

Global Investment Performance Standards (GIPS)

LEARNING OUTCOMES

Mastery The candidate should be able to:

- a. describe the key features of the GIPS standards and the fundamentals of compliance;
- b. describe the scope of the GIPS standards with respect to an investment firm's definition and historical performance record;
- c. explain how the GIPS standards are implemented in countries with existing standards for performance reporting and describe the appropriate response when the GIPS standards and local regulations conflict;
- d. describe the nine major sections of the GIPS standards.

I. INTRODUCTION

Preamble—Why Is a Global Investment Performance Standard Needed?

Standardized Investment Performance

Financial markets and the investment management industry have become increasingly global in nature. The growth in the types and number of financial entities, the globalization of the investment process, and the increased competition among investment management firms demonstrate the need to standardize the calculation and presentation of investment performance.

Global Passport

Asset managers and both existing and prospective clients benefit from an established global standard for calculating and presenting investment performance. Investment practices, regulation, performance measurement, and reporting of performance vary considerably from country to country. By adhering to a global standard, firms in countries with minimal or no investment performance standards will be able to compete for business on an equal footing with firms from countries with more developed standards. Firms from countries with established practices will have more confidence in being fairly compared with local firms when competing for business in countries that have not previously adopted performance standards. Performance standards that are accepted globally enable investment firms to measure and present their investment performance so that investors can readily compare investment performance among firms.

Investor Confidence

Investment managers that adhere to investment performance standards help assure investors that the firm's investment performance is complete and fairly presented. Both prospective and existing clients of investment firms benefit from a global investment performance standard by having a greater degree of confidence in the performance information presented to them.

Objectives

The establishment of a voluntary global investment performance standard leads to an accepted set of best practices for calculating and presenting investment performance that is readily comparable among investment firms, regardless of geographic location. These standards also facilitate a dialogue between investment firms and their existing and prospective clients regarding investment performance. The goals of the GIPS Executive Committee are:

- To establish investment industry best practices for calculating and presenting investment performance that promote investor interests and instill investor confidence;
- To obtain worldwide acceptance of a single standard for the calculation and presentation of investment performance based on the principles of fair representation and full disclosure;
- To promote the use of accurate and consistent investment performance data;

- To encourage fair, global competition among investment firms without creating barriers to entry;
- To foster the notion of industry “self-regulation” on a global basis.

Overview

Key features of the GIPS standards include the following:

- The GIPS standards are ethical standards for investment performance presentation to ensure fair representation and full disclosure of investment performance. In order to claim compliance, firms must adhere to the requirements included in the GIPS standards.
- Meeting the objectives of fair representation and full disclosure is likely to require more than simply adhering to the minimum requirements of the GIPS standards. Firms should also adhere to the recommendations to achieve best practice in the calculation and presentation of performance.
- 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 in order to prevent firms from cherry-picking their best performance.
- The GIPS standards rely on the integrity of input data. The accuracy of input data is critical to the accuracy of the performance presentation. The underlying valuations of portfolio holdings drive the portfolio’s performance. It is essential for these and other inputs to be accurate. The GIPS standards require firms to adhere to certain calculation methodologies and to make specific disclosures along with the firm’s performance.
- Firms must comply with all requirements of the GIPS standards, including any updates, Guidance Statements, interpretations, Questions & Answers (Q&As), and clarifications published by CFA Institute and the GIPS Executive Committee, which are available on the GIPS website (www.gipsstandards.org) as well as in the GIPS Handbook.

The GIPS standards do not address every aspect of performance measurement or cover unique characteristics of each asset class. The GIPS standards will continue to evolve over time to address additional areas of investment performance. Understanding and interpreting investment performance requires consideration of both risk and return. Historically, the GIPS standards focused primarily on returns. In the spirit of fair representation and full disclosure, and in order to provide investors with a more comprehensive view of a firm’s performance, the 2010 edition of the GIPS standards includes new provisions related to risk.

Historical Performance Record

- A firm is required to initially present, at a minimum, five years of annual investment performance that is compliant with the GIPS standards. If the firm or the composite has been in existence less than five years, the firm must present performance since the firm's inception or the composite inception date.
- After a firm presents a minimum of five years of GIPS-compliant performance (or for the period since the firm's inception or the composite inception date if the firm or the composite has been in existence less than five years), the firm must present an additional year of performance each year, building up to a minimum of 10 years of GIPS-compliant performance.
- Firms may link non-GIPS-compliant performance to their GIPS-compliant performance provided that only GIPS-compliant performance is presented for periods after 1 January 2000 and the firm discloses the periods of non-compliance. Firms must not link non-GIPS-compliant performance for periods beginning on or after 1 January 2000 to their GIPS-compliant performance. Firms that manage private equity, real estate, and/or wrap fee/separately managed account (SMA) portfolios must also comply with Sections 6, 7, and 8, respectively, of the Provisions of the GIPS standards that became effective as of 1 January 2006.

Compliance

Firms must take all steps necessary to ensure that they have satisfied all the requirements of the GIPS standards before claiming compliance. Firms are strongly encouraged to perform periodic internal compliance checks. Implementing adequate internal controls during all stages of the investment performance process—from data input to preparing performance presentations—will instill confidence in the validity of performance presented as well as in the claim of compliance.

Firms may choose to have an independent third-party verification that tests the construction of the firm's composites as well as the firm's policies and procedures as they relate to compliance with the GIPS standards. The value of verification is widely recognized, and being verified is considered to be best practice. The GIPS Executive Committee strongly recommends that firms be verified. In addition to verification, firms may also choose to have specifically focused composite testing (performance examination) performed by an independent third-party verifier to provide additional assurance regarding a particular composite.

Effective Date

The effective date for the 2010 edition of the GIPS standards is 1 January 2011. Compliant presentations that include performance for periods that begin on or after 1 January 2011 must be prepared in accordance with the 2010 edition of the GIPS standards. Prior editions of the GIPS standards may be found on the GIPS website (www.gipsstandards.org).

Implementing a Global Standard

The presence of a local sponsoring organization for investment performance standards is essential for effective implementation and ongoing support of the GIPS standards within a jurisdiction. Such sponsors also provide an important link between the GIPS Executive Committee, the governing body for the GIPS standards, and the local markets in which investment managers operate.

The sponsor, by actively supporting the GIPS standards and the work of the GIPS Executive Committee, ensures that the jurisdiction's interests are taken into account as the GIPS standards are developed. Compliance with the GIPS standards is voluntary, and support from the local market sponsor helps to drive the adoption of the GIPS standards.

The GIPS Executive Committee strongly encourages countries without an investment performance standard to promote the GIPS standards as the local standard and translate them into the local language when necessary. Although the GIPS standards may be translated into many languages, if a discrepancy arises, the English version of the GIPS standards is the official governing version.

The GIPS Executive Committee will continue to promote the principles of fair representation and full disclosure and develop the GIPS standards so that they maintain their relevance within the changing investment management industry.

The self-regulatory nature of the GIPS standards necessitates a strong commitment to ethical integrity. Self-regulation also assists regulators in exercising their responsibility for ensuring the fair disclosure of information within financial markets. The GIPS Executive Committee encourages regulators to:

- Recognize the benefit of voluntary compliance with standards that represent global best practices;
- Give consideration to taking enforcement actions against firms that falsely claim compliance with the GIPS standards; and
- Recognize and encourage independent third-party verification.

Where existing laws, regulations, or industry standards already impose requirements related to the calculation and presentation of investment performance, firms are strongly encouraged to comply with the GIPS standards in addition to applicable regulatory requirements. Compliance with applicable law and/or regulation does not necessarily lead to compliance with the GIPS standards. In cases in which laws and/or regulations conflict with the GIPS standards, firms are required to comply with the laws and regulations and make full disclosure of the conflict in the compliant presentation.

II. PROVISIONS OF THE GLOBAL INVESTMENT PERFORMANCE STANDARDS

The provisions within the GIPS standards are divided into the following nine sections: Fundamentals of Compliance, Input Data, Calculation Methodology, Composite Construction, Disclosure, Presentation and Reporting, Real Estate, Private Equity, and Wrap Fee/Separately Managed Account (SMA) Portfolios.

The provisions for each section are categorized into requirements and recommendations. Firms must meet all the requirements to claim compliance with the GIPS standards. Firms are encouraged to implement as many of the recommendations as possible. These recommended provisions are considered to be industry best practice and assist firms in fully adhering to the spirit and intent of the GIPS standards.

0 Fundamentals of Compliance: Several core principles create the foundation for the GIPS standards, including properly defining the firm, providing com-pliant presentations to all prospective clients, adhering to applicable laws and regulations, and ensuring that information presented is not false or misleading. Two important issues that a firm must consider when becoming compliant with the GIPS standards are the definition of the firm and the firm's definition of discretion. The definition of the firm is the foundation for firm-wide compliance and creates defined boundaries whereby total firm assets can be determined. The firm's definition of discretion establishes criteria to judge which portfolios must be included in a composite and is based on the firm's ability to implement its investment strategy.

1 Input Data: Consistency of input data used to calculate performance is critical to effective compliance with the GIPS standards and establishes the foundation for full, fair, and comparable investment performance presentations. For periods beginning on or after 1 January 2011, all portfolios must be valued in accordance with the definition of fair value and the GIPS Valuation Principles.

2 Calculation Methodology: Achieving comparability among investment management firms' performance presentations requires uniformity in methods used to calculate returns. The GIPS standards mandate the use of certain calculation methodologies to facilitate comparability.

3 Composite Construction: A composite is an aggregation of one or more portfolios managed according to a similar investment mandate, objective, or strategy. The composite return is the asset-weighted average of the performance of all portfolios in the composite. Creating meaningful composites is essential to the fair presentation, consistency, and comparability of performance over time and among firms.

4 Disclosure: Disclosures allow firms to elaborate on the data provided in the presentation and give the reader the proper context in which to understand the performance. To comply with the GIPS standards, firms must disclose certain information in all compliant presentations regarding

their performance and the policies adopted by the firm. Although some disclosures are required for all firms, others are specific to certain circumstances and may not be applicable in all situations. One of the essential disclosures for every firm is the claim of compliance. Once a firm meets all the requirements of the GIPS standards, it must appropriately use the claim of compliance to indicate compliance with the GIPS standards. The 2010 edition of the GIPS standards includes a revised compliance statement that indicates if the firm has or has not been verified.

5 Presentation and Reporting: After constructing the composites, gathering the input data, calculating returns, and determining the necessary disclosures, the firm must incorporate this information in presentations based on the requirements in the GIPS standards for presenting investment performance. No finite set of requirements can cover all potential situations or anticipate future developments in investment industry structure, technology, products, or practices. When appropriate, firms have the responsibility to include in GIPS-compliant presentations information not addressed by the GIPS standards.

6 Real Estate: Unless otherwise noted, this section supplements all of the required and recommended provisions in Sections 0–5. Real estate provisions were first included in the 2005 edition of the GIPS standards and became effective 1 January 2006. The 2010 edition of the GIPS standards includes new provisions for closed-end real estate funds. Firms should note that certain provisions of Sections 0–5 do not apply to real estate investments or are superseded by provisions within Section 6. The provisions that do not apply have been noted within Section 6.

7 Private Equity: Unless otherwise noted, this section supplements all of the required and recommended provisions in Sections 0–5. Private equity provisions were first included in the 2005 edition of the GIPS standards and became effective 1 January 2006. Firms should note that certain provisions in Sections 0–5 do not apply to private equity investments or are superseded by provisions within Section 7. The provisions that do not apply have been noted within Section 7.

8 Wrap Fee/Separately Managed Account (SMA) Portfolios: Unless otherwise noted, this section supplements all of the required and recommended provisions in Sections 0–5. Firms should note that certain provisions in Sections 0–5 of the GIPS standards do not apply to wrap fee/SMA portfolios or are superseded by provisions within Section 8. The provisions that do not apply have been noted within Section 8.

0 Fundamentals of Compliance

Fundamentals of Compliance—Requirements

0.A.1 Firms must comply with all the requirements of the GIPS standards, including any updates, Guidance Statements, interpretations, Questions & Answers (Q&As), and clarifications published by CFA Institute and the GIPS Executive Committee, which are available on the GIPS standards website (www.gipsstandards.org) as well as in the GIPS Handbook.

0.A.2 Firms must comply with all applicable laws and regulations regarding the calculation and presentation of performance.

0.A.3 Firms must not present performance or performance-related information that is false or misleading.

0.A.4 The GIPS standards must be applied on a firm-wide basis.

0.A.5 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.

0.A.6 If the firm does not meet all the requirements of the GIPS standards, the firm must not represent or state that it is “in compliance with the Global Investment Performance Standards except for . . .” or make any other statements that may indicate partial compliance with the GIPS standards.

0.A.7 Statements referring to the calculation methodology as being “in accordance,” “in compliance,” or “consistent” with the Global Investment Performance Standards, or similar statements, are prohibited.

0.A.8 Statements referring to the performance of a single, existing client portfolio as being “calculated in accordance with the Global Investment Performance Standards” are prohibited, except when a GIPS-compliant firm reports the performance of an individual client’s portfolio to that client.

0.A.9 Firms must make every reasonable effort to provide a compliant presentation to all prospective clients. Firms must not choose to whom they present a compliant presentation. As long as a prospective client has received a compliant presentation within the previous 12 months, the firm has met this requirement.

0.A.10 Firms must provide a complete list of composite descriptions to any prospective client that makes such a request. Firms must include terminated composites on the firm's list of composite descriptions for at least five years after the composite termination date.

0.A.11 Firms must provide a compliant presentation for any composite listed on the firm's list of composite descriptions to any prospective client that makes such a request.

0.A.12 Firms must be defined as an investment firm, subsidiary, or division held out to clients or prospective clients as a distinct business entity.

0.A.13 For periods beginning on or after 1 January 2011, total firm assets must be the aggregate fair value of all discretionary and non-discretionary assets managed by the firm. This includes both fee-paying and non-fee-paying portfolios.

0.A.14 Total firm assets must include assets assigned to a sub-advisor provided the firm has discretion over the selection of the sub-advisor.

0.A.15 Changes in a firm's organization must not lead to alteration of historical composite performance.

0.A.16 When the firm jointly markets with other firms, the firm claiming compliance with the GIPS standards must be sure that it is clearly defined and separate relative to other firms being marketed, and that it is clear which firm is claiming compliance.

Fundamentals of Compliance—Recommendations

0.B.1 Firms should comply with the recommendations of the GIPS standards, including recommendations in any updates, Guidance Statements, interpretations, Questions & Answers (Q&As), and clarifications published by CFA Institute and the GIPS Executive Committee, which will be made available on the GIPS website (www.gipsstandards.org) as well as in the GIPS Handbook.

0.B.2 Firms should be verified.

0.B.3 Firms should adopt the broadest, most meaningful definition of the firm. The scope of this definition should include all geographical (country, regional, etc.) offices operating under the same brand name regardless of the actual name of the individual investment management company.

0.B.4 Firms should provide to each existing client, on an annual basis, a compliant presentation of the composite in which the client's portfolio is included.