Performance Perspectives

with Dave Spaulding

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Since 1990, The Spaulding Group has had an increasing presence in the money management industry. Unlike most consulting firms that support a variety of industries, we focus on the money management industry.

Our involvement with the industry isn't limited to consulting. We're actively involved as members of the Association for Investment Management & Research (AIMR), the New York Society of Security Analysts (NYSSA), and other industry groups. Our president and founder regularly speaks at and/or chairs industry conferences and is a frequent author and source of information to various industry publications.

Our clients appreciate our industry focus. We understand their business, their needs, and the opportunities to make them more efficient and competitive.

For additional information about The Spaulding Group and our services, please visit our web site or contact Chris Spaulding at CSpaulding@SpauldingGrp.com.

http://www.SpauldingGrp.com

Commenting on "Gold" GIPS

With this newsletter, we've included **a copy of my response** to the proposed revisions to GIPS®, known as "Gold" GIPS. While these changes will impact any firm that complies with GIPS or any of the CVGs (Country Versions of GIPS), its impact may be felt most by firms that comply with the AIMR-PPS®.

Now why do I say this? Well, for one thing because of the elimination of the ability to allocate cash when carving out segments from a balanced portfolio. While the effective date for this change has been moved from 1 January 2005 to 1 January 2010, it's still there. In my opinion, this ability should continue to be allowed (my letter goes into detail as to why I feel this way).

And while the provision to mandate verification starting in 2010 will obviously impact many firms, we have several clients who currently claim compliance with the AIMR-PPS, but haven't gotten verified. We know for a fact that some will give up their claim of compliance because they cannot justify this cost.

But while there are some items that I oppose, there are many that I enthusiastically support. Such as:

- the clarification of the requirement that firms provide compliant presentations to prospects
- the clarification of the requirement that firms be able to provide such presentations for any composite, even those that they don't market (often referred to as "non marketed composites")
- the elimination of the need to report total firm assets[1, 2]
- the requirement to calculate composite returns at least monthly[3]
- the requirement for written policies and procedures[4]
- that you need to comply with guidance statements and the information presented in the GIPS Handbook
- that you must have a list of composites to present to prospects[5]

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[1] I have jokingly said that when this requirement was added, it was because there must be a shortage of calculators, since if you know the amount of composite assets (a requirement) and the percentage that the composite represents of the total firm assets (a requirement), to figure out the total firm assets shouldn't be all that difficult.

[2] On page 34 of "Gold" GIPS you'll find a sample presentation that shows "total firm assets." This is a mistake. While you can still show it, if you do you should indicate that it's *supplemental* information.

[3] Since 2001, you've been required to calculate portfolio returns at least monthly, so this change shouldn't be a difficult one and should yield more accurate results.

[4] We have always encouraged our clients to have written policies and procedures. And when GIPS was introduced, there was a requirement for verifiers to review them, implying that firms had to have them. However, since the requirement wasn't clearly stated, one could interpret the standards as saying that you needed them if you were going to get verified, which wasn't the case. This clarification is needed.

[5] This is actually one of those funny items. There has been a requirement that you have the statement that "a list and description of composites is available upon request," but this doesn't actually say you have to have such a list. A technicality? YES! However, we've actually worked with firms that had the sentence in their materials but didn't have the list, so apparently this clarification is needed.

We are also including with this issue, **a link to a draft of the standards** , which I have highlighted to identify the changes. Please review it or an original copy (which you can get from the AIMR website) and determine what you like and what you don't. And, please comment! You only have until 1 August 2004, so *be heard!!!* These are critical changes and if you have an opinion, take the time to voice it. Thank you.

Wrap Fee Accounts

You may know that I teach a class with Herb Chain (Deloitte & Touche) and Matt Forstenhausler (Ernst & Young) for AIMR – a one-day workshop on the standards. We just taught a class in Philadelphia and some questions were raised about wrap fee accounts which probably warrant comment here.

The standards are, in my opinion, pretty clear: "All actual fee-paying discretionary portfolios must be included in at least one composite." Is a wrap fee portfolio fee paying and discretionary? I think so. So, you've got to include it.

The challenge has been that many wrap fee sponsors don't provide their managers with the requisite details to satisfy this rule. And, for many, the cost to shadow portfolios is cost prohibitive.

The AIMR-PPS Implementation Committee is reviewing these rules, but the rules are still as they've always been.

So, what does this mean for a firm that has wrap fee portfolios but not the ability to include them in a composite? Today, you have two choices: define the firm as everything *except* the wrap fee business or not comply. I'm sorry, but that's the way it is today.

Do firms that have wrap fee portfolios but not all of them in composites claim compliance today? Yes. Absolutely. But if we were their verifiers we'd caution them that technically they aren't compliant.

I cannot comment on the state of the discussions of the implementation committee. As soon as I have something I'm able to report, I will.

Selecting a verifier

Even though I oppose mandatory verification, I support and encourage firms to become verified. But selecting a qualified and appropriate verifier requires due diligence.

Again, in Philadelphia this month we encountered two situations where verifiers had given what can only be called "bad advise."

In one case, the verifier told their client that they didn't have to be concerned about their lack of records for the wrap fee portfolios. WRONG! As noted above, you do have to be concerned. At least be aware of the situation. But to hear "don't worry about them" is not the kind of advise I'd expect to hear.

And the second case involved a manager who was told they could define their firm *by product*. Again, wrong! This doesn't qualify as an acceptable method. A multi-product firm can't select those products they want to market and define themselves by that approach.

Performance Measurement – a *growth* or *mature* market?

We just held a roundtable discussion with the cosponsors for our upcoming *Technology Supplement* to *The Journal of Performance Measurement*®. It was an excellent session and a discussion I'm sure you'll want to read.

One item we discussed was whether this market can be viewed as one of *growth* or whether we should consider it *mature*. The *marketing life cycle* defines various stages of product development, and these are two of them.

The group we assembled had no doubt about it – this is a growth market. Characteristics of such a market include fairly easy entry for new players, dynamic product development and change, along with mergers and acquisitions. And that's what we're seeing.

We recently began working with a software vendor who is planning to expand their product to include performance measurement capabilities and have heard from at least one other who is planning to do the same thing.

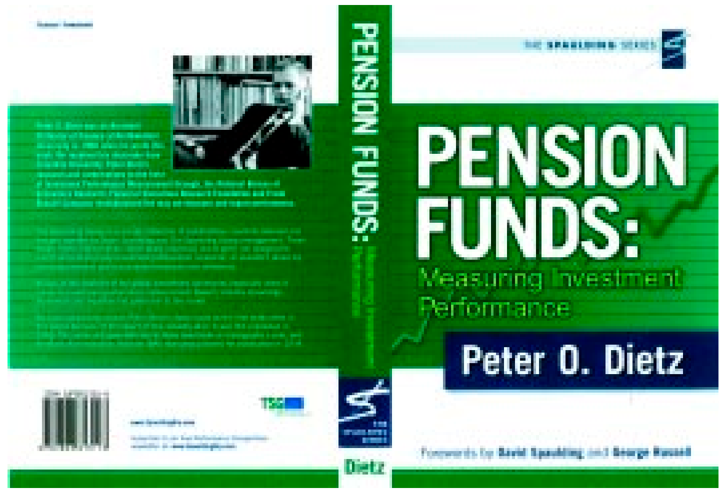
What does this mean for the consumer? Well, first of all it means *more to choose from*. It also means that the changes will continue.

Gary Brinson, *et al* said in their famous *FAJ* article: "Performance attribution while not new is still an evolving discipline,"[6] and I've suggested that we could also say: "performance measurement while not new is still an evolving discipline". The labeling of the market as one of growth only suggests that the evolution continues.

[6] Brinson, Gary P., L. Randolph Hood, and Gilbert L. Beebower, "Determinants of Portfolio Performance," *Financial Analysts Journal,* July/August 1986, page 36.

Dietz book is coming!

I'm pleased to report that our rewrite of Peter Dietz's 1966 classic is about to be ready for shipment. We've already received many orders for it. This reprinting effort has taken a great deal more time and effort than we expected. The fact that the entire book had to be transcribed (i.e., typed manually) was only one of the challenges we faced. But our goal will soon be achieved.



Our graphic designer did a fantastic job designing the cover. And we're looking forward to her involvement with our next publishing effort: the 1968 BAI Standards. Stay tuned!

This newsletter is produced by TSG Publications. It is written and edited by Dave Spaulding. The opinions expressed are his and are a result of his own industry experience.

UPCOMING TRAINING DATES

INTRODUCTION TO PERFORMANCE MEASUREMENT

LOCATION	DATES
Chicago, IL	April 19 - 20, 2004
San Francisco, CA	May 4 - 5, 2004
Cape Town, ZA	July 19 - 20, 2004
Johannesburg, ZA	July 27 - 28, 2004
New York, NY	September 20 - 21, 2004
Boston, MA	October 4 - 5, 2004
Los Angeles, CA	October 18 - 19, 2004

Receive 15 CPE Credits for attending this Two-day class!

PERFORMANCE MEASUREMENT ATTRIBUTION

LOCATION	DATES
Chicago, IL	April 21 - 22, 2004
Cape Town, ZA	July 21 - 22, 2004
New York, NY	September 22 - 23, 2004
Boston, MA	October 6 - 7, 2004
Los Angeles, CA	October 20 - 21, 2004

Receive 11 CPE Credits for attending this One and a Half day class!

Gold GIPS®

LOCATION	DATES
Cape Town, ZA	July 23, 2004

These programs may qualify for AIMR Professional Development credit. If you are an AIMR member, please refer to the AIMR Web site to determine whether this program meets the criteria for AIMR PDP credit, to calculate credit hours, and to verify documentation requirements.
(www.aimr.org/memservices/continuinged/ceprogram)

2004
Performance Measurement Forum Schedule

San Francisco, CA	**May 6 - 7, 2004**
Edinburgh, Scotland	**June 9 - 10, 2004**
Madrid, Spain	**November 10 - 11, 2004**
Orlando, FL	**December 9 - 10, 2004**