

GIPS Compliance for Hedge Fund Managers: Increasing Demand for Transparency and Performance Comparability

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Introduction

The GIPS Standards – Background:

- Set of principles or standards for the calculation and presentation of investment performance.
- Adhered to by investment managers throughout the world.
- Administered by the CFA Institute.
- Original GIPS standards released in April, 1999.
 - Grew out of the AIMR-PPS standards.
- Revised for the first time in 2005.



History of the Standards

- First version of AIMR-PPS released in 1993
 - Originally written with the traditional institutional long only manager in mind
- Need for a global standard → GIPS formally endorsed in 1999
- Converged to one set of standards (the GIPS) in 2005 version
- 2010 revision of the Standards (effective 01/01/11)
- Draft Guidance for alternative managers expected in 2011



Why is GIPS® Important for Hedge Funds?

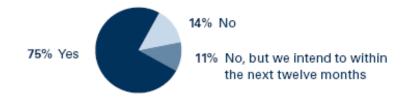
- Transparency
- Operational due diligence
- Separate / managed accounts
- Credibility
- Comparability
- Commitment to Compliance Program
- Manager selection





The Value of GIPS Compliance

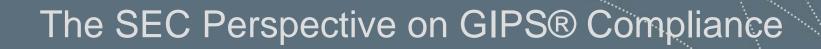
Does your firm currently claim compliance with the GIPS®?



Has your firm's claim of compliance been verified?



Source: The ACA Beacon Verification/eVestment Alliance survey - The Value of GIPS Compliance - December 2009







"We don't endorse or enforce compliance with GIPS, but if you say you're compliant, we're going to check it out."

Quote from SEC during a 2009 CCO Outreach Regional Seminar



The SEC and GIPS®

- If registered and compliance is claimed, noncompliance may be considered an SEC violation
- SEC rules also govern:
 - Performance reporting
 - Advertising
- SEC requires maintenance of documents to support the performance track record
- Disclosures for compliant firms are a combination of GIPS & SEC requirements
- Many of GIPS-related best practices will go hand-inhand with future compliance initiatives





GIPS - Fundamentals of Compliance- It's Easier than You Think

- Definition of the Firm
 - Claim of compliance at the firm level, not the fund level
- Policies and Procedures Document
- Firm Assets
- Providing a Compliant Presentation
 - A firm must "make every reasonable effort to provide a compliant presentation to all prospective clients"



Calculation Methodology

- GIPS require a time-weighted rate of return calc (except for private equity)
 - Good thing is that most funds have at minimum monthly liquidity
 - Use of third-party administrator for performance reporting (NAV)
 - Will be more challenging with separate accounts
- For private equity funds, an SI-IRR calc is appropriate (control of cash flows)



Calculation Methodology - Continued

- Treatment/Calculation of Fees
- How do we calculate/present a net-of-fees return?
 - Track original investor
 - Aggregation/weighted average approach
 - Onshore/offshore consideration
 - Model fee
- Wide range of fee structures and approaches



Calculation Methodology - Continued

- Gross vs. Net Reporting
- If net, needs to be net of management and incentive fees
 - Should we/must we accrue the carry? Problems with such an approach
- How do you determine the highest applicable fee?
- What do we do if our fee schedules changes?
- What if we have available two fee structures based on liquidity?

^{***} Firms will need to approach these issues independently; there is no one size fits all solution



Side Pockets

What about side pockets? (not available to everyone)

- Liquid share class option (show returns w/o side pocket impact)
- Track original investor in all side pockets
- Availability of return streams with and without side pocket

What about side pockets? (when illiquid securities are carved-out)

- Be careful- can't eliminate historical performance
- Show both return streams post-split
- Extra, extra disclosure required in such cases



GIPS – Disclosures/Presentation Reporting

XYZ INVESTMENT MANAGEMENT

January 1, 2005 through December 31, 2009

ABC Composite - Net Returns

Year	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD	S&P 500
2005	-5.71%	9.98%	5.48%	0.46%	0.63%	0.06%	7.08%	-1.49%	0.82%	1.62%	3.19%	-4.38%	17.99%	4.90%
2006	2.34%	0.8%	0.84%	0.89%	6.38%	0.31%	-0.62%	-0.26%	0.92%	5.39%	1.71%	0.96%	21.24%	15.77%
2007	1.96%	-6.81	-0.21%	0.56%	-0.59%	-1.17%	-5.37%	2.19%	-1.32%	3.02%	0.54%	0.11%	-7.31%	5.48%
2008	5.42%	6.48%	-6.91%	-6.37%	0.19%	-0.96%	-4.13%	-0.84%	-3.95%	4.68%	-1.68%	-2.62%	-11.15%	-37.03%
2009	-3.73%	-0.34%	4.70%	1.23%	0.93%	-0.66%	-0.06%	2.90%	-1.66%	4.91%	0.98%	-0.56%	8.63%	26.5%

	2005	2006	2007	2008	2009
Composite Assets (\$ Millions)	\$884.9	\$1,072.86	\$994.44	\$883.51	\$959.67
Total Firm Assets (\$ Millions	\$1,327.35	\$1,609.29	\$1,491.65	\$1,325.27	\$1,439.51

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

Firm and Composite Information

XYZ Investment Management is an independent management firm that manages alternative investment strategies for high net worth individuals and institutions.

The ABC Composite invests in equities, fixed income securities, commodities, and derivatives to produce an absolute return. The ABC Composite was created on January 1, 2005. A complete list and description of firm composites is available upon request. Additional information regarding the firm's policies and procedures for calculating and reporting performance results in available upon request.

The fund utilizes leverage and derivative transactions, including futures and swap transactions. The returns from these transactions are material to the performance of the composite. Further information about the use of derivatives and leverage is available upon request.

Benchmark

The volatility of the index shown may be materially different from the individual performance attained by a specific investor. The index has not been selected to represent an appropriate benchmark to compare an investor's performance, but rather is disclosed to allow for comparison of the investor's performance to that of a certain well-known and widely recognized index.

Performance Calculation

Valuations and returns are computed and stated in U.S. Dollars. Results reflect the reinvestment of dividends and other earnings.

Gross-of-fees returns are presented before management and custodial fees, but after all trading expenses and withholding taxes. The calculation of the net-of-fees return is the aggregate performance of all un-affiliated onshore investors and is based on the gross of fees return, less expenses, administration fee, management fee and performance fee. We believe this return is indicative of the return expected by a full fee paying investor.

Fees include a 1.0% per annum investment management fee, and a 20% performance fee that is accrued monthly.

For the entire period presented above, the composite consisted of a sole account. As the composite has consisted of one account for all periods, dispersion is not applicable.

Verificatio

XYZ has received a firm-wide verification from ACA Beacon Verification Services for the period 01/01/05 – 12/31/09. The ABC Composite has received a Performance Examination for the same time period. A copy of the verification report is available upon request.

Past performance does not guarantee future results.

Questions



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*If you are interested in a copy of the GIPS Checklist, please contact Matt Prinn at matt.prinn@klgates.com