

# Get to grips with GIPS

Brian Henderson explains how Global Investment Performance Standards are transforming the industry, and David Gould examines the UK's role in the formation of GIPS

It has often been said that past performance cannot be bought, yet performance statistics still feature highly in most quantitative assessments of asset managers during the selection process. An evaluation of managers usually combines an analysis of questionnaire responses but may also draw on a consultant's proprietary manager research programme or ongoing experience of managers. But with the latest version of the Global Investment Performance Standards, funds will have the potential to be judged in a far more balanced way.

Many of the distinctions that can be drawn between fund managers are based on subjective judgement. In an attempt to provide quantitative analysis, managers are typically scored on a range of criteria.

When considering the strengths and weaknesses of any particular manager, it is common practice to focus on the three Ps: philosophy, people and process. Past performance usually results from a combination of each manager's application of the three Ps, prevailing market conditions and a random element (noise or luck).

It is not unusual for past performance to be given a modest weighting when considering a new manager appointment. Whilst underperformance after a manager has been appointed clearly focuses the mind, and probably merits a larger percentage weighting, it can generally be tolerated if the three Ps remain strong. After all, there is plenty of evidence to suggest that even the best managers can experience disappointment every now and again.

It is future rather than past performance that is sought. If only it was that easy to achieve. There is now a standard that at least removes some of the uncertainty in the decision making process; unfortunately the same cannot be said for the future.

## Background

In February, the CFA Institute released the latest version of the Global Investment Performance Standards (GIPS). The new version contained the

previous values of fair presentation and full disclosure, but what made most investment firms in the US and Canada sit up and pay attention was that GIPS will replace the AIMR Performance Presentation Standards (AIMR-PPS) on January 1, 2006. However, it would be wrong to view this initiative from a purely North American perspective.

GIPS goes back to 1995 and after a decade of activity, the results are outstanding:

- 27 countries in North America, Europe, Africa and the Asia Pacific have adopted GIPS
- A survey by PricewaterhouseCoopers found that 90% of their sample of asset managers were either compliant or actively working to become compliant
- GIPS is now the recognised performance standard around the world.

By choosing to comply with GIPS, investment managers assure clients that historical performance track records are both complete and fairly presented. Additionally, because the standards are global, investors around the world receive the requisite transparency to compare managers on a like for like basis across countries. It is this passporting of performance records that is one of the key attractions of GIPS.

As key influencers in the investment manager decision making process, consultants also have much to benefit from a single investment performance standard.

## Overview of GIPS

The standards are based on an ethical rather than a regulatory approach. This is designed to accomplish a level playing field and to ensure fair comparisons between firms.

They are divided into five sections: input data, calculation methodology, composite construction, disclosures and presentation and reporting. Firms must meet all the requirements set out in the standards in order to claim compliance. They are encouraged to perform periodic internal checks to ensure the validity of compliance claims. Fundamentally, this means managers must to adhere to the following:

- Compliance only on a firm-wide basis, not



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**GIPS allows investment managers around the world to transport results to other countries**

product or composite

- Total firm assets must include both discretionary and nondiscretionary assets under management
- Firms must document all policies and procedures used to establish and maintain compliance
- Firms must provide a list and description of composites to any prospective client making such a request and provide a compliant presentation for any composite listed
- Firms must make every reasonable effort to provide compliant presentations to all prospective clients.

The standards embrace a firm-wide approach. To avoid cherry-picking, results of similar portfolios are built into so-called ‘composites’ and to avoid distortion and misrepresentation, annual results are presented. Firms must include all actual, fee-paying, discretionary portfolios in composites and show a minimum of five years of annual performance history, or history since fund inception.

Certain calculation and presentation methods must be used in addition to requiring certain disclosures along with the performance record. Model, simulated, or back-tested results are not permitted. The standards also rely on the

integrity of input data, which is critical to the accuracy of the performance presentation.

It is vital that firms adhere to the goal of full disclosure and fair representation of investment performance.

**The road to GIPS**

The need for a common, accepted set of guidelines for the calculation and presentation of investment performance to prospective clients originally led the Association for Investment Management and Research (AIMR), the predecessor of the CFA Institute, to develop the AIMR Performance Presentation Standards (AIMR-PPS) in the late 1980s. The AIMR-PPS standards are the manifestation of two fundamental ethical principles: fair representation and full disclosure.

In 1991, AIMR formally adopted the AIMR-PPS standards to serve as an industry yardstick for evaluating fairness and accuracy in investment performance presentation.

By the mid-1990s, investment consultants and potential clients began to exclude from their competitive bids any investment-management firm that did not report their historical results in compliance with the AIMR-PPS standards.

Today, industry surveys indicate that nearly 80% of US investment firms and 65% of Canadian firms comply with the AIMR-PPS standards.

In 1995, AIMR began to address the need for one globally accepted set of performance standards.

In February 1999, the CFA Institute Board of Governors formally endorsed the Global Investment Performance Standards (GIPS) as the worldwide standard for calculating and reporting investment performance (see [www.cfainstitute.org/standards/pdf/gips.pdf](http://www.cfainstitute.org/standards/pdf/gips.pdf)).

The introduction of GIPS has allowed investment managers around the world to ‘transport’ their historical investment results to many other countries without having to restate them using different calculation and presentation rules.

The revised GIPS incorporate many of the best practices already followed by many North American firms and should simplify the compliance process; not to mention removing some of the confusion concerning multiple standards in that marketplace. On closer inspection, there are relatively few major differences between AIMR-PPS and GIPS and those that do exist will be mapped out in some detail over the coming months to AIMR-PPS compliant firms. In reality, the biggest difference between the two is the change in name.



### Benefits of compliance

GIPS broadly benefit three main groups: prospective or existing investors, those who advise on manager selection and those whose job it is to manage the money.

Clients have a greater level of confidence in the integrity of performance presentations as well as the general practices of a compliant firm. They can also more easily compare performance across different firms.

From a consultant's perspective, while GIPS do not replace the need for other due diligence, compliance with the standards provides a level of credibility to the performance results of those firms that have chosen to undertake this responsibility.

By choosing to comply with the GIPS, investment management firms assure prospective clients that the historical track record they report is both complete and fairly presented. Compliance enables the GIPS-compliant firm to participate in competitive bids against other compliant firms throughout the world.

### Back to the future?

So, if past performance is at best an inaccurate guide to the future, why should we embrace GIPS, a global standard devoted entirely to performance? In true consultant speak, 'the answer depends on your attitude to risk'. Can you afford to run the risk of appointing of a manager who does not believe in conforming to highest industry standards of integrity and best practice?

Equally, if you cannot compare historic investment performance accurately, how can you say with any degree of confidence the three Ps will deliver the desired outcome? Furthermore, with the introduction of GIPS there is now a worldwide standard for ensuring the process is accurate and consistent.

This has to be of benefit to those of us who seek to make a living out of identifying managers who, on balance, are likely to deliver the required performance. Sometimes, even a quick look in the rear view mirror can give a valuable insight into what lies ahead.

## The history of GIPS

The UK's input into GIPS can be traced back to 1989, writes David Gould of the National Association of Pension Funds (NAPF). Then, in response to apparent market abuse, NAPF's Investment Committee commissioned an independent study into performance measurement. Its terms of reference were 'to examine the manner in which investment performance measurement is constructed, presented and used'.

The Committee of Enquiry's report into was issued in December 1990 and said: 'The NAPF Investment Committee should establish a working party to agree standards for a voluntary code of practice in advertising.'

### First steps

In 1992 the NAPF Monitoring Group issued a standardised code for the presentation of performance data for UK discretionary balanced pension fund accounts. This was followed in 1996 by the issue of a second voluntary standard for the presentation of track records for specialist accounts, as well as a revised version of the code for balanced funds.

To respond to the globalisation of investment markets the Monitoring Group began in 1996 to work with the US standard-setters (now the CFA Institute) and the European Federation of Financial Analysts Societies (EFFAS) to develop the concept of a single Global Investment Performance Standard (GIPS). During 1997 the NAPF Investment Committee and the Monitoring Group agreed that, if GIPS could be delivered, the UK would relinquish its own investment performance standard. To this end the UK provided much of the thought leadership that went into shaping GIPS.

GIPS was issued in 1999 and only in one area was there a gap. The UK Monitoring Group took the view that the high standards in the NAPF Codes should not be lost in the convergence process. As a result the UK adopted a sort of GIPS plus code – GIPS plus mandatory verification. The UK version, known as the UK Investment Performance Standard (UKIPS) was adopted at the NAPF Investment Conference in March 2000. UKIPS was subsequently recognised as a Country Version of GIPS with the NAPF being the country sponsor. ■

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*A full review of the standards is available at [www.cfainstitute.org/cfacentre/lips/](http://www.cfainstitute.org/cfacentre/lips/)*

UKSIP is running a half day seminar on Monday November 14 on performance measurement.

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