Performance  
Services LLC

**2008**

**Survey of Compliance with the Global Investment  
Performance Standards (GIPS®)**

<http://www.vincentperformance.com/Survey.htm>

# 2008 Survey of Compliance with the Global Investment Performance Standards (GIPS®)



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## Introduction

We are pleased to present the results of the Vincent Performance Services LLC 2008 Survey of Compliance with the Global Investment Performance Standards (GIPS®). We had several motivations for conducting the survey. First, we are frequently asked some variation on the following questions: What percentage of firms claim compliance with the GIPS standards? Do small firms claim compliance, or only large firms? Do most firms have performance examinations done in addition to the verification? We wanted to respond to these questions with facts rather than anecdotal information. Second, we wanted to know if firms are ready for the pending changes to the GIPS standards scheduled to take effect on January 1, 2010. Third, we wanted to learn what areas of the GIPS standards are the most challenging, including which topics would benefit from additional clarification or guidance.

## Methodology

The Vincent Performance Services LLC 2008 Survey of Compliance with the Global Investment Performance Standards (GIPS®) was conducted from February 2008 to April 2008. The results of the survey are divided into seven sections: Firm Description, Claiming Compliance, Account Calculations, Composite Calculations and Construction, Verification, Future Changes to the GIPS Standards, and Comments/Suggestions.

The population for the survey was determined as follows. We began with the 767 largest money managers of U.S. institutional tax-exempt assets as listed in the May 28, 2007 *Pensions & Investments*. From this list we identified the U.S. and Canadian firms. The *Pensions & Investments* article provided firm information for only the top 500 firms. We therefore had to eliminate some firms whose name alone did not allow us to identify the firm. We also attempted to identify individual “GIPS firms” within some of the larger firms. This process resulted in a final survey population of 661 firms. Of the 661 firms invited to participate in the survey, we received 134 responses, resulting in a response rate of 20%.

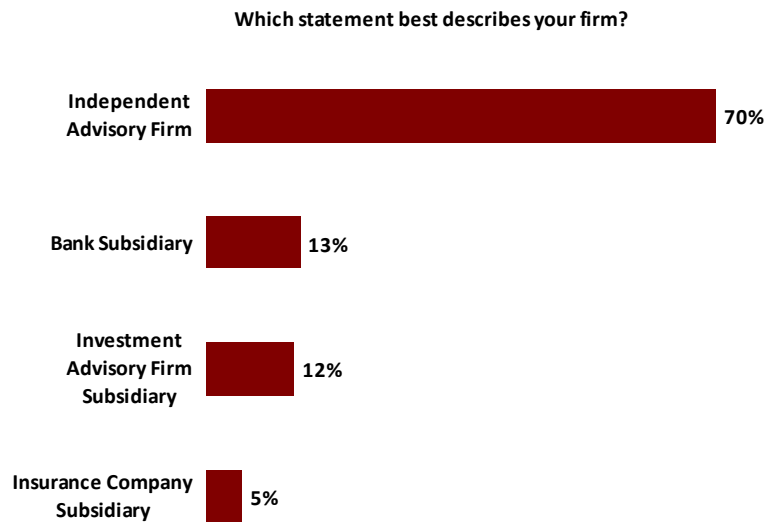
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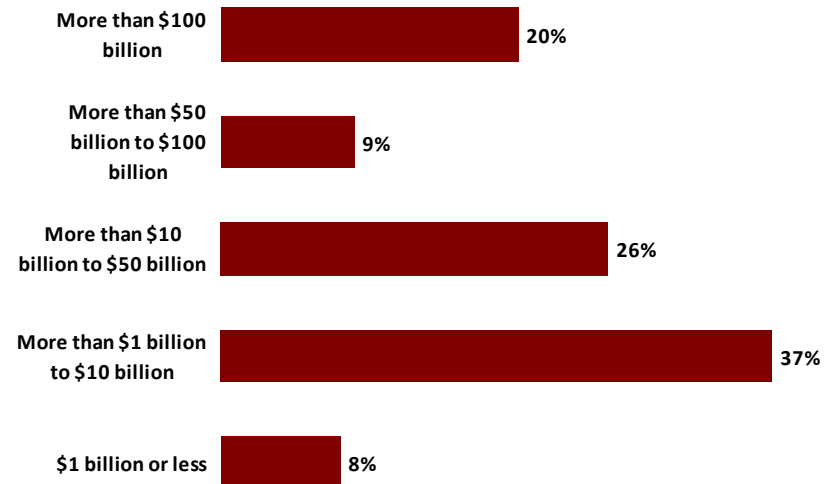
## Firm Description

Most respondents identified themselves as independent advisory firms, although results also include responses from subsidiaries of investment advisors, insurance companies, and banks.



Firms of all sizes responded to the survey.

## What are your firm's current assets under management?



For analytical purposes, we classified firms as either small or large. Small firms are defined as firms with assets under management (AUM) of \$10 billion or less, and large firms as greater than \$10 billion AUM.

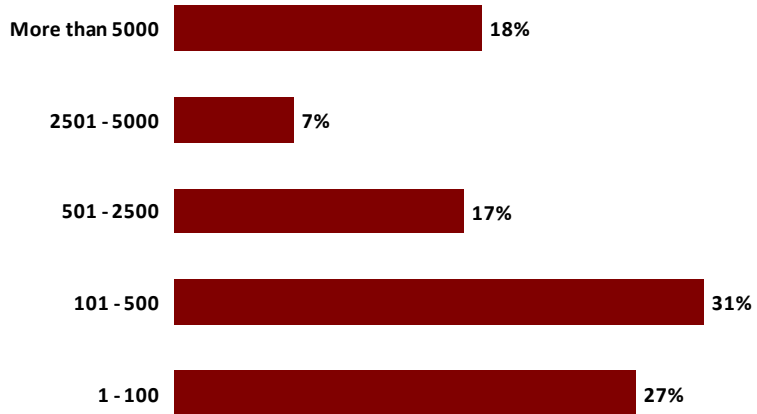
Almost 60% of the responding firms manage 500 or fewer accounts, yet 78% of those firms manage assets with an average account size greater than \$10 million. Of the roughly 40% of firms managing more than 500 accounts, only 49% had an average account size greater than \$10 million. This might suggest that the managers with fewer accounts typically manage larger pension and foundation accounts, while those with a large number of accounts are more likely to manage high net worth or individual accounts in addition to institutional accounts.

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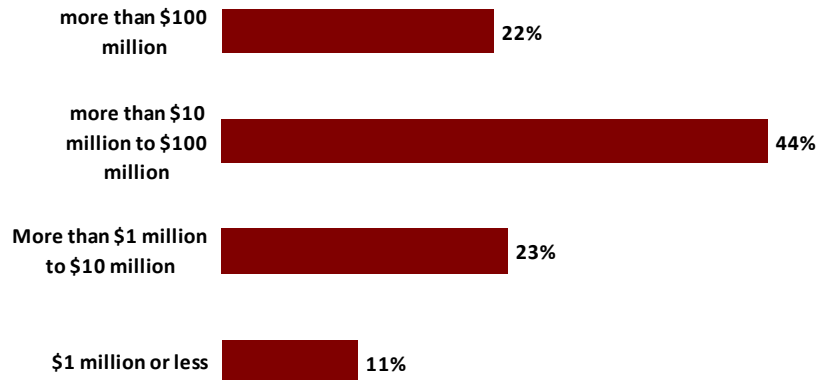
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How many accounts do you currently manage?

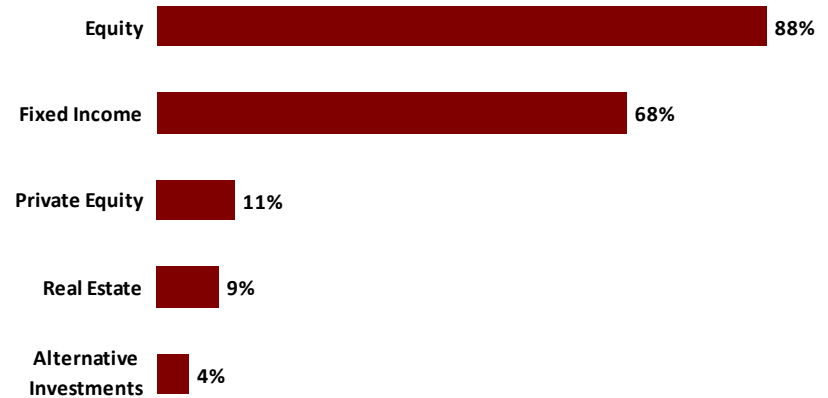


What is your average account size?



Respondent firms manage a diverse set of assets including fixed income, equity, private equity, non-REIT real estate, and alternative assets.

Which asset classes does your firm manage?

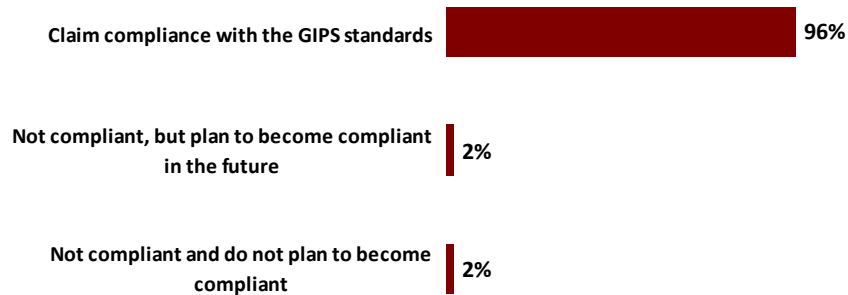




## Claiming Compliance

Anecdotal evidence suggests that compliance with the GIPS standards is the industry standard for institutional asset managers. Few institutional clients in North America issue RFPs without asking if the manager is compliant with the GIPS standards, as do most databases. Although we believe that compliance is the norm in the institutional marketplace, we were surprised at the extremely high rate of compliance. Ninety-six percent of respondents claim compliance with the Standards, 2% do not currently claim compliance, but plan to in the near future, and 2% were not compliant and do not plan on becoming compliant.

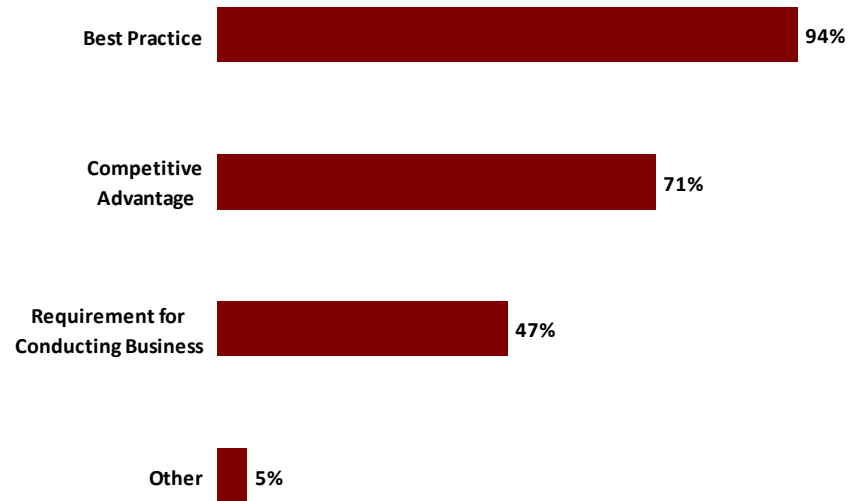
Which statement best describes your firm's compliance with the GIPS standards?



We asked why firms choose to claim compliance with the GIPS standards. The vast majority of firms (94%) answered that claiming compliance is best practice. Many firms (71%) also believe that claiming compliance provides a competitive advantage in the marketplace. A smaller, yet sizeable, 47% of respondents said claiming compliance is a requirement of doing business. "Other" responses primarily were additional comments relating to the requirement to be in compliance specifically in the institutional marketplace.

One respondent stated that claiming compliance results in better internal processes and procedures, and makes them a better firm.

Why does your firm claim compliance with the GIPS standards?



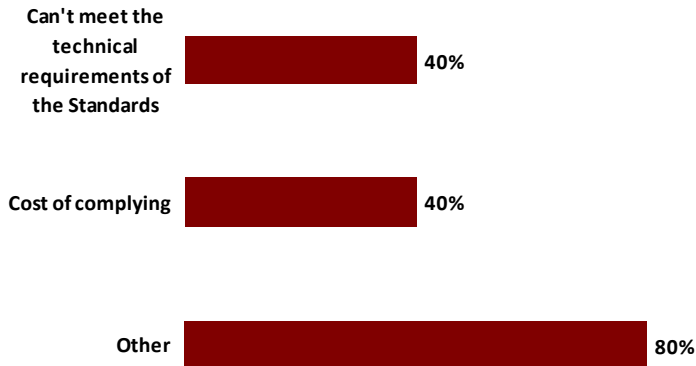
We asked non-compliant firms why they do not comply with the Standards. Forty percent of the non-compliant firms answered that the cost of compliance and difficulty meeting the technical requirements of the Standards were the reasons for non-compliance. The inability of a firm to be sure that it is fully compliant was also given as a reason. None of the non-compliant firms answered that compliance was not important as a reason for their non-compliant status.

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# Survey of Compliance with the Global Investment Performance Standards (GIPS®)



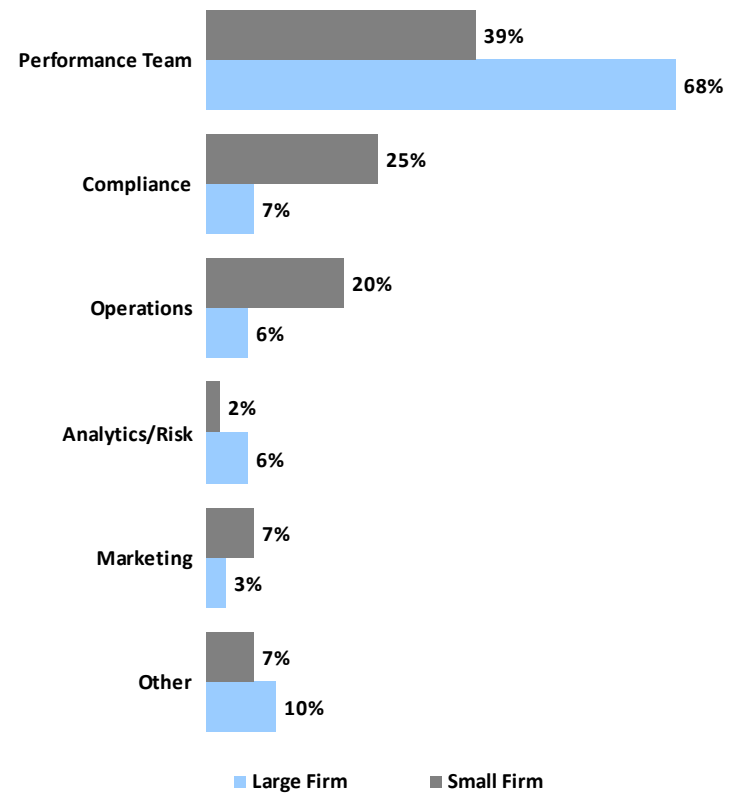
Why does your firm not claim compliance with the GIPS standards?



When it comes to the responsibility of maintaining GIPS compliance, less than 40% of small firms have dedicated performance teams. Given that smaller firms generally do not have enough performance-related functions to warrant a dedicated performance team, these results are expected. Among small firms that do not have dedicated performance teams, the near equal number answering that responsibility for GIPS compliance falls under either the Compliance or Operations departments demonstrates that there is no single “correct” solution that works for every firm when assigning responsibility for GIPS compliance to a department.

In contrast, nearly 70% of large firms have teams dedicated to performance measurement. The demands and complexities of GIPS compliance can quickly increase as the firm size increases, which often necessitate a dedicated team.

Who is primarily responsible for maintaining composites in compliance with the GIPS standards?



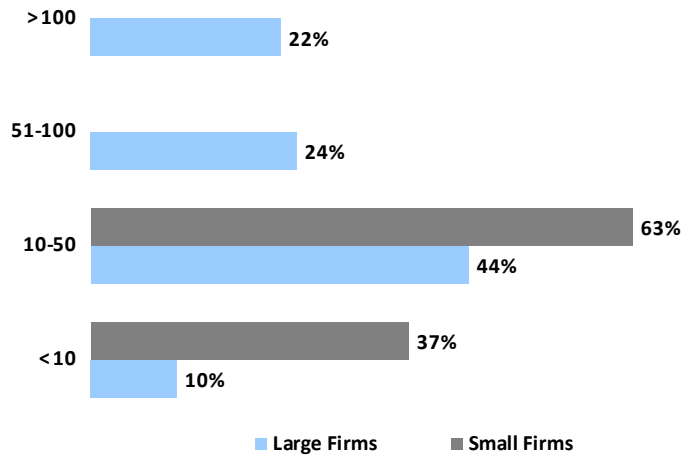
As expected, large firms typically maintain more composites than small firms. Forty-six percent of large firms maintain more than 50 composites, 44% maintain 10-50 composites, and 10% maintain fewer than 10 composites. By contrast, no small firms maintain more than 50 composites. The majority of small firms maintain 10-50 composites.

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How many composites does your firm maintain?



### After-Tax Provisions

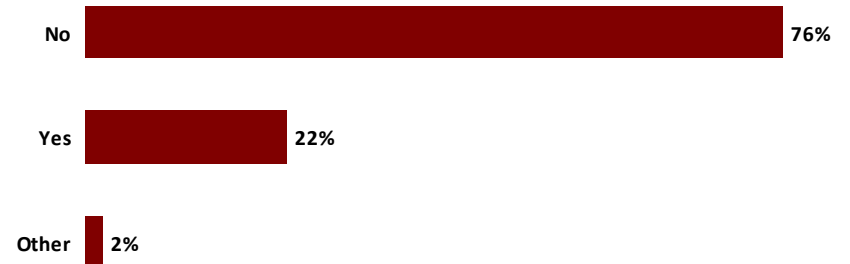
A GIPS-compliant firm that presents after-tax results to prospective clients that are U.S. tax payers is required to follow the U.S. Country-Specific Taxations Issues Guidance. We know of very few firms that follow the after-tax provisions, and were very curious to know how many firms comply with the GIPS United States After-Tax Guidance. We first determined that 40% of the respondents manage assets on a tax aware basis, and were thus potentially required to follow the After-Tax Guidance.

Does your firm manage taxable portfolios on a tax aware basis?



Of the compliant firms that manage portfolios on a tax-aware basis, only 22% of firms follow the GIPS United States After-Tax Guidance.

If your firm manages taxable assets on a tax aware basis, do you calculate and report after-tax composite results in compliance with the GIPS United States After-Tax Guidance?

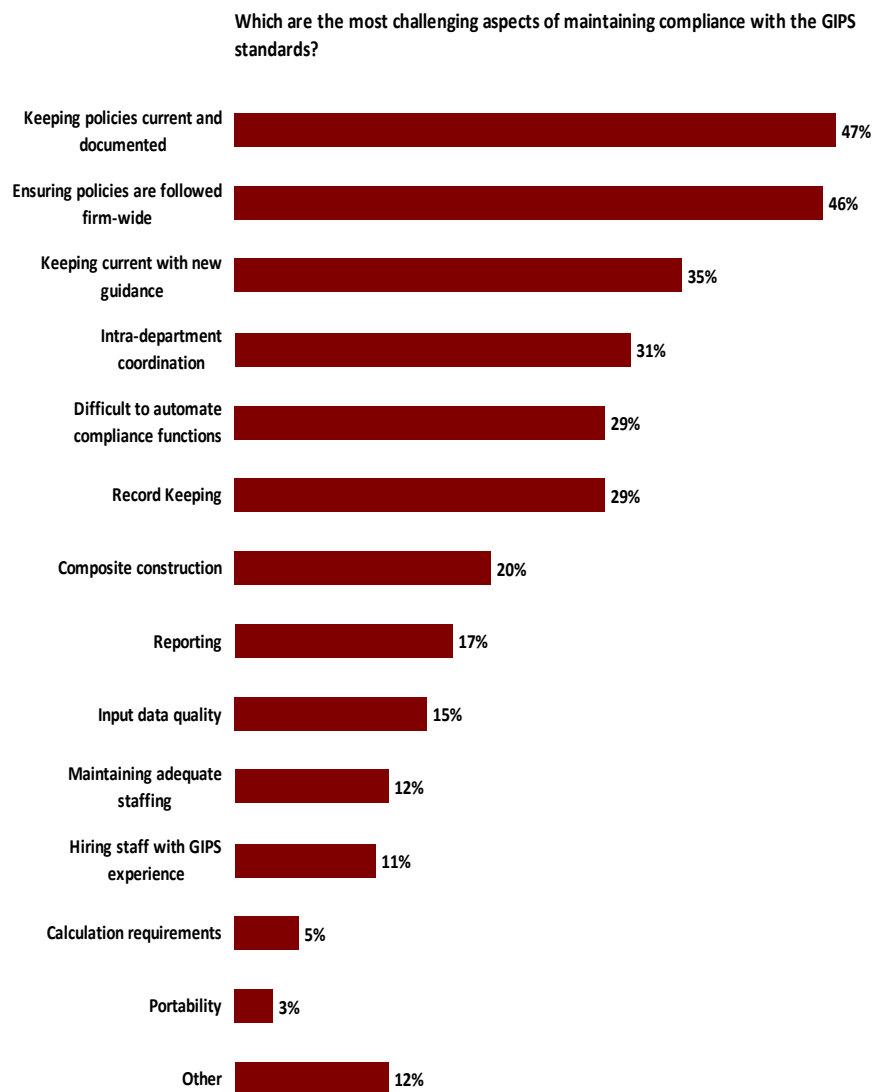


# 2008 Survey of Compliance with the Global Investment Performance Standards (GIPS®)



## Challenges of Compliance

We asked firms to select the three most challenging aspects of maintaining compliance with the GIPS standards. The most significant challenges identified were documenting and keeping the GIPS Policy and Procedures manual current, ensuring that policies are followed firm-wide, and keeping up-to-date with new GIPS guidance. The respondents answering “other” listed ambiguity within the Standards, complexity of compliance, data consolidation, and having to answer inaccurate questions in consultant databases as other challenges to maintaining compliance.

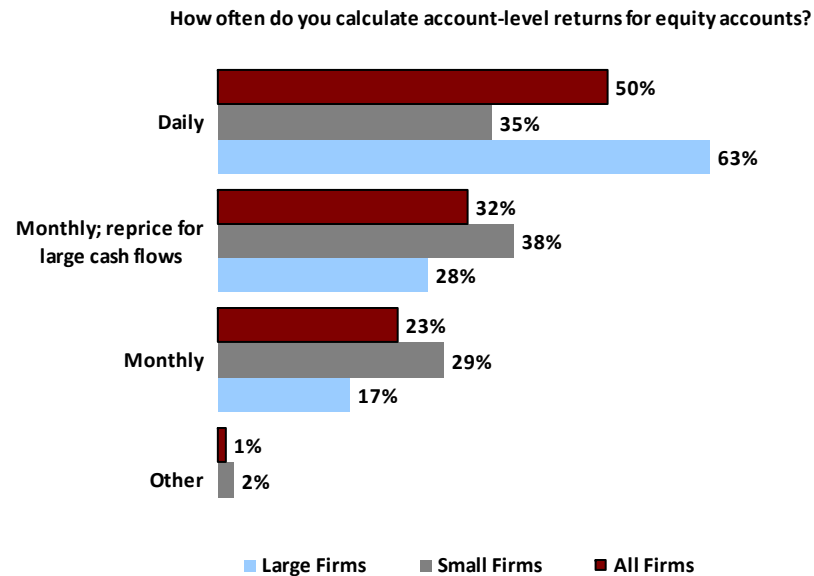




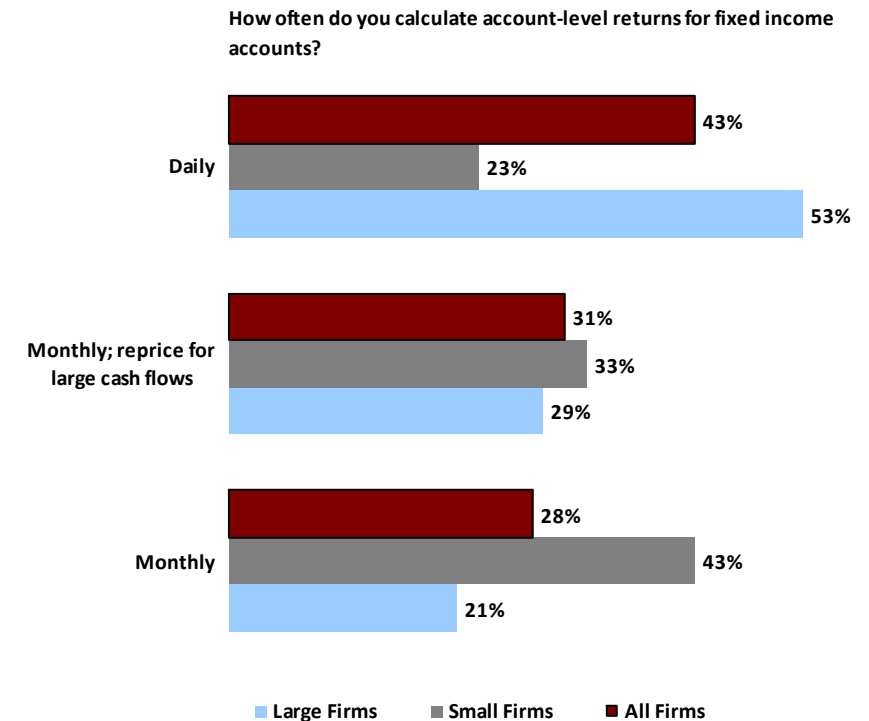
## Account Calculations

Anecdotal evidence suggests that the industry is quickly moving towards daily performance, but we were keen to learn what percentage of managers had actually done so. We were also curious to know whether or not the size of the firm and type of assets managed by the firm played a role in the frequency of performance calculations.

For large firms managing equity securities, 63% calculate performance daily, 27% calculate using modified Dietz with large cash flow revaluation, and 17% calculate returns monthly using modified Dietz. Small firms managing equities were more likely than large firms to value portfolios monthly. Note that the numbers below may add to more than 100%, because some respondents noted that they use one calculation for one set of accounts (i.e. institutional) and a different calculation for other accounts (i.e. wrap/sma).



For firms that manage fixed income portfolios, large and small firms were equally likely to calculate account returns using modified Dietz with large cash flow revaluation or daily calculations. However, compared to large firms, twice as many small firms calculate returns on a monthly basis. The reverse was true for daily calculations where large firms were nearly twice as likely as small firms calculate performance daily.

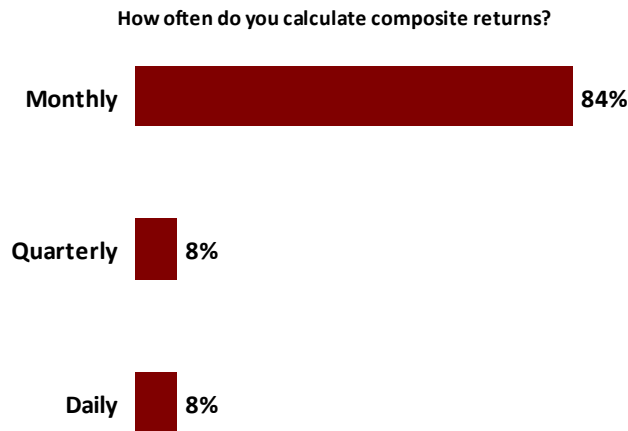




## Composite Calculations and Construction

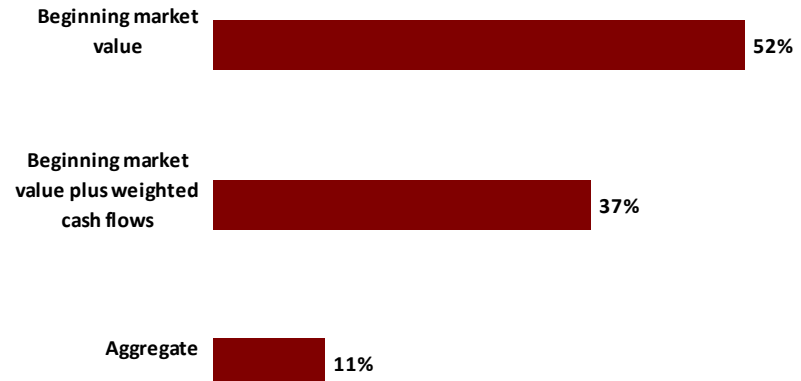
### Frequency

The vast majority (84%) of firms calculate composite returns on a monthly basis, while 8% of firms calculate composite returns on a quarterly basis and 8% on a daily basis. There was no relationship between firm size and the frequency of composite calculations.



A majority of firms calculate composite returns by weighting account returns by beginning market values. Thirty-seven percent of respondents refine the composite calculation to weight account returns by beginning market values plus weighted cash flows. Only a small percentage uses the aggregate method to calculate composite returns.

### Which method do you use to calculate composite returns?

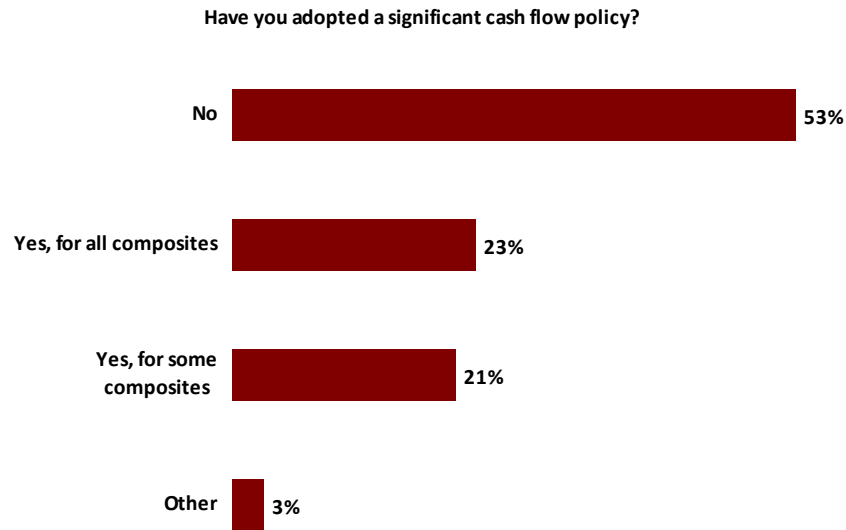


### Significant Cash Flow Policy

The GIPS standards allow a firm to temporarily remove a portfolio that experiences a “significant” cash flow from its assigned composite. Significant cash flow policies must be established in advance and applied consistently within a composite. While the idea sounds simple, we have found that firms often struggle with implementing such policies consistently. Approximately half of all compliant firms surveyed do not use a significant cash flow policy. Of the firms that have significant cash flow policies, approximately half have adopted a significant cash flow policy for all composites, while the other half have adopted such a policy for only certain composites. Only one firm answered that they use temporary new accounts in lieu of a significant cash flow policy to handle large cash flows. Our experience with implementation of both policies has shown them to be difficult to manage and prone to manual error.

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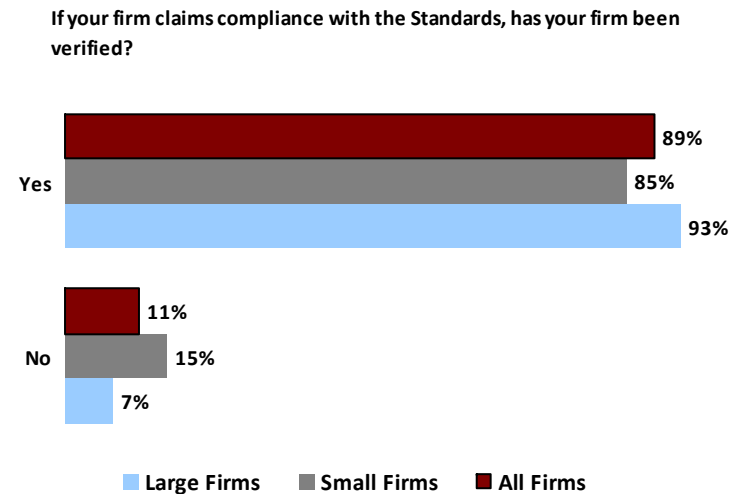
## Verification and Examinations

### Firm Verification

Verification is the review of an investment management firm’s performance measurement processes and procedures by an independent third-party verifier. Currently the GIPS standards do not require a firm to be verified, however, they recommend that firms pursue verification.

While there has been much discussion over whether verification will become mandatory at some point in the future, the current view from the GIPS Executive Committee (the committee that oversees the Standards) is that verification will not be mandatory. Instead, the plan is to change the GIPS claim of compliance and require a firm to disclose whether or not it has been verified.

Of the firms that stated they claim compliance with the Standards, 89% are verified. There was not a large difference in the percentage of large and small firms choosing to be verified.



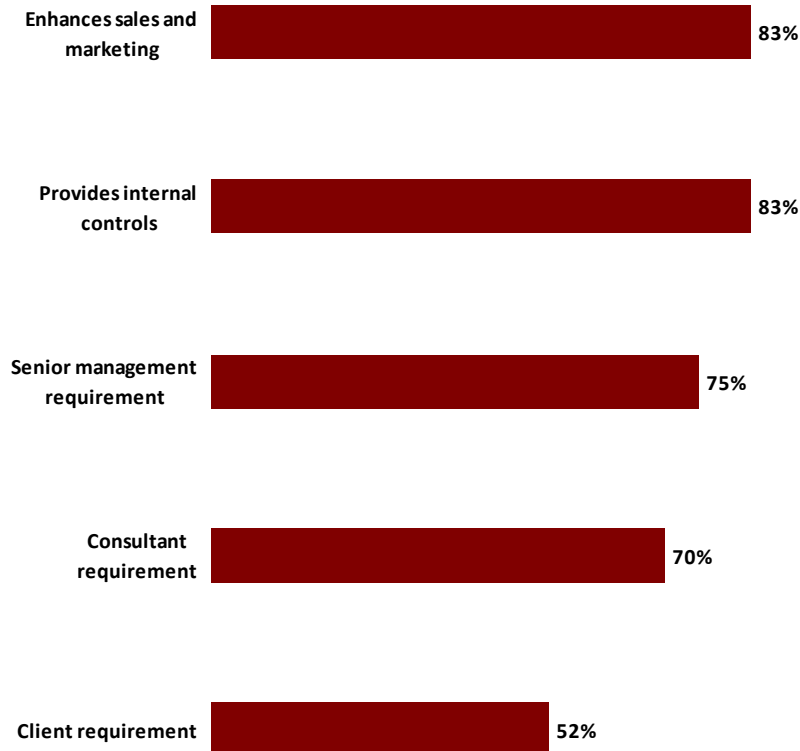
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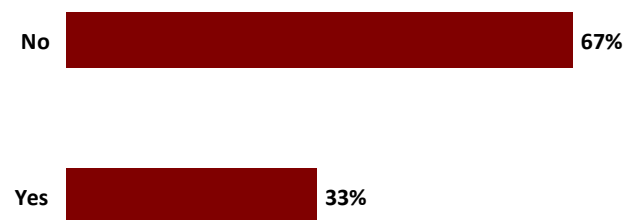
We asked firms to identify the reasons why their firm voluntarily chose to be verified. Firms most frequently responded that they are verified because it provides good internal controls and verification benefits sales and marketing efforts.

If your firm was verified, why did you undertake the verification?



Although a vast majority of respondents are verified, a majority of firms felt that verification should not be mandatory.

If your firm claims compliance with the Standards, do you think verification should be mandatory?



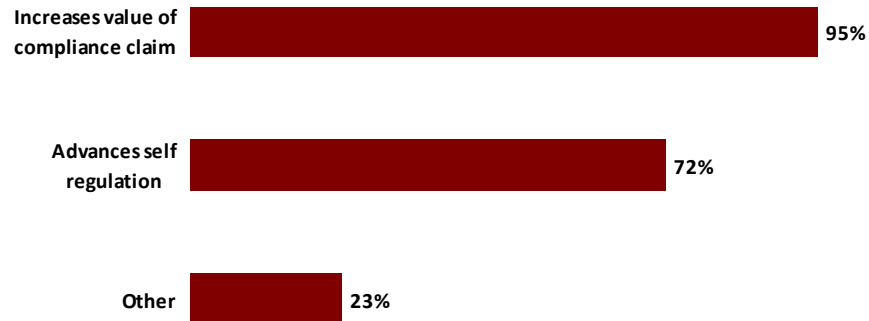
Of the firms claiming compliance with the Standards who responded that verification should be mandatory, 95% said that verification increases the value of the claim of compliance with the GIPS standards and 72% said it advances the concept of self-regulation. “Other” included responses that verification confirms that investment firms understand the application of the GIPS standards and prevents firms from falsely claiming compliance. Several respondents stated that verification levels the playing field as it creates a uniform application of the Standards.

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# Survey of Compliance with the Global Investment Performance Standards (GIPS®)

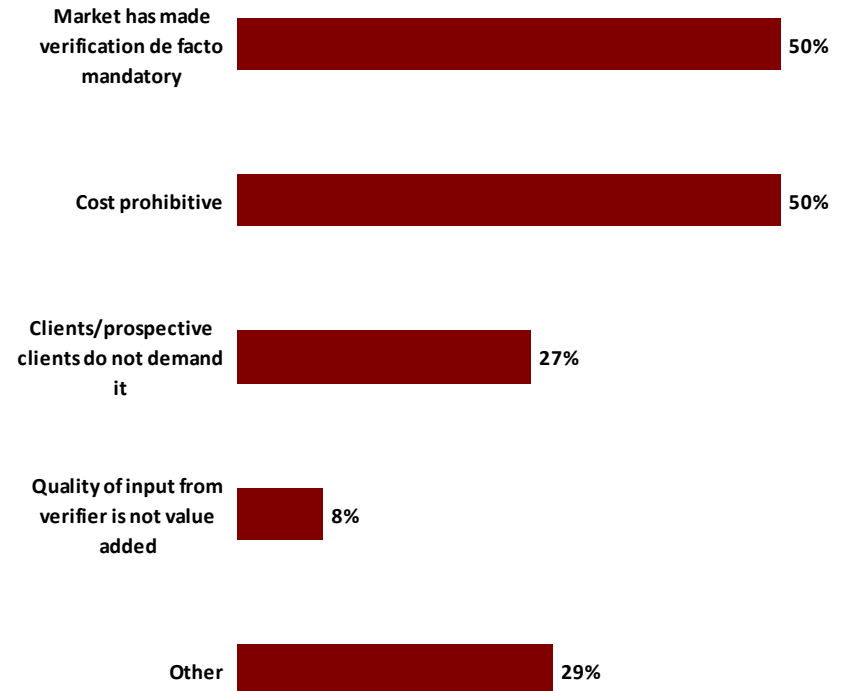


If your firm claims compliance and you believe verification should be mandatory, why do you believe in mandatory verification?



We asked firms that believe verification should remain voluntary to identify the reasons why they believe verification should not become mandatory. Most firms cited cost or the belief that the market has already made verification de-facto mandatory. “Other” responses included concerns about the availability of qualified verifiers and the ability to engage verifiers in all markets. Several firms also said they would lose a competitive advantage if verification became mandatory.

If your firm claims compliance and you believe verification should be voluntary, why do you believe it should remain voluntary?



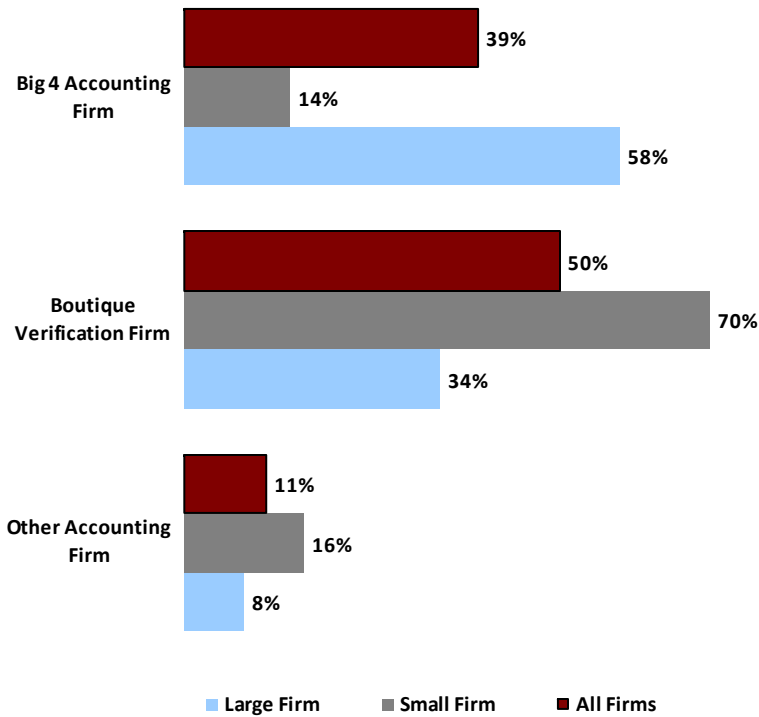
Among firms that are verified, half selected a boutique verification firm. The Big 4 accounting firms predominate as verifiers for large firms while boutique firms predominate as verifiers for small firms.

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If your firm is verified, who performed the most recent verification?



### Composite Examinations

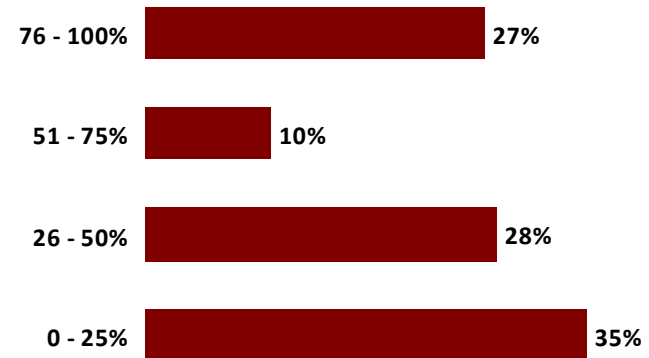
In addition to verification, a firm may choose to have additional testing performed on a specific composite. This is referred to as a composite examination or composite audit. Of the firms that were verified, 84% opted to have composites examined.

In addition to a firmwide verification, did your firm have composites examined?



Of the firms that have composites examined, 27% chose to have 76 - 100% of their composites examined. Nearly two-thirds had 50% or fewer of their composites examined.

What percent of your firm's total composites were examined in the most recent verification/examination?

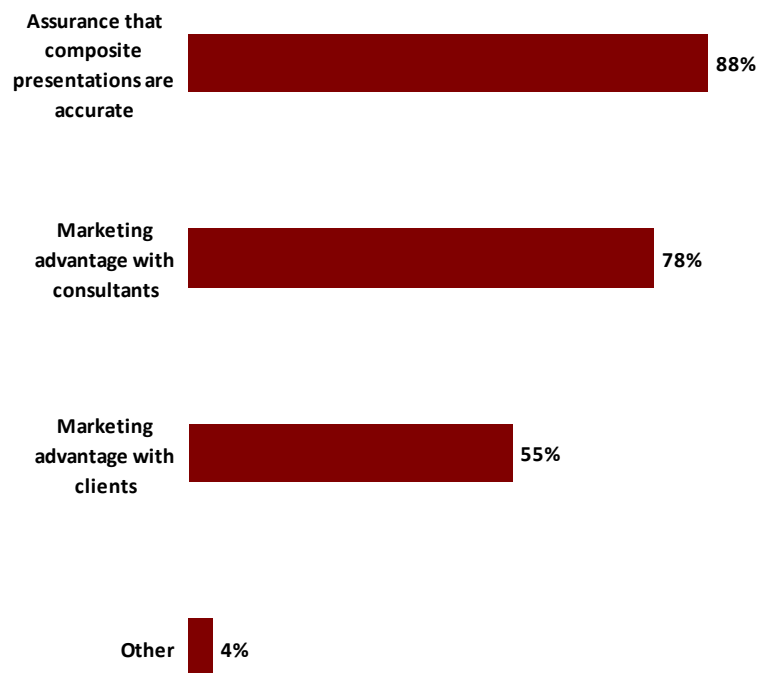


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Of the firms choosing to have performance examinations, 88% said they did so because it provides assurance that specific performance presentations are accurate. In addition, nearly 80% responded that they choose to have composites examined because it provides a marketing advantage with consultants and clients.

What was your firm's motivation for having composites examined?





## Future changes to the GIPS Standards

On January 1, 2010, several changes are scheduled to occur with the GIPS standards. Specifically, firms must revalue portfolios for large cash flows. Firms will no longer be allowed to include in composites, accounts that are carve-outs with allocated cash. There has been perceived resistance from the industry to the scheduled changes and we were curious to know if firms were prepared for the upcoming changes and the resulting effects of the changes.

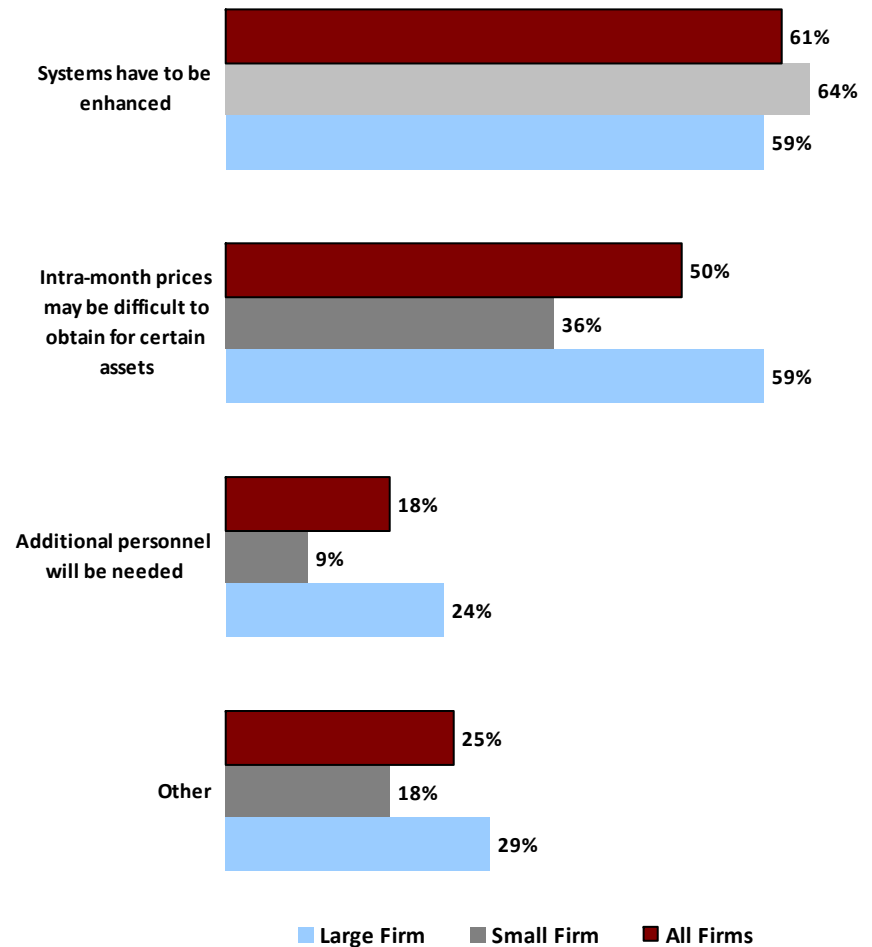
### 2010 requirement to revalue portfolios for large cash flows

As of January 1, 2010, the GIPS standards will require firms to revalue portfolios for large cash flows above a pre-established threshold. A firm may decide what constitutes a “large” cash flow that would trigger the repricing. Either the modified Dietz method with re-pricing for large cash flows or a daily return calculation will suffice. There has been a significant amount of debate within the industry about the costs associated with daily pricing versus the benefit of additional precision since daily pricing is more expensive for the asset manager. Depending on the asset class, more overhead in terms of systems and personnel may be required. Also, there are well known difficulties in obtaining reliable prices for thinly traded or illiquid securities in markets such as municipal bonds and international fixed income.

Despite the belief that there is much resistance in the industry, only 22% of firms indicated they would be impacted by the requirement to revalue for large cash flows.

Of the firms answering that they would be impacted by the pricing changes, 61% said that system enhancements would be required, 50% said that obtaining intra-month prices for certain assets would be difficult, and 18% said that additional personnel would be required. Of the 25% that answered “other”, over half identified increased expense as a significant impact resulting from the required pricing frequency change.

How will the requirement to revalue portfolios for cash flows above a predetermined threshold impact your firm?

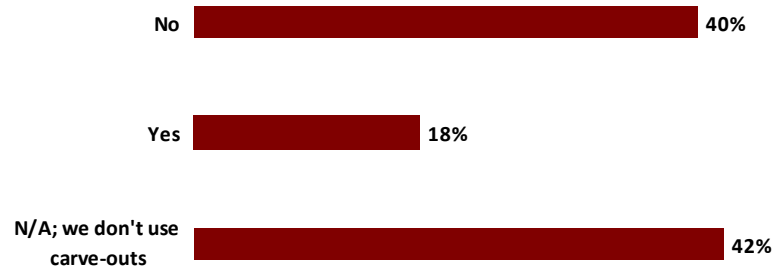




### 2010 ban on carve-outs

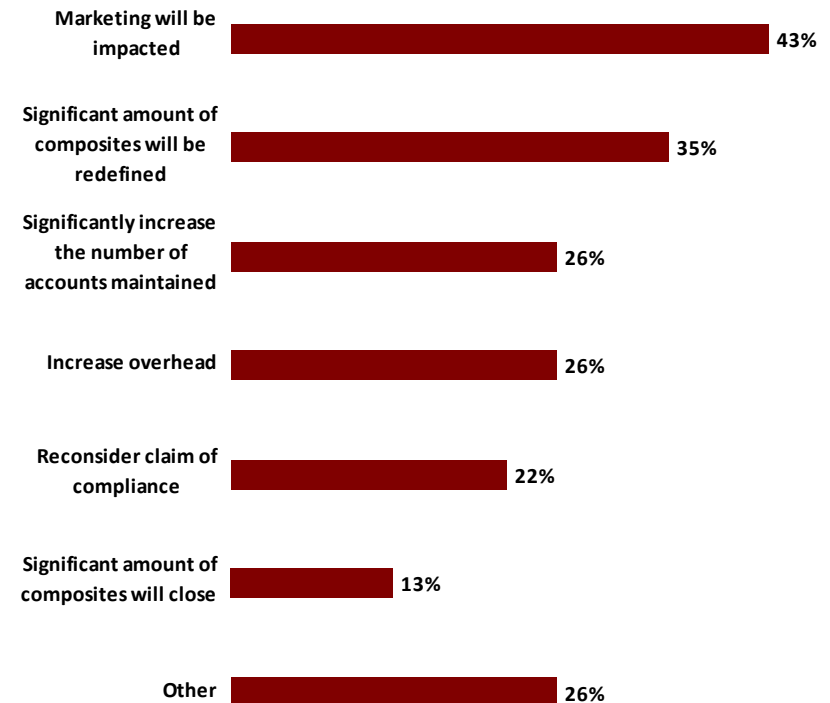
Carve-out returns continue to be a hot topic within the performance community. Currently the Standards permit carve-outs so long as each segment is managed with a distinctive strategy and has cash allocated to it. Proponents of carve-outs argue that portfolio managers and marketing departments should have the flexibility to use carve-out returns to show the firm’s capabilities in specific strategies when those strategies are sub-strategies of larger portfolios. Critics argue that the cash allocation methodology used to assign cash to carve-outs does not mimic reality and that carve-outs will never be managed exactly the same as a separate account and, therefore, carve-outs are not comparable to separate accounts. As of January 1, 2010, the GIPS standards will no longer permit carve-outs with allocated cash to be included in composites. Instead, each sleeve or segment of the portfolio will have to be managed as a separate sub-portfolio with its own cash balance. Since many firms rely heavily on carve-out composites (especially managers of balanced products), we were curious to learn what impact the change would have on those managers. Twenty-two percent of the firms surveyed currently have composites that include carve-outs. Of those firms, 76% said they would be impacted by the 2010 ban on carve-outs.

As of 1/1/2010 a firm will no longer be able to include carve-outs (with allocated cash) in asset-class composites. Will the ban on carve-outs in the year 2010 impact you?



Over 40% of the firms indicating they would be impacted by the ban said that marketing would be significantly affected by the resulting composite closures and/or redefinitions. Approximately one-quarter of respondents indicated that they will require additional resources due to increases in operational overhead associated with the increased number of accounts that will have to be maintained on accounting and performance systems. The inability to use carve-outs will cause 22% of respondents to reconsider whether they should continue to claim compliance with the GIPS standards.

How will the ban on the use of carve-outs as of 1/1/2010 impact your firm?



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## Comments/Suggestions

We asked which topics/areas firms believe should be addressed by or enhanced within the GIPS standards. Responses are summarized below.

Several firms responded that more guidance is needed on performance attribution, with one respondent specifying fixed income attribution in particular.

Several firms believe derivatives needed to be addressed in greater detail including the use of notional value in a pure derivatives strategy and the use of leverage. One respondent also felt there should be guidance on “deleveraging” to achieve comparability.

We received six comments on the need for more guidance for alternative investments, with another six comments for the need for more guidance on hedge funds. Most of the comments were general in nature, stating that more guidance is needed on the two topics. In a few cases, specific comments were made. One respondent stated that “sidepockets” should be addressed. Another respondent said, “I don’t believe that there should be separate GIPS standards for hedge funds. In my opinion the current standards already work for hedge funds with no additional need to expand or alter disclosures. I believe it would create a barrier for new managers and be a hassle for managers that already claim compliance and manage hedge funds.”

There were several responses that the GIPS standards should do a better job in addressing and closing the inconsistencies between the Standards and SEC requirements.

Several respondents were looking for better advertisement guidelines, especially in relation to mutual funds and separately managed accounts.

Two firms commented that the Standards should better address performance incentive fees.

Several firms commented that error correction guidance should be finalized and materiality should be addressed. For example, on materiality, one respondent

said there should be guidance on assessing what qualifies as a material error in firm assets versus a material error in composite returns.

Two firms were looking for more guidance on performance portability.

Three firms commented on carve-outs. One respondent said the earliest possible notification should be given if the effective date will be postponed again. To quote another respondent, “Carve-out must be clarified. I agree we should abolish the ability to pluck securities from a mandate and make a composite. We should not abolish cash allocation methodology, and force sub accounting for straight forward balanced mandates. Separate the issue and solve the right problem.”

The same respondent continued on to address the 2010 change to require revaluation for all large cash flows, and said, “We should not move forward with mandated daily pricing. How much do we gain? In my opinion, not enough. Focusing on writing guidance for the more esoteric assets and attribution, would be better time spent, in my opinion.” Others made similar comments.

Two respondents said more guidance is needed on when it is appropriate to use time weighted returns and internal rate of returns (IRR).

Several people responded more clarity is needed on wrap/sma guidance, including the handling of bundled fees.

One firm said more guidance on record keeping, disclosure requirements, securities lending, and supplemental information (better definition of what is supplemental and what is not) should be provided.

One person commented that the CFA website should be changed to make it easier to find relevant data, while another said that more seminars should be offered on GIPS requirements and should be more broadly disseminated.

And finally, one person said guidance is needed on the presentation of overlay accounts.

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## Conclusion

The results of the Vincent Performance Services LLC 2008 Survey of Compliance with the GIPS Standards included firms of all sizes representing all of the major investable asset classes. The diverse set of firms provided us with a broad cross section of investment management firms from which to gain concrete answers on why firms choose or do not choose to pursue GIPS compliance, methods used to calculate account and composite returns, decisions relating to verification and examination, and firm preparedness for future changes to the Standards.

A few of the results from the survey stand out. First, we were surprised to learn that, in general, the size of the firm does not make a significant amount of difference with regard to GIPS compliance decisions. Although we highlighted a handful of questions where firm size did impact GIPS-related decisions, in most instances the size of the firm had no bearing on the results. Second, we were pleased to see the large percentage of verified firms who believe verification should remain voluntary, as we have been long time opponents of mandatory verification. Finally, given the perceived resistance from industry on the carve-out ban and valuation frequency scheduled to take place in 2010, we were surprised by the minimal impact firms said these changes would have on their operations.

Although many firms want to know how others in the industry handle implementation of the GIPS standards, often this information is opaque or anecdotal at best. We hope that our survey has shed light on how the industry approaches the Standards and will serve as the basis for analysis of future changes. If you have any questions on this survey or suggestions for future surveys, please contact us at [info@vincentperformance.com](mailto:info@vincentperformance.com)

Finally, we would like to thank the survey respondents for their participation in our survey. Without their shared time and insights this report would not be possible.

## About Us

Vincent Performance Services LLC provides GIPS verification and consulting services to investment managers of all sizes and complexity located throughout the world. We are committed to delivering unsurpassed service based on a real understanding of the issues and a genuine enthusiasm for what we do.

Additional information about our services and expertise can be found at [www.vincentperformance.com](http://www.vincentperformance.com)