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## **An Opportunity to Improve Investment Performance**

By Matt Price, Ernst & Young

The Global Investment Performance Standards (GIPS®) have provided traditional managers with a framework for presenting investment returns in a fair and consistent manner, underpinned by strong controls over the production and reporting process. This framework has much to offer alternative asset managers wishing to compete effectively in an increasingly competitive market for new business while strengthening internal controls.

There has been significant adoption of GIPS by institutional asset managers since the Standards were launched in 1999. In 2002, the accounting firm PWC reported that of 500 global asset managers surveyed, 95% of respondents confirmed they were either compliant with at least one performance presentation standard (a Country Version of GIPS) or were looking to become so in the near future.

In 2004, the Investment Management Association (IMA) reported in their 2003 survey of the UK asset management industry that over 50% of respondents were GIPS compliant. This masks a much higher rate of adoption however, since the population included insurance companies and retail asset managers for whom GIPS is considered less relevant. The statistics demonstrate that with the support of investment consultants, GIPS has been embedded into the tender process for major new institutional business searches.

At present, there has been only limited adoption by alternative asset managers, which is owed in part to a lack of communication about the Standards themselves and the benefits of GIPS compliance. AIMA has taken an active role in attempting to address this issue as it relates to hedge funds, through an earlier article on GIPS in this Journal written by the CFA Institute, the sponsor of the Standards. Since then, AIMA has furthered its involvement through a seat on the UK Investment Performance Committee (UKIPC). At this time, there are no plans by the CFA Institute to create hedge fund GIPS.

The UKIPC is a cross-industry Committee sponsored by the National Association of Pension Funds (NAPF) that has taken a prominent role in the development of GIPS. The Committee provides regular and valuable feedback to the Investment Performance Council (IPC), the organisation responsible for setting the Standards. Recently the UKIPC has been engaged in supporting the development of Gold GIPS, a revised version of the 1999 GIPS to be effective from 1 January 2006.

GIPS are performance presentation standards, but they set out a framework of best practice that stretches back from the actual form and content of what is presented to the production and generation of the performance returns themselves, delivering a consistent approach to important variables such as the supporting disclosures to performance presentations, the calculation methodology and input data.

Asset managers seeking to comply with GIPS must design and implement procedures at entity (referred to as 'Firm') level to ensure that portfolio accounting data is prepared and transformed into investment returns and then reported in accordance with the provisions of the Standards. This process is then reviewed and approved by an independent third party known as a verifier. Verification, which is mandatory in the UK, adds essential credibility to a Firm's claim of compliance with the Standards.

GIPS compliance therefore delivers benefits on two levels. First, in achieving and maintaining compliance, the Firm's internal control framework is strengthened through increased formalisation of procedures linking the various operational and client facing teams - from portfolio accounting through to marketing. The creation of such an infrastructure can be particularly important for growing organisations, providing a sound operational platform to absorb new products. Second, and perhaps more importantly, a Firm's claim of compliance can be marketed as a competitive advantage or (depending on the level of adoption by rival Firms) to avoid a competitive disadvantage.

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While the most important factor in any tender process should rightly be the ability of the investment process to generate returns that satisfy the investor's objectives, competition in this area is often very tight, with the implication that less fundamental distinctions and differences do matter.

The widespread adoption of GIPS within the institutional segment can also be attributed to the fact that the principles underlying GIPS were devised to address the inconsistent manner and, in some cases, unreasonable assumptions being used to present institutional portfolio returns. However, it is an aim of the IPC to broaden the sphere of adoption beyond the institutional marketplace, an initiative which the UKIPC and AIMA strongly support.

There are two obstacles to achieving this where alternative asset managers are concerned. First, there is the question of the relevance and sufficiency of the provisions themselves, and second, whether there is sufficient knowledge of the Standards on the part of private clients and their advisors to embed GIPS compliance into the tender process.

The Standard setting process itself empowers the IPC to address the first issue. The core principles of GIPS remain set in stone, but they continue to be supplemented by Guidance Statements (setting out in more detail best practice on a specific area within the Standards) and added to through sector specific provisions, which have been released for Real Estate and Private Equity. For hedge funds specifically, the Guidance Statement on the Use of Leverage and Derivatives seeks to establish best practice for specific disclosures and risk reporting in order to fairly present the returns from more complex investment products within the presentation and disclosure framework set out in GIPS.

Educating the clients of alternative asset managers about GIPS is much more difficult without the coordinating infrastructure from which institutional clients benefit. That said, asset managers are experiencing an increasing demand from private clients for performance data to be "audited" and GIPS compliance allows alternative asset managers to comply with the substance of this request. Alternative asset managers should therefore (assuming they have readily accessible accounting and client correspondence records for portfolios managed) view GIPS compliance as a cost effective opportunity to improve client service and internal controls.

While some alternative asset managers are adopting GIPS to help them compete on equal terms with institutional managers and in response to their more direct competitors doing so, the Standards exist to serve the needs of clients and it is they who, over time, are most likely to make GIPS compliance a 'must have' for alternative asset managers.