

**Commentary on the GIPS® 2010 Exposure Draft**  
**Vincent Performance Services LLC**  
**March 2009**



## Introduction

In 2005 all country versions of the Global Investment Performance Standards (GIPS®) standards, including the AIMR-PPS standards, “converged” to the GIPS standards. At that time it was agreed that the GIPS standards would be reviewed on a five year cycle. Over the past year or so many GIPS committees and CFA Institute staff members have been reviewing and editing all of the existing guidance, as well as creating new guidance where needed. The final result is the GIPS 2010 Exposure Draft, which is available on the [GIPS standards website](#). Comment letters will be accepted until 1 July 2009.

This revision process was meant to be an update, and not a complete overhaul. However, when you open the tracked changes version, and see the quantity of changes, you’re going to think it was in fact an overhaul. Don’t be misled by the quantity of changes as it looks worse than it is. Many of the changes were done to standardize the language throughout, as well as use terms that are defined in the glossary, or were added to the glossary. Considering that the GIPS standards are translated into numerous languages, we whole heartedly support the use of more precise language throughout.

We prepared this analysis of the GIPS 2010 Exposure Draft to assist firms in understanding the proposed changes, and to help them formulate a comment letter. We do not address every change, but only those changes we consider to be significant. Our comments and views are those of Vincent Performance Services LLC and should be read as such. Our comments on specific items included in the GIPS 2010 Exposure Draft follow. Where appropriate we show the edited version of the current GIPS provision as it appears in the tracked changes version of the GIPS 2010 Exposure Draft.

## Fundamentals of Compliance

1. Requirement 0.A.6: FIRMS MUST document, ~~in writing~~, their policies and procedures used in establishing and maintaining compliance with ~~all the applicable REQUIREMENTS of~~ the GIPS standards.

**VPS View:** The changes in this provision reinforce the need for complete documentation of all policies and procedures followed for maintaining compliance with the GIPS standards. The removal of the wording “all the applicable REQUIREMENTS” is intended to encourage firms to document procedures related to any GIPS recommendations with which the firm complies. We agree with the proposed change.

2. Requirement 0.A.7: Once a FIRM has met all ~~the applicable REQUIREMENTS~~ ~~elements~~ of the GIPS standards, the FIRM MUST use one of the following compliance statements to indicate that the FIRM is in compliance with the GIPS standards. The compliance statement MUST remain in a single paragraph.

For FIRMS that are currently verified:

" [Insert name of FIRM] ~~claims compliance with the Global Investment Performance Standards (GIPS®) and~~ has prepared and presented this report in compliance with the ~~Global Investment Performance Standards (GIPS®)~~ standards. [Insert name of FIRM] ~~has been independently verified for the periods [insert dates]. A copy of the VERIFICATION REPORT(S) is/are available upon request.~~ "

For FIRMS that have been verified, but are not currently verified:

"[Insert name of FIRM] claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. [Insert name of FIRM] has been independently verified for the periods [insert dates]. The FIRM is not currently independently verified.

For purposes of this provision, a VERIFICATION is considered current if the VERIFICATION REPORT covers a period ending not more than 24 months ago.

For FIRMS that have not been verified:

"[Insert name of FIRM] claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. [Insert name of FIRM] has not been independently verified."

**VPS View:** We are very pleased that verification is not mandatory for a firm to claim compliance, as was previously intended. We believe that the compromise position, whereby a firm is required to disclose if they have or have not been verified, is a much better alternative. We find that many firms already disclose their verification status. However, we continue to be concerned that firms, and readers of compliant presentations, do not understand what kind of assurance, or lack thereof, is provided from a verification. A verification does not provide any assurance as to the results of a specific composite, yet we still hear comments made concerning whether a “composite” or “returns” have been verified. Putting this concern aside, we do agree that disclosing a firm’s verification status provides helpful information to prospective clients.

With respect to the proposed compliance statements, we believe that this change could be accommodated with two compliance statements: one for firms that are verified and one for firms that are not. The compliance statement for a firm that has been verified already indicates whether a firm has been verified recently, or not, and provides the information a prospective client can use to determine if the firm has been “currently verified” or not. Also, the 24 months limit seems a bit arbitrary. Some prospective clients may think 24 months is too short a time period, while others may think it is too long. Providing the dates covered by the verification opens the door for a reader of a compliant presentation to question why verification has not been done recently, if that is the case. In our opinion, having a second statement for firms that have not been currently verified is unnecessary. While we appreciate the concept, we question whether the “not currently verified” compliance claim accomplishes much and would prefer to see only the two statements. We also think it would be difficult to ensure the proper claim is included on compliant presentations at the precise moment when the 24 month clock expires. Instead, we would suggest imposing a time limit after which a verification “expires.” Should a firm that was verified 8 years ago be able to say that the firm is verified, even if they disclose they are not currently verified? After a certain amount of time has passed the assurance that is provided by verification will no longer have any relevance.

Finally, ignoring the portion of the claim of compliance that speaks to verification status, you should note a change in the wording used. Now, a firm must first state that they claim compliance with the Standards. Then, and only then, can they say they have prepared a compliant presentation. We fully support this change.

3. Requirement 0.A.16: [FIRMS MUST comply with all applicable laws and regulations regarding the calculation and reporting of returns.](#)

**VPS View:** While not currently included in the provisions themselves, the requirement to comply with all applicable laws and regulations was implicit insofar as a firm is required to disclose if a presentation conforms with local laws and regulations that differ from the GIPS requirements (GIPS Provision 4.A.9). Other documents, including several Guidance Statements, make reference to a firm's requirement to first and foremost comply with all applicable laws and regulations. We agree that, for clarity's sake, this should be stated in the GIPS provisions themselves.

4. Requirement 0.A.17: [FIRMS MUST NOT present performance or performance related information that is false or misleading.](#)

**VPS View:** We fully support the concept, but we are a bit concerned about the scope of this provision. If an overly aggressive marketing person prepares and presents one marketing piece that one person feels is slightly misleading, does that mean the firm can no longer claim compliance with the GIPS standards? Could one person's actions jeopardize an entire firm's claim of compliance? We agree with the change, but believe that guidance is needed as to the reach of this provision.

#### **Input Data**

5. Requirement 1.A.1: All data and information necessary to support [all items included in a COMPLIANT PRESENTATION](#) ~~FIRM'S performance presentation and to perform the REQUIRED calculations~~ MUST be captured and maintained.

**VPS View:** We see this as a broadening of the requirement, particularly with respect to supplemental information that might be included in a compliant presentation. Currently the Guidance Statement on Recordkeeping Requirements carves out an exception for supplemental information that is included in a compliant presentation, and does not require a firm to maintain records to support such information. (An example would be a non-portable track record that does not meet the portability tests and may not be linked to the composite at the current firm, but is shown as supplemental information.) The ability to show supplemental information for which the firm does not have supporting records would be eliminated. With this change, a firm would need to have supporting records for all information in a compliant presentation, including supplemental information. We may be stating the obvious here, but if a firm had the records to support a track record, they probably would not need to consider the prior track record as supplemental information. Firms that show non-portable returns as supplemental information will need to evaluate if they have adequate records to support these returns. If not, this information will need to be removed from the compliant presentation. (Note that this situation raises questions concerning what is, and is not, "supplemental information." We firmly believe that additional guidance on this topic is needed.) We understand and agree with the need to be able to support all information that is included in a compliant presentation and we agree with this change.

6. Requirement 1.A.2: [For periods beginning on or after 1 January 2011, PORTFOLIOS valuations MUST be valued at FAIR based on MARKET VALUES in accordance with the GIPS Valuation Principles in Appendix D.](#)

**VPS View:** Throughout the Standards, the concept of using market value has been replaced with fair value. While this change is consistent with accounting trends throughout the world, we believe this proposed change could significantly impact some firms in two ways.

First, currently a firm is allowed to exclude from firm assets those assets to which the Standards cannot be applied. Such assets include investment vehicles that are based on cost or book values rather than market values. The typical adjustment we see is for stable value assets, as they may be carried at book value. Prospectively these assets would be required to be included in firm assets, and thus composites.

Second, although accounting standards throughout the world are moving toward a fair value concept, there are many firms that are not subject to either SEC or IFRS requirements. Adopting fair value is not an insignificant event, and we are concerned that it may be too burdensome for firms that are not required to use fair value for regulatory purposes.

To determine fair value, a firm would be required to follow the GIPS Valuation Principles; see our comments on item number 48.

While we agree with the general idea of using fair value, we think it may be a bit too ambitious to require all firms throughout the world, particularly for smaller firms, to use fair value. We strongly recommend thinking long and hard about what a move to fair value would mean to your firm. If you comment on only one item, this should be it.

### Calculation Methodology

7. Requirement 2.A.2: TIME-WEIGHTED RATES OF RETURN that adjust for EXTERNAL CASH FLOWS MUST be used. Periodic returns MUST be geometrically ~~linked~~ [LINKED](#). EXTERNAL CASH FLOWS MUST be treated in a consistent manner with the FIRM'S documented, COMPOSITE-specific policy. ~~At a minimum:~~ [FIRMS MUST define LARGE CASH FLOW for each COMPOSITE to determine when the PORTFOLIOS in that COMPOSITE are to be revalued for calculating performance.](#)

~~a. For periods beginning 1 January 2005, FIRMS MUST use approximated rates of return that adjust for daily weighted EXTERNAL CASH FLOWS.~~

~~b. For periods beginning 1 January 2010, FIRMS MUST value PORTFOLIOS on the date of all LARGE EXTERNAL CASH FLOWS.~~

**VPS View:** This change is simply to explicitly state that defining large cash flows is done on a composite-specific basis, and must be done for all composites as of 1 January 2010 (or earlier.) We agree with the clarification.

### Composite Construction

8. Requirement 3.A.1: All actual, ~~fee paying,~~ discretionary PORTFOLIOS MUST be included in at least one COMPOSITE. ~~Although non-fee paying discretionary PORTFOLIOS may be included in a COMPOSITE (with appropriate disclosures), n~~[N](#)~~ondiscretionary PORTFOLIOS are not permitted to~~ [MUST NOT](#) be included in a FIRM'S COMPOSITES.

**VPS View:** Currently a firm may exclude from composites non-fee paying portfolios, based solely on the fact that they are non-fee paying. We agree that all discretionary portfolios, regardless of fee-paying status, should be included in a composite. If the portfolio is managed to a strategy, then we feel it is appropriate that the returns of that portfolio be included in the respective composite's performance. By making the change, we believe that the compliant presentation will show a more complete representation of the firm's performance in a specific strategy.

9. Requirement 3.A.9: FIRMS MUST NOT present a COMPOSITE to a PROSPECTIVE CLIENT known to have a PORTFOLIO with assets less than the COMPOSITE'S minimum asset level.

**VPS View:** This new requirement is an “upgrade” of a current recommendation. (For those of you who have been around long enough, you may remember that this was a requirement in the old AIMR-PPS standards.) A composite minimum is supposed to represent the amount of money a firm needs in order to fully implement the composite’s strategy. We feel that if a prospective client cannot obtain the strategy represented by a composite with a minimum asset requirement the client cannot meet, then the composite should not be presented to the prospective client. Firms that use composite minimums will need to establish policies to ensure their marketing and sales personnel don’t violate this requirement.

## Disclosures

10. Requirement 4.A. 5: FIRMS MUST disclose the presence, use, and extent of leverage, ~~or derivatives~~ and/or short positions, (if material), including a ~~sufficient~~ description of the ~~use~~, frequency of use and characteristics of the instruments sufficient to identify risks.

**VPS View:** The addition of short positions to this disclosure is consistent with the increased emphasis on enhancing disclosures to allow a prospective client to better understand a composite’s strategy. We agree with the proposed change.

11. Requirement 4.A.7. FIRMS MUST disclose relevant details of the treatment of withholding tax on dividends, interest income, and capital gains, if material. ~~If using indexes that are net of taxes, the FIRM MUST disclose the tax basis of the benchmark (e.g., Luxembourg-based or U.S. based) versus that of the COMPOSITE. FIRMS MUST also disclose if BENCHMARK returns are net of withholding tax.~~

**VPS View:** We are very pleased to see these changes. By adding the words “if material” many firms will be allowed to remove a disclosure they were required to include even if they only held a few ADRs. We also agree with requiring the related disclosure for the benchmark only if the benchmark is net of withholding tax. These changes will eliminate what we believe are often throw away disclosures that are included just to tick the box that the disclosure is included, but do not provide meaningful information.

12. Requirement 4.A.10: For any performance presented for periods prior to 1 January 2000 that does not comply with the GIPS standards, FIRMS MUST disclose the period of noncompliance, ~~and how the presentation is not in compliance with the GIPS standards.~~

**VPS View:** We fully support this change. We strongly believe that disclosures should be limited to information that is meaningful and relevant. While it may be important for a prospective client to know what data and information is GIPS-compliant and what is not, we do not believe that the reason is that significant. Too often we see firms struggle with trying to explain why the presentation is not in compliance, and none of the disclosures seem to add much value. Let’s hear it for keeping disclosures short and to the point.

13. Requirement 4.A.16: When presenting NET-OF-FEES RETURNS, FIRMS MUST disclose:

a) If any other fees are deducted in addition to the INVESTMENT MANAGEMENT FEE and direct TRADING EXPENSES.

b) If model or actual INVESTMENT MANAGEMENT FEES are used.

c) If returns are net of PERFORMANCE BASED FEES.

**VPS View:** While many calculation details are best kept in the GIPS policies and procedures manual, we do feel it is prudent to explain to prospective clients how net-of-fees returns are calculated. After all, prospective clients will not be earning a gross return; they will be earning a net return. Knowing how net returns are calculated will allow for better comparability between firms. If performance-based fees are not deducted, the prospective client should know that actual net returns could be significantly different from the model returns presented. We agree with this change, but suggest adding language to describe the calculation. Simply saying that performance-based fees are reflected in the calculation does not provide much information. Knowing that they are accrued quarterly versus recorded annually would be much more informative. The same would be true for understanding how model fees are reflected in the calculation.

14. Requirement 4.A.20: FIRMS MUST disclose the COMPOSITE DESCRIPTION which must include sufficient information to allow a PROSPECTIVE CLIENT to understand the key characteristics of the COMPOSITE strategy, including risks.

**VPS View:** While we believe in keeping disclosures short and sweet, we feel this must be balanced with the need to provide prospective clients with the information they need to make investment decisions. A prospective client should know, after reading the composite description, what risks they are assuming. In this case, we believe that more information is better. However, while we agree with the idea of disclosing the risks of a strategy, we believe guidance on what types of disclosures are contemplated is needed. Otherwise, once the lawyers get going, the risk disclosures will be many pages long.

15. Requirement 4.A.27: If the FIRM has adopted a SIGNIFICANT CASH FLOW policy for a specific COMPOSITE, then the FIRM must disclose how the FIRM defines a SIGNIFICANT CASH FLOW for that COMPOSITE, and for which period(s).

**VPS View:** This is simply moving the existing requirement from the Significant Cash Flow Guidance Statement to a provision. All firms should already be disclosing this information if they have adopted a significant cash flow policy. Currently, for any composite that has adopted a significant cash policy, a firm must disclose the following in the compliant presentations:

- How the firm defines a significant cash flow for that composite;
- The “grace period” (new account inclusion policy) for that composite;
- If the definitions, policies, or grace periods for handling significant cash flows have been redefined, firms must disclose the date and nature of the change; and
- That additional information regarding the treatment of significant cash flows is available upon request.

Only the first of these currently required disclosures was carried forward. We support the streamlining of this disclosure.

16. [Requirement 4.A.28: FIRMS MUST disclose, for a minimum of 12 months, any change to the COMPLIANT PRESENTATION due to a correction of a material error.](#)

**VPS View:** This is moving the existing requirement from the Error Correction Guidance Statement into the provisions themselves. We applaud the clarification for how long a material error correction should be disclosed in a compliant presentation, and believe that certain other disclosures should also have a time frame associated with them. See our comments on the next point.

17. [Requirement 4.A.29: FIRMS MUST disclose the 3 year annualized EX-POST STANDARD DEVIATION \(using a minimum of monthly periods\) for the COMPOSITE and for the BENCHMARK as of the most recent annual period presented. The PERIODICITY of the COMPOSITE MUST be identical to the PERIODICITY of the BENCHMARK when calculating EX-POST STANDARD DEVIATION.](#)

**VPS View:** There has been much discussion concerning the need to incorporate risk measures and disclosures into the GIPS standards. Many people would argue that analyzing performance without considering the related risks is like looking at only half the picture. This new provision, which requires all firms and composites to use the same risk measure, is intended to allow a prospective client to compare not only returns but risks across firms. The calculation itself is straightforward. (Assuming you use monthly returns, dump the 36 monthly returns for the composite into Excel, use the STDEVP function, multiply by the square root of 12, and you're done. Do the same thing for the benchmark.) Note that you have to use returns that are calculated at least monthly. Whichever period you use, you must use the same for the benchmark calculation.

While we agree in principle with the required disclosure, we wonder whether this risk measure will provide meaningful information for all managers, for all composites, particularly for active managers. But, we applaud the effort and will be interested to see if this information proves to be helpful or not.

18. Prior to listing the disclosure requirements in section 4, two questions are asked:

- Should firms be allowed to remove certain disclosures after a defined period of time?
- If so, which disclosures would be eligible for removal and after what period of time?

**VPS View:** With the exception of the new disclosure related to material error corrections described above, all disclosures are currently required to be included for what works out to be forever. We believe that certain disclosures may lose relevance over time, and should be allowed to be removed from the presentation after the noted period of time, but only if the firm determines the disclosure is no longer meaningful. We suggest:

- 4.A.19: significant events, eligible for removal after 3 years;
- 4.A.21: firm redefinition, eligible for removal after 3 years;
- 4.A.23: composite name changes, eligible for removal after 3 years;
- 5.A.6.b: benchmark change when the entire historical record is replaced, eligible for removal after 3 years.

## Presentation and Reporting

19. Requirement 5.A.1: The following items MUST be included in each COMPLIANT PRESENTATION: ~~reported for each COMPOSITE presented:...~~

b) Annual returns for all years. For COMPOSITES with a COMPOSITE INCEPTION DATE beginning on or after 1 January 2011, when the initial period is less than a full year, FIRMS MUST present returns from the COMPOSITE inception through the initial year-end.

**VPS View:** Assume you start a new composite with an inception date of July 1, 2011, and you report your composites as of December 31<sup>st</sup>. Must you prepare a compliant presentation that would include returns for the partial year of 2011? In the past some have argued that you did not have to show the initial period for a new composite if it was not a full period, as only annual returns are required in the compliant presentation. We have long considered this a best practice and always recommend that performance for the initial period be included in the compliant presentation. With the change in this requirement, firms can no longer ignore the initial partial period for composites that begin on or after January 1, 2011. They must be included in the compliant presentation. We agree with the change.

20. Requirement 5.A.4:

a. Performance track records of a past ~~FIRM~~ firm or affiliation MUST be ~~linked~~ LINKED to or used to represent the historical record of a new FIRM ~~or new affiliation~~ if, on a COMPOSITE-specific basis:

- i. Substantially all the investment decision makers are employed by the new FIRM (e.g., research department, portfolio managers, and other relevant staff),
- ii. The ~~staff and~~ decision-making process remains substantially intact and independent within the new FIRM, and
- iii. The new FIRM has records that document and support the reported performance.

b. The new FIRM MUST disclose that the performance results from the past ~~FIRM~~ firm or affiliation are ~~linked~~ LINKED to the performance record of the new FIRM,

~~e) In addition to 5.A.4.a and 5.A.4.b, when one FIRM joins an existing FIRM, performance of COMPOSITES from both FIRMS MUST be linked to the ongoing returns if substantially all the assets from the past FIRM'S COMPOSITE transfer to the new FIRM.~~

~~dc) If a compliant FIRM acquires another firm or affiliation or is acquired by a noncompliant FIRM, the FIRMS ~~have~~ has 1 year to bring ~~the~~ any non-compliant assets into compliance.~~

**VPS View:** Mergers and acquisitions are a part of almost every firm's life. We believe these changes acknowledge that acquisitions are not as black and white as originally contemplated. Here's what we like. First, it is stated that the portability test must be met for a specific composite. There is a sleeper of a Q&A that was originally published in January 2006 that states that only a composite is portable, and that a firm may not recreate a track record using only a subset of accounts managed at the prior firm. While we don't necessarily agree with the view, it should be clear that only a complete composite's track record is portable. Second, a critical change is the removal of "staff" in 5.A.4.ii and the addition of a "substantially all" threshold. As currently written, it appears that the staff and decision making process must remain exactly the same at the new firm. We all know that

things change with staff and decision making processes within an ongoing firm. Expecting no changes at all after an acquisition is not realistic. Now, emphasis is placed on the continuation of the decision-making process, along with continued independence. But our favorite change is the deletion of the requirement for “substantially all assets from the past firm’s composite” to transfer to the new firm. This was a difficult test for firms to meet and we feel the removal of it was appropriate as it is not a meaningful test of continuity of the strategy. We believe some firms may look back and reconsider whether they can link to a track record that was previously considered not portable. Finally, the one year time allowance to bring acquired assets into compliance is no longer limited to a compliant firm acquiring a non-compliant firm. A compliant firm that acquires another compliant firm should also have the same ability to take one year to ensure all acquired assets are brought into compliance “in the new firm.”

Also, we believe the language should be changed back to the format as it appeared in the original version of the GIPS standards, to say that these are the tests that must be met if a firm wishes to link to a track record from a prior firm. As currently written, the emphasis is on requiring a firm to link to a prior track record if the tests are met. This is to prevent a firm from choosing which track records from the prior firm to show. However, there is no meat to these requirements. It would be so easy for anyone to say why just one of these tests isn’t met for a certain composite. We believe it would be most appropriate to emphasize the tests that must be met in order to link to a prior track record.

21. [Requirement 5.A.8: For periods beginning on or after 1 January 2011, if a COMPOSITE contains any PROPRIETARY ASSETS, the FIRM MUST present, as of the end of each annual period, the percentage of the COMPOSITE assets represented by the PROPRIETARY ASSETS.](#)

**VPS View:** Proprietary assets are defined as assets owned by the firm, the firm’s management, or the firm’s parent company. We do not feel that this is meaningful information to a prospective client and should not be a requirement. Any account that is discretionary and managed in the prescribed strategy should be considered an equitable contributor to the return. We do not feel the source of the funding is critical to the investment decision for a prospective client and therefore, should not be included in a compliant presentation. Also, in most cases, non-fee paying accounts are proprietary assets, and a firm must disclose the percentage of the composite that is composed of non-fee paying assets. We do not support this proposed change.

22. Recommendation 5.B.6: [FIRMS SHOULD update COMPLIANT PRESENTATIONS quarterly.](#)

**VPS View:** Although we are not commenting on most recommendations, we chose to comment on this as we feel strongly that preparing quarterly compliant presentations should not be a recommendation. Every time a compliant presentation is created, a firm opens itself up to the possibility of an error occurring. Not only is creating a presentation a time-consuming process, so is error correction. Error correction can also be a highly public event. We would rather see firms focus on creating a single, accurate compliant presentation once a year. Of course a firm may still present performance through the most recent period in other marketing materials as additional information.

### **Other Asset Classes/Account Types**

The GIPS standards include guidance specific to real estate, private equity, and wrap fee/SMA accounts. When a firm manages accounts that fall into these three categories, the firm must consider the “regular” GIPS guidance, as well as the guidance specific to these three asset classes and account types. In some instances the asset class/account type guidance overrides the “regular” GIPS guidance. The real estate/private equity/wrap fee/SMA guidance now explicitly states which

“regular” GIPS provisions are not applicable for the asset type. We fully support the addition of this information.

## Real Estate

23. Introduction – Paragraph 3: If a PORTFOLIO includes a mix of REAL ESTATE and other investments that are not REAL ESTATE, then these REQUIREMENTS and RECOMMENDATIONS MUST apply if the majority of the FAIR VALUE of PORTFOLIOS investments are REAL ESTATE.

**VPS View:** If the real estate majority test is met, then is a firm to apply the rules to all assets in the portfolio, or just the real estate assets in the portfolio? How would component returns be calculated for such a portfolio? We agree with the concept, but believe more clarification needs to be added to this statement so a firm can understand which assets must follow this guidance, particularly given that carve-outs without allocated cash are not allowed to be used as of 1 January 2010.

24. Requirement 6.A.2: REAL ESTATE investments MUST be valued by an independent external PROFESSIONALLY DESIGNATED, CERTIFIED, OR LICENSED COMMERCIAL PROPERTY VALUER/APPRaiser at least once every 36 months. For periods beginning on or after 1 January 2012, REAL ESTATE investments MUST be valued by an independent external, PROFESSIONALLY DESIGNATED, CERTIFIED, OR LICENSED COMMERCIAL PROPERTY VALUER/APPRaiser at least once every 12 months. In markets where neither professionally designated nor appropriately sanctioned valuers or appraisers are available and valuers or appraisers from other countries bearing such credentials do not commonly operate, then the ~~party responsible for engaging such services locally shall~~ FIRM MUST take necessary steps to ensure that only well-qualified independent property valuers or appraisers are used.

**VPS View:** The change in this requirement could have an enormous impact on cost and should have many eyebrows rising. In the 2006 version of the GIPS standards, electing to have real estate assets valued externally every 12 months was a recommendation. We feel strongly that this should remain a recommendation and not become a requirement. Firms who own real estate assets know those properties and normally their valuation of a property is as accurate as those of an external party, if not more so. We do not believe that accuracy will be increased through more frequent external valuation. We acknowledge that in many instances firms already are valuing their real estate assets annually, for those products where annual valuation is required. This is a cost-prohibitive requirement and could have dire consequences for smaller firms who cannot absorb the expense. We believe that market pressure should drive the frequency of real estate valuation in each market.

25. Requirement 6.A.4: INCOME and CAPITAL RETURNS (component returns) MUST be calculated separately using geometrically LINKED TIME-WEIGHTED RATES OF RETURN.

**VPS View:** Many firms will calculate the total time-weighted rate of return and the income return, with the capital return determined as the difference between the two. (We also see where the capital return is calculated and the income return is the designated difference.) With this proposed change, a firm will no longer be able to use the assumption that  $A - B = C$ . Instead, a firm will now need to calculate all three components. While we acknowledge that there may be a slight difference in calculated versus derived component returns, we believe that the minor, if any, increase in accuracy does not justify the additional cost of doing the calculation. If a firm already has the systems in place to do this, then great, they can do it, but if not, we feel the current process adequately provides reasonable results. We suggest this become a recommendation versus a requirement.

26. Requirement 6.A.8.: ~~In addition to the other disclosure REQUIREMENTS of the GIPS standards, performance presentations for REAL ESTATE investments MUST disclose~~ The following items MUST be disclosed in COMPLIANT PRESENTATIONS for REAL ESTATE COMPOSITES:

- a. ~~The calculation methodology for component returns that is, component returns are (1) calculated separately using chain-linked time-weighted rates of return, or (2) adjusted such that the sum of the income return and the capital return is equal to the total return,~~The FIRM's description of discretion.
- b. The valuation methodologies ~~and procedures~~ (e.g., discounted cash flow valuation model, capitalized income approach, sales comparison approach, the valuation of debt payable in determining the value of leveraged REAL ESTATE) and material changes to valuation methodologies.
- c. For periods beginning on or after 1 January 2012, FIRMS MUST explain and disclose the impact of material differences between:
  - i. The valuation used in performance reporting and the valuation used in financial reporting.
  - ii. The EXTERNAL VALUATION and the valuation used in performance reporting.
- d. As a measure of annual dispersion, the high and low TIME-WEIGHTED RATES OF RETURN ~~The range of performance returns~~ for the individual PORTFOLIOS ~~accounts~~ in the composite,
- e. ~~The source of the valuation (whether valued by an external valuer or INTERNAL VALUATION or whether values are obtained from a third party manager) for each period, The percent of total FAIR MARKET VALUE of COMPOSITE assets (asset weighted not equally weighted) to total real estate assets~~ valued by using an EXTERNAL VALUATION to total FAIR VALUE of COMPOSITE assets for each period, and
- f. For periods beginning prior to 1 January 2012, ~~the~~ frequency REAL ESTATE investments are valued by external valuers or appraisers.

**VPS View:** We have several comments on this provision, as follows. 1) While not a change, firms are required to disclose the description of discretion in the presentation (6.A.8.a). We understand that the concept of discretion can be quite different for a real estate manager, as often discretion is shared between the real estate manager and the client. If this is the disclosure that is intended, we would suggest adding language to that effect. 2) In our opinion, financial reporting and performance reporting are not the same, and to introduce aspects of financial reporting into the performance report adds a level of unnecessary complexity (6.A.8.c.i). A firm that manages mutual funds and includes them in composites along with other institutional accounts is not required to disclose differences between information reported by the mutual fund and fund information used for composites (and we don't believe they should be required to do so); why should a real estate manager be required to do so? We do not feel that the client (prospective or otherwise) would find this information of value. As for requiring disclosure of material differences between external valuations and those used in performance reporting (6.A.8.c.ii), we are confused. Is this saying that a firm may choose to not use a valuation that was obtained from an external source? If that is acceptable, then the firm would be using an internal valuation. Is a firm required to determine an internal valuation and compare it to external valuations, and then override external valuations if they think the external valuations aren't correct? And wouldn't this bring into question the validity of external valuations? 3) With respect to 6.A.8.e, we understand that this disclosure is intended to let the reader know what percentage of a portfolio is externally valued versus internally valued, but how would this be calculated? Most firms will spread out the external valuations throughout the year. Also, a portfolio is

not consistent throughout a year, as positions may be added and some may be sold. So, given these factors, exactly how is this amount calculated? We feel clarification is needed on exactly how this calculation is to be made.

## Real Estate – Closed-End Funds

27. Requirement 6.A.6: [The annualized since inception INTERNAL RATE OF RETURN \(SI-IRR\) must be calculated using the period-end valuation of the COMPOSITE as a terminal value. For periods beginning on or after 1 January 2011, SI-IRR MUST be calculated using daily cash flows.](#)

**VPS View:** A new section has been added to the Real Estate guidance to address closed-end real estate funds. A firm would be required to create composites for closed-end real estate funds based on strategy and vintage year. In addition to calculating “regular” time-weighted component and total returns, firms would be required to calculate and present net of fees since inception internal rates of returns (SI-IRRs), and make numerous disclosures similar to those required for private equity composites. This new concept results in the addition of several additional provisions. Instead of commenting on each of the provisions, we will simply say that we do not agree that a firm should be required to create closed-end real estate fund composites, and calculate and report SI-IRRs, and we believe that all of these proposed provisions should be deleted. While we do agree that SI-IRRs may be more appropriate for accounts for which the manager controls the timing of the cash contributions and withdrawals, we do not agree that this concept should be applied only to closed-end RE funds, but instead should be more broadly introduced for managers of any asset class. Also, if a firm believes that IRRs are meaningful for a certain closed-end real estate fund, they are welcome to calculate and present that information. Requiring a new series of composites and historical calculations for managers of this asset class just does not seem fair.

## Private Equity

28. Applicability of private equity provisions: The introduction to the Private Equity Provisions states that these provisions apply to private equity investments other than open-end and evergreen funds, which must follow the “regular” GIPS provisions. The assumption is that all private equity funds follow the traditional structure of being a closed-end fund, which is no longer true, and we would argue has not been true for a very long time. What is a firm to do if they manage an account that is invested in private equity investments, but the client can decide to make additional contributions which can be called by the manager, so it is effectively open ended? It would not be possible for the manager to value the investments monthly, as required by the “regular” GIPS standards. Also, we would argue that an internal rate of return is a much more meaningful number for such an account versus a time-weighted return. Just because the client can increase their capital contribution does not mean the private equity provisions shouldn’t apply. We strongly believe the scope of these provisions needs to be broadened to not preclude managers of private equity open end funds from complying with these provisions, if appropriate.

29. Requirement 7.A.4: [For periods beginning on or after 1 January 2011, ~~the~~ the annualized SI-IRR MUST be calculated using ~~either~~ daily ~~or monthly~~ cash flows and the period-end valuation of ~~the unliquidated remaining holdings~~ the COMPOSITE as a terminal value. Stock DISTRIBUTIONS MUST be included as cash flows and MUST be valued at the time of DISTRIBUTION.](#)

**VPS View:** Currently a firm may use monthly cash flows when calculating SI-IRRs, but monthly cash flows would no longer be allowed after 1 January 2011. Instead a firm would be required to use daily cash flows beginning on that date. The difference in calculated SI-IRR return using daily or monthly cash flows is generally minimal, if it is even observable, yet the cost to the firm to change systems to

accommodate could be quite large. We believe that cost versus benefit should be considered and we support continuing to allow firms to have both options.

30. Requirement 7.A.5: NET-OF-FEES RETURNS MUST be net of actual investment management fees (including CARRIED INTEREST) and TRANSACTION EXPENSES.

**VPS View:** This is a clarification of the original requirement, emphasizing that net returns must reflect actual fees. We agree with this change. Model fees do not make sense for private equity performance reporting.

31. Requirement 7.A.6: ~~For INVESTMENT ADVISORS,~~ All returns must be net of all underlying partnership and/or fund fees and CARRIED INTEREST and NET-OF-FEES RETURNS MUST, in addition, be net of all ~~the INVESTMENT ADVISOR'S~~ actual INVESTMENT MANAGEMENT FEES, expenses, and CARRIED INTEREST.

**VPS View:** This is again making the same point noted above, that net returns must be net of actual fees. We agree.

32. Requirement 7.A.8: Partnership/fund investments strategies and DIRECT INVESTMENTS strategies ~~and OPEN-END PRIVATE EQUITY investments (e.g., EVERGREEN FUNDS)~~ MUST be included in separate COMPOSITES.

**VPS View:** This is the only asset class where the Standards require accounts that are managed to the same investment strategy to be split into separate composites based on the type of investments held. We believe the creation of composite definitions should be left to the manager, and should not be dictated by the Standards. We believe this requirement should be deleted.

33. Requirement 7.A.9.: For funds of funds, all discretionary investments MUST be included in at least one COMPOSITE defined by investment strategy and/or VINTAGE YEAR.

**VPS View:** We were very pleased to see acknowledgement that composites based on vintage year may not be the right answer for managers of private equity funds of funds. Including the “and/or” statement gives a manager the flexibility to create funds of funds composites that are most appropriate for the manager. We agree with this new provision.

34. Requirement 7.A.10: FIRMS MUST disclose the VINTAGE YEAR of the COMPOSITE and how the VINTAGE YEAR is defined.

**VPS View:** There are two ways to define a vintage year. As described by the updated definition of vintage year in the GIPS Glossary, the first is to define the year as the first year the fund took a drawdown, or made a capital call, from its investors. The second is to use the year that the initial contract for committed capital from investors was closed and legally binding. We agree with the change.

35. Requirement 7.A.13: ~~For the most recent period,~~ FIRMS MUST disclose the valuation methodologies used to value ~~their~~ PRIVATE EQUITY investments. If any material change in valuation methodologies occurred, ~~in either valuation basis or methodology from the prior period,~~ the change MUST be disclosed.

**VPS View:** The removal of “For the most recent period” from this requirement now means that the valuation method must be disclosed for every period noted on the compliant presentation. We feel this could result in lengthy disclosures and also implies that a change is a bad thing. Firms change procedures

all the time, hopefully to improve performance reporting. Also, how can you determine that a change in valuation methodologies is material or not? Would a firm have to calculate performance using both the old and new methodologies in order to determine if the change is material or not? We believe the second sentence in this provision should be deleted.

36. ~~Requirement 7.A.14: FIRMS MUST document the FIRM'S valuation review procedures and disclose that the procedures are available upon request.~~

**VPS View:** Provision 0.A.6 requires a firm to document all policies followed for maintaining compliance with the GIPS standards, and Provision 4.A.17 requires a firm to disclose that information regarding the firm's policies is available upon request. Given these two provisions in "regular" GIPS, this provision is redundant. We agree with the deletion.

37. ~~Requirement 7.A.15: FIRMS MUST disclose the definition of the COMPOSITE investment strategy (e.g., early stage, development, buy-outs, generalist, turnaround, mezzanine, geography, middle market, and large transaction).~~

**VPS View:** This requirement is covered by requirement 4.A.20 (disclosure of the composite description), and thus is redundant. We agree with the deletion of the requirement in this section.

38. Requirement 7.A.17: FIRMS MUST explain and disclose the impact of material differences between the valuation used in performance reporting and the valuation used in financial reporting at period end.

**VPS View:** Once again, as described in our comments on real estate provision 6.A.8. above, we disagree with financial reporting being introduced into performance reporting. We feel that these are two completely different types of reporting and comparisons between the two are not appropriate for a compliant presentation. We do not support this requirement.

39. Requirement 7.A.21: For periods beginning on or after 1 January 2011, for funds of funds, if the COMPOSITE is defined by investment strategy only, FIRMS MUST also present the GROSS-OF-FEES and/or NET-OF-FEES annualized SI-IRR of the underlying funds by VINTAGE YEAR as of the most recent annual period end.

**VPS View:** As previously discussed, we agree with the ability of a firm to create a composite for funds of funds that is based solely on strategy and does not contemplate vintage year. For such composites, a firm would be required to calculate the SI-IRR for each vintage year "within" the composite as of the most recent period end. We agree with this requirement.

40. Requirement 7.A.22: FIRMS MUST present as of each period end ~~For each period presented, FIRMS MUST report:~~
- a. Total COMPOSITE since inception PAID-IN CAPITAL ~~to-date~~ (cumulative DRAWDOWN),
  - b. ~~Total current INVESTED CAPITAL, and Cumulative~~ Total COMPOSITE since inception DISTRIBUTIONS ~~to-date~~.

**VPS View:** Most of these changes are simply clarification of language. The real win here is the removal of the requirement to calculate and report current invested capital going forward. While it seems like this might be a straight forward calculation, it gets awfully tricky once a firm starts making distributions. We agree with the change.

41. Requirement 7.A.23: For periods beginning on or after 1 January 2011, FIRMS MUST present as of each period end:
- a. Total COMPOSITE since inception COMMITTED CAPITAL
  - b. Total COMPOSITE since inception AMOUNT REALIZED

**VPS View:** “Amount realized” is defined in the GIPS Glossary as the proceeds obtained from the liquidation of investments. Considering most private equity firms distribute the proceeds from selling their portfolio investments, and provision 7.A.22.b. requires disclosure of cumulative distributions, we do not believe this disclosure should be required as it does not provide new and meaningful information.

### **Wrap Fee/Separately Managed Accounts (SMA)**

When you look at the tracked changes version of this section of the GIPS standards, it looks like the entire section was changed, but it was not. There are no changes to the current provision themselves, but two provisions were added to clarify that the minimum effective date for wrap fee/SMA accounts is 1 January 2006, versus 1 January 2000 for “regular GIPS.”

42. Provision 8.A.6 allows a firm to create sponsor-specific composites, versus style-specific composites. These sponsor specific composites may be used only for presenting performance of existing accounts for a specific strategy to that sponsor. Sponsor-specific composites are widely used by wrap/SMA managers, as that is the performance that the sponsor often requests. Although there are no proposed changes to this provision, two questions are asked related to this provision, as follows:
- Is it appropriate and/or necessary to include this provision (8.A.6), which addresses presenting performance to existing clients, in the GIPS standards?
  - Should firms be allowed to present a ‘sponsor-specific composite’ as opposed to a ‘style-specific composite’?

**VPS View:** We believe it is appropriate to include this provision, as well as allow for sponsor-specific composites. This practice has been allowed for several years, is widely used, and to our knowledge has not been abused at all. Instead, we think that having the ability to create sponsor-specific composites has encouraged and enabled wrap managers to comply with the Standards. We would not support any change to this current provision.

### **Verification**

This section was updated, to clarify

- The scope and purpose of verification (verification does not, and never has, confirmed that a firm is properly claiming compliance with the GIPS standards);
- The tests that a verifier must perform;
- The verifier must be independent of the verification client.

There are no big changes in concepts. While we as a verifier care deeply about each and every wording change in this section, we won’t bore you with our comments on the nitty-gritty details.

## Appendix C – GIPS Advertising Guidelines

43. When a GIPS-compliant firm prepares an advertisement, the firm has three options:

- Make no mention of the GIPS standards in the advertisement;
- Claim compliance in the advertisement by including a compliant presentation; or
- Claim compliance in the advertisement by following the GIPS Advertising Guidelines.

If the firm chooses to claim compliance following the GIPS Advertising Guidelines, certain disclosures are required. If the firm wishes to include performance in the advertisement, additional disclosures must be included.

One of the required disclosures, whether performance is included in the advertisement or not, is a claim of compliance following the GIPS Advertising Guidelines. Because a compliant presentation is not included in the ad, the language is slightly different from the “regular” claim of compliance. Three options for claiming compliance are included, based on the “regular claims.” Here is the claim of compliance for a firm that is verified:

Requirement B3: The GIPS Advertising Guidelines compliance statement for advertisements. The compliance statement MUST remain in a single paragraph.

For FIRMS that are currently verified:

"[Insert name of FIRM] claims compliance with the Global Investment Performance Standards (GIPS®). [Insert name of FIRM] has been independently verified for the periods [insert dates]. A copy of the verification report(s) is/are available upon request."

You can see that the first sentence is slightly different from the “regular claim of compliance” as there is no reference to the compliant presentation. Advertising Guidelines claims of compliance are also included for firms that have never been verified, and for firms that are not currently verified. Our opinion on this requirement is consistent with our prior comments on Requirement 0.A.7. We feel that only two disclosures are necessary, one for firms that are verified and one for firms that are not verified. The date range in the first option covers the period of verification and allows the prospective client to question a lack of current verification.

44. If the firm chooses to include performance results in the advertisement, certain performance results must be presented. Currently the firm has two options: show five years of annual results, or 1-, 3- and 5-year annualized results, with the end period for those performance results consistent with the end date as reported in the related compliant presentation. A new third option, which is not tied to the date reported in the compliant presentation, is as follows:

5. COMPOSITE performance results according to one of the following:  
a. 1-,3-,and 5-year annualized COMPOSITE returns through the most recent period with the end-of-period date clearly identified. If the COMPOSITE has been in existence for less than 5 years, FIRMS MUST also present the annualized returns since inception of the COMPOSITE....

**VPS View:** We support the new option.

45. Currently the GIPS Advertising Guidelines say that supplemental information may be included in the advertisement, as long as it is clearly labeled as such. The concept of supplemental information doesn't really work in an advertisement that is prepared following the GIPS Advertising Guidelines, as there is no compliant presentation included, so there is no composite for the supplemental information to supplement! This confusing language was removed and the following language was added:

Other Information: FIRMS may include other information beyond what is REQUIRED under the GIPS Advertising Guidelines provided the information is shown with equal or lesser prominence to the information REQUIRED by the GIPS Advertising Guidelines and does not contradict or conflict with the GIPS standards and/or the GIPS Advertising Guidelines. FIRMS MUST adhere to the principles of fair representation and full disclosure when creating an advertisement.

**VPS View:** We agree with this change.

46. Requirement B9: ~~The description of the~~ The presence, use, and extent of leverage, ~~and derivatives, and/or short positions, if material, including a description of the frequency of use and characteristics of the instruments sufficient to identify risks. if leverage or derivatives are used as an active part of the investment strategy (i.e., not merely for efficient PORTFOLIO management) of the COMPOSITE. Where leverage/derivatives do not have a material effect on returns, no disclosure is REQUIRED~~

**VPS View:** This change mirrors the change for the disclosure that is required in a compliant presentation. See our comments on requirement 4.A.5. We agree with requiring more disclosure concerning the composite strategy.

47. Requirement B11: If the advertisement conforms with local laws and regulations that conflict with the GIPS standards and/or the GIPS Advertising Guidelines, FIRMS MUST disclose this fact and the manner in which the local laws and regulations conflict with the GIPS standards and/or the GIPS Advertising Guidelines.

**VPS View:** This disclosure mirrors the long-standing disclosure for compliant presentations. We agree with the change.

## **Appendix D – GIPS Valuation Principles**

48. As described in item 6 above, a firm must determine fair value by following the proposed GIPS Valuation Principles, which set out a pricing hierarchy similar to, but stricter than, FAS 157. We support the notion of a pricing hierarchy, which will enable a firm to value all types of investments in any type of market environments. Given the market volatility in the past year, we certainly understand the need to come up with a valuation system that is not dependent on current market trading activity. However, we believe the proposed valuation hierarchy needs to be amended to allow for management's judgment. As currently written, a firm must follow the hierarchy in a lock-step manner and may be forced to use valuations that are available in the market, but there may be other conditions that would make the valuations not appropriate. For example, there would be no ability to ignore fire sale prices if they are observable, even if they do not represent a "fair" and appropriate value. Even the SEC has acknowledged that fire sale prices may not be appropriate and may be ignored. We strongly recommend adding the term "if appropriate" to the first four steps in the hierarchy, which would allow a firm to properly exercise their judgment and determine if they should move to a lower step in the hierarchy.

49. GIPS Valuation Principle 8: [FIRMS MUST disclose if PORTFOLIO investments are valued using subjective, unobservable inputs that are material to the COMPOSITE as of each period end.](#)

**VPS View:** The bottom tier represents values that are determined using subjective, unobservable inputs for the investments where markets are not active at the measurement date. If a material amount of a composite is valued using such valuations, a firm would be required to disclose this fact in the compliant presentation. We agree with this disclosure.

## Appendix E – GIPS Glossary

50. Definition of [PROSPECTIVE CLIENT](#) [Any person or entity that qualifies to invest in a COMPOSITE strategy \(e.g., has assets above the COMPOSITE minimum asset level\) and has expressed interest in one of the FIRM'S strategies. Existing clients may also qualify as PROSPECTIVE CLIENTS for any strategy that is different from their current investment mandate. Investment consultants are included as PROSPECTIVE CLIENTS if they represent investors that qualify as PROSPECTIVE CLIENTS.](#)

**VPS View:** GIPS Provision 0.A.11 requires a firm to make every reasonable effort to provide a compliant presentation to all prospective clients; therefore, a compliant firm must establish procedures to ensure all prospective clients receive the appropriate compliant presentation(s). We do not agree with this definition, as we believe it is much too broad. As written, a GIPS-compliant firm would be required to show composite information to a potential investor in a mutual fund, and this must not be the case. The attempt to limit the distribution to only a person or entity who “has expressed interest in one of the firm’s strategies” also does not accomplish the goal of limiting the distribution. As written, a firm would be required to show a compliant presentation to any person or entity that has shown an interest in ANY strategy, and the firm would have to show a compliant presentation for all composites whose performance is presented.

We note that in the original draft of the prior version of the GIPS standards, there was a footnote on the first use of “prospective client” that said: “The calculation and presentation of pooled unitized products, such as mutual funds and open ended investment companies, is regulated in most markets. These vehicles are not subject to this requirement when a firm is advertising performance solely for a pooled unitized product.” While this language was not included in the final version, we believe such language would be very helpful. However, we also believe that defining prospective client in a manner that is appropriate for all firms is not possible. Instead, we suggest explicitly requiring a firm to define prospective client in the firm’s GIPS policies.

51. Definition of [LINK](#): 1) [Mathematical linking: The method by which sub-period returns are geometrically combined to calculate the period return using the following formula: Period total return = \(1+R<sub>1</sub>\)\\*\(1+R<sub>2</sub>\)...\(1+R<sub>n</sub>\) where R<sub>1</sub>, R<sub>2</sub>...R<sub>n</sub> are the sub-period returns for sub-period 1 through n respectively.](#)  
2) [Presentational linking: To be visually connected or otherwise associated within a COMPLIANT PRESENTATION \(e.g. two pieces of information can be LINKED by placing them next to each other\).](#)

**VPS View:** We think additional clarity surrounding what linking means outside the context of compounding is extremely helpful. We agree with the definition.

## **GIPS United States After-Tax Guidance**

52. GIPS United States After-Tax Guidance is not included in the GIPS 2010 Exposure Draft.

**VPS View:** Firms that claim compliance with the GIPS standards and choose to present after-tax performance to prospective clients subject to U.S. taxation must comply with the GIPS U.S. After-Tax Guidance. This effectively requires a firm to create a series of after-tax composites that are based on strategy and tax considerations. After-tax return calculations must reflect the deduction of estimated taxes when income and gains are incurred, versus when taxes are paid. We could keep going, as there are numerous other calculation requirements.

The original intention was to create some basic principles for performing after-tax calculations that would be accepted worldwide. However, it was decided that this may not be possible, and that it was appropriate to remove the U.S. after-tax guidance from the GIPS standards. For those of you that comply with the after-tax guidance, note that they are not disappearing. They will be maintained somewhere, but it will be outside of the GIPS standards themselves. Stand by for more information.

### **Conclusion**

We hope you find our analysis to be informative and helpful in writing your firm's comment letter. Please don't hesitate to contact us if you have any questions or comments on our analysis. We can be contacted as follows:

Karyn D. Vincent, CFA, CIPM  
Vincent Performance Services LLC  
2014 NE Broadway Street  
Portland, OR 97232  
503-288-2704, ext. 102  
kvincent@vincentperformance.com