



ATTEST BVS

Hello and welcome to the March edition of Attest BVS. In this offering we will discuss benchmark selection as it pertains to GIPS compliance. This is an important component of being GIPS compliant. Given that the spirit of the GIPS is based on full disclosure and fair representation, it is important to compare a composite’s performance to that of a benchmark that closely represents the strategy at hand. In addition, we also continue our periodic reminder of upcoming changes to the GIPS in 2010. Coincidentally, we would like to highlight that we have an upcoming webcast pertinent to these very changes. As always, please let us know if you have any questions or comments.

INSIDE THIS ISSUE

Benchmark Selection	1	Upcoming Webcast	4
Countdown to 2010 – Carve-Outs	3	Beacon Comes to NY Metro!	4

Benchmark Selection

Theoretically, building a compliant presentation should be straightforward. By this point, the firm has already constructed composites, calculated performance, and dealt with the idiosyncratic nuances of the firm’s structure. However, this is not the time to give up on the **dedication to compliance**.

The GIPS compliant presentation is a fundamental pillar of the claim of compliance and still requires plenty of thought. One of the basic presentation requirements is that firms present their performance against a benchmark. Standard 5.A.6 states: “The total return for the Benchmark (or Benchmarks) that reflects the investment strategy or mandate represented by the composite must be presented for each annual period.” While it is fairly easy to choose some common barometers of the market, such as the S&P 500, or the Barclay’s Aggregate Index, let

us first discuss the fundamentals of a benchmark selection process which can yield a more appropriate index choice.

The benchmark of a composite really should be the most appropriate index that a perspective client could use to compare against the particular strategy being employed. It should serve as the “opportunity cost” or basically what the investor could have achieved had he invested in an index of the strategy instead of the specific investment strategy (CONTINUED)



being offered. There are several types of benchmarks to consider, from the broad market index to the factor-model based benchmark. The important part to consider is the validity of said benchmark. Validity in this sense refers to the benchmark's ability to reflect properly the management strategy. There are also different basic properties of a valid benchmark; one of the most intuitive characteristics is its appropriateness. While the firm might want to show a small cap composite's returns compared to the S&P 500 simply because the prospective investor is more familiar with the S&P 500, we would encourage firms also to display a more appropriate benchmark which is more reflective of the particular risk and return factors of the accompanying strategy. In this instance, it would be more appropriate for the firm to show the Russell 2000 in addition to the S&P, since the Russell 2000 is a closer proxy to what the investor could have achieved had he not been invested in the firm's strategy.

Deciding on the composite benchmark should be an internal conversation that includes the management team as well as the compliance and operations personnel. For client reporting purposes, it is understood that not all the individual investors within the same composite will necessarily have the same benchmark for their own portfolio, but a firm must still present a benchmark for the whole composite which corresponds to that composite's investment strategy. Since the composite must be an aggregation of like-managed accounts, there must be a common denominator for a composite benchmark.

For asset allocation strategies, there are some well known benchmarks that blend different asset classes; however, the Standards do allow for the creation of custom benchmarks. In this case, the firm must disclose the benchmark creation and rebalancing process. For example, a firm presenting a balanced strategy might choose to create a custom benchmark comprised of the S&P 500 and Barclay's Aggregate Bond Index. In this example, the firm

would need to disclose that the benchmark is a 50% allocation of each index, and that the benchmark is rebalanced on say a quarterly basis. As with everything else, proper disclosure is imperative.

One recent development we have seen with the intensified interest from hedge funds to claim compliance with the Standards is the lack of appropriate benchmarks. Given the various types of funds and their underlying strategies, it can be rather difficult to commit to a particular benchmark. First, firms should try to identify a suitable index taking into account the risk characteristics of the strategy. Some informative websites to visit include:

www.barclayhedge.com
www.greenwichai.com
www.hedgefundresearch.com
www.hennesseegroup.com

However, in the absence of an appropriate index, firms do have the option of not presenting a benchmark as long as they disclose the reason. While a benchmark is not required by the GIPS, firms will want to consider such omission from other regulatory perspectives. When a strategy is so unique that an appropriate benchmark does not exist, the SEC prefers at the very least, that a broad market index be presented for comparison purposes. Please refer to the Clover letter for more on this issue. (CONTINUED)





A final point to note, changes (and corresponding dates) to benchmarks must be disclosed. Once a firm has presented a benchmark, changing it requires a disclosure of the change as well as the reason behind it. This underscores the idea of minimizing the frequency of change to the presentation.

The choice of the composite benchmark is an integral part of a firm's claim of compliance. The decision should not be taken lightly as poor benchmark selection can be detrimental to the evaluation of

the strategy. The decision of the suitable benchmark can have enduring impacts on the composite's presentation and should be thoughtfully discussed prior to building the compliant presentation. ◀

Deciding on the composite benchmark should be an internal conversation that includes the management team as well as the compliance and operations personnel.

Countdown to 2010 – Carve-Outs

2010 is quickly approaching and with it will come many changes. To ensure that nobody gets caught unaware, we will periodically send out reminders of some of the most significant changes that will be required by the beginning of that year.

This segment's focus is on carve-outs. The GIPS state that, "beginning January 01, 2010, carve-out returns are not permitted to be included in single asset class composite returns unless the carve-out is actually managed separately with its own cash balance." This move is consistent with the GIPS' continuing evolution toward more frequent and accurate calculation methodologies.



By eliminating the ability to allocate cash, the standard setting body of the GIPS believes that future returns of carve-out segments will yield more accurate

performance. Though the GIPS have not provided a great deal of additional insight into this change in carve-outs, they have provided three possible methods for properly accounting for the cash positions of the carve-outs. These methods are:

1. **Separate portfolios:** Cash and securities are actually segregated into a separate portfolio at the custodian.
2. **Multiple cash accounts:** Each segment's cash is accounted for separately (e.g., equity cash account, fixed-income cash account, etc.).
3. **Sub-portfolios:** Each segment of a portfolio is accounted for as if it were a separate portfolio within the firm's performance measurement system.

We strongly encourage firms to start integrating these changes to ensure a seamless transition. If you have further questions concerning carve-outs and their treatment after 01/01/10 we would be pleased for you to join our webcast devoted to this topic or feel free to contact your verification associate. ◀



Congratulations!

We would like to offer our warmest congratulations to Kamelia Dari for passing the Level I exam of the CFA Program! Kamelia looks forward to taking Level II in June.

Upcoming Webcast

Changes to the GIPS Specifically Related to Carve-Outs

March 24, 2009

Alicia Hyde, CIPM, CFA Level III Candidate, Verification Manager

Mike Sonnenburg, Senior Verification Associate

Effective January 1, 2010, carve-out returns are not permitted to be included in single asset class composite returns unless the carve-out is managed separately with its own cash balance. This has been on the horizon for many years, and it is finally here. For the firms that manage carve-out portfolios, this webcast will go over available options and best practices to ensure you comply with all applicable requirements by 2010.

Beacon Comes to NY Metro!

As Beacon continues to grow, we are very excited to announce the upcoming opening of Beacon's first satellite office in NY Metro!

This expansion will allow us to better serve our increasingly large client base in the Northeast. Stay tuned for more details.

ACA Spring 2009 Compliance Conference

ACA Compliance Group and *ACA Insight* announce the Spring 2009 Compliance Conference at the Bellagio in Las Vegas!
April 22-24, 2009



Industry experts will lead interactive and well-paced discussions on the crucial issues faced in today's uncertain times.

Topics Include:

- New Form ADV Part II
- Trading and Privacy
- Advertising
- SEC Updates and Examinations
- GIPS Compliance, and More!

ACA Compliance Group **Beacon Verification Services**
1428 Williams Street, Suite D Chattanooga, TN 37408
866.279.0750 **PHONE** 423.266.8334 **FAX**

www.beaconvs.com
www.acacompliancegroup.com