# Performance Perspectives

## with Dave Spaulding

Volume 1- Issue 5
January 2004


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

**A New Year with lots to look forward to**

Happy New Year! We sincerely hope that you had a great holiday and that the new year is starting off well for you. Last year was better for our firm than the prior two, and we hope that this trend continues.

**Gold GIPS – what you don't know may hurt you!**

This year will be a significant one for our industry with the introduction of Gold GIPS®. If you're compliant with the AIMR-PPS® or some other local presentation standard, you may question why you even care about GIPS. Well, let me take a moment right now to clarify a few things.

**You may think that because you've been compliant with the AIMR-PPS for several years that you don't have to pay much attention to GIPS and Gold GIPS.**
**You're wrong!**

A lot of U.S.-based firms are under the impression that the AIMR-PPS and GIPS are two, fairly distinct and independent sets of standards, and that compliance with the AIMR-PPS is adequate. Our last two performance presentation standard surveys both showed a number of firms claiming compliance with the AIMR-PPS, but showing absolutely no interest in GIPS. And, we found many plan sponsors and investment consultants who hadn't even heard of GIPS.

While the AIMR standards were the first set of performance presentation standards, GIPS has taken over and are now the universally accepted standard. The AIMR standards are actually a *country version of GIPS* (or CVG) for both the U.S. and Canada. If you look at the most recent version of the AIMR-PPS (dated 2002), you'll see that GIPS is at the *core* of these standards. While the AIMR standards have had items that weren't originally included in GIPS (e.g., standards for advertising, private placements, real estate) and require 10 years of records rather than the five of GIPS, GIPS is still the basis for the standards. And, (this is important) any change which is made to GIPS must automatically be included within the AIMR-PPS. Oh, and if you comply with the AIMR-PPS, then you automatically comply with GIPS!

Over the past couple of years, GIPS has adopted (or is adopting) some additional requirements, including standards for private placements, real estate, fees, and advertising. These will supplant what the AIMR-PPS has previously had.

The U.S. and Canada aren't the only countries with local standards or CVGs. Ireland, the UK, and Switzerland are just three of the countries which have adopted them. In addition, there are *translated versions of GIPS* which essentially take GIPS as they are, but translate them into the local language (e.g., Polish for Poland and German for Austria).

CVGs are essentially GIPS, plus some additional requirements, which may result from past practices (e.g., the AIMR-PPS requirement for 10 years of records, dating back to their inception) or local regulatory rules.

The global standards have evolved a bit since the concept first arose several years ago. The goal today is for a firm that complies with GIPS to be able to compete in any market, even where there is a CVG. For example, if an Australian money manager wishes to compete in the UK (where there CVG is the UK-IPS), even though that manager may not comply with the CVG, its mere compliance with GIPS is supposed to allow that manager to compete with those local firms that do comply with the CVG. I don't know if anyone knows how successful this has been so far; I'm aware that some firms have been turned away because they didn't comply with the CVG, which is obviously a right of the consumer. In other words, it's probably not working exactly as we intend. However, the ultimate goal is for a GIPS-compliant firm to be given a fair opportunity to compete. And Gold GIPS will help.

So, what is this thing called Gold GIPS and why should you care about it?

Gold GIPS is the first attempt to significantly reduce the differences between GIPS and the CVGs. Ultimately, we would like to see no CVGs, just GIPS. But this may take some time. The first step will be to make some pretty broad changes to GIPS will reduce the differences.

Gold GIPS is scheduled to be published towards the end of February. It will be available for several months for public comment. It is critical that you become familiar with this new version and the changes that are planned. They very well may impact the way you operate.

Even though I'm a member of the Investment Performance Council (which oversees GIPS) and am privy to what's going to be included, I am not yet at liberty to discuss any of these proposed changes. They need to be reviewed by the AIMR Board of Governors before they're presented to the public. After the proposed revised standards are released, we will share with you some of the key changes as well as our opinions about them.

You may think that because you've been compliant with the AIMR-PPS for several years that you don't have to pay much attention to GIPS and Gold GIPS. Perish the thought. To (a) insure that you continue to be compliant and (b) that you're comfortable with the proposed changes, you must pay attention. You must get involved. You must invest your time into this. These revisions are extremely significant and you can't ignore them. Trust me, it is worth your time to read through them. We will do our best to highlight the proposed changes so you can assess how they will/ may impact you.

**Treatment of Large Cash Flows**

One of the changes that was made to GIPS fairly recently was the provision to allow managers to temporary remove portfolios from composites in the event of large cash flows. This is a battle which I have waged for quite some time, along with a few of my industry associates. Fortunately, we were able to get the idea accepted and the standards changed.

Previously, you had to keep the portfolios in the composite. Or, you could avail yourself of a *temporary new account,* which is a very difficult thing to implement. The reality is that many managers did remove portfolios temporarily if large flows occurred (and, some verifiers allowed this to happen), in spite of AIMR's firm and clear disallowance of it.

Temporary removal makes sense. If a client drops a large amount of cash into her portfolio, it may take you time to invest it. In the interim, you've got a return which has been impacted by an event (the contribution) which you don't control. Since you're allowed a delay to get a new client invested before moving it into a composite, why wouldn't you be allowed to do the same for a client that just gave you a large contribution (or, is asking for a large withdrawal)?

Well, now it's permissible. You need to establish a *documented* policy on what percentage of a flow (relative to the portfolio market value) would warrant the removal of a portfolio (e.g., 25%) and how long the portfolio would be out (e.g., 2 months). Because of volatility / liquidity differences between markets, you can have different rules for different composites. But, you need to disclose this information and keep track of when portfolios are removed.

What if you were one of those firms that had been doing this all along (temporarily removing portfolios from composites when large flows occurred)? Well, you get amnesty. You don't have to go back and put the portfolios back in.

But, what if you were a firm that didn't remove the portfolio because you knew it wasn't permitted, but want to go back now and retroactively apply this rule. Sorry, you can't do it. Only going forward. The logic is that firms that would go back would be those that would benefit from the change, so rather than risk this happening, it's simply not permitted.
The effective date for this change is 30 June 2002. Think about how this might benefit you.

TSG Publishing, Inc.

**A new publishing venture**

In 1990 when I started our firm, I had no expectation whatsoever that we'd be doing any publishing. Well, with *The Journal of Performance Measurement®* now in its eighth year, and the publication of the first guide to the presentation standards, a formula reference guide, and numerous surveys, I guess we can be excused for considering ourselves publishers (along with a host of other things).

A pet project of ours for quite some time has been to republish Peter Dietz's classic book, <u>Pension Funds: Measuring Investment Performance</u>. If you don't know, this book was the foundation for the Bank Administration Institute's (BAI) 1968 performance standards, which subsequently led to the publication of the Investment Council Association of America's standards, as well as other standards on performance measurement. Peter's book has been out of print for many years. And we felt that this book is an important, fundamental, and foundational part of our industry and how we measure performance today. So, we wanted to republish it.

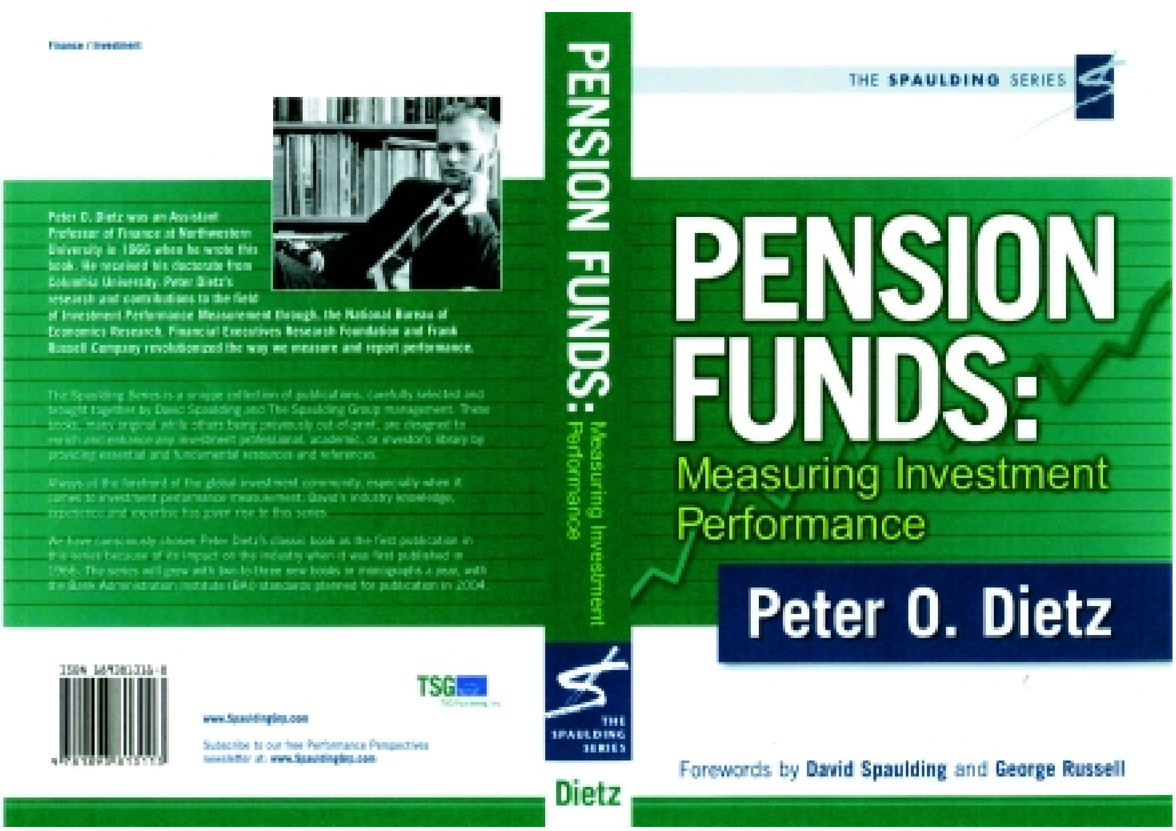
It literally took us a few years to track down who had the rights to the book, since the original publisher (Free Press, which at the time was a division of MacMillian Company) had been acquired and we had to figure out *by whom*. Once we did that, finding out who to speak with wasn't trivial, But, we eventually succeeded and obtained the exclusive rights to republish it.

The next challenge was to get the copy set. This was quite an undertaking. Because the book was so old, no film existed. We tried to do the transcription in-house, but that proved to be more difficult and time consuming then we expected. So, we found an outside party to do it for us. But, she took a lot longer than we anticipated. But, we are coming closer to the point where we can turn the book over to our printer. We expect the book to be available in April.

But, this is only one book we want to publish or republish. We have recently obtained the rights to republish the BAI standards. This will be a 3rd/4th quarter project for us.

We plan to publish two-to-three books a year, all dealing with investment performance. Some, like the Dietz and BAI books, will be the republishing of out-of-print books. Others will be brand new.

If you have any ideas or suggestions regarding this publishing effort, please let us know.



# UPCOMING TRAINING DATES

## INTRODUCTION TO PERFORMANCE MEASUREMENT

| | |
|---|---|
| **New York, NY** | **February 10 - 11, 2004** |
| **London, England** | **Fedbruary 23 - 24, 2004** |
| **Chicago, IL** | **April 19 - 20, 2004** |
| **San Francisco, CA** | **May 4 - 5, 2004** |

*Receive 15 CPE Credits for attending this two-day class.*

## PERFORMANCE MEASUREMENT ATTRIBUTION

| | |
|---|---|
| **New York, NY** | **February 12 - 13, 2004** |
| **London, England** | **Fedbruary 25 - 26, 2004** |
| **Chicago, IL** | **April 21 - 22, 2004** |

*Receive 11 CPE Credits for attending this two-day class.*

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 these programs meet the criteria for AIMR PDP credit, to calculate credit hours, and to verify documentation requirements. (www.aimr.org/pdprogram)

## 2004 PERFORMANCE MEASUREMENT FORUM

| | |
|---|---|
| **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** |