



## Highlights from the GIPS® Standards Annual Conference

The GIPS® Standards Annual Conference was held in Boston on September 22<sup>nd</sup> and 23<sup>rd</sup>. The conference was hosted by Jonathan Boersma, Executive Director, Global Investment Performance Standards, CFA Institute. Highlights from three of the sessions follow. Our next newsletter will include highlights from other sessions.

### GIPS 2010 Update

When the GIPS standards “converged” with all of the country versions of the GIPS standards in 2005, it was agreed that the GIPS standards would be reviewed and updated once every five years. A draft of the next version of the GIPS standards, referred to as the “Exposure Draft,” was available for public comment through June 30<sup>th</sup>. Over 140 comment letters were received, which is the largest number of comments received on any GIPS-related document that has been issued for public comment. Over the past few months various GIPS committees, led by CFA Institute staff, have been sorting through the comments and determining any necessary changes. The week before the Boston conference the GIPS Executive Committee (EC) met in Singapore and made decisions concerning sections 0-5 of the Standards. The agreed changes were announced in Singapore at the open meeting of the GIPS EC on Friday, September 18<sup>th</sup> and were presented to conference attendees by Karyn Vincent, Chairperson of the GIPS Interpretations Subcommittee and member of the GIPS EC, and Jonathan Boersma. The following background points were noted:

- While the GIPS EC made final decisions for sections 0-5, until the final revised Standards are issued in early 2010, they are still subject to fine tuning and may be edited.
- The remaining sections of the GIPS standards, including verification, real estate, and private equity, are currently being edited but no final decisions on those sections have been reached yet.
- The revised GIPS standards, which are expected to be issued in January 2010, are often referred to as “GIPS 2010.” This name refers to the expected issuance date of the Standards. This differs from the effective date of the Standards, which is January 1, 2011. By not making them effective until almost one year after issuance, firms will have quite a bit of time to make

any necessary changes to comply with the 2010 GIPS standards.

- The effective date of January 1, 2011 applies as follows: Compliant presentations that include performance results for periods that begin on or after January 1, 2011 must be prepared in accordance with the revised GIPS standards. For example, assume a firm prepares compliant presentation annually, as of December 31. Compliant presentations that include performance results through December 31, 2010 can be prepared in accordance with the current version of the Standards. When the firm updates compliant presentations as of December 31, 2011, the firm must comply with the 2010 GIPS standards. The same would be true if the firm decides to update the compliant presentation and include year to date results, such as through March 31, 2011. The Standards also include changes that impact calculations. A firm must comply with these changes when calculating performance as of January 1, 2011.
- In the “old AIMR-PPS days”, when the Standards were first being introduced, recommendations were intended to be upgraded to a requirement at some point in the future. However, that is no longer true. Recommendations should not be read as if they will eventually become a requirement. Instead, recommendations should be viewed as best practice. A firm has complete discretion over whether or not to comply with a recommendation.

Highlights of decisions on sections 0-5 of the Standards are as follows:

- Firms will be required to disclose their verification status. The new claim of compliance for a firm that has been verified is: “[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]. A copy of the verification report(s) is/are available upon request.” For a compliant firm that has not been verified, their claim of compliance will read as follows: “[Insert name of firm] claims compliance with the Global Investment Performance Standards (GIPS®) and

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has prepared and presented this report in compliance with the GIPS standards. [Insert name of firm] has not been independently verified." The Exposure Draft included a third option for a firm that was not "currently" verified. This third option will not be adopted.

- There is still much confusion about what exactly a verification tests, and what kind of assurance is provided by a verification report. Verification does not confirm that a firm is actually in compliance with the GIPS standards. Verification also does not provide assurance on the results of any specific composite. Also, while the Standards were out for public comment, some firms that claimed compliance with the GIPS standards and were verified (or claimed to be verified) were found to either be a Ponzi scheme or were fraudulently reporting fictitious AUM. Given all of these factors, the EC decided that it was in everyone's interest to require a firm to clearly state what verification is, as well as what verification is not. A firm that is verified would need to disclose the following: "Verification is intended to determine whether a) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis, and b) the firm's processes and procedures are designed to calculate and present performance results in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation." The EC felt that the location of this disclosure was very important, and that this disclosure would need to be included with the claim of compliance or immediately follow it. Guidance surrounding the required location of this disclosure will follow.
- Many firms, particularly those in the U.S., choose to have additional testing performed on specific composites, which is referred to as a performance examination or performance audit. A performance exam does provide assurance on the results of a specific composite. If a firm wishes to disclose that a composite has been examined, the disclosure above would be changed to delete the sentence, "Verification does not ensure the accuracy of any specific composite presentation." and would be replaced with, "The [named] Composite has been examined for the periods [insert dates.] "
- Currently, a firm must make every reasonable effort to provide a compliant presentation to all prospective clients. (Provision 0.A.11.) The new provision will recommend providing a compliant presentation to

current clients on an annual basis. This recommendation generated many comments, primarily from those opposed to having the GIPS standards reach into client reporting. It was stressed that this is simply a recommendation and there is no intention to have the GIPS standards address client reporting. In fact, a new working group, outside of the GIPS standards, will be established by CFA Institute, to create best practices for client reporting.

- A definition of "prospective client" was included in the Exposure Draft. The proposed definition generated many comments, with most stating the definition was too broad and did not, for example, allow a firm the ability to decide to not provide information if requested by a competitor. The definition has been narrowed a bit, and is expected to read as follows: "Any person or entity that qualifies to invest in a composite strategy and has expressed interest in one of the firm's composite strategies. Existing clients may also qualify as prospective clients for any strategy that is different from their current investment mandate. Investments consultants and other third parties are included as prospective clients if they represent investors that qualify as prospective clients."
- Currently, a firm must provide a compliant presentation for any composite on the firm's list and a composite description to any prospective client that makes such a request. (Provision 0.A.13.) This will be changed to require a firm to provide such information to any prospective *or current* client who makes such a request. Also, the term "list and a composite description" has been changed to read: "list of composite descriptions." It was always intended that this was one document, as can be seen by reviewing Appendix B in the current Standards, which is a sample list and description of composites. Because some people read this as requiring two documents this language was changed for clarity.
- The proposed provisions, "Firms must comply with all applicable laws and regulations regarding the calculation and reporting of returns" and "Firms must not present performance or performance related information that is false or misleading" will be included as requirements in GIPS 2010.
- Composites that have a partial first year will explicitly be required to show the initial partial first year in the compliant presentation. For example, a firm that starts a new composite on June 1, 2011 and presents compliant presentations for all com-

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*"Firms must comply with all applicable laws and regulations regarding the calculation and reporting of returns" and "Firms must not present performance or performance related information that is false or misleading."*

*New requirements  
GIPS 2010*

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- positives with annual periods ended December 31 will be required to show the initial partial year return from June - December 2011 in the compliant presentation. This requirement applies only to composites that are created after January 1, 2011.
- If a composite is terminated mid-year, the composite's compliant presentation will be required to include the partial year performance. For example, if a composite is terminated in mid-August 2011, the presentation must include performance from January through July 31, 2011.
  - Provision 0.A.12 requires a firm to include closed composites on the list of composite descriptions. The word "closed" has been changed to "terminated" in order to differentiate a truly closed composite from a composite that has a strategy that is closed to new investors.
  - Currently, the term "market value" is used throughout the Standards, with an exception for Private Equity, which uses the concept of fair value. The concept of fair value, versus market value, will be adopted. (VPS Note: This is not fair value with respect to mutual funds, to prevent market timing transactions.) Firms will also be recommended to obtain fair values from an independent third party.
  - Currently, firm assets must include the total market value of all discretionary and nondiscretionary assets under management. With the move to fair value, as described above, a firm will be required to include in firm assets all managed assets that have a fair value. This will be a significant change for some firms, as firm assets determines the universe of accounts to be considered for inclusion in composites.
  - Firms will be required to value investments in accordance with the GIPS Valuation Principles. Included in the Exposure Draft was a required pricing hierarchy, which has been changed to a recommended pricing hierarchy.
  - For periods after January 1, 2011, firms will be required to disclose if investments are valued using subjective, unobservable inputs (Level 3 under FAS 157) if material to the composite.
  - One big proposed change relates to the treatment of non-fee paying portfolios. Currently non-fee paying portfolios are allowed to be excluded from composites based solely on their non-fee paying status. Non-fee paying portfolios, if discretionary, may be included in a composite with additional disclosures. It was proposed to remove the distinction between fee paying and non-fee paying status, requiring all discretionary portfolios to be included in a composite regardless of fee paying status. While many comment letters agreed with the proposed change, many did not. It was decided that the impact of making this change was not worth the benefit, therefore the proposed change will not stand. There will be no change to the current ability to exclude non-fee paying accounts from composites, based solely on their fee paying status. Of course a firm could choose to include non-fee paying accounts in a composite as allowed under the existing Standards, which requires the firm to include a disclosure that shows the percentage of the composite that is composed of non-fee paying portfolios as of each annual period end.
  - Another proposed change that generated many comments would require firms to disclose the percentage of a composite that is composed of proprietary portfolios. A proprietary portfolio is a portfolio that is funded by the firm itself, and may also be known as seed money or a house account. Given the concerns raised by many firms about being required to disclose confidential information, as well as the difficulty of doing this calculation, it was decided that this would not be a requirement. Instead a firm will be recommended to disclose that the composite includes proprietary assets; no disclosure related to the percentage of proprietary portfolios would be recommended.
  - Currently, a firm should not market a composite that has a minimum size for inclusion to a prospective client who has less money than the required composite minimum. It was proposed that this would be changed to make this a requirement, with the added language that a firm must not show such a composite to a prospective client if the firm knows that the prospective client would not qualify for inclusion in the composite. Many of the comment letters received were not in support of this change and expressed concern that it would be very difficult to establish procedures to prevent this from happening, as firms do not necessarily know exactly how much money a prospective client may invest with them. This provision will not be upgraded to a requirement.
  - As of January 1, 2010, firms are required to revalue portfolios on the date of all "large" external cash flows. (Provision 2.A.2.b.) The definition of "large" is left to each firm to decide and can be different from composite to composite. (Large cash flow is

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defined as the level at which the firm determines that a cash flow may distort performance if the portfolio is not revalued.)

There is a new explicit requirement to not deviate from this policy, meaning that if a cash flow falls below your “large” threshold, you won’t be allowed to revalue the portfolio.

- A firm must disclose the composite description, which is currently defined as general information regarding the strategy of the composite. (Provision 4.A.20.) It was proposed to require disclosing enough information to allow a prospective client to understand all of the key characteristics, including risks, of the composite strategy. Although the EC is very much in favor of including relevant information about the risk of a strategy in a compliant presentation, they decided to delete “including risks” and would instead provide examples of suggested composite descriptions, which will include information about risks of the strategy.
- There is a new requirement to disclose the benchmark description. Before you get excited, it was made clear that a description for a readily-recognized index could be as brief as the name of the benchmark.
- If net returns are presented, firms will be required to disclose whether actual fees or model fees are used, and how performance-based fees, if any, are reflected in the calculations.
- Currently, firms must disclose relevant details of the treatment of withholding taxes. (Provision 4.A.7.) This disclosure will now be required only if withholding taxes are material. Firms will also be required to disclose if benchmark returns are reflected net of withholding taxes, if that information is available.
- Currently, firms must disclose the presence, use and extent of leverage and/or derivatives, if material. (Provision 4.A.5.) “Short positions” will be added to this disclosure requirement.
- Currently, firms are required to disclose any periods of non-compliance prior to January 1, 2000 and the reason why the presentation is not in compliance. (Provision 4.A.10.) The requirement to disclose the reason for non-compliance will be eliminated, but a firm must continue to disclose if any non-compliant periods are presented.
- Currently, firms are required to disclose that additional information regarding policies for calculating and reporting returns is available upon request. (Provision 4.A.17.) This provision will be amended to say, “additional information for calculating and reporting returns *and preparing compliant presentations* is available upon request.”
- It was proposed that firms would be required to disclose, for a minimum period of 12 months, any changes to a compliant presentation due to a correction of a material error. (This requirement comes directly from the recently adopted Error Correction Guidance Statement.) It was decided that this requirement should be reconsidered, and it will not be included as a provision. However, because it is in the Guidance Statement, firms still must meet this disclosure requirement as of January 1, 2010, barring any changes to this guidance. Stand by for more guidance on this topic.
- Firms will be required to disclose an ex-post annualized standard deviation of the composite and the benchmark for each annual period ended after January 1, 2011, using monthly returns. (Note the change from the Exposure Draft, which required this disclosure only for the most recent 3 year period.) Additional guidance will be forthcoming addressing what a firm must do if they don’t have 36 monthly returns historically.
- The Exposure Draft asked for feedback on whether certain disclosures should be allowed to be deleted after a certain period of time, and if so which disclosures, and for which period. A wide range of comments was received, but unfortunately there was no consensus either on which disclosures could be removed, or for which time periods. It was decided that there would not be time periods for specific disclosures included in the provisions, but it was agreed that this issue would be given another look in the future.
- Currently a firm is required to maintain all data and information necessary to support a firm’s performance presentation and to perform the required calculations. (Provision 1.A.1.) This language will be changed to require a firm to have data necessary to support all items included in a compliant presentation. Firms will be required to have records to support any additional or supplemental information included in a compliant presentation.
- All proposed changes to the portability tests will be made. Currently one of the portability tests requires that the staff and decision making process must remain intact and independent within the new firm.

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*“Firms will be required to have records to support any additional or supplemental information included in a compliant presentation.”*

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(GIPS Provision 5.A.4.a.ii.) The new test requires the decision-making process to remain substantially intact and independent within the new firm. Also, the current test requiring “substantially all” of the assets from the prior firm to transfer to the new firm will be eliminated (GIPS Provision 5.A.4.c.) The one year allowance for firms to bring acquired assets into compliance will not be limited to an acquisition where one of the firms is not compliant. Finally, there is clarification that portability tests must be met on a composite-specific basis, as opposed to a firm-wide basis.

- The (U.S.) After-Tax Provisions will be removed from the GIPS standards. They will not disappear, but instead will find a new home under the oversight of the US Investment Performance Council (USIPC), the committee that oversees the GIPS standards within the U.S. Stand by for more information.

### SEC Update

This session was presented by Lucille Corkery, Associate Regional Director for Examinations, and Melissa Clough, Senior Staff Accountant, both from the Boston Regional Office of the SEC, and focused on recent developments within the SEC.

Ms. Corkery started the presentation by noting that the role of the SEC is much more challenging in the current market environment. In response to the events of the past year, the Commission has embarked on several initiatives designed to increase the effectiveness of its examination and enforcement programs.

In order to assist the Commission with its ambitious agenda on behalf of investors, three new subcommittees were created under the Investor Advisory Committee, which was formed by SEC Chairman Mary Schapiro in order to give investors a greater voice in the Commission’s work. The new subcommittees were formed to focus on specific categories of regulatory issues that the Investor Advisory Committee plans to address. The Investor Education Subcommittee was created to focus on matters related to financial literacy of investors, educational resources available for investors and the way that issuers and boards of directors communicate with investors. The Investor as Purchaser Subcommittee addresses the needs of investors when they purchase specific financial products (e.g. mutual funds, hedge funds) and services (e.g. brokerage, financial planning). The Investor as Shareholder Subcommittee will review proxy voting, executive compensation practices and other share-

holder-related issues. Each subcommittee will be chaired by an academic who is independent of the SEC.

Throughout the SEC, there is an increased focus on risk assessment. Ms. Corkery and Ms. Clough described the Commission’s continued move towards risk-based examination approach for investment advisors which will focus on identifying investment advisors with higher risk profiles and selecting them for examination. Factors included in the analysis of a firm’s risk include:

- Firm structure, including multiple affiliate relationships;
- Firm size;
- Type of client (e.g. retail, institutional);
- Performance, with focus on returns that are outliers or appear too consistent over time;
- Unknown auditor;
- Complex assets or assets that are difficult to validate in terms of custody and valuation (e.g. LP interests); and
- Disciplinary history of firm and its employees.

Additionally, the SEC intends to collaborate with third parties to assess risk of individual firms. As part of the Commission’s focus on risk-based examinations, the Office of Risk Assessment and the Office of Economic Analysis were recently combined to form the Risk, Strategy, and Financial Innovation Division, which is tasked with the identification and review of developing risks and trends in the market place.

The Commission is also focusing on enhancing examination guidelines and improving fraud detection techniques. This will include more rigorous review of fraud risk during pre-examination work (e.g. reviewing findings from a prior examination), increasing the amount of time dedicated to identifying and reviewing affiliates, and increasing the amount of work done to validate information with outside entities. During the examination process, there will be increased emphasis on validating custody, which will include verifying asset balances with both clients and custodians.

The Commission has proposed a new rule regarding the safeguarding of assets and custody. The proposed rule would require that registered investment advisors that have custody of client funds or securities undergo an annual ‘surprise’ audit, conducted by an independent public accounting firm to verify client assets. All assets will be subject to the surprise audit including real estate holdings,

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LP interests, and any other asset type where custody may be challenging to validate. Investment advisors that self-custody client assets must also obtain a written report from an independent public accounting firm that includes an opinion on the qualified custodian's controls as they relate to the custody of client assets.

The SEC has also undertaken several internal initiatives in order to streamline investigative procedures. These include reorganizing and restructuring departments to expedite the examination process; removing a management layer to improve communication and streamline decision-making processes, and coordinating and integrating examinations of investment advisors and their broker/dealer affiliates.

The SEC has also improved the process for handling the hundreds of thousands of tips and complaints received each year. The Commission will be centralizing the collection and analysis of this information in order to more effectively identify leads for potential enforcement actions. Tips and complaints will be analyzed on a stand alone basis and in aggregate to reduce the risk of missing important information. Additionally, the Commission will be implementing new technology to improve internal communications and the sharing of information across offices. The SEC is also lobbying the government to establish a whistleblower fund to reward those that come forward with credible leads that result in enforcement actions.

The SEC also has several staff initiatives in place. Currently there are 450 examiners to cover all registered investment advisors and broker/dealers within the United States. The Commission has asked for more funding to hire additional staff so more examinations can be conducted. Special focus will be placed on hiring staff with industry experience and specialized knowledge in trading, portfolio management, compliance, specialized products, and forensic accounting and deploying them on the appropriate examinations (e.g. staff with broker/dealer background will be assigned to broker/dealer examinations). Training and professional development will be emphasized for all staff, with specific focus on fraud detection, hedge funds, specialized financial products, and complex trading strategies. Staff will be encouraged to pursue certifications, such as the Certified Fraud Examiner and Chartered Financial Analyst designations.

*“SEC staff will no longer rely on the name, reputation or pre-existing relationships between a firm and the SEC or another regulatory body as a basis for reducing the level of evidence required to satisfy staff inquiries. “*

### Preparing for an SEC Exam

The session was presented by Kevin W. Goodman, Associate Regional Director, Regulation, Denver Regional Office of the SEC, and Steven W. Stone, Partner, Morgan, Lewis & Bockius LLP, and covered how firms should prepare for an SEC examination.

The first part of the presentation focused on specific changes the SEC has made to the way it approaches examinations in response to the Bernie Madoff case and the findings in the report issued by the SEC's Office of the Inspector General. The second portion of the presentation focused on specific actions firms should take in order to prepare for an SEC examination.

Mr. Goodman reiterated many of the themes in Ms. Corkery and Ms. Clough's presentation relating to internal initiatives within the SEC, but also discussed key changes firms should expect to see in terms of how the Commission will approach examinations going forward. The first key change will be the way SEC staff prepares for an examination. Significant emphasis will be placed on planning and preparation for the examination so you can expect that staff will be thoroughly prepared when they arrive onsite. During the planning phase, SEC staff will specifically focus resources on reviewing public information, such as the firm's website. When SEC staff arrive onsite to begin the examination, firms should also be prepared for a greater degree of professional skepticism. SEC staff will no longer rely on the name, reputation or pre-existing relationships between a firm and the SEC or another regulatory body as a basis for reducing the level of evidence required to satisfy staff inquiries. Mr. Stone quoted a signature phrase of former President Ronald Reagan's to describe the new SEC approach to examinations and professional skepticism, "Trust, but verify."

In terms of examination procedures, Mr. Goodman stated that the SEC is still developing new guidelines, but repeated that more emphasis will be placed on the custody of assets, valuation, document production, and the level of cooperation exhibited by the firm during the examination. In order to confirm the existence of assets, firms should expect SEC staff to confirm asset balances with third parties, which includes both custodians and clients. In order to test pricing, firms should be prepared for SEC staff to thoroughly review internal controls on valuation. Firms should also expect the SEC staff to obtain outside verification of prices, even

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in those situations where a portfolio manager or pricing committee has input on the final price used to value a security. Mr. Goodman also stated that SEC staff will tenaciously pursue red flags and follow up on all identified potential issues and unreconciled discrepancies. Firms should also be prepared to provide documents in a prompt fashion. If SEC staff believes that a firm is intentionally delaying the production of requested documentation, it will be easier for SEC staff to obtain subpoenas for the documentation as the SEC has moved the power to grant subpoenas to the regional offices. Finally, SEC staff will evaluate the overall examination and will be empowered to bring enforcement action against firms if the tone and conduct of a firm during an examination is not cooperative. This is intended to prevent firms from intimidating SEC staff, which was identified as a significant problem during the SEC examinations of Madoff's firm.

Mssrs. Goodman and Stone provided several ideas for how firms can best prepare for an SEC examination. Before the firm is selected for an examination, firms should consider having the Compliance Department perform mock examinations to assess the firm's readiness and identify potential weaknesses. Firms should review prior examination letters and consult the SEC's sample request list as a guide for structuring mock examinations.

(VPS Note: During the Q&A section of the presentation, Mr. Goodman said that work on an updated sample request list based on the new examination process was currently in progress and suggested that firms keep an eye out for new sample request lists in the coming months.) Areas that a mock examination should cover include the effectiveness of control and compliance systems; prompt production of documents SEC staff may request; preparation of the firm's employees for interviews with SEC staff; and review of compliance policies and procedures to ensure they match the controls actually being used. One deficiency that Mr. Goodman said he frequently notes is inadequate policies and procedures for performance. A mock SEC examination would be a perfect opportunity for the firm to review, update and enhance both the Compliance Manual and the GIPS Policies and Procedures Manual to ensure that the manuals are current and complete.

Once a firm has received notice from the SEC that it will be examined, the firm should thoroughly review the SEC's request list and identify any requested items that require clarification, identify potential issues (e.g. documents that may be difficult to produce), obtain and organize requested documents,

and make the requested documents available to SEC staff. Mr. Goodman suggested firms prepare a production schedule of deliverables and distribute it to the various departments involved in document gathering to facilitate communication and coordination. This may help firms coordinate production of requested documents in a timely manner.

Additionally, firms should anticipate and prepare for questions that are likely to be asked. Mr. Stone suggested that firms give a presentation to SEC staff at the beginning of the examination which covers the firm's background and uses the results of the Compliance Department's annual review of internal controls as the centerpiece of the presentation. Mr. Stone also suggested including a discussion of known issues and errors, but cautioned that these items should be discussed with legal counsel prior to discussion with SEC staff. The rationale is that SEC staff appreciate it when firms are transparent with known deficiencies. Allowing SEC staff to discover known issues and errors during the examination could be interpreted as trying to obfuscate or mislead. Additionally, both Mssrs. Stone and Goodman emphasized that the key to communication with SEC staff is precise and accurate answers. Mr. Stone provided the following additional suggestions:

- Provide adequate working space for SEC staff;
- Designate a liaison to work with SEC staff;
- Communicate with SEC staff so the progress of the examination can be gauged and emerging issues can be identified;
- Maintain logs of documents requested and provided; and
- Date stamp documents produced.

While performance is generally not the start of an SEC inquiry, it is usually covered by SEC staff as part of the statistical review process, and specifically focuses on performance outliers (e.g. performance higher relative to peers, or performance that is consistent over time) and advertising. Mr. Stone suggested that firms review recent advertising materials as SEC staff will review advertising materials as part of the planning process. Mr. Stone also said that performance teams should have a solid understanding of their firm's strategies and how portfolio managers make decisions and recommendations with performance in mind. A significant portion of any SEC review of advertising materials is determining if the information in the advertisement is misleading so firms should consider whether or not decisions that impact performance need to be disclosed. Finally,

*“While performance is generally not the start of an SEC inquiry, it is usually covered by SEC staff as part of the statistical review process, and specifically focuses on performance outliers (e.g. performance higher relative to peers, or performance that is consistent over time) and advertising.”*

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Mr. Stone suggested looking to the Financial Industry Regulatory Authority (FINRA) for guidance on performance advertising. FINRA is on the leading edge of new issues as they relate to advertising performance (e.g. ETF performance).

Some of the Q&As from both sessions were as follows:

**Q:** Does a firm's claim of compliance with GIPS create extra work during an SEC examination?

**A:** There is not a dramatic increase in the amount of work during an examination for those firms that claim compliance with the GIPS standards over those firms that do not claim compliance with GIPS. However, SEC staff will go a little more in depth on performance and do some degree of review on the firm's claim of GIPS compliance. While SEC staff are not experts in GIPS, they will reach out to their contacts at CFA Institute for assistance with any issues encountered during their reviews.

**Q:** If a firm has been verified, does that have any weight on the SEC exam?

**A:** It will be one factor the SEC reviews, and they will take into consideration the firm that performed the verification, but SEC staff will still perform the same amount of work regardless of the firm's verification status.

**Q:** How does the SEC test GIPS compliance?

**A:** When a firm claims GIPS compliance, it adds another layer to the examination. Areas SEC staff will cover as part of this review include recalculating performance to ensure accuracy of returns, reviewing composite assignments to ensure that all accounts that should be in a composite are in a composite, and reviewing marketing materials and presentations to ensure all proper disclosures are made.

**Q:** Relating to GIPS compliance, what are the common deficiencies that are identified during examinations?

**A:** The most common deficiencies that have been encountered are:

- Firms do not meet all of the GIPS requirements;
- Policies and procedures are not fully documented or are not current;
- All accounts are not in a composite (VPS Note: By all accounts, we assume they mean all fully discretionary and fee-paying accounts);
- Not having a list of composite descriptions readily available; and
- Disclosures, specifically the disclosure on dispersion, are missing.

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Our next newsletter will include highlights from other sessions at the Boston conference.