

GIPS 2010: GIPS® get a face lift

Dear Reader,

In this issue of GIPS News, we would like to bring to your attention the latest adopted changes to the GIPS Standards. In our interview with Mr. Colin Morrison, we gain additional insight into the recent GIPS development process and the future direction in the years ahead.

Furthermore, we throw the spotlight on the GIPS “operating model” framework, which calls for strategic considerations by many investment managers, not only during the stage of GIPS implementation but also during ongoing compliance with the Standards. The GIPS operating model is a multifaceted, multidisciplinary framework, comprising people, processes and technology. To protect themselves from unpleasant surprises in terms of risk and reputation associated with supplying inaccurate or misleading investment performance data, firms need to clearly identify in advance and take into account various business-related issues.

Hedge funds, which continue to increase in number and even in their ability to affect influence in the corporate boardroom, increasingly need to rely on sound investment reporting practices in order to regain the trust of investors in the aftermath of the crisis. Achieving and maintaining GIPS compliance represents an opportunity to possess a competitive advantage in the marketplace.

We hope and trust that you will enjoy reading this issue of GIPS News.

Susanne Klemm

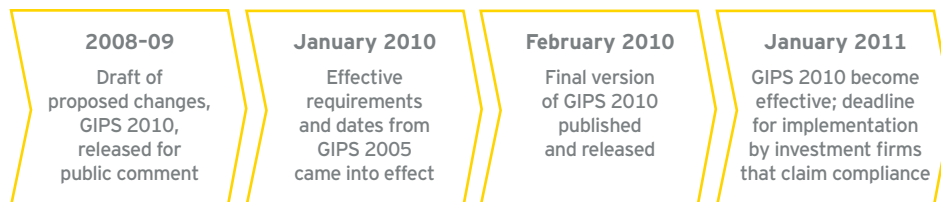
Head of Investment Performance Services, Switzerland
susanne.klemm@ch.ey.com

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The GIPS 2010 timeline



Key changes and enhancements to GIPS – the GIPS 2010

Eugene Skrynnik, eugene.skrynnik@ch.ey.com; **Susanne Klemm**, susanne.klemm@ch.ey.com



Eugene Skrynnik



Susanne Klemm

Before delving into the strategic considerations related to GIPS for investment firms, we first present a summary of the eight key changes to the existing GIPS standards in GIPS 2010:

1. *Fair value methodology is established:* Assets will have to be valued using a fair value methodology when no market value is available. GIPS 2010 provide new valuation principles, recommend a valuation hierarchy, require firms to disclose whether a firm's valuation policy and hierarchy materially differs from GIPS requirements, and disclose the availability of valuation policies and procedures upon request.
2. *The importance of risk comes of age:* Firms will be required to present the (three-year annualized ex-post) standard deviation of the monthly returns of both the composite and the benchmark, and to show an additional (three-year ex-post) risk measure if the firm determines that the standard deviation is not a relevant or appropriate risk measure.

3. *Compliance statement with verification status disclosure:* As part of the GIPS compliance statement, disclosure of the verification status (i.e., whether a firm has been verified) and prescribed details of what verification covers, will be required.
4. *Increased understanding and consistency of GIPS verification:* The scope and purpose of verification, as well as the required verification procedures that have to be followed by verifiers, have been clarified.
5. *More frequent external valuation of real estate:* For periods starting 1 January 2012, real estate investments must be valued by an independent external valuer or appraiser at least once a year unless client agreements stipulate otherwise (in which case an external valuation has to be performed at least once every three years).
6. *Specific requirements for real estate closed-end funds as well as new disclosure and presentation provisions for private equity fund of funds.* Important

to highlight is that on the private equity side, composite construction and calculation methodology requirements got updated. All private equity primary funds will have to be included in a composite defined by vintage year *and* investment mandate, objective or strategy, while fund-of-funds will have to be included in a composite defined by fund-of-funds vintage year *and/or* investment mandate, objective or strategy. Further, firms will need to calculate annualized Since Inception Internal Rates of Return (SI-IRR) of private equity investments using daily cash flows (rather than monthly cash flows).

7. *New (but already known) provisions came into force on 1 January 2010:* Investment firms have to:
 - ▶ *Value portfolios* as of (calendar) month-end (or the last business day of the month) and on the date of all large cash flows ("large" defined on a composite-specific basis). GIPS 2010 explicitly require not to deviate from this policy and prohibit revaluing portfolios if cash flows do not meet the definition of large
 - ▶ *Calculate composite returns* by asset weighting the individual portfolio returns at least monthly
 - ▶ *Not include carve-outs* in a composite unless the carve-outs are actually managed separately with their own cash balances
 - ▶ *Disclose error corrections* due to a correction of a material error and any changes to a compliant presentation that has been provided to prospective clients; the Error Correction Guidance Statement applies
8. *The text and language of GIPS 2010 are simplified, clarified and made consistent throughout the provisions.*

For a more detailed overview of the changes to provisions 0. to 5. of the GIPS Standards, please refer to the Appendix.

The winding road to GIPS 2010 and continued development of the Standards

An interview with Mr. Colin Morrison

Matt Price, matt.price@uk.ey.com



The GIPS 2010 process seems to have been a bit of a marathon. From your perspective, how has the race been run and won?

Unlike previous releases, the more significant changes for 2010 had been flagged well in advance, indeed some as far back as 2005, which gave firms ample time to prepare. Maybe this contributed to the notion of a marathon journey. Running and winning the race was down to volunteers: it is difficult to underestimate the importance of people in the process, whether these are members of the sub-committees, working parties, Executive Committee or CFA Institute's staff. Above all else though it is the unprecedented numbers who provided well-argued and objective feedback during the consultation period that allowed GIPS 2010 to be well balanced and correctly positioned.

What was your particular highlight?

Without doubt the risk provisions. While in no way downplaying some of the other significant developments, extending the Standards into the area of risk was both natural and necessary. There was considerable debate within the industry as to whether the Standards should encompass risk – witness the range of opinions expressed during the consultation period. From my perspective, all but a very small minority will agree that risk and return are inexorably linked – trying to make sense of an investment strategy using one without the other is both inconceivable and ill-advised.

If I was able to select another but more general highlight, it would be recognition in the growth and prominence of the alternatives market, most notably the hedge fund industry. Throughout all the deliberations and decision-making on GIPS 2010, we were very conscious of the differing practices and behaviors of the hedge fund world, so we took great pains to ensure that the language, provisions and recommendations were consistent and workable for the hedge fund industry.

Those efforts complement the initiative to issue a full Guidance Statement on Alternative Assets in the near future, which a separate sub-committee has been working to develop over a number of years.

Any regrets or disappointments?

Initially yes, in that to my mind the risk provisions contained in the original 2010 draft did not go far enough. Remember that the Standards were developed for the asset owner, so it was difficult to see how a single risk figure at a single point in time would have provided investment strategy insight and transparency when up against a barrage of performance returns. Through lobbying and some less gentle persuasion, I am glad to say that sense prevailed, and the final version requires and recommends a range of measures designed to provide the prospective client with a rounded view of the derivation and quantification of the risks inherent in the strategy behind those returns.

While neither regret nor disappointment, perhaps the strongest emotion currently is one of foreboding in that having completed GIPS 2010, there is the colossal task of reviewing every existing Guidance Statement to ensure it is consistent with the current version of the Standards. With over twenty in existence, this will probably need a great deal of tenacity to test every statement to ensure none contradicts, and each is consistent with the Standards. On the subject of Guidance

Statements, it is worth mentioning that there is recognition (either through changed market practices or broader industry developments) that some guidance will require more radical overhaul. One of the most pressing needs is to have fuller and more complete guidance on acquisitions and mergers where the complexity of the corporate event can give rise to myriad questions as to how a firm handles and treats the many underlying moving parts.

What do you think will be the primary challenges (if any) of implementation for GIPS-compliant managers?

We have spoken about the well-flagged changes to the Standards for 2010, so it would surprise me if, having been given several years advance warning of the more significant changes, that firms were caught off guard by this. Most gratefully accepted the lead-in time, so should have prepared themselves well in advance. And while the devil is often in the details, I doubt any firm will find the challenges insurmountable – indeed that is neither the purpose nor intent of the Standards.



Name	Colin Morrison
Job Title	Director
Company	Paradigm Investment Consulting Limited
E-mail	colinmorrison@paradigm-icl.co.uk
Current Industry Representation	
▶ Member of GIPS Executive Committee	
▶ Chair of Investor Consultant Sub-Committee	
▶ Co-Chair of CFA Institute Alternative Investment Strategy Working Group	
▶ Co-Chair of CFA Institute Risk Working Group	
▶ Member of UK and European Investment Performance Councils	
▶ Member of IMA Investment Performance Working Party	

One of the challenges I see lies not with the firm but with the verifiers who are being asked to test the policies and procedures behind a firm's claim of GIPS compliance. As markets, strategies and products evolve, so too will the Standards which will drive change in the skill set requirement of verifier staff away from the traditional audit background much more toward those with industry practitioner knowledge and experience.

What will be the direction and focus of new GIPS guidance for the coming years, and are there any battle lines already drawn for 2015 GIPS?

GIPS 2010 is without doubt the most technical version of the Standards to date, and I can only see this increasing in the future to match product innovation and broader market developments, the Standards and supporting Guidance Statements must fully reflect how firms administer, manage and present their products and strategies. To get some idea as where the Standards are going, one only has to look at the strategic plan: Guidance Statements on alternatives and risk, creation of a working party on best practices for reporting to existing clients, and finally a working party on the measurement of portfolio transitions.

One further area to consider: retail investors. While there is nothing in the Standards that precludes retail investors or retail-oriented investment houses, there probably needs to be some interpretational guidance that recognizes the different behaviors, habits and investment objectives of that segment of the market.

What do you see as the most important challenges facing asset management industry today, and how is GIPS relevant to the brave new world?

Anyone brave enough to stick their head above the parapet will still be trying to see what the brave new world looks like. Last year's dark mutterings from regulators broadly speaking still have to crystallize into fact – noble talk of product transparency in place of its greedy predecessor "opaque sophistication" still has to be evidenced. Regulators regulate but most also recognize that regulation is not always the complete answer, so voluntary but widely adopted industry best practices and Standards such as GIPS have an important and valuable place within that framework.

Ernst & Young would like to thank Mr. Morrison for this interview.

New GIPS logo for GIPS-compliant firms

Susanne Klemm, susanne.klemm@ch.ey.com

During its meeting in Lisbon, Portugal, on 19 March 2010, the GIPS Executive Committee announced the completion of the GIPS logo by the CFA Institute.

The GIPS logo is a visual representation indicating that a firm claims compliance with the GIPS standards. To use the logo, firms must be in compliance with the GIPS standards and may only present it in a GIPS-compliant presentation or in an advertisement that adheres to the GIPS Advertising Guidelines.

Firms that wish to use the GIPS logo must email the CFA Institute (at standards@cfainstitute.org) the following information:

- ▶ Firm name, address, phone number and website



Global Investment Performance Standards

- ▶ Name, phone number and email address of contact at the firm
- ▶ Whether the firm claims compliance with the GIPS Standards
- ▶ If the firm has been verified; and if yes, by which verification firm

Once this information is received by the CFA Institute, a confirmation email will be provided together with the GIPS logo. The logo can be viewed as an additional service from the CFA Institute and is not required as part of compliance with GIPS. The use of the logo is free of charge. Additional information is available at www.gipsstandards.org.

Strategic considerations for investment management firms

Eugene Skrynnik, eugene.skrynnik@ch.ey.com

It is important to consider the content of GIPS 2010 as a driver for some necessary adjustments and implementations in an existing GIPS operating framework. The above key changes indicate that firms will need to review their policies and procedures (including internal controls), composite constructions, performance measurement, and composite presentations and disclosures, to name the least. Compliant presentations that include performance results for periods beginning on or after 1 January 2011 will have to be prepared in accordance with GIPS 2010. Furthermore, compliant firms must consider all respective Guidance Statements and Q&As,¹ which will also

undergo changes throughout 2010, and not just the Standards themselves.

GIPS 2010 create enhanced opportunity for investment managers to compare their investment performance, strengthen their investment processes and controls, and provide more transparency to investors. Of course, there is the cost benefit analysis associated with GIPS, which essentially boils down to the question of direct cost – how easily a firm will be able to gather relevant portfolio information and data, and coordinate resources to construct and maintain this information in a GIPS-compliant manner.

¹ Further information available at the GIPS Standards Website at <http://www.gipsstandards.org/standards/index.html>

In the current market environment, many investment managers and senior executives understand the risks associated with supplying inaccurate or misleading investment performance data and the significance of investment performance reporting standards. However, a number of firms still fail to address the risks, and more importantly, to understand the overall, detailed processes involved in the investment performance reporting framework, as well as the extent of potential reputational and operational risks as a result of inefficient and inaccurate processes and unreliable performance reporting. The dilemma here is often that investment reporting issues fail to make their way to the top of an investment firm until there is a major problem. How should firms go about building an efficient business operating model in line with the GIPS framework as well as improving the overall risk management? Firms are first advised to address investment performance reporting proactively from both a bottom-up and a top-down perspective. Adopting compliance with GIPS and sustaining it over the long term

is feasible by creating an efficient and effective operating model with senior management buy-in, participation and oversight. Firms then have to create a consistent, firm-wide investment performance reporting operating model supported by the right processes, people and up-to-date technology.

Formal procedures are needed to serve as building blocks for an operational and internal control framework, under which various functional departments can work together on an end-to-end basis to drive data collection, data maintenance and correction, composite management, calculation of performance and assets under management, performance reporting and analysis, and record retention. Ideally, an effective compliance program for investment performance reporting standards should encompass the entire end-to-end process and include policies and procedures, internal controls, and information technology to support the calculation of performance figures and assets under management, composite maintenance, performance reporting and disclosure,

policy and procedure updates, and record retention.

GIPS compliance is also a process that needs key stakeholders to be involved. Frequently, we see that minimal communication exists among marketing, legal, operations and information technology departments, as well as up and down the management chain. Therefore, firms must create clear communication channels and protocols and allocate human capital sufficiently to be able to detect problem areas and to ensure that the processes and technology in place run smoothly. In order to sustain continued GIPS compliance, firms need effective management and oversight of the investment performance reporting infrastructure to ensure that all aspects of the performance measurement and presentation process are harmonized and standardized. This is possible when all functional groups involved in the process understand and adhere to the Standards and assume responsibility for better information data management, improved internal controls and increased efficiency.²

Challenges of the GIPS Standards:

- ▶ Allocating new accounts/portfolios to appropriate investment strategies and composites
- ▶ Aligning and coordinating the performance reporting and disclosure functions across disparate operational, legal, compliance, sales and marketing divisions
- ▶ Operational and IT challenges related to the maintenance and management of data, records, reports across multiple tools, systems and spreadsheet technologies, as well as the accuracy and timeliness of performance reporting
- ▶ Inadequate technologies, non-automated and fragmented processes, and missing controls
- ▶ Poor governance structure and weak internal communication
- ▶ Need for continued senior management buy-in and support

Potential Benefits of the GIPS Standards:³

- ▶ Enhanced ability to compare performance between investment firms and strategies
- ▶ Consistency in calculation and presentation of performance results, such as frequency of valuation, treatment of large cash flows and handling of accruals, thus preventing cherry picking of an investment manager's best-performing accounts
- ▶ Full disclosure of important details on performance data, such as fees, composite investment strategy, dispersion of returns, etc.
- ▶ Firms recognized for adherence to industry leading practice
- ▶ Strengthened internal processes and controls, improved risk management

Who can benefit from the GIPS Standards:

- ▶ Investors:
 - ▶ Plan sponsors, institutional
 - ▶ High-net-worth investors
 - ▶ Retail investors
- ▶ Investment managers:
 - ▶ Including equity, fixed income, hedge fund, private equity, and real estate investment management firms
- ▶ Intermediaries:
 - ▶ Consultants
 - ▶ Family offices
 - ▶ Regulators

² *Investment performance reporting: from obligation to differentiator*, Financial Services, Ernst & Young, August 2008.

³ *GIPS Standards Today 2010*, CFA Institute, March 2010

GIPS 2010: An opportunity or an obligation for hedge funds and alternative investments firms?

Eugene Skrynnik, eugene.skrynnik@ch.ey.com

In the eyes of some managers and executives in the hedge funds and alternative investments business, GIPS are not applicable to their firms. However, this impression is now outdated. On the one side, GIPS already cover alternative investment instruments, including real estate, private equity and venture capital, while a GIPS Guidance Statement dedicated to alternative assets is scheduled for publication in the second half of this year. On the other side, the industry view on this debate is changing compared to some years ago. For example, a Glass Hammer/Stone House Consulting survey of buy-side industry trends in October 2009 found that two-thirds of survey respondents expected compliance with GIPS to come for hedge funds in the next few years. Furthermore, industry associations and working groups, including the UK Hedge Fund Standards Board and the President's Working Group on Financial Markets in the US, actively call on hedge fund managers to comply with GIPS.

At this stage, those hedge funds and alternative investments firms not compliant with GIPS should analyze their operational investment reporting set-up and be prepared for the developments ahead. Today, most investors expect firms to be GIPS compliant and rely on firms to report performance that is both accurate and verified. In this context, it is important to consider the following strategic aspects⁶ as to why GIPS is increasingly important to hedge fund and alternative investments firms and their investors:

- ▶ **Transparency:** The key benefit, as always, is for clients and investors of the investment firm; the Standards require key product data and disclosures to be provided to these parties in a comparable format. More importantly, the demand and pressure from the client/investor side have come to life.
- ▶ **Improved view of the firm's track record:** Many hedge fund managers have started managing separate accounts. GIPS-compliant managers would have one or more composites reflecting the track record of the separate accounts that are managed. Current and potential investors could compare performance results between the hedge fund and any separate accounts following the same strategy.
- ▶ **Reputation:** GIPS compliance provides credibility to the performance track record of the firm.

- ▶ **Due diligence:** GIPS-compliant hedge fund managers have adopted many best-practice processes and procedures that can reduce operational risk.
- ▶ **Consistency:** The GIPS ensure that the same standard of care is applied to the selection and review of alternative investment managers as that applied to traditional investment managers.
- ▶ **Flexibility:** GIPS are accepted and recognized in most regulatory environments around the world. Further, the option of GIPS compliance as a global GIPS firm as well as the marketing and selling of products across geographical boundaries (the primary benefit of global firm compliance) exists.⁷

While firms are not obliged to adopt GIPS (the Standards are voluntary), the transparency these standards provide can mean the difference in a firm's ability to compete effectively for investor capital. GIPS are widely recognized as an industry best practice, add credibility to performance presentations and provide client confidence in investment firms. Given today's increased emphasis on operational, market and regulatory risks, clients and investors are demanding more robust risk and governance practices from their asset managers (please refer to a recent survey of Ernst & Young Switzerland).⁸ As investors flock more toward alternative investment options, they will increasingly require more standardization and reliability from firms' presentations when evaluating their offerings.

Hedge fund and alternative investment managers, including private equity, stand to benefit from GIPS 2010. In particular, hedge funds, which continue to increase in number, will increasingly need to rely on sound investment-reporting practices in order to gain the trust of new investors. Achieving and maintaining GIPS compliance represents an opportunity to possess a competitive advantage in the marketplace. By placing investment performance reporting at the forefront of

their operating model, and maintaining the proper people, policies, processes and technology to maintain it, firms can be positioned to capture further growth in an evolving and challenging market environment. It is, therefore, highly advised that the non-compliant firms proactively analyze their current situation and adjust their operating model in the most efficient way necessary. We expect the number of hedge funds and alternative investment managers utilizing GIPS to increase further over the next five years.

Conclusion

Firms that achieve and maintain an efficient and effective investment performance reporting framework can differentiate themselves from competitors. GIPS 2010 is a core component of such a framework – a set of standards that can help firms either improve or establish a competitive advantage by developing stronger operational and technological infrastructure, devising streamlined processes and training people to support accurate and timely investment-performance reporting. Those that adopt the right processes, can go to market with a higher level of confidence that their performance data is accurate and that customers and investors rely on it.

As investment managers continue to leverage new and more complex investment products and hedge fund strategies to increase assets under management, their ability to compete and effectively market such products has a direct correlation with the reliability and accuracy with which they report the investment performance of these, and all, vehicles to investors. Among other important criteria, investment managers will primarily differentiate themselves in the future on their quality of service – investment process, experience and qualifications, track record and reputation.⁹ Success will particularly lie with the strength of reputation and reliability of investment performance data and reporting processes.

⁶ Some aspects taken from *GIPS Standards Today 2010*, CFA Institute, March 2010

⁷ *GIPS compliance as a global firm: the turbulent rise of the global project*, GIPS® news, Ernst & Young, September 2008

⁸ *Asset Management Industry in Switzerland Survey – Future Trends and Developments*, Ernst & Young, February 2010

⁹ *Asset Management Industry in Switzerland Survey – Future Trends and Developments*, Ernst & Young, February 2010

Appendix – GIPS 2010: Overview of key changes to GIPS provisions 0. to 5.¹

The GIPS 2010 edition can be downloaded at www.gipsstandards.org

Susanne Klemm, susanne.klemm@ch.ey.com

Legend:

Underlined text: new additions

Text in italics: interpretations and remarks

GIPS provisions	New provisions	Revised provisions	Recommendations (new and/or revised)
Effective date 1 January 2011: Compliant presentations that include performance results for periods that begin on or after 1.1.2011 must be presented in accordance with the 2010 edition of the GIPS standards. <i>Early adoption is encouraged; selective adoption of GIPS 2010 requirements is possible. Requirements of GIPS 2005 may not be abandoned before adopting all requirements of GIPS 2010.</i> ²			
Fundamentals of Compliance (0.)	<ul style="list-style-type: none"> ▶ Firms must comply with all applicable laws and regulations regarding the calculation and presentation of performance (0.A.2). ▶ Firms must not present performance or performance-related information that is false or misleading (0.A.3). <p><i>These requirements were implicit in GIPS 2005.</i></p>	<ul style="list-style-type: none"> ▶ Firms must document their policies and procedures used in establishing and maintaining compliance with the GIPS standards, <u>including ensuring the existence and ownership of client assets</u>, and must apply them consistently (0.A.5). ▶ Firms must provide a complete list of composite <u>descriptions</u> to any prospective client that makes such a request. Firms must include terminated composites on the firm's list of composite descriptions for at least five years after the composite termination date. (0.A.10). <i>Firms cannot present a list of only composite names without including the composite descriptions.</i> ▶ Total Firm assets must be the aggregate <u>fair</u> value of all discretionary and non-discretionary assets <u>managed</u> by the Firm. This includes both fee-paying and non-fee-paying portfolios (0.A.13). <i>Change from "market" value to "fair" value and from assets "within" the defined Firm to assets "managed."</i> 	<ul style="list-style-type: none"> ▶ Firms should provide to each existing client, on an annual basis, a compliant presentation of the composite in which the client's portfolio is included (0.B.4).
Input Data (1.)		<ul style="list-style-type: none"> ▶ All data and information necessary to support all items included in a compliant presentation must be captured and maintained (1.A.1). <i>This requirement covers also any additional or supplemental information that is included in a compliant presentation.</i> ▶ Portfolios must be valued in accordance with the definition of fair value and the GIPS valuation principles in Chapter II. (1.A.2). <i>This will not result in a change to the valuations of liquid securities in active markets, but will apply more to illiquid or hard-to-value investments or to investments where no observable market price is available (see GIPS Valuation Principles, p. 25 of the GIPS 2010 Standards).</i> ▶ As of 1.1.2010, firms must value portfolios on the date of all large cash flows; firms must define large cash flow for each composite (1.A.3). <i>See also the definition in the GIPS 2010 Glossary (p. 40).</i> ▶ Portfolios must not be valued more frequently than required by the valuation policy (1.A.3). 	
Calculation methodology (2.)	<ul style="list-style-type: none"> ▶ Effective 1.1.2010 firms have to calculate composite returns by asset weighting the individual portfolio returns at least monthly (2.A.7). <i>No significant changes, mainly editorial revisions.</i> 		
Composite construction (3.)	<ul style="list-style-type: none"> ▶ Firms that wish to remove portfolios from composites in cases of significant cash flows must define "significant" on an ex-ante, composite-specific basis and must consistently follow the composite-specific policy (3.A.10). <i>See also the GIPS Guidance Statement on Significant Cash Flows, GIPS 2010 Glossary (p. 43) as well as disclosure 4.A.32.</i> 	<ul style="list-style-type: none"> ▶ Composites must be defined according to investment mandate, objective, or strategy. <u>Composites must include all portfolios that meet the composite definition</u>. Any changes to a composite definition must not be applied retroactively. The composite definition must be made available upon request (3.A.4). <i>The GIPS 2010 Glossary (p. 37) contains further information.</i> ▶ For periods beginning on or after 1.1.2010, a carve-out must not be included in a composite unless the carve-out is managed separately with its own cash balance (3.A.8). <i>Refer also to new definition of a carve-out in the GIPS 2010 Glossary (p. 37).</i> 	
Disclosures (4.)	<ul style="list-style-type: none"> ▶ Firms must disclose the benchmark description (4.A.4). <i>See also GIPS 2010 Glossary (p. 36).</i> 	<ul style="list-style-type: none"> ▶ <i>Firms are required to disclose if the firm has been verified or not and must include a standard sentence on the scope of verification (4.A.1):</i> "[Insert name of firm] claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. [Insert name of firm] has been independently verified for the periods [insert dates]. The verification report(s) is/are available upon request. 	<ul style="list-style-type: none"> ▶ Firms should disclose if a composite contains proprietary assets (4.B.8). <i>See also GIPS 2010 Glossary (p. 42).</i>

1 GIPS provisions cross reference guide, CFA Institute, Global Investment Performance Standards (GIPS®):

As adopted by the GIPS Executive Committee on 29 January 2010, www.gipsstandards.org/standards/current/2010_edition_gips.html

2 GIPS 2010: Review of the New Standards, Karyn D. Vincent, Presentation to the CFA Institute Conference, London, 24 February 2010

Overview of key changes to GIPS provisions 0. to 5. (continued)

GIPS provisions	New provisions	Revised provisions	Recommendations (new and/or revised)
<p>Disclosures (4.)</p>	<ul style="list-style-type: none"> ▶ When presenting net-of-fees returns, firms must disclose: If any other fees are deducted in addition to the investment management fees and trading expenses; if model or actual investment management fees are used; and if returns are net of any performance based fees (4.A.6). ▶ Firms must disclose the use of subjective unobservable inputs for valuing portfolio investments (as described in the GIPS Valuation Principles in Chapter II) if the portfolio investments valued using subjective unobservable inputs are material to the composite (4.A.27). ▶ Firms must disclose if the composite's valuation hierarchy materially differs from the recommended hierarchy in the GIPS Valuation Principles in Chapter II (4.A.28). ▶ If the firm has adopted a significant cash flow policy for a specific composite, the firm must disclose how it defines a significant cash flow for that composite and for which periods (4.A.32). <i>A simplification of the existing provision, however, the firm still has to provide additional information on significant cash flows upon request.</i> ▶ Firm must disclose if the three-year annualized ex-post standard deviation of the composite and/or benchmark is not presented because 36 monthly returns are not available (4.A.33). <i>See also new reporting requirement 5.A.2.</i> ▶ If the firm determines that the three-year annualized ex-post standard deviation is not relevant or appropriate, the firm must (4.A.34) <ul style="list-style-type: none"> a) Describe why ex-post standard deviation is not relevant or appropriate; and b) Describe the additional risk measure presented and why it was selected. 	<p>Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation."</p> <ul style="list-style-type: none"> ▶ <i>Firms that have not been verified must include the following sentence:</i> "[Insert name of firm] claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. [Insert name of firm] has not been independently verified." ▶ The claim of compliance must only be used in a compliant presentation (4.A.1). <i>A different claim of compliance is required for advertising purposes (see GIPS 2010, p. 29).</i> ▶ Firms must disclose that the firm's list of composite descriptions is available on request (4.A.11). <i>This document lists all composite names and descriptions (see also Appendix C of GIPS 2010, pp. 66-69).</i> ▶ Firms must disclose that policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request (4.A.12). ▶ Firms must disclose the presence, use, and extent of leverage, derivatives, and, <u>short positions</u>, if material, including a description of the frequency of use and characteristics of the instruments sufficient to identify risks (4.A.13). ▶ For any performance presented for periods prior to 1.1.2000 that does not comply with the GIPS standards, firms must disclose the periods of non-compliance (4.A.15). <i>There is no requirement any more to provide the reason for non-compliance.</i> ▶ Firms must disclose relevant details of the treatment of withholding taxes on dividends, interest income, and capital gains, <u>if material</u>. Firms must also disclose if benchmark returns are net of withholding taxes <u>if this information is available</u> (4.A.20). ▶ Firms must disclose and describe any known <u>material differences</u> in exchange rates or <u>valuation sources</u> used among the portfolios within a composite, and between the composite and the benchmark (4.A.21). 	
<p>Presentation and reporting (5.)</p>	<ul style="list-style-type: none"> ▶ For composites with a composite inception date of 1.1.2011 or later, when the initial period is less than a full year, returns from the composite inception date through the initial annual period end (5.A.1.c). <i>Partial period returns must be shown.</i> ▶ For composites with a termination date of 1.1.2011 or later, returns from the last annual period end through the composite termination date (5.A.1.d). <i>Partial period returns must be shown.</i> ▶ For periods ending on or after 1.1.2011, firms must present, as of each annual period end (5.A.2) <ul style="list-style-type: none"> ▶ the three-year annualized ex-post standard deviation (using monthly returns) of the composite and the benchmark ▶ if the firm determines that the standard deviation is not relevant or appropriate, it must present an additional three-year ex-post risk measure for the composite and the benchmark. The calculation periodicity must be identical for the composite and benchmark <p><i>GIPS 2010 do not prescribe a formula for calculating the standard deviation measure.</i></p>	<ul style="list-style-type: none"> ▶ Composite returns for each annual period. Composite returns must be clearly <u>identified</u> as gross-of fees or net-of-fees (5.A.1.b). ▶ Performance of a past firm or affiliation must be linked to or used to represent the historical performance of a new or acquiring firm if, on a <u>composite-specific basis</u>: <ol style="list-style-type: none"> 1. Substantially all of the investment decision makers are employed by the new or <u>acquiring</u> firm; 2. The decision-making process remains <u>substantially</u> intact and independent within the new or <u>acquiring</u> firm; 3. The new or <u>acquiring</u> firm has records that document and support the reported performance. 	<ul style="list-style-type: none"> ▶ For each period for which an annualized ex-post standard deviation of the composite and the benchmark are presented, the corresponding annualized return of the composite and the benchmark should also be presented (5.B.4). ▶ Firms should present more than 10 years of annual performance in the compliant presentation (5.B.7). ▶ Firms should update compliant presentations quarterly (5.B.9).

Note: For changes in provisions 6. (real estate) and 7. (private equity), please refer to the GIPS 2010 Standards.

Ernst & Young Investment Performance Services – Contacts

To learn more about how Ernst & Young Investment Performance Services practice can help you comply and compete, please contact one of our professionals:

Australia

Ernst & Young
Brett Kallio
8 Exhibition Street
Melbourne VIC 3000
Australia
Phone +61 3 9288 8597
Fax +61 3 8650 7710
brett.kallio@au.ey.com

Austria

Ernst & Young
Alexander Schimek
Wagramer Strasse 19
IZD-Tower
1220 Vienna
Austria
Phone +43 1 21170 1292
Fax +43 1 216 20 77
alexander.schimek@at.ey.com

Canada

Ernst & Young
Leon Chin
Ernst & Young Tower
222 Bay Street
Toronto-Dominion Centre
Toronto, Ontario M5K 1J7
Canada
Phone +1 416 943 3311
Fax +1 416 943 3796
leon.chin@ca.ey.com

China

Ernst & Young Hua Ming
Chengsen Yeh
23/F, The Center
989 Changle Street
Shanghai, China 200031
Phone +86 21 2228 2196
Fax +86 21 2228 0043
chengsen.yeh@cn.ey.com

Denmark

Ernst & Young
Carsten Collin
Gyngemose Parkvej 50
2860 Soeborg
Denmark
Phone +45 35 87 22 22
Fax +45 35 87 22 00
carsten.collin@dk.ey.com

Finland

Ernst & Young
Teemu Luovila
Elielinaukio 5B
00100 Helsinki
Finland
Phone: +358 40 772 1974
Fax +358 2 273 1410
teemu.luovila@fi.ey.com

France

Ernst & Young
Bernard Charrue
Tour Ernst & Young
Faubourg de l'Arche
92037 Paris-La Défense
France
Phone +33 1 46 93 72 33
Fax +33 1 55 24 61 33
bernard.charrue@fr.ey.com

Germany

Ernst & Young
Wulf H. H. Ley
Mergenthalerallee 3-5
65760 Eschborn
Germany
Phone +49 6196 996 17014
Fax +49 181 3943 17014
wulf.ley@de.ey.com

Hong Kong

Ernst & Young
David Sung
Carlyon Knight-Evans
18th Floor, Two IFC
8 Finance Street
Hong Kong
Phone +852 2846 9882
Fax +852 3185 4695
david.sung@hk.ey.com
carlyon.knight-evans@hk.ey.com

Italy

Ernst & Young FBA
Emilio Maffi
Via della Chiusa, 2
20123 Milan
Italy
Phone +39 02 7221 2203
Fax +39 02 7221 2208
emilio.maffi@it.ey.com

Japan

Ernst & Young ShinNihon
Yoh Kuwabara
Hibiya Kokusai Bldg., 19F
2-2-3, Uchisaiwai-cho
Chiyoda-ku, Tokyo 100-0011
Japan
Phone +81 3 3503 3244
Fax +81 2 3503 1488
kuwabara-y@shinnihon.or.jp

Korea (South)

Ernst & Young Han Young
Justin (Jun-Seo) Pak
Taeyoung Bldg.
10-2 Yeoido-dong, Youngdeungpo-gu
Seoul 150-777
Korea (South)
Phone +82 2 3787 6528
Fax +82 2 3783 5891
justin.pak@kr.ey.com

Luxembourg

Ernst & Young
Laurent Denayer
Parc d'Activité Syrdall 7
5365 Munsbach
Luxembourg
Phone +352 42 124 8340
Fax +352 42 124 5 8340
laurent.denayer@lu.ey.com

The Netherlands

Ernst & Young Actuarissen BV
Remco Stam
Mark van Eijk
Antonio Vivaldistraat 150
1083 HP Amsterdam
The Netherlands
Phone +31 88 407 0831
Fax +31 88 407 0820
remco.stam@nl.ey.com
mark.van.eijk@nl.ey.com

Norway

Ernst & Young
Thomas Lorentzen
Christian Frederiks plass 6
Oslo Atrium
0051 Oslo
Norway
Phone +47 24 00 20 35
Fax +47 24 00 24 01
thomas.lorentzen@no.ey.com

Poland

Ernst & Young
Pawel Flak
Rondo ONZ 1
00124 Warszawa
Poland
Phone +48 22 557 7000
Fax +48 22 557 7001
pawel.flak@pl.ey.com

Russia

Ernst & Young (CIS) B.V.
Igor Turuev
Eugenia Zaichikova
Sadovnicheskaya nab., 77, bld. 1,
Moscow, 115035
Russia
Phone +7 495 755 9700
Fax +7 495 755 9701
igor.turuev@ru.ey.com
eugenia.zaichikova@ru.ey.com

Singapore

Ernst & Young
Brian Thung
One Raffles Quay
North Tower, Level 18
Singapore 048583
Phone +65 6309 6227
Fax +65 6532 7662
brian.thung@sg.ey.com

South Africa

Ernst & Young
Chris Sickle
P.O. Box 656
Cape Town 8000
South Africa
Phone +27 21 443 0434
Fax +27 21 443 1434
chris.sickle@za.ey.com

Sweden

Ernst & Young
Jesper Nilsson
Jakobsbergsgatan 24
P.O. Box 7850
10399 Stockholm
Sweden
Phone +46 8 520 590 00
Fax +46 8 520 513 88
jesper.nilsson@se.ey.com

Switzerland

Ernst & Young
Susanne Klemm
Belpstrasse 23
3001 Berne
Switzerland
Phone +41 58 286 6914
Fax +41 58 286 6969
susanne.klemm@ch.ey.com

United Kingdom

Ernst & Young
Matt Price
1 More London Place
London SE 1 2AF
United Kingdom
Phone +44 20 7951 2223
Fax +44 20 7951 2358
matt.price@uk.ey.com

USA

Ernst & Young
Todd Johnson
5 Times Square
New York, NY 10036-6530
USA
Phone +1 212 773 8667
Fax +1 866 862 1710
todd.johnson@ey.com

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Tamara Antioco

Phone +41 58 286 55 16

Fax +41 58 286 59 16

tamara.antioco@ch.ey.com

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gips@sba.ch

Contacts

GIPS®

Susanne Klemm

Head of Investment Performance Services,
Switzerland

susanne.klemm@ch.ey.com

Phone +41 58 286 69 14

Eugene Skrynnyk

Manager Asset Management Switzerland

eugene.skrynnyk@ch.ey.com

Phone +41 58 286 36 82

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Imprint

GIPS® news

Electronic publication in English

Designed and produced by

Ernst & Young Ltd.
Marketing & External Communications
P.O. Box
8022 Zürich

Subscriptions/address changes

www.ey.com/ch/newsletter

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EYG no. EH0050

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