

REIS ADOPTING RELEASE

Summary of Modifications to Chapter 3: Performance Measurement and Reporting Standards

Issued by the Real Estate Information Standards Council in Conjunction with the Real Estate Information Standards Board

March 27, 2008

Executive Summary

This adopting release summarizes the changes made to REIS Chapter 3 – Performance Measurement and Reporting Standards (“Chapter 3”). These changes are to be considered a technical update to Chapter 3 in order to conform the chapter to the Global Investment Performance Standards (GIPS). GIPS are the foundational standard within REIS for performance measurement. The most recent version of GIPS was issued in 2005.

REIS requires compliance with GIPS. Therefore, if a firm has any discretionary portfolios they must be in compliance with GIPS in order to be in compliance with REIS. Our industry includes firms that manage no discretionary portfolios (i.e., non-discretionary single investor separate accounts) which are, by definition, not subject to GIPS and therefore cannot comply with GIPS. In order to be all-inclusive for REIS compliance, Chapter 3 includes performance measurement guidance for both discretionary and non-discretionary firms. Chapter 3 requires non-discretionary firms to follow the provisions of GIPS as if they were subject to it, and disclose clearly where they are not in compliance in order to claim REIS compliance. Minimum requirements are the valuation and calculation methodologies from GIPS for non-discretionary compliance. Chapter 3 includes additional required provisions which are not included in GIPS and to which all funds seeking REIS compliance must adhere.

Chapter 3 does not address other performance measures which could be useful for portfolio (fund and single investor separate accounts) performance analytics and attribution analysis and does not address different levels of performance information such as property level. During the first quarter of 2008, a task force of the REIS Council will be identified to address minimum standards for such other measures and Chapter 3 will be modified.

Modifications to REIS Standards

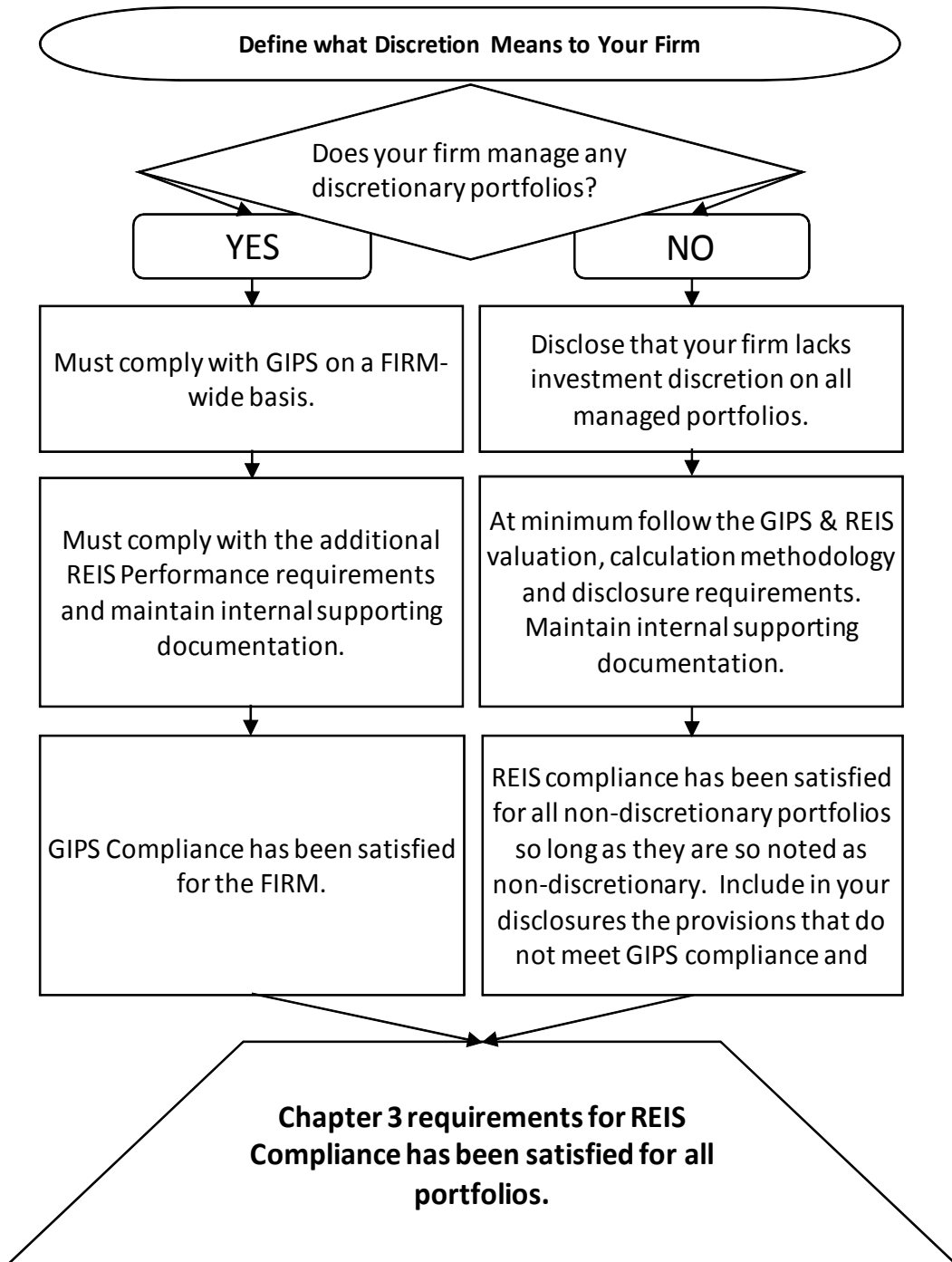
This Adopting Release serves to replace the version of Chapter 3 that was released in March 2003 which is included in the current version of REIS which has been updated through March 2007. The March 2003 version of Chapter 3 is included herein as Exhibit A. As of March 27 2008, Chapter 3, Performance Measurement and Reporting Standards included in REIS are as follows:

Chapter 3: Performance Measurement and Reporting Standards

Introduction

- .01 The Performance Measurement and Reporting Standards and associated guidance are intended to promote and assist the practitioner with the fair representation and full disclosure of real estate investment and property performance that is readily comparable within the appropriate sector of the asset class. The fundamental principles underlying these standards are to be applied to all disclosures of performance measurement, including Investment and Composite.
- .02 The CFA Institute sponsors the Global Investment Performance Standards (GIPS). Within this Performance Measurement Chapter of REIS, GIPS is the foundational standard to which REIS conforms. The CFA Institute, like other standards setting organizations referenced within REIS, is continuously reviewing and updating its standards as the need arises. As GIPS is revised, REIS will be revised to incorporate the relevant changes.
- .03 GIPS applies to all “fee-paying, discretionary portfolios” and as such does not have provisions for the portion of a real estate investment manager’s assets under management that are non-discretionary, except for the provision that “Assets Under Management be reported at “fair value”. In fact, GIPS does not permit the inclusion of non-discretionary portfolios in a firm’s composites. A significant portion of the real estate investment assets under management by real estate investment managers in the United States today are non-discretionary. As such, and in order to broadly promote standardization and transparency within the US institutional real estate investment industry, the REIS Board has brought non-discretionary investments into the scope of this Performance Chapter of REIS.
- .04 Determining GIPS compliance is an individual firm responsibility. REIS starts with a presumption of GIPS compliance. Firms subject to GIPS must comply with GIPS and all of the additional provisions listed in this Chapter in order to claim REIS compliance. The only reason a real estate investment management firm would not be subject to GIPS is the lack of Discretion over the entire real estate investment portfolio they manage for clients. Firms that determine that GIPS does not apply to their firm must fully disclose why they are not subject to GIPS.
- .05 Investment firms managing non-discretionary investments that wish to claim REIS compliance need to follow the provisions of GIPS, as if they were subject to such provisions, and all of the additional REIS provisions listed in this Chapter. As the manager proceeds through the REIS compliance process they need to disclose in their non-discretionary performance presentation(s) which of the provisions of GIPS they are not in compliance with and concisely state the reason(s) for non-compliance. The non-discretionary performance presentation needs to be clearly titled as non-discretionary.
- .06 A future version of this chapter will address REIS required and recommended practices for additional performance measures to be used in fund/account reports including property, investment and portfolio.

The Compliance Decision Tree



Investment Performance Standards

.07 The Investment Performance standards that follow are grouped into five categories that reflect the basic elements involved in presenting performance information: Input Data; Calculation Methodology; Composite Construction; Disclosures; and Presentation and Reporting. This format is consistent with the provisions of GIPS and the relevant concepts within GIPS are referenced in parentheses, where appropriate and available.

.08 Listed below are the additional required and recommended practices a firm must follow in order to claim REIS compliance.

.09 Input Data – Data consistency is the foundation of full, fair, and comparable investment performance presentations.

Required Practice:

- a. Investment valuation updates must be completed at least quarterly, maintained internally for verifiability purposes, and available for verification for the period that compliance is claimed.

.10 Calculation Methodology - Achieving comparability of returns requires uniformity in calculation methodologies.

Required Practices:

- a. Quarterly time-weighted returns that adjust for cash flows must be used at a minimum. For returns greater than one period, all periodic total returns must be geometrically linked. Annualized returns must be computed for periods greater than one year. Actual valuations at the time of external cash flows are not practical for real estate investments and are therefore not required. (GIPS 2.A.2). (GIPS 2.A.6)
- b. Composites may include investments that have partial periods when there is more than one investment in the composite; however, when the composite contains only one investment the composite must not include any individual investment's partial period that occurs prior to the first full period of the investment/composite or after the last full period of the investment/composite. Unrealized appreciation/depreciation from a sale should be recognized in the period prior to the partial period in order not to alter actual performance. (GIPS 3.A.3)
- c. The definition of “period” must be explained and used consistently. For real estate investment composite performance calculation a quarterly period is the minimum period option. (GIPS 2.A.2)

Recommended Practices:

- d. Performance adjustments for external cash flows should be treated consistently. For significant cash flows (e.g. greater than 10% of portfolio beginning of period market value) that potentially distort performance, performance should be recalculated with a more appropriate methodology, such as XIRR, return on investment, or sub-period time weighting. Actual valuations at the time of external cash flows are not expected to be practical for real estate investments. The treatment of significant cash flows should be disclosed.
- e. If property level performance is provided, then the leveraged and unleveraged NCREIF property level calculations should both be used.

.11 Composite Construction – A composite is one or a number of investments or portfolios that represent an investment objective or strategy. In compositing, whether discretionary or non-discretionary investments, it may be appropriate (due to strategy differences) to make one investment its own composite. The return in a composite is asset weighted. Composites prepared for non-discretionary portfolios must clearly be labeled as supplementary information and cannot be included in a GIPS compliant firm’s composite presentation.

Required Practices:

- a. If a firm discloses non-discretionary performance presentations for marketing purposes, then all non-discretionary portfolios need to be included in at least one composite.
- b. Any non-discretionary composites should be identified as supplementary non-discretionary investment performance information and returns for these assets presented separately from any discretionary composites.

Recommended Practice:

- c. For each composite, detailed attribute information should be maintained and made available upon request. The purpose of identifying composite attributes is to enhance the comparability of performance data. These attributes are key indicators of the risk return profile of the composite and will assist in identifying the investment strategy or style.

.12 Disclosures - Disclosures allow for elaboration on the data as well as the performance presentation and calculation methodology.

Required Practices:

- a. The basis of the firm's accounting must be disclosed.
- b. Each fee's category definition and amounts of all fees, including "carried interest" or "promote," must be disclosed.
- c. The methodology of all fees inclusion (i.e., capitalized or expensed, or billed separately outside of the fund), the effect on the performance calculations and how these fees are recognized in the firm's accounting must be disclosed.

Recommended Practice:

- d. If investment level leverage materially affects the performance of the investment, then the firm should disclose either 1) the un-levered investment level return or 2) the weighted average percentage of leverage and weighted average interest rate of the investment level debt.

.13 Presentation and Reporting - This section intentionally left blank.

.14 Useful Websites - The following websites may provide additional useful information.

The CFA Institute: <http://www.cfainstitute.org/>

GIPS: <http://www.gipsstandards.org/standards>

Appendix A: Chapter 3- Performance Measurement and Reporting Standards as of March 16, 2007

Chapter 3 - Performance Measurement and Reporting Standards

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Chapter 3 - Performance Measurement and Reporting Standards

Introduction

.01 The Performance Measurement and Reporting Standards and associated guidance are intended to promote and assist the practitioner with the fair representation and full disclosure of real estate investment and property performance that is readily comparable within the appropriate sector of the real estate asset class.

Performance Measurement and Reporting Standards are currently in a transition phase. The global governing professional body, AIMR is migrating toward global performance standards at the March 2003 REIS publication date. REIS standards adopt many elements of the planned Real Estate Provisions of the Global Investment Performance Standards (GIPS-Real Estate), which are currently being finalized. It is projected that GIPS-Real Estate will be effective sometime in 2005, allowing ample time to update REIS as appropriate. References within this document to GIPS-Real Estate refer to the draft invitation to comment on Real Estate Provisions and Guidance to the GIPS circulated by the AIMR Investment Performance Council in 2001.

In order to claim compliance with REIS the firm needs to either a) be claiming compliance with Association for Investment Management and Research Performance Presentation Standards (AIMR-PPS®), amended and restated as the AIMR-PPS® standards, the U.S. and Canadian version of GIPS®, issued in 2001 and adopt all required REIS Performance Measurement and Reporting Standards or b) disclose specific matters that prohibit AIMR compliance at the presentation date. REIS does not supersede AIMR-PPS® or GIPS, it is meant to be additive.

Differences from AIMR-PPS Reporting for other Asset Classes

.02 There are several differences between REIS and GIPS reporting for other asset classes and non-core sectors of the real estate asset class. First, REIS acknowledges the difference between real estate investment level returns and real estate property level returns. In the real estate asset class the calculation of performance is meaningful to

investors at both the investment level (often called portfolio or fund) and the property level (often called operating). The property level is the operating level of real estate and can be an individual building or a group of buildings. The investment level in real estate measures the return from the perspective of the investor. The investment level can be a single real property asset entity or a commingled real estate fund or fund of funds. In situations where direct investments have been made in properties not through a fund or other entity, returns are to be calculated using investment-level methodology. Second, traditional real estate performance reporting includes individual components of income and appreciation, in addition to total return. Other asset classes disclose only total return. Third, REIS recommends the addition of internal rate of return calculations for certain sectors of the real estate asset class. Fourth, the version of GIPS Real Estate being considered for approval incorporates a twenty-four month external valuation frequency for real property, beginning January 1, 2005. NCREIF has recommended to AIMR that the thirty-six month external valuation frequency be retained. Finally, in the remainder of this section, REIS requires or recommends adopting certain provisions of GIPS, GIPS Real Estate or other industry conventions.

Required and Recommended Practices

Investment Performance Standards

.03 The Investment Performance standards below are grouped into five sections that reflect the basic elements involved in presenting performance information: Input Data, Calculation Methodology, Composite Construction, Disclosures, and Presentation Reporting. This format is consistent with the GIPS provisions and GIPS is referenced in parentheses, where appropriate.

A. Input Data – Data consistency is the foundation of full, fair, and comparable investment performance presentations.

Required Practices:

1. Investment valuation updates must be completed at least quarterly. (GIPS 1.A.3.)
2. Real property must be valued by an independent, professionally designated property valuer or appraiser at least once every thirty-six months.

B. Calculation Methodology - Achieving comparability of returns requires uniformity in calculation methodologies

Required Practices:

1. Quarterly time-weighted returns that adjust for cash flows must be used at a minimum. For returns greater than one period, all periodic returns must be geometrically linked. Annualized returns must be computed for periods greater than one year. Time-weighted rates of return adjusted for daily weighted cash flows must be used for periods beginning 01/01/05. Actual valuations at the time of external cash flows are not practical for real estate investments and are thus not required. (GIPS 2.A.2.).

2. Composites must be asset weighted using beginning of period weightings or weighted average equity. The asset weighting methodology must be consistently applied within each composite. (GIPS 2.A.4.)

3. For the acquisition and disposition of an individual direct property investment, the partial period return should not be included in return calculations for that property. This differs from treatment when constructing composites. Composite construction would incorporate individual investment related partial periods, unless they occur at the beginning or end of the composite period.

Recommended Practices:

1. For returns greater than one period, income, appreciation, and total returns should be geometrically linked (AIMR-PPS (6.A.4)). The cumulative effect of cross compounding may cause the sum of income and appreciation components to not equal the total.

2. Performance adjustments for external cash flows should be treated consistently within each composite. For significant cash flows (i.e. greater than 10% of portfolio) that potentially distort performance, performance should be recalculated with a more appropriate methodology such as Modified-Dietz, ROI or sub period time weighting. Actual valuations at the time of external cash flows are not expected to be practical for real estate investments and therefore are not anticipated to be required from 01/01/10, as stated in GIPS. (GIPS 2.B.2)

C. Composite Construction - A composite is one or a number of investments or portfolios that represent an investment objective or strategy. The return in a composite is asset weighted.

Required Practices:

1. If the firm sets a minimum asset level for portfolios, whether net or gross of leverage, to be included in a composite, no portfolios with aggregate asset values below that level can be included in that composite. AIMRPPS (2.A.7).

Recommended Practices:

1. For each composite, detailed attribute information shall be maintained and made available upon request. The purpose of identifying composite attributes is to enhance the comparability of performance data. These attributes are key indicators of the risk/return profile of the composite and will assist in identifying the investment strategy or style. NCREIF intends to define investment strategy composites sometime in the future. A list of suggested composite attributes is available at www.ncreif.org.

D. Disclosures - Allows for elaboration on the data, as well as the performance presentation and calculation methodology.

Required Practices:

1. Quarterly valuation methods and procedures. (GIPS 4.B.1)
2. Calculation methodology, including asset-weighting methodology. (GIPS 4.B.2)
3. The firm's definition of Investment Discretion. (GIPS Real Estate)
4. The firm's investment strategy definitions.

Recommended Practices:

1. Internal rate of return-inception to date should be disclosed for discretionary closed-end commingled funds or partnerships and discretionary separate accounts using quarterly cash flows at a minimum.
2. If the investment level (e.g. partnership, joint venture, LLC, C-Corp, S-Corp...) leverage materially affects (e.g. 50 basis points) the performance of the investment then it is recommended that an unlevered investment level return or the weighted average percentage leverage, and weighted average interest rate of the investment level debt be disclosed.

E. Presentation and Reporting - Incorporate information in presentations based on the GIPS guidelines. GIPS require gross returns be presented and SEC advertising rules under the Investment Advisors act of 1940 require net of fees return presentation.

Required Practices:

1. Returns are to be displayed gross of investment management fees and other fees (e.g. disposition fee, incentive fee, acquisition fee, asset management) paid to firm by the client. (GIPS 4.A.8)
2. Composite presentations require (GIPS 5.A.1.) a range of performance returns for the individual accounts in the composite.

Recommended Practices:

1. Returns are to be displayed net of investment management fees and other fees (e.g. disposition fee, incentive fee, acquisition fee, asset management) paid to firm by the client. (GIPS 4.A.8)
2. Separate component returns for income, appreciation and total return are to be displayed. The cumulative effect of cross compounding may cause the sum of income and appreciation components to not equal the total.

Authority within AIMR-PPS®

.04 AIMR promulgates global performance information standards and allows for the adoption of country specific standards where appropriate. Information about the Additional Real Estate Provisions and Guidance to GIPS standards, which AIMR is finalizing as of this printing, is noted by “GIPS Real Estate” where appropriate throughout the document. Reference is provided to GIPS when relevant information is available.

Appendix B – Basis for Conclusions Reached

The structure of REIS is to incorporate by reference the governance from other standards-setting bodies, where applicable, to the institutional equity real estate investment management community. These standards-setting entities are constantly reviewing their standards and updating them as needed. The REIS Board and REIS Council periodically update REIS to incorporate relevant changes made by these organizations. The Global Investment Performance Standards (GIPS) sponsored by the CFA Institute is the foundational standard within REIS for performance measurement and as such, in order to be in compliance with REIS a firm must be in compliance with GIPS if the firm is subject to it. The most recent version of GIPS was issued in 2005. Chapter 3 was changed to conform to GIPS.

A principal objective for the development of GIPS was to provide a fair, consistent and comparable presentation of the performance of a firm in order to assess how well the firm executed its investment strategy. GIPS was developed for marketing purposes. A mission of REIS is to develop a set of standards which are fair, consistent and comparable for the tax exempt institutional real estate investment industry. As GIPS addresses performance measurement of a firm's investment strategy it, by definition excludes nondiscretionary investments (because the investment strategy is that of the investor). In order to align with the spirit of GIPS, and be all inclusive, Chapter 3 specifically addresses both discretionary and non-discretionary performance presentation.

REIS provides standards and guidance in areas where the existing foundational standards are silent or subject to interpretation. REIS requires additional performance measurement disclosures in Chapter 3 which are not currently included in GIPS but which the REIS Council and Board think are critical for the understanding of the performance of an individual portfolio and are useful for comparing portfolios.

Chapter 3 does not currently address performance measures which could be useful for portfolio (fund and single investor separate accounts) performance analytics and attribution analysis and does not address different levels of performance information such as property level. The REIS Council agrees with the respondents to the public comment process who indicated that such information would be very useful. Accordingly, during the first quarter of 2008, a task force of the REIS Council will be identified to address minimum standards for such other measures and Chapter 3 will be modified.

Appendix C – Public Comment Process

The key issues and questions considered by industry participants as part of the public comment process for the Chapter 3 exposure draft are as follows:

1. In order to be consistent with GIPS, the Task Force has concluded that New Chapter 3 should address firm compliance for performance measurement standards. In order to promote compliance within REIS, the REIS Council has concluded that overall compliance with REIS should be measured on an account level. As such, firm compliance would not be precluded. Do you agree that performance measurement standards should be developed on a firm basis consistent with GIPS?

The respondents were split on this matter. One respondent indicated that although Standards should be developed on a firm basis consistent with GIPS, REIS should concern itself with performance of properties, investments and portfolios not with composites which are covered under GIPS. Similarly, two other respondents indicated that account level compliance was more important. . The REIS Council recognizes the need to include additional performance measures in Chapter 3 which are not currently addressed in GIPS and is planning to issue an exposure draft addressing additional performance measures during 2008. Since account compliance is not precluded using the concept of firm compliance, the REIS Council determined that consistency with GIPS is important since GIPS is a foundational standard for REIS and compliance should be developed on a firm basis consistent with it.

2. Investment managers with no discretionary accounts are not subject to the provisions of GIPS since GIPS applies only to firms with discretionary accounts. In New Chapter 3 compliance with GIPS is required for all firms subject to GIPS. In order to claim REIS compliance the main acceptable reason for non-compliance with GIPS is when a firm has no discretionary accounts. Do you think that compliance with REIS should be predicated on compliance with GIPS? Why or why not?

The respondents were split on this matter. Reasons given for compliance with REIS not to be predicated on compliance with GIPS are: a) creates obstacles to implementation of REIS standards in situations where they would otherwise be useful; and b) compliance with GIPS may be expensive and cost prohibitive. The principal reason given for compliance with REIS to be predicated on compliance with GIPS is that GIPS is a world-wide standard which is foundational to REIS. The Council concluded that the notion that GIPS is a world-wide recognized and established standard for performance measurement which is used for all investable asset classes far outweighs the notion that compliance with GIPS could be expensive and cost prohibitive. The Council concluded that compliance with GIPS has become a cost of doing business in the marketplace and should be foundational within REIS. The Council thinks that recommending rather than requiring valuation and calculation methodologies described would foster further non-comparability within the real estate asset class. Quarterly valuations are required for REIS within Chapter 1, Property Valuation Standards. Therefore, in order to be in compliance with REIS, investments must be valued quarterly

3. In order to claim REIS compliance, the proposed New Chapter 3 requires those firms which are not subject to GIPS to follow, to the extent possible, all of the GIPS provisions, as if the firm were subject to GIPS. At a minimum, the valuation and calculation methodology requirements must be followed. Do you think nondiscretionary firms should be required to follow the applicable provisions of GIPS in order to be in compliance with REIS? If your answer is “no”, please cite specific provisions within GIPS which would cause your firm not to seek REIS compliance.

Three respondents answered this question. One respondent indicated yes, one respondent indicated no except to the extent of valuation and calculation methodology and one respondent said that the valuation and calculation methodology should be recommended and not required because the valuation methodology could be cost prohibitive. Based upon the mixed views received the Council determined that the requirement as stated was reasonable as the premise of Chapter 3 is that GIPS is the foundational standard to which REIS should conform and therefore, non discretionary managers should follow the provisions of GIPS even though they are not subject to it. It should be noted that the reason why nondiscretionary managers are not subject to GIPS is because GIPS was designed to provide for consistency of reporting of a manager’s investment strategy. For nondiscretionary accounts the strategy is not the manager’s but rather the client’s and as such cannot be marketed as the manager’s. Nondiscretionary managers can follow all of the provisions of GIPS (i.e., Input Data (for fair representation of data), Calculation Methodology, Composite Construction and Disclosures) when presenting information for client reporting and marketing nondiscretionary fund management services.

4. In order to promote comparability and transparency within private, institutional real estate investment, REIS contains standards which are applicable to both discretionary and non-discretionary accounts. Firms which have only non-discretionary accounts are not subject to GIPS. In order to be in compliance with REIS, non-discretionary firms need to prepare and present information in a manner which conforms to GIPS compliant presentation. Accordingly, under REIS, firms which have nondiscretionary accounts are required to prepare composites which are identified as nondiscretionary and presented separately from discretionary composites. Do you think this requirement is appropriate? Please provide sufficient detail to support your answer.

Three respondents indicated that it is not appropriate. The reasons given were: 1) GIPS precludes it; and 2) the composites can’t be marketed so it is not productive to prepare them. Two respondents indicated that nondiscretionary composites should be required because preparation and disclosure of such a composite could serve as an important element reconciling performance reporting to total assets under management. The Task force members reviewed the GIPS requirements and concluded that nondiscretionary composites could be prepared and presented as supplemental information. However, the Council appreciates the notion that composites are not necessary if they are not used for marketing purposes. As a result of the feedback received the Council has changed the requirement to stipulate that if nondiscretionary composites are prepared for marketing purposes they must clearly be labeled as nondiscretionary and presented as supplemental information.

5. In addition to the GIPS provisions, in order to be in compliance with REIS, each firm must comply with additional REIS provisions in New Chapter 3 which include requirements to: a) maintain information for quarterly investment valuation updates which can be available for verification for the period in which compliance with REIS is claimed (3.09.a); b) disclose the basis of the firm's accounting (3.12.a); c) disclose each fee's category definition and amounts of all fees, including "carried interest" or "promote" (3.12.b); and d) disclose the methodology of all fees inclusion, the effect on the performance calculations and how these fees are recognized in the firm's accounting model (3.12.c). Do you think these additional provisions are appropriate? Would any particular item(s) cause your firm not to seek REIS compliance?

With the exception of the fee disclosures, the respondents agreed that the additional provisions are appropriate. Two respondents indicated that the fee disclosure was not appropriate, with one respondent taking exception to (d) for lack of clarity and one respondent taking exception to (c) and (d) as the impact of fees is apparent through the requirement to produce gross and net returns. It should be noted that GIPS does not require presentation of both gross and net of fee returns and therefore the additional disclosures should be required within REIS in order to foster comparability. Based on the other comment received, the language written in (d) above was clarified to indicate the methodology for fee inclusion means to describe if the fees are capitalized or expensed or billed separately outside of the fund.

6. New Chapter 3 acknowledges the differences between investment level and property level returns and proposes standards for measures of performance applicable to both discretionary and non-discretionary accounts and composites and properties. In the future, specific measures of performance for properties, investments and funds will be incorporated into the performance measurement chapter of REIS. Please indicate which performance measures would be particularly useful to you and your clients.

The respondents noted that Chapter 3 does not provide guidance (including calculation guidance) for property level, investment level, portfolio level returns and IRR. In addition, a comment was offered that the measurement of debt exposure should not be formulaic. Based upon the feedback received, the Council added a paragraph to the Chapter which indicates that a future version of the chapter would incorporate other performance metrics including fund, investment and property level. The REIS Council is expected to identify a task force for the development of this information during Quarter 1, 2008.

7. Please provide any additional comments you have concerning the contents of this chapter which would help us better understand your response.

Based upon the additional comments received miscellaneous edits were made to the document to clarify its content. This included an overall simplification of the Compliance Decision Tree.