INVITATION TO COMMENT:
Redrafting the AIMR-PPSTM Standards

The Association for Investment Management and Research (AIMR) seeks comment on the proposals set forth below regarding revisions to the AIMR-PPS standards.

Comments must be submitted in writing and be received by AIMR no later than December 31, 2000. All comments and replies will be put on the public record. Comments should be addressed to:

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AIMR accepts responses by fax or e-mail, but it would be helpful if a hardcopy response is submitted as well.

Executive Summary

AIMR has long been committed to establishing one broadly accepted standard for calculating and presenting investment performance history. Over 13 years ago, the investment performance standards that have now become the AIMR Performance Presentation Standards™ (AIMR-PPS) were first introduced in North America. In February 1999, AIMR adopted the Global Investment Performance Standards™ (GIPS™) for the global investment industry. The establishment of GIPS was a vital step in facilitating the acceptance of a set of investment performance standards accepted globally. GIPS are based on the AIMR-PPS standards. The AIMR-PPS Implementation Committee now seeks public comment on taking an important next step in supporting the convergence to one worldwide performance standard by harmonizing the provisions of the AIMR-PPS and GIPS. The Committee is seeking industry input on its recommendations.

Since the AIMR-PPS standards were first established, AIMR has continuously revised the standards through interpretations and new requirements to maintain the relevance and effectiveness of the AIMR-PPS. The last major redraft of the standards occurred in 1997 and was made to clarify and simplify the standards to facilitate the standards comprehension. With rapid globalization and growth of the investment industry, the AIMR-PPS Implementation Committee is now proposing to revise the AIMR-PPS standards to ensure their consistency with GIPS as the global standard while continuing to remain relevant and effective in the North-American market.
The Implementation Committee’s goal in redrafting the standards to converge with GIPS is to change the organization and substance of the AIMR-PPS standards as little as possible to avoid confusion and minimize the costs to firms currently complying with the AIMR-PPS standards. Because GIPS are fundamentally based on the AIMR-PPS standards, the proposed redraft of the AIMR-PPS standards is primarily a reorganization of the existing provisions. Those few substantive changes that are being considered by the Committee are aimed at strengthening and clarifying the standards. Firms already compliant with the standards will need to do minimal additional work to continue to comply with the AIMR-PPS standards going forward.

The recommended changes include strengthening and clarifying the standards by:

- Removing the original requirements and recommendations in the AIMR-PPS relating to “international” portfolios as the requirements of GIPS now address these issues,
- Eliminating carve-outs based on cash allocation beginning in 1/1/2005,
- Eliminating the “all cash” basis requirement for returns with leverage,
- Requiring limited additional disclosures relating to the total firm assets for each period, the valuation sources and methodology, and return calculation methodology,
- Restating the Level I Verification procedures to emphasize firmwide verification.

Attached is the proposed redraft of the AIMR-PPS standards. The AIMR-PPS Implementation Committee seeks public comment on the proposed redraft as the Committee views industry comment on the standards as critical to maintaining their relevance and usefulness to investment managers.

**Background**

AIMR has developed and promulgated the AIMR Performance Presentation Standards (AIMR-PPS). The North American investment industry has embraced these standards as the industry practice for presenting investment performance. However, the rapid globalization and growth of the investment industry has heightened the need for consistent, globally accepted standards for the calculation and presentation of performance.

Investment management firms face many challenges when reporting investment performance results to prospective and current clients. These challenges increase when the firm operates outside its country of residence. Investment practices, regulation, performance measurement, and reporting of performance results vary considerably from country to country. Some countries have established performance calculation and presentation guidelines that are domestically accepted, while others have few or no standards. In 1995, AIMR recognized the need for one globally accepted set of standards for the calculation and presentation of investment performance. AIMR sponsored and funded the Global Investment Performance Standards Committee to develop and publish one global standard by which firms calculate and present performance to clients and prospective clients. On February 19, 1999, AIMR formally endorsed the GIPS as the worldwide standard for calculating and presenting investment performance.
The GIPS standards, based on the AIMR-PPS principles of fair representation and full disclosure, have been crafted to meet the needs and capacity of a broad range of global markets. A global investment performance standard gives investors confidence that a firm’s record is an accurate and complete picture of its historical performance achievement. Such a standard also facilitates competition in the global investment industry by allowing clients and potential clients to make an “apples to apples” comparison of investment advisory firms, regardless of their domicile.

To provide a practical and effective implementation structure for GIPS and to encourage wider public participation in its domestic and international investment performance presentation standard-setting efforts, AIMR recently established the Investment Performance Council (IPC). The IPC will be responsible for developing, promulgating, administering, and promoting all of AIMR’s activities regarding its investment performance presentation standards. The IPC will implement new procedures and controls to ensure that the AIMR-PPS standards and GIPS are consistently applied, interpreted, and expanded with broad public comment. Through the IPC, AIMR will promote the Global Investment Performance Standards as the global standard for reporting investment performance. The IPC will work with regulators, societies, and other industry groups around the world in adopting and implementing GIPS. The IPC’s goal is that compliance with GIPS will act like a "passport" to create a level playing field for all firms to compete on an equal footing. More information on the structure and workings of the IPC is available from AIMR at its website www.aimr.org/standards/ipc/.

The IPC strongly encourages countries without an investment performance standard in place to accept GIPS as the local standard. Countries with an existing investment performance standard are encouraged to move the standard towards GIPS by first adapting to a Country Version of GIPS (CVG). The CVG approach attempts to give countries flexibility to deal with differences between the local standard and GIPS by requiring the commitment to remove such differences during an acceptable transition period. The CVG must contain all the fundamental aspects of GIPS as the core provisions from the outset. At the conclusion of the transition period, all differences except for those justified by law, regulation or well-established practice must be removed from CVGs. The goal is that compliance with GIPS will provide investment managers with a 'right of access' to be considered alongside investment managers who comply with the local standards, thereby leveling the playing field. Also, compliance with a CVG will mean compliance with GIPS. This way, investment management firms already complying with AIMR-PPS can effectively compete for business in non-North American markets by also claiming compliance with GIPS. As a result of the proposed changes, we believe that most firms who are compliant with AIMR-PPS after the changes will also be compliant with GIPS1.

The Implementation Committee wants to take the lead in promoting the CVG approach, to set an example for other standard setters outside the U.S that are considering moving to a global standard by eventually adopting GIPS. In February of 1999, AIMR took the first step in moving

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1 The one exception to the claim of GIPS compliance for AIMR-PPS-compliant firms relates to the treatment of accrued income on fixed income instruments. The AIMR-PPS standards did not require firms to accrue income until January 1, 1997, where GIPS compliance requires the use of accrued income in all compliant years. Firms who seek GIPS compliance must retroactively utilize accrued income in all five compliant yearly returns (5 years minimum for GIPS).
toward a global investment performance standard by revising the requirements of the AIMR-PPS standards to bring them in line with GIPS. These changes were formally after receiving positive comment from the investment industry on the harmonization of GIPS and the AIMR-PPS standards. The Implementation Committee is now proposing to take the next step by redrafting the AIMR-PPS standards to comply with GIPS and is actively seeking industry comment on the proposed changes.

**Summary of Proposed Changes to the AIMR-PPS Standards**

Because GIPS grew out of the AIMR-PPS standards, the AIMR-PPS Implementation Committee is proposing few substantive changes to the AIMR-PPS standards. The Implementation Committee is proposing to alter the format of the Standards to follow the IPC recommended CVG approach. The Implementation Committee believes this new format will allow the AIMR-PPS standards to be accepted as “AIMR-PPSTM – the North American version of GIPS” as well as clarify and strengthen the existing standards for firms seeking to comply with the Standards. Because the changes contemplated by the Committee are largely structural in nature, in most cases firms already in compliance will remain in compliance with the Standards by making a few additional disclosures.

The Committee has incorporated the Introduction and all five sections of GIPS standards as the “core” of the proposed redraft of the AIMR-PPS standards. The few differences between the AIMR-PPS standards and GIPS, which will remain if this proposal is adopted, are highlighted in Section I.B of the Introduction to the AIMR-PPS standards and italicized next to the appropriate GIPS provision. Sections six through nine of the proposed redraft of the AIMR-PPS standards contain the requirements and recommendations for technical subjects not yet addressed by GIPS that already exist in the AIMR-PPS standards. These sections address the calculation and presentation of performance results for real estate, venture and private placements, wrap-fee (all-in) accounts, and after-tax performance.

While the proposed revisions are generally structural in nature, the Implementation Committee is continuing the process of recommending substantive changes that will strengthen and clarify the Standards as well as harmonize them with the provisions of GIPS. The Committee is proposing to incorporate certain provisions of GIPS into the current AIMR-PPS standards as well as remove other provisions that are redundant with or are addressed by the core GIPS requirement. If these recommended revisions are adopted, the AIMR-PPS standards and GIPS will have substantially the same basic requirements and recommendations. The proposed changes are summarized below:

**Proposed Changes to Existing Provisions of the AIMR-PPS Standards**

1. **Treatment of “Carve-outs” or Single Asset Segments of Multiple Asset Portfolios**

Currently under the AIMR-PPS standards, firms can carve out multiple asset portfolio segments and include them as part of a single asset composite as long as the firm allocates cash to the
segment return being presented. For purposes of the AIMR-PPS and GIPS standards, a carve-out is a single or multiple asset class segment of a multiple asset class portfolio. The Implementation Committee is proposing to change this provision to bring it in line with the GIPS requirement.

Under GIPS, firms may continue to carve-out portfolio segments and include them in single asset composites with allocation of cash and disclosure of the allocation method. However, beginning January 1, 2005, firms can include carve-out returns with single asset composite returns only if the carve-outs are actually managed separately with their own cash allocations.

The Implementation Committee believes that allocating cash to segments of multiple asset class portfolios in calculating segment returns can lead to arbitrariness, the potential for abuse, and the distortion of a firm’s true performance history. Firms can only present a true record of the manager's performance in a particular asset class or segment when cash is actually managed with the portfolio segment. For example, carving out the technology sector of an equity portfolio and allocating cash to that segment is typically not representative of a firm’s technology strategy.

The Committee proposes that firms have until 2005 to continue using cash allocation for carve-out returns. The future implementation date puts firms that are using or considering using carve-out returns on notice that cash allocation will not be acceptable under the redrafted AIMR-PPS standards and will allow firms ample time to adjust their composites accordingly. This will be a forward-looking change. The AIMR-PPS standards will not require firms to discontinue using historic composite returns that include carve-out segments with cash allocations. However, going forward from 1/1/2005, those segments that are not actually managed separately with their own allocations will have to be removed from the carve-out composites. Firms can present segment-only returns or segment returns with cash allocation to prospective and current clients only as supplemental information.

2. Fee Schedule Disclosure

Currently, under the AIMR-PPS standards, if firms present net-of-fee performance, and gross-of-fee performance is not also shown, the firm must disclose the average weighted management fee. GIPS only recommends firms disclose this fee. The Implementation Committee recognizes that in most cases, both net-of-fee and gross-of-fee results are needed in order to accurately calculate the average-weighted management fee. Further, most performance presentations include either gross-of-fee performance or both net-of-fee and gross-of-fee results. Investors seeking the average weighted management fee can calculate this information for themselves. In an effort to adopt GIPS, the Committee is proposing to amend this requirement to a recommendation and recommend firms to disclose the average-weighted management fee when presenting only net-of-fee performance.

3. End of Period Disclosures

The AIMR-PPS standards state that firms must disclose the number of portfolios, the amount of assets in the composite and the percentage of the firm's total assets represented by the composite. When making these disclosures, the AIMR-PPS standards currently allow firms to choose to
make these disclosures as of either the beginning of the period or the end of the period so long as the method is followed consistently.

The Implementation Committee is proposing to modify this requirement by adopting the provision in GIPS, which states that firms must disclose the number of portfolios, the amount of assets in the composite and the percentage of the firm's total assets represented by the composite at the end of each period. The Committee believes that this change will lead to further consistency of presentations and comparability of investment performance results.

The Committee recognizes that firms in compliance with Standards may be using beginning of the period weightings. Because this is a forward looking change to the Standards, these firms will remain in compliance with the Standards and will not have to go back and revise these disclosures. However, until firms claiming compliance with the AIMR-PPS standards have 5 years of performance reports that disclose end of period information, they will not be able to claim compliance with GIPS.

4. Material Change in Personnel Disclosure

Firms are required to disclose a material change in personnel responsible for investment management under the current AIMR-PPS standards. GIPS recommends that firms disclose any significant events within the firm (such as ownership or personnel changes), which would help a prospective client interpret the performance record.

The Implementation Committee believes that information about significant events in the firm that are unrelated to personnel changes may be of interest and relevant to investors. By requiring only that firms disclose a material change in personnel, the Committee fears that the Standards imply information on other significant events are not worthy of disclosure. Under the proposed AIMR-PPS standards, firms should continue to disclose any significant events within the firm. However, in an effort to improve full disclosure of firmwide events that transcend all areas of the firm, the Committee is proposing to change this requirement to a recommendation but broaden its scope by adopting the language used in GIPS. As a result, the standards will more clearly indicate that the manager has a responsibility to disclose to clients information on any significant events with the firm that may shed light on the performance record.

This change would be retroactive in nature. AIMR would recommend that a firm go back and include these types of disclosures in their presentations for historic returns. However, since these disclosures would be recommended rather than required, this revision would not force firms to amend their presentations to remain in compliance with the AIMR-PPS standards.

5. Relevant Risk Disclosures

Through interpretations, the Committee has recommended that firms disclose both total (absolute) and market (relative) risks in conjunction with composite returns. In an effort to provide more meaningful information on risk appropriate to particular asset classes or styles, the Committee is proposing to adopt the GIPS provision, which recommends firms to disclose relevant risk measures - such as volatility, tracking error, beta, modified duration, etc. - along
with total return for both benchmarks and composites. These disclosures, if made, will provide more comprehensive information that investors may use to evaluate a firm’s composite performance.

This change would be retroactive in nature. AIMR would recommend that a firm go back and include these types of disclosures in their presentations for historic returns. However, since these disclosures would be recommended rather than required, this revision would not force firms to amend their presentations to remain in compliance with the AIMR-PPS standards.

6. Verification

Both the AIMR-PPS and GIPS standards currently recommend that firms verify their claims that performance is in compliance with the Standards.

Verification under the AIMR-PPS standards currently consists of two levels: Level I and Level II. AIMR considers Level I verification to be the primary level of verification as it tests the validity of a firm’s claim of compliance on a firmwide basis rather than testing the claim for one or two composites. However, some in the industry view the procedures and discussion set forth in the AIMR-PPS Handbook for Level I verification confusing and unclear. Several of the preeminent verifiers in North America do not offer Level I verification services because Level I procedures are perceived as being too comprehensive and in conflict with other professional policies and procedures by which they must abide. Consequently, these verifiers only issue Level II verification reports on particular composites.

The GIPS verification procedures were drafted to refocus the verification process on the importance of firmwide verification. GIPS verification seeks to provide clear, workable procedures for firms seeking to conduct verifications in an efficient and cost effective manner. Under GIPS, verification only consists of one level that confirms that the firm has complied with all the composite construction requirements on a firmwide basis and that the firm's processes and procedures are designed to calculate and present performance results in compliance with the GIPS standards.

In an effort to provide more workable Level I verification procedures, AIMR is proposing to revise the AIMR-PPS Level I Verification procedures to conform to GIPS verification. Level II, or composite verification would only remain for the near future. The Implementation Committee contemplates that - by 1/1/2005 - Level II verification would be eliminated. Instead, like GIPS, an investment manager firm may choose to have a further, more extensive, specifically focused examination, or performance audit, of a specific composite presentation. Firms would not be able to make the claim that a particular composite has been “verified” but can claim that the composite returns have been audited.

The Implementation Committee believes that the revised Level I Verification procedures will:

- work to blend AIMR-PPS and GIPS standards into one globally accepted set of performance standards,
- clarify procedures for Level I Verification,
Proposed GIPS Provisions to Add to the AIMR-PPS Standards

1. Additional Disclosures
   
a. Under the proposal, the GIPS requirement that a firm must disclose the total firm assets for each period in a compliant presentation will be added to the AIMR-PPS standards. The Implementation Committee believes that the additional disclosure, while small and easily determined by the firm, will increase the amount of material information given to investors and clarify for investors the information regarding composite assets as a percentage of total firm assets. This disclosure will be a retroactive addition since the information will be readily available to firms and involve minor changes to existing presentations.

   b. Also included in the redrafted AIMR-PPS standards is the GIPS requirement that firms must disclose whether the presentation conforms with local laws and regulations that differ from GIPS requirements and the manner in which the local standards conflict with GIPS. The intent of this requirement is to disclose whether the local standards conflict or detract from the GIPS provisions.

Because the AIMR-PPS and GIPS standards will be very similar if the proposed changes are approved by the AIMR Board, firms that comply with the AIMR-PPS standards will at least meet the minimum requirements of GIPS and will not conflict with GIPS. However, according to the AIMR-PPS standards, compliance with the AIMR-PPS standards require compliance with all applicable laws and regulations. The language of this provision will be modified slightly to require firms to disclose whether the presentation conforms with local laws and regulations that differ from the AIMR-PPS standards and the manner in which the local standards conflict with AIMR-PPS.

As all of the provisions of the AIMR-PPS standards are compliant with U.S. law, this provision will only affect those firms claiming compliance with the AIMR-PPS standards who are making presentations outside the United States where local country law differs from the standards.

2. Additional Disclosures Recommended by GIPS

Under the proposal, the AIMR-PPS standards, like the GIPS standards, will recommend that firms disclose the valuation sources and methods as well as the calculation methodology used by the firm. This disclosure, if made, will provide investors more comprehensive information about how the firm derived its investment returns and facilitate a comparison with the performance results of investment firms among all markets. These disclosures may look like the following example: “The firm values the portfolios on this composite on a daily basis with values obtained by Bloomberg. Results are computed using the Modified Dietz Method to calculate time weighted total rate of return.”
Provisions to be Removed from the AIMR-PPS Standards

The Implementation Committee is considering the removal of the following provisions as part the proposed redraft. Some of these AIMR-PPS provisions are duplicative or inconsistent with the core GIPS standards. Other provisions are confusing and there removal will strengthen the standards.

1. Removal of All-Cash Basis Requirement for Returns with Leverage

The AIMR-PPS standards currently require that returns for leveraged portfolios be calculated on an actual and restated "all cash" basis. The AIMR-PPS standards state that for composites containing portfolios that use leverage:

- If the use of leverage is discretionary, the performance presented must include the effects of the leverage. Performance on a restated, all-cash basis (i.e., removing the effect of the leverage from the return) must also be provided.

- If the use of leverage is nondiscretionary (i.e., mandated by the client), performance must be presented on an all-cash basis.

The Committee recognizes that the restatement to an "all cash" basis is quite complicated from a practical standpoint, largely due to the fact that changes in leverage must be treated as a cash flow in the calculation. This complication is best understood by considering that the "all cash" return calculation uses total assets, not net assets, and that total assets change whenever leverage (or liabilities) changes. Moreover, leverage resulting from derivatives, as opposed to stock purchases on margin, is not easily restated to an "all cash" basis. The provisions have engendered significant confusion from firms trying to comply with the AIMR-PPS standards.

The Committee is proposing to eliminate the current requirements of the AIMR-PPS standards and adopt the language of the GIPS standards, which address leverage and derivatives. GIPS currently require firms to disclose the presence, use and extent of leverage or derivatives, including a description of the use, frequency and characteristics of the instruments sufficient to identify risks.

The Committee believes that restatement to an all cash basis is not effective in accomplishing the AIMR-PPS goal of conveying the full and comprehensive disclosure of performance history. The Standards, as currently written, do not adequately address multiple types of leverage and derivatives. The Committee believes that revisions will simplify, for the time being, the Standards to promote understanding and compliance with the Standards.

While the Committee is proposing to remove the all cash requirement, firms can continue to present their historical all cash returns as supplemental information. However, if the firm chooses, the all cash returns can be dropped from historical presentations.
The Committee believes that eliminating the "all cash requirement" will be a short-term solution. In the future, the Leverage and Derivatives Subcommittee, a technical subcommittee of the Investment Performance Council, will develop effective standards for addressing all types of leverage and derivatives. These standards will be developed in the context of GIPS and apply on a global basis. Once developed, it is expected that these provisions will be incorporated into the AIMR-PPS standards.

2. Removal of the AIMR-PPS requirement to disclose the firm’s effective date of compliance

Currently, firms must disclose the firm’s effective date of compliance with the AIMR-PPS standards. This disclosure was originally included in the Standards to indicate whether a firm complied with the Standards prior to the effective date of the Standards (e.g., January 1, 1993). Today, the effective date of firm compliance provides little value. Prospective clients now place more emphasis on the composite creation date. The composite creation date enables clients and prospective clients to determine if the performance report has been created relatively recently or is more established. The Committee believes the removal of the requirement to disclose the firm’s effective date of compliance will have little or no impact on performance presentations.

3. Removal of “International” Requirements and Recommendations

The AIMR-PPS standards currently include a number of requirements that the AIMR-PPS standards refer to as relating to “international” portfolios and composites. These requirements predate the creation of a global investment performance standard. With the advent of GIPS, the Implementation Committee believes that there is no longer a need to include provisions that address international performance reporting and calculation guidelines under AIMR-PPS. GIPS will serve as the global standard for reporting investment performance and address the subjects relating to global performance reporting.

The Implementation Committee proposes to eliminate the provisions of the AIMR-PPS standards that specifically relate to the performance presentation of international assets and to address the subjects dealt with in these provisions by adopting the requirements and recommendations in the GIPS standards as the core provisions of the AIMR-PPS standards. In several instances, the GIPS standards address these provisions in a different manner so that the basic requirement or recommendation remains in the Standards but in a different form. As a result, the substance of the requirement is retained in the Standards, but stated in a different way or addressed in a different manner.

To summarize, the existing international standards which would be removed are as follows:

**International Requirements:**

I.A.2. Firms can carve-out segments from international portfolios as long as the segments are managed as separate entities with their own cash allocation and currency management.

I.B.2. The firm must calculate the benchmark for any currency overlay portfolio in accordance with the mandate of the portfolio, unless the benchmark is actually the currency return on a published benchmark.
I.C.2. If a stand-alone composite is formed using subsectors from multiple composites, the firm must present its return with 1) a list of the underlying composites from which the subsector was drawn and 2) the percentage of each composite the subsector represents.

I.D.2 The firm must disclose whether composites and benchmarks are presented gross or net of withholding taxes on dividends, interest, and capital gains; if net, the assumed tax rate for both the composite and the benchmark.
- The firm must disclose whether the composite is a subsector of a larger portfolio and, if so, the percentage of the larger portfolio the subsector represents.
- The firm must disclose whether representative portfolios are used in the returns of subsectors shown as supplemental information.
- For composites managed against specific benchmarks, the firm must disclose the percentage of the composites invested in countries or regions not included in the benchmark.
- The firm must disclose for returns that exclude the effects of currency, whether the returns are presented in local currency and, if so, a statement that the local currency return does not account for interest rate differentials in forward currency exchange rates.

International Recommendations:

II.A.2 For international composites, separate composites should be created for:
- portfolios that allow currency hedging (versus those that prohibit currency hedging) unless the use of hedging is judged to be immaterial and
- portfolios that are managed against hedged benchmarks (versus those that are managed against unhedged benchmarks).

II.B.2.a. A consistent source of exchange rates should be used.

II.B.2.b Returns should be calculated net of withholding taxes on dividends, interest, and capital gains.

II.B.2.c. The firm should revalue the currency overlay portfolios whenever the currency overlay manager is notified of changes in the underlying currency exposures as a result of a shift in the underlying assets.

II.C.2. The firm should calculate local currency returns using spot rates and calculate hedged returns using forward rates for presentations excluding currency.

II.D.2.a. The firm should disclose:
- the range or the average country weights of a composite that is managed against a specific benchmark and
- inconsistencies among portfolios within a composite in the treatment of exchange rates.
II.D.2.b. For presentations of returns excluding currency (e.g., for attribution purposes), firms should disclose whether the return is the hedged return or the local return should be specified. Local returns should be accompanied by a statement that the local return is in local currency and does not account for interest rate differentials in forward currency exchange rates.

4. Removal of the AIMR-PPS recommendation to use temporary new accounts for significant cash flows

The AIMR-PPS standards currently suggest that accounts with significant cash flows should treat these cash flows as temporary new accounts. The recommendation was introduced in an attempt to reduce the tendency of some firms to move accounts into and out of “discretionary” status as a result of large cash flows. However, in practice, this process is very difficult and time consuming. Firms may continue this practice of using temporary new accounts; however, in an effort to harmonize the AIMR-PPS and GIPS standards, the AIMR-PPS standards will no longer recommend that firms use temporary new accounts.

Comment Requested

We seek public input on the proposals set forth in this document, including:

- Do you support AIMR’s effort to redraft the standards into “AIMR-PPS - the North American version of GIPS” standard?
- Do you believe the proposed name ‘AIMR-PPS, the North American Version of GIPS’ best reflects the changes and relationship of the AIMR-PPS to GIPS or should a different name be considered?
- Do you believe restructuring the AIMR-PPS standards in the proposed manner will cause confusion for firms who have attained compliance already and those in the process of trying to comply with the Standards?
- Should any changes be made to these proposals?
- Should AIMR consider any other methods for meeting the objectives of adopting the GIPS standards as set forth above?

If commentators put forward other proposals, AIMR requests that commentators explain how their proposals satisfy these objectives.
AIMR PERFORMANCE PRESENTATION STANDARDS™ (AIMR-PPS™)

Amended and restated as
AIMR-PPS
The North American Version of GIPS™

OUTLINE

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   B. AIMR-PPS SAMPLE PRESENTATION
I. APPLICATION OF GIPS AT THE LOCAL LEVEL

A. BACKGROUND

The AIMR Performance Presentation Standards were first introduced by the Financial Analysts Federation’s Committee for Performance Presentation Standards in the September/October 1987 issue of the Financial Analysts Journal. Since that time, the AIMR-PPS standards have been reviewed extensively by members of the industry and revised in response to their many comments and recommendations. The underlying principles of fair representation and full disclosure, however, have remained the same.

Since their establishment, the AIMR-PPS standards have received overwhelming acceptance from North American investment management firms. However, on a global basis, only a few countries outside North America have adopted AIMR-PPS standards to serve as the local performance standards. Other countries have chosen to adhere to their nationally accepted guidelines while others have few or no standards for presenting investment performance. These practices have reduced the comparability of performance results from firms in different countries and have hindered the ability for firms to penetrate markets on a global basis.

Implementing a Global Standard

In 1995, AIMR recognized the need for one globally accepted set of standards for the calculation and presentation of investment performance. AIMR sponsored and funded the Global Investment Performance Standards (GIPS) Committee to develop and publish one global standard by which firms calculate and present performance to clients and prospective clients. On February 19, 1999, AIMR formally endorsed the Global Investment Performance Standards as the worldwide standard to calculate and present investment performance.

The GIPS standards, based on the underlying principles of fair representation and full disclosure, have been crafted to meet the needs and capacity of a broad range of global markets. Such a standard also facilitates competition in the global investment industry by allowing clients and potential clients to make an “apples to apples” comparison of investment advisory firms.

Investment Performance Council

Following the AIMR Board’s approval of the GIPS standards in 1999, the GIPS committee’s role and responsibility in developing the Standards concluded. However, effective promotion, implementation and interpretation of the Standards requires an effective governance structure to meet the ongoing needs for maintaining and evolving high-quality global investment performance standards. To provide a practical and effective implementation structure for GIPS and to encourage wider public participation in its domestic and international investment performance presentation standard-setting efforts, AIMR recently established the Investment Performance Council (IPC).

The principal goal of the IPC is to have all countries adopt the Global Investment Performance Standards (GIPS) as the standard for investment firms seeking to present historical investment performance.

The establishment and acceptance of GIPS is a vital step in facilitating the availability of comparable investment performance history on a global basis. Both the IPC and AIMR envision that GIPS compliance will act like a “passport” to create a level playing field for all firms to compete on an equal footing. The IPC
recognizes that some countries will need to adopt certain requirements in addition to GIPS, especially when required by specific local regulation or to meet existing practice. Therefore, to achieve a globally harmonized investment performance presentation practice, the IPC is promoting a “Country Version of GIPS” (CVG) approach. Under this approach, countries will adopt GIPS as their core standards. This core will be supplemented only where provisions over and above GIPS are necessary, preferably only to satisfy local regulatory or legal requirements and well-established practices and any other differences must be transitioned out of the CVG during a specified period, so that the CVG converges to GIPS. Eventually, the goal is that compliance with GIPS will provide investment managers with a 'right of access' to be considered alongside investment managers who comply with the local standards, thereby leveling the playing field. It is also desirable that compliance with an IPC endorsed CVG will mean compliance with GIPS.

The IPC will also develop and evolve GIPS as quickly as is practicable into a “gold standard” to be used around the world. The gold standard will eventually incorporate as many of the regulatory and well-established best practices that exist in local markets around the world.

AIMR-PPS Standards and GIPS

In early 1999, AIMR took the first step in moving toward a global investment performance standard by significantly revising the requirements of the AIMR-PPS standards to bring them in line with GIPS. AIMR has taken the next step by redrafting the AIMR-PPS standards into the CVG format and restating them as the North American version of GIPS.

Because GIPS is based on the AIMR-PPS standards, redrafting the AIMR-PPS standards into the CVG format was primarily a reorganization of the existing provisions, with only a few substantive changes. The AIMR-PPS standards now incorporate all the GIPS requirements and recommendations. The full text of the GIPS standards is contained in Section II of this document. Several additions to the GIPS provisions will apply in North America representing well-established practices and firms must observe them in addition to all GIPS requirements in order to be compliant with the AIMR-PPS standards. These minimal additions are noted in the text of the Provisions (Section II) in italics as well as summarized in the AIMR-PPS Introduction in Section I.B.

- Additional AIMR-PPS Specific Requirements and Recommendations.

The AIMR-PPS standards will automatically incorporate future developments to the GIPS standards, particularly those provisions affecting technical areas that are currently addressed in the AIMR-PPS standards but not yet addressed in GIPS (e.g., Real Estate and Venture Capital).

AIMR hopes that this redraft of the AIMR-PPS standards will set an example of how countries or regions with existing standards can move toward one global standard, by incorporating GIPS as the core of the local standard with additional provisions only as necessary to satisfy the country-specific requirements.

B. ADDITIONAL AIMR-PPS SPECIFIC REQUIREMENTS AND RECOMMENDATIONS

Although the AIMR-PPS standards incorporate all of the core GIPS requirements and recommendations, additional provisions apply to the AIMR-PPS standards by nature of well-established practices. Managers must observe these additional provisions in addition to the GIPS requirements to be compliant with the AIMR-PPS standards. These additions are included in the body of the AIMR-PPS Provisions (Section II) as notations that are italicized.
The following provisions of the AIMR-PPS standards serve to supplement existing GIPS requirements and/or recommendations.

Requirements

Under GIPS, firms are required to disclose whether the presentation conforms with local laws and regulations that differ from GIPS requirements and the manner in which the local standards conflict with GIPS. According to existing interpretations on the AIMR-PPS standards, firms must disclose whether the presentation conforms with local laws and regulations that differ from the AIMR-PPS requirements. The GIPS provision will be modified slightly to require firms to disclose whether laws and regulations conflict with the AIMR-PPS standards.

Section II.4.A.16.
Under GIPS, firms are recommended to disclose the fee schedule (see Section II.4.B.3.). The AIMR-PPS standards require firms to disclose the fee schedule. To claim compliance with the AIMR-PPS standards, the presentation must disclose the firm’s fee schedule.

Section II.5.A.1.(a).
AIMR-PPS standards have a more stringent requirement regarding the length of the historical record of performance that must be shown. GIPS require firms to present five years (initially, building up to ten years) whereas AIMR-PPS requires ten years. Firms claiming compliance with AIMR-PPS standards must present ten years of performance history.

Section II.5.A.1.(e).
Firms must use the approved AIMR-PPS “Compliance Statement” as provided in Section B of the AIMR-PPS Introduction (below) in order to claim compliance with the AIMR-PPS standards.

Section II.5.A.8.
The AIMR-PPS standards state that composite results may not be restated following changes in a firm’s organization.

Recommendations

Section II.4.B.6.
The AIMR-PPS standards recommend that firms disclose the differences in portfolio structure relative to the designated benchmarks.

Section II.4.B.7.
The AIMR-PPS standards recommend that firms disclose the portfolio size range for each composite and the percentage of total assets managed in the same asset class as represented by the composite.

Section III. (Verification)
GIPS contain one level of Verification, whereas Verification under the AIMR-PPS standards consists of two levels: Primary or Level I (firmwide verification) and Secondary or Level II (composite verification). The
Verification procedures for Level I have been redrafted so that they are the same, in all material respects, to the verification procedures for GIPS. The plan is to discontinue use of Level II Verification by 1/1/2005.

Additional AIMR-PPS Sections

By implementing the Country Version of GIPS approach, AIMR-PPS has adopted the GIPS standards as the core principles (subject to minor differences noted in italics). Sections 1-5 reflect the basic elements involved in presenting performance information: Input Data, Calculation Methodology, Composite Construction, Disclosures, and Presentation and Reporting. The AIMR-PPS standards also consist of four additional sections (6-9) that address the calculation and presentation of performance for alternative asset categories (e.g., real estate, venture and private placements, wrap-fee (all-in) accounts, and after-tax returns). These additional sections will be changed to conform as GIPS guidelines in these technical areas are developed and adopted by the IPC and AIMR.

Claim of Compliance

Once a firm has met all of the required elements of the AIMR-PPS standards, the firm may use the following “Compliance Statement” on a performance presentation that meets all of the requirements of the Standards to indicate that the presentation is in compliance with the AIMR-PPS standards:

[Insert name of firm] has prepared and presented this report in compliance with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPSTM), the North American Version of the Global Investment Performance Standards™ (GIPS™). AIMR has not been involved in the preparation or review of this report.

The AIMR-PPS Claim of Compliance statement can only be made on a fully compliant presentation. This statement should be made in addition to the GIPS Claim of Compliance, as stated in the GIPS Introduction, Number I.17.

If a performance presentation does not meet all of the requirements of the AIMR-PPS standards, firms cannot represent that the performance presentation is “in compliance with the AIMR-PPS standards except for . . .” Statements referring to the calculation methodology used in a presentation as being “in accordance (or compliance) with AIMR-PPS standards” are prohibited.

Effective Dates for Compliance

For an investment firm to claim compliance with the AIMR-PPS standards, the firm must meet the following effective dates:

- From January 1, 1993, all of the firm’s actual discretionary fee-paying nontaxable portfolios solely invested in US and/or Canadian investments (“North American portfolios”) must be presented in composites that adhere to the Standards.

- From January 1, 1994, all of the firm’s actual discretionary fee-paying portfolios invested in non-US and/or non-Canadian investments (“international portfolios”) and taxable portfolios (both North American and international) must be presented in composites that adhere to the Standards.
• From July 1, 1995, all of the firm’s actual discretionary fee-paying portfolios meeting the definition of a wrap-fee account must be presented in composites that adhere to the Standards.

• From January 1, 1997, going forward, all of the firm's composites and performance presentations must include accrued income in market value performance calculations.

Retroactive Compliance

The AIMR-PPS standards require that firms report, at a minimum, 10 years of investment performance (or performance since the inception of the firm if inception is less than 10 years) to claim compliance with the Standards.

Firms with records or performance calculations for periods prior to the applicable effective date(s) that are not in conformance with the AIMR-PPS standards can still claim compliance with the Standards if certain conditions are met. To claim compliance, the firm has three options:

• restate its historical performance numbers in accordance with the Standards,

• restate its historical performance in accordance with the Relaxed Retroactive Standards, explained in the following paragraph, for retroactive compliance, or

• use its nonconforming historical performance and disclose specifically when and how the performance is not in compliance.

The first option is the desired approach. For the second option, under the Relaxed Retroactive Standards for compliance prior to January 1, 1993, two relaxations are allowed:

• Portfolios and composites may be valued on an annual basis as a maximum. Valuation periods for both portfolios and composites may be as long as one year (although if cash flows were significant during the year, valuations should be done more frequently). To qualify for inclusion in a composite that is valued annually, a portfolio must have been under management according to a strategy appropriate to the composite for at least one year.

• Accrual accounting need not be applied.

For the third option, if a firm claims compliance with the AIMR-PPS standards but the performance record prior to the applicable effective date is not in compliance and the noncompliance periods are linked to periods that are in compliance, the firm must

• disclose that the full record is not in compliance,

• identify the noncompliance periods, and

• explain exactly how the noncompliance periods are out of compliance.

In any case, the performance record after the applicable effective dates must be fully compliant.
C. GLOBAL INVESTMENT PERFORMANCE STANDARDS INTRODUCTION

The AIMR-PPS Standards, the North American version of GIPS, is seeking IPC endorsement as a CVG. The IPC’s standardized CVG approach requires that the CVG include the GIPS Introduction in its entirety with no additions or changes. The following section contains the full text of the GIPS Introduction as adopted by the AIMR Board of Governors on February 19, 1999.

I. Introduction

Preamble - Why Is A Global Standard Needed?

1. The financial markets and the investment management industry are becoming increasingly global in nature. Given the variety of financial entities and countries involved, this globalization of the investment process and the exponential growth of assets under management demonstrate the need to standardize the calculation and presentation of investment performance.

2. Prospective clients and asset managers will benefit from an established standard for investment performance measurement and presentation that is recognized worldwide. Investment practices, regulation, performance measurement, and reporting of performance results vary considerably from country to country. Some countries have guidelines that are widely accepted within their borders, and others have few recognized standards for presenting investment performance.

3. Requiring investment managers to adhere to performance presentation standards will help assure investors that the performance information is both complete and fairly presented. Firms in countries with minimal presentation standards will be able to compete for business on an equal footing with firms from countries with more developed standards. Firms from countries with established practices will have more confidence of being fairly compared to “local” firms when competing for business in countries that have not previously adopted performance standards.

4. Both prospective and existing clients of investment firms will benefit from a global investment performance standard by having a greater degree of confidence in the performance numbers presented by the firms. Performance standards that accepted in all countries enable all investment firms to measure and present their investment performance so that clients can readily compare investment performance among firms.

Vision Statement

5. A global investment performance standard leads to readily accepted presentations of investment performance that (1) present performance results which are readily comparable among investment managers, without regard to geographic location, and (2) facilitate a dialogue between investment managers and their prospective clients about the critical issues of how the manager achieved performance results and future investment strategies.

Objectives

6. To obtain worldwide acceptance of a standard for the calculation and presentation of investment performance in a fair, comparable format that provides full disclosure.
7. To ensure accurate and consistent investment performance data for reporting, record keeping, marketing, and presentation.

8. To promote fair, global competition among investment firms for all markets without creating barriers to entry for new firms.

9. To foster the notion of industry “self-regulation” on a global basis.

Overview

10. The “Global Investment Performance Standards” (GIPS) have several key characteristics:

   a. GIPS are ethical standards for investment performance presentation to ensure fair representation and full disclosure of an investment manager’s performance.

   b. GIPS exist as a minimum worldwide standard where local or country-specific law, regulation, or industry standards may not exist for investment performance measurement and/or presentation.

   c. GIPS require managers to include all actual fee-paying, discretionary portfolios in composites defined according to similar strategy and/or investment objective and require firms to show GIPS compliant history for a minimum of 5 years, or since inception of the firm or composite if in existence less than 5 years.

   d. GIPS require firms to use certain calculation and presentation methods and to make certain disclosures along with the performance record.

   e. GIPS rely on the integrity of input data. The accuracy of input data is critical to the accuracy of the performance presentation. For example, benchmarks and composites should be created/selected on an ex ante basis, not after the fact.

   f. GIPS consist of guidelines that firms are required to follow in order to claim compliance. The adoption of other elements of GIPS is recommended for firms to achieve best practice in performance presentation.

   g. GIPS apply to the presentation of investment performance of assets managed on behalf of a third party.

   h. GIPS should be applied with the goal of full disclosure and fair representation of investment performance. Meeting the objective of full and fair disclosure is likely to require more than compliance with the minimum requirements of GIPS. If an investment firm applies GIPS in a performance situation that is not addressed specifically by the standards or is open to interpretation, disclosures other than those required by GIPS may be necessary. To fully explain the performance included in a presentation, firms are encouraged to present all relevant supplemental information.
i. In cases in which applicable local or country-specific law or regulation conflicts with GIPS, the Standards require firms to comply with the local law or regulation and make full disclosure of the conflict.

j. GIPS do not address every aspect of performance measurement, valuation, attribution, or coverage of all asset classes. GIPS will evolve over time to address additional aspects of investment performance. Certain recommended elements in GIPS may become requirements in the future.

Scope

11. Application of GIPS. Investment management firms from any country may come into compliance with GIPS. Compliance with GIPS will facilitate a firm’s participation in the investment management industry on a global level.

12. Definition of a Firm. GIPS must be applied on a firmwide basis. A firm may define itself as:

   a. an entity registered with the appropriate national regulatory authority overseeing the entity’s investment management activities; or

   b. an investment firm, subsidiary, or division held out to clients or potential clients as a distinct business unit (e.g., a subsidiary firm or distinct business unit managing private client assets may claim compliance for itself without its parent organization being in compliance).

   c. (until January 1, 2005), all assets managed to one or more base currencies (for firms managing global assets).

When presenting investment performance in compliance with GIPS, an investment management firm must state how it defines itself as a “firm.”

13. Historical Performance Record.

   a. A firm is required to present, at a minimum, 5 years of annual investment performance that is compliant with GIPS. If the firm or composite has been in existence less than five years, firms must present performance since the inception of the firm or composite; and

   b. After a firm presents five years of compliance history, firms must present additional annual performance up to ten years. For example, after a firm presents five years of compliant history, the firm must add an additional year of performance each year so that after five years of claiming compliance, the firm presents a ten-year performance record.

   c. A firm may link non-GIPS-compliant performance record to their compliant history, so long as no non-compliant performance is presented for periods after January 1, 2000 and the firm discloses the periods of non-compliance and explains how the presentation is not in compliance with GIPS.

Nothing in this section shall prevent firms from immediately presenting more than five years of performance results.
Compliance

14. Requirements. Firms must meet all the requirements set forth in GIPS to claim compliance with GIPS. Although GIPS requirements must be met immediately by a firm claiming compliance, the following requirements do not go into effect until a future date:

a. Portfolios must be valued at least monthly for periods beginning January 1, 2001.

b. Time-weighted rates of return adjusted for cash flows are required. Firms must use time-weighted rates of return adjusted for daily-weighted cash flows for periods beginning January 1, 2005.

c. For periods beginning January 1, 2010, firms will likely be required to value portfolios on the date of any external cash flow.

d. Firms must use trade date accounting for periods beginning January 1, 2005.

d. Accrual accounting must be used for dividends (as of the ex dividend date) for periods beginning January 1, 2005.

Until these future requirements become effective, these provisions should be considered recommendations. Firms are encouraged to implement these requirements prior to their effective date. To ease compliance with GIPS when the future requirements take effect, firms should design performance software to incorporate these future requirements.

15. Compliance Check. Firms must take all steps necessary to ensure that they have satisfied all of the requirements of GIPS before claiming compliance with GIPS. Firms are strongly encouraged to perform periodic internal compliance checks and implement adequate business controls on all stages of the investment performance process -- from data input to presentation material -- to ensure the validity of compliance claims.

16. Third-party Performance Measurement and Composite Construction. GIPS recognize the role of independent third-party performance measurers and the value they can add to the firm’s performance-measurement activities. Where third-party performance measurement is an established practice or is available, firms are encouraged to use this service as it applies to the investment firm. Similarly, where the practice is to allow third parties to construct composites for investment firms, firms can use such composites in a GIPS-compliant presentation only if the composites comply with GIPS.

17. Claim of Compliance. Once a firm has met all of the required elements of GIPS, the firm may use the following “Compliance Statement” to indicate that the performance presentation is in compliance with GIPS:

(Insert name of firm) has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS).
If the performance presentation does not meet all of the requirements of GIPS, firms cannot represent that the performance presentation is “in compliance with the Global Investment Performance Standard except for...” Statements referring to the calculation methodology used in a presentation as being “in accordance (or compliance) with the Global Investment Performance Standards” are prohibited except when applied to the performance of a single, existing client.

18. Sample Presentation. A sample presentation, shown in Appendix A, provides an example of what a compliant performance presentation could look like, including disclosures.

Relationship Of Gips With Country-Specific Laws, Regulations, And Industry Standards

19. GIPS fill the void where no country standards exist. Regulators and investment organizations worldwide are strongly encouraged to recognize and adopt GIPS as the performance presentation standard applicable to their constituencies. If there is a need for country-specific guidelines that go beyond GIPS, regulators and organizations are encouraged to develop and implement such guidelines to augment, but not conflict with, GIPS. Regulators are urged to supervise country compliance with GIPS and any country-specific standards that may exist.

20. Where existing laws, regulations, or industry standards already impose performance presentation standards, firms are strongly encouraged to comply with GIPS in addition to those local requirements. Compliance with applicable law or regulation does not necessarily lead to compliance with GIPS. When complying with GIPS and local law or regulation, firms must disclose any local laws and regulations that conflict with GIPS.

21. The establishment of GIPS will minimize the complexities that result with the existing contingent reciprocity agreements among organizations with their own standards. Organizations are encouraged to recognize GIPS rather than establish “country-to-country” reciprocity agreements for country-specific standards. When a country or group establishes local performance presentation standards, such standards should incorporate all of the required elements of the GIPS and state that compliance with GIPS is equivalent to compliance with the local standards.
SECTION II.

Content of the AIMR-PPS Standards
(Amended and Restated as the AIMR-PPS Standards, the North American Version of GIPS)

Outline

Provisions of the AIMR-PPS and Global Investment Performance Standards*

1. Input Data
2. Calculation Methodology
3. Composite Construction
4. Disclosures
5. Presentation and Reporting

Additional AIMR-PPS Provisions For Alternative Asset Categories

6. Real Estate
7. Venture and Private Placements
8. Wrap-Fee (All-In) Accounts
9. After-Tax Performance

* The GIPS Provisions above have been supplemented with additional AIMR-PPS requirements and recommendations. The additions are highlighted in italics in this section and are summarized in the AIMR-PPS Introduction Section I.B.
Provisions of the AIMR-PPS and Global Investment Performance Standards

All references made to GIPS below are relevant to the AIMR-PPS standards as well *(except where highlighted in italics)*.

GIPS are divided into five sections that reflect the basic elements involved in presenting performance information: Input Data, Calculation Methodology, Composite Construction, Disclosures, and Presentation and Reporting.

1. **Input Data**: Consistency of input data is critical to effective compliance with GIPS and establishes the foundation for full, fair, and comparable investment performance presentations. The Standards provide the blueprint for a firm to follow in constructing this foundation.

2. **Calculation Methodology**: Achieving comparability among investment management firms’ performance presentations requires uniformity in methods used to calculate returns. The Standards mandate the use of certain calculation methodologies (e.g., performance must be calculated using a time-weighted total rate of return method).

3. **Composite Construction**: A composite is an aggregation of a number of portfolios into a single group that represents a particular investment objective or strategy. The composite return is the asset-weighted average of the performance results of all the portfolios in the composite. Creating meaningful, asset-weighted composites is critical to the fair presentation, consistency, and comparability of results over time and among firms.

4. **Disclosures**: Disclosures allow firms to elaborate on the raw numbers provided in the presentation and give the end user of the presentation the proper context in which to understand the performance results. To comply with GIPS, firms must disclose certain information about their performance presentation and the calculation methodology adopted by the firm. Although some disclosures are required of all firms, others are specific to certain circumstances, and thus may not be applicable in all situations.

5. **Presentation and Reporting**: After constructing the composites, gathering the input data, calculating returns, and determining the necessary disclosures, the firm must incorporate this information in presentations based on the guidelines set out in GIPS for presenting the investment performance results. No finite set of guidelines can cover all potential situations or anticipate future developments in investment industry structure, technology, products, or practices. When appropriate, firms have the responsibility to include in GIPS-compliant presentations information not covered by the Standards.

The Standards for each section are divided between requirements, listed first in each section, and recommended guidelines. Firms must follow the required elements of GIPS to claim compliance with GIPS. Firms are strongly encouraged to adopt and implement the recommendations to ensure that the firm fully adheres to the spirit and intent of GIPS. An example of a GIPS-compliant presentation for a single composite is included in Appendix A. *An example of an AIMR-PPS compliant presentation is also provided in Appendix B.*

Although GIPS may be translated into many languages, if a discrepancy arises between the different versions of the standards, the English version of GIPS is controlling.
Additional AIMR-PPS Provisions For Alternative Asset Categories

The following four sections (6-9) contain additional requirements and recommendations for firms to follow when presenting the performance results of Additional Asset Categories in compliance with the AIMR-PPS standards.

6. **Real Estate**: Because of its unique characteristics, particularly the lack of a readily verifiable secondary market to determine asset values, real estate performance presentation guidelines warrant separate treatment. This section provides guidelines for calculating and presenting the performance results of real estate investments.

7. **Venture and Private Placements**: AIMR recognizes that there are difficulties inherent in applying the requirements of the AIMR-PPS standards to investments in venture and private placements. AIMR developed this section to recognize the special requirements of these different asset classes within the overall ethical framework of the standards.

8. **Wrap-Fee (All-In) Accounts**: Firms must follow the requirements in this section when reporting performance results on wrap-fee accounts in compliance with the AIMR-PPS standards. For purposes of the AIMR Performance Presentation Standards, the definition of a wrap account is the same as the U.S. Securities and Exchange Commission’s definition of a wrap fee program: “a program [account] under which any client is charged a specified fee or fees not based directly upon transactions in a client’s account for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and execution of client transactions.”

9. **After-Tax Performance**: Currently, firms are recommended to present performance results after the effects of taxes. Firms must follow the requirements in this section if reporting performance results after-tax. The objective of these guidelines is to provide additional information that will help prospective clients to assess results in a meaningful way when considering the tax implications of the investment.
1. **Input Data**

1.A. **Requirements**

1.A.1. All data and information necessary to support a firm’s performance presentation and to perform the required calculations must be captured and maintained.

1.A.2. Portfolio valuations must be based on market values (not cost basis or book values).

1.A.3. Portfolios must be valued at least quarterly. For periods beginning January 1, 2001, portfolios must be valued at least monthly. For periods beginning January 1, 2010, it is anticipated that firms will be required to value portfolios on the date of any external cash flow.


1.A.5. Accrual accounting must be used for fixed income securities and all other assets that accrue interest income.

1.A.6. Accrual accounting must be used for dividends (as of the ex dividend date) for periods beginning January 1, 2005.

1.B. **Recommendations**

1.B.1. Sources of exchange rates should be the same between the composite and a benchmark.

2. **Calculation Methodology**

2.A. **Requirements**

2.A.1. Total return, including realized and unrealized gains plus income, must be used.

2.A.2. Time-weighted rates of return that adjust for cash flows must be used. Periodic returns must be geometrically linked. Time-weighted rates of return that adjust for daily-weighted cash flows must be used for periods beginning January 1, 2005. Actual valuations at the time of external cash flows will likely be required for periods beginning January 1, 2010.

2.A.3. In both the numerator and the denominator, the market values of fixed income securities must include accrued income.

2.A.4. Composites must be asset-weighted using beginning-of-period weightings or another method that reflects both beginning market value and cash flows.

2.A.5. Returns from cash and cash equivalents held in portfolios must be included in total return calculations.

2.A.6. Performance must be calculated after the deduction of all trading expenses.
2.A.7. If a firm sets a minimum asset level for portfolios to be included in a composite, no portfolios below that asset level can be included in that composite.

2.B. **Recommendations**

2.B.1. Returns should be calculated net of non-reclaimable withholding taxes on dividends, interest, and capital gains. Reclaimable withholding taxes should be accrued.

2.B.2. Performance adjustments for external cash flows should be treated in a consistent manner. Significant cash flows (i.e., 10 percent of the portfolio or greater) that distort performance (i.e., plus or minus 0.2 percent for the period) may require portfolio revaluation on the date of the cash flow (or after investment) and the geometric linking of subperiods. Actual valuations at the time of any external cash flows will likely be required for periods beginning January 1, 2010.

3. **Composite Construction**

3.A. **Requirements**

3.A.1. All actual, fee-paying, discretionary portfolios must be included in at least one composite.

3.A.2. Firm composites must be defined according to similar investment objectives and/or strategies.

3.A.3. Composites must include new portfolios on a timely and consistent basis after the portfolio comes under management - unless specifically mandated by the client.

3.A.4. Terminated portfolios must be included in the historical record of the appropriate composites up to the last full measurement period that the portfolio was under management.

3.A.5. Portfolios must not be switched from one composite to another unless documented changes in client guidelines or the redefinition of the composite make it appropriate. The historical record of the portfolio must remain with the appropriate composite.

3.A.6. Convertible and other hybrid securities must be treated consistently across time and within composites.

3.A.7. Carve-out returns excluding cash cannot be used to create a stand-alone composite. When a single asset class is carved out of a multiple-asset portfolio and the returns are presented as part of a single-asset composite, cash must be allocated to the carve-out returns and the allocation method must be disclosed. Beginning January 1, 2005, carve-out returns must not be included in single asset class composite returns unless the carve-outs are actually managed separately with their own cash allocations.

3.A.8. Composites must include only assets under management and may not link simulated or model portfolios with actual performance.
3.B. **Recommendations**

3.B.1. Separate composites should be created to reflect different levels of allowed asset exposure.

3.B.2. Unless the use of hedging is negligible, portfolios that allow the use of hedging should be included in different composites from those that do not.

4. **Disclosures**

4.A. **Requirements**

The following disclosures are mandatory:

4.A.1. The definition of “firm” used to determine the firm’s total assets and firmwide compliance.

4.A.2. Total firm assets for each period.

4.A.3. The availability of a complete list and description of all of the firm’s composites.

4.A.4. If settlement-date valuation is used by the firm.

4.A.5. The minimum asset level, if any, below which portfolios are not included in a composite.


4.A.7. The presence, use and extent of leverage or derivatives, including a description of the use, frequency and characteristics of the instruments sufficient to identify risks.

4.A.8. Whether performance results are calculated gross or net of investment management fees and other fees paid by the clients to the firm or to the firm’s affiliates.

4.A.9. Relevant details of the treatment of withholding tax on dividends, interest income and capital gains. If using indexes that are net-of-taxes, firms must disclose the tax basis of the composite (e.g. Luxembourg based or U.S. based) versus that of the benchmark.

4.A.10. For composites managed against specific benchmarks, the percentage of the composites invested in countries or regions not included in the benchmark.

4.A.11. Any known inconsistencies between the chosen source of exchange rates and those of the benchmark must be described and presented.

4.A.12. Whether the firm has included any non-fee-paying portfolios in composites and the percentage of composite assets that are non-fee-paying portfolios.
4.A.13. The AIMR-PPS standards require that firms disclose whether the presentation conforms with local laws and regulations that differ from AIMR-PPS requirements and the manner in which the local standards conflict with the AIMR-PPS standards. (GIPS requirement: Whether the presentation conforms with local laws and regulations that differ from GIPS requirements and the manner in which the local standards conflict with GIPS.)

4.A.14. The effective dates for AIMR-PPS compliance are provided in the AIMR-PPS Introduction, Section I.B. For any performance presented for periods prior to the applicable effective dates, the period of non-compliance and how the presentation is not in compliance with the AIMR-PPS standards. (GIPS requirement: For any performance presented for periods prior to January 1, 2000 that does not comply with GIPS, the period of non-compliance and how the presentation is not in compliance with GIPS.)

4.A.15. When a single asset class is carved out of a multiple-asset portfolio and the returns are presented as part of a single asset composite, the method used to allocate cash to the carve-out returns.

4.A.16. The AIMR-PPS standards require firms to disclose the firm’s fee schedule(s) appropriate to the presentation (see Section 4.B.3.).

4.B. Recommendations

The following disclosures are recommended:

4.B.1. The portfolio valuation sources and methods used by the firm.

4.B.2. The calculation method used by the firm.

4.B.3. The AIMR-PPS standards require that firms disclose the fee schedule appropriate to the presentation (See Section 4.A.16.). (GIPS recommendation: When gross-of-fee performance is presented, the firm’s fee schedule(s) appropriate to the presentation.)

4.B.4. When only net-of-fee performance is presented, the average weighted management and other applicable fees.

4.B.5. Any significant events within the firm (such as ownership or personnel changes) that would help a prospective client interpret the performance record.

4.B.6. The AIMR-PPS standards recommend that firms disclose the differences in portfolio structure relative to the designated benchmarks.

4.B.7. The AIMR-PPS standards recommend that firms disclose the portfolio size range for each composite and the percentage of total assets managed in the same asset class as represented by the composite.

5. Presentation and Reporting
5.A. **Requirements**

5.A.1. The following items must be reported:

(a) *The AIMR-PPS standards require firms to present, at a minimum, ten years of performance history. See Introduction section I.B. for a discussion on the Effective Dates and Retroactive Compliance.* *(GIPS requirement: At least five years of performance (or a record for the period since firm inception, if inception is less than five years) that is GIPS compliant. After presenting five years of performance, firms must present additional annual performance up to ten years. For example, after a firm presents five years of compliant history, the firm must add an additional year of performance each year so that after five years of claiming compliance, the firm presents a 10-year performance record.)*

(b) Annual returns for all years.

(c) The number of portfolios and amount of assets in the composite and the percentage of the firm’s total assets represented by the composite at the end of each period.

(d) A measure of the dispersion of individual component portfolio returns around the aggregate composite return.

(e) *The AIMR-PPS standards require firms to use the approved AIMR-PPS “Compliance Statement” provided in the AIMR-PPS Introduction, Section I.B. indicating firmwide compliance with the AIMR-PPS standards.* *(GIPS requirement: The standard Compliance Statement indicating firmwide compliance with the GIPS.)*

(f) The composite creation date.

5.A.2. *The Effective Dates of Compliance and Retroactive Compliance Guidelines for the AIMR-PPS standards are provided in the AIMR-PPS Introduction, Section I.B. (GIPS requirement: Firms may link non-GIPS compliant performance to their compliant history so long as firms meet the disclosure requirements of Section 4 and no non-compliant performance is presented for periods after January 1, 2000. (For example, a firm that has been in existence since 1990 that wants to present its entire performance history and claim compliance as of January 1, 2000, must present performance history that meets the requirements of GIPS at least from January 1, 1995, and must meet the disclosure requirements of Section 4 for any non-compliant history prior to January 1, 1995.))*

5.A.3. Performance for periods of less than one year must not be annualized.

5.A.4. Performance results of a past firm or affiliation can only be linked to or used to represent the historical record of a new firm or new affiliation if:

(a) a change only in firm ownership or name occurs, or
(b) the firm has all of the supporting performance records to calculate the performance, substantially all the assets included in the composites transfer to the new firm, and the investment decision-making process remains substantially unchanged.

5.A.5. If a compliant firm acquires or is acquired by a non-compliant firm, the firms have one year to bring the non-compliant firm’s acquired assets into compliance.

5.A.6. If a composite is formed using single asset carve-outs from multiple asset class composites, the presentation must include the following:

(i) a list of the underlying composites from which the carve-out was drawn, and

(ii) the percentage of each composite the carve-out represents.

5.A.7. The total return for the benchmark (or benchmarks) that reflects the investment strategy or mandate represented by the composite must be presented for the same periods for which the composite return is presented. If no benchmark is presented, the presentation must explain why no benchmark is disclosed. If the firm changes the benchmark that is used for a given composite in the performance presentation, the firm must disclose both the date and the reasons for the change. If a custom benchmark or combination of multiple benchmarks is used, the firm must describe the benchmark creation and re-balancing process.

5.A.8. *The AIMR-PPS standards state that composite results may not be restated following changes in a firm’s organization.*

5.B. **Recommendations**

5.B.1. The following items should be included in the composite presentation or disclosed as supplemental information:

(a) composite performance gross of investment management fees and custody fees and before taxes (except for non-reclaimable withholding taxes),

(b) cumulative returns for composite and benchmarks for all periods,

(c) equal-weighted means and median returns for each composite,

(d) volatility over time of the aggregate composite return,

(e) inconsistencies among portfolios within a composite in the use of exchange rates.

5.B.2. Relevant risk measures - such as volatility, tracking error, beta, modified duration, etc. - should be presented along with total return for both benchmarks and composites.

6. **Real Estate**
6.A. **Requirements**

6.A.1. *Real estate must be valued through an independent appraisal at least once every three years unless client agreements state otherwise.*

6.A.2. *Real estate valuations must be reviewed at least quarterly.*

6.A.3. *Component returns for participating or convertible mortgages must be allocated as follows:*

(a) basic cash interest to income return,

(b) contingent interest (current receivable) to income return,

(c) basic accrued interest (deferred) to income return,

(d) additional contingent interest (deferred; payable at maturity, prepayment, or sale) to appreciation return,

(e) return that is currently payable from operations to income return, and

(f) all other sources of income that are deferred or realizable in the future to the appreciation component.

6.A.4. *Returns from income and capital appreciation must be presented in addition to total return.*


(a) the absence of independent appraisals,

(b) the source of the valuation and the valuation policy,

(c) total fee structure and its relationship to asset valuation,

(d) the return formula and accounting policies for such items as capital expenditures, tenant improvements, and leasing commissions,

(e) the cash distribution and retention policy,

(f) whether the returns are

* • based on audited operating results,*

* • exclude any investment expense that may be paid by the investors,* and

* • include interest income from short-term cash investments or other related investments,* and

(g) the cash distribution and retention policies with regard to income earned at the investment level.
6.B. **Recommendations**

6.B.1. Income earned at the investment level should be included in the computation of income return regardless of the investor’s accounting policies for recognizing income from real estate investments.

6.B.2. Equity ownership investment strategies should be presented separately.

6.B.3. When presenting the components of total return, recognition of income at the investment level, rather than at the operating level, is preferred.

7. **Venture and Private Placements**

7.A. **Requirements**

7.A.1. All discretionary pooled funds of funds and separately managed portfolios must be included in composites defined by vintage year (i.e., the year of fund formation and first takedown of capital).

7.A.2.a. For General partners:

(1) Cumulative internal rate of return (IRR) must be presented since inception of the fund and be net of fees, expenses, and carry to the limited partner.

(2) IRR must be calculated based on cash-on-cash returns plus residual value.

7.A.2.b. For Intermediaries and investment advisors:

(1) For separately managed accounts and commingled fund-of-funds structures, cumulative IRR must be presented since inception of the fund and be net of fees, expenses, and carry to the limited partners but gross of investment advisory fees unless net of fees is required to meet applicable regulatory requirements.

(2) Calculation of IRR must be based on an aggregation of all the appropriate partnership cash flows into one IRR calculation—as if from one investment.

7.A.3.a. For General Partners:

(1) Cumulative IRR must be presented since inception of the fund.

(2) Presentation of return information must be in a vintage-year format.

7.A.3.b. Intermediaries and investment advisors

(1) For separately managed accounts and commingled fund-of-funds structures, cumulative IRR must be presented since inception.
(2) The inclusion of all discretionary pooled fund-of-funds and separately managed portfolios in composites must be defined by vintage year.

(3) For calculating composite returns, the IRR must be based on an aggregation of all the appropriate partnership cash flows into one IRR calculation—as if from one investment.

7.A.4.a. For general partners, the performance presentation must disclose:

(1) changes in the general partner since inception of fund,

(2) type of investment, and

(3) investment strategy.

7.A.4.b. For intermediaries and investment advisors, the performance presentation must disclose:

(1) the number of portfolios and funds included in the vintage-year composite, composite assets,

(2) composite assets in each vintage year as a percentage of total firm assets (discretionary and nondiscretionary committed capital), and

(3) composite assets in each vintage year as a percentage of total private equity assets.

7.B. Recommendations

7.B.1. General partners:

(a) Industry guidelines should be used for valuation of venture capital investments,

(b) Valuation should be either cost or discount to comparables in the public market for buyout, mezzanine, distressed, or special situation investments, and

(c) IRR should be calculated net of fees, expenses, and carry without public stocks discounted and assuming stock distributions were held.

7.B.2. Net cumulative IRR (after deduction of advisory fees and any other administrative expenses or carried interest) should be calculated for separately managed accounts, managed accounts, and commingled fund-of-funds structures.

7.B.3.a. For general partners, the following should be disclosed:

(1) gross IRR (before fees, expenses, and carry), which should be used at the fund and the portfolio level, as supplemental information,
(2) the multiple on committed capital net of fees and carry to the limited partners,
(3) the multiple on invested capital gross of fees and carry,
(4) the distribution multiple on paid-in capital net of fees to the limited partners, and
(5) the residual multiple on paid-in capital net of fees and carry to the limited partners.

7.B.3.b. For intermediaries and investment advisors, the number and size should be disclosed in terms of committed capital of discretionary and nondiscretionary consulting clients.

8. **Wrap-Fee (All-In) Accounts**

8.A. **Requirements**

8.A.1. Wrap-fee performance must be shown net of all fees charged directly or indirectly to the account (unless transaction expenses can be determined and deducted).

8.A.2. When a firm presents portfolios included in a wrap-fee composite that do not meet the wrap-fee definition, the firm must disclose for each year presented:

(a) the dollar amount of assets represented and
(b) the fee deducted.

8.A.3. When wrap-fee composite returns are presented before fees, the performance presentation must disclose:

(a) fees,
(b) investment style, and
(c) the information that “pure” gross-of-fees return does not include transaction costs.

8.B. **Recommendations**

8.B.1. Wrap-fee portfolios should be grouped in separate composites from nonwrapped composites.

8.B.2. Pure gross-of-fees performance should be reported (in addition to the required net-of-fees performance), but gross-of-fees performance should be presented only to prospective wrap-fee clients.

9. **After-Tax Performance**
Following are provisions that apply to firms that choose to present their results after the effect of taxes. Currently, firms are only recommended to present after-tax performance.

9.A. **Requirements**

9.A.1. **For after-tax composites:**

(a) Taxes must be recognized in the same period as when the taxable event occurred.

(b) Taxes on income and realized capital gains must be subtracted from results regardless of whether taxes are paid from assets outside the account or from account assets.

(c) The maximum federal income tax rates appropriate to the portfolios must be assumed.

(d) The return for after-tax composites that hold both taxable and tax-exempt securities must be adjusted to an after-tax basis rather than being “grossed up” to a taxable equivalent.

(e) Calculation of after-tax returns for tax-exempt bonds must include amortization and accretion of premiums or discounts.

(f) Taxes on income are to be recognized on an accrual basis.

9.A.2. **The performance presentation must disclose:**

(a) for composites of taxable portfolios, the composite assets as a percentage of total assets in taxable portfolios (including nondiscretionary assets) managed according to the same strategy for the same type of client,

(b) the tax rate assumptions if performance results are presented after taxes, and

(c) both client average and manager average performance if adjustments are made for nondiscretionary cash withdrawals.

9.B. **Recommendations**

9.B.1. Portfolios should be grouped by tax rate.

9.B.2. Portfolios may be grouped by vintage year, or similar proxy, to group portfolios with similar amounts of unrealized capital gains.

9.B.3. Cash-basis accounting is to be used if required by applicable law.


9.B.5. Benchmark returns should be calculated using the actual turnover in the benchmark index, if available; otherwise, an approximation is acceptable.
9.B.6. If returns are presented before taxes, a total rate of return for the composite should be presented without adjustment for tax-exempt income to a pretax basis.

9.B.7. If returns are presented after taxes, client-specific tax rates may be used for each portfolio (but composite performance should be based on the same tax rate for all clients in the composite).

9.B.8. The following presentations should be made for composites:

(a) beginning and ending market values,

(b) contributions and withdrawals,

(c) beginning and ending unrealized capital gains,

(d) realized short-term and long-term capital gains,

(e) taxable income and tax-exempt income,

(e) the accounting convention used for the treatment of realized capital gains (e.g., highest cost, average cost, lowest cost, FIFO, LIFO), and

(g) the method or source for computing after-tax benchmark return.
III. VERIFICATION

The primary purpose of verification is to establish that a firm claiming compliance with AIMR-PPS standards has adhered to the standards. Verification will also increase the understanding and professionalism of performance-measurement teams and consistency of presentation of performance results.

The AIMR-PPS standards currently recommend that firms verify their claims of compliance with the AIMR-PPS standards. Verification under the AIMR-PPS standards consists of two levels Primary or Level I (firmwide verification) and Secondary or Level II (composite verification).

The AIMR-PPS standards outline certain procedures that verifiers must follow when performing a Level I or Level II Verification. The verification procedures for Level I are the same, in all material respects, to the verification procedures for GIPS. The AIMR-PPS Level I procedures attempt to strike a balance between ensuring the quality, accuracy and relevance of performance presentations and minimizing the cost to investment firms of independent review of performance results. Investment firms should assess the benefits of improved internal process and procedures, which are as significant as the marketing advantages of verification. The goal in drafting the GIPS Verification procedures (Level I) is to encourage broad acceptance of verification.

Until January 1, 2005 firms can choose to have a Level II verification completed on a specific composite. However, as the efficiencies associated with the revised Level I verification procedures occur (e.g., cost savings, availability, etc.), AIMR expects that the focus of the industry will shift from Level II verification to Level I and, by 1/1/2005, the Level II verification will be removed from the AIMR-PPS verification guidelines. At that point, firms will no longer be able to make a claim that a particular composite has been independently verified with respect to the AIMR-PPS standards.

It is likely that once Secondary or Level II Verification has been removed from the AIMR-PPS standards, Primary or Level I Verification will simply be re-termed ‘Verification’.
A. PRIMARY OR LEVEL I VERIFICATION

I. Scope and Purpose of Level I Verification

1. Level I verification is the review of an investment management firm’s performance measurement processes and procedures by an independent third-party “verifier.” Level I Verification is the primary level of verification. It tests:

   A. Whether the investment firm has complied with all the composite construction requirements of AIMR-PPS on a firmwide basis, and
   B. Whether the firm’s processes and procedures are designed to calculate and present performance results in compliance with the AIMR-PPS standards.

   A single verification report is issued in respect of the whole firm; AIMR-PPS Level I verification cannot be carried out for a single composite.

2. Third party verification brings credibility to the claim of compliance, and supports the overall guiding principles of full disclosure and fair representation of investment performance. Verification is strongly encouraged and is expected to become mandatory (but no earlier than 2005).

3. The initial minimum period for which verification can be performed is one year of a firm’s presented performance. The recommended period over which verification is performed will be that part of the firm’s track record for which AIMR-PPS compliance is claimed.

4. A Level I verification report must confirm that:

   A. the investment firm has complied with all the composite construction requirements of the AIMR-PPS standards on a firmwide basis, and
   B. the firm’s processes and procedures are designed to calculate and present performance results in compliance with the AIMR-PPS standards.

   Without such a report from the verifier, the firm cannot claim that its claim of compliance with the AIMR-PPS standards has been Level I verified.

5. After performing the Level I verification, the verifier may conclude that the firm is not in compliance with AIMR-PPS, or that the records of the firm cannot support a complete verification. In such situations, the verifier must issue a statement to the firm clarifying why a verification report was not possible.

6. A principal verifier may accept the work of a local or previous verifier as part of the basis for the principal verifier’s opinion.

7. The minimum AIMR-PPS Level I verification procedures are described in Section III.A.II “Required Level I Verification Procedures.”
II. Required Level I Verification Procedures

The following are the minimum procedures that verifiers must follow when completing a Level I verification on an investment firm’s compliance with the AIMR-PPS standards. Verifiers must follow these procedures prior to issuing a Level I verification report to the firm:

1. Pre-verification Procedures

A. Knowledge of the Firm. Verifiers must obtain selected samples of the firm’s investment performance reports, and other available information regarding the firm, to ensure appropriate knowledge of the firm.

B. Knowledge of AIMR-PPS. Verifiers must understand the requirements and recommendations of the AIMR-PPS standards, including any updates, reports, or clarifications of the AIMR-PPS published by the AIMR-PPS Implementation Committee, the AIMR sponsored body responsible for interpreting, clarifying and expanding the AIMR Performance Presentation Standards.

C. Knowledge of Firm Policies. Verifiers must determine the firm’s assumptions and policies for establishing and maintaining compliance with all applicable requirements of the AIMR-PPS standards. At minimum, verifiers must determine the firm’s following policies and procedures of the firm:

   i. Policy with regard to investment discretion. The verifier must receive from the firm, in writing, the firm’s definition of investment discretion and the firm’s guidelines for determining whether accounts are fully discretionary.

   ii. Policy with regard to the definition of composites according to investment strategy. The verifier must obtain the firm’s list of composite definitions with written criteria for including accounts in each composite.

   iii. Policy with regard to the timing of inclusion of new accounts in the composites.

   iv. Policy with regard to timing of exclusion of closed accounts in the composites.

   v. Policy with regard to the accrual of interest and dividend income.

   vi. Policy with regard to the market valuation of investment securities.


   viii. Assumptions on the timing of capital inflows/outflows.

   ix. Method for computing composite returns.

   x. Policy with regard to the presentation of composite returns.

   xi. Policies regarding timing of implied taxes due on income and realized capital gains for reporting performance on an after-tax basis.
xii. Policies regarding use of securities/countries not included in a composite’s benchmark.

xiii. Use of leverage and other derivatives.

xiv. Any other policies and procedures relevant to performance presentation.

D. Knowledge of Valuation Basis for Performance Calculations. Verifiers must ensure that they understand the methods and policies used to record valuation information for performance calculation purposes. In particular, verifiers must determine that:

i. the firm’s policy on classifying fund flows (e.g., injections, disbursements, dividends, interest, fees, taxes, etc.) is consistent with the desired results and will give rise to accurate returns;

ii. the firm’s accounting treatment of income, interest and dividend receipts is consistent with cash account and cash accruals definitions;

iii. the firm’s treatment of taxes, tax reclaims, and tax accruals is correct, and the manner used is consistent with the desired method (i.e., gross- or net-of-tax return);

iv. the firm’s policies on recognizing purchases, sales, and the opening and closing of other positions are internally consistent, and will produce accurate results; and

v. the firm’s accounting for investments and derivatives is consistent with AIMR-PPS standards.

2. Level I Verification Procedures

A. Definition of the Firm. Verifiers must determine that the firm is, and has been, appropriately defined.

B. Composite Construction. Verifiers must be satisfied that:

i. the firm has defined and maintained composites according to reasonable guidelines in compliance with the AIMR-PPS standards;

ii. all of the firm’s actual discretionary fee-paying portfolios are included in a composite;

iii. the manager’s definition of discretion has been consistently applied over time;

iv. at all times, all accounts are included in their respective composites and no accounts that belong in a particular composite have been excluded;

v. composite benchmarks are consistent with composite definitions and have been consistently applied over time;

vi. the firm’s guidelines for creating and maintaining composites have been consistently applied; and
vii. the firm’s list of composites is complete.

C. **Non-Discretionary Accounts.** Verifiers must obtain a listing of all firm portfolios and determine on a sampling basis whether the manager’s classification of the account as discretionary or non-discretionary is appropriate by referring to the account agreement and the manager’s written guidelines for determining investment discretion.

D. **Sample Account Selection.** Verifiers must obtain a listing of open and closed accounts for all composites for the years under examination. Verifiers may check compliance with AIMR-PPS using a selected sample of a firm’s accounts. Verifiers should consider the following criteria when selecting the sample accounts for examination:

i. number of composites at the firm;

ii. number of portfolios in each composite;

iii. nature of the composite;

iv. total assets under management;

v. internal control structure at the firm (system of checks and balances in place);

vi number of years under examination; and

vii computer applications, software used in the construction and maintenance of composites, the use of external performance measurers and the calculation of performance results.

This list is not all-inclusive and contains only the *minimum* criteria that should be used in the selection and evaluation of a sample for testing. For example, one potentially useful approach would be to choose a portfolio for the study sample that has the largest impact on composite performance because of its size or because of extremely good or bad performance. The lack of explicit record keeping, or the presence of errors, may warrant selecting a larger sample or applying additional verification procedures.

E. **Account Review.** For selected accounts, verifiers must determine:

i. whether the timing of the initial inclusion in the composite is in accordance with policies of the firm;

ii. whether the timing of exclusion from the composite is in accordance with policies of the firm for closed accounts;

iii. whether the objectives set forth in the account agreement are consistent with the manager’s composite definition as indicated by the account agreement, portfolio summary, and composite definition;

iv. the existence of the accounts by tracing selected accounts from account agreements to the composites;

v. that all portfolios sharing the same guidelines are included in the same composite; and
vi. that shifts from one composite to another are consistent with the guidelines set forth by the specific account agreement or with documented guidelines of the firm’s clients.

F. Performance Measurement Calculation. Verifiers must determine whether the firm has computed performance in accordance with the policies and assumptions adopted by the firm and disclosed in its presentations. In doing so, verifiers should:

i. recalculate rates of return for a sample of accounts in the firm using an acceptable return formula as prescribed by the AIMR-PPS standards (i.e., time-weighted rate of return); and

ii. take a reasonable sample of composite calculations to assure themselves of the accuracy of the asset weighting of returns, the geometric linking of returns to produce annual rates of returns, and the calculation of the dispersion of individual returns around the aggregate composite return.

G. Disclosures. Verifiers must review a sample of composite presentations to ensure that the presentations include the information and disclosures required by the AIMR-PPS standards.

H. Maintenance of Records. The verifier must maintain sufficient information to support the verification report. The verifier must obtain a representation letter from the client firm confirming major policies and any other specific representations made to the verifier during the examination.

III. Level I Verification Reports

A Level I Verification Report must include the following information:

- That the report is for a Level I Verification,
- The timeframe covered by the report,
- The verifier followed Level I Verification procedures outlined by AIMR, and
- That:
  1. The firm has complied with all the creation and maintenance of composites requirements of the AIMR-PPS standards on a firmwide basis, and
  2. The firm’s processes and procedures are designed to calculate performance results in compliance with the AIMR-PPS standards, and
  3. The firm has available composite presentations that comply with the AIMR-PPS standards.

These statements must be made either in the text of the report or in a footnote. Without these statements from the verifier, the firm cannot claim that it has been verified.

Firms can only claim compliance with the AIMR-PPS standards by making the following statement on a fully compliant presentation:

“[Insert firm name] has prepared and presented this report in compliance with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPSTM), the North American Version of the Global Investment Performance Standards™ (GIPS™). AIMR has not been involved with the preparation or review of this report.”
This claim of compliance implies that:

- The firm has complied with all the creation and maintenance of composites requirements of the AIMR-PPS standards on a firmwide basis, and
- The firm’s processes and procedures are designed to calculate performance results in compliance with the AIMR-PPS standards, and
- The firm has available composite presentations that comply with the AIMR-PPS standards.

Verifiers may require that the firm explicitly state these assertions, in writing, to the verifier prior to and as a condition of the verifier issuing a Level I Verification Report. Once a firm has made these assertions, the verifier will examine these assertions by performing the verification procedures outlined above.

IV. Standard Level I Verification Report Language

The following is the standard verification statement that should be used in the Level I verification reports issued by verifiers to firms that have received verifications under the AIMR-PPS standards. The language is subject to any applicable professional standards of the verifier.

For general claims of Level I Verification:

“[ABC, name of the verifier] has completed a Level I Verification of [XYZ, name of the firm] for the time period [state the time period]. We completed this Level I Verification in accordance with the Level I Verification Procedures set forth in the AIMR-PPS standards [as well as any other standards if applicable]. In our opinion, 1) the firm complies with all the composite construction requirements of the AIMR-PPS standards, 2) it’s processes and procedures are designed to calculate and present performance results in compliance with the AIMR-PPS standards, and 3) firm has available composite presentations that comply with the AIMR-PPS standards.”

If the firm’s claim of Level I Verification is a part of an AIMR-PPS compliant presentation that has not been Level II verified, the verifier should include in its report the following language in addition to the above statement:

“In performing the Level I Verification, we [the verifier] have not determined the accuracy or validity of the performance record of any particular composite presentation, including this presentation.”

If the firm’s claim of Level I Verification is contained on an AIMR-PPS compliant presentation that has been Level II verified, the verifier should include in its report the following language in addition to the above statement:

“In addition to the firmwide Level I Verification, we [the verifier] have performed a Level II verification on this particular composite presentation and determined that this performance presentation is accurate, correct and fully complies with the AIMR-PPS standards.”

V. Use of the Level I Verification Report
Once a firm has obtained a Level I Verification, the firm can state that the firm is “Level I verified” or has obtained a Level I Verification. Such claim need not accompany presentation of performance history. However, if a statement that the firm has received a Level I Verification does accompany a report of performance history, that presentation of performance must be fully compliant with the AIMR-PPS standards. (Note that once a firm claims compliance with the AIMR-PPS standards, all presentations to clients or prospective clients must be compliant with the AIMR-PPS standards unless other performance is specifically requested by the client or prospective client - in this case, a compliant presentation must accompany the specifically requested information.)
B. SECONDARY OR LEVEL II VERIFICATION

I. Scope and Purpose of Level II Verification

1. Until January 1, 2005, an investment management firm may choose to have a further, more extensive, specifically focused examination (or performance audit) of a specific composite presentation. Such examination, for the purposes of the AIMR-PPS standards, is referred to as a Level II Verification. Level II Verification is the secondary level of verification. It requires that:

   A. The verifier follows the procedures for a Level I Verification, and
   B. Performance results of the specific composite being verified at Level II are accurate and fully comply with the AIMR-PPS standards.

2. A Level II verification must be accompanied by a firmwide list of composites and the required disclosures for each composite (e.g., number of portfolios, composite assets, and the composite assets as a percentage of firm assets). Without the list of firmwide composites, the firm cannot claim a Level II verification. The firm is obligated to attach the composite list to the Level II verification statement.

3. A Level II Verification report is issued only with respect to the composite examined by the verifier and does not verify the validity of the firmwide claim of compliance or the accuracy of a performance presentation for any other composite.

4. The initial minimum period for which verification can be performed is one year of a firm’s presented performance. The recommended period over which verification is performed will be that part of the firm’s track record for which AIMR-PPS compliance is claimed.

5. After performing the Level II verification, the verifier may conclude that the firm is not in compliance with AIMR-PPS, or that the records of the firm cannot support a complete verification. In such situations, the verifier must issue a statement to the firm clarifying why a verification report was not possible.

6. A principal verifier may accept the work of a local or previous verifier as part of the basis for the principal verifier’s opinion.

II. Required Level II Verification Procedures

When issuing a Level II verification on a specific composite, a verifier must have first performed a firmwide Level I verification.

The following are the minimum procedures that verifiers must follow when completing a Level II verification on an investment firm’s composite. Verifiers must follow these procedures prior to issuing a Level II verification report to the firm:

1. Pre-verification Procedures

   Verifiers must complete the Pre-verification Procedures as outlined for Level I verification (above) prior to initiating a Level II verification.
2. Level II Verification Procedures

Verifiers must perform the following procedures:

A. Cash flows, income, and expenses. Verifiers must determine whether capital contributions and withdrawals that are used in the performance calculations are recorded in the proper accounts, at the right amounts, and on a timely basis. Verifiers should carry out the following procedures:

   i. For each account in the selected sample basis, verify income streams, including the timing and actual receipt of dividends, accrued interest, other income, and treatment of various fees and expenses. Dividends may be recorded on a cash basis, but AIMR recommends accrual-basis treatment.

   ii. Agree dividend payments to an independent source on a test basis.

   iii. Recalculate interest income and various fees and agree to custodian statement on a test basis.

   iv. Trace cash flows to appropriate independent documentation and ensure bona fide recording in the proper account and proper period.

   v. Footnote cash flow details on the transaction detail report for a number of individual accounts on a test basis.

   vi. Obtain and review bank reconciliation to ensure proper recording of cash flows.

   vii. Agree to composite schedule.

   viii. Determine the reasonableness of the methods used to account for cash flows of managed accounts.

B. Portfolio trade processing. Verifiers must determine whether executed trades have been recorded in the proper accounts at the correct amounts on the appropriate dates. Verifiers should carry out the following procedures:

   i. For each composite or custodian statement, trace the trade to the following:

      a. agree the CUSIP (Committee on Uniform Securities Identification Procedures) number, equity name, trade date, settlement date, price per share (principal amount), and total cost of proceeds on the transaction summary principal cash ledger to the custodian statement;

      b. agree the CUSIP number, equity name, trade date, settlement date, price per share (principal amount), and total cost of proceeds on the transaction summary principal cash ledger to the independent broker confirmation;

      c. ascertain the reasonableness of the purchase/sales price of a security from an independent pricing source;
d. trace each purchase/sale selection to the daily listing of portfolios and ensure proper inclusion/exclusion;

e. verify distributions based on the allocation sheet showing the breakup and distribution of total purchase/sale to various customer accounts, if applicable;

f. agree exchange rates to independent source, if applicable.

ii. Agree to composite schedule.

C. Portfolio valuation management. Verifiers must determine whether the end-of-month (quarter) valuation of the security positions is accurate. Verifiers should carry out the following procedures:

i. For each account selected in the basic sample, obtain the client firm’s end-of-month quarter) portfolio price makeup sheet and perform the following:

  a. agree all securities on the price makeup sheet to the month-end custodian statement (exceptions may arise because of unsettled purchases/sales transactions and differences in security prices);

  b. agree open purchases/sales to the subsequent custodian statement for clearance, if applicable;

  c. agree the market value of the price makeup sheet to an independent price source on a test basis;

  d. on a test basis, recalculate and footnote the total market valuation from the summary position sheet and agree to the list performance detail report,

  e. agree exchange rates to an independent source, if applicable.

ii. Agree to composite schedule.

iii. Obtain externally pooled portfolio records (custodian statements) or historical internally produced documents (customer statements) and agree to portfolio valuation in the composite, as applicable and practicable.

D. Performance measurement calculation. Verifiers must determine whether the client firm’s performance measurement statistics have been computed in accordance with the AIMR-PPS standards as well as the policies and assumptions indicated by the firm in the footnotes to the report. For these tasks, verifiers should consider performing the following procedures:

i. Obtain from the client firm the composite schedule for composite accounts for the years under examination; recalculate quarterly (monthly) rates of return for each account in the basic sample using an acceptable return formula as prescribed by AIMR (i.e., time-weighted rate of return) based on the information contained in the composites.
ii. Recalculate the following for all composites under examination and agree to the client firm’s reported figures:

   a. the linked annual rates of return for all composite accounts under examination;

   b. the average annual rate of return for all composites under examination.

iii. Agree composite schedule to cash flows, trade tickets, and portfolio positions tested previously.

E. *Net-of-fees testing.* When a manager chooses to create and verify net-of-fees performance results, the verifier must determine whether the calculation of the net-of-fees performance is accurate. Verifiers should carry out the following procedures:

   i. Obtain quarterly (monthly) customer invoices for each selected portfolio.

   ii. Recompute the fee per the invoice and agree the total quarterly fee to the sum of the related monthly fees or the performance detail report.

   iii. Recalculate the monthly allocation, which is based on the portfolio market value weighted by each month (for billings in arrears) or by dividing the quarterly fee by 3 (for billings in advance). For any discrepancies, agree allocation used to the client firm’s fee schedule. (Recalculate fees based on the client firm’s contracts on a test basis.)

   iv. Test allocations of fees to specific managed accounts; consider impact of allocation methodology on time-weighted performance calculations.

   v. Agree the fees per the performance detail report to the fees listed per the related composite performance report.

III. Standard Level II Verification Report Language

The following is the standard verification statement that should be used in the Level II verification reports issued by verifiers to firms that have received verifications under the AIMR-PPS standards. The language is subject to any applicable professional standards of the verifier.

Verifier [X, name of verifier] has completed a Level II verification of compliance in accordance with the AIMR Performance Presentation Standards (AIMR-PPS™) on Composite [A, identification of composite] for Firm [XYZ, name of firm] for the time period [time period]. In the opinion of Verifier [X], Composite [A]: (1) includes all of the firm’s actual discretionary fee-paying portfolios that share the similar strategy or investment objective in the firm’s definition of this composite and (2) includes composite securities, income, and pricing data that are valid; (3) performance results have been calculated in compliance with the AIMR-PPS standards.
Firm [XYZ] has represented to Verifier [X] in writing: (1) that Firm [XYZ] complies with the AIMR-PPS standards on a firmwide basis and (2) that a list of all firm composites is available and the required disclosures for each composite have been made.

Verifier [X] is not responsible for the accuracy of the list of firm composites and has relied solely upon information provided by Firm [XYZ] for its claim of firmwide compliance with the AIMR-PPS standards.

IV. Use of the Level II Verification Report

Any statement by a firm that an independent third party has verified a particular composite at Level II must only appear on the compliant performance presentation of that composite.
APPENDIX A

GIPS SAMPLE PRESENTATION

XYZ Investment Firm Performance Results: Balanced Composite, January 1, 1995, through December 31, 1999

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Return (percent)</th>
<th>Benchmark Return (percent)</th>
<th>Number of Portfolios</th>
<th>Composite Dispersion (percent)</th>
<th>Total Assets at End of Period (DM millions)</th>
<th>Percentage of Firm Assets</th>
<th>Percentage of Non-Fee-Paying Portfolios</th>
<th>Total Firm Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>16.0</td>
<td>14.1</td>
<td>26</td>
<td>4.5</td>
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<td>236</td>
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<tr>
<td>1996</td>
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<td>1.8</td>
<td>32</td>
<td>2.0</td>
<td>235</td>
<td>68</td>
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<td>346</td>
</tr>
<tr>
<td>1997</td>
<td>22.4</td>
<td>24.1</td>
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<td>65</td>
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<td>529</td>
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<tr>
<td>1998</td>
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<td>6.0</td>
<td>45</td>
<td>2.8</td>
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<td>64</td>
<td>0</td>
<td>695</td>
</tr>
<tr>
<td>1999</td>
<td>8.5</td>
<td>8.0</td>
<td>48</td>
<td>3.1</td>
<td>520</td>
<td>62</td>
<td>0</td>
<td>839</td>
</tr>
</tbody>
</table>

XYZ Investment Firm has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS).

Notes:

1. XYZ Investment Firm is a balanced portfolio investment manager that invests solely in German securities. XYZ Investment Firm is defined as an independent investment management firm that is not affiliated with any parent organization.

2. The benchmark: 30 percent DAX 100; 70 percent EFFAS Bund Index rebalanced monthly. Annualized compound composite return = 11.9 percent; annualized compound benchmark return = 11.4 percent.

3. Valuations are computed in German marks and from Reuters.

4. The dispersion of annual returns is measured by the standard deviation across asset-weighted portfolio returns represented within the composite for the full year.

5. Performance results are presented before management and custodial fees but after all trading commissions. The management fee schedule is attached.

6. This composite was created in February, 1995. No alteration of composites as presented here has occurred because of changes in personnel or other reasons at any time. A complete list of firm composites and performance results is available upon request.
### XYZ Investment Firm Performance Results: U.S. Balanced Composite
January 1, 1990, through December 31, 1999

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Return (percent)</th>
<th>Benchmark Return (percent)</th>
<th>Number of Portfolios</th>
<th>Composite Dispersion (percent)</th>
<th>Total Assets at End of Period (US$ millions)</th>
<th>Percentage of Firm Assets</th>
<th>Percentage of Non-Fee-Paying Portfolios</th>
<th>Total Firm Assets</th>
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<td>62</td>
<td>0</td>
<td>839</td>
</tr>
</tbody>
</table>

XYZ Investment Firm has prepared and presented this report in compliance with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPS™), the North American Version of the Global Investment Performance Standards™ (GIPS™). AIMR has not been involved in the preparation or review of this report.

**Notes:**

1. XYZ Investment Firm is an independent investment management firm, established in 1989. XYZ Investment Firm manages a variety of equity, fixed income and balanced assets for primarily North American institutional clients.

2. These results have been prepared and presented in compliance with the AIMR-PPS standards only for the period January 1, 1992, through December 31, 1999. The full period is not in compliance. Prior to January 1, 1992, not all fully discretionary portfolios were represented in appropriate composites. Composite results for the years 1990 through 1992 include the five largest institutional portfolios that were managed in accordance with the balanced strategy. These five accounts are consistently represented in the composite for the full period from 1990 through 1999.

3. The benchmark: 60 percent S&P 500 Index; 40 percent Lehman Intermediate Aggregate Index - rebalanced monthly. Annualized compound composite return = 11.9 percent; annualized compound benchmark return = 11.4 percent.

4. Valuations are computed and returns are stated in US Dollars.

5. The dispersion of annual returns is measured by the standard deviation across asset-weighted portfolio returns represented within the composite for the full year.

6. Performance results are presented before management and custodial fees but after all trading commissions. The management fee schedule is attached.

7. This composite was created in February 1993.

8. The minimum portfolio size limit for the U.S. Balanced Composite is $5,000,000.

9. Settlement-date accounting was used prior to 1992.

10. A complete list of firm composites and performance results is available upon request.