



LEVEL 1: ETHICS

Reading 59 (4th out of 5): THE GIPS STANDARDS

Difficulty:

easy

Benchmark Study Time:

2h

2022

<https://soleadea.org/>





THIS E-BOOK:

- ❖ is a selective summary of the corresponding Reading in your CFA® Program Curriculum,
- ❖ provides place for your own notes,
- ❖ helps you structure your study and revision time!

How to use this e-book to maximize your knowledge retention:

1. **Print** the e-book in duplex and bind it to keep all important info for this Reading **in one place**.
2. **Read** this e-book, best twice, to grasp the idea of what this Reading is about.
3. **Study** the Reading from your curriculum. **Here add** your notes, examples, formulas, definitions, etc.
4. **Review** the Reading using this e-book, e.g., write your summary of key concepts or revise the formulas at the end of this e-book (if applicable).
5. **Done?** Go to [your study plan](#) and change the Reading's status to **green** :
(it will make your Chance-to-Pass-Score™ grow ☺).
6. **Come back** to this e-book from time to time to **regularly review for knowledge retention!**

NOTE: While studying or reviewing this Reading, you can use the tables at the end of this e-book and mark your study/review sessions to hold yourself accountable.



GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS)

Defining the GIPS standards

Global Investment Performance Standards (GIPS) = ethical principles for standardized calculation and presentation of investment performance set by CFA Institute and applied voluntarily by numerous firms, organizations, etc. all around the world.

Key features of GIPS:

WHAT IS THIS?

- ethical standards
- for asset managers/owners
- to be applied both company-wide and industry-wide
- **goals:** accurate investment performance measurement, fair representation, full disclosure
- govern the investment performance process: from data input to performance presentation
- include not only returns provisions but also risk provisions (as of 2010)

HOW IT WORKS:

- industry best practice established through requirements & recommendations
- use of composites required
- integrity of input data and specific calculation methodologies required
- compliance with all requirements demanded, incl. updates, interpretations, etc.
- requirements are just the minimum (for full compliance, adherence to recommendations may be also needed)

MORE DATA:

- set by CFA Institute
- governed by GIPS Executive Committee
- newest **edition: 2020**, effective as of **1 Jan 2020**
- partners in over 40 countries and regions around the world



HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, etc.



3 Chapters of the 2020 GIPS Edition

The newest 2020 edition of the GIPS standards distinguishes three different categories. It specifically differentiates between the principles established for firms and the principles established for asset owners. In the past, asset owners could be uncertain as to what extent the GIPS standards applied to them. Now, the new 2020 edition clearly identifies the principles to be followed by specific categories of investors.

Also, there's a separate set of rules for verifiers.

3 chapters of the 2020 GIPS edition:

- 1) GIPS Standards **for Firms** – to be followed by firms, organizations, etc. that compete for business and those asset owners that market their services
- 2) GIPS Standards **for Asset Owners** – to be followed by asset owners that do not market their services
- 3) GIPS Standards **for Verifiers** – to be followed by verifiers when conducting a verification or performance examination

CFA candidates are required to know parts of the Global Investment Performance Standards for Firms, including the Preface, the Introduction, and Section 3.A. (Composite and Pooled Fund Maintenance – Requirements).

You can find the complete version of the GIPS for Firms on CFA Institute's website:

<https://www.cfainstitute.org/en/ethics-standards/codes/gips-standards/firms>

<https://www.cfainstitute.org/-/media/documents/code/gips/2020-gips-standards-firms.ashx>

Also – to facilitate learning – you can **find the required reading summed up** on the following pages of this e-book.



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Why the GIPS were created

Companies often use different methodologies to measure their performance, which makes the comparison among companies impossible or difficult (even for companies which value ethics). Moreover, many companies may adopt different misleading practices, which hinders comparison and evaluation even more. All these difficulties can be handled as companies demonstrate a growing interest in the GIPS standards application.

Objectives:

- ▶ to instill investor confidence
- ▶ to standardize performance measurement practices
- ▶ to ensure accurate and consistent data and enable:
 - accurate and credible assessment of investment performance
 - easier comparison of investment performance among companies (based on the investment performance data)
- ▶ to promote fair, global competition (and avoid misleading practices such as representative accounts, survivorship bias, or varying time periods*)
- ▶ to promote industry self-regulation on a global basis

***representative accounts** = when a company selects its top-performing portfolio to show the company's performance

***survivorship bias** = when a company presents its average performance and excludes weak portfolios

***varying time periods** = when a company presents its performance only for a period of time when the returns were excellent

Who can claim compliance

- ▶ GIPS standards application is voluntary
- ▶ any **investment management company** that manages assets can become GIPS-compliant
- ▶ a company can comply either fully or not at all (no partial compliance claim nor reference to the GIPS standards for just some of the company's products or composites allowed)

NOTE: Only a company that manages assets can claim compliance once it meets all the requirements of the GIPS standards! (no software vendor or any consultant, though they can claim to endorse the standards).



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Who benefits from compliance

1. investment management company	2. investors/current and prospective clients
HOW?	
e.g.: - enhanced credibility (historical performance viewed as complete and fairly presented) - stronger performance-related procedures and internal controls	e.g.: - confidence in the integrity of analyzed data - easier comparison of different companies' performances

Thanks to the GIPS standards, companies avoid misrepresentations and communicate all relevant information. Owing to complete and fairly presented investment performance, greater investor confidence is just natural. Also, investors worldwide can compare investment performance among different companies (even from various countries).

Composites

composite = when all actual, discretionary, fee-paying portfolios managed according to a similar mandate, objective, or strategy (both currently and historically) are presented together

aim >> to endorse fair investment performance presentation and avoid selection or misrepresentation

requirement >> pre-established criteria for inclusion in the composite

The GIPS standards require that a company:

- ▶ creates and maintains composites for all strategies for which the company manages segregated accounts or markets to segregated accounts,
- ▶ includes all actual, fee-paying, discretionary segregated accounts in at least one composite defined by investment mandate, objective, or strategy (pooled funds must also be included in any composite for which the pooled fund meets the composite definition),
- ▶ maintains and shares information about all of the strategies the company manages using composites or pooled funds.



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Claim of compliance

The company is responsible for its claim of compliance and maintaining compliance with the GIPS standards. Thus, companies are strongly encouraged to perform **periodic internal compliance checks**.

When a company implements adequate internal controls during all stages of the investment performance process, i.e., from data input to preparing GIPS Composite Reports and GIPS Pooled Fund Reports (cf. below), it instills confidence both in the validity of performance presented and in the company's claim of compliance.

Verification

For better assurance of investors and the company's internal procedures improvement, it is best if the company has verification performed from time to time. Such verification must be carried out by an independent third party.

The purpose of verification is to see whether:

- ✦ the company's regulations are written to comply with the GIPS standards
- ✦ the company complies with all the requirements on composite construction on a company-wide basis

GIPS for Firms – structure

8 sections of the 2020 edition:

1. Fundamentals of Compliance	4. Composite Time-Weighted Return Report	7. Pooled Fund Money-Weighted Return Report
2. Input Data & Calculation Methodology	5. Composite Money-Weighted Return Report	8. GIPS Advertising Guidelines
3. Composite & Pooled Fund Maintenance (REQUIRED reading!)	6. Pooled Fund Time-Weighted Return Report	+ Glossary



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GIPS for Firms – sections description

8 sections of the 2020 edition:

1. Fundamentals of Compliance

important:

Core principles behind the GIPS standards:

- a proper definition of the firm,
- providing GIPS Reports to all prospective clients and prospective pooled fund investors,
- adherence to applicable laws and regulations,
- ensuring that information presented is not false or misleading.

According to the GIPS for Firms, the company should adopt the broadest definition, e.g., include all its geographical offices and their operation. Moreover, the company's definition of discretion is crucial to put the GIPS in place.

definition of the company = foundation of company-wide compliance, it should define the company's assets as broadly and accurately as possible

company's definition of discretion = criteria used for including portfolios in a particular composite, they should be based on the company's ability to implement its investment strategy

2. Input Data and Calculation Methodology

important:

Consistency of input data is key to accurate performance calculation and full, fair, and comparable performance presentation. Comparability among companies is possible if a uniform methodology is used to calculate returns. To facilitate comparability, the GIPS standards require the use of specific return calculation methods.



HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, etc.



3. Composite and Pooled Funds Maintenance

important:

Meaningful composite construction ensures fair presentation, consistency, and comparability of performance over time and among companies. Pooled funds must be included in composites if they meet a composite definition.

Remember that Section 3.A. is your OBLIGATORY READING! For more details, find it here:

<https://www.cfainstitute.org/-/media/documents/code/gips/2020-gips-standards-firms.ashx>

composite return = asset-weighted average of the performance of all portfolios on the composite

4-7. Reporting Sections:

- ▶ 4. Composite Time-Weighted Return Report
- ▶ 5. Composite Money -Weighted Return Report
- ▶ 6. Pooled Fund Time-Weighted Return Report
- ▶ 7. Pooled Fund Money-Weighted Return Report

important:

These are the 4 reporting sections that a company must follow depending on the type of report (composite vs pooled fund) and the type of return (time- vs money-weighted).

The company needs to construct the composites, gather the input data, calculate returns, and then create GIPS Reports based on the requirements in the GIPS standards for presenting investment performance. When applicable, companies need to include any important information even it is not specified in the GIPS.

Disclosure of performance and the policies used is obligatory. No negative assurance disclosure is needed (e.g., a company need not state that it does not use leverage). Also, the claim of compliance needs to be properly disclosed (a GIPS Compliance Notification Form needs to be submitted to CFA Institute when the company first claims compliance and then on an annual basis).

8. GIPS Advertising Guidelines

important:

GIPS-compliant companies need not follow the GIPS Advertising Guidelines when creating an advertisement. However, if a company would like to claim compliance with the GIPS standards in an advertisement, it must adhere to the GIPS Advertising Guidelines or include a GIPS Report.



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Requirements vs Recommendations

requirements = a company that wants to be GIPS-compliant must obey all of the GIPS requirements

recommendations = a company that wants to be GIPS-compliant is encouraged to follow the GIPS recommendations, which are considered industry best practices and help to maintain compliance

Historical performance record (requirements)

If a company wants to claim compliance with the GIPS standards:

- ✦ initially >> minimum 5 years of annual GIPS-compliant investment performance (or from the company's inception for companies existing for less than 5 years)
- ✦ then >> building up to minimum 10 years by presenting GIPS-compliant performance each consecutive year
- ✦ must link only to GIPS-compliant performance for periods after (i) 1 Jan 2006 for real estate, private equity composites, pooled funds, or wrapped fee composites; (ii) 1 Jan 2000 for other composites and pooled funds
- ✦ may link to non-compliant performance only if these periods were before 1 Jan 2000/2006 (must disclose periods of non-compliance)
- ✦ should perform periodic internal compliance checks

GIPS vs local regulations for performance reporting

where no existing laws >> countries/companies encouraged to comply with GIPS

where existing laws >> countries/companies encouraged to comply with GIPS
in addition to the existing laws

in case of conflict with local laws >> companies are required to abide by local regulations and fully disclose the conflict with the GIPS standards + English GIPS version is the official governing version in case of any discrepancies resulting from translation

local sponsoring organization (sponsor) = a local partner that acts as a link between the local markets in a country and the GIPS Executive Committee for the purpose of GIPS promotion and implementation



Sponsors:

- ▶ promote and implement GIPS as a global standard
- ▶ make sure that the country's interest is taken into account as the GIPS standards are developed
- ▶ provide local support and input for the GIPS standards
- ▶ present local issues to the GIPS Executive Committee
- ▶ participate in the governance of the GIPS standards

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Summarizing key concepts:

☐ Defining the GIPS standards

My summary:

☐ Why the GIPS were created

My summary:

☐ Who can claim compliance

My summary:

☐ Who benefits from compliance

My summary:

☐ Composites

My summary:



☐ Claim of compliance

My summary:

☐ Verification

My summary:

☐ GIPS for Firms – sections & their short description

My summary:

☐ Requirements vs Recommendations

My summary:

☐ GIPS vs local regulations for performance reporting

My summary:



Keeping myself accountable:

TABLE 1 | STUDY

When you sit down to study, you may want to **try the Pomodoro Technique** to handle your study sessions: study for 25 minutes, then take a 5-minute break. Repeat this 25+5 study-break sequence all throughout your daily study session.



Tick off as you proceed.

POMODORO TIMETABLE: study-break sequences (25' + 5')													
date		date		date		date		date		date		date	
25'		25'		25'		25'		25'		25'		25'	
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25'		25'		25'		25'		25'		25'		25'	
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TABLE 2 | REVIEW

Never ever neglect revision! Though it's not the most popular thing among CFA candidates, regular revision is what makes the difference. If you want to pass your exam, **schedule & do your review sessions**.

REVIEW TIMETABLE: When did I review this Reading?													
date		date		date		date		date		date		date	
date		date		date		date		date		date		date	