



## New Questions & Answers Issued

When the GIPS Executive Committee approved the 2010 edition of the GIPS® standards, it was announced that numerous Q&As would be forthcoming, to help firms understand and interpret the changes to the GIPS standards. In the past few weeks over 20 new Q&As were issued. To find all of the Q&As that were recently issued on the [GIPS standards website](#), you can do a search for all Q&As that were posted after April 2010. (Note that all references to GIPS provisions below refer to the 2010 edition of the GIPS standards.) Highlights from selected Q&As follow.

**Early adoption of the 2010 edition of the GIPS standards.** The effective date of the 2010 edition of the GIPS standards is 1 January 2011. Once a firm prepares a compliant presentation that includes performance for periods that begin after December 31, 2010, the presentation must meet the disclosure and presentation requirements of the 2010 edition. Also, as of 1 January 2011, a firm must comply with any requirements that impact the calculation of performance. But a firm does not have to wait until 1 January 2011 to comply with the 2010 edition. A firm may decide to early adopt all of the requirements of the 2010 edition. A firm may also choose to early adopt selected new requirements of the 2010 edition, as long as the firm does not stop complying with all requirements of the current (2005) edition.

**Ability to differentiate between current and former prospective clients.** By no later than 1 January 2010, a firm must have established an error correction policy. This policy must address how the firm handles errors that appear in compliant presentations, including determining which errors are considered “material.” If a firm has a material error and corrects a compliant presentation, the Error Correction Guidance Statement says the corrected compliant presentation must be provided to all prospective clients and others that received the incorrect presentation. The question is asked: Does this include former prospective clients who received the incorrect presentation, but who subsequently decided not to hire the firm? If a firm has the ability to differentiate between “current” prospective clients and “former” prospective clients, the firm is not required to provide the cor-

rected presentation to a former prospective client who decided not to hire the firm.

**No “opportunistic” valuation of portfolios.** Provision 1.a.3. describes the minimum frequency for valuing portfolios:

- Prior to 1 January 2001: at least quarterly;
- As of 1 January 2001: at least monthly;
- As of 1 January 2010: at least monthly and on the date of all large cash flows.

In addition to telling firms when they must value portfolios, a firm is now told when not to value portfolios. Provision 1.A.3.c. states that portfolios must not be valued more frequently than required by the (composite-specific) valuation policy. Therefore, if the composite policy is to value monthly and for cash flows greater than 5% of the portfolio’s market value, a portfolio may not be valued unless it is at month end or on the date of a cash flow greater than 5%. If a cash flow equal to 4% of the portfolio’s value occurs, the portfolio cannot be revalued. This prohibition reinforces the concept of selecting a policy and applying it consistently.

**Policies with respect to ensuring the existence and ownership of client assets.** A compliant firm must document policies and procedures used in establishing and maintaining compliance with the GIPS standards. Provision 0.A.5. requires a firm to document policies and procedures for ensuring the existence and ownership of client assets. This change is simply re-enforcing the point that a composite must be based on real assets. Performance based on model or hypothetical portfolios must not be included in a composite. A firm must also ensure that the investments of a real portfolio reflect the actual assets managed by the firm. A firm could most easily accomplish this through the custodian reconciliation process. As the firm normally does not have any control over the selection of the custodian, the reconciliation to an independent third party is strong proof that the client’s assets exist and the positions of the assets are properly stated. If the assets are not held at a custodian, as would be true for private equity investments, additional procedures will need to be developed. Verifiers are also explicitly required to test policies with respect to existence of client assets.

*(Continued on page 2)*

### Inside this issue:

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More Highlights from GIPS 2010: Advertising Guidelines	2
Brazil IOF Tax: Cash Flow or Not?	4
Annual GIPS Conference and EC Meeting in San Francisco	4

## New Questions & Answers Issued

*(Continued from page 1)*

**Composite-specific valuation policy may differentiate frequency of valuation based on portfolio type.** Assume a firm maintains a composite that includes a mutual fund that is valued daily, and institutional accounts that are valued monthly and for cash flows greater than 5% of the account's beginning of month market value. A firm's valuation policy does not need to be consistent for all accounts within a composite. Instead a firm may create a valuation policy for a composite that considers account type and differentiates valuation frequency based on the type of account.

**Fair value for mutual fund NAV-reporting purposes is different from fair value for GIPS purposes.** As of 1 January 2011, portfolios must be valued in accordance with the GIPS definition of fair value. Mutual funds in the U.S. have been required to be fair valued for many years, to prevent market timing abuses. The Q&A makes it clear that just because the same term is used does not mean that mutual funds that are fair valued for NAV purposes must use that NAV fair value for GIPS composite reporting purposes. A mutual fund could have two fair values: one for NAV purposes and one for GIPS purposes.

## More Highlights from GIPS 2010: Advertising Guidelines

*“Fair value for mutual fund NAV-reporting purposes is different from fair value for GIPS purposes.”*

On January 29, 2010, the GIPS Executive Committee approved the 2010 edition of the GIPS standards. Our January 2010 newsletter included highlights of the key changes in the main body of the GIPS standards (sections 0-5.) Our April 2010 newsletter covered changes in the verification section. In this article we will review changes to the GIPS Advertising Guidelines. Because we continue to see firms struggle with understanding when to follow the GIPS Advertising Guidelines, we will take the opportunity to do a refresher on the GIPS Advertising Guidelines. We highlight the significant changes below.

### **Can any firm follow the GIPS Advertising Guidelines?**

Any firm that claims compliance with the GIPS standards may choose to follow the GIPS Advertising Guidelines in an advertisement.

### **Do the GIPS Advertising Guidelines replace the GIPS standards?**

No. The GIPS Advertising Guidelines were created to allow a GIPS-compliant firm to claim compliance in an abbreviated manner. Without the GIPS Advertising Guidelines, a compliant firm could claim compliance only by using the GIPS claim of compliance in a fully compliant (and lengthy) composite presentation.

### **When may we follow the GIPS Advertising Guidelines?**

You may choose to follow the Advertising Guidelines if you wish to include a claim of compliance in an advertisement, which is defined as any materials that are designed for use in newspapers, magazines, firm bro-

chures, letters, media, websites, or any other written or electronic material addressed to more than one prospective client. You may also think of an advertisement as any materials that are not used in a one-on-one meeting with a prospective client. We see firms follow the GIPS Advertising Guidelines primarily in two places: in ads in industry journals such as *Pension & Investments*, and on company websites.

### **Must we claim compliance with the GIPS standards in an advertisement?**

No. There is no requirement to claim compliance, and thus be required to follow the GIPS Advertising Guidelines, or include a compliant presentation, in an advertisement. When a GIPS-compliant firm prepares an advertisement, the firm has three options:

- Include in the advertisement a compliant presentation;
- Prepare the advertisement following the GIPS Advertising Guidelines; or
- Make no mention of the GIPS standards.

### **If we wish to include a claim of compliance in an advertisement and not include performance results, which disclosures are required?**

Three items must be disclosed:

- The compliance statement: [Firm name] claims compliance with the Global Investment Performance Standards (GIPS®);
- The definition of the firm; and
- How a prospective client can obtain a compliant presentation and/or the firm's list of composite descriptions (revised language from the 2005 edition).

*(Continued on page 3)*

## More Highlights from GIPS 2010: Advertising Guidelines

*(Continued from page 2)*

**If we wish to include in an advertisement a claim of compliance with the GIPS standards by following the GIPS Advertising Guidelines, and include performance results, which composite returns must be included?**

The firm has three options for presenting composite returns. The firm may present:

**Option 1:** 1-, 3-, and 5-year annualized composite returns through the most recent period. (Note that the prior requirement to present annualized returns through the same period of time as presented in the respective composite's corresponding compliant presentation has been eliminated.)

**Option 2:** Period-to-date composite returns, in addition to 1-, 3- and 5-year annualized composite returns through the same period of time as presented in the corresponding compliant presentation. (New option for the returns that may be presented.)

**Option 3:** Period-to-date composite returns in addition to 5 years of annual composite returns through the same period of time as presented in the corresponding compliant presentation.

**If a composite does not yet have five years of history, are we precluded from preparing an advertisement following the GIPS Advertising Guidelines?**

No. If the composite has less than 5 years of history, and the firm has chosen to follow either option 1 or 2, the firm must also present the annualized returns since the composite inception as well as all other available annualized returns. For example, if the composite has 3.5 years of history, and the firm is following Option 1, the firm would present the 1-year, 3-year, and since inception (for 3.5 years) annualized returns. For Option 3, the firm would present three years of annual returns, along with period-to-date composite returns, if applicable.

**If we wish to include in an advertisement a claim of compliance with the GIPS standards by following the GIPS Advertising Guidelines, and include performance results, which benchmark returns must be included?**

The advertisement must include benchmark total returns for the same periods as presented for the composite. The benchmark must be the same benchmark that is used in the corresponding compliant presentation.

**If we wish to include in an advertisement a claim of compliance with the**

**GIPS standards by following the GIPS Advertising Guidelines, and include performance results, which additional disclosures must be included?**

The advertisement must include the following disclosures:

- The composite description;
- Whether performance is gross or net of fees. (Of course, in the U.S. net returns must be shown, and gross returns may also be included);
- The benchmark description;
- If the firm determines no appropriate benchmark exists, why no benchmark is presented;
- The currency used to express performance;
- A description of the use and extent of leverage, derivatives, and short positions, if material (revised language);
- If non-compliant performance prior to 1 January 2000 is presented, the periods of non-compliance (eliminated the requirement to disclose the reason that performance was not in compliance); and
- If the advertisement conforms with laws and/or regulations that conflict with the requirements of the GIPS standards and/or the GIPS Advertising Guidelines, and the manner in which the laws and/or regulations conflict (new requirement).

**Does claiming compliance in an advertisement relieve us of our responsibility to make every reasonable effort to provide a compliant presentation to all prospective clients?**

No. You must make every reasonable effort to provide a compliant presentation to all prospective clients, whether you choose to prepare advertisements following the GIPS Advertising Guidelines or not.

**Should we prepare advertisements following the GIPS Advertising Guidelines?**

Each firm must decide for itself whether or not to (voluntarily) follow the GIPS Advertising Guidelines. If you do decide to follow the GIPS Advertising Guidelines, we strongly recommend double checking the ad, to ensure all required disclosures are included. We have seen too many advertisements, in industry publications and on firm websites, that include the GIPS Advertising Guidelines claim of compliance, but don't quite get it right. Be careful you aren't sending a message to your favorite regulators that you don't really comply with the GIPS standards.

*“Each firm must decide for itself whether or not to (voluntarily) follow the GIPS Advertising Guidelines.”*

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## Brazil IOF Tax: Cash Flow or Not?

As of October 20, 2009, Brazil imposes a 2.0% tax on foreign exchange transactions for the purchase of securities in the Brazilian market. The IOF (Tax on Financial Transactions) tax is charged only on money entering the Brazilian market, and is added to the cost of the security to be purchased. The amount of the purchased Brazilian currency must cover both the purchased security and the IOF tax. How should this tax be treated for performance calculation purposes? Given the nature of the tax, we believe this tax should be considered a cost of investing and should not be a cash flow. To ensure we were not being too conservative in our view, several months ago we surveyed a number of firms

who invest in the Brazilian market, as well as some of our verification colleagues from other firms. The overwhelming majority view from both firms and verifiers was that the tax should not be a cash flow. Because there was such a consensus, we assumed this tax would not be an issue. However, we recently found an instance where a firm's back office was treating this tax as a cash flow, so performance was not reduced by the tax. In an abundance of caution, we thought we should cover the issue in our newsletter. If you invest in the Brazilian market, we recommend reviewing your performance calculations to ensure this tax is treated properly.

## Annual GIPS Conference and EC Meeting in San Francisco

The 2010 annual GIPS conference, sponsored by CFA Institute, will be at the Westin Market Street Hotel in San Francisco on September 29-30, 2010. The GIPS Standards workshop will also be offered the day before the conference, on September 28, 2010. Note that these events are from Tuesday-Thursday, which is a departure from the norm. Preliminary information about these events is available on the [GIPS standards website](#).

Most years the conference and the workshop sell out, so if you plan to attend make sure you register early.

The GIPS Executive Committee (EC) is also meeting in San Francisco. The open EC meeting will also be on Tuesday morning, September 28th. If you are interested in attending this meeting, keep an eye on the GIPS standards website as you must register to attend this meeting.

For our clients in the San Francisco area, and those who will be attending the conference, please plan to attend our client dinner on Tuesday evening, September 28<sup>th</sup>. We are in the process of finalizing dinner details, so please stand by for more information. We hope to see you there!