INREV RESEARCH & MARKET INFORMATION

AN ANALYSIS OF THE GIPS STANDARDS IN EUROPEAN REAL ESTATE PERFORMANCE REPORTING

INREV

JUNE 2013

INREV
STRAWINSKYLAAN 631
1077 XX AMSTERDAM
THE NETHERLANDS

T +31 (0)20 799 39 60
INFO@INREV.ORG
WWW.INREV.ORG

INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. Our aim is to improve the accessibility of non-listed real estate funds for institutional investors by promoting greater transparency, accessibility, professionalism and standards of best practice.

As a pan European body, INREV represents an excellent platform for the sharing and dissemination of knowledge on the non-listed real estate industry.

CONTENTS

EXECUTIVE SUMMARY

The European property fund management community is lagging behind the US property fund management community and other asset classes when it comes to compliance with the Global Investment Performance Standards (GIPS).

The results of this report show that 93% of respondents are not compliant with the GIPS standards making it clear that the Standards have yet to gain general acceptance in the European real estate investment industry. The main reason for this is the lack of external pressure, absence of client requests to be compliant, lack of recommendation by industry organisations and the notion that compliance does not improve companies' marketing position.

We tried to determine the size of the gap between the day-to-day practice of calculating and presenting performance and the GIPS standards; unwittingly, managers might already adhere to many of the requirements within GIPS.

At 89%, most respondents said their organisation was responsible for the major investment decisions for the majority of its mandates. One important task for compliance with the GIPS standards is documenting the firm's definition of discretionary and to review current and past investment contracts to determine if these contracts are or were discretionary.

Many companies do not use the composites to communicate investment results for their strategies to potential clients. Composites are the aggregation of portfolios that are managed according to a similar investment mandate. Companies usually report performance on a single fund or mandate basis.

However, in most cases the creation of meaningful composites would be feasible given the level of detail of data stored in the company's administration systems. Around 80% keep more than two years of data electronically available to calculate historic performance. The actual creation of composites and calculation of composite performance could require effort from fund managers to complete.

For valuation compliance, fund managers need to value their properties internally on a quarterly basis and externally on an annual basis. Around half of respondents' companies' value internally on a quarterly or monthly basis, and just over 90% value externally on a yearly or more frequent basis. This shows a starting point for the industry to meet the GIPS standards but there is room for improvement on valuation frequency.

Fair value is the GIPS standards required base for real estate asset valuations and all interviewed managers said they complied with this requirement. Most real estate investment companies will not fail the fair value requirement in GIPS, but a lot of companies still have a valuation frequency that is below what is required by the Standards.

Most real estate investment managers seem to keep sufficient history of adequate detail in their administration systems to be able to recreate performance figures for (to be created) composites.

Performance calculation and presentation for both existing and potential clients is far from standardised in the European real estate investment industry. This potentially complicates the comparison between asset managers. Broad acceptance of the GIPS standards would facilitate this comparison.

The industry would also need to improve the data management requirements. This is mainly done through Excel based tools with few managers having a separate performance department. This means that achieving adequate data quality and adopting integrated performance management systems would be important priorities for companies. In addition, procedures for valuation, performance calculation and presentation are not always documented as required by the GIPS standards.

Most interviewees recognise the positive aspects of investment performance and presentation standards such as the GIPS standards with increased comparability being the most frequently mentioned benefit. Improved transparency and standardisation of processes are also seen to be advantages of compliance with the GIPS standards. Around 81% of non-compliant managers would consider compliance if requested by a client.

1 INTRODUCTION

The Global Investment Performance Standards (GIPS) have become a global standard for investment managers to report performance to prospective clients across non-real estate asset classes. In the US, it has also become a standard for real estate companies looking to raise capital from institutional investors. However, in Europe there has been little traction within real estate investment management companies.

In the first quarter of 2013, INREV conducted a European survey that spanned more than 18 countries, with participants from 69 European real estate fund managers. This report provides an insight into the performance standards used by fund managers and their compliance with the GIPS standards.

The purpose of this survey is to determine:

> What are the pressures on European fund managers to adopt the GIPS standards?
> What is the existing adoption level of the GIPS standards by European fund managers?
> Are more European fund managers expected to adopt the GIPS standards in the near term?
> What are the challenges and solutions to adoption?
> Which investment performance methodologies are used by European fund managers?

SURVEY APPROACH

The report is based on the results of an online survey completed by European property fund managers. In total over 200 online surveys were distributed, which were completed by 69 fund managers. The survey was sent out to senior representatives involved in performance management and/or managing client relations in each organisation, with each response intended to represent a company view. In addition, information was collected through 25 qualitative interviews with fund managers. The institutions covered in this study are fund manager members of INREV with a European base and which manage European products.

In addition to the interviews with fund managers, interviews were also conducted with representatives from Investment Property Databank (IPD) and the National Council of Real Estate Investment Fiduciaries (NCREIF). These interviews were conducted because it was noticed during the interviews that there was confusion between issues such as whether meeting the Real Estate Investment Standards (REIS) and IPD standards implied that a fund manager meets the GIPS standards.

2 OVERVIEW OF THE GIPS STANDARDS

The GIPS standards are a set of standardised, industry-wide ethical principles that provide investment companies with guidance on how to calculate and present their investment results to prospective clients.

The GIPS standards are a voluntary set of best practices for calculating and presenting investment performance to prospective clients. They were developed by the CFA Institute (CFA) and experts from the finance industry, with a number of revisions since 1987. The Standards have been designed to provide a like for like comparison of investment managers' performance to prospective clients. In order to comply, organisations must meet standards set by the CFA for defining the firm, input data, composite construction, performance calculation methodology, disclosures and the presentation of performance figures.

The intent of the GIPS standards is to offer an adequately broad framework so that all types of asset managers can achieve compliance with them.

WHAT DO THE GIPS STANDARDS MEAN FOR REAL ESTATE?

The following is a summary of some of the key elements of compliance with the GIPS standards for real estate funds, but it is important to read the full GIPS documentation available from *www.gipsstandards.org*. The specific real estate requirements are in Section 6.

- The GIPS standards must be applied on a Firm-wide basis (the entity defined for compliance with the Standards) for all discretionary, fee-paying portfolios. Firm-wide is inclusive of all asset classes, including real estate. All actual, fee-paying, discretionary portfolios meeting the criteria must be included in at least one composite while real estate can be broken out of the wider firm as separate composites. A composite is an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy and must include all fee-paying, discretionary portfolios that meet the composite definition.
- The GIPS standards apply largely to fund level performance and not, in the case of real estate, to property level performance. Performance must be calculated on a time-weighted basis.
- Real estate valuations are required at least quarterly (internally or externally) and external at least once every 12 months, unless client agreements stipulate otherwise, in which case they must have external valuations at least once every 36 months or per the client agreement if the client agreement requires external valuations more frequently than every 36 months.
- Closed end funds are required to be broken out into separate composites with additional disclosure requirements (see Section 6 of the GIPS standards, *www.gipsstandards.org*). These relate to the vintage year and internal rate of return (IRR) requirements of closed end funds.

In order to be compliant with the GIPS standards all actual, fee-paying, discretionary portfolios must be included in at least one composite. A composite is an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy and must include all portfolios that meet the composite definition. When creating composites it is very likely that a single portfolio would be included as it is the only portfolio that matches a particular definition of mandate, objective or strategy. For example, with a pan-European open end fund composite – few managers run more than one of these types of portfolios.

To date, in Europe, there has been confusion about what it means to be compliant with the GIPS standards for real estate. The following actions do not make a company compliant:

- Having a portfolio of direct real estate investment's performance measured by IPD. IPD methodologies are in the "spirit" of the GIPS standards but this alone does not mean compliance.
- Being in compliance with INREV Guidelines for performance reporting.

3 SURVEY SAMPLE

The 69 respondents to our survey are a cross-section of fund managers in Europe, some of which have head offices outside the region. Respondents were diverse in terms of assets under management, geographical location and number of institutional clients served. In addition to the survey, 25 telephone interviews with a selection of fund manager respondents were undertaken to find out more information about the responses and to question them on performance-related issues impacting fund managers.

This survey did not include investors so any statements made about the interest of investors are as perceived by fund managers.

FIGURE 01 / NUMBER OF INSTITUTIONAL CLIENTS SERVED BY RESPONDENTS

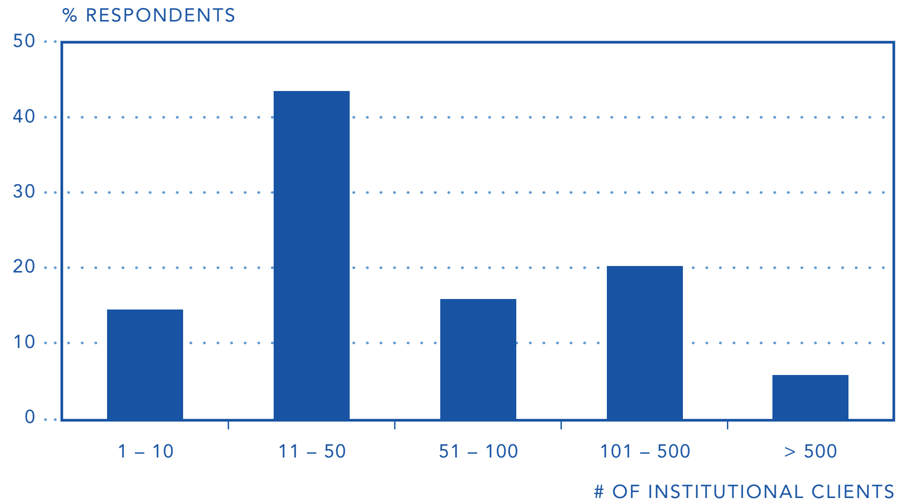


FIGURE 02 / AVERAGE SIZE OF MANDATE FOR RESPONDENTS' INSTITUTIONAL CLIENTS

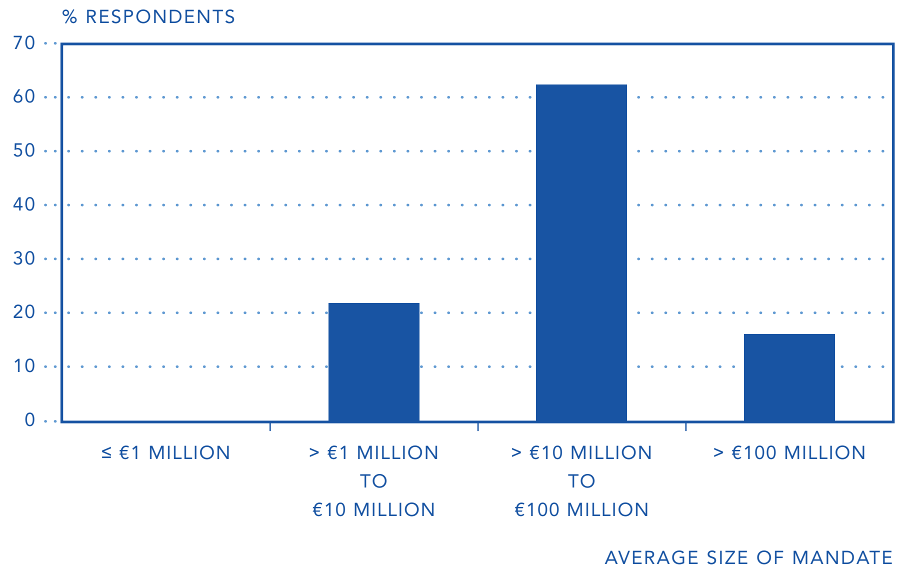


FIGURE 03 / LOCATION OF RESPONDENTS' HEAD OFFICE

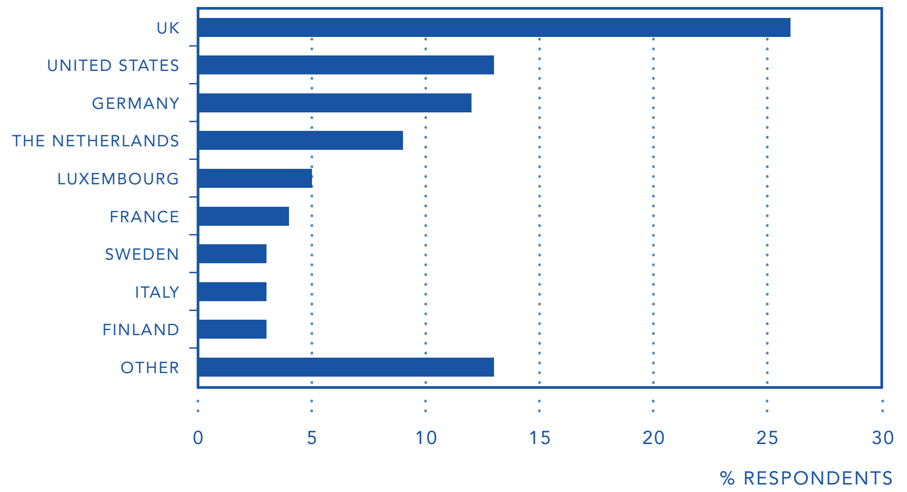


FIGURE 04 / RESPONDENT COMPANIES' REAL ESTATE ASSETS UNDER MANAGEMENT

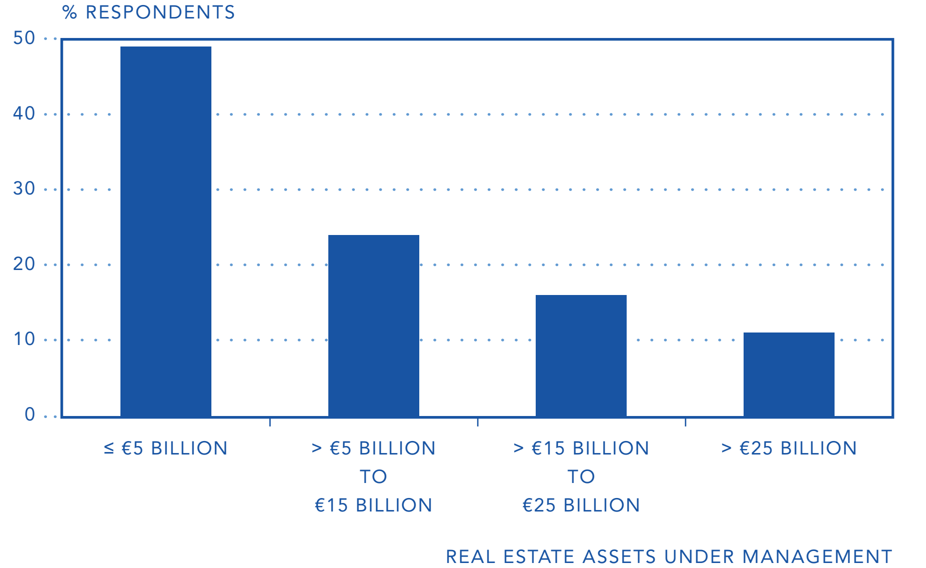


Figure 01 shows that the fund managers in the sample service a range of numbers of clients. The largest part of the sample, at 44%, has between 11 and 50 clients. It also has representation at the lower end of the scale with 15% having one to 10 clients and 6% having more than 500.

Figure 02 shows that 62% of respondents stated that their company manages a mandate that lies between €10 million and €100 million, but the sample also includes companies managing smaller mandates. The largest managers, those with a mandate in excess of €100 million, represented approximately 16% of survey respondents.

Over 17% of survey respondents represent companies whose head office is located outside Europe. Companies with a head office in the US companies account for 15%, while companies with a European head office represent approximately 83% of the respondents.

In most cases, the managers interviewed offer a mix of core, value added and opportunity strategies, hardly any specialist companies.

4 COMPLIANCE WITH AND KNOWLEDGE OF THE GIPS STANDARDS

4.1 Compliance with the GIPS standards

The question at the centre of this report is how many of the survey respondents claim to be compliant with the GIPS standards. Figure 05 shows that only 7% of fund managers claim to be compliant. However, 25%, are planning to become compliant in the future.

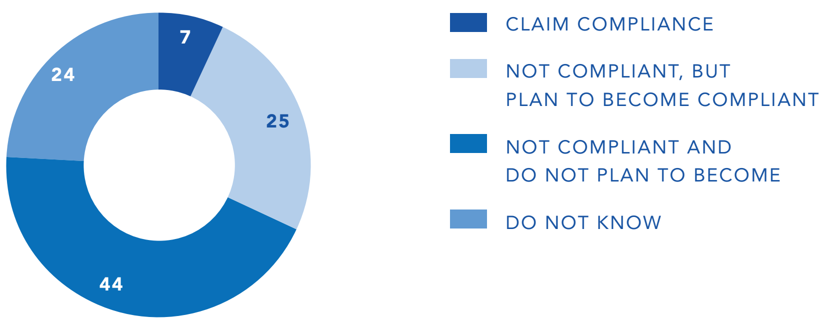
At 44%, a large number of respondents have no plans to become compliant while 24% did not know if their company claims compliance or not. The results confirm the lack of understanding of the GIPS standards among European fund managers.

The compliant companies tend to have interest from investors in the US and mainly manage not only real estate but other asset classes as well.

Interestingly, many non-compliant fund managers said during the interview that their overseas colleagues (of the same company) were compliant with the GIPS standards. Indicating that the GIPS Firm was defined for these organisations by legal entity and/or geographical boundaries.

FIGURE 05 / PERCENTAGE OF RESPONDENTS THAT CLAIM COMPLIANCE WITH THE GIPS STANDARDS

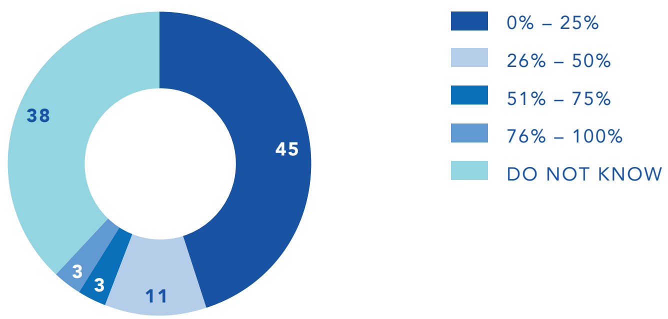
% RESPONDENTS



Respondents were also asked to assess the compliance of their competitors with many of them providing accurate estimates. Figure 06 (page 10) shows that 45% believed that less than 25% of their competitors were compliant, while only 6% estimated this percentage to be higher than 50%. Notably, this included two companies that claim compliance with the GIPS standards. It is possible that these companies are part of a broader asset manager that also manages equity and fixed income portfolios, and therefore answered this question with multi-asset managers in mind, where compliance with the GIPS standards is much higher.

FIGURE 06 / PERCENTAGE OF COMPETITORS THAT RESPONDENTS BELIEVE ARE COMPLIANT WITH THE GIPS STANDARDS

% RESPONDENTS



GIPS, IPD AND REIS

The interviews highlighted that there was confusion between the GIPS standards and other performance standards such as IPD and the Real Estate Investment Standards (REIS).

IPD supports its clients by calculating investment performance on an asset level using an international standardised template. Therefore, IPD states that its reports are in a sense aligned with the GIPS standards. One important difference, is the creation and maintenance of composites. The GIPS standards require compliant firms to create meaningful composites as an aggregate of investments with a similar strategy or objective. IPD does not routinely report on such an aggregate level, but rather on a mandate or fund level.

In some cases the GIPS standards tend to be less strict than the standards IPD upholds. For example, GIPS allows for more calculation methods and different types of input compared with IPD. In other cases, the GIPS standards are stricter. For example, the quarterly valuation frequency of the GIPS standards is higher than the annual frequency permitted by IPD.

Like the GIPS standards, REIS are a set of ethical policies and procedures for standardising the reporting of performance results for real estate investments on the basis of fair representation and full disclosure. However, like IPD, REIS focuses on reporting performance to existing clients, while the GIPS standards primarily deal with reporting to potential clients. Once again, reporting is executed on a fund/mandate level, and not on an aggregate composite level. The concept of investment discretion is also more important in the framework of the GIPS standards than it is for IPD or REIS.

Both IPD and REIS indicate that complying to its standards can be used by companies aspiring to become compliant with the GIPS standards.

US VERSUS THE REST OF THE WORLD

The GIPS standards appear to be more accepted among real estate fund managers in the US compared with Europe or the rest of the world. A recent survey of 50 US companies by NCREIF into compliance with the GIPS standards found that one company that was planning to become compliant, two companies had no plans and the rest were already compliant. Some US companies were resistant to the GIPS standards initially, but its popularity grew because of investor and consultant requests.

4.2 Reasons for non-compliance

Respondents were asked why they did not claim compliance with the GIPS standards. Figure 07 shows that the number one reason is the lack of external pressure from clients followed by the perception that compliance does not improve a company's marketing position. The cost associated with compliance with the GIPS standards was the third most mentioned reason.

FIGURE 07 / REASON FOR RESPONDENTS' ORGANISATION NOT TO ADHERE TO GIPS

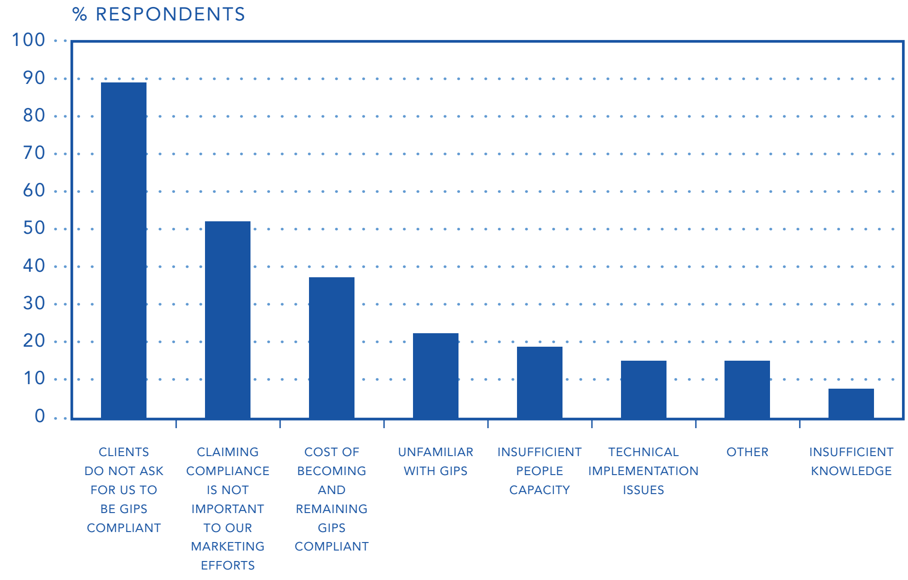
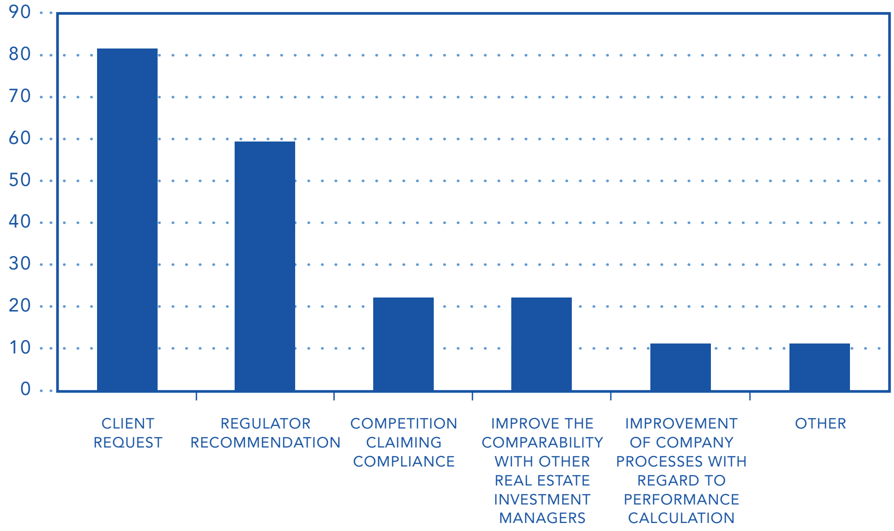


Figure 08 (page 12) shows the key reasons that would prompt a company to implement the GIPS standards. The answers mirror Figure 07 with external pressure being behind all the main reasons. This includes pressure from clients or reference to/recommendation by regulators, or keeping up with the competition. The main motivation for establishing the investment performance standards, which is for comparability and transparency, is of secondary importance.

FIGURE 08 / KEY REASONS TO IMPLEMENT GIPS

% RESPONDENTS



Fund managers were asked if their clients value standards for investment performance calculation and presentation. Interestingly, 42% said these standards are significant for investors when selecting an asset manager (Figure 09). During the interviews, it was established that when considering these types of standards, the respondents also had in mind the methods used by IPD based on local market practice. Respondents believed these are considered by potential investors to be more important than the GIPS standards. Figure 10 (page 13) shows that compliance with these standards is occasionally part of the criteria set in request for proposals by investors.

FIGURE 09 / RESPONDENTS VIEW ON SIGNIFICANCE OF GIPS WHEN SELECTING A FUND MANAGER

% RESPONDENTS

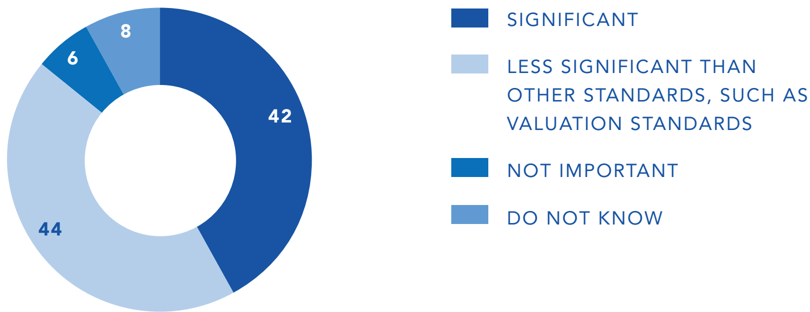
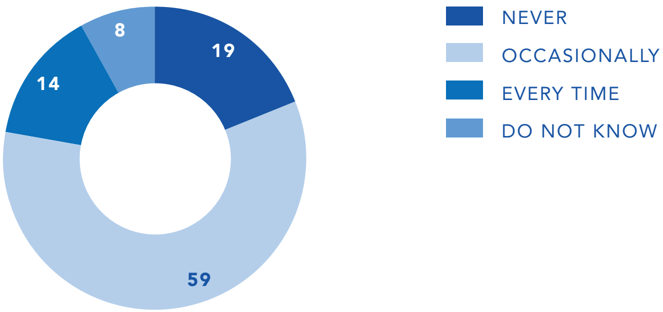


FIGURE 10 / FREQUENCY OF REQUEST FOR INFORMATION ON INVESTMENT PERFORMANCE IN REQUESTS FOR INFORMATION

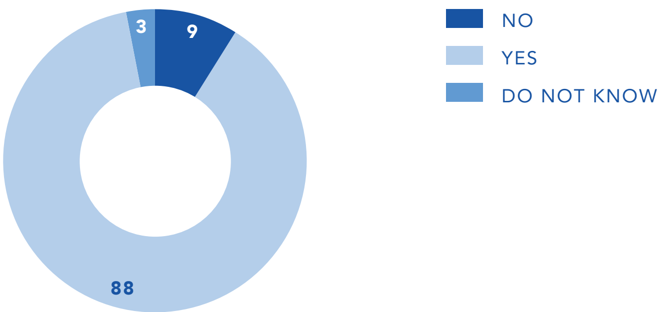
% RESPONDENTS



Although the GIPS standards are mainly set up with potential investors in mind, the perceived lack of interest from existing investors for the Standards is also interesting, particularly as 88% of fund managers receive some sort of compensation for achieved investment performance (Figure 11). From the interviews it became clear that investors in Europe – especially the UK – rely on IPD for performance calculation and presentation for core funds. This is less the case for value added or opportunity funds.

FIGURE 11 / PERCENTAGE OF RESPONDENTS' AGREEMENTS THAT INCLUDE COMPENSATION TIED TO PERFORMANCE RESULTS

% RESPONDENTS



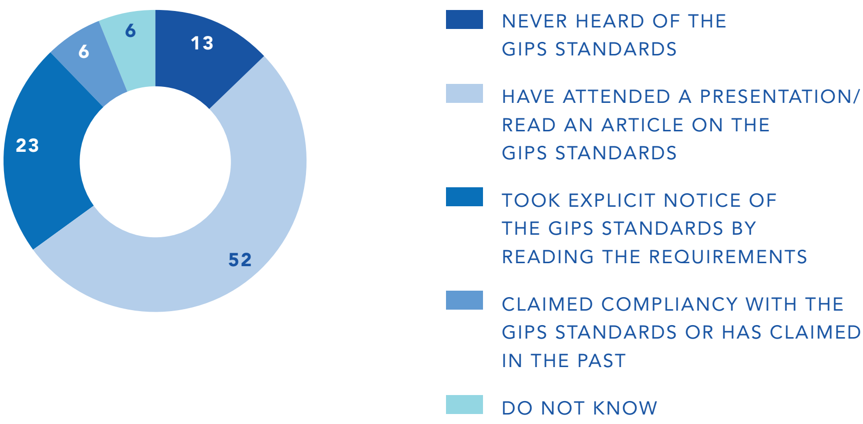
4.3 Level of knowledge about the GIPS standards

Given the perceived absence of interest from investors in the GIPS standards and the low number of companies being compliant, it would follow that fund managers would lack basic knowledge about the Standards. However, this does not seem to be the case: Figure 12 shows that 75% have some knowledge of the Standards, albeit on a relatively passive level through attending a presentation or reading the documents related to the GIPS standards.

"Do not know" indicates that the respondent personally does not know if there is any knowledge of the GIPS standards in the organisation, whereas "Never heard of" indicates that the respondent knows that there is no knowledge of the GIPS standards in the organisation.

FIGURE 12 / HOW FAMILIAR IS YOUR ORGANISATION WITH THE GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS)?

% RESPONDENTS



5 POTENTIAL GAPS FOR COMPLIANCE WITH THE GIPS STANDARDS

With few fund managers claiming compliance with the GIPS standards and the consequent view this means they are not a high priority for potential investors when selecting fund managers in Europe, it is interesting to determine the size of the gap between the day-to-day practice of calculating/presenting performance and the Standards. It may be that managers already adhere to many of the requirements within the GIPS standards.

5.1 Investment discretion

A key part of becoming compliant with the GIPS standards is the definition of investment discretion. The GIPS standards require firms to include all actual, discretionary, fee-paying portfolios in at least one composite defined by investment mandate, objective, or strategy. This is in order to prevent companies from cherry-picking their best performance. Discretion is the ability of the company to implement its intended strategy. The company is not allowed to include non-discretionary portfolios in its composites.

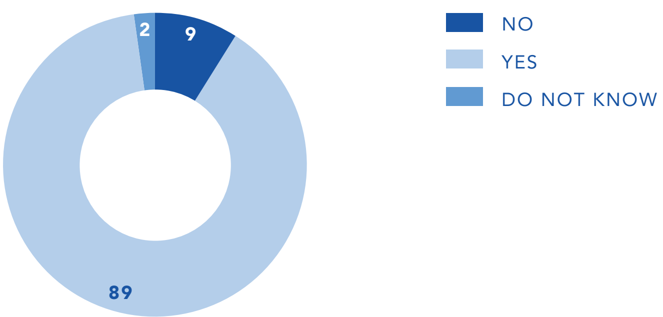
This raises two important questions for fund managers seeking to become compliant. First, can managers consider themselves a discretionary fund manager for at least some of their vehicles? Second, do they have a clear overview of which vehicles can truly be considered discretionary?

Figure 13 shows that at 89% have sole or primary responsibility for major investment decisions for the majority of their accounts.

Most respondents agree that they have primary responsibility for management of under-lying vehicles. The majority of survey respondents that did not, tended to represent smaller companies, whose assets under management have a relatively high percentage of separate mandates for which they agree on the strategy in close collaboration with the investors.

FIGURE 13 / PERCENTAGE OF RESPONDENTS WHO FOR THE MAJORITY OF ACCOUNTS HAVE SOLE OR PRIMARY RESPONSIBILITY FOR MAJOR INVESTMENT DECISIONS

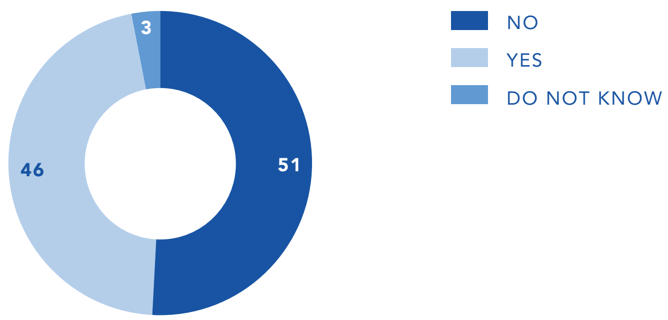
% RESPONDENTS



For investment restrictions, the responses are less aligned (Figure 14). Roughly half agree that clients can impose limitations and restrictions that hinder the implementation of strategy while the other half disagrees.

FIGURE 14 / PERCENTAGE OF RESPONDENTS WITH ACCOUNTS WHERE CLIENTS CAN IMPOSE INVESTMENT RESTRICTIONS

% RESPONDENTS



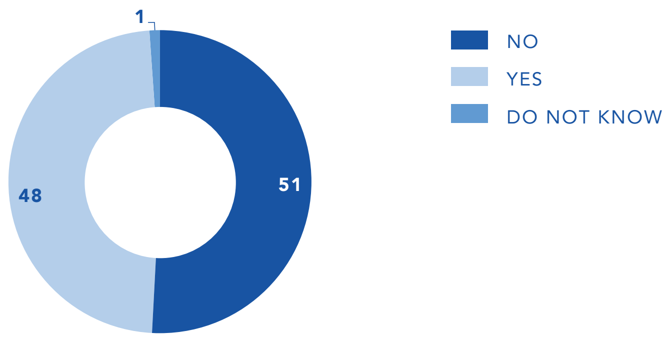
Following this conflicting result, the topic was raised during the interviews. Most interviewees contend they have a clear overview of which investments/funds/mandates can be considered discretionary, and which cannot. Many claim complete discretion within the mandate, and indicate that although clients can impose restrictions on investments, such restrictions are set at the start of the fund/mandate and are rarely altered. Once set, the managers do in general feel free to implement the investment policy without client's approval for each investment decision. They do have to consult with the clients, should a change of parameters be necessary.

Companies in general make a distinction between funds for which the companies determine the investment policy, limitations and boundaries, and separate accounts where clients might have a say in strategy and put in place investment restrictions. These restrictions are often from pension funds as a result of strict regulations.

Interviewees said that in some cases, clients do have strong opinions on investment decisions, and some said that recently investors have become more demanding and have made liquidation decisions in their portfolios, which could have an impact on discretionary. This indicates that investor approval may be becoming more important. That being said, Figure 15 shows that half of the responding companies say that they have sole responsibility for determining the strategy.

FIGURE 15 / PERCENTAGE OF RESPONDENTS WHO HAVE CLIENTS WHICH DECIDE ON A STRATEGY FOR THE COMPANY TO EXECUTE

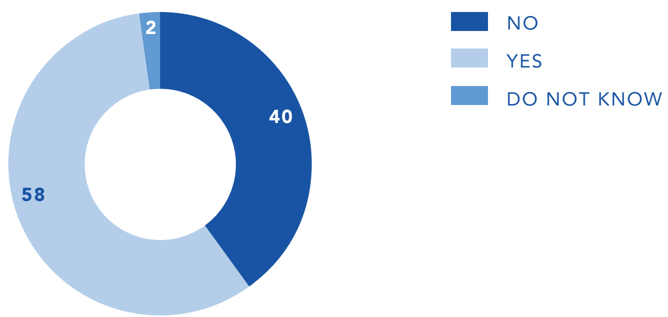
% RESPONDENTS



Finally, Figure 16 shows that, despite the previous responses, companies believe that clients can mandate the liquidation of assets when the fund manager believes that timing is not optimal. This suggests that the managers might not be able to implement their strategy as freely as possible.

FIGURE 16 / PERCENTAGE OF RESPONDENTS WHO HAVE ACCOUNTS WHERE CLIENTS CAN MANDATE LIQUIDATION OF THE PORTFOLIO WHEN TIMING/VALUE IS NOT OPTIMAL

% RESPONDENTS



5.2 Composite creation

Another key element that companies implementing the GIPS standards face is the creation of composites. A composite is an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy. The Standards state that "Creating meaningful composites is essential to the fair presentation, consistency, and comparability of performance over time and among firms."

Compliant firms are required to include all discretionary, fee-paying funds/vehicles in at least one composite. A list containing all past and present composites must be available to potential clients, and composite performance reports must be made available upon request of those potential clients. Therefore, the creation of meaningful composites is an important task for aspiring fund managers.

During the interviews, the majority of the fund managers said they already group investments for internal reporting purposes by geography, sector and fund category such as by style. Grouping is also sometimes done internally at the property level. The companies interviewed also group investments into funds and separate accounts. Most funds are dedicated to a particular investment strategy such as by region, sector or style.

The interviewees report that in most cases, cash flow data is available at the property level, therefore it should be possible to generate aggregations at all desired levels.

One sentiment expressed during the interviews, which also might explain the lack of compliance with the GIPS standards, is that grouping funds/vehicles according to strategy or objective (for example reporting an aggregated performance over all office mandates the company manages) is not specifically requested within the real estate business.

The results show that companies do not use composites as a means to communicate investment results for their strategies to potential clients. In most cases, however, the creation of meaningful composites would be feasible given the level of detail of data stored in the companies' systems. The actual creation of composites and calculation of composite performance could potentially require significant effort.

5.3 Valuation

Although the GIPS standards are not valuation standards, they do contain requirements about the valuation of portfolios: Real estate requirements differ from equity and fixed income mainly on the frequency and use of external valuations. For periods starting in or after 2008, a minimum of quarterly valuation is necessary. This does not have to be an external valuation. Those are required at least once every 36 months for periods prior to 1 January 2012, and once every 12 months for periods after that, unless client agreements stipulate otherwise.

Figures 17 and 18 (page 19) show the frequency of internal and external valuations. It is encouraging to note that half of all companies value internally on a quarterly or monthly basis, and just over 90% value externally on a yearly or more frequent basis. However, it is interesting to note the number of companies that have an external or internal valuation less frequently than quarterly. This is the case for 32% of respondents and becoming compliant with the GIPS standards would require them to increase their valuation frequency.

FIGURE 17 / FREQUENCY OF INTERNAL VALUATION AT RESPONDENTS' ORGANISATION

% RESPONDENTS

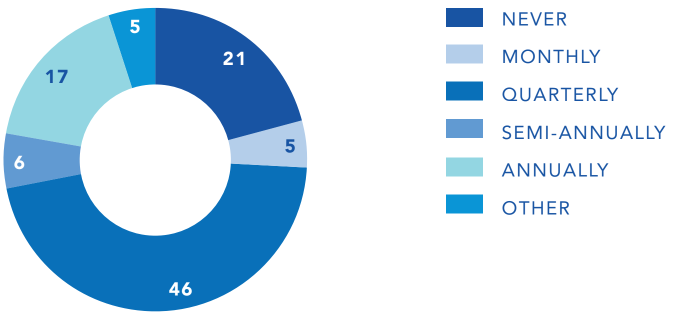
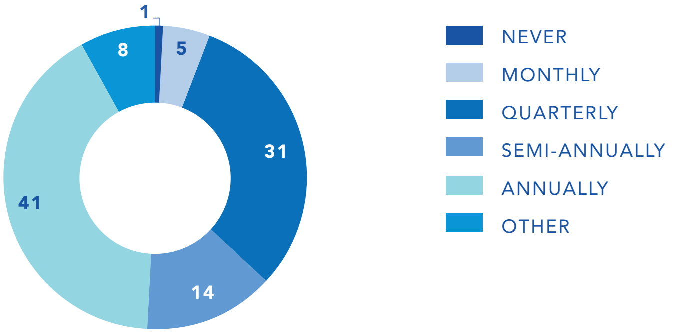


FIGURE 18 / FREQUENCY OF EXTERNAL VALUATION AT RESPONDENTS' ORGANISATION

% RESPONDENTS



During the interviews, fund managers explained that valuation frequency is usually part of client agreements. It varies between funds and mandates but is usually quarterly, bi-annually or annually. Furthermore, the frequency and timing of external valuations requested varies depending on where the investor is based.

Fair value is the requirement in the GIPS standards for real estate asset valuations. All interviewed managers declared that they comply with this requirement because they already use valuation methods based on fair value such as IFRS and the RICS Red Book.

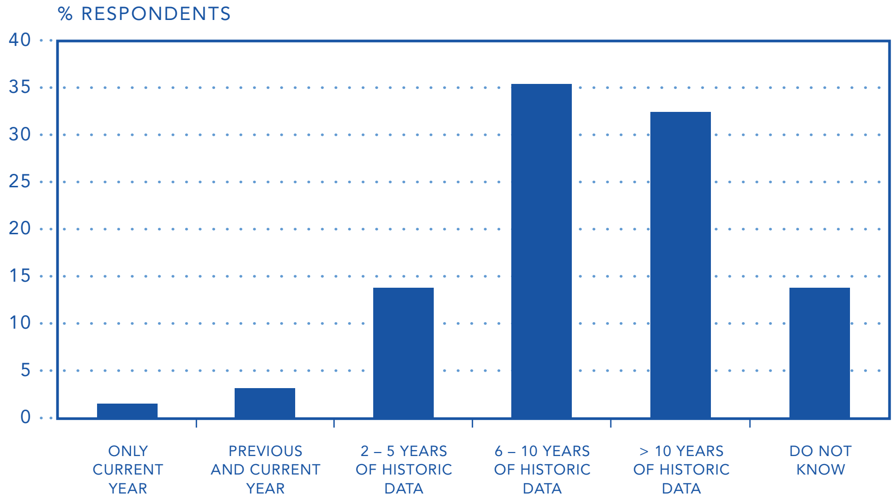
The results show that most fund managers would not fail the fair value requirement in the GIPS standards, but that many would have a valuation frequency that is below what is required.

5.4 Record keeping

The next key component is the record keeping policy that companies follow to retain historical data needed to calculate investment performance. The GIPS standards prescribe that compliant companies must be able to present at least five years of performance history, or since inception of the composite/company. They must retain all data necessary to calculate this performance history.

Figure 19 shows that most companies in the survey retain the required data necessary to calculate years of historical returns. Only a minority of survey respondents keep data in their electronic administration of recent history, which is current year and last year (but they could be keeping the records in another form, such as paper or spreadsheets).

FIGURE 19 / YEARS OF HISTORIC DATA NECESSARY FOR PERFORMANCE CALCULATION HELD BY RESPONDENTS' COMPANY



The interviewees explained that the level of detail is very high, and that the following data is recorded in their systems:

- Valuation
- External cash flows including timing
- Capital expenditures
- Sales proceeds
- Accrued investment income
- Non-recoverable expenditures
- Interest payment on debt
- Property taxes

The results show that most fund managers appear to keep sufficient historical data in their administration systems to be able to recreate performance figures for composites.

5.5 Performance calculation and presentation

A key aspect of the GIPS standards is the actual calculation of investment performance. Because of the illiquid nature of real estate, the Standards require that compliant firms report both income and capital return, in addition to total return. Most of the interviewees comply with this and indicate that they calculate both returns. A minority indicate that they only report total return. However, if all historic data necessary to recreate the performance figures is present in the administration systems, it should be feasible to calculate both income and capital returns.

The Standards require the firms to calculate the composite Time-Weighted rates of Return (TWR), including component returns, by portfolio-weighting the individual portfolio returns at least quarterly. In addition, for closed end funds firms must calculate annualised IRR since inception.

In the interviews, the majority of fund managers stated that they were able to calculate component returns and report those to existing clients. What is actually reported is very diverse. Some managers said they calculate component returns using TWR but do not report them to clients unless specifically requested. However, most calculate the since-inception IRR. Almost all interviewed fund managers indicate that reporting is very flexible and depends on client demands, as well as the nature and objective of the fund. For instance, UK funds report net asset value (NAV) to NAV based performances. For funds that follow IPD, returns calculated using the IPD methodology are presented. For value added and opportunity strategies, mostly the since-inception IRR is calculated. In some countries, the local regulator prescribes a certain calculation method; for example German KAG funds. Also many companies only present the most recent fund performance, confident that clients keep past performance reports themselves. There does not seem to be a uniform way of calculating and presenting performance to existing clients.

Performance reporting to potential clients seems to have the same level of diversity. For reasons of confidentiality, companies often report custom performance anonymously to potential investors. Again, the reporting sometimes depends on what the customers requested and many managers indicate that there is no uniform way to present and calculate investment performance. In most cases, potential clients receive data on the historical performance of requested funds, not strategies or composites, and in some cases only receive data on the most recent performance with no extended history.

The question of which people/departments are responsible for the calculation of performance also yields a range of outcomes. A dedicated performance measurement team is rare, and we encountered many situations where people are performing double roles. Among the people responsible are reporting teams, accounting teams, client servicing teams and fund/portfolio managers. In addition, we found that performance calculation is, with few exceptions, executed in spread sheets.

In general, the stakeholders receiving performance reports are external such as existing clients and regulators, and internal for executive management, reporting teams, sales department, fund management, board of directors, group finance departments and investor relations departments. Notably, the interviewees rarely mentioned potential clients spontaneously, but confirmed when asked that they can also be considered stakeholders.

5.6 Documentation of procedures

It is important to realise that being compliant with the GIPS standards does not end with calculating and presenting performance in a standardised fashion. Compliance relates to the firm's organisation adhering to all requirements of the GIPS standards including for example creating meaningful composites. For instance, companies are not allowed to state that the performance calculation method they use is compliant with the GIPS standards, because that is just one aspect of the Standards.

With regard to the documentation of procedures, the Standards require that "Firms must document their policies and procedures used in establishing and maintaining compliance with the GIPS standards, including ensuring the existence and ownership of client assets, and must apply them consistently".

To comply with this requirement, firms will compile valuation manuals, performance calculation manuals and have documented procedures regarding performance presentation (for instance, what history is presented, and what gets disclosed).

Valuation methods are generally documented, either in an internal manual, which in some cases is also available for external parties, or disclosed in valuation report or financial statements. Only one fund manager explained that no methods were documented because the valuation is performed externally.

From the interviews, it is clear that performance calculation methods are less well documented. In the opinion of many interviewees the calculation methods are so simple that documentation has little priority. In some cases fund managers refer to external standards such as IPD and INREV for a description of the calculation methods. However, some companies do have some sort of performance manual, or they disclose the methods in their financial statements.

Finally, hardly any fund managers interviewed have documented procedures, guidelines or standards for communicating investment performance to potential clients. Possibly this is due to the fact that in most cases the communication is tailored to the client who places the request, but the opposite might also be equally valid. Perhaps, the lack of standardised communication is due to the non-existence of documented standards.

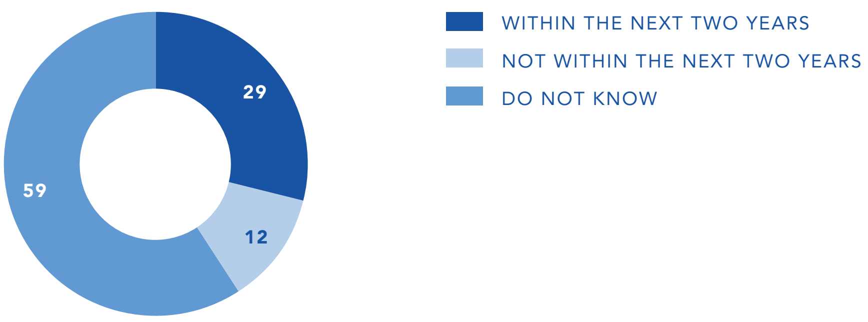
It can be concluded that procedures with respect to valuation, performance calculation and presentation are not always documented, possibly due to the lack of pressure from external parties.

6 OUTLOOK

In section 4, some 25% of the respondents, indicate that they are considering compliance with the GIPS standards. Of these, almost 30% believe that compliance will be achieved within the next two years (Figure 20), almost 12% are certain it will take more than two years, while the majority does not know in what time frame compliance will be achieved.

FIGURE 20 / WHEN RESPONDENTS EXPECT THEIR COMPANY TO BECOME COMPLIANT?

% RESPONDENTS



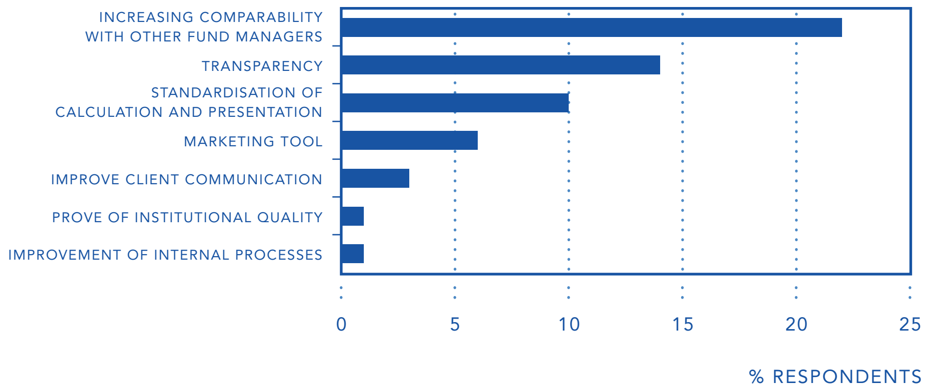
Interviewees identified a number of difficulties that they expect to encounter when implementing the GIPS standards. Some of the issues they anticipate are technical, such as guaranteeing that all data acquired from the different entities within the company – such as foreign subsidiaries or managers – is of uniform and consistent quality. Another technical issue involves the application of a consistent performance method for different types of funds with different characteristics and objectives.

Some companies are wary of implementing what they regard to be yet another set of reporting standards, alongside accountancy standards, Solvency II, valuation standards and IPD, although most of them suggest that this may be due to a lack of knowledge of the GIPS standards.

Other possible difficulties raised by survey respondents are of an operational nature. Some cite a lack of resources to gain full knowledge of the contents of the GIPS standards and start the implementation process, especially taking into account the lack of pressure from clients. Additionally, they expect a lot of work for the organisation, such as deciding what has to be included and what not and recreating historical performance. Finally, getting wider support within the organisation is deemed necessary when implementing the GIPS standards.

Regardless of whether a company is determined to become compliant or not, most interviewees recognised positive aspects of investment performance standards (Figure 21, page 24). Increased comparability is the most frequently mentioned benefit followed by improved transparency and standardisation of processes. Improving the company's internal processes is mentioned less frequently.

FIGURE 21 / RESPONDENTS' VIEWS ON THE GIPS STANDARDS



FURTHER READING

2010 Edition of the GIPS standards
http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n5.1

Global Investment Performance Standards Handbook, Third Edition
http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2012.n4.full

Guidance statements respond to questions that raise new issues beyond the scope of the simple application of the Standards and/or require additional interpretation and clarification
http://www.gipsstandards.org/standards/guidance/Pages/CurrentGuidance.aspx

Guidance Statement on Real Estate
http://www.gipsstandards.org/standards/guidance/Documents/Comments/gs_real_estate_clean.pdf

Guidance Statement on Private Equity
http://www.gipsstandards.org/standards/guidance/Documents/Comments/gs_private_equity_clean.pdf

Guidance Statement on Alternative Investment Strategies and Structures
http://www.gipsstandards.org/standards/guidance/Documents/Comments/gs_alternative_investment_strategies_and_structures.pdf

PREA
http://www.prea.org/research/reis.cfm

NCREIF
http://www.ncreif.org