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The VERIFIER

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GIPS® VERIFICATION and COMPLIANCE

Proposed Changes Announced for GIPS 2010

Good news for managers of GIC assets. Earlier versions of the GIPS and AIMR-PPS standards have disallowed the inclusion of GIC and other "hard to value" assets from the GIPS-compliant firm. The draft of GIPS 2010, available for comment in early 2009, will eliminate such a distinction, and firm assets will be determined based on whether the assets are managed or unmanaged.

Similarly, it is expected the distinction between fee-paying and non-fee-paying assets will also be removed for determining whether accounts should be included in composites.

Firms are encouraged to comment on key issues currently under consideration, addressing changes they like as well as changes they take issue with. Highlights of the issues discussed at the GIPS Executive Committee meeting in Amsterdam earlier this year include:

- Providing guidance for the length of time certain disclosures must be included in compliant presentations before becoming nonmaterial.
- Requiring IRR calculations when managers can control cashflows.
- Dividend accruals and verification to remain recommendations, not requirements.
- Confirmation that all 2010 provisions, except for mandatory verification, will be effective in 2010. The list of provisions requires firms to:
  - value portfolios on the date of all large external cash flows, as well as on the calendar month-end of the last business day of the month.
  - calculate composite returns by asset weighting the individual portfolio returns at least monthly.
  - exclude carve-outs of portfolio segments from single asset class composites unless the segments are actually managed separately with their own cash.

Firms can expect more guidance regarding carve-outs and sub-accounts prior to the elimination of carve-outs; it is unlikely, however, that this provision to eliminate carve-outs will be extended again.

And finally, just to confirm, verification will NOT be mandatory in 2010; it will remain a recommended provision of the Standards. ■

Experts IN THE FIELD

Hedge Fund Best Practices Now Include the GIPS Standards

Following suit with the U.K. Hedge Fund Working Group, the U.S. President's Working Group on Financial Markets recommended in April, 2008, that investors require compliance with the GIPS standards as best practice for hedge fund and hedge fund of fund managers.

The hedge fund industry has been slow to adopt the Standards in the U.S., in part because hedge fund investment advisers were exempt from SEC registration in the 1990s and not held to the same level of transparency as advisers offering more mainstream products to less sophisticated investors.

In 2008, in a "culture of compliance" environment, the President's Working Group hopes to change all that. Russell Read, CIO of the California Public Employees' Retirement System, and chair of the Investor's Committee of the Presidents Working Group, stated that the committee's goal is to "have such best practices be accepted by both investors and hedge fund managers and perhaps most importantly, *continued on reverse*

Firms with Carve-outs in Composites

TIPS & TRICKS

For firms that have a majority of their assets in carve-outs, it's time to do some serious strategic planning. What will your composites look like when those assets drop off? As difficult as splitting the accounts up on your portfolio accounting system may seem, it may be better than the alternative of not being able to show the performance of the sub-strategy.

Many of our cliens are choosing to create multiple cash accounts in order to deal with the carve-out issue. Another solution for start-up firms: have your clients open additional custodial accounts for the multiple asset classes the firm will be managing for them. In today's world of electronic custodial statements, the time saved by being able to continue automatic reconciliations is significant. Also most accounting systems can easily roll-up several accounts and still provide your clients one consolidated or unconsolidated statement, or both.

For firms that can't imagine asking existing clients to open additional accounts, consider just asking this of new clients over the next 18 months. Setting existing accounts up separately on your accounting system is the next best thing, but it does add a layer of complication to any automatic reconciliation processes in place.

Of course, another option would be to garner a few large single-asset clients over the next 18 months in composites that have been using carve-outs; then your single asset composites can continue on without more than a blip in composite assets as the carved-out segments are eliminated. ■

continued from front to have those recommendations become common practice throughout the industry."

One of the most difficult challenges when presenting hedge fund performance is calculating performance-based fees. Other questions around share classes, onshore and offshore accounts, and side pockets typically arise when trying to decide what return information to capture when reporting a GIPS compliant composite return, since most fund administrators are typically providing individual investor level performance. Because of varying fund structures, each firm may address similar challenges with completely different solutions.

Ashland's Performance Resource Group is an independent business unit that can provide expert consulting and performance computation for hedge funds and fund of fund managers interested in complying with GIPS. For more information, contact Christian Nelson, 541.842.2713.

Seniors New to Top Ten

Lori Richards, Director of the SEC's Office of Compliance Inspections and Examinations ("OCIE"), reviewed OCIE's "Top 10" compliance issues during the IA Compliance Best Practices Summit held in March 2008. Most of the focus areas have been on the top ten list in the past. The 2008 Top 10 are:

- Controls Over Valuation,
- Controls Over Non-Public Information,
- Compliance and Supervision,
- Senior Investors,
- Portfolio Management,
- Brokerage Arrangements and Best Execution,
- Allocations of Trades,
- Performance Advertising, Marketing and Fund Distribution Activities,
- Safety of Clients' and Funds' Assets, and
- Information Processing and Protection

New to the list this year is "Senior Investors," as the SEC has prioritized the protection of the nation's growing senior population. OCIE is interested in understanding the practices that firms are developing in areas as they relate to senior investors. Some of the specific areas identified for the focus include marketing and advertising to seniors, account opening, product and account suitability, ongoing review of the relationship and suitability of products, discerning the changing needs of seniors, surveillance and compliance reviews, and training firm employees.

For more information on services available from Ashland Compliance Group, please contact Elizabeth Cope at 541.864.1641 or elizabeth@ashlandpartners.com.

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Let Ashland Learning Center come by your office and conduct on-site training. See our website at www.ashlandpartners.com/alc for information on workshops tailored to fit your specific training needs and time constraints.

Sign up now for these upcoming web events:

Fair Valuing Investment Assets: June 5, 2008, featuring Michael S. Caccese, Partner, K&L Gates. The GIPS Executive Committee is planning to expand the definition of market value in the Standards' glossary to include the notion of fair market value for all assets. This session will cover SEC considerations and practical challenges of fair market value pricing.

SEC Hot Topics for RIAs: June 6, 2008, presented by Matthew S. Hardin, J.D., Managing Director, Ashland Compliance Group. This session will provide an overview of the current regulatory front for RIAs, including the proposed changes to Part 2 of Form ADV, the top 10 focus areas of SEC examiners and proposed amendments to Regulation S-P.

Basic Attribution: June 26, 2008, presented by Carl Bacon This intensive seminar including spreadsheet-worked examples, provides a thorough introduction to basic performance attribution.

ASHLAND PROFILE

Matthew S. Hardin
Managing Director – Ashland Compliance Group

Matthew Hardin, Managing Director of Ashland Compliance Group, is a securities attorney and regulatory compliance consultant, mediator, and arbitrator, and is licensed to practice law in Pennsylvania, Missouri and Illinois. Matt consults with firms throughout the United States on regulatory legal/compliance/risk management issues, performs due diligence and compliance reviews and internal investigations of SEC registrants such as Broker-Dealers, Investment Advisers and Mutual Funds. He has over 20 years of experience in the financial services industry, including 4 years at the United States Securities and Exchange Commission. Mr. Hardin received his Bachelor of Science in Business Administration from the University of Dayton in 1983, his JD from Pepperdine University in 1986, and his LL.M. in federal securities regulation from Georgetown University in 1987. Mr. Hardin is FINRA licensed Series 7, 24 and 66.

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3549 Lear Way, Suite 105, Medford OR 97504
Tel: 541.857.8800 | Fax: 541.779.5660