PERFORMANCE PERSPECTIVES *with David Spaulding*

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MY GIPS WISH LIST, PART I

We are in that period when we would expect the GIPS® (Global Investment Performance Standards) Executive Committee to be hard at work deciding what changes will be recommended to GIPS, come 2015/2016. I thought it might be fun to start a list of items I'd like changed and/or added (feel free to offer yours, too!). Note that this is the first edition; additional items may be added later.

1. **Sunset Provisions:** an earlier attempt was made to introduce "sunset" provisions into the Standards. That is, the timing to allow firms to remove certain disclosures. Think about it, do you really care that a firm's composite changed names 10 years ago?

   We have verification clients that are the RIA (registered investment advisor) to a bank. And, if you've noticed, for the past 20+ years, banks frequently (a) buy other banks, (b) get bought by other banks, and (c) change their names. As a result, the RIA often changes its name. What's the benefit of seeing the entire history of name changes? Fine, if the firm wants to include this, they can, but shouldn't they be allowed to drop it?

   The last time this was attempted was by the IPC (Investment Performance Council); no recommendations were made for sunset rules. Instead, the public was asked to submit ideas, and few were, so nothing was done. Well, it's time to try again, but this time the EC should identify a preliminary list. If they want help, I'll be happy to offer suggestions.

2. **Discretionary Portfolio:** perhaps no term in the Standards is more confusing than this one. We're all familiar with the requirement that "all actual, discretionary, fee-paying portfolios must be included in at least one composite." "Actual" is easy: a real account. "Fee-paying" simply means that the client pays a fee to the manager. But "discretionary"? That's a tough one.

   The industry has used the word "discretionary" to mean relationships where the client has granted the manager the authority to trade on their behalf for many decades. Its choice for the Standards was less than ideal. GIPS has a totally different meaning for the term (although it's absent from the glossary): discretionary portfolios are ones that have not imposed restrictions on the management of their assets such that they would not be representative of the composite's strategy; or, simply, portfolios whose returns are representative of the composite's strategy. Non-discretionary accounts are ones that have restrictions that cause the portfolio to <u>not</u> be representative of the strategy. The GIPS meaning has nothing to do with the authorization to invest on the client's behalf; that's a given and understood. When conducting verifications we frequently run into problems with this term's meaning, since it's other meaning is so well known and understood. An alternative term should be introduced, and the terms "discretionary" and "non-discretionary" should be consistent with the broader industry's use.

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3. **Internal Rate of Return:** while I am happy that some real estate products must include the IRR, the rules are still product specific, when they should be simplified as follows: if the manager controls the cash flows, the IRR is required. That's it. Of course, the potential for additional disclosures remains, too, but as for the IRR, it should be based solely on who controls the cash flows. Even in private equity, what does it matter if it's a closed or open-ended fund? If the manager controls the flows, IRR. And, TWRR (time-weighted rate of return) shouldn't be required; it can be an option, though it serves no purpose if the manager is the one controlling the flows.

   Several years ago, we had a client who offered closed-end public equity partnerships, and was required to show TWRR, in spite of the fact that they controlled the flows. Their partnerships looked almost exactly like a private equity manager; the only difference was what they invested in (public vs. private equities). It's time to realize that the IRR is the right return WHENEVER the manager controls cash flows.

4. **Fund-of-fund manager rules:** we need clearer rules for fund-of-fund managers.

5. **Advertising guidelines:** the word "guidelines" is a bit weak; guidance isn't a standard. Granted, when you dig deeply into it, you realize there are some requirements, but the name should be changed to "Advertising Rules." Anytime a firm references the Standards in an advertisement (which includes their website), then they must abide. And so, they're rules, not guidelines. By changing the title, it will add emphasis to this fact.

6. **Verifiers and fraud detection:** the Standards should clearly state that verification is not designed to detect fraud. Additional guidance should be included, to assist the verifier should they believe that fraud is being conducted (e.g., that if they discover actual fraud, or suspect it, that they should consult with their firm's management, and most likely refer the matter to the appropriate regulator; that a client relationship is secondary to regulatory rules). I'm aware of one case where the verifier simply exited the relationship (resigned as the verifier). Was this enough? I think not. But, without guidance it's difficult to say.

7. **Effective dates for Q&As:** the Standards should create "effective dates" for Q&As, and indicate that they are, in most cases, not considered retroactive.

   I'd also welcome the opportunity to challenge Q&As. Years ago I asked two people on the help desk a question: I got two different answers. I disagreed with both. I then asked the person who was ultimately responsible for the Standards; I received a third response, which happened to be the one I favored. Given the important role Q&As take, shouldn't there be some flexibility and openness?

8. **Changes to the Standards:** the Standards should clearly state that rule changes are not to be introduced within Q&As or Guidance Statements. In my opinion, the decision to disallow composite membership changes within a month is such a rule change, since there is nothing within the Standards to support the Q&A. Going forward, such actions should be disallowed, as it is confusing and in conflict with the Standards' history regarding rule changes, which always require public comment.

Again, more items may be added, and we welcome your input. It's better to get these ideas out now rather than after the draft has been prepared.

The Journal of Performance Measurement® has begun a series on performance measurement professionals, and we need your help to identify the folks we should include. We focus on one or two people in each issue, with the list driven by input from other PMPs.

And so, please contact our editor, Doug Spaulding (732-873-5700) with your suggestions.

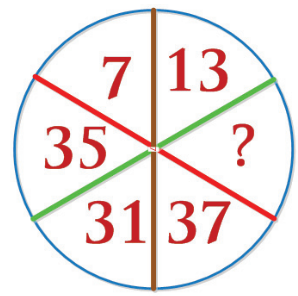
GOT NEWS TO SHARE? LET US KNOW!

We've decided to open our monthly newsletter up to news items. You're welcome to tell us about new clients, job changes, new hires, etc. We, of course, have the right to edit or exclude an item, but we hope that will be rare. If you have something you'd like to include, simply send it to me (DSpaulding@SpauldingGrp.com).

PUZZLE TIME!

<u>March Puzzle</u>

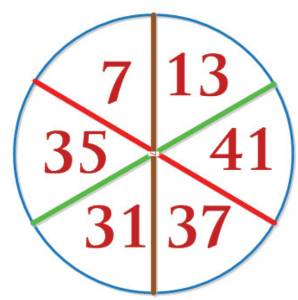
Last month's puzzle asked that you fill in the missing piece of the accompanying pie chart.



Two possible solutions were identified. The first is rather straightforward: you look at the numbers that are across from one another (7 and 37; 31 and 13); their sums are 44. Therefore, the missing number must be 9 (35 + 9 = 44).

A few folks got that right: Anthony Howland (UK), Greg Hiers (US), and Johan Jongejan (The Netherlands).

The second took a bit of imagination. My colleague, Jed Schneider (US) and friend, Larry Campbell (USA), solved it this way. Jed provided the logic:



- The difference between 7 and 13 is 6. The difference between 31 and 37 is 6.
- The difference between 7 and 35 is 28.
- The difference between 31 and 35 is 4.

If you plug 41 into the slice with the question mark, you come up with the same differences.

- The difference between 7 and 13 is 6. The difference between 31 and 37 is 6.
- The difference between 7 and 35 is 28. The difference between 13 and 41 is 28.
- The difference between 31 and 35 is 4. The difference between 37 and 41 is 4.

I think this is a highly creative approach, but it lacks consistency.

We're dealing with pairs of numbers:

- $13 - 7 = 37 - 31 = 6$: these numbers are opposite one another, where the brown line above is a common dividing line.
- $35 - 7 = 41 - 13 = 28$: these pairs are adjacent to one another
- $35 - 31 = 41 - 37 = 4$: again, these pairs are adjacent.

KEEP THOSE CARDS & LETTERS COMING

We appreciate the e-mails we receive regarding our newsletter. Mostly, we hear positive feedback while at other times, we hear opposition to what we suggest. That's fine. We can take it. And more important, we encourage the dialogue. We see this newsletter as one way to communicate ideas and want to hear your thoughts.

There is nothing that the three paired results (6, 28, 4) have in common; two involve adjacencies while one involves opposites. I'm impressed that two individuals came up with this, but I'd rule it being wrong…and, as the saying goes, two wrongs don't make a right. Sorry.

BUT, I'm open to being persuaded.

I "rule" that the correct answer is 9. Disagree? Have yet another solution? Chime in!

April Puzzle

We thank our friend Anthony Howland for offering this month's puzzle:

What is the next number in the series:

13 - 44 - 88 - 176 - 847 - ?

Anthony says "it's a tricky one," and we believe him.

Hint: if you're like me, you'll think you solved it and then hit a roadblock: don't despair...just step back and take another look.

THE SPAULDING GROUP'S 2013 INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
May 14-15, 2013	Fundamentals of Performance Measurement Training	Philadelphia, PA
May 15, 2013	Fundamentals of GIPS Workshop	Philadelphia, PA
May 16-17, 2013	PMAR XI	Philadelphia, PA
May 25, 2013	Performance Measurement For Non-Performance Professionals	San Francisco, CA (USA)
June 11-12, 2013	PMAR Europe IV	London, England
July 16-17, 2013	Fundamentals of Performance Measurement Training	San Francisco, CA (USA)
July 18-19, 2013	Performance Measurement Attribution Training	San Francisco, CA (USA)
July 23-24, 2013	Fundamentals of Performance Measurement Training	Sydney, Australia
July 25-26, 2013	Performance Measurement Attribution Training	Sydney, Australia
August 19-20, 2013	CIPM Principles Exam Preparation	Chicago, IL (USA)
August 21-23, 2013	CIPM Expert Exam Preparation	Chicago, IL (USA)
September 18, 2013	Portfolio Risk	Boston, MA (USA)
September 24-25, 2013	Fundamentals of Performance Measurement Training	Vancouver, BC, Canada
September 26-27, 2013	Performance Measurement Attribution Training	Vancouver, BC, Canada
October 22-23, 2013	Fundamentals of Performance Measurement Training	Chicago, IL (USA)
October 24-25, 2013	Performance Measurement Attribution Training	Chicago, IL (USA)
November 19-20, 2013	Fundamentals of Performance Measurement Training	Boston, MA (USA)
November 21-22, 2013	Performance Measurement Attribution Training	Boston, MA (USA)
December 10-11, 2013	Fundamentals of Performance Measurement Training	New Brunswick, NJ (USA)
December 12-13, 2013	Performance Measurement Attribution Training	New Brunswick, NJ (USA)

For additional information on any of our 2013 events, please contact Christopher Spaulding at 732-873-5700

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May 14-15, 2013 – Philadelphia, PA
July 16-17, 2013 – San Francisco, CA
Sept. 24-25, 2013 – Vancouver, BC, Canada
October 22-23, 2013 – Chicago, IL
November 19-20, 2013 – Boston, MA
December 10-11, 2013 – New Brunswick, NJ

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July 18-19, 2013 – San Francisco, CA
Sept. 26-27, 2013 – Vancouver, BC, Canada
October 24-25, 2013 – Chicago, IL
November 21-22, 2013 – Boston, MA
December 12-13, 2013 – New Brunswick, NJ

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This class is intended for investment professionals who would like to gain a better understanding of investment risk as it pertains to portfolio risk reporting, as well as it's use in predicting results.

Sept. 18, 2013 – Boston, MA

IN-HOUSE TRAINING

The Spaulding Group has offered in-house training to our clients since 1995. Beginning in 1998, we formalized our training, first with our Introduction to Performance Measurement class and later with our Performance Measurement Attribution class. We now also offer training for the CIPM program. To date, close to 3,000 individuals have participated in our training programs, with numbers increasing monthly.

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