



GIPS® 2010 Exposure Draft Issued

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](#).

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. But 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 have prepared a [detailed analysis of the Exposure Draft](#), which is available on our website. This analysis includes our commentary on the proposed changes. Highlights from the Exposure Draft follow.

Effective Date The revised Standards have an effective date of 1 January 2011. All compliant presentations that include performance results for periods beginning after 31 December 2010 must be prepared in accordance with the revised Standards. Unless noted otherwise, all changes will be required to be made on a prospective basis only.

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. An option is also provided for a firm that has not been “currently” verified. Currently is defined as a verification that occurred more than 24 months ago.

Non-fee paying exclusion eliminated Currently a firm may exclude from composites non-fee paying portfolios, based solely on the fact that they are non-fee paying. For

periods beginning on or after 1 January 2011, non-fee paying accounts will be required to be included in composites.

Fair Value Throughout the Standards the concept of using market value has been replaced with fair value. Fair value is defined as the amount at which an asset could be exchanged in a current arm’s length transaction between willing parties in which the parties each acted knowledgeably, prudently, and without compulsion. Fair value must be determined in accordance with the GIPS Valuation Principles.

GIPS Valuation Principles Hierarchy To determine fair value, a firm must use the following hierarchy:

- Valuations must be objective, observable, unadjusted market prices in active markets; if not available, then must use
- Objective, observable quoted market prices for similar investments in active markets; if not available, then must use
- Quoted prices for identical or similar investments in markets that are not active; if not available, then must use
- Market based inputs other than quoted prices observable for the investment; if not available, then must use
- Subjective, unobservable inputs for the investments where markets are not active at the measurement date. Unobservable inputs should only be used to the extent that observable inputs and prices are not available.

If investments are valued using subjective, unobservable inputs (the bottom tier) and are material to the composite as of each annual period end, then the firm must disclose this fact.

Exclusions from “firm assets” no longer appropriate Currently a firm is allowed to exclude from firm assets “assets to which the Standards cannot be applied.” This was originally written contemplating GICs (Guaranteed Investment Contracts) that were carried at book value and could not be valued at market value. There was also an exclusion for “art or other hard to value assets.” With the move to fair value, such portfolios will be required to be in-

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cluded in firm assets, and then included in composites.

Proprietary Portfolios A proprietary portfolio is defined as a portfolio that is owned by the firm, the firm's management, or the firm's parent company. Firms will be required to disclose, as of the end of each annual period, the percentage of the composite that is composed of such portfolios.

Disclosure of net return calculation Currently, if net returns are presented, the firm must disclose if anything other than transaction costs and management fees are deducted. Firms will be required to disclose

- If actual or model fees are used;
- If returns are net of performance-based fees.

Composite minimums A firm may establish a minimum size for inclusion in a composite. The minimum is supposed to represent the amount of money needed to manage an account in the composite's strategy, i.e. to make the account discretionary. A firm will be prohibited from showing a composite to a prospective client who is known to have a portfolio that does not meet the composite minimum.

Composite description Currently a firm must disclose the composite description, which is currently defined as general information regarding the strategy of the composite, and must include all salient features of the composite strategy. This will be expanded to require including enough information to allow a prospective client to understand all of the key characteristics, including risks, of the composite strategy.

New risk disclosure Firms must disclose, as of the most recent annual period end, the ex-post standard deviation of the composite and the benchmark over the past 36 months, using monthly (or more frequent) returns. The periodicity of the returns used must be the same for both the composite and the benchmark calculations.

Firms must comply with all applicable laws and regulations regarding the calculation and reporting of returns This explicitly states what has been assumed in many GIPS guidance documents, such as guidance statements.

Firm must not present performance-related information that is false or misleading This is another explicit statement of an implicit assumption.

Compliant presentations must include any initial partial period If a composite begins during the year, a firm will not be allowed to exclude the first partial year return from the compliant presentation just because it is not a complete annual return.

Use of short positions must be disclosed Currently firms must disclose the presence, use and extent of leverage and/or derivatives. Short positions will be 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 (1 January 2000 for most assets; 1 January 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. The reason for non-compliance will no longer be required to be disclosed.

Records required for all items in a compliant presentation 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. This will be expanded to require a firm to have supporting records for all items included in a compliant presentation. This effectively eliminates the record-keeping exception for supplemental information that is currently included in the Record-keeping Guidance Statement.

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 tests now explicitly state the test must be met on a composite-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. Also, the one year allowance to bring acquired assets into compliance is no longer limited to the case where a compliant firm acquires a non-compliant firm.

Definition of prospective client A firm must make every reasonable effort to provide a compliant presentation to all prospective clients. To date prospective client had not been defined, but now the glossary includes the following definition: Any person or entity that qualifies to invest in a composite strategy and has expressed interest in one of the firm's strategies. Investment con-

"A firm will be prohibited from showing a composite to a prospective client who is known to have a portfolio that does not meet the composite minimum.."

GIPS Provision O.A.11

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sultants and other third parties are included as prospective clients if they represent investors that qualify as prospective clients.

Increase in frequency of valuation of RE assets Currently real estate assets must be externally valued at least once every 36 months. As of 1 January 2012 real estate assets must be externally valued at least once every 12 months.

Closed-end RE fund composites must calculate and report IRRs Closed-end RE fund composites must be created based on strategy and vintage year. In addition to reporting time-weighted component and total returns, these composites will also be required to report since inception, net of fees, internal rates of return (SI-IRR) for each year since the composite's inception. Daily cash flows must be used as of 1 January 2011. Such composite presentations must also include numerous disclosures similar to those required for private equity composites, such as realization and paid in capital multiples.

Private Equity return calculations must use daily cash flows 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.

Private Equity fund of funds composites may be created based on strategy only Unlike other private equity composites, which must be based on strategy and vintage year, fund of funds composites can be created based only on strategy. For such strategy-only composites, as of the most recent period end the presentation must include the SI-IRR for each vintage year within the fund-of-funds composite.

Wrap fee/SMA sponsor-specific composites 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 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'?

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 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 GIPS 2010 Exposure Draft Firms that claim compliance with the GIPS standards and choose to present after-tax performance to prospective clients sub-

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"As of 1 January 2012 real estate assets must be externally valued at least once every 12 months."

VPS Survey to be Issued Shortly

In early 2008 we conducted a survey of compliance with the GIPS standards. Our survey population was taken from the May 26, 2007 *Pensions & Investments* ("P&I") list of the 767 largest managers of U.S. institutional assets. (Survey results are available on our website.) We are preparing to send out the survey again, and this year will focus on key proposed changes in the GIPS 2010 Exposure Draft. We will again be using the same institutional manager list from the May

26, 2008 edition of P&I. Invitations to participate in the survey will be sent out in the next few weeks after we are confident most firms have had a chance to read the GIPS 2010 Exposure Draft. If your firm is included in the P&I list we would love to hear from you to confirm contact information if you haven't done so already. Please contact Janet Mellish in the Portland office at 503-288-2704, ext 105.

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Vincent Performance Services LLC provides consulting and verification services to firms that comply, or wish to comply, with the Global Investment Performance Standards (GIPS®). Our clients range in size from less than \$1 billion of assets under management to over \$500 billion and are located throughout the U.S.

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ject 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 US 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.

Public Comment Period Do not think that the proposed changes are a done deal, as everything is subject to change based on comments received during the public comment process. We cannot begin to stress how important it is for all firms to read the draft and provide a comment letter. We promise that you are not wasting your time. Every single comment is read and considered. And, if you don't want your comments to be made public, you have that option. You will be living with the next version of the GIPS standards for many years. Let your voice be heard! Comments will be accepted until 1 July 2009.

Boston Again: Mark Your Calendar

The location and timing of the next annual GIPS conference, sponsored by CFA Institute, has already been decided. The conference will return to Boston and will be held on September 22-23, 2009. The GIPS Standards workshop will also be offered the day before the conference, on September 21, 2009. Note that these events are from Monday-Wednesday, which is a departure from the norm. Preliminary information about the workshop and

conference is available on [CFA Institute's website](#). Both the workshop and conference sold out last year, so we encourage you to register early.

For our clients in the Boston area, and those who will be attending the conference, please plan to attend our client dinner on Monday evening, September 21 at [Vinalia Restaurant](#). Cocktails will begin at 6:00. We hope to see you there!