



2010 Edition of the GIPS® Standards Issued

The 2010 edition of the Global Investment Performance Standards (GIPS®) was approved by the GIPS Executive Committee (EC) on January 29, 2010, during an open EC conference call that had over 200 observers. The 2010 edition is available on the [GIPS standards website](#), as well as a very helpful [tracked changes version](#) showing changes from the current 2005 edition. A discussion of key points and changes that should be noted by a GIPS-compliant firm follows.

Effective Date: The effective date of the 2010 edition is January 1, 2011. Compliant presentations that include any performance results for periods beginning on or after January 1, 2011 (“as of January 1, 2011”) must comply with the presentation and disclosure requirements of the 2010 edition at the time of the update. All input and calculation data requirements (e.g., the use of fair value) must be followed the minute January 1, 2011 arrives. Early adoption of the 2010 edition is encouraged.

The update became an overhaul: Don’t panic when you open the tracked changes version. It looks much worse than it is. As was explained when the Exposure Draft was issued, many of these changes were done to standardize the language throughout the Standards, and to use terms that are defined in the glossary or were added to the glossary. Even more changes to tighten up the language have been done since the Exposure Draft. Who knew how many ways there are to refer to a compliant presentation? Some of the provisions were also moved to different sections and provisions within sections were re-ordered to better organize the Standards. It will be great to have all disclosure requirements in the disclosure section!

Compliant presentation defined: A compliant firm must make every reasonable effort to provide a compliant presentation to all prospective clients. Compliant presentation is now defined as a presentation for a composite that contains all the information required by the GIPS standards and may also include additional or supplemental information. Appendix A in the 2010 edition includes sample compliant presentations.

Prospective client defined: Now that we know exactly what must be provided to a prospective client, the next step is to define who must receive a compliant presentation.

Prospective client is newly defined as any person or entity that has expressed interest in one of the firm’s composite strategies and qualifies to invest in the composite. Existing clients may also qualify as prospective clients for any strategy that is different from their current investment strategy. Investment consultants and other third parties are included as prospective clients if they represent investors that qualify as prospective clients. The definition of prospective client explicitly identifies who must receive a compliant presentation.

Comply with laws and regulations: New provision 0.A.2. requires a firm to comply with all applicable laws and regulations regarding the calculation and presentation of performance. 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. Other documents, including several Guidance Statements, make reference to a firm’s requirement to first and foremost comply with all applicable laws and regulations. This change should be a non-event for most firms.

No false or misleading information: New provision 0.A.3. requires a firm to not present performance or performance-related information that is false or misleading. This provision builds on the longstanding GIPS principles of fair representation and full disclosure. Since it is not possible for a firm to fairly represent performance and simultaneously present false or misleading information, this change should be another non-event for most firms.

GIPS policies and procedures: A firm’s policies and procedures used in establishing and maintaining compliance with the GIPS standards must include how the firm ensures the existence and ownership of client assets. As most firm are already reconciling to custodian records, this provision should (hopefully) not require any operational changes.

Records required for all items in a compliant presentation: Currently a firm is required to maintain all data and informa-

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tion necessary to support a firm's performance presentation and to perform the required calculations. This has been expanded to require a firm to have supporting records for all items included in a compliant presentation. This would include any additional or supplemental information included in the compliant presentation.

List of composite descriptions: The term "list and description of composites" was replaced with "list of composite descriptions" throughout the Standards. This is only a change in wording but should make it clear that this list must include all composites and their descriptions.

Fair Value: As of January 1, 2011, total firm assets must be the aggregate total fair value of all assets managed by the firm. Currently firm assets is the sum of the market value of all assets under management. The concept of market value automatically removes from firm assets any portfolio for which a market value cannot be determined, as well as assets carried at cost or book value (think stable value assets.) With the move to fair value, the exclusion of such assets from firm assets is eliminated. These assets will need to be included in firm assets on a prospective basis. Once included in firm assets, the portfolios must then be considered for inclusion in a composite. Such portfolios would need to be included in firm assets (and composites) as of January 1, 2011, on a prospective basis only.

Fair value definition: As of January 1, 2011, portfolios must be valued in accordance with the definition of fair value and the GIPS Valuation Principles. Fair value is defined as the amount at which an investment could be exchanged in a current arms length transaction between willing parties in which each acted knowledgeably and prudently. This replaces the old requirement that portfolios be valued at market. For those firms that manage liquid securities that trade in active markets, the change to fair value should not require any changes in valuation policies.

Valuation Hierarchy: A firm must establish a valuation hierarchy for determining valuations. The first tier must be the same for all firms: Investments must be valued using objective, observable, unadjusted quoted market prices for identical investments in active markets on the measurement date, if available. If a firm manages assets that are not able to be valued in this manner, the firm must establish a hierarchy for determining how these assets will be valued. A recommended hierarchy is in-

cluded in the Valuation Principles. If a firm creates a valuation hierarchy that materially differs from the recommended hierarchy they must disclose this fact. The recommended hierarchy will be recognizable to those of you that are familiar with U.S. or international accounting standards.

Subjective, unobservable inputs: New provision 4.A.27 will require firms to disclose the use of subjective, unobservable inputs for valuing investments (the bottom tier in the recommended valuation hierarchy) if they are material to the composite.

New risk disclosure: New provision 5.A.2. requires a firm to disclose, for each annual period ending on or after January 1, 2011, the annualized ex-post standard deviation of the composite and the benchmark over the past 36 months, using monthly returns. (This is a change from the Exposure Draft, which required this measure only as of the most recent annual period end.) If a firm believes that this is not a relevant or appropriate risk measure for the composite, the firm must still present the standard deviation, and must also present an additional ex-post risk measure for the benchmark (if available and appropriate) and the composite. The periodicity of the returns used must be the same for both the composite and the benchmark calculations (if calculated for both.) A firm will also be required to disclose why standard deviation is not relevant or appropriate, which additional risk measure is presented, and why it was selected.

Compliant presentations must include any initial or final partial period: For composites that have an inception date after January 1, 2011, if the composite begins mid year, a firm will be required to present the first partial year return in the compliant presentation. The same is true for a composite with a termination date after January 1, 2011. The final partial year of performance must also be included in the compliant presentation. (Remember that a firm must include terminated composites on the list of composite descriptions for at least five years. A firm must also be prepared to provide a compliant presentation for any composite on this list, including terminated composites, therefore a final partial year for a terminated composite cannot be ignored.)

Portability tests updated: If a firm wishes to link its current track record to a track record from a prior firm or affiliation, certain portability tests must be met. The provision now explicitly states that the portability tests must be met on a composite-

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"As of January 1, 2011, portfolios must be valued in accordance with the definition of fair value and the GIPS Valuation Principles."

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specific basis. Only an entire composite is portable, and not the performance of only selected accounts from the prior firm. The test that required substantially all of the assets from the prior firm to transfer to the new firm has been eliminated. (Yay!) Also, the one year allowance to bring acquired assets into compliance is no longer limited to the situation where a compliant firm acquires a non-compliant firm.

Required Disclosure of Verification

Status: In the claim of compliance firms will be required to explicitly state whether the firm has been verified or not. If the firm has been verified, the firm must indicate for which period the firm has been verified. A verified firm must also disclose what verification tests, as well as state that verification does not provide an opinion on any specific composite. The full claim of compliance for a verified firm is as follows:

“[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 verification report(s) is/are available upon request.”

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm’s policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.”

An option is provided for a verified firm that has chosen to also obtain a performance examination for a specific composite

The Exposure Draft included an option for a firm that was not currently verified. It was decided that this option was not necessary, as disclosing the dates covered by the verification would allow a reader to determine for themselves if the verification is current.

Composite description: The definition of composite description was expanded to state that it must include enough information to allow a prospective client to understand the key characteristics of the composite’s investment mandate, objective, or strategy. While the Exposure Draft language that explicitly required disclosure of a composite’s risks is not included, reviewing the sample composite descriptions (included in GIPS Appendix C) makes it clear that the intention is for a composite description to include the key risks of a strategy.

Benchmark description: A firm must disclose the benchmark description. Before you panic, the glossary definition includes the following, “...The description must include the key features of the benchmark, or the name of the benchmark for a readily recognized index or other point of reference.” You will not be expected to describe the creation details of the S&P 500 Index.

Availability of policies and procedures:

Currently a firm must disclose that additional information regarding policies for calculating and reporting returns is available upon request. (Note that only policies must be made available, not procedures.) This has been expanded, and a firm must now offer to provide policies for valuing portfolios, calculating performance, and preparing compliant presentations.

Net return calculations: Currently, if net returns are presented, the firm must disclose if anything other than transaction costs and management fees are deducted from net returns. In addition to this disclosure, firms will also be required to disclose if actual or model fees are used, and if returns are net of any performance-based fees.

Use of short positions must be disclosed: Currently firms must disclose the presence, use and extent of leverage and/or derivatives. Short positions have been added to this disclosure requirement.

Disclosure of the reason for non-compliance eliminated: Currently, if a firm presents non-compliant performance for periods prior to the minimum required compliance date (January 1, 2000 for most assets; January 1, 2006 for real estate, private equity, and wrap fee/SMA) a firm must disclose the periods of non-compliance and the reason for non-compliance. While disclosure of the period of non-compliance must still be made, the reason for non-compliance will no longer be required.

New option for Advertising Guidelines:

A GIPS-compliant firm may choose to advertise their claim of compliance by following the GIPS Advertising Guidelines, which is essentially a “shortcut” method for claiming compliance with the GIPS standards. 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

“Verification does not ensure the accuracy of any specific composite presentation.”

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related compliant presentation. A new third option, which is not tied to the date reported in the compliant presentation, is to report the 1-, 3-, and 5-year annualized composite returns through the most recent period.

GIPS U.S. After-Tax Guidance not included in the 2010 edition: Currently 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.

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 provisions, note that they are not disappearing. They will be maintained somewhere, but outside of the GIPS standards themselves. Stand by for more information.

In future newsletters we will review the changes specific to the real estate, private equity and wrap fee/SMA provisions, as well as the verification guidance.

Finally, you should expect to see updated and new Guidance Statements and Q&As throughout 2010. A new GIPS Handbook will also be created.

Upcoming GIPS Workshop and European Conference

On behalf of CFA Institute, we will be instructing an introductory GIPS workshop in Phoenix on March 11, 2010. The workshop is suited for performance professionals who are new to the GIPS standards, or those who wish have a thorough refresher on complying with the GIPS standards. We will also be highlighting changes made in the 2010 edition of the GIPS standards.

We will also be speaking at the 2010 European GIPS Standards Conference, which will be held in London on February 24-25, 2010. We will be discussing the key changes made in the 2010 edition of the GIPS standards. (Can you tell what we will be talking about for the next year?) Information about and registration for these events is available on the [GIPS standards website](#).