AIMR-PPS Database

The information contained in this document should be used for historical compliance purposes only.

Accrual Accounting

The AIMR-PPS standards state that "accrual accounting must be used for fixed-income and all other securities that accrue income." Please clarify whether the requirement refers to equities as well as fixed income.

Accrual accounting is a requirement for fixed-income securities, and a recommendation for equity. Firms must include the income that would have been received had the security actually been sold at the end of the performance period. For example, most fixed-income securities accrue income on a pro rata basis. This income is payable at the coupon date or when the security is sold, so it must be accrued unless the price of the security already reflects such accrual. Dividends are not payable unless the stock was owned on the record date, so dividends should be accrued as income on the ex-dividend date for trade valuations (note that this approach is a recommendation, not a requirement; cash-based accounting for equities is acceptable if it does not distort performance).

Source: Standards Reporter, Nov - Dec 1997

What is AIMR's position regarding cash versus accrual accounting of management fees for investment managers?

Currently, the AIMR-PPS standards do not require the presentation of performance net-of-fees. However, if a firm chooses to present performance net-of-fees, the firm should accrue management fees when those fees go unpaid beyond a typical billing period (at a maximum quarterly). Accruing fees on a regular basis avoids the occurrence of performance distortions when an irregular payment takes place.

Source: AIMR Advocate, Jan - Feb 2000

If accrual accounting for dividends is not a requirement until January 1,2005, what does this mean for historical performance calculations where dividends were not accrued (our custodians download only on paid dates, not accrued dates)? Do these all need to be reconstructed?

No. This requirement is not a retroactive requirement; therefore, the firm would not have to recalculate historical performance using accrual accounting for dividends. The firm would simply have to begin using accrual accounting from January 1, 2005 forward. However, firms are encouraged to implement these requirements prior to their effective dates.

Source: AIMR Webcast, 22 April 1999

Asset Allocation

When must a total return be calculated for portfolios invested in more than one commingled fund or mutual fund?

For portfolios that are invested in more than one fund or unit trust, when the manager has discretion over the percentages of assets invested in each, i.e., when the manager is running a total return portfolio using a combination of commingled funds and/or individual securities, a total return must be calculated and performance included in a total return, multiple-asset composite.

Source: AIMR Newsletter, Jan - Feb 1994

Asset Only Returns

The AIMR-PPS standards state that "asset-only returns must not be mixed with asset-plus-cash returns." (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 11). Please clarify this statement.

The requirement of the AIMR-PPS standards that asset-only returns must not be mixed with asset-plus-cash returns refers to the segment returns of multiple-asset composites. If a firm reports the performance of the segments of multiple-asset portfolios broken out by asset segments (e.g., equity, fixed income), the Standards allow the performance to be displayed in one of two ways: (1) as supplemental information to the presentation of the performance of the total multiple-asset portfolio or composite, in which case cash need not be allocated to each segment in calculating returns; or (2) as a stand-alone portfolio (by itself, grouped in a composite with other multiple-asset portfolio segments, or grouped in a composite with single-asset portfolios), in which case cash must be allocated to the segment in calculating the return.

If an asset segment is broken out from a multiple-asset composite without the cash allocation, that asset-only return cannot be combined with any performance results that include an asset segment plus the cash associated with the segment. The asset-only return can be shown only as supplemental information. The AIMR Performance Presentation Standards Handbook, 1997 edition, has an example of a supplemental performance presentation on page 134.

Source: Standards Reporter, Mar - Apr 1997

Assimilating Assets

Our bank was very close to completing a lengthy and expensive process of bringing all our tax-exempt assets into compliance with the AIMR-PPS standards as of January 1, 1993 and taxable assets into compliance as of January 1, 1994. Just prior to completing these compliance requirements, our bank acquired another entity whose assets are not in

compliance. Is there some sort of grace period that we will be allowed after making such an acquisition? Or, will we have to postpone making a claim of compliance for the efforts we have already completed until the acquired assets are also brought into compliance?

Assimilating Assets

If the acquired accounts are to be transition into the investment style and strategy of the acquiring firm, they should be treated as new accounts and placed in a composite labeled "acquisition of XYZ" until such time as the assets can be blended over time into compliance. The acquiring firm will need to set reasonable and consistently applied criteria that is well documented for determining when the acquired assets complete the transition to the new style. Some accounts will be modified more quickly than others. Therefore, rather than setting one arbitrary time frame for bringing all acquired assets into existing composites that meet compliance requirements, different portfolios can transition at different times, as long as the criteria are consistently followed. The historical performance records for these strategies will be those of the acquiring firm. Availability of the records of the acquired firm must be disclosed and provided upon request, even though the strategies have been discontinued.

If the investment style and strategy of the acquired firm is to be maintained and its accounts represent separate composites, the assets of the acquired firm must meet compliance requirements as of the first full reporting period one year after the acquisition date, for a firm to claim compliance. In other words, there will be a one-year grace period for bringing the acquired assets into compliance if the strategies of the acquired assets are to be maintained. For example, if the assets are acquired in mid-July, the assets would need to meet compliance requirements as of the beginning of the fourth quarter of the following year. The historical performance records for these strategies will be those of the acquired firm.

To claim compliance, taxable assets must meet compliance requirements by at least January 1, 1994; tax-exempt assets must meet compliance requirements by at least January 1, 1993. Prior periods to do not have to be in compliance, as long as this is disclosed, with an explanation of how the past is not in compliance. If an historical record, even an historical record that does not meet compliance requirements, is not available because underlying records were not maintained or because performance was not calculated, this must be disclosed. For periods after January 1, 1993 for tax-exempt, and January 1, 1994 for taxable assets, a lack of performance calculations cannot be disclosed as a means of claiming compliance. After these dates, only the absence of underlying records can be used as a basis for not meeting compliance requirements, and the absence of such records must be disclosed.

Systems Problems

The AIMR-PPS Implementation Committee has discussed the problems of integrating different portfolio management, accounting and performance measurement systems for different branches or subsidiaries or for different types of assets or client groups. While recognizing the practical problems and costs of integrating systems or of initiating performance measurement of portfolios, the Committee has determined that compliance with the AIMR-PPS standards requires investment in the necessary systems to evaluate portfolio performance. Therefore, systems incompatibilities cannot be used as a reason for not claiming compliance for all assets, i.e., a manager cannot make the claim of compliance for only those assets that are measured and monitored on compatible systems.

Disclosures

It is recommended, rather than required, that an acquiring firm disclose when an acquisition is made, the amount of assets and the number of portfolios involved. As the new assets are brought into compliance, prospective clients will see an increase in the size of assets and number of portfolios through the required composite disclosures. Therefore, full disclosure of acquisitions is in the best interests of both the prospective client and the acquiring firm.

Source: AIMR List of 75 Question and Answers, 1994

If two investment management firms merge, with one being in compliance with the AIMR-PPS standards and the other not, how should the new organization change its compliance claims, composite performance presentation, and disclosures? May these be different for those composites that will continue, those that represent styles to be dropped, and those for which the style of the acquiring firm will replace the style of the acquired firm (even if the product category is the same)? How should the new combined firm define itself in terms of assets?

Under the "definition of the firm," the new / combined firm may continue to define itself as two separate entities if it holds itself out to the market as such (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 3). One entity could thus continue to claim compliance while the other does not. Each would have to refer to only its own assets under management in making performance presentations. If the new / combined firm wishes to define itself as a single entity and claim compliance with the AIMR-PPS standards, then eventually, it must follow all of the rules for doing so. In particular, all discretionary, fee-paying portfolios previously managed by either firm must be included in at least one composite and the performance record for all composites must include a 10-year history (or history since inception, if less than 10 years). The new / combined firm has a one-year period during which it may claim compliance for those composites that are already in compliance or for which the style will continue, but it must disclose that portfolios managed by the non-compliant firm are not yet included in all composites (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 78). If the two firms both have products with similar mandates but have decided that only a single management style will prevail, the historical performance record for the prevailing style must be used for this composite, with full disclosure that the surviving fund is a combination of two products (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 79).

The AIMR-PPS standards are ethical standards. In the interest of full and fair disclosure during the one-year grace period, the Standards recommend that the new / combined firm fully disclose a list of all styles and assets under management, even those for which historic composites do not yet exist, so that prospective clients can fully understand the firm.

Source: Standards Reporter, Sep - Oct 1997

Balanced Composites/Portfolios

A balanced portfolio manager has an account in which the manager does not have discretion over the cash segments of a portfolio. How can a manager include this account in a multiple asset composite?

If the manager does not control the actual investment of cash (e.g., cash is always invested in a bank STIF or invested separately by the client) but the manager does control the percentage of cash allocated, then the cash assets must be included in the manager’s total assets and the performance of cash must be included in the total account performance. The fact that the performance of cash is technically not under the manager’s control will not generally affect the total portfolio results as much as the allocation of assets to cash, which is under the manager’s control.

Source: Standards Reporter, Mar - Apr 1997

When managing portfolios that include international and/or real estate assets as part of a balanced portfolio approach are the requirements and mandatory disclosures listed in the AIMR Performance Presentation Standards Handbook, 1997 edition, necessary, or are these requirements and disclosures necessary only when presenting portfolios consisting entirely of international or real estate in an asset class specific composite?

The requirements and mandatory disclosures outlined in the AIMR Performance Presentation Standards Handbook, 1997 edition, for real estate and international portfolio are intended for composites of those specific asset classes. Therefore, when these assets classes are included in a balanced portfolio and composite, it would not be necessary to provide specific disclosures for the asset classes unless in the manager's judgment it is necessary to do so for a fair presentation.

Source: AIMR Newsletter, May - Jun 1995

Regarding multiple-asset portfolios, the standards state that if the firm does not have discretion over the asset mix, the segments (with their respective cash positions) can be presented as a stand alone portfolio. What if we have discretion over the asset mix? My understanding is that if we have asset mix discretion, balanced accounts must be included in a balanced composite. Can discretionary asset-mix balanced accounts have the asset segments segregated?

Yes. If a firm maintains discretion over the asset mix of a multiple-asset portfolio, the firm can either present the total return of the multiple-asset portfolio in a balanced composite and/or present each segment return with its own cash allocation as a stand alone portfolio grouped in a composite with other multiple-asset portfolio segments or grouped in a composite with other single-asset portfolio segments. The firm can choose to present the segment returns of the multiple-asset portfolio as stand alone composites as long as each segment (with its appropriate cash allocation) is represented in at least one of the firm's discretionary composites.
The Standards go on to state that only portfolios for which the firm has asset-mix discretion should be included in balanced composites. This statement does not imply that all portfolios over which the firm has asset-mix discretion must be included in balanced composites. Instead, the statement is meant to exclude portfolios where the firm does not have asset-mix discretion from balanced composites.

If the firm chooses to present the segments of a multiple-asset portfolio, the segments can be presented in one of two ways:

· As supplemental information to the presentation of the performance of the total composite, in which case cash need not be allocated to the segment being presented, or
· As a stand alone portfolio (by itself, grouped in a composite with other multiple-asset portfolio segments, or grouped in a composite with single-asset portfolios), in which cash must be allocated to the segment being presented.

Source: AIMR Advocate, Sep - Oct 1999

We are increasing the equity exposure of our balanced composite from 65 percent equity to 75 percent. Should we adjust the previous balanced composite to be consistent with this new

level or just add another disclosure indicating the change in the equity percentage and the effective date?

The AIMR-PPSTM standards recommend that balanced portfolios with different asset mixes be grouped in separate composites defined by the percentages of each asset in the composite portfolios (AIMR Performance Presentation Standards Handbook (1997, second edition) pp. 32). The treatment of the balanced composite depends on how the firm has defined the balanced composite.

In this situation, if the firm has defined this composite as a specific 65%/35% asset mix, and the firm decides to increase the equity portion of the firm's balanced composite, the change in asset mix would result in a change in the composite's defining investment style or strategy. The firm must create a new balanced composite to reflect the higher equity percentage and the new composite would not have historical performance results because the new composite represents a newly implemented strategy. The historical performance results of the old balanced composite can be presented as supplemental information.

However, if the firm has defined the balanced composite with more general guidelines (i.e., asset mix between 50%/50% and 75%/25%), then a shift from 65% in equities to 75% might not result in a change in the composite's defining investment style or strategy.

Source: AIMR Advocate, Nov - Dec 1999

Benchmarks

If the firm changes the benchmark for a composite, should the benchmark be changed historically for the composite?

When making this decision, the firm should consider that the AIMR-PPS standards are an ethical set of guidelines for presenting composite performance. The firm must keep in mind the spirit of fair representation and full disclosure of the Standards when considering this retroactive change. Changes to the benchmark primarily intended to make historical performance look better by lowering the benchmark return, violate the spirit of the Standards. If the firm deems the new benchmark is a more representative test of the effective implementation of an investment strategy, the firm may consider changing the benchmark retroactively. However, the firm must disclose the date the benchmark is changed and the reason it has been retroactively applied.

Source: Standards Reporter, May - Jun 1999

According to the new requirements of the AIMR-PPS standards, beginning 1/1/2000, "the appropriate 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, an explanation of why no benchmark must be disclosed." If the firm does not believe presentation of a benchmark is appropriate, can the firm disclose this reasoning and satisfy the new requirement?

Yes. This new requirement leaves the choice and selection of an appropriate benchmark to the firm. If the firm determines that no benchmark is appropriate, the firm can disclose why no benchmark return is provided when presenting the performance of this composite.

Source: Standards Reporter, May - Jun 1999

We changed our benchmark because of the Euro. Do we have to calculate the return of the old benchmark for the history?

Beginning 1/1/200, firms are required to define an appropriate benchmark and present the total return for the benchmark for each period shown in a performance presentation. When a firm is considering changing the benchmark historically, the firm should consider that the AIMR-PPS standards are an ethical set of guidelines for presenting composite performance. The firm must keep in mind the spirit of fair representation and full disclosure of the Standards when considering this retroactive change. Changes to the benchmark primarily intended to make historical performance look better by lowering the benchmark return, violate the spirit of the Standards. If the firm deems the new benchmark is a more representative test of the effective implementation of an investment strategy, the firm may consider changing the benchmark retroactively. However, the firm must disclose the date the benchmark is changed and the reason it has been retroactively applied.
In the situation you describe, it appears that the change in benchmark is simply due to the change in the currency and not due to a newly discovered benchmark that more appropriately tests the implementation of the investment strategy. Therefore, the firm should simply change the benchmark as of a certain date, disclosing the date and reason for the change.

Source: AIMR Webcast, 22 April 1999

If you are using a custom benchmark that includes fewer countries or regions than the investment universe of the composite, you might face the troublesome task of reporting percentages of the composite invested abroad. How do we solve that problem with respect to the AIMR-PPS standards? Would it be acceptable to interpret regions as a group of countries – for example, Europe – and stick to reporting the percentage of the composite invested in regions not included in the benchmark?

The AIMR-PPS standards state that, for composites measured against specific benchmarks, the firm must disclose the percentage of the composites invested in countries or regions not included in the benchmark. If the firm created a custom benchmark to manage portfolios in a composite, it is not clear why the firm created a benchmark that does not include the countries and regions that are represented in the composite. The Standards, however, leave it up to the firm to define the term “regions” in this disclosure. Once the regions are defined, the firm should disclose how they are defined and provide the percentage of the composite that is not represented in the benchmark regions.

Source: AIMR Webcast, 22 April 1999

Calculation Methodology

AIMR requires the use of a time-weighted, total rate of return calculation and provides in the Handbook three calculation methods, along with formulas for calculating gross-of-fee versus net-of-fee performance. Are these the required formulas or is there flexibility in determining a preferred method?

The AIMR Performance Presentation Standards Handbook, 1997 edition, pp. 44-46 provides alternative performance calculations for portfolios and composites. The intent is not to require revision of existing performance calculations or associated computer software that conforms to the concepts of quarterly, time-weighted total returns. Rather, for those who desire a single guideline, widely used definitions, formulas, and methodologies are included for each area of consideration. The important criteria to follow is to establish a consistent calculation methodology that incorporates the time-weighted, total rate of return components.

Source: AIMR Newsletter, Jul - Aug 1995

A composite holds both portfolios with daily valuation and portfolios with weekly valuation (NAV). At the end of the monthly reporting period, how should we extrapolate the valuation of the "weekly" portfolios from the last weekly valuation date to the last daily valuation of the daily portfolios? For example, the last valuation of the weekly portfolios falls on June 28; however, the last valuation of the daily portfolios falls on June 30. There will be two days that are not included in the weekly portfolio valuation. Can we use the performance of the composite's benchmark to replicate the two days? If not, how should we calculate performance on this composite?

The performance calculation dates for portfolios in a composite must be the same. The performance or portfolios that are calculated on non-calendar quarters or mid-month pricing must be included in composites using similar valuation periods. Alternatively, these portfolios must be revalued on conforming dates to be included in standard calendar quarter composites.

The firm may not link the results from the benchmark to the actual results of the composite. The Standards prohibit the practice of linking model or simulated portfolios to actual performance results.

Source: AIMR Advocate, Jan - Feb 2000

What is an appropriate industry method for calculating portfolio turnover?

According to the U.S. Securities and Exchange Commission Form N-SAR, this measure can be calculated by dividing the lesser of purchases or sales by the average value of portfolio assets during the period. This measure shows the average buying and selling activity in the portfolio and is expressed in terms of how much of the portfolio's value gets turned over in a given time period.

Source: AIMR Advocate, Jan - Feb 2000

Can a firm calculate performance returns from a composite that consists of multiple portfolios that are managed in several different currencies? If so, what conversion method should be used?

In cases where a composite contains member portfolios with different base currencies, the firm must define a base currency for the composite and then convert the individual portfolio values to the composite's base currency in order to calculate a composite return. The overall composite return can then be translated into the appropriate currency for a particular presentation. The AIMR-PPS and GIPS standards require that the currency used to express performance must be disclosed.

The Standards do not recommend a particular way to convert performance returns from one currency to another. The firm has many options in translating currency for a performance presentation. Two possible options are to convert the underlying data (market values and capital flows) if it is using the aggregation method of composite calculation or to first calculate the individual returns and then convert the returns and beginning market values if it is using the weighted average method of composite calculation. It is up to the firm to determine the currency conversion method. Once a method is established, it should be consistently applied and firms are encouraged to disclose the method used.

Source: AIMR Advocate, Jul - Aug 2000

Explain the differences between the new AIMR-PPS requirement that performance must be calculated using a time-weighted return that adjusts for cash flows, the requirement that after 1/1/2005 performance must be calculated using a time-weighted rate of return that adjusts for daily-weighted cash flows, and the likely requirement that after 1/1/2010 actual valuations at the time of cash flows must be used.

Currently, the AIMR-PPS standards require firms to use a time-weighted rate of return (TWRR) which adjusts for cash flows. Time-weighted rates of return that adjust for cash flows can be calculated using many different methods. A number of calculation methods included in the AIMR Performance Presentation Standards Handbook (1997, second edition) are meant to provide examples of acceptable formulas or calculation methods. The Handbook is not intended to be, nor should it be, considered the sole or even primary source of guidance in calculating these statistics.

The AIMR-PPS standards require the following:

TWRR that adjusts for cash flows (Currently the minimum required)
Various forms of approximation of TWRR are acceptable. The purpose of these methods is to produce as good an estimate as possible in circumstances where daily valuations are not available. An example of an acceptable method: Original Dietz Method - this method approximates when cash flows are received into an account by assuming that all cash flows occur at the midpoint of the period.

TWRR that adjusts for daily-weighted cash flows (Required beginning 1/1/2005)
Beginning 1/1/2005, the approximation method used for TWRR should include adjustment for the timing of cash flows during the measurement period. Firms should calculate the return for each month using a denominator that reflects the weighting of cash flows for the time they have been invested in the month. This method contrasts with other approximation methods that may, for example, assume that all cash flows are spread evenly through the month. An example of an acceptable method: Modified Dietz or Modified BAI Method - these methods weight each cash flow by the amount of time it is held in the portfolio. These are an estimate of the true TWRR.

TWRR that uses actual valuation at the time of the cash flow (Required beginning 1/1/2010)
The actual valuation of the portfolio every time there is a cash flow will make the calculation of TWRR very accurate. In practice, this requirement can only be met by having daily valuations on a continuous basis. An example of an acceptable method: Daily Valuation Method - this method calculates the true TWRR rather than an estimate.

Source: Standards Reporter, Mar - Apr 1999

Cash

The AIMR-PPS standards require that returns associated with cash, cash equivalents, and substitute assets held in the portfolio must be included in the presentation. Does this require a separate presentation for these assets?

No. Cash and cash equivalents and substitute assets (e.g., seller financing, etc.) must be combined with other assets and performance returns must be computed and presented on a consolidated basis.

Source: AIMR Newsletter, Jan - Feb 1994

Please clarify if income on cash and cash equivalents should be accounted for on an accrual or cash basis and should these positions be considered fixed income instruments?

An investment management firm may determine how to categorize cash instruments based on the strategy associated with their inclusion in a portfolio. For example, one firm may be utilizing U.S. Treasury Bills to implement a fixed income strategy, while another firm may hold these as a cash substitute. If a cash instrument is categorized as a fixed income instrument then accrual accounting is required as stated in the AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 39

Income earned by a stable net asset value fund (commonly called a money market or short term investment fund) may be difficult to accurately accrue since the income amount may not be known until after the end of the period. A firm may estimate income based on the previous period, accrue at that rate, and adjust at the end of the period or may use cash basis accounting.

Source: Jan - Feb 1996

Clients commit a certain amount of assets for management, but not all the assets are available for investment at the onset of the relationship. Can the manager assume a certain rate of interest on the cash not yet received, based on the fact that the client is earning interest on that cash?

It is not permissible under the Standards to assume a certain cash rate of return for assets committed to but not yet received by the manager. Under a GIC arrangement, for example, the rate of return guaranteed to the client is based upon the full amount of assets to be committed. The client might commit to investing $100 million, and the manager makes a forward commitment for the full $100 million, even if the client has only put up $20 million at that point. As the money comes in, it goes to cash. In this instance, the manager cannot add an assumed interest rate to the cash balance outstanding. The manager could disclose that returns might be conservative because the manager engages in forward contracts to protect the client from price volatility, and does not earn interest on the full cash amount until received.

Source: AIMR List of 75 Question and Answers, 1994

Explain the recommendation in the AIMR-PPS standards allowing the use of temporary new accounts for large cash flows (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. ix).

When large cash flows occur in an account, the firm may treat these cash flows as temporary "new" accounts. For example, if a significant cash flow is moving out of an account at the end of the month, a manager would move the cash and/or securities into a temporary new account for liquidation to the client. The account would reflect the withdrawal of funds and/or securities as a cash outflow of the portfolio, and the performance figures would be calculated to include this cash outflow. The temporary new account would receive the funds and/or securities as a cash inflow. The assets would remain in this temporary new account until the funds are distributed. The firm should document the procedures taken and apply the principles consistently for all accounts. For purposes of preparing a performance presentation in compliance with the AIMR-PPS standards, the firm would not have to report the performance of this temporary new account.

Source: Standards Reporter, May - Jun 1997

Can a firm temporarily move an account to non-discretionary status if a large cash flow occurs? (Most frequently asked)

No. A firm should not move an account to non-discretionary status based on significant cash inflows or outflows. If the firm does not wish to reflect the impact of the cash flow in the portfolio performance, the AIMR-PPS standards recommend the use of temporary new accounts for significant cash flows.

Source: Standards Reporter, Feb 1997 (excerpt)

For funds with a monthly net asset value (NAV) calculation, which performance calculation is recommended—the simple rate of return using the NAV or the time-weighted rate of return (TWRR) of the fund—when a significant cash flow produces a marked difference between the two (the TWRR has been appropriately updated for the cash flow)?

The Standards require TWRR. When a cash flow occurs, a fund is typically required to calculate its NAV to determine the value of the fund units that are either purchased or sold. This method is referred to as the "unitized method" or "daily valuation method" of the time-weighted rate of return. Two other typical methods of computing the TWRR are the modified Deitz method and the modified Bank Administration Institute (BAI) method. These methods result in approximations of the daily valuation method and are acceptable methods of computing the TWRR but are not as accurate as the daily valuation method.

Source: Standards Reporter, Nov - Dec 1997

Our firm created composites in 1995. As part of our composite construction policy, portfolios with an external cash flow during the current performance measurement period of 15% or greater (calculated as of the previous performance measurement period's portfolio ending market value) would be removed from the composite. The composite construction policy also stated that portfolios which were removed from a composite due to a cash flow would be placed back in the composite at the beginning of the performance measurement period following a 45-day investment period. We have claimed compliance with the AIMR-PPS standards since 1996. Does this policy comply with the AIMR-PPS standards?

No, for part of the time cited, implementing the above policy was prohibited by the AIMR-PPS standards. It should be noted that this answer does not address the situation where a firm has a minimum account size policy for a composite and, due to a cash flow, a portfolio falls below the minimum.

In January 1996, the AIMR-PPS Implementation Committee issued a question and answer in the January – February 1996 edition of the AIMR Standards Reporter clarifying its position that removing portfolios due to large cash flows was not permitted.

In 2001, the AMR-PPS standards became a Country Version of the GIPS standards, meaning that the AIMR-PPS standards automatically incorporated future developments to the GIPS standards. The Guidance Statement on the Treatment of Significant Cash Flows, adopted 13 March 2002 and effective 30 June 2002, allowed portfolios with significant cash flows to be excluded from composites, provided specified criteria were met. The Guidance Statement is available at the www.cfainstitute.org website.

Consequently, for the period from January 1996 to June 2002 removing portfolios from composites due to large cash flows was not permitted under the AIMR-PPS standards (i.e., firms could not use cash flows as a criterion to define portfolios as temporarily non-discretionary). However, a firm has always been permitted to show, as supplemental information, a performance track record excluding portfolios with large cash flows.
Firms currently coming into compliance with the GIPS standards should rely on the Guidance Statement on the Treatment of Significant Cash Flows and not on previously-issued AIMR-PPS standards guidance when claiming compliance with the GIPS standards.

Source: North American Investment Performance Council

If my firm is compliant with the redrafted AIMR-PPS standards, can we also claim compliance with the GIPS standards?

Firms currently wishing to comply with the Global Investment Performance Standards (GIPS®) must be able to meet all of the GIPS requirements, including a five-year compliant historical record. As of January 1, 2002, all firms that claim compliance with the AIMR-PPS® standards will also have a minimum of five years of GIPS-compliant history (or compliant history since firm inception) and can therefore claim compliance with the GIPS standards. However, before asserting their GIPS claim, firms must consider that the GIPS standards include a disclosure requirement that states any performance presented prior to January 1, 2000, that does not comply with the GIPS standards must be disclosed and firms must explain how the presentation is not in compliance with the GIPS standards (Section II.4.A.14). From a calculation perspective, the AIMR-PPS and the GIPS standards are the same for all performance results for periods after January 1, 1997. However, for performance results for periods prior to 1997, two potential issues exist under the AIMR-PPS standards that could result in performance reporting that adheres to the AIMR-PPS standards but does not meet the GIPS requirements and would warrant the additional GIPS disclosure:
* Disclosures: Under the GIPS standards, firms are required to disclose the number of portfolios and amount of assets in the composite and the percentage of the firm's total assets represented by the composite as of the end of the period. Under the AIMR-PPS standards, firms must disclose these figures as of the end of the period for all periods after January 1, 1997, but prior to 1997, firms can choose when to make these disclosures (beginning or end of period) under the AIMR-PPS standards.
* Appropriate Treatment of Accrued Income: According to the GIPS standards, in both the numerator and denominator, the market values of fixed-income securities must include accrued income for all periods. Prior to January 1, 1997, the AIMR-PPS standards did not specify that firms must accrue income in both the beginning and ending market values (numerator and denominator) for performance calculations.

Source: AIMR Advocate, Sep - Oct 2001

Guidance Statement on the Treatment of Significant Cash Flows

Cash Flow

Explain the recommendation in the AIMR-PPS standards allowing the use of temporary new accounts for large cash flows (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. ix).

When large cash flows occur in an account, the firm may treat these cash flows as temporary "new" accounts. For example, if a significant cash flow is moving out of an account at the end of the month, a manager would move the cash and/or securities into a temporary new account for liquidation to the client. The account would reflect the withdrawal of funds and/or securities as a cash outflow of the portfolio, and the performance figures would be calculated to include this cash outflow. The temporary new account would receive the funds and/or securities as a cash inflow. The assets would remain in this temporary new account until the funds are distributed. The firm should document the procedures taken and apply the principles consistently for all accounts. For purposes of preparing a performance presentation in compliance with the AIMR-PPS standards, the firm would not have to report the performance of this temporary new account.

Source: Standards Reporter, May - Jun 1997

Can a firm temporarily move an account to non-discretionary status if a large cash flow occurs? (Most frequently asked)

No. A firm should not move an account to non-discretionary status based on significant cash inflows or outflows. If the firm does not wish to reflect the impact of the cash flow in the portfolio performance, the AIMR-PPS standards recommend the use of temporary new accounts for significant cash flows.

Source: Standards Reporter, Feb 1997 (excerpt)

For funds with a monthly net asset value (NAV) calculation, which performance calculation is recommended—the simple rate of return using the NAV or the time-weighted rate of return (TWRR) of the fund—when a significant cash flow produces a marked difference between the two (the TWRR has been appropriately updated for the cash flow)?

The Standards require TWRR. When a cash flow occurs, a fund is typically required to calculate its NAV to determine the value of the fund units that are either purchased or sold. This method is referred to as the "unitized method" or "daily valuation method" of the time-weighted rate of return. Two other typical methods of computing the TWRR are the modified Deitz method and the modified Bank Administration Institute (BAI) method. These methods result in approximations of the daily valuation method and are acceptable methods of computing the TWRR but are not as accurate as the daily valuation method.

Source: Standards Reporter, Nov - Dec 1997

Our firm created composites in 1995. As part of our composite construction policy, portfolios with an external cash flow during the current performance measurement period of 15% or greater (calculated as of the previous performance measurement period's portfolio ending market value) would be removed from the composite. The composite construction policy also stated that portfolios which were removed from a composite due to a cash flow would be placed back in the composite at the beginning of the performance measurement period following a 45-day investment period. We have claimed compliance with the AIMR-PPS standards since 1996. Does this policy comply with the AIMR-PPS standards?

No, for part of the time cited, implementing the above policy was prohibited by the AIMR-PPS standards. It should be noted that this answer does not address the situation where a firm has a minimum account size policy for a composite and, due to a cash flow, a portfolio falls below the minimum.

In January 1996, the AIMR-PPS Implementation Committee issued a question and answer in the January – February 1996 edition of the AIMR Standards Reporter clarifying its position that removing portfolios due to large cash flows was not permitted.

In 2001, the AMR-PPS standards became a Country Version of the GIPS standards, meaning that the AIMR-PPS standards automatically incorporated future developments to the GIPS standards. The Guidance Statement on the Treatment of Significant Cash Flows, adopted 13 March 2002 and effective 30 June 2002, allowed portfolios with significant cash flows to be excluded from composites, provided specified criteria were met. The Guidance Statement is available at the www.cfainstitute.org website.

Consequently, for the period from January 1996 to June 2002 removing portfolios from composites due to large cash flows was not permitted under the AIMR-PPS standards (i.e., firms could not use cash flows as a criterion to define portfolios as temporarily non-discretionary). However, a firm has always been permitted to show, as supplemental information, a performance track record excluding portfolios with large cash flows.
Firms currently coming into compliance with the GIPS standards should rely on the Guidance Statement on the Treatment of Significant Cash Flows and not on previously-issued AIMR-PPS standards guidance when claiming compliance with the GIPS standards.

Source: North American Investment Performance Council

If my firm is compliant with the redrafted AIMR-PPS standards, can we also claim compliance with the GIPS standards?

Firms currently wishing to comply with the Global Investment Performance Standards (GIPS®) must be able to meet all of the GIPS requirements, including a five-year compliant historical record. As of January 1, 2002, all firms that claim compliance with the AIMR-PPS® standards will also have a minimum of five years of GIPS-compliant history (or compliant history since firm inception) and can therefore claim compliance with the GIPS standards. However, before asserting their GIPS claim, firms must consider that the GIPS standards include a disclosure requirement that states any performance presented prior to January 1, 2000, that does not comply with the GIPS standards must be disclosed and firms must explain how the presentation is not in compliance with the GIPS standards (Section II.4.A.14). From a calculation perspective, the AIMR-PPS and the GIPS standards are the same for all performance results for periods after January 1, 1997. However, for performance results for periods prior to 1997, two potential issues exist under the AIMR-PPS standards that could result in performance reporting that adheres to the AIMR-PPS standards but

does not meet the GIPS requirements and would warrant the additional GIPS disclosure:
* Disclosures: Under the GIPS standards, firms are required to disclose the number of portfolios and amount of assets in the composite and the percentage of the firm's total assets represented by the composite as of the end of the period. Under the AIMR-PPS standards, firms must disclose these figures as of the end of the period for all periods after January 1, 1997, but prior to 1997, firms can choose when to make these disclosures (beginning or end of period) under the AIMR-PPS standards.
* Appropriate Treatment of Accrued Income: According to the GIPS standards, in both the numerator and denominator, the market values of fixed-income securities must include accrued income for all periods. Prior to January 1, 1997, the AIMR-PPS standards did not specify that firms must accrue income in both the beginning and ending market values (numerator and denominator) for performance calculations.

Source: AIMR Advocate, Sep - Oct 2001

Guidance Statement on the Treatment of Significant Cash Flows

Changes to the Standards

Why is AIMR eliminating the Level II verification in 2003 and how will that affect my firm?

The redrafted AIMR-PPS® standards clarify the verification procedures and help reduce the confusion that has developed over the years with respect to the two types of verification. For instance, confusion arose surrounding the terms "Level I" and "Level II", where some people interpreted "Level II" to be superior to "Level I". Also, some firms confused "compliance" and "verification", actually claiming to be "Level II compliant".

Since compliance with the Standards can only be attained on a firm-wide basis, AIMR's intent has always been to emphasize the validation of a firm-wide claim of compliance through Level I verification. There were, however, practical and professional issues for verification firms that prevented many from being able to issue Level I verification reports. The unintended result was a focus of activity and interest on Level II verification, which only validates the accuracy of a particular composite's returns.

The redrafting of the Standards provided the perfect opportunity to clarify the issue and emphasize the importance of firm-wide verification (Level I). Also, Level II verification is now termed "Performance Examination (Level II)" and beginning January 1, 2003, firms will no longer be allowed to state that a specific composite has been "Level II verified". Instead, at that time the AIMR-PPS standards will allow firms that have received or are in the process of receiving a firm-wide (Level I) verification report to have a further, more extensive performance examination or audit of a specific composite presentation. However, firms will not be able to make the claim that a particular composite has been "verified". Performance Examination (Level II) procedures focus on the need for the verifier to conduct and report a Level I verification in order to issue a Performance Examination (Level II) report.

Once the term "Level II" verification is removed from the AIMR-PPS standards, "Level I" will simply be re-termed "verification." This will clearly link the term "verification" with the validation of a firm-wide claim of compliance.

Source: AIMR Advocate, Sep - Oct 2001

What will happen to the AIMR-PPS interpretations and Q&A's available on the website once the revised AIMR-PPS standards take effect on 1 January 2002?

The AIMR-PPS Standards, the U.S. and Canadian version of GIPS, were formally endorsed by the Investment Performance Council (IPC) as a Country Version of GIPS (CVG) on 11 September 2001. As part of the CVG process, the AIMR-PPS standards must incorporate all interpretations, guidance, and changes to the GIPS standards.

The Interpretations Subcommittee of the IPC has the responsibility of addressing questions and developing guidance regarding the GIPS standards. The Subcommittee established a process to develop Guidance Statements for the GIPS standards that will incorporate much of the outstanding guidance on a particular topic. Many of the AIMR-PPS Q&A's have already been incorporated into the GIPS guidance in this manner. The Interpretations Subcommittee will review the remaining AIMR-PPS Q&A's and, when appropriate, transfer specific Q&A's to the GIPS Interpretations Library (www.aimr.org/standards/pps/gips_library.html). Certain newly issued guidance will supersede existing AIMR-PPS Q&A's. Q&A's that have been superseded will be clearly labeled in the AIMR-PPS Q&A database, which is accessible through the GIPS Interpretations Library.

Source: AIMR Advocate, Jan - Feb 2002

My firm constructs compliant presentations once a year and will add performance information for this year (2001) to our compliant presentations after we reconcile our records in mid-January 2002. The redrafted AIMR-PPS standards take effect on January 1, 2002. Since we will be stating 2001 performance, which falls before the "effective" date of the redraft, can we wait to make the necessary changes when we update our composites with the 2002 data (in January 2003)?

No; the AIMR-PPS standards, amended and restated as the U.S. and Canadian version of GIPS, require that firms comply with the revised standards on January 1, 2002. Firms wishing to maintain compliance with the Standards must make all the necessary changes (e.g., add total firm assets disclosure, report key disclosures as of the end of the period, document policies and procedures, change the compliance statement, etc.) to their performance presentations created on or after January 1, 2002. Firms are strongly encouraged to implement the changes prior to 2002.

Source: AIMR-Advocate, Nov - Dec 2001

Other than satisfying all the required elements of the AIMR-PPS standards, what other responsibilities does a firm that claims compliance with the AIMR-PPS standards have?

The redrafted AIMR-PPS standards include several sections that affect a firm's compliance status. Inherent in a firm's claim of compliance is the need to stay abreast of developments and modifications to the Standards. The AIMR-PPS standards now specifically require firms who claim compliance to understand the Standards, including updates, reports and clarifications (guidance statements and questions and answers listed in the AIMR-PPS Interpretations database) published by AIMR and its committees. These changes and guidance are made publicly available via the AIMR Web site (www.aimr.org/standards) as well as through published articles in the AIMR Advocate and will provide sufficient notice to allow firms to implement the necessary changes.

Additionally, by January 1, 2002, firms claiming compliance with the AIMR-PPS standards must document, in writing, their policies and procedures used in establishing and maintaining compliance with all the applicable requirements of the AIMR-PPS standards. Documenting policies and procedures will benefit firms in their ongoing maintenance of compliance as well as assist in the verification process. Following are a few examples of policies and procedures that firms should develop and document:

· XYZ Investments defines discretion as all accounts with client restrictions that do not hinder XYZ's ability to implement their intended investment strategy. Examples of accounts that are classified as discretionary, but have client restrictions that do not hinder XYZ's management of the assets include: portfolios with “sin” stock restrictions, directed brokerage portfolios, and “green” portfolios (environmentally friendly).

- For the Large-Cap Growth Composite, XYZ Investments adds new portfolios to the composite at the beginning of the month following the inception date of each new portfolio. For the Emerging Markets Composite, XYZ Investments adds new portfolios to the composite within three months of the inception date of each new portfolio.
  Any changes to the definition of XYZ firm (for purposes of compliance) or changes to the definition of XYZ's composites require a 75% majority vote by XYZ’s Management Committee.
- For all Composites, XYZ Investments uses the Modified Dietz method to calculate individual portfolio returns and the Aggregate Return method to calculate composite returns.
- Firms are reminded that meeting the objectives of fair representation and full disclosure may, and probably will, require more than meeting the minimum requirements outlined in the AIMR-PPS standards.

Source: AIMR-Advocate, Nov - Dec 2001

Can our firm use the AIMR-PPS Advertising Guidelines prior to 1/1/2002 if the firm is not yet compliant with the redrafted Standards?

No. The AIMR-PPS Advertising Guidelines require the use of the following compliance statement:

[Insert name of firm] claims compliance with the AIMR Performance Presentation Standards (AIMR-PPS®), the U.S. and Canadian version of GIPS®. AIMR has not been involved with or reviewed [insert name of firm]'s claim of compliance.

If the firm is not yet compliant with the redrafted AIMR-PPS standards, the firm cannot make this claim of compliance. Firms are encouraged to adopt the new Standards prior to 1/1/2002 and must adopt them by 1/1/2002 if they intend to maintain their compliance with the AIMR-PPS(tm) standards. Once firms comply with the redrafted Standards, they may then utilize the AIMR-PPS Advertising Guidelines. The changes necessary to claim compliance with the redrafted Standards should be relatively straightforward for the firm to implement. The major changes firms must make to comply with the redrafted Standards include:

1. Firms must retroactively disclose total firm assets as of the end of each period.
2. Firms must, for periods after January 1, 1997, retroactively disclose the number of portfolios in the composite, the composite assets, and composite assets as a percentage of total firm assets as of the end of the period.
3. Firms must use the revised Compliance Statement.

There are also new, more subtle, disclosure requirements that may affect certain firms and composites. Firms should consider the full details of these changes as well.

Source: AIMR Advocate, Sep - Oct 2001

Changing Composites

Please specify when portfolios may be moved from one composite to another. Would reasons such as portfolios falling below the minimum size criteria or large cash flows be reasons to justify this movement.

Portfolios must not be switched from one composite to another unless documented changes in client guidelines make this appropriate. Managers may set a policy that accounts are considered non-discretionary when their portfolio value declines below a determined minimum size either by reasons of cash flow and/or market action. All such accounts would then be required to be removed from the composite and become non-discretionary. Further, the AIMR-PPS standards do not permit a manager to remove a portfolio from a composite because of a large cash flow and then to return it to the composite the next measurement period. Cash flows are to be absorbed and recognized, without distorting performance results, by using a time-weighted rate of return calculation and/or subperiod valuations as described in Appendix A.

Source: AIMR Newsletter, Jan - Feb 1996

A firm in compliance with the AIMR-PPS standards wants to make a change to an existing composite that contains tax-exempt and taxable portfolios. Going forward, the firm wants to include only tax-exempt portfolios in one composite and only taxable portfolios in another composite. How should this be done?

The composite that consists of tax-exempt and taxable portfolios would cease to exist. Two new separate composites would be created for the taxable portfolios and tax-exempt portfolios. Going forward, the new composites would report only performance returns from the new composite strategy (i.e., only taxable returns or only tax-exempt returns). To determine the historical results for each of the new composites, the firm should break out the performance results of the taxable and tax-exempt portfolios from the existing combined composite. For example, the taxable composite would restate the performance results of all the taxable portfolios, including any such portfolios managed in prior years even if they are no longer clients. Firms must fully disclose these changes.

Source: Standards Reporter, May - Jun 1997

A firm in compliance with the AIMR-PPS standards wants to combine two existing composites into one composite. How should this be done?

When a firm decides to combine the investment strategies/objectives of two (or more) different composites, the firm would create a new composite. The new composite will consist of all portfolios of the combined composites. The existing composites that the firm wishes to combine into this new composite would cease to continue. The new composite would not have historical performance results because the new composite is newly implemented. The firm would maintain and have available the performance results of the previous composites.

Source: Standards Reporter, May - Jun 1997

If a firm creates a new composite and wants to transfer a portion of the portfolios from an existing composite but still maintain the existing composite, how can a firm make the change and remain in compliance with the AIMR-PPS standards?

The AIMR-PPS standards state, “Portfolios must not be switched from one composite to another unless documented changes in client guidelines make switching appropriate.” (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 11) The firm would have to document the client’s investment guideline change in order to move their portfolios from the existing investment style/strategy that the firm originally recommended. The portfolios with the client-approved changes in investment guidelines would be transferred to the new composite. Because the firm is maintaining the existing composites, those composites would continue and historical numbers must not be restated. The new composite would not have any historical performance results.

Source: Standards Reporter, May - Jun 1997

Our firm has recently changed the core investment focus of one of our composites. We are looking into the implications of this change on our compliance with the AIMR-PPS standards. To be able to still claim compliance, how should we continue using our historical data for this composite?

If the firm changes the investment strategy/style of one of its composites to a strategy that is new to the firm, the firm would create a new composite defined according to the new strategy. The new composite will consist of all portfolios from the old composite that are now managed according to the new strategy. The new composite would not have historical performance results if the strategy of the new composite is newly implemented. However, if a firm determines to shift the management of the portfolios in the old composite to an existing investment strategy at the firm, the portfolios of the old composite would be added to the existing composite representing the investment strategy.

In either case, the old composite would cease to continue if there are no accounts managed to this style, although the firm must make available the performance results of the old composite.

Source: AIMR Advocate, Sep - Oct 2000

Claim of Compliance

If a firm cannot meet the technical requirements of the AIMR-PPS standards, can the firm claim compliance?

No. The Standards set forth minimum requirements and disclosures that must be met to make the claim of compliance. In fact, because these are minimum requirements, it may be necessary for a manager to provide more information to meet the full ethical intent of the Standards. It was never intended that the spirit of full disclosure and fair representation be replaced by a list of technical requirements. To that end, the number of technical requirements has purposefully been kept to a minimum.

Source: AIMR Newsletter, Mar - Apr 1994

Source: AIMR Newsletter, Mar - Apr 1994

Many consultants, plan sponsors and software vendors claim compliance with the AIMR Performance Presentation Standards. Is this appropriate and are they able to make the claim?

No. Plan sponsors and software vendors cannot make the claim of compliance because they do not present performance results on actual assets under their management, unless the consultant, plan sponsor or software vendor actually manage the assets to which the compliance with the AIMR-PPS standards is directed. These groups can claim to endorse the Standards and/or require that their managers claim compliance.

Source: AIMR Newsletter, May - Jun 1995

Is the statement "calculated in accordance with AIMR Performance Presentation Standards" acceptable when referring to only the methodology of the performance calculations?

No. Any firm claiming compliance with the AIMR-PPS standards must use only the following legend when the performance presentation is in compliance with the relevant AIMR-PPS requirements:

"[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-PPS). AIMR has not been involved with the preparation or review of this report."

This statement is to standardize the claim of compliance for industry wide recognition. To claim compliance with the AIMR-PPS standards, firms must meet all the requirements applicable to that firm's specific situation.

Source: Standards Reporter, Nov - Dec 1996

Our firm claims compliance with the AIMR-PPS standards. However, we only provide compliant presentations to those prospective clients that request a compliant presentation. We present non-compliant performance (without all the required disclosures) to those prospects that do not specifically request an AIMR-PPS compliant presentation. The non-compliant presentations do not claim compliance or even mention the AIMR-PPS standards. Can we choose with whom we want to make the claim of compliance?

No. The firm cannot choose to whom they want to present compliant performance. The fundamental principles of the AIMR-PPS standards are based on the notion of fair representation and full disclosure. If a firm claims compliance with the Standards, the firm must present a fully compliant performance presentation to all prospective clients. The firm may provide any supplemental information in addition to the compliant presentation. This requirement applies regardless of whether a client requested a compliant presentation or not. (Quarterly or flash reports that are not in full compliance can be provided to consultants and prospective clients that have already received a compliant presentation in the past 12 months.) The firm cannot present compliant information to one prospect and non-compliant information to another. If the firm claims compliance with one prospective client or consultant, the firm must claim compliance and present a compliant presentation to all prospective clients (including database and consultant questionnaires).

Source: AIMR Advocate, Mar - Apr 2000

Our firm groups its accounts in composites as required by the AIMR-PPS standards. Do we have to actually calculate composite performance in order to claim compliance with the Standards? Can we just calculate the performance for the composites we use for performance presentations but not for the other composites to claim compliance with the Standards?

To claim compliance with the AIMR-PPS standards, all the requirements of the Standards must be met when creating investment performance presentations. If a firm claims compliance, the firm must be able to provide a compliant presentation in response to requests from those to whom the firm makes that claim. It is not enough to create composites without calculating a composite return. Firms must calculate the performance of all the composites but need not include the return history of every composite in a compliant presentation. Firms must also make available the composite performance to be included in the presentation.

Source: Standards Reporter, Jan - Feb 1999

Although in the past we have been verified as fully compliant with the AIMR-PPS standards, we no longer present our performance history in compliance with the AIMR-PPS standards and have removed a claim of compliance from our marketing material. However, because we have been compliant, can we continue to claim compliance on RFP's?

No. A firm can only claim AIMR-PPS compliance if it is actually in compliance with the AIMR-PPS standards. This claim includes oral claims, responses to RFP's, or claims included with performance material. When a claim of compliance is made, it must be made using the statement set forth in the AIMR-PPS Handbook. In effect, this is the only method that AIMR permits others legally to use its AIMR-PPS mark. A firm has two choices: (i) it does not comply with all of the applicable requirements of the AIMR-PPS standards on a firm wide basis and makes no mention of AIMR-PPS in any response, or (ii) it does comply and can only claim compliance through use of the compliance statement. A firm does not have the flexibility to decide to claim compliance in response to an RFP but then exclude the compliance statement from the performance material.

Source: Standards Reporter, Jan - Feb 1999

We may hire a CFA candidate in the near future. Our firm presently is not AIMR compliant. We have heard that firms who employ CFA charterholders must be AIMR compliant. Is this true?

No. The AIMR-PPSTM standards are a voluntary set of ethical guidelines firms can follow when presenting their performance results. Firms are not required to comply with the Standards when presenting performance, but the Standards are widely recognized as the most effective guidelines for fair and accurate reporting of investment performance. AIMR Members, CFA charterholders and CFA candidates are encouraged to inform their employers of the AIMR-PPS standards and to encourage their employers to adopt the Standards.

Source: AIMR Advocate, Sep - Oct 1999

ABC Investment Management Co. is based in Montreal and is compliant with the AIMR-PPS standards. There are many occasions in which they make presentations to prospective clients in French and would like to also translate the AIMR-PPS claim of compliance

statement into French. Is this permissible and if so, does AIMR have specific language they require?

Yes. Canadian firms that are compliant with the AIMR-PPS standards and find it necessary to present their composite presentations in French can use the following translated Claim of Compliance statement:

“[Insérer le nom du gestionnaire] a établi et présente ce rapport conformément avec les standards de présentation de performance de l’Association for Investment Management and Research (AIMR-PPS®), la version américaine et canadienne des Global Investment Performance Standards (GIPS®). L’AIMR n’a pas été impliqué dans la préparation ou la revue de ce rapport.”

Source: Implementation Committee Meeting, Dec 2002

Client Updates

A firm presents its quarterly performance results of its composites in a newsletter format, or in another "flash" type of report. How can the firm present its results in compliance within the format of a quarterly update?

The Standards require presentation of performance at a minimum of annually. As long as prospective clients have received past results in compliance with the required disclosures within the past 12 months, the flash numbers can be presented without quarterly disclosures, and a reference made that full presentation in compliance with the Standards is available upon request. If the prospective client is receiving investment results for the first time, the required disclosures must be included in or must accompany a flash report.

Source: AIMR Newsletter, Jul - Aug 1993

For a firm to claim compliance, must current clients be shown the performance of their funds on a year-by-year basis?

Current clients must be provided returns that are calculated according to methods that conform to the Standards and that are consistent with the calculation methods applied to the manager's composites (e.g., a total, time-weighted rate of return using accrual accounting for fixed-income) and that cover time periods that are determined by the client to be relevant and appropriate.

Source: AIMR Newsletter, Jan - Feb 1994

Composite Construction

When constructing composites, can portfolios be combined based on size to show results that are meaningful to certain clients?

Composites are to be constructed on the basis of common strategies or objectives. If portfolios above or below a certain size are managed differently, size can be used as a singular criteria for constructing composites. If strategies or objectives do not differ by size, a composite is to include portfolios managed according to the common strategy or objective. A composite breakdown by size can be presented as supplemental information.

Source: AIMR Newsletter, Jul - Aug 1993

The term "marketing" composite is occasionally used in conjunction with verification services. Is this term defined in the Standards?

The Standards do not refer to “marketing” composites. Portfolios must be grouped according to common strategies or objectives and included in one or more of the firm's composites. The only portfolios to be excluded are nondiscretionary, non-fee paying, or portfolios below the minimum size criteria established by the manager. (For a discussion of minimum size criteria see AIMR Performance Presentations Standards Handbook, 1997 edition, pg. 85.)

A verifier may agree that a firm satisfies Level I verification if all of its discretionary, fee-paying portfolios are in a composite even if, due to their unique nature, some are included in single-portfolio-composites. Level II verification requires detailed analysis of individual composites but need not be completed on all composites.

Source: AIMR Newsletter, Jul - Aug 1993

If a fund invests in publicly traded equities for both limited partnerships and for separately managed accounts, should the manager set up different composites for each legal structure?

A composite should include all portfolios that are managed according to the same strategy. Differences in legal structure alone would not warrant a separate composite definitions. However, it is up to the manager to decide how results can presented in the most meaningful way, and if differences in legal structure cause the results of portfolios to differ, then the manager would split limited partnerships and separately managed accounts into separate composites.

Source: AIMR List of 75 Question and Answers, 1994

A firm manages private client portfolios. Depending upon when the portfolio came under management, returns will vary because of opportunities available at the time. Can a firm establish composites based on the date a portfolio comes under firm management?

No. The composites should represent consistency—or lack of consistency—of a strategy over time. Therefore, a composite based on inception date would not show representative results of how their strategy performs over time as market conditions change. New portfolios are added to a composite at the start of the next full performance measurement period, or according to reasonable and consistently applied manager guidelines.

Source: AIMR Newsletter, Jul - Aug 1993

When constructing composites, should foreign client accounts be included in composites along with domestic clients? If so, should a firm view foreign clients as taxable or tax-exempt from the firm's perspective or from that of the investor’s home jurisdiction?

Whether or not a firm includes foreign client accounts in composites constructed in compliance with the AIMR-PPS standards depends upon the definition of the firm. If the firm has defined itself to include foreign as well as domestic clients, then the composites must include both to the extent that the assets are managed the same way. The tax status of the account (i.e., taxable or tax-exempt) must be from the perspective of the investor.

Source: Standards Reporter, Jan - Feb 1998

Can a firm include a single portfolio in more than one of the firm's composites?

Yes. Both the AIMR-PPS and GIPS standards state that firms must include all discretionary fee-paying portfolios in at least one of the firm's composites. Provided the account meets the prescribed criteria for inclusion in each composite, the firm may choose to include a portfolio in more than one of the firm's composites. For example, a firm may have a balanced composite and a large-cap equity composite. If the firm manages a portfolio that meets the criteria for inclusion in the balanced composite as well as the large-cap equity composite, the firm can include the balanced portfolio in the balanced composite and also include the equity segment of the balanced portfolio (with cash allocated to the segment in calculating the return) in the equity composite.

Source: AIMR Advocate, Sep - Oct 2000

We have an investment strategy for managing all of our investment accounts regardless of size. All accounts managed to that strategy are included in one composite. However because of different fee structures, the net-of-fee returns for the accounts is dramatically different for smaller accounts compared to larger accounts. We believe that including all such accounts in a single composite distorts the net-of-fee composite return to potential investors. Various current and potential investors as well as consultant databases specifically request net-of-fee performance returns. As a result, we want to create composites that will be defined by both strategy and by size of account. According to the AIMR-PPS standards, can we do such a thing?

The AIMR-PPS standards recommend that firms present performance results gross-of-fees and include the required disclosure of the firm's fee schedule. The AIMR-PPS standards state it would be more representative to show results before the deduction of management fees and provide a fee schedule that represents the fee that would actually be paid by the prospective client. Firms are also encouraged to present any additional supplemental information that the firm deems valuable to prospective and current clients. This could include net-of-fee information for a composite of a select group of accounts.

The intent of the AIMR-PPS standards is to provide the most accurate representation of performance results to potential and current clients. If presenting the net-of-fee results of a composite consisting of all similarly managed portfolios with differing fee schedules does not provide an accurate representation to a prospective client, it may be acceptable for the firm to create two or more composites with a subset of accounts with similar fees in an effort to present relevant and accurate performance. In situations where the firm is requested to present net-of-fee results (e.g., consultant questionnaires), if the net-of-fee composite dispersion figure is significantly different from the gross-of-fee figure because of the fees charged, this may indicate the need for two or more separate composites. In this situation, it would be acceptable to create two or more net-of-fee composites based on the different fee structures historically applied to the accounts (not on the different portfolio sizes).

If a manager creates net-of-fee composites in this manner, the firm is required to present results for the composite appropriate to the prospective client, e.g., use the higher fee composite for smaller prospective clients who would pay the higher percentage fees.

Source: AIMR Advocate, Mar - Apr 2000

You stated that you could set up non-discretionary composites-but we have been told we cannot set up junk portfolios. The non-discretionary composite sounds like a junk portfolio. Shouldn't one just avoid using these non-discretionary accounts in any composite?

According to AIMR-PPS standards, a junk portfolio is an aggregation of portfolios with unique investment characteristics into a catch-all or dustbin composite. This practice does not provide meaningful composite performance. Firms may have a number of non-discretionary accounts managed according a similar strategy. These portfolios can be grouped together to create a meaningful composite. Non-discretionary composites differ from junk composites because non-discretionary accounts are grouped according to similar style or strategy in non-discretionary composites. Junk composites group accounts with unique styles and strategies into one composite.

However, a firm may provide the performance results of non-discretionary composites as supplemental information only.

Source: AIMR Webcast, 4 April 1999

Why should each discretionary fee-paying portfolio be included in at least one composite? If a portfolio represents a style we never plan to market in the future, why should we have to include it in a composite?

The AIMR-PPS standards are ethical guidelines for firms to follow when presenting their performance results. The Standards are based on the principles of fair representation and full disclosure. They are not marketing or advertising standards.

The requirement for firms to include all fee-paying discretionary portfolios in at least one composite ensures that firms record an accurate picture of the firm's complete performance record. Without this requirement, there is a potential for firms to exclude poor performing portfolios from the appropriate composites. Portfolios that might otherwise belong in the composite could be grouped with "unmarketed" portfolios. Because the intent of the Standards is to accurately and fairly represent firm performance, all fee-paying discretionary portfolios must be included in at least one of the firm's composites.

Firms are also required to disclose that a complete list of the firm's composites is available on each compliant presentation. Potential clients can review descriptions of all composites to determine if any similarities exist. Prospective clients can also request to see additional information on the firm's historical performance record through other composites on the list. These requirements exist to provide prospective clients with a complete picture of the firm's investment performance achieved on all accounts under the firm's discretion.

Source: AIMR Advocate, Nov - Dec 1999

Consultant Questionnaires

Consultant questionnaires often require managers to fill in quarterly performance charts. The questionnaires then ask the manager to indicate whether or not the numbers presented in the chart have been prepared in accordance with the AIMR-PPS standards. How should a firm respond to these questions?

To claim compliance, the firm must meet the requirements of the AIMR-PPS standards on a firmwide basis. Presentations claiming compliance must meet each requirement of the Standards including disclosure requirements. Performance results cannot be "in compliance" unless all the requirements of the Standards are met. Questions regarding whether returns “are prepared” in compliance with the Standards demonstrate a misunderstanding of the meaning of being in compliance with the AIMR-PPS standards. However, if the performance numbers used to answer questionnaires are from an AIMR-PPS compliant presentation, then the manager can state the information provided is in compliance. Appendix C of the AIMR Performance Presentation Standards Handbook, 1997 edition, suggest a model RFP for consultants to use when seeking AIMR-PPS compliant information.

Source: Standards Reporter, Jan - Feb 1998

We are asked in questionnaires and RFP’s if our mutual fund performance is in compliance with AIMR-PPS standards. Is there an appropriate way to address this question when it comes up from consultants and/or prospective clients?

To claim compliance, firms must meet the requirements of the AIMR-PPS standards on a firm wide basis. A mutual fund, or any other single account of a firm, will never be AIMR compliant. The Standards require that all actual fee-paying discretionary accounts must be included in at least one composite defined according to a similar strategy or investment objective (AIMR Performance Presentation Standards Handbook, 1997 second edition, page 27). As a result of the SEC staff no-action letter to AIMR, investment managers may now include mutual funds in composite performance presented gross-of-fees so long as composite performance is shown as net-of-fees. The no-action letter states that an advertisement must display both gross and net performance results with equal prominence in a format designed to facilitate ease of comparison of the gross-of-fee and net-of-fee results. The advertisement must not state that mutual funds are included in the composite.

The consultants should be asking whether your firm is in compliance with the AIMR-PPS standards and not if your mutual funds are in compliance. Questions such as these demonstrate a misunderstanding of the meaning of compliance with the AIMR-PPS standards. Appendix C of the AIMR Performance Presentation Standards Handbook suggests a model RFP for consultants to use when seeking AIMR-PPS compliant information.

Source: Standards Reporter, Sep - Oct 1998

Our firm groups its accounts in composites as required by the AIMR-PPS standards. Do we have to actually calculate composite performance in order to claim compliance with the Standards? Can we just calculate the performance for the composites we use for

performance presentations but not for the other composites to claim compliance with the Standards?

To claim compliance with the AIMR-PPS standards, all the requirements of the Standards must be met when creating investment performance presentations. If a firm claims compliance, the firm must be able to provide a compliant presentation in response to requests from those to whom the firm makes that claim. It is not enough to create composites without calculating a composite return. Firms must calculate the performance of all the composites but need not include the return history of every composite in a compliant presentation. Firms must also make available the composite performance to be included in the presentation.

Source: Standards Reporter, Jan - Feb 1999

Convertible Securities

Is it permissible to switch a convertible security from an equity category to a fixed income category prior to the expiration of the convertible feature if the switch is documented, clients are notified, and the switch is based upon a reasonable belief that the security will trade as a fixed income security?

No. As stated in the AIMR Performance Presentation Standards Handbook, 1997 edition, on page 32 "Convertibles and other hybrid instruments should be treated consistently among and within composites except when meeting client directives. Convertibles should be treated as equity instruments unless the firm and the client have decided otherwise." This provision requires that a manager consistently treat hybrid instruments in a determined manner and may not switch the hybrid to a different asset class unless mutually agreed to by client and applied to all convertibles.

Source: AIMR Newsletter, Jan - Feb 1996

Disclosures

AIMR-PPS disclosure requirements state "for all composites, a performance presentation must disclose a material change in personnel responsible for investment management." Is a general statement indicating that a material change in personnel has occurred sufficient to meet this requirement? Also, many firms are reporting that their portfolios are 'team managed,' so that when a member of the team leaves, they are not reporting this in the disclosure material. I have even heard it suggested that this disclosure would ONLY apply to a substantial change in the firm's philosophy. What would AIMR consider a material change in this circumstance?

The AIMR-PPS standards are based on the principles of full disclosure and fair representation. Meeting these objectives requires a good faith commitment on the part of the presenter to adhere to the spirit of the AIMR-PPS standards. The Standards require the firm to disclose the occurrence of a material change in personnel responsible for investment management. The type of disclosure necessary depends on the circumstances of each case. The firm has the responsibility to provide enough information to inform investors about the change in the decision-making process.

A general statement indicating that a material change in investment personnel has occurred may meet this minimum disclosure requirement, depending on the situation. However, the Standards also state that meeting the full intent of the AIMR-PPS standards requires more than meeting the minimum requirements. In some instances, firms should disclose information specific to the departure of the personnel.

For example, a firm has an equity composite that is managed by one investment manager. The equity manager decides to leave the firm; therefore, the firm hires another manager to continue managing the composite according to the same strategy. The firm must disclose the change in personnel responsible for the management of that composite. The firm should also include a statement that the manager responsible for the history of the composite is no longer with the firm and the date of the original manager’s departure.

This requirement must be applied to all relevant staff involved in the investment management process. The firms that use a “team management” approach may have to disclose that a member of the team has left the firm if this team member was a material part of the firm's investment management process. It is not the case that this disclosure is only required when there has been a substantial change in the firm’s philosophy.

Source: AIMR Advocate, Sep - Oct 1999

According to AIMR-PPS standards concerning the new requirement to disclose the composite creation date, if the firm does not know the exact date the composite was created, what should the firm disclose?

The intent of this disclosure is to enable clients and prospective clients to determine if the compliant performance report has been created recently or is more established. Firms are required to show the date the composite was first presented in compliance with the Standards. For example, a historical composite that on 1/1/93 was restated to come into compliance with the Standards must use 1/1/93 as the composite creation date. If a firm comes into compliance on 1/1/99 by restating its history in compliance with the Standards, the composite creation date will be 1/1/99.

Source: Standards Reporter, May - Jun 1999

Are the new requirements that were added to the AIMR-PPS standards last year only applicable to performance presentations that contain performance calculations for periods after January 1, 2000, or will they apply to all presentations after the date January 1, 2000, even if the presentations only contain performance returns up to December 31, 1999?

AIMR added nine new requirements to the AIMR-PPS standards on February 12, 1999. Four of those requirements became effective as of January 1, 2000 and are as follows:

1. For all composites, the total return for the appropriate 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, an explanation of why no benchmark is shown must be 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.
2. Firms must disclose the percentage of composite assets that are non-fee paying portfolios.
3. All presentations must state the currency used to express performance.

4. The composite creation date must be disclosed.

These additional disclosures must be included on all composite presentations after January 1, 2000. Even if the firm only presents performance information through December 31, 1999, these four required disclosures must be included in each presentation, regardless of whether the presentation only contains information prior to 2000.

Source: AIMR Advocate, May - Jun 2000

What is the definition of the "composite creation date"? Is it the first date the composite returns were ready for presentation, the first date the in the composite series, or the date the composite's strategy was implemented (even if the composite had not been calculated)?

The intent of this new disclosure is to enable clients and prospective clients to determine if the compliant performance report has been created recently or is more established. Beginning 1/1/2000, firms are required to show the date the composite was first presented in compliance with the Standards. For example, a historical composite that on 1/1/93 was restated to come into compliance with the Standards must use 1/1/93 as the composite creation date. If a firm comes into compliance on 1/1/99 by restating its history in compliance with the Standards, the composite creation date will be 1/1/99.

Source: AIMR Webcast, 4 April 1999

Discretion

Can a firm construct multiple composites by taking a single strategy and dissecting it into various levels of investment discretion or restrictions?

Yes, but in order to avoid confusion in terminology, such composites should use labels and descriptions which refer to "levels of restrictions" rather than "levels of discretion." The AIMR-PPS standards use the word "discretion" with a very specific meaning: portfolios are either discretionary or non-discretionary based on the firm's definition. All discretionary, fee-paying portfolios must be included in at least one composite. A firm is responsible for creating its own reasonable definition of discretion and applying that definition consistently to all accounts. Different levels of investment restrictions, such as acceptable maturity risk or allowed portions of the broad market, may represent valid criteria for creating separate composites.

Source: Standards Reporter, Mar - Apr 1998

A balanced portfolio manager has an account in which the manager does not have discretion over the cash segments of a portfolio. How can a manager include this account in a multiple asset composite?

If the manager does not control the actual investment of cash (e.g., cash is always invested in a bank STIF or invested separately by the client) but the manager does control the percentage of cash allocated, then the cash assets must be included in the manager's total assets and the performance of cash must be included in the total account performance. The fact that the performance of cash is technically not under the manager's control will not generally affect the total portfolio results as much as the allocation of assets to cash, which is under the manager's control.

Source: Standards Reporter, Mar - Apr 1997

According to the AIMR-PPS standards a portfolio may be considered nondiscretionary if client-imposed investment restrictions hinder or prohibit the application of the firm's intended investment strategy. (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 30) Can a firm "temporarily" consider a portfolio nondiscretionary if client-driven restrictions are imposed?

Yes. If a client imposes investment restrictions, such as trading restrictions or security allocation restrictions, the firm has the choice to move this portfolio to nondiscretionary status or maintain its discretionary status. Large cash flows do not qualify as client-imposed restrictions. If a firm chooses to temporarily move a portfolio to nondiscretionary status until the restrictions are removed, the portfolio would be taken out of the composite until the firm restores its discretionary status. The firm must develop its own definition of discretionary and nondiscretionary portfolios based on the general principle that a portfolio is nondiscretionary if the portfolio has restrictions that interfere with the application of the firm's investment strategy.

The critical requirements are that the firm apply reasonable, well-documented procedures in a consistent manner when determining whether to include or exclude portfolios with client-imposed investment restrictions, and that there is written client documentation setting forth the restriction.

Source: Standards Reporter, May - Jun 1997

How should a firm report assets managed through currency overlay, asset allocation, and similar overlay strategies for which the manager does not have investment discretion over the underlying assets?

The mandatory disclosure by a firm of the percentage of total firm assets represented by a composite refers to the percentage of total discretionary and nondiscretionary assets managed by the firm. Total firm assets in the AIMR Performance Presentation Standards does not refer to assets underlying overlay investment strategies such as currency overlays, options and future overlays, securities lending programs, and asset allocation overlay strategies, unless the firm actually manages the underlying assets. If the manager has discretion over the underlying assets, they would be included in total firm assets.

For example: If a firm manages $10 billion in equity assets (discretionary and nondiscretionary), $2 billion in currency overlay portfolios, and $13 billion in asset allocation overlays, the percentage of firm assets is based on $10 billion. If the manager maintains discretion over either all or part of the underlying assets for the overlay strategies, these underlying assets would be included in the $10 billion total. The manager must also disclose separately the total assets managed in the currency overlay and asset allocation strategies. When presenting composite performance of the overlay strategies, the manager must disclose the composite's percentage of assets managed according to that general overlay strategy (currency, asset allocation, etc.) when reporting total firm assets.

Source: AIMR Newsletter, May - Jun 1993

Fixed income securities managed by a firm are held until maturity, i.e., the firm is not free to trade these securities. Are these assets considered nondiscretionary and excluded from composites? The firm also manages fixed income assets with a yield-only strategy. How is performance to be reported?

If a firm is not free to trade portfolio securities, the assets are considered nondiscretionary and are to be excluded from firm composites. If a firm is free to trade the securities, then the assets are considered discretionary and are to be included in the firm's composites. Performance of yield-only strategies is required by the Standards to be reported on a total return basis.

Source: AIMR Newsletter, July - Aug 1993

If a firm has a large number of private client portfolios that are fully discretionary in the legal sense and yet have client-imposed guidelines or restrictions that would make the portfolios non-discretionary for purposes of including them in composites, what is the recommended treatment?

If the manager determines that portfolios should not be included in composite performance because of account specific constraints, the portfolios would be considered non-discretionary for purposes of compliance with the AIMR-PPS standards. As supplemental information, the manager might choose to group portfolios according to a general type of constraint. For example, portfolios in which a significant portion of assets is invested in securities which the manager is not free to trade might be grouped according to this common constraint. Such portfolios might include inherited securities with a low cost basis or of sentimental attachment to the client, founder's stock, stock in closely-held businesses, or other such issues. The manager might also choose to present statistics such as percentage of similarly managed institutional assets or percentage of private client assets managed according to similar strategies. Prospective clients thereby can gain insight into the amount and type of restricted firm assets.

Source: AIMR Newsletter, Mar - Apr 1994

If a portfolio holds restricted assets, what percentage of total account assets would make this account a non-discretionary account?

The AIMR-PPS standards allow the firm the ability to define discretionary versus non-discretionary portfolio in light of the unique, situational aspects and services of the particular firm. There is no universal definition of discretionary. However, just as there is flexibility in creating composites according to a meaningful, representative framework, the firm must also determine when including particular or specific securities would have the effect of rendering a portfolio non-discretionary. For example, a firm may decide to exclude a non-material portion of an otherwise discretionary account for reasons normally attributed to defining an entire portfolio non-discretionary, such as founders stocks, low cost basis, sentimental attachment, prior trade approval or other restrictions. Definition and policy must be consistently applied over all portfolios and time periods.

Source: AIMR Newsletter, Jul - Aug 1995

Please provide AIMR's position on retroactively removing an account that has become non-discretionary from a performance composite.

Managers have the responsibility of creating their own definitions of discretionary and non-discretionary accounts and applying these definitions consistently over time to all accounts. An account that changes from discretionary to non-discretionary status may be removed from a composite on a prospective basis only; the account may not be removed retroactively. In addition, the manager must have written documentation from the client to justify the change from discretionary to non-discretionary status.

Source: Standards Reporter, Sep - Oct 1998

If a fund is excluded from a composite because it is considered "restricted" based on client mandate, does this need to be disclosed?

No. The AIMR-PPS standards allow the firm to distinguish between discretionary and non-discretionary portfolios in light of the unique, situational aspects and services of a particular firm. The firm's definition of discretionary and non-discretionary must be well documented and applied consistently. If a portfolio is deemed nondiscretionary due to client-imposed restrictions, the firm can remove the nondiscretionary portfolio from the composite on a prospective basis. The firm is not required to disclose its removal from the composite.

Source: AIMR Advocate, Nov - Dec 1999

Dispersion

How should a firm that calculates rates of return on a quarterly or monthly basis meet the AIMR-PPS standards requirement of including a measure of composite dispersion in a performance presentation in compliance with the AIMR-PPS standards?

When disclosing the dispersion of portfolio returns within each composite, only the portfolios that have been managed for the full year should be included in the dispersion calculation (AIMR Performance Presentation Standards Handbook, 1997 edition, pp. 97-100). The returns (monthly or quarterly) of those full-year portfolios should be calculated and linked together to determine the annual returns for each portfolio. The annual returns of these portfolios should be used to compute the composite dispersion.

Source: Standards Reporter, Mar - Apr 1997

The calculation in the AIMR Performance Presentation Standards Handbook, 1997 edition, leaves our firm questioning the accuracy of dispersion versus the actual linked-quarter performance for the year (AIMR Performance Presentation Standards Handbook, 1997 edition, pp. 97-100). More specifically, if the full-year dispersion is calculated for "full-year-only" portfolios yet linked-quarter performance for the year includes portfolios that were added or removed from the composite during the year, do the two numbers really have relevance to one another? This especially holds if the actual composite performance differs materially from the performance of the full-year-only composite.

The AIMR-PPS standards acknowledge that, by using only portfolios that have been managed for the full year for the annual composite dispersion calculation, the dispersion number will not precisely correlate to the actual reported performance. The dispersion result will be accurate enough, however, to provide a client an idea of what the dispersion is in the composite for the year. The

AIMR-PPS standards do not require a specific formula for dispersion. A firm could present the annualized monthly or annualized quarterly standard deviation, a range, quartiles, or any other appropriate method of central dispersion.

Source: Standards Reporter, Nov - Dec 1997

A firm claiming compliance with the AIMR-PPS standards has a composite that consists of fewer than five accounts. When reporting a measure of composite dispersion, can a firm report "fewer than five accounts" instead of the actual measure of composite dispersion?

A firm may use the statement "five or fewer portfolios" instead of the actual standard deviation when reporting a measure of composite dispersion for performance presentation in compliance with the AIMR-PPS standards. A performance presentation in compliance with the Standards is required to include a measure of composite dispersion for each year represented (AIMR Performance Presentation Standards Handbook, 1997 edition, pp. 97-100). The most widely accepted measure of dispersion within a composite is standard deviation, but the standard deviation of fewer than five portfolios may not be meaningful.

Source: Standards Reporter, Mar - Apr 1997

AIMR-PPS Implementation Committee Interpretation on COMPOSITE DISPERSION

The recent revisions to the AIMR-PPS standards include a requirement that a measure of composite dispersion be included for each year presented in a performance presentation. A firm wishing to remain in compliance with the Standards has three options:

1. If a firm has given a client AIMR-PPS-standards-compliant performance numbers prior to January 1, 1997 and plans to give periodic performance updates, the firm does not have to include a measure of composite dispersion in the periodic updates. As long as the prospective client has received past results within a 12-month period that were in compliance with the Standards, firms may present interim data and returns (i.e., "flash reports") without AIMR-PPS-standards-compliant quarterly disclosures (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 89).

2. If a firm is presenting AIMR-PPS-standards-compliant performance to a prospective client for the first time and the performance presentation includes only performance through December 31, 1996, the firm does not have to include a measure of composite dispersion although it is strongly encouraged (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 5).

3. If a firm is presenting AIMR-PPS-standards-compliant performance to a prospective client for the first time and the performance presentation includes performance after December 31, 1996, the firm must include a measure of composite dispersion for each year presented (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 5).

If a firm wants to claim compliance with the AIMR-PPS standards but does not have the records to calculate a measure of composite dispersion for each year presented, the firm can claim compliance with the Standards if the firm discloses the lack of records for the missing period(s) (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 8). Lack of records means that due to circumstances beyond the control of the firm that the underlying data to support the performance record were either never kept or were lost or destroyed because of extreme circumstances beyond the control of the manager (e.g., a natural disaster).

Regulatory agencies require firms to maintain all documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts that the adviser uses in advertisements (current and historical performance results).

AIMR Performance Presentation Standards Handbook, 1997 edition

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AIMR Performance Presentation Standards Handbook, 1997 edition

Error Correction

If a firm discovers an error in the calculation and/or presentation of performance results that were presented to their clients as being in compliance with the AIMR Performance Presentation Standards, what must the firm do to remain in compliance with the Standards?

The firm has an obligation to promptly: (i) bring the composite calculation and performance presentation in compliance with the AIMR-PPS standards including, if applicable, recalculating the performance of the portfolio(s) in which the error occurred; (ii) deliver AIMR-PPS compliant performance with the disclosure that the composite performance has been corrected to clients and others that the firm reasonably believes relied upon the non-compliant performance, including consultants and verifiers; and (iii) institute steps to ensure that errors will not recur. A firm should also consider the legal and regulatory requirements that it is required to follow when correcting inaccurate investment performance delivered to its clients.

Source: Standards Reporter, Jan - Feb 1997

Fees

The AIMR-PPS standards recommend that performance results be presented gross (before deduction) of management fees. What is the treatment of custodial fees and is it permissible for custodial fees to be deducted as cash flow withdrawals for purposes of presenting performance results?

Custodial fees are not charged against performance. In the case of a brokerage firm's annual charges, the treatment of this as a withdrawal versus as a charge against performance will depend on whether this annual fee is in lieu of separately levied transactions costs. If this fee is really a commission, then it would be deducted from performance. If it is a custodial fee, it would not be charged against performance and should be treated as a cash flow withdrawal.

Source: AIMR Newsletter, Mar - Apr 1995

The SEC staff requires that investment managers present performance information net of advisory fees, although it is permissible in one-on-one presentations to present performance results without the deduction of advisory fees. The AIMR-PPS standards recommend calculation of performance results prior to the deduction of investment management fees unless net-of-fee calculations are required to meet SEC advertising requirements. Please clarify these two positions.

The AIMR-PPS standards recommend that performance results be presented gross (before deduction) of management fees, except where this will conflict with the SEC's position on advertising performance. This is because manager's fees are usually scaled resulting in performance information that will not be representative for a portfolio that is much larger or smaller than the size of the portfolio represented by the average fee. The AIMR-PPS standards feel it is more representative to show results before the deduction of management fees and to provide a fee schedule that represents the fee that would actually be paid by the prospective client. The choice of net versus gross is left to the manager, as long as the manager discloses which method is used and includes a fee schedule. When net of fee composite results are shown, the manager must also disclose the weighted average fee.

The SEC staff allows performance information to be presented gross of management fees in one-on-one presentations accompanied with disclosures that (i) the results do not reflect the deduction of investment management fees, (ii) the client's return will be reduced by the management fees and any other expenses incurred in the management of its account, (iii) disclosure of the investment advisory fees are described in Part II of the adviser's Form ADV. Also accompanying these disclosures must be "a representative example" which shows the effect an investment advisory fee, compounded over a period of years, could have on the total value of a client's portfolio. The SEC staff defines one-on-one presentations as manager performance presentations to any client, prospective client, consultant or affiliated group entrusted to consider manager selection and retention. Communications by managers can, therefore, be made to multiple representatives of a given prospect, even if there are several portfolios within the group. Any written performance presentation material distributed to more than one client or prospect, in other than one-on-one presentations, must present performance results after deduction of management fees and cannot present gross of fee performance results.

Source: AIMR Newsletter, May - Jun 1995

An investment management firm manages both pooled funds and separate client accounts and charges investment management fees for its services to both. Clients may hold pooled funds as part of their separate account investments and in this case are being charged double for investment management services at both the pooled funds and separate account level. The firm deposits on a monthly basis, a "fee rebate" to client accounts holding the pooled funds. How should this "fee rebate" be treated in performance calculations?

If an investment management firm reduces its management fee charged to clients, the recommended method is to waive the appropriate portion of the management fee so that there is neither a withdrawal or deposit of cash (i.e., payment or refund of fees). A reduction in fee should not be treated as income to the separate account since this will erroneously inflate performance. Since the "fee rebate" is not generated as income or capital of the portfolio, it should have no influence on performance results.

Source: AIMR Newsletter, Jan - Feb 1996

We are questioning how to report net-of-fee performance numbers of a composite when the firm's fee schedule has increased over the years. When showing net-of-fee results, should we state the actual performance returns for all portfolios, which would deduct the actual fee paid by each portfolio, or should we restate performance and apply the current fee schedule to historical portfolios?

The firm should not restate historical performance in this situation. If the firm chooses to present net-of-fee results, then the actual fee should be deducted as it had been paid from the accounts historically. If presenting only net-of-fee results, the firm should also disclose the weighted-average fee to enable a prospective client to compute composite performance on a gross-of-fee basis. The weighted-average fee along with the fee schedule for the composite will give potential clients an indication of the differences in fees currently charged and the fees historically paid. In addition, the firm is strongly encouraged to disclose the original fee schedule as well as the date of the change in fee schedule.

The AIMR-PPS standards recommend that firms present performance results gross-of-fees. In the situation you describe, the firm can use the actual performance results of the composite (which would not include any management fee charge) to present gross-of-fee results. However, the firm is required to disclose the firm's fee schedule (which should be the current fee the prospective client can expect to pay). The AIMR-PPS standards state it would be more representative to show results before the deduction of management fees and provide a fee schedule that represents the fee that would actually be paid by the prospective client.

Source: AIMR Advocate, Mar - Apr 2000

The AIMR Performance Presentation Standards Handbook, 1997 edition, states, "When wrap-fee composites are presented to prospective wrap-fee clients, the composites may include portfolios managed according to the same style or strategy that do not meet the wrap-fee definition only if performance results are reported after the deduction of the maximum wrap fee included in the composite, less actual, determinable transaction costs (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 83)." Can an investment manager make a presentation of the performance of a composite that includes wrap fees with the actual fee the client would be paying?

Yes. As long as the firm presents the actual wrap fee the client would be paying, the firm does not have to deduct the highest possible wrap fee from non-wrap-fee accounts in the composite.

Source: Standards Reporter, Nov - Dec 1997

The AIMR-PPS Wrap Fee Subcommittee Report defined a wrap account as "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" which is the same definition as that of the Securities and Exchange Commission. Please explain how a wrap account is different from other types of accounts, products or investment advisory relationships.

A typical wrap fee account has a contract/contracts (and fee) involving a broker (sponsor) as the investment advisor, a money manager (as a subcontractor to the broker investment advisor), other services (custody, consulting, reporting, performance, selection, monitoring, and execution of trades), and the client (brokerage customer). It is an all-inclusive "asset based" brokerage relationship, which may include other services, and is not a trust account, mutual fund, typical brokerage account, or private investment advisory relationship.

Source: AIMR Newsletter, Jul - Aug 1995

Our firm has several wrap-fee accounts that we assign to a Wrap-Fee Sponsor for management. Since the firm maintains investment discretion over the underlying assets assigned to the sponsor, we would like to advertise the performance of the wrap-fee composite and claim compliance with the AIMR-PPS standards. Because of the manner in which the wrap-fee program is operated, the wrap-fee sponsor calculates the performance of the wrap-fee composite and provides us with the composite performance and the back-up documentation including the performance of each account included in the composite.

We would like to insert a statement in our Claim of Compliance for this wrap-fee composite that indicates our Wrap-Fee Sponsor calculated the returns. The new claim would read: “XYZ Investment Management Firm has prepared and presented this report in compliance with the performance presentation standards of the Association for Investment and Research (“AIMR-PPS TM”) based on results calculated by ABC Wrap-Fee Sponsor...” Is this adjustment to the Claim of Compliance statement acceptable?

As stated in the AIMR Performance Presentation Standards Wrap-Fee Subcommittee Report published in January 1995, when claiming compliance with the AIMR Performance Presentation Standards, the presenting firm is ultimately responsible for the presentation of performance results, regardless of whether the firm performs the calculations or relies upon others.

The claim of compliance legend is provided on page 8 of the AIMR Performance Presentation Standards Handbook (1997, second edition). Any other use of the terms "AIMR" or "AIMR-PPS" except as specifically provided in the legend is prohibited.

The presenting firm is responsible for the performance results (including the performance calculated by the wrap-fee sponsor) and they must take the necessary steps to ensure that all of the requirements of the Standards are met. Therefore, if the presenting firm relies upon the wrap-fee sponsor to calculate the composite return, the presenting firm must ensure the wrap-fee sponsor calculates the return in compliance with the AIMR-PPS standards.

Source: AIMR Advocate, Sep - Oct 1999

Firm Assets

It is required that managers disclose individual performance composite assets as a percentage of total firm assets. Should non-fee paying assets be included in total firm assets for this purpose?

Non-fee paying assets may be excluded from total firm assets, but must be included if non-fee paying assets are included in any of the firm's composites. The inclusion of non-fee paying assets in a composite must be disclosed.

Source: AIMR List of 75 Question and Answers, 1994

Firm Definition

An existing division of a company would like to hold itself out to the public as a firm according to the AIMR-PPS standards definition of a "firm." What historical performance results should be presented in a performance presentation in compliance with the Standards? Can a division claim compliance from January 1, 1997, going forward?

The Standards define a "firm" to include "an autonomous investment firm, subsidiary, or division held out to the public as a separate entity" (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 2). For a division of an existing organization with historical performance results in managing assets to present "firmwide" performance, the division/"firm" must meet the requirement of presenting a 10-year performance record (or a record for the period since firm inception if inception is less than 10 years) to claim compliance with the Standards (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 41). In this instance, "inception of the firm" does not mean from the time the division began defining itself as a "firm" for purposes of the AIMR-PPS standards. Because the division/"firm" has historical performance results, the division holding itself out to the public as a firm must present the performance results of the managed assets (both current and historical) in their performance presentation in full compliance with the AIMR-PPS standards. All of a firm's actual discretionary fee-paying nontaxable portfolios invested in U.S. and/or Canadian investments must be presented in composites that adhere to the AIMR-PPS standards to meet the effective date for compliance as of January 1, 1993.

The division/"firm" is required to state in its performance presentation exactly how it is defining itself for purposes of compliance with the Standards. In defining the "firm" entity, organizations need to keep in mind the spirit and full intent of the Standards, namely fair representation and full disclosure.

Source: Standards Reporter, Mar - Apr 1997

Guidance Statement on Definition of the Firm

Fixed Income

How should a firm claiming compliance with the AIMR Performance Presentation Standards treat bonds in default when calculating their performance results?

The AIMR Performance Presentation Standards Handbook, 1997 edition, states on page 47, "Accrual accounting must be used for fixed-income and all other securities that accrue income." If a bond goes into default during the accrual cycle, a firm must recognize the loss when it occurred. The performance figures must not be recalculated. The accrual of interest must be included in the calculation method up until the point of the bond's default. At that point, the calculation method would reflect the loss of accrued interest by adjusting the amount of accrued interest to zero.

Once a bond goes into default the firm should assure itself that the bond is marked to market by valuing the bond "based on a reasonable estimate of the current value of assets if they were sold on that date to a willing buyer" (AIMR Performance Presentation Standards Handbook, 1997 edition, pp. 50-51). When and if the bond comes out of default and there is a reasonable expectation that the bond will commence paying interest, including back interest, the firm must begin accruing for such interest payments. The firm is not permitted to allocate such payments over periods when they were originally due, but not paid.

Source: Standards Reporter, Jan - Feb 1997

How do the Standards apply to GIC portfolios?

Traditional GIC portfolios provide stable results that are not based on a mark-to-market valuation. The valuation of the traditional GIC is based on book value, not on current market, as required by the total return calculation and reporting requirements of the AIMR Performance Presentation Standards. Accordingly, unless the assets in these portfolios are separately marked to market, the portfolio results cannot be reported in compliance with the Standards. GIC assets would be reported separately, i.e., not included in the statistic, "total firm assets" as defined by the Standards.

Firms managing both traditional GIC and other assets are exempted from reporting GIC assets in compliance with the AIMR-PPS standards. These firms may claim compliance for the remaining assets. Managed GICs and other non-traditional GIC strategies that meet the total return and market valuation requirement are eligible for the claim of compliance.

Source: AIMR Newsletter, May - Jun 1993

Global Investment Performance Standards (GIPS)

What is the difference between AIMR-PPS standards and GIPS?

The AIMR-PPS and GIPS standards are both ethical standards for investment performance presentation used by investment managers to ensure fair representation and full disclosure of an investment firm's performance. North American firms generally use the AIMR-PPS standards, whereas GIPS are designed to meet the needs of investment firms on a global basis. The GIPS standards are based on, and are very similar to, the AIMR-PPS standards. Both GIPS and the AIMR-PPS standards are voluntary and consist of requirements that must be followed for a firm to claim compliance with the Standards. As a general matter, firms complying with the AIMR-PPS standards will likely be in compliance with GIPS. It is the expectation of both the AIMR-PPS Implementation Committee and the GIPS Committee that the requirements of both sets of standards eventually will be the same.

Source: Standards Reporter, Sep - Oct 1998

You have stated through your Q&A publication that compliance with the AIMR-PPS standards also means compliance with GIPS. If a U.K. based (head office) global firm wants to claim compliance with GIPS, but its U.S. based office is AIMR-PPS compliant, is there a potential problem because the U.K. had office would include the U.S. office in its definition of a "firm"?

If a U.S. based office of a multinational entity can define itself as a "firm" for the purposes of the AIMR-PPS standards, it may claim compliance with the Standards. It may want to do so to market to U.S. clients who are familiar with the AIMR-PPS standards. The U.S. based office cannot use any of the assets of its parent in a performance presentation. However, the parent company may still claim compliance with GIPS and include the U.S. based office as part of the firm for a GIPS presentation. In that case, the parent company is not prevented from defining itself as different firms for the purposes of different presentations as long as each entity can meet the definition of a firm in the standards and each firm is in full compliance with the standards on a firm wide basis. Given the definition of a firm in GIPS and the AIMR-PPS standards, in most cases it will be difficult for an entity to define itself as multiple firms.

Source: Standards Reporter, Jan - Feb 1999

What is the relationship of the AIMR-PPS standards and GIPS? What will be the future standard; that is, do you see the AIMR-PPS standards going away in favor of GIPS?

The AIMR-PPS standards and GIPS are both ethical standards for investment performance presentation used by investment managers to ensure fair representation and full disclosure of an investment manager's performance. North American firms generally use the AIMR-PPS standards; whereas GIPS are designed to meet the needs of investment firms on a global basis. The GIPS standards are based on, and are very similar to, the AIMR-PPS standards. Both GIPS and the AIMR-PPS standards are voluntary and consist of requirements that must be followed for a firm to claim compliance with the Standards. As a general matter, firms complying with the AIMR-PPS standards will likely be in compliance with GIPS. It is the expectation of both the AIMR-PPS Implementation Committee and the GIPS Committee that the requirements of both sets of standards will eventually be the same.

Source: Standards Reporter, Sep - Oct 1998

AIMR has recently shifted its focus from the AIMR-PPS standards to GIPS, even referring to GIPS as “The Next Step.” What effect will GIPS have on the AIMR-PPS standards?

Over the next several years, AIMR expects that the Global Investment Performance Standards^{TM} (GIPS^{TM}), the AIMR Performance Presentation Standards^{TM} (AIMR-PPS^{TM}), and other regional standards will consolidate to form one global investment performance standard. In early 1999, the requirements of the AIMR-PPS standards were significantly revised to bring them closer to GIPS. AIMR is now taking a strong lead in promoting the acceptance of GIPS in North America by redrafting the AIMR-PPS standards to incorporate both the format and content of GIPS.

Largely, GIPS and the AIMR-PPS standards are similar with only slight differences in format and content. Very few substantive changes are necessary to bring the AIMR-PPS standards and GIPS together and AIMR will make a strong effort to minimize the differences between the two standards. The redraft of the AIMR-PPS standards will serve as an example of how countries or regions with existing standards can embrace one global standard, by incorporating GIPS as the core of the local standard and adopting additional provisions only when necessary to satisfy local regulation or to meet existing practice. Until one standard is achieved, the AIMR-PPS standards will serve as the North American version of GIPS. The redrafted standards will be available for public comment later this year on the AIMR Web site (www.aimr.org).

Source: AIMR Advocate, Jul - Aug 2000

Implementation Dates

Does the implementation date for taxable portfolios of January 1, 1994, mean that a firm can be in compliance as of 1993 for its tax exempt portfolios, and as of 1994 for its taxable portfolios?

The deadline extension for taxable portfolios means that a manager can claim compliance for tax exempt portfolios as of January 1, 1993, and for taxable portfolios as of January 1, 1994. The effective date of a manager's compliance for tax exempt and for taxable portfolios must be disclosed.

Source: AIMR List of 75 Question and Answers, 1994

If a firm has been in existence prior to 1993, can the firm claim compliance as of January 1, 1995?

The Standards require that all portfolios invested in US and/or Canadian securities managed for US-based or Canada-based clients must be presented in composites that adhere to the AIMR-PPS standards to claim compliance as of January 1, 1993, or before, if a firm has been in existence at least since 1993. Taxable portfolios and investments in non-US and non-Canadian securities must be brought into compliance as of January 1, 1994, or before, as long as the firm has been in existence since at least 1994. If a firm does not have records to substantiate performance after 1993 or 1994, it could come into compliance if the lack of records is disclosed. Lack of records for periods after 1993 or 1994 means that due to circumstances beyond the control of the manager, the underlying data to support the performance record were either never kept or were lost or destroyed.

Source: AIMR Newsletter, Mar - Apr 1994

If a firm that is in existence prior to 1993 cannot come into compliance until sometime after the appropriate implementation dates for reasons other than lack of records, when can the firm claim compliance?

If a firm comes into compliance after the implementation date, the firm must be able to present a 10-year record in compliance before the claim of compliance can be made. For example, a firm is founded in 1990 but does not come into compliance until 1996. The firm may claim compliance with the AIMR-PPS standards once it has achieved a ten-year record in compliance with the Standards, which in this case would be in the year 2006.

Source: AIMR Newsletter, Mar - Apr 1994

Can a firm claim that its international portfolios are in compliance as of 1993 by fulfilling the domestic requirements?

If a manager has implemented all of the domestic requirements for non-U.S. and non-Canadian portfolios an of January 1, 1993, the claim of compliance can be made. When managers claim compliance for international assets and clients as of January 1, 1994, the additional requirements and disclosures will apply.

Source: AIMR List of 75 Question and Answers, 1994

Junk Composites

What is the recommended treatment for portfolios that are fully discretionary in the investment sense, but which have unique investment objectives requiring tailored strategies? Do the AIMR-PPS standards recommend single-portfolio composites, or can the manager aggregate dis-similar accounts into a catch-all or "dustbin" composite?

The Standards require that all discretionary portfolios be included in one or more appropriate composites defined according to strategy. An aggregation of portfolios with unique investment characteristics into a catch-all or dustbin composite will not provide meaningful average performance. Because the intent of the Standards is to account appropriately for all portfolios, these unique portfolios must remain as single-portfolio composites. However, a firm need not individually list the single-portfolio composites, except upon request. An acceptable presentation would be to simply state on the firm's list of composites the number of such unique portfolios, the total assets represented by these portfolios, and the percentage of firm assets. The manager must also include a brief description of the strategies that typify these portfolios, such as "global portfolios managed to very specific benchmarks". The performance results of any of the single-portfolio composites must be made available to prospective clients.

Source: AIMR Newsletter, Mar - Apr 1994

Leverage/Derivatives

When a firm is managing a market neutral strategy using "phantom cash" how should performance be presented? In this case, the term phantom cash refers to the aggregate amount of cash that a client might have with multiple managers, with responsibility for

managing the cash placed with one manager in particular. Let's also assume that the manager is allowed to leverage the cash position by a multiple of 2.5 times.

In the Leverage/Derivative Examples section included in the AIMR Performance Presentation Standards Handbook, 1997 edition, Example 12 on page 122 presents a simple case of going long and short securities to produce a market neutral strategy. The portfolio is not leveraged in a strict economic sense, because the return may not differ from a portfolio of cash equivalents, assuming that the long and short securities are reasonably well correlated with each other and hedge each other. It is leveraged, however, because the portfolio's return clearly depends on the returns of the long versus short securities, and because the strategy can be employed without any outlay of cash (ignoring the technical details of the use of proceeds from the short sales). The recommended solution is that the manager must disclose the risk/return profile of the strategy and the potential impact on portfolio return. Because it is unclear what all-cash means with regard to short sales, the portfolio would not be restated to an all-cash position.

The same principles apply to the more complex case now presented, i.e., when "phantom cash" is used and when the portfolio may be leveraged up to a certain multiple times the underlying cash. To illustrate, let's assume that a client allocates $10 million in cash to a manager who will then leverage this cash position by 2.5 times. The manager will go long $25 million in one type of security and go short $25 million in other securities. The cash may not be in an account that is directly attributable to the manager, i.e., the client may be allocating cash that is actually held in accounts being managed by multiple managers, but one manager is assigned the management of a total amount of cash earmarked for a market neutral strategy. The returns to the market neutral strategy would be based on $10 million, with disclosure of the type of strategy being employed. Restatement to an all-cash basis would not be possible. The $25 million would be reported separately as part of cash overlay assets; $10 million would be included in firm assets.

Source: AIMR Newsletter, Jan - Feb 1995

If portfolios are managed according to the same strategy but some portfolios use leverage and some do not, can the results be combined in a single composite, and what information is required?

The report of the Subcommittee on Leverage and/or Derivatives that was published in the Double Issue 1994 (Volume 5, No. 1) of the AIMR Newsletter required that performance be presented on both a leveraged basis and on an all-cash basis. The all-cash presentation is required as supplemental information. Portfolios that use leverage may be included in the same composite with portfolios that do not use leverage as long as the strategies are the same except for leverage. In this case, the portfolios must be restated to an all-cash basis, and performance on a leveraged basis is not required.

For example, if the strategy is to pick stocks based on fundamental research and the leveraged portfolio simply uses margin to always buy the same stocks in the same relative proportion as the unleveraged portfolio (but totaling over 100% of the account value), then leveraged portfolios and unleveraged portfolios may be included in the same composite. However, if the strategy involves any discretion of when or how much to leverage (market timing, for example), then the leverage becomes a separate and distinct strategy and would require full separate reporting. In this case, performance must be presented on a leveraged basis, with performance on an all-cash basis presented as required supplemental information.

Source: AIMR List of 75 Question and Answers, 1994

Linking Results

When calculating an annual asset-weighted composite return linking quarterly results, will the number of portfolios be constant over the year, i.e., must portfolios be under management for a full year to be included in the annual return?

No. Because the AIMR-PPS standards require linked quarterly returns at a minimum, the number of portfolios may change from quarter-to-quarter (or month-to-month), depending on the frequency of valuation. A new portfolio enters the composite after the first full measurement period (e.g., quarter or month) or according to consistently and reasonably applied manager guidelines. For example, some managers may choose to add portfolios after one month of management, others may choose a quarter, and yet others may choose six months. The guideline must be consistently applied. Terminated portfolios are excluded from the composite for partial periods, i.e., they are included as of the last full measurement period. When disclosing the number of portfolios included in the composite's annual return, the manager may choose to report the number of portfolios as of the beginning of the period or as of the end of the period. The method must be followed consistently for also disclosing the amount of composite assets and composite assets as a percentage of firm assets, and must be followed consistently across time periods.

Source: AIMR Newsletter, Sep - Oct 1993

Portfolio returns are calculated on a monthly basis, the monthly returns are linked, and the quarterly portfolio returns are weighted with portfolio values as of the beginning of the quarter. Must portfolios be under management for one month or for one quarter to be included in the quarterly average?

Inclusion in the composite depends upon the weighting factor. As noted in the AIMR Performance Presentation Standards Handbook, 1997 edition, on page 49, there are two ways to calculate quarterly returns. The preferred and more accurate method is to calculate monthly portfolio returns, and then weight each of the portfolio returns in the composite by the asset value of the portfolio as of the beginning of the month (or beginning value plus weighted cash flows for the month) to get a weighted monthly composite return. These weighted monthly composite returns are then linked to get the quarterly composite return. For this method, portfolios could be added after one full month. Under the second method, you would calculate monthly portfolio returns, link the monthly portfolio returns to get quarterly returns, and then calculate the quarter composite return by weighing each of these quarterly portfolio returns by the portfolio's assets as of the beginning-of-the-quarter (or beginning of quarter plus weighted cash flows). In this case, the portfolio would have to be under management for at least one full quarter before being added to the composite. The same rules apply to terminated portfolios.

Source: AIMR Newsletter, Sep - Oct 1993

Component returns linked over multiple periods do not equal the total return. Is there an appropriate methodology to make the component parts equal to the total return?

It is recommended that the return components are not forced to equal the total return. There is no consensus on a methodology to make the component returns equal to the total return. If a methodology is used to force the components to add up, the methodology must be disclosed.

Source: AIMR Newsletter, Jan - Feb 1995

Can a firm in compliance with the AIMR-PPS standards present cumulative performance results that "link" compliant and non-compliant "supplemental" performance results? For example, Firm XYZ has compliant results for 1997. All prior years are from a prior affiliation and are not AIMR-PPS compliant. Thus, the firm presents the results for years 1996 and prior as "supplementary" information. However, can Firm XYZ still claim compliance with the AIMR-PPS standards and present, for example, cumulative 3-year, 5-year, 10-year, and "since inception" performance results that include both the compliant and non-compliant periods? Can these cumulative results (i.e., cumulative returns) be presented along with the firm's compliant presentation and/or along with the firm's AIMR-PPS "Compliance Statement"?

If past performance results do not meet all the requirements of portability of investment results under the AIMR-PPS standards, the past performance record cannot be "linked" to the record of the new firm-this includes cumulative results. "Linking" in this context can be considered, placing the historical information of the prior affiliation on the same page as the performance of the investment firm, in this case firm XYZ. The past performance record of the prior affiliation can only be presented as supplemental information provided the past record is clearly identified and the firm gives credit for the performance to the prior affiliation and describes the manager's responsibilities at the prior firm. The firm also must maintain or have access to the appropriate records to establish that the performance reported is true and accurate. The firm may not present cumulative 3-year, 5-year, 10-year, and since inception results that link both the compliant and non-compliant periods. AIMR strongly believes that any lesser standard has the potential to cause performance to be misleading to the client.

Source: Standards Reporter, Sep - Oct 1998

List of Composites

According to the AIMR-PPS standards, a performance presentation must disclose the availability of a complete list and description of the firm's composites. Please specify what type of information should be included.

The AIMR-PPS standards require that a firm disclose the availability of a complete list and description of the firm's composites. (AIMR Performance Presentation Standards Handbook, 1997 edition, pp. 89-90). The firm must also include a brief description of the strategies that typify the portfolios within the composites. A performance record for those composites must also be available.

Source: Standards Reporter, Mar - Apr 1997

Minimum Asset Size

Please clarify the criteria for determining a minimum portfolio size.

A firm may establish size-limit criteria for composites. This minimum size limit is designed to identify portfolios the firm considers too small to be representative of the firm's intended investment strategy. The criteria for determining a minimum portfolio size limit might include the minimum size limit currently being accepted for management or the cutoff for which the firm accepts new accounts below the limit into the composite (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 31). A firm must disclose the existence of a minimum portfolio size and apply the limit consistently.

Source: Standards Reporter, Mar - Apr 1997

Is there a minimum amount of firm assets that can be excluded from composites under the minimum portfolio-size criteria?

The minimum portfolio-size criteria allow managers to exclude large numbers of portfolios that in aggregate represent a small percentage of assets. An allowable percentage for exclusion has not been specified, but the percentage should have a negligible impact of the asset-weighted average. When reviewing the minimum portfolio-size criteria for present and past compliance, managers should consider their firm's minimum portfolio size criteria for accepting business appropriate to the period. Once a minimum size is established, it must be applied consistently, and portfolios above this limit must be included. A manager cannot use composite results to market to portfolios below that size limit.

Source: AIMR List of 75 Question and Answers, 1994

What is to prevent managers from abusing the minimum portfolio-size criteria as a way to select results?

Keep in mind that there are certain disclosures that must accompany each composite's performance results. These disclosures must be made at least on an annual basis for each composite. The manager must disclose the number of portfolios, composite assets, and composite assets as a percentage of firm assets. Firm assets mean ALL firm assets, i.e., discretionary and non-discretionary assets as well as assets below the minimum size portfolio. Therefore, prospective clients will have background information to help them determine the representatives of a composite, and to highlight the possible "cherry-picking" of results.

Source: AIMR List of 75 Question and Answers, 1994

If a firm claiming compliance with the AIMR-PPS standards makes a change to the minimum portfolio size limit for a composite, what disclosures are necessary?

If a firm makes a change to the minimum portfolio size limit for an existing composite, the firm must disclose the change to the minimum portfolio size and apply this new limit consistently. Also, the firm must not restate historical performance figures to reflect only the portfolios that met the new minimum portfolio size. The Standards state that the existence of a minimum portfolio size limit, once established for a composite, must be disclosed and applied consistently (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 31).

Source: Standards Reporter, Mar - Apr 1997

We have a set of criteria for inclusion in our composites. One of those criteria for one of our composites is that the market value of any account included must be a minimum of $500,000. With market fluctuations, accounts can and do occasionally drop below $500,000. I remove these accounts for the quarter(s) that they drop below the size limit. Should they later rise

back above the $500k, they would be added back for those quarters. Is there anything wrong with this approach on this criterion?

The AIMR-PPS standards allow firms to establish size-limit criteria for composites. This minimum size limit is designed to identify portfolios the firm considers too small to be representative of the firm's intended investment strategy. If the firm chooses to establish a minimum portfolio size limit, the firm must disclose the existence of the size limit and apply the limit consistently. It appears in the situation you described that your firm has established a minimum account size limit and is applying it consistently as the Standards recommend.

Source: AIMR Webcast, 4 April 1999

We have 300 accounts that are small portfolios (all under $15,000). Each account meets the firm's definition of discretionary, but we cannot implement our intended style on these accounts due to the lack of appropriate funds. Must we include these portfolios that fall below the minimum in a composite?

No. The Standards allow firms to define minimum portfolio size limits for composites. The minimum portfolio size is designed to identify portfolios the firm considers too small to be representative of the firm’s intended investment strategy. Once a limit has been defined, the firm must apply that limit consistently.

All discretionary portfolios above the limit must be included in one or more composites. Portfolios that fall below the limit cannot be included in the composite with the size limit. The portfolios that fall below the limit are not required to be included in the firm's composites.

Source: AIMR Advocate, Nov - Dec 1999

Model Results

If a manager has control over the timing of asset allocations, that is, the manager times asset class switches based on a timing model, can the results be presented in accordance with the AIMR-PPS standards?

The AIMR-PPS standards require that performance results be based on actual assets. If a manager is using a timing model based on an index, and is calculating the effect of the timing signal as it is applied to the index, the presentation will not meet the requirement of being based on actual results. This approach does not deduct any transaction costs, and would be considered to be model results. Model results may be presented as supplemental information, but may not be presented as being in compliance with AIMR-PPS standards, and may not be linked to actual results.

A manager could claim compliance with the AIMR-PPS standards if the results for the actual dollars under management are presented. If the manager does not have discretion over selection of the underlying funds, the performance of the timing signal will be the differential between the return of the actual portfolio using the timing signal, and the return of the portfolio minus the timing signal. As an example, assume that a manager has discretion to switch client assets out of a particular mutual fund selected by the client and into cash at points determined by the manager's timing model. The effectiveness of the timing signal can be measured by comparing the actual performance of the portfolio (using the timing signal) against the return of the mutual fund over that same period. As long as the manager has discretion to actually switch assets, such a presentation would meet compliance requirements.

Source: AIMR List of 75 Question and Answers, 1994

What disclosures must accompany my model portfolio results in order to present it in compliance with the AIMR-PPS and GIPS standards?

Both the AIMR-PPS and GIPS standards state that composite results must include only assets under management and may not link simulated or model results with actual performance. Because model or simulated portfolios have no actual assets under management, the performance of these portfolios cannot be presented as “in compliance” with the AIMR-PPS or GIPS standards. Model performance can be presented as supplemental information, provided it is clearly defined as such and is not linked to actual performance results. In order to present the performance results of a model investment strategy in compliance with the Standards, the firm would have to create an actual account with real assets based on this strategy.

Source: AIMR Advocate, Jul - Aug 2000

Mutual Funds

A firm claiming compliance with the AIMR-PPS standards wants to advertise the performance results of a composite that includes a mutual fund in accordance with the guidelines set forth in the SEC's recent no-action letter to AIMR. What constitutes gross-of-fee performance for a mutual fund?

The gross-of-fee performance for the mutual fund would put it on the same basis as the separately managed portfolios in the same composite. It is the pure gross return minus transaction costs and any other fees normally deducted from separately managed account performance. Because management fees are negotiated and not related to managers' ability to buy and sell securities, they should be added back to the performance on a gross-of-fee basis. The same would apply for all fees and expenses included in the fund's Statement of Operations, such as custody, transfer agent, share registration, and 12(b)-1 fees. Looked at another way, gross-of fee performance equals net-of-fee performance plus period costs, such as management fees or any other fees and expenses that are listed in the mutual fund's Statement of Operations. Transaction costs and foreign withholding taxes should not be added back.

The SEC staff no-action letter to AIMR allows investment managers to include mutual funds in composite performance presented gross of fees so long as composite performance is also shown net of fees. The no-action letter states that an advertisement must display both gross and net performance results with equal prominence in a format designed to facilitate ease of comparison of the gross- and net-of-fee results. The advertisement must not identify that mutual funds are included in the composite.

Source: Standards Reporter, Nov - Dec 1997

Should closed-end funds be included in composites? If so, should the performance be that of the traded shares or of the net asset value (NAV) of the fund?

A closed-end fund should be included in one or more composites and, like open-end mutual funds, it could be designated as a separate single-portfolio composite if managed according to a unique style from other portfolios.

If performance is being presented from the point of view of the manager of the closed-end fund, then performance should be calculated in the same way as for separately managed portfolios; i.e., it should be based on the market prices and income of the underlying securities. In this case, the price of the closed-end fund traded shares (involving discounts or premiums to NAV) would be irrelevant.

If performance is being presented from the point of view of a manager who owns the closed-end fund within another portfolio, then the fund should be priced just like any other security. In other words, performance should be based on the traded shares, not based on the NAV, because the manager in this case is not responsible for the underlying securities and only the market price of the closed-end fund itself is significant.

Source: Standards Reporter, Mar - Apr 1998

According to the AIMR-PPS standards, with regards to dividend reinvestments, if the firm does not know the closed end fund price, can the firm substitute the ex-date's NAV for the reinvest price to perform calculations until the reinvest price is published at month end?

Yes. The AIMR-PPS standards are based on the principles of full disclosure and fair representation of performance results. Firms are encouraged to use the best-known available information when calculating performance. For closed end funds as well as open-end funds, if the reinvestment price is not available until a later date, it would be acceptable for the firm to use a reasonable estimate for the dividend reinvestment price based on historical dividend information. The firm must disclose that the returns are preliminary using an estimated reinvest price. As soon as practicable, the firm should recalculate the returns using the actual reinvest price.

Source: AIMR Advocate, Jan - Feb 2000

What actually constitutes a fee-paying discretionary account? Is a Mutual Fund a fee-paying account?

A fee-paying account is a portfolio for which the client has agreed to pay a fee to the investment firm or its affiliates regardless of whether an actual fee is paid in a given period. If the mutual fund receives management or advisory fees from its investors, then it is considered a fee-paying account. The Standards leave it up to the firm to define the terms discretionary and non-discretionary, as there are no universal definitions.

Source: AIMR Webcast, 4 April 1999

New Composites

A firm in compliance with the AIMR-PPS standards creates a new composite. Beyond the required and recommended disclosure guidelines of the Standards, are there any other items a firm should include in their presentation?

Firms are strongly encouraged to disclose the date on which the composite was created. Additionally, firms who are just coming into compliance with the Standards are strongly encouraged to disclose the date on which all their composites were created. This will enable clients and prospective clients to determine if the performance report being presented has been created using ex ante decision making.

Source: Standards Reporter, May - Jun 1997

New Portfolios/Accounts

With regard to proper timing of inclusion of new portfolios in the respective composite(s), the AIMR-PPS standards state: "Composites must include new portfolios at the start of the next performance measurement period (at least quarterly) after the portfolio comes under management or according to reasonable and consistently applied firm guidelines (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 11)." We interpret the above statement, specifically the last part of the sentence, to indicate that a firm must include new portfolios in composites the first full quarter under management, or sooner (i.e., the first full month under management). Several firms have interpreted the above statement to mean that they can determine whatever inclusion rules they want for including new portfolios in composites, as long as they do so consistently. For example, many firms will include new portfolios in composites after the first full quarter under management; a portfolio that is new as of January 5 would, therefore, not be included in a composite until July 1, or until the third quarter. Theoretically, a firm could decide to include new portfolios after the first full year under management, using the rationale that they are consistently applying their guidelines. We believe that these alternative approaches are not keeping with the "spirit" of the Standards. Could you please provide additional guidance as to the intent of this statement?

The AIMR-PPS standards recognize that firms may need time for the assets of new accounts to be invested to reflect the firm's investment strategy, and the Standards thus allow firms some discretion on the timing of inclusion of new accounts into composites. Because the AIMR-PPS standards are based on the principles of full and fair disclosure, firms should not abuse the discretion allowed under the Standards by holding portfolios out of composites for longer than necessary to incorporate the portfolios into the investment strategy of the firm.

Source: Standards Reporter, Nov - Dec 1997

A firm claiming compliance with the AIMR-PPS standards has an existing composite that lost all of its portfolios within the composite for one month. New portfolios were added to the composite at the start of the next performance measurement period after the portfolios came under management, which created a gap in which the composite had no existing portfolios. Can a firm maintain a composite for a period when no portfolios are included in the composite and claim compliance with the AIMR-PPS standards? How should a firm present the annual performance composite results in such an instance?

If a composite loses all its portfolios for any performance measurement period, the composite does not continue to exist. Only the composite performance for the period in which the composite had existing portfolios can be reported. If new portfolios are added to the composite at a future date, the composite performance results must show the current and historical performance results for the composite and will thus recognize the gap in performance. The historical composite performance cannot be linked to the current composite results. No adjustment to the actual results for the composite or the benchmark (if used) should be made, and the results must be accompanied with the appropriate disclosure.

Source: Standards Reporter, Mar - Apr 1997

A commissioned registrant (a person registered or required to be registered under the Commodity Futures Trading Commission rules) is required under CFTC regulations to reflect that a new portfolio is brought into an advisor's program or that a withdrawing portfolio leaves, as part of a 6-column format. However, the AIMR-PPS standards state that "New portfolios must not be added to a composite until the start of the next performance measurement period (month or quarter) after the portfolio comes under management or according to reasonable and consistently applied manager guidelines." Both the AIMR-PPS standards and the CFTC require that performance be computed according to the accrual method of accounting and the periodic ROR be computed on a time-weighted, total rate of return. Would it be a violation of the AIMR-PPS standards which states that a new portfolio should not be added to a composite until the start of the next performance measurement period, if the Advisor includes a new portfolio in the "additions" column of a CFTC required 6-column format table?

No. Compliance with the AIMR Performance Presentation Standards requires adherence to applicable federal, state, and local law. Also, the AIMR-PPS standards are directed primarily at achieving an accurate ROR for an Advisor's composite. Therefore, so long as the RORs reported in a table are computed according to AIMR-PPS standards, inclusion of new or withdrawing portfolios in the "additions" or "withdrawals" columns of a CFTC required 6-column format would not be deemed to be a deviation from the AIMR-PPS standards.

Source: AIMR Webcast, 4 April 1999

If you are notified on June 30 that a portfolio is to be terminated from your management service on September 30, however, assets are to be managed as usual until September 30, is this account to be removed from the composite during the second calendar quarter or the third? In other words, would you remove it on the date of notification or the date of actual termination?

The removal date of this portfolio from the composite will depend on the manner in which the portfolio is managed after the notification date. The AIMR-PPS standards state that composites must exclude terminated portfolios after the last full performance measurement period that the portfolios were under management. These portfolios must remain in the historical performance record. Survivor-only performance is not in compliance.

If the firm will continue to manage the portfolio with no changes to the style or strategy from June 30 to September 30, it appears the portfolio would remain completely under the firm's discretion. If the firm is calculating performance on calendar quarters, the portfolio could stay in the composite until September 30. However, if the notification of the termination changes the manner in which the portfolio is managed (i.e., asset liquidation or trade approval), the portfolio should be removed from the composite as of June 30.

Source: AIMR Advocate, Nov - Dec 1999

If an account closes in the middle of December, would it have to be included in the composite through the entire reporting period? Would that mean that it would have to be included in the Q4 composite, even though the account was not open for the entire reporting period? If so, what if the account is being liquidated - the sales of the assets often will have an effect on performance.

Terminated portfolios are excluded from the composite for partial periods, i.e., they are included as of the last full measurement period. For example, assuming a calendar quarter, if a firm uses quarterly valuations and a portfolio is terminated on December 16th, that portfolio will be included in the 3rd quarter performance calculations for the composite (assuming the quarter ended on September 30) but should be excluded from the 4th quarter calculations because it was terminated before the end of the 4th quarter.

Source: AIMR Webcast, 4 April 1999

New Standards

When requirements of the AIMR-PPS standards are changed or clarified, must the manager restate past results to make sure that results are in compliance?

If a firm has chosen to bring results into compliance, it is obligated to make sure that results meet current compliance requirements for all periods for which the manager is claiming compliance. The main requirements of the Standards, however, are not expected to undergo changes that would cause a revamping of performance presentations for firms that already meet compliance requirements. Further, if major changes were made, firms in compliance under existing standards, would not be expected to revise past period information for the revisions. For example, if the standards someday became daily time-weighted returns, presentations using monthly or quarterly returns would not have to be recalculated for past years.

Source: AIMR List of 75 Question and Answers, 1994

According to the new requirements of the AIMR-PPS standards, beginning 1/1/2000, "the appropriate 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, an explanation of why no benchmark must be disclosed." If the firm does not believe presentation of a benchmark is appropriate, can the firm disclose this reasoning and satisfy the new requirement?

Yes. This new requirement leaves the choice and selection of an appropriate benchmark to the firm. If the firm determines that no benchmark is appropriate, the firm can disclose why no benchmark return is provided when presenting the performance of this composite.

Source: Standards Reporter, May - Jun 1999

According to AIMR-PPS standards concerning the new requirement to disclose the composite creation date, if the firm does not know the exact date the composite was created, what should the firm disclose?

The intent of this disclosure is to enable clients and prospective clients to determine if the compliant performance report has been created recently or is more established. Firms are required to show the date the composite was first presented in compliance with the Standards. For example, a historical composite that on 1/1/93 was restated to come into compliance with the Standards must use 1/1/93 as the composite creation date. If a firm comes into compliance on 1/1/99 by restating its history in compliance with the Standards, the composite creation date will be 1/1/99.

Source: Standards Reporter, Mar - Apr 1999

Explain the differences between the new AIMR-PPS requirement that performance must be calculated using a time-weighted return that adjusts for cash flows, the requirement that after 1/1/2005 performance must be calculated using a time-weighted rate of return that adjusts for daily-weighted cash flows, and the likely requirement that after 1/1/2010 actual valuations at the time of cash flows must be used.

Currently, the AIMR-PPS standards require firms to use a time-weighted rate of return (TWRR) which adjusts for cash flows. Time-weighted rates of return that adjust for cash flows can be calculated using many different methods. A number of calculation methods included in the AIMR Performance Presentation Standards Handbook (1997, second edition) are meant to provide examples of acceptable formulas or calculation methods. The Handbook is not intended to be, nor should it be, considered the sole or even primary source of guidance in calculating these statistics.

The AIMR-PPS standards require the following:

TWRR that adjusts for cash flows (Currently the minimum required)
Various forms of approximation of TWRR are acceptable. The purpose of these methods is to produce as good an estimate as possible in circumstances where daily valuations are not available. An example of an acceptable method: Original Dietz Method - this method approximates when cash flows are received into an account by assuming that all cash flows occur at the midpoint of the period.

TWRR that adjusts for daily-weighted cash flows (Required beginning 1/1/2005)
Beginning 1/1/2005, the approximation method used for TWRR should include adjustment for the timing of cash flows during the measurement period. Firms should calculate the return for each month using a denominator that reflects the weighting of cash flows for the time they have been invested in the month. This method contrasts with other approximation methods that may, for example, assume that all cash flows are spread evenly through the month. An example of an acceptable method: Modified Dietz or Modified BAI Method - these methods weight each cash flow by the amount of time it is held in the portfolio. These are an estimate of the true TWRR.

TWRR that uses actual valuation at the time of the cash flow (Required beginning 1/1/2010)
The actual valuation of the portfolio every time there is a cash flow will make the calculation of TWRR very accurate. In practice, this requirement can only be met by having daily valuations on a continuous basis. An example of an acceptable method: Daily Valuation Method - this method calculates the true TWRR rather than an estimate.

Source: Standards Reporter, May - Jun 1999

Are the new requirements that were added to the AIMR-PPS standards last year only applicable to performance presentations that contain performance calculations for periods

after January 1, 2000, or will they apply to all presentations after the date January 1, 2000, even if the presentations only contain performance returns up to December 31, 1999?

AIMR added nine new requirements to the AIMR-PPS standards on February 12, 1999. Four of those requirements became effective as of January 1, 2000 and are as follows:
5. For all composites, the total return for the appropriate 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, an explanation of why no benchmark is shown must be 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.
6. Firms must disclose the percentage of composite assets that are non-fee paying portfolios.
7. All presentations must state the currency used to express performance.
8. The composite creation date must be disclosed.
These additional disclosures must be included on all composite presentations after January 1, 2000. Even if the firm only presents performance information through December 31, 1999, these four required disclosures must be included in each presentation, regardless of whether the presentation only contains information prior to 2000.

Source: AIMR Advocate, May - Jun 2000

What is the definition of the "composite creation date"? Is it the first date the composite returns were ready for presentation, the first date the in the composite series, or the date the composite's strategy was implemented (even if the composite had not been calculated)?

Please define 'composite creation date' for the new requirements effective 1/1/2000. The intent of this new disclosure is to enable clients and prospective clients to determine if the compliant performance report has been created recently or is more established. Beginning 1/1/2000, firms are required to show the date the composite was first presented in compliance with the Standards. For example, a historical composite that on 1/1/93 was restated to come into compliance with the Standards must use 1/1/93 as the composite creation date. If a firm comes into compliance on 1/1/99 by restating its history in compliance with the Standards, the composite creation date will be 1/1/99.

Source: AIMR Webcast, 4 April 1999

If accrual accounting for dividends is not a requirement until January 1,2005, what does this mean for historical performance calculations where dividends were not accrued (our custodians download only on paid dates, not accrued dates)? Do these all need to be reconstructed?

No. This requirement is not a retroactive requirement; therefore, the firm would not have to recalculate historical performance using accrual accounting for dividends. The firm would simply have to begin using accrual accounting from January 1, 2005 forward. However, firms are encouraged to implement these requirements prior to their effective dates.

Source: AIMR Webcast, 4 April 1999

What is the best way to keep up with changes to the AIMR-PPS standards?

AIMR has several opportunities for firms to learn about upcoming changes to the Standards. The AIMR Web site (www.aimr.org/standards/) is updated with all proposed and recently adopted changes to the Standards. The AIMR Advocate is a source document that publishes information on the AIMR Performance Presentation Standards including committee reports, interpretations, exposure drafts, frequently asked AIMR-PPS questions and answers, and any other updates. AIMR also offers conferences and workshops on the development of the AIMR-PPS and GIPS standards. Please contact AIMR directly at 804.951.5499 or info@aimr.org for additional information on a specific conference or workshop.

Source: AIMR Advocate, Nov - Dec 1999

What is the minimum valuation period allowed by the Standards?

Currently portfolios must be valued at least quarterly, and periodic returns must be geometrically linked. For periods beginning, 1/1/2001, portfolios must be valued at least monthly, and periodic returns must be geometrically linked.

Non-fee Paying Portfolios

Non-fee paying accounts are not required to be included in composites. If a firm chooses to include non-fee paying accounts in composites, the AIMR-PPS standards require the firm to disclose this information and include the non-fee paying accounts in the definition of firm assets. Can a firm remove non-fee paying accounts from composites once they are included and remain in compliance?

The intent of this provision is, in part, to allow firms with a small number of accounts in a composite to raise their asset value and total firm assets under management. This may assist smaller firms when reporting information to consultants and prospective clients. Once a firm creates a policy or procedure, it must consistently follow this policy or procedure and can change it only for legitimate, documented reasons unrelated to performance. Firms must not move non-fee paying accounts into and out of composites based on performance.

Source: Standards Reporter, Jan - Feb 1998

There are a handful of clients for whom we have temporarily "forgiven" our quarterly fees. We have negotiated an arrangement whereby we will not charge these clients the quarterly management fees until the performance of said accounts has improved. Thus, these accounts have become (temporarily) "non fee-paying" accounts. Should these accounts be removed from our discretionary, fee-paying composites until such time they are assessed fees again?

It appears that these portfolios are still fee-paying portfolios, even though the firm has made temporary arrangements to rebate or forgive the fees due to poor performance. Because the fees are only temporarily forgiven, the firm should not remove the portfolios from the firm’s composites. Removing these accounts from the composite would, in effect, be removing them because of poor performance, which is clearly in violation of the spirit of the Standards.

Source: AIMR Advocate, May - Jun 2000

Recently, the SEC censured and fined an investment management company because it had included hot IPO investment performance in its performance records for an incubator fund. How does AIMR suggest we handle incubator fund performance under the AIMR-PPS Standards?

Incubator funds typically are accounts set up with firm assets to initiate a new style of asset management. As such, they are typically non-fee-paying accounts. The AIMR-PPS standards only require fee-paying portfolios to be included in the firm's composites. However, the Standards permit firms to include non-fee-paying portfolios in its composites. If non-fee-paying portfolios are included in the firm's composites, the Standards require firms to disclose the inclusion of non-fee-paying portfolios in a composite. Also, beginning January 1, 2000, firms must disclose the percentage of non-fee-paying portfolios represented in the composite.

If the fund represents an investment style or objective that is unique with respect to other management styles of the firm, it should be included in a single-portfolio composite. However, if at any time the firm discontinues this strategy, the composite would also discontinue. Although form discontinued the strategy, the firm must maintain and provide the information on the discontinued composite when requested.

The AIMR-PPS standards are a set of ethical guidelines for firms to follow when presenting their investment performance results. The Standards are based on the principles of fair representation and full disclosure and serve as the minimum standards that firms should follow. Although the Standards do not specifically address the presentation of performance of incubator funds, in order to meet the objectives of the Standards, firms should include disclosures that contain material information not covered in the Standards. The firm should disclose all relevant information that would clarify the firm's investment results. The firm should consider disclosing to clients when a single account composite consists of an incubator fund as well as other relevant information.

With regard to removing non-fee-paying portfolios from composites, please refer to the interpretation published in the January/February 1998 issue of the AIMR Standards Reporter for additional clarification.

Source: AIMR Advocate, Jan - Feb 2000

Can a non-fee-paying portfolio be included in a fee-paying composite? What disclosures are required?

The AIMR-PPS standards allow firms to include non-fee-paying accounts in fee-paying composites as long as the firm discloses the inclusion of the non-fee-paying portfolios in the composite and in the firm's total assets. Beginning 1/1/2000, firms must disclose the percentage of composite assets that are non-fee-paying portfolios.

Source: Standards Reporter, May - Jun 1999

Do you have to merge non-fee-paying and fee-paying funds into the same composite?

The Standards leave it up to the firm to define composites according to similar style or strategy. If the firm chooses to include a non-fee-paying portfolio in a composite managed according to a similar style, the firm must disclose the inclusion of non-fee-paying portfolios included in the composite as well as included in total firm assets. Beginning 1/1/2000, firms must disclose the percentage of composite assets that are non-fee-paying portfolios.

Source: AIMR Webcast, 4 April 1999

Overlay Strategies

How should a firm report assets managed through currency overlay, asset allocation, and similar overlay strategies for which the manager does not have investment discretion over the underlying assets?

The mandatory disclosure by a firm of the percentage of total firm assets represented by a composite refers to the percentage of total discretionary and nondiscretionary assets managed by the firm. Total firm assets in the AIMR Performance Presentation Standards does not refer to assets underlying overlay investment strategies such as currency overlays, options and future overlays, securities lending programs, and asset allocation overlay strategies, unless the firm actually manages the underlying assets. If the manager has discretion over the underlying assets, they would be included in total firm assets.

For example: If a firm manages $10 billion in equity assets (discretionary and nondiscretionary), $2 billion in currency overlay portfolios, and $13 billion in asset allocation overlays, the percentage of firm assets is based on $10 billion. If the manager maintains discretion over either all or part of the underlying assets for the overlay strategies, these underlying assets would be included in the $10 billion total. The manager must also disclose separately the total assets managed in the currency overlay and asset allocation strategies. When presenting composite performance of the overlay strategies, the manager must disclose the composite's percentage of assets managed according to that general overlay strategy (currency, asset allocation, etc.) when reporting total firm assets.

Source: AIMR Newsletter, May - Jun 1993

Partial Period Returns

If an investment, portfolio or composite started mid-month or mid-quarter, how do you present the partial period of return when presenting quarterly returns?

Partial period (e.g., partial month or quarter) investment and portfolio returns may be disclosed as partial period returns provided that the period covered is clearly noted. Partial period returns may not be extrapolated to the full period or included in any composite representing the manager's performance for the entire period. The Standards require that the calculation of an investment or portfolio return for inclusion in a composite is required to commence either at the beginning of the first full reporting period for which the investment or portfolio is under management, or according to reasonable and consistently applied manager guidelines. Additionally, performance must be calculated at least quarterly (monthly as of 1/1/2001). As an example, applying these guidelines, if the manager calculates performance quarterly, investment or portfolios must be under management as of the beginning of the quarter to be included in the composite. If the manager calculates performance monthly, the manager may choose to add new investments or portfolios to the composite after one full month, three full months or longer, as long as the guidelines for inclusion are consistently applied. It is acceptable for the inclusion guideline to be longer than the calculation period.

Source: AIMR Newsletter, Jan - Feb 1995

How are partial year returns incorporated in the presentation of annual returns?

Partial year returns may be disclosed as partial year returns provided that the period covered is clearly noted. The Standards require the geometric linking of period returns, quarterly at a minimum, to produce annual returns. However, partial year returns may not be extrapolated to the full year. Therefore, if a manager has returns for three full quarters and two months, the manager may only show an 11 month return.

Source: Standards Reporter, Nov - Dec 1996

Portability

May we link performance from a prior firm to a new firm?

When a manager or a group of managers joins a new firm, the manager can link his past performance with the ongoing results of the new firm only if:

- all the investment decision makers come over to the new firm (i.e., research department, portfolio managers, and other relevant staff),
- the staff and the decision-making process remain intact and independent within the new firm,
- the new firm discloses the availability of the performance records from the new manager's old firm and provides the performance records when requested, and
- the new firm has documents supporting the reported performance.

Most cases will not meet all of these requirements, in which case the past performance record of the manager cannot be linked to the performance record of the firm. The past performance record of the manager can be presented as supplemental information when relevant. When one firm joins an existing firm, performance from the merged firm can be linked to the ongoing results of the existing firm only if:

- substantially all the investment decision makers come over to the new firm,
- substantially all the assets come over to the new firm,
- the staff and decision making process remain intact and independent within the existing firm, and
- the acquiring firm discloses the availability of the performance records of the acquired firm and provides the performance records when requested.

The AIMR-PPS standards strongly believe that any lesser standard has the potential to cause performance to be misleading to the client. If the manager/firm does not meet each of the above requirements, the AIMR-PPS standards permit the use of performance data from a prior firm as supplemental information as long as the past record is identified clearly as such and is not linked to the results of the new firm.

Source: Standards Reporter, Nov - Dec 1997

Big Bank purchased Small Bank in 1994. Each bank had its own investment advisory groups with a long history and claimed compliance with the AIMR-PPS standards. The purchase had very little impact on the portfolio managers, and they continued to manage accounts in the

same style as they had for many years. The banks had very few overlaps of styles historically. Although the investment advisory function may have contributed to the merger, the purchase was basically a bank buying a bank, not an advisor buying another advisor. The merger left neither of the two firms as a clear survivor firm. Primarily, Big Bank advisors continued their fixed-income styles, and Small Bank advisors continued with their equity styles. No portfolio managers from either side were terminated. Until January 1, 1996, the merger was ongoing. The Combined Bank views January 1, 1996, as the start of the combined entity, primarily from a marketing perspective. The Combined Bank seeks to claim compliance with the AIMR-PPS standards, but what should it do with the performance history of Big Bank and Small Bank prior to January 1, 1996?

The AIMR-PPS standards provide guidelines for the presentation of performance, but no finite set of guidelines can cover all potential situations. Meeting the objectives of fair presentation and full disclosure requires a conscientious, good faith commitment by the presenter to adhere to the spirit of the AIMR-PPS standards under specific circumstances (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 1). To drop all the history and reported performance as of January 1, 1997, would be misleading. Combined Bank must show the actual historical performance of each on going composite no matter where it came from.

The firm should be defined as the Combined Bank going forward from January 1, 1996. For the period prior to that date, each bank should be defined as its own firm such that Combined Bank can present a historical performance record. Prior to January 1, 1996, Combined Bank must make the required disclosures (such as number of accounts, firm assets) as if each bank had been its own firm. When the disclosure is made that a complete list and description of all composites is available upon request, however, Combined Bank must provide the list and description of both banks' composites for this period. Combined Bank also has the responsibility to include all information and disclosures necessary for full and fair presentation, even if the information and disclosures go beyond the minimum requirements of the Standards (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 1).
Source: Standards Reporter, Sep - Oct 1997

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Source: Standards Reporter, Sep - Oct 1997

A firm presenting performance in compliance with the AIMR-PPS standards (presenting firm) hires other firms to manage a portion of client assets. When a presenting firm terminates one of its hired firms (former firm) and transfers the assets to another firm (new firm), can the presenting firm use the historical performance numbers from the former firm as part of its performance presentation?

The presenting firm's use of the former firm's performance depends on how the presenting firm holds itself out to its clients. If the presenting firm is a "manager of managers" and is hired by its clients because of the presenting firm's manager selection skills, then the presenting firm must include the hired firm's performance within the presenting firm's composite(s). Similarly, if the presenting firm replaces one firm with another, the presenting firm must include within the same composite the performance of the new firm managing the assets assigned to the new firm going forward and leave the results from the former firm unchanged.

If the presenting firm is not a "manager of managers" and hires another firm to manage assets that the presenting firm does not manage for various reasons (e.g., emerging markets expertise, currency overlay management) then the presenting firm cannot include the hired firm's performance within the presenting firm's composites.

Source: Standards Reporter, Mar - Apr 1997

How should the AIMR-PPS standard's rules on portability of prior investment results be applied to the merged results of commingled funds, i.e., when two commingled funds are merged into one, which results should be presented as the historical record?

According to the full disclosure requirements of the Standards, disclosure must be made that the surviving fund is a combination of Fund X and Fund Y. The manager must determine which is the "surviving" fund, i.e., which fund represents continuity in investment process. Portability of that record as the historical record will depend on whether investment process, investment objective, and staff remain the same. Continuity requirements for linking the historical record to the ongoing record of the merged fund are the same as for the general portability guidelines of the Standards. The record of the "non-surviving" fund must be made available upon request.

If the investment process is changed, or if the investment staff changes, the historical records of each of the merged funds must be presented, and cannot be linked to the ongoing record of the merged fund.

Source: AIMR Newsletter, May - Jun 1993

How do the rules of portability apply to the merger of two investment firms? Whose historical record should be presented?

When a firm is acquired by another, the historical record is that of the acquiring firm, i.e., the acquiring firm can show the performance results of the acquired firm as supplemental information, but cannot claim that past record as its own.

Source: AIMR Newsletter, May - Jun 1993

If a firm is purchased for the purpose of bringing on staff and resources to offer a product specific to the acquired firm but new to the acquiring firm, can the acquiring firm show the past performance record of the acquired firm as its own and still claim compliance?

The rules of portability will apply, i.e., if all the investment decision makers and substantially all the assets come with the acquired firm, and if the staff and decision-making process remain intact and independent, the performance record of the acquired firm for that product can be shown as the performance record of the acquiring firm and can be linked to ongoing results. If, however, the staff of the two merged firms are combined, and the decision making is shared, the performance record of the acquired firm would be presented as supplemental information, and must not be linked to ongoing results.

Source: AIMR Newsletter, May - Jun 1993

With regards to portability, if 11 of the 13 investment professionals left their old firm to join a new firm (along with all of the support staff), can the new firm meet the criteria for linking performance history?

Due to the unique circumstances surrounding the use of prior performance results, portability of performance must be addressed on a case-by-case basis. The Standards state that substantially all investment decision-makers must join the new firm and the investment decision-making process must remain intact in order to link the historical performance results with the ongoing results of the new firm. It appears that the investment decision-making process may not have remained intact since not all of the decision-makers are joining the new firm. In addition, if the eleven investment professionals are merged with the existing staff of the new firm, and the decision making is shared, the historical performance record of the eleven should only be presented as supplemental information, and must not be linked to ongoing results.

Source: Standards Reporter, May - Jun 1999

If a manager meets all the rules of portability and determines she can take the track record with her to her new firm, can the original firm continue to claim the historical track record even though the manager responsible for the performance is no longer with the original firm?

The AIMR-PPS standards state that “Performance is the record of the firm, not of the individual.” If the original firm wishes to continue managing the assets remaining with a new manager according to the same style and objectives as the original manager, the original firm can use the historical performance of that composite. However, the firm must disclose the occurrence of a material change in personnel responsible for the management of that composite.

Source: Standards Reporter, May - Jun 1999

If a person was previously employed by an adviser that was not AIMR compliant, but that person brought all supporting transaction documents and met the other criteria required for portability of performance, can this performance become AIMR compliant at the new employer or is it forever tainted due to its prior non-compliant status? Further, if indeed the performance is portable, is the new employer required to keep the track records separate because the old performance was non-AIMR compliant, and the new performance is AIMR compliant?

To clarify, the performance history can never "become AIMR compliant." Compliance with the Standards can only be achieved on a firmwide basis.
The rules of investment performance portability are:
· all the investment decision makers come over to the new firm (i.e., research department, portfolio managers, and other relevant staff),
· the staff and the decision-making process remain intact and independent within the new firm,
· the new firm discloses the availability of the performance records from the new manager's old firm and provides the performance records when requested, and
· the new firm has documents supporting the reported performance.
If the firm determines that all the rules of portability have been satisfied and the firm (including the new manager's historical composites) meets all the requirements of the Standards, the firm can claim compliance with the Standards. The firm then determines it can present the historical performance as the historical record of the firm. There would be no need to separate the historical performance of the new manager from the historical performance of the firm.

Most cases of portability will not meet all of the requirements, in which case the past performance record of the manager cannot be linked to the performance record of the firm. The past performance record of the manager can be presented as supplemental information when relevant.
Please note one of the rules of portability requires that the staff and decision-making process remain intact at the new firm. If the investment process is somehow changed, or if the investment staff changes, the historical records of the new manager can only be presented as supplemental information and cannot be linked to the ongoing record of the firm.

Source: AIMR Webcast, 4 April 1999

"When a firm is purchased for the purposes of bring staff and resources to offer a product specific to the acquired firm but new to the acquiring firm, the rules of portability apply" (AIMR Performance Presentation Standards Handbook (1997, second edition), page 78). Does the acquired firm have to offer a product new to the acquiring firm for the firms to link the past performance to ongoing performance? What if they offer similar products?

When one firm joins an existing firm, performance from the merged firm can be linked to the ongoing results of the existing firm only if:

· substantially all the investment decision makers come over to the new firm,
· substantially all the assets come over to the new firm,
· the staff and decision-making process remain intact and independent within the existing firm, and

· the acquiring firm discloses the availability of the performance records of the acquired firm and provides the performance records when requested.

If the acquired firm offers a product that is new to the acquiring firm and the management of that product continues in the same manner, it is likely that the investment decision-making process remains intact and independent. If the other rules of portability are met, the performance of the acquired firm can be linked to the ongoing performance results at the acquiring firm.

If the acquired firm brings a product that is similar to a product at the acquiring firm, a critical issue is whether the decision-making process remains intact. If the decision-making process is incorporated into the acquiring firm's existing style, the investment decision-making process of the acquired firm's product has changed. The rules of portability are not met and the performance of the acquired firm can only be shown as supplemental information. If the acquired managers join the management of the acquiring firm's existing composite, the existing composite must contain a disclosure that a material change in personnel responsible for investment management has occurred.

Source: AIMR Advocate, Sep - Oct 1999

Guidance Statement on Performance Record Portability

Real Estate

What is meant by the concept of the recognition of income at the "investor level"?

The term "investor level" is intended to be synonymous with investment level. This means that all real estate investment program income and expenses (short-term interest income, appraisal, legal, accounting, cash management and banking charges, portfolio management fees, asset management fees, investment management fees, corporate or fund-level expenses and reporting expenses) are included in the return calculations. The concept of investment level is distinct from the operating or property level returns which may exclude some or all of the non-property investment income and expenses. The disclosure which accompanies the performance return presentation must describe whether the returns are presented at the investment level or property level, and must disclose the exclusion of any investment expense that may be paid by the investors.

Income is equivalent to net investment income (before or after investment management fees, as applicable) and income is determined pursuant to Generally Accepted Accounting Principles ("GAAP"). Any differences to GAAP must be disclosed along with the other disclosures required by the AIMR-PPS standards. The AIMR-PPS standards recognize that there exist various alternatives of private real estate investment forms available to real estate investors, including wholly-owned real estate, joint venture real estate investments, co-investments, separate accounts, and commingled funds. Each investment form may offer significant differences in financial policies and agreements pertaining to the distributing of earned income to investors and the retention and reinvestment of earned income. In those situations where income is earned at the investment level but is not distributed to investors and, therefore, retained at the investment level, there exists the possibility that the accounting policies of some investors may not recognize the earned income unless it is distributed. To promote consistent and comparable reporting practices between real estate investment managers that are subject to differing cash distribution and retention policies, the AIMR-PPS standards recommend that income earned at the investment level be included in the computation of the income return, regardless of the investors' accounting policies for recognizing income from real estate investments. However, the investment manager is required to disclose the cash distribution and retention policies with regard to income earned at the investment level.

Source: AIMR Newsletter, Jan - Feb 1994

The AIMR-PPS standards state that the value of a real estate portfolio must be reviewed at least quarterly. What does review mean?

The typical practice of providing quarterly reports satisfies the quarterly review requirements because the issuance process should include a review of the real estate portfolio, a review of net asset value for financial and performance purposes, and review and disclosure of any factors that may result in a material change to net asset value. An appraisal is not required every quarter and the minimum requirement is once every three years, unless client agreements do not require independent appraisals. The frequency or the absence of independent appraisals must be disclosed.

Source: AIMR Newsletter, Jan - Feb 1994

Where do real estate mortgages fit within the AIMR-PPS standards?

For the purpose of performance reporting, real estate mortgages with fixed or variable interest rate are considered fixed-income securities. Therefore, the core sections of the AIMR-PPS standards are applicable.

Participation and convertible mortgages (i.e., hybrid mortgages) are considered real estate investments. In addition, component returns must be allocated as follows:

- Basic cash interest (current receivable) - allocate to income return component.
- Contingent interest (current receivable) - allocate to income return component.
- Basic accrued interest (deferred) - allocate to appreciation return component.
- Additional contingent interest (deferred; payable at maturity, prepayment or sale) - allocate to appreciation return component.

Therefore, if the return is currently payable from operations, allocate to the income return. All other sources of return that are deferred or realizable in the future should be allocated to the appreciation component. When presenting returns, it is recommended that separate presentations be prepared for equity ownership investment strategies.
Source: AIMR Newsletter, Jan - Feb 1994

Should the real estate returns be presented net of leverage, after the effects associated with mortgage and similar long term liabilities?

Yes, it is required that real estate returns be presented net of leverage (interest expense related to third-party debt) coupled with appropriate disclosure on the amount of leverage that is employed in producing the returns.

Source: AIMR Newsletter, Jan - Feb 1995

The AIMR-PPS standards for real estate require disclosure of "Return formulas and accounting policies for items such as capital expenditures, tenant improvements and leasing commissions." What types of information must be disclosed?

The disclosure for capital expenditures, tenant improvements and leasing commissions must, at a minimum, indicate whether the costs are capitalized or expensed. If costs are capitalized and amortized over some future period(s), this additional information must be included.

It is acceptable for the required disclosure to appear in the entity's financial statements (most likely in the Significant Accounting Policies section), and to be incorporated by reference in the AIMR-PPS-related disclosures, as long as prospective clients have been provided the full financial statements within the last 12 months. In addition, for interim financial statements where full footnote disclosures are not presented, the appropriate disclosures (which would be included in the financial statements in the applicable Annual Report) can be incorporated by reference as long as prospective clients are provided the most recent annual financial statements. Incorporation by reference (for appropriate items) eliminates significant duplication of disclosure.

Source: AIMR Newsletter, Jan - Feb 1995

A real estate manager has real estate appraisals completed either yearly or every three years depending on the client's agreement. Prior to 1980, the manager allocated the appreciation back over the previous period. Therefore, for a three-year appraisal, the manager would restate past performance to recognize the appreciation over each of the past three years. Post 1980 the manager recognized the gain or loss in value in the quarter of the appraisal. Is the real estate manager in compliance with the AIMR-PPS standards?

Consistent with industry practice, the AIMR-PPS standards require that changes in valuation, including unrealized gains and losses, be recognized in the reporting period that includes the effective date of the appraisal. This requirement is effective for performance presented for periods subsequent to December 31, 1993. To clarify, before December 1993 either immediate recognition or an allocation of changes in valuation is acceptable with any change in methodology disclosed, along with the dates effected.

Source: AIMR Newsletter, May - Jun 1995

Define the terms "investment level" and "property level".

Investment level means that all real estate investment program income and expenses (short-term interest income appraisal, legal, accounting, cash management and banking charges, portfolio management fees, asset management fees, investment management fees, corporate or fund-level expenses and reporting expenses) are included in the return calculations. The concept of investment level is distinct from the operating or property level which may exclude some or all of the non-property investment income and expenses. See Exhibit 1 for summary of differences between property and investment level returns.

Exhibit 1
Summary of Differences Between Property and Investment Level Returns

Property Level Returns are primarily based upon the cash invested in a property (at acquisition plus subsequent capitalized expenditures); recognized changes in value; and principal payments on debt. Returns are based upon the total equity of the investors in the investment program. "Net income" is the accrual basis net income at the property (which would ultimately be consolidated into the investment program net income). "Net income" is accrual basis net income for the consolidated investment program as reported in the financial statements. Net income is not considered to be retained by the property, so it does not have to be "earned on" (does not affect denominator). Net income is retained by the investment program, is included in the denominator, and must be "earned on." Recognized appreciation/depreciation (realized and unrealized) affects the denominator and must be "earned on." Recognized appreciation/depreciation (realized and unrealized) affects the denominator and must be "earned on." Capital expenditures affect the denominator and must be "earned on." Capital expenditures have no effect on the denominator. Capital contributions by investors have no effect on the return calculation. Capital contributions affect equity, therefore they are weighted into the denominator based on actual days. Cash distributions to investors have no effect on the return calculation. Cash distributions affect equity, therefore they are weighted into the denominator based on actual days.

Source: AIMR Newsletter, Jan - Feb 1995

Will the 1/1/2001 monthly valuation requirement apply to real estate?

No. The new requirement states for periods beginning 1/1/2001, portfolios must be valued at least monthly. Currently, real estate valuations must be performed at least once every three years by an independent, objective appraiser and real estate valuations must be reviewed at least quarterly. This new requirement does not require firms to value or review real estate securities more frequently.

Source: AIMR Advocate, Nov - Dec 1999

Record Keeping

If a firm has been in existence prior to 1993, can the firm claim compliance as of January 1, 1995?

The Standards require that all portfolios invested in US and/or Canadian securities managed for US-based or Canada-based clients must be presented in composites that adhere to the AIMR-PPS standards to claim compliance as of January 1, 1993, or before, if a firm has been in existence at least since 1993. Taxable portfolios and investments in non-US and non-Canadian securities must be brought into compliance as of January 1, 1994, or before, as long as the firm has been in existence since at least 1994. If a firm does not have records to substantiate performance after 1993 or 1994, it could come into compliance if the lack of records is disclosed. Lack of records for periods after 1993 or 1994 means that due to circumstances beyond the control of the manager, the underlying data to support the performance record were either never kept or were lost or destroyed.

Source: AIMR Newsletter, Mar - Apr 1994

Specifically, what are the requirements for documentation and record keeping an investment advisor must keep on file and how long must records be maintained. Are the requirements different for current clients versus clients that have terminated their relationship with the firm?

According to normal legal requirements, an investment adviser must keep files for the previous six years. This requirement refers to correspondence and other business related documents. Please be aware that securities regulation generally requires an investment adviser to keep all documents (confirmations, statements, etc.) that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts that the adviser uses in advertisements (current and historical performance results). Therefore, it would be necessary to have the documents for each year that an adviser is showing performance results, however many years that may be, and for all portfolios that are included in the performance results.

Source: AIMR Newsletter, Jul - Aug 1995

Does AIMR allow a firm that has lost or is unable to obtain its records, to use documentation or reports from a consulting firm as the back-up records supporting a performance presentation?

Compliance with the AIMR-PPS standards requires firms to demonstrate or recreate their performance calculations with supporting documentation. Firms may use information provided by consulting groups such as the Mobius Group, Wilshire Associates, and SEI, which offer independent analysis of investment manager's data to make these calculations. However, the firm must be able to demonstrate or recalculate their performance history if questioned by a potential client, a verifier, or a regulator.

Source: Standards Reporter, Sep - Oct 1998

According to the AIMR-PPS standards, what are the requirements for documentation and record keeping that an investment advisor must keep and how long must records be maintained?

In order to claim compliance with the AIMR-PPS standards, the firm should maintain the underlying data necessary to recreate the performance of their composites. Underlying data encompasses any records that enable a firm to accurately recreate the historical performance results for all composites. Firms should maintain this information for as long as they present composite performance.

Source: Standards Reporter, May - Jun 1999

Retroactive Compliance

The Standards require performance presentation for a ten-year period. Could you explain how this relates to retroactive requirements?

A firm is not required to restate performance prior to 1993 to claim compliance as of 1993 and going forward. A firm must show a ten-year history, or history since inception of the firm. The reference to a ten-year record means that as of 1993 a firm must build prospectively at least a ten-year record that will be in compliance. For example, by the year 2003, any firm in business in 1993 will have to present a ten-year performance record to meet the claim of compliance. Firms are encouraged to retroactively comply for at least five years and, preferably, for their entire history if possible.

Source: AIMR Newsletter, Jul - Aug 1993

Can a manager show a performance record, either in or out of compliance with the Standards, for only a certain portion of its history? For example, is it acceptable for a firm

that has been in existence for 12 years to present performance only for those years that are in 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 (AIMR Performance Presentation Standards Handbook, 1997 edition, page 5). The record prior to 1993 need not be restated for a manager to claim compliance." If a firm has been in existence prior to 1993, the firm must report its past performance on a yearly basis, at a minimum, for at least ten years or since the inception of the firm if less than ten years whether or not the record has been restated to meet compliance requirements. The Standards permit a firm to link the performance record of periods that are in compliance with those that are not in compliance as long as the periods are clearly identified as such and the manager discloses why the past periods are not in compliance. If documentation for past performance does not exist, the firm must make this disclosure. Lack of records for periods prior to 1993 means that the performance record was either never kept or was lost or destroyed. The full disclosure requirements of the AIMR-PPS standards clearly prohibit the cherry-picking of favorable performance periods.

For example, a firm has been in existence since 1980, with both taxable and tax-exempt assets under management. The firm calculated performance and has records to substantiate such performance beginning in 1986. To claim compliance with the Standards, the firm must present its tax-exempt assets in compliance at least since 1993; it must present its taxable assets in compliance at least since 1994. It must also present annual performance for at least 10 years back from the most recent annual performance presentation date or since the firm's inception. The firm must disclose that it does not have records to substantiate performance for any portion of the 10-year period which includes years prior to 1986. Performance prior to 1993 for tax-exempt assets and prior to 1994 to taxable assets does not have to be restated as long as the firm discloses the periods for which it is in compliance and discloses why the past periods do not meet compliance requirements.

Source: AIMR Newsletter, Mar - Apr 1994

Segments/Carve Outs

Can a firm construct subsets of composites segregating, for example, assets managed on behalf of insurance company clients from other clients, if the insurance clients are managed to gain/loss restrictions unlike other clients?

A firm should separate portfolios into composites based on common style/strategy or investment objective. Within that style or strategy, certain accounts may have different level or client restrictions. If insurance company assets are managed in a style similar to other accounts, these assets can be included in a large composite representing all assets managed under that style. However, if, because of investment restrictions or other reasons, insurance accounts are managed so differently that it prevents the firm from implementing the style or strategy, then the insurance company accounts should be included in a separate composite based upon their unique style, strategy, and restrictions.

Source: Standards Reporter, Mar - Apr 1998

Our firm wishes to combine the returns of European equities and bonds from our EAFE-mandate portfolios. Is this permissible under the AIMR-PPS standards?

If a manager "carves out" a geographic segment from a portfolio invested in international securities, the returns may not be presented as an AIMR-PPS-standards-compliant composite unless the sector has its own cash and currency management (AIMR Performance Presentation Standards Handbook, 1997 edition, p. 11). The carve-out may be presented as supplemental information, and additional disclosures are required. The manager must list the composite(s) from which the carve-out is drawn, and must disclose the percentage of each composite's assets represented by the carve-out. The appropriateness of combining different types of asset classes by region will be determined by the underlying strategy.

If the asset allocation at the carve-out level is driven by the asset allocation guidelines at the total portfolio level, the carve-out of European stocks and bonds will not be representative of an active asset allocation decision between European stocks and bonds, and may not be presented as such. For example, assume that a manager first determines the proportion of assets to be invested in different asset classes. Within these overall asset allocation guidelines, the manager may have chosen to underweight European equities and overweight Japanese equities, and overweight European bonds and underweight Japanese bonds. Until the overall allocation to equities is changed, the proportion invested in European equities will be determined by its relative attractiveness to equities of other regions, not by its relative attractiveness to European fixed income investments.

If, however, the manager is given a specific amount of assets to be invested in a particular region, and has discretion to allocate those assets between stocks and bonds of that region, the carve-out returns would be representative of an active allocation decision at the segment level. In this case, the carve-out could be presented on a total return basis as supplemental information with the required carve-out disclosures. It could not be presented as an AIMR-PPS-standards-compliant composite unless it had separate cash and currency management.

Source: AIMR List of 75 Question and Answers, 1994

STIFS

How should income on Short Term Investment Fund (STIFs) be treated by portfolios which own shares in such STIFs?

The intent of the AIMR-PPS standards is to ensure fair and comparable representation of income. Accrual of income from fixed income instruments is required. Unlike bonds with a known coupon rate, there is no published interest rate for STIF accounts on which to base such accruals. Common practice is to use the last actual interest rate from the STIF (e.g., the prior month's rate) to accrue income for the most recent month. When the actual rate becomes known, an adjustment can then be make to allocate the actual income earned to the proper period. In this way, there is no systematic under- or over-estimation of income, but income is also properly assigned to the period when earned. Cash basis accounting (recording the STIF income as it is actually received) will tend to lag the above accrual method by crediting income a month after it was earned; however, either method is acceptable. What is important is the consistent application of the method selected.

Source: Standards Reporter, Mar - Apr 1998

Subadvisors

If a manager has control over the timing of asset allocations, that is, the manager times asset class switches based on a timing model, can the results be presented in accordance with the AIMR-PPS standards?

The AIMR-PPS standards require that performance results be based on actual assets. If a manager is using a timing model based on an index, and is calculating the effect of the timing signal as it is applied to the index, the presentation will not meet the requirement of being based on actual results. This approach does not deduct any transaction costs, and would be considered to be model results. Model results may be presented as supplemental information, but may not be presented as being in compliance with AIMR-PPS standards, and may not be linked to actual results.

A manager could claim compliance with the AIMR-PPS standards if the results for the actual dollars under management are presented. If the manager does not have discretion over selection of the underlying funds, the performance of the timing signal will be the differential between the return of the actual portfolio using the timing signal, and the return of the portfolio minus the timing signal. As an example, assume that a manager has discretion to switch client assets out of a particular mutual fund selected by the client and into cash at points determined by the manager's timing model. The effectiveness of the timing signal can be measured by comparing the actual performance of the portfolio (using the timing signal) against the return of the mutual fund over that same period. As long as the manager has discretion to actually switch assets, such a presentation would meet compliance requirements.

Source: AIMR List of 75 Question and Answers, 1994

A firm presenting performance in compliance with the AIMR-PPS standards (presenting firm) hires other firms to manage a portion of client assets. When a presenting firm terminates one of its hired firms (former firm) and transfers the assets to another firm (new firm), can the presenting firm use the historical performance numbers from the former firm as part of its performance presentation?

The presenting firm's use of the former firm's performance depends on how the presenting firm holds itself out to its clients. If the presenting firm is a "manager of managers" and is hired by its clients because of the presenting firm's manager selection skills, then the presenting firm must include the hired firm's performance within the presenting firm's composite(s). Similarly, if the presenting firm replaces one firm with another, the presenting firm must include within the same composite the performance of the new firm managing the assets assigned to the new firm going forward and leave the results from the former firm unchanged.

If the presenting firm is not a "manager of managers" and hires another firm to manage assets that the presenting firm does not manage for various reasons (e.g., emerging markets expertise, currency overlay management) then the presenting firm cannot include the hired firm's performance within the presenting firm's composites.

Standards Reporter, Mar - Apr 1997

Systems Compatibility

Our bank was very close to completing a lengthy and expensive process of bringing all our tax-exempt assets into compliance with the AIMR-PPS standards as of January 1, 1993 and taxable assets into compliance as of January 1, 1994. Just prior to completing these

compliance requirements, our bank acquired another entity whose assets are not in compliance. Is there some sort of grace period that we will be allowed after making such an acquisition? Or, will we have to postpone making a claim of compliance for the efforts we have already completed until the acquired assets are also brought into compliance?

This situation represents three main areas of consideration:

1. The time frame for assimilating acquired assets into a framework that can meet AIMR-PPS compliance requirements.

2. Systems problems, i.e., integrating accounts that may be evaluated through different portfolio management, accounting and/or performance measurement systems.

3. Recommended disclosures in the case of an acquisition.

Assimilating Assets

If the acquired accounts are to be transition into the investment style and strategy of the acquiring firm, they should be treated as new accounts and placed in a composite labeled "acquisition of XYZ" until such time as the assets can be blended over time into compliance. The acquiring firm will need to set reasonable and consistently applied criteria that is well documented for determining when the acquired assets complete the transition to the new style. Some accounts will be modified more quickly than others. Therefore, rather than setting one arbitrary time frame for bringing all acquired assets into existing composites that meet compliance requirements, different portfolios can transition at different times, as long as the criteria are consistently followed. The historical performance records for these strategies will be those of the acquiring firm. Availability of the records of the acquired firm must be disclosed and provided upon request, even though the strategies have been discontinued.

If the investment style and strategy of the acquired firm is to be maintained and its accounts represent separate composites, the assets of the acquired firm must meet compliance requirements as of the first full reporting period one year after the acquisition date, for a firm to claim compliance. In other words, there will be a one-year grace period for bringing the acquired assets into compliance if the strategies of the acquired assets are to be maintained. For example, if the assets are acquired in mid-July, the assets would need to meet compliance requirements as of the beginning of the fourth quarter of the following year. The historical performance records for these strategies will be those of the acquired firm.

To claim compliance, taxable assets must meet compliance requirements by at least January 1, 1994; tax-exempt assets must meet compliance requirements by at least January 1, 1993. Prior periods to do not have to be in compliance, as long as this is disclosed, with an explanation of how the past is not in compliance. If an historical record, even an historical record that does not meet compliance requirements, is not available because underlying records were not maintained or because performance was not calculated, this must be disclosed. For periods after January 1, 1993 for tax-exempt, and January 1, 1994 for taxable assets, a lack of performance calculations cannot be disclosed as a means of claiming compliance. After these dates, only the absence of underlying records can be used as a basis for not meeting compliance requirements and the absence of such records must be disclosed.

Systems Problems

The AIMR-PPS Implementation Committee has discussed the problems of integrating different portfolio management, accounting and performance measurement systems for different branches or subsidiaries or for different types of assets or client groups. While recognizing the practical problems and costs of integrating systems or of initiating performance measurement of portfolios, the Committee has determined that compliance with the AIMR-PPS standards requires investment in the necessary systems to evaluate portfolio performance. Therefore, systems incompatibilities cannot be used as a reason for not claiming compliance for all assets, i.e., a manager cannot make the claim of compliance for only those assets that are measured and monitored on compatible systems.

Disclosures

It is recommended, rather than required, that an acquiring firm disclose when an acquisition is made, the amount of assets and the number of portfolios involved. As the new assets are brought into compliance, prospective clients will see an increase in the size of assets and number of portfolios through the required composite disclosures. Therefore, full disclosure of acquisitions is in the best interests of both the prospective client and the acquiring firm.

Source: AIMR Newsletter, Jan - Feb 1995

Tax Issues

The AIMR-PPS standards state that for taxable clients "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." Are gross-of-tax performance returns required?

No. The Standards recommend gross-of-tax performance for presentation of results to prospective clients. Gross-of-tax reporting is preferred because of the complexities of presenting after-tax performance in a way that is meaningful and comparable with current systems' constraints (AIMR Performance Presentation Standards Handbook, 1997 edition, pp. 59-61).

Source: Standards Reporter, Mar - Apr 1997

For the reporting of pre-tax total returns of taxable portfolios that include both tax-exempt and taxable bonds, is it appropriate to gross up the income on the tax-exempt portion of portfolios as long as the tax rate assumption is disclosed?

It is recommended that income on tax-exempt bonds NOT be grossed up to a pre-tax basis. When composites include both taxable and tax-exempt securities, the manager should state the percentages of each class and, where possible, present results for each of the portions separately. Therefore, it is recommended that a total rate of return for the composite be presented without adjustment for tax-exempt income to a pre-tax basis. In addition, it is recommended that the manager present the percentages invested in tax-exempt and taxable securities, with returns (unadjusted) on each segment reported separately. As supplemental information, the manager could show an after-tax total rate of return for the composite by applying the federal tax rates to the taxable portion, rather than by grossing up the tax-exempt portion.

Source: AIMR Newsletter, Mar - Apr 1994

When reporting the composite results of taxable portfolios, what disclosures must be made?

In addition to the required disclosure of composite assets as a percentage of total firm assets (discretionary and nondiscretionary), the manager must also disclose composite assets as a percentage of taxable assets (discretionary and nondiscretionary) managed according to the same strategy for the same type of client. This disclosure is required for taxable composites when either before-tax or after-tax results are presented.

Source: AIMR Newsletter, Mar - Apr 1994

The AIMR Performance Presentation Standards states that gross-of-tax performance is currently recommended for the presentation of results to prospective clients, yet portfolio returns should be calculated net of withholding taxes on dividends, interest and capital gains. Please clarify.

The case for reporting international results net of withholding taxes is based on the concept of reporting performance net of transaction costs. Just as a manager's performance includes his ability to negotiate transaction costs, internationally a manager's performance is based on his ability to choose the countries in which to invest based on tax consequences. Basically, a manager has control (to some degree) over transaction costs for his clients, just as a manager has control over which countries are represented in a portfolio. Country selection is part of the performance process and should include analysis of tax treaties. Specific country tax impact should be part of the performance process, just as security selection (net of transaction costs) is part of the process.

Source: AIMR Newsletter, Jul - Aug 1995

When reporting after-tax performance, if we begin managing an account that held securities prior to us managing them, when we sell those securities do we use their original cost or the value of the securities when our firm acquired the account? In other words, do we use the value on the date the client originally purchased or the securities' value on the date we began managing it at our firm? In computing performance this could make what is actually a long-term gain a short-term gain if we use the date at our inception as the purchase date for purposes of after-tax performance.

In other words, should my firm be penalized for presenting the after-tax account performance of securities that were not purchased by us?

First to clarify, the AIMR-PPS standards apply to the presentation of composite results. They do not apply to individual portfolio returns. Currently, the AIMR-PPSSM standards recommend that firms present their performance results gross-of-taxes. However, if the firm chooses to present returns after-taxes, the firm must subtract taxes on income and realized gains from the composite results. The tax rates assumed for the after-tax composite must be the maximum federal tax rates appropriate to that type of client for each year.

The Standards leave it up to the firm to form meaningful composites. Because taxable portfolios are subject to unique investment constraints, the Standards recognize that separate composites may be necessary to reflect the different strategies and accommodate client sectors with different tax structures and risk tolerances.

In the situation described, the original purchase date of the security does not change when the new firm takes over management of the portfolio. Therefore, the firm would apply the actual federal tax rates applicable to that type of client and the cost basis to that client, whether the assets had recently been transferred into your firm or were purchased under the firm's management.

Source: AIMR Advocate, Jan - Feb 2000

Valuation

Does accounting on a trade date-plus-one basis meet compliance requirements?

Because trade date is preferred rather than required, trade date-plus-one is acceptable.

Is amortized cost an AIMR-PPS compliant valuation method to compute a time-weighted total return for cash and cash equivalents?

The pricing of all assets must be based on a reasonable estimate of current value of assets sold on that date to a willing buyer. In cases of frequently traded securities, standardized pricing quotations must be used. Mark to market is clearly the preferred valuation. Amortization or accretion are allowable valuation methods for cash and cash equivalent positions so long as that valuation method reasonably approximates market value. For example, it is industry practice to define cash and cash equivalents to be securities with maturities of one year or less. However, in valuing U.S. mutual funds, the SEC currently allows amortization valuation for (i) cash and cash equivalents with maturities up to 60 days; and (ii) U.S. money market instruments with maturities up to 90 days, but requires that actual market value be determined for maturities longer than those specified. In addition, there may be industry and regulatory guidelines to be followed for particular cash equivalent securities.

Source: AIMR Newsletter, May - Jun 1995

What is the minimum valuation period allowed by the Standards?

Currently portfolios must be valued at least quarterly, and periodic returns must be geometrically linked. For periods beginning, 1/1/2001, portfolios must be valued at least monthly, and periodic returns must be geometrically linked.

Venture/Private Placements

The Report of the Subcommittee on Venture and Private Placements, published in the Double Issue 1994 edition of the AIMR Newsletter, required that all discretionary investments be aggregated by vintage year (year of fund formation and first takedown of capital). The report stated that the concept of composites does apply to fund-of-fund managers who manage either pooled funds or separately managed accounts. If a separately managed portfolio contains both investment partnerships and direct private company placements, how should composites be constructed?

If a separately managed portfolio is invested in both partnership interests and in direct private company investments, it is recommended that both types of investments be combined by vintage year. Each vintage year composite will contain the cash flows and residual value associated with the partnership investments, as well as the cash flows and carrying values associated with the direct company investments.

Source: AIMR List of 75 Question and Answers, 1994

How should vintage year be defined when an investment partnership holds its initial closing (i.e., fund formation) in a calendar year other than that year in which its first takedown of capital occurs? Many partnerships hold what is termed as a "dry" closing, i.e., a closing upon which subscription documents are exchanged without a capital contribution.

For a General Partner presenting performance on a venture fund, the partnership's vintage year is determined to be the year in which the fund's initial capital contribution occurs regardless of the fund formation date. For some buy-out funds, however, billing sometimes starts before the first drawdown occurs. In this case, the vintage year must be based on the date when funds are first remitted, either for the first takedown or for payment of fees.

Source: AIMR List of 75 Question and Answers, 1994

How should vintage year be determined when an advisor invests in a limited partnership on behalf of clients but the initial takedowns of capital for those clients occur in different years?

This question must be considered from the perspective of both existing clients and prospective clients.

- For an LP (or investment advisor) presenting performance on separately managed accounts to existing clients, the date on the LP's initial capital contribution for that client will determine the partnership's vintage year.
- For an investment advisor presenting aggregate performance to prospective clients, the date of the first directed capital contribution will determine the vintage year. For buy-out funds, vintage year must be based on the date when funds are first remitted, either for the first takedown or for when fees are paid.

Source: AIMR Newsletter, Mar - Apr 1995

When an advisor buys a position in an existing limited partnership, may the performance of that fund be presented as a continuous record? What disclosures are required?

For reporting to current or prospective clients, the past performance of a fund that has been bought out, i.e., purchased in the secondary market, is not relevant. The new cost basis will be the actual purchase price on the transaction date. Therefore, when an advisor or other investor buys a position in an existing limited partnership, vintage year is based on the year of the secondary purchase. If the performance of the initial fund is presented as supplemental information, it may not be linked to the record of the secondary purchase. The year of the secondary purchase must be disclosed.

Source: AIMR Newsletter, Mar - Apr 1995

Verification

The AIMR Performance Presentation Standards recommend that firms verify their claims that performance is in compliance with the Standards. The AIMR-PPS standards set forth verification procedures that are described as "minimum procedures that must be followed when a verification of compliance with the AIMR-PPS standards is conducted and a statement of verification is issued." If a verifier is a member of a widely-recognized government-sanctioned licensing organization that requires specific procedures equal to or greater than the minimum procedures set forth in the AIMR-PPS standards, can the verifier perform an AIMR-PPS compliant verification and still comply with the licensing organization's requirements?

The AIMR-PPS standards establish two levels of verification. Primary verification (Level I verification) deals with firmwide compliance with the Standards. The secondary level (Level II verification), deals with the creation and calculation related to specific composites. The purpose of establishing minimum procedures required for verification of compliance with the AIMR-PPS standards is to standardize verification. The AIMR-PPS standards recognize, however, that as verification becomes increasingly popular, additional participants with diverse backgrounds will become verifiers, including members of widely recognized government-sanctioned licensing organizations.

The AIMR-PPS standards state that if a standard is contrary to or in conflict with an applicable law or regulation, the applicable law or regulation is to be followed (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 72). Accordingly, if a verifier is required by its licensing body to follow certain procedures in performing AIMR-PPS-standards-compliant verifications that are equal to or stricter than the minimum AIMR-PPS verification procedures, the licensing body requirements may be followed. In such a situation, the verification procedure used must be disclosed in the verification statement. This interpretation does not relieve the firm, claiming compliance with the AIMR-PPS standards from its obligation to receive a verification statement that enables a consultant or prospective client to determine the scope of verification received (i.e., Primary / Level I or Secondary / Level II). Without such a statement from the verifier, the firm cannot claim that its investment performance has been verified (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 103).

Source: Standards Reporter, Sep - Oct 1997

Is verification of my firm's claim of compliance required?

No. The AIMR-PPS standards recommend that firms have their claims verified by an independent third party. Verification consists of two levels: Level I verification applies to all firm composites; Level II verification applies to specific composites and requires a Level I verification at least on the specific composites being verified at Level II.

Each verification must include a verification statement. The verification attestation must state the level of verification service the statement covers (i.e., Level I or Level II). The Level I or Level II statement may be made through a footnote. Without such representation, the firm cannot claim that its investment performance has been verified.

Source: Standards Reporter, Nov - Dec 1996

The AIMR-PPS standards recommend that firms verify their claims that performance presentation results are in compliance with the Standards. (AIMR Performance Presentation

Standards Handbook, 1997 edition, pg. 103) Can a verification be performed on an individual account or fund within a composite?

No. In order to claim compliance with the AIMR-PPS standards, all requirements of the Standards must be met on a firmwide basis. Level I verifications attest to firmwide compliance with the Standards. When a verifier issues a Level II verification report, the report is composite-specific, but compliance with the Standards must be firmwide.

Source: Standards Reporter, May - Jun 1997

The firm for which I work is completing an AIMR performance verification engagement with an outside auditor. My firm's management has decided to omit measures of dispersion from the report. Our auditors have agreed to sign an attestation letter with an "except for" paragraph. They have also stated that with such a paragraph our performance report will be "AIMR compliant." Based on the 1997 AIMR Performance Presentation Standards Handbook, I do not believe this to be correct.

The AIMR-PPS standards require that a measure of composite dispersion be shown for each year presented. Firms may not omit required information from an AIMR-PPS compliant brochure and remain "in compliance." Firms must be in compliance on a firm wide basis and meet all the requirements of the Standards to claim compliance. Firms cannot state they are in compliance "except for" certain provisions.

Verification firms must follow the guidelines/procedures discussed in Chapter Five of the Handbook. The verifier has the responsibility to ensure that all the requirements of Level I and Level II have been met on a firm wide basis before issuing a verification statement.

Source: Standards Reporter, Sept - Oct 1998

Firm XYZ is AIMR-PPS compliant and has 10 years of compliant performance history with multiple composites. However, Firm XYZ has obtained Level II verification from an independent third party on only one composite and only for the years 1993 – 1995 (the results for 1996 and 1997 have not been verified). Can the firm advertise that its "performance results for this composite have been verified?" In advertisements (or performance presentations) that include statements concerning verification, does the firm need to specify the exact years of performance that have actually been verified? Please specify the guidelines and if at what point a verification (Level I or II) effectively "expires."

It would be misleading for a firm to simply state that a Level I or Level II verification has been performed – this would imply that the verification was performed on all composites and for all periods. In preparing performance reports, firms must keep in mind the spirit and objectives of the Standards: fair representation and full disclosure. The firm may advertise that a Level I or Level II verification has been performed, provided it discloses the period(s) for which the verification has been performed and, for a Level II verification, the exact composite(s) verified. A verification does not expire after a certain period of time and firms are not required to periodically re-verify historical numbers.

Source: Standards Reporter, Sept - Oct 1998

According to the AIMR-PPS standards, there are two levels of verification: Level I and Level II. GIPS only have one level of verification. How do GIPS and AIMR-PPS Verification procedures differ? Is AIMR-PPS Level I Verification the same as GIPS Verification?

Verification under the AIMR-PPS standards consists of two levels: Level I verification deals with firm wide compliance with the Standards; Level II verification applies to specific composites and requires a Level I verification at least on the specific composites being verified at Level II.

GIPS verification consists of one level of verification and attempts to strike a balance between ensuring the quality, accuracy, and relevance of performance presentations and minimizing the cost to investment management firms of independent review of performance results. The verification procedures outlined in GIPS focus on firm wide verification and examine the policies and procedures in place at the firm. They also require the verifier to determine whether the firm has computed performance in accordance with the policies and assumptions adopted by the firm. Separate from GIPS verification, firms can choose to have a specific composite examined with respect to the GIPS standards. However, firms cannot state that a specific composite has been "GIPS verified" or make any claim to that effect. GIPS verification relates only to firm wide verification.

AIMR is currently working to redraft the Level I Verification procedures of the AIMR-PPS standards to make them identical to the GIPS Verification procedures. In the future, AIMR-PPS Level I Verification and GIPS Verification will be the same. Adopting GIPS Verification will provide more clear, workable procedures for firms seeking to conduct Level I Verifications in an efficient and cost effective manner.

Source: AIMR Advocate, May - Jun 2000

What requirements must a verifier meet in order to be able to perform an AIMR-PPS or GIPS verification?

Any independent third-party that is knowledgeable about the Standards may perform a verification; independence is the key word. A firm could not have its own internal audit department perform a verification, as they would not be independent.

AIMR Advocate, Jul - Aug 2000

What system is in place to ensure verifiers are qualified to perform a verification?

Currently, AIMR does not formally regulate the verification industry. However, the group responsible for the maintaining AIMR's performance standards globally, the Investment Performance Council (IPC), has recently created the Verification Subcommittee that will provide a discussion forum for worldwide verification issues. The Subcommittee will attempt to develop and promote a consistent global approach to verification and will attempt to answer the question "who verifies the verifiers."

Source: AIMR Advocate, Jul - Aug 2000

When can a firm claim "Level II compliance"? What is the difference between Level II compliance and firmwide compliance?

There is no such thing as “Level II compliance”. To claim compliance with the AIMR-PPS standards, the firm must comply with all the requirements of the Standards on a firmwide basis. The AIMR-PPS Compliance Statement, as provided in the AIMR Performance Presentation Standards Handbook (1997, second edition), on pp. 8, may be used only after the firm ensures it has met all the required elements of the Standards.

The terms Level I and Level II refer to the types of verification that are currently in existence under the AIMR-PPS standards. A firm can only claim it has been verified after the firm has received a verification statement from an independent third party verifier. Level I verification tests compliance with the Standards on a firmwide basis; Level II verification applies to specific composites and requires a Level I verification at least on the specific composites being verified at Level II. While “Level II verification” may be composite specific, compliance with the AIMR-PPS standards can only be firmwide.

AIMR will shortly propose revising the Verification procedures to address only firmwide verification. This change will lead to only one type of verification, eliminate the confusion between Level I and Level II, and make the procedures identical to the Global Investment Performance Standards™ (GIPS™) Verification procedures. In the future, AIMR-PPS Level I Verification and GIPS Verification will be the same. Firms will still be able to obtain a performance audit of their composite returns, but this will not be a “verification” of compliance with the Standards. Adopting GIPS Verification will provide more clear, workable procedures for firms seeking to conduct Level I verifications in an efficient and cost effective manner.

Source: AIMR Advocate, Sep - Oct 2000

Although in the past we have been verified as fully compliant with the AIMR-PPS standards, we no longer present our performance history in compliance with the AIMR-PPS standards and have removed a claim of compliance from our marketing material. However, because we have been compliant, can we continue to claim compliance on RFP’s?

No. A firm can only claim AIMR-PPS compliance if it is actually in compliance with the AIMR-PPS standards. This claim includes oral claims, responses to RFP’s, or claims included with performance material. When a claim of compliance is made, it must be made using the statement set forth in the AIMR-PPS Handbook. In effect, this is the only method that AIMR permits others legally to use its AIMR-PPS mark. A firm has two choices: (i) it does not comply with all of the applicable requirements of the AIMR-PPS standards on a firmwide basis and makes no mention of AIMR-PPS in any response, or (ii) it does comply and can only claim compliance through use of the compliance statement. A firm does not have the flexibility to decide to claim compliance in response to an RFP but then exclude the compliance statement from the performance material.

Source: Standards Reporter, Jan - Feb 1999

Wrap Fees

The AIMR Performance Presentation Standards Handbook, 1997 edition, states, "When wrap-fee composites are presented to prospective wrap-fee clients, the composites may include portfolios managed according to the same style or strategy that do not meet the wrap-fee definition only if performance results are reported after the deduction of the maximum wrap fee included in the composite, less actual, determinable transaction costs (AIMR Performance Presentation Standards Handbook, 1997 edition, pg. 83)." Can an investment

manager make a presentation of the performance of a composite that includes wrap fees with the actual fee the client would be paying?

Yes. As long as the firm presents the actual wrap fee the client would be paying, the firm does not have to deduct the highest possible wrap fee from non-wrap-fee accounts in the composite.

Source: Standards Reporter, Nov - Dec 1997

The AIMR-PPS Wrap Fee Subcommittee Report defined a wrap account as "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" which is the same definition as that of the Securities and Exchange Commission. Please explain how a wrap account is different from other types of accounts, products or investment advisory relationships.

A typical wrap fee account has a contract/contracts (and fee) involving a broker (sponsor) as the investment advisor, a money manager (as a subcontractor to the broker investment advisor), other services (custody, consulting, reporting, performance, selection, monitoring, and execution of trades), and the client (brokerage customer). It is an all-inclusive "asset based" brokerage relationship, which may include other services, and is not a trust account, mutual fund, typical brokerage account, or private investment advisory relationship.

Source: AIMR Newsletter, Jul - Aug 1995

Our firm has several wrap-fee accounts that we assign to a Wrap-Fee Sponsor for management. Since the firm maintains investment discretion over the underlying assets assigned to the sponsor, we would like to advertise the performance of the wrap-fee composite and claim compliance with the AIMR-PPS standards. Because of the manner in which the wrap-fee program is operated, the wrap-fee sponsor calculates the performance of the wrap-fee composite and provides us with the composite performance and the back-up documentation including the performance of each account included in the composite.

We would like to insert a statement in our Claim of Compliance for this wrap-fee composite that indicates our Wrap-Fee Sponsor calculated the returns. The new claim would read: "XYZ Investment Management Firm has prepared and presented this report in compliance with the performance presentation standards of the Association for Investment and Research ("AIMR-PPS TM") based on results calculated by ABC Wrap-Fee Sponsor..." Is this adjustment to the Claim of Compliance statement acceptable?

As stated in the AIMR Performance Presentation Standards Wrap-Fee Subcommittee Report published in January 1995, when claiming compliance with the AIMR Performance Presentation Standards, the presenting firm is ultimately responsible for the presentation of performance results, regardless of whether the firm performs the calculations or relies upon others.

The claim of compliance legend is provided on page 8 of the AIMR Performance Presentation Standards Handbook (1997, second edition). Any other use of the terms "AIMR" or "AIMR-PPS" except as specifically provided in the legend is prohibited.

The presenting firm is responsible for the performance results (including the performance calculated by the wrap-fee sponsor) and they must take the necessary steps to ensure that all of the requirements of the Standards are met. Therefore, if the presenting firm relies upon the wrap-fee sponsor to calculate the composite return, the presenting firm must ensure the wrap-fee sponsor calculates the return in compliance with the AIMR-PPS standards.

Source: AIMR Advocate, Sep - Oct 1999