

INVESTMENT PERFORMANCE COUNCIL ADOPTION OF THE GUIDANCE STATEMENT ON THE DEFINITION OF THE FIRM

SUMMARY: In October 2001, the Association for Investment Management and Research (AIMR[®]) released for public comment the proposed Guidance Statement on the Definition of the Firm.

The Guidance Statement on the Definition of the Firm provides clarification for the Global Investment Performance Standards (GIPS[®]) relating to how the firm is defined for purposes of claiming compliance with the Standards.

ADDITIONAL INFORMATION: For further information on this Guidance Statement and the GIPS standards, contact AIMR's Professional Standards and Advocacy department via facsimile at 434-951-5320, via e-mail at gips-info@aimr.org, or at 560 Ray C. Hunt Drive, P.O. Box 3668, Charlottesville, VA 22903-3668.

I. PURPOSE OF GUIDANCE STATEMENTS

Guidance Statements are developed to respond to questions that raise new and novel issues that fall beyond the scope of the simple application of the Standards and/or require additional interpretation and clarification. They incorporate all of the applicable existing interpretations that have been published on a subject in an effort to consolidate all related information and add clarification.

II. SUMMARY OF COMMENTS

In general, most of the comments received during the public comment period were in support of the objectives of the Guidance Statement. Below is a summary of the comments received along with the changes generated by the comments. The firm or individual making each comment is indicated using the following abbreviations:

ANON:	Anonymous
CAPS:	Karyn Vincent, CFA; CAPS, Inc.
HSBC:	David Flint; HSBC Global Fund Services Limited
NSFA:	The Norwegian Society of Financial Analysts
PWC:	Kelvin Laing-Willaims and Peter McNamara; PricewaterhouseCoopers
SAAJ:	The Security Analysts Association of Japan
SBA:	The Swiss Bankers Association
UBS:	Paul Weller; UBS Asset Management

1. Comments on Guiding Principles

The original proposal included several Guiding Principles that govern how all firms must be defined.

Comment: The fifth Guiding Principle states, “When jointly marketing with other firms, the firm must disclose that a definition of each firm and a list of composites for each firm are available upon request.” As written, this principle seems to suggest that a non-compliant firm could jointly market with a compliant firm, and benefit from the compliant firm’s claim of compliance. We believe that this practice would contradict the purpose of requiring firmwide compliance. We believe that joint marketing efforts should be limited to jointly owned compliant firms. If one of the firms is not compliant, the joint marketing efforts should include no mention of compliance with the Standards. (CAPS)

Comment: We cannot understand what cases are assumed under the fifth Guiding Principle and for what purposes. Please give more explanation with respect to this point in the Guidance Statement. (SAAJ)

When firms are jointly marketed with other firms (particularly when there are multiple firms within a parent organization), the firm claiming compliance must be sure that it is clearly defined and separate relative to any other firms being marketed and that it is clear which firm is claiming compliance. For example, some firms outsource their marketing function to a third party who markets the firm’s performance along side other firms.

Revision: ***Clarified Guiding Principle regarding jointly marketed firms.***

Comment: The sixth Guiding Principle states, “If a parent company contains multiple defined firms, each firm within the parent company is strongly encouraged to disclose a list of the other firms contained within the parent company.” We agree with this principle, and believe that the comment should be strengthened. If a firm has defined itself as a “portion” of a larger entity, the firm should take the necessary steps to ensure the definition of the firm is explicitly disclosed. Requiring a disclosure of other parent company “firms” would help a reader understand exactly how the “firm” is defined. (CAPS)

Comment: Please give more explanation with respect to the sixth Guiding Principle. (SAAJ)

Many large firms contain within them multiple firms defined according to the Standards for compliance purposes. In order for prospective clients to clearly understand how the firm is defined, it is recommended that firms disclose any other defined firm within the same parent company. While this disclosure is being introduced as a recommendation through this Guidance Statement, it may be upgraded to a requirement at some point in the future.

Revision: *None.*

Comment: The Guidance states that “If a firm manages fee paying, discretionary assets but the performance measurement or record-keeping function is performed by another entity (e.g., custodian, broker/dealer, etc.), the firm must still include these assets in its definition of the firm and must include these portfolios in at least one of the firm’s composites.” As there could be other valid reasons for characterizing these assets as non-discretionary, we suggest that the above wording be revised to indicate that the performance of record-keeping by another party is not a valid reason to support the characterization of the product as non-discretionary or excluded from the definition of the firm. (PWC)

Comment: The last two points of the Guiding Principles (addressing the use of third party performance measurement and systems incompatibilities) will present issues to some firms attempting to attain compliance. The UKIPC believes that the basis for these principles is sound but that more guidance is required. For example, should data obtained from other entities or systems be prepared inconsistently with other data, the statement should offer guidance as to when data should be recalculated and what disclosures are required. (UKIPC)

A firm that claims compliance must ensure that all of the requirements of the Standards have been met. If the firm relies on information provided from another source, it must take the necessary steps to ensure that the information is calculated and provided according to the Standards. However, third party record-keeping or performance measurement is not a valid reason to classify assets as non-discretionary. Because the firm makes the decision to outsource the record keeping and/or performance measurement function, it must assume responsibility for that decision and include those assets within the definition of the firm. As the issue of firm definition and discretion are inter-related, firms should also review the clarification regarding determining discretion in the Guidance Statement on Composite Definition.

Revision: *Clarified relationship with third party record-keepers and performance measurers.*

2. Comments on Firm Definition Criteria

The original proposal included guidance addressing each of the three possible ways in which a firm may be defined.

Comment: With regard to the option for defining the firm according to Regulator Registration, the draft Guidance Statement states, “Thus it is straightforward and relatively unambiguous for a firm to define itself as the entity registered with the appropriate national regulatory authority overseeing the entity’s investment management activities.” We believe that the regulatory structure of many investment management firms is often much more complicated than would be obvious. Leaving the interpretive

language as is might allow firms to define themselves as a portion of the legal entity, but one that does not operate as a distinct business unit. We suggest the wording be changed to specifically prevent a firm from using this legal entity definition of the firm if they do not meet the tests for Criteria B as a distinct business unit. (CAPS)

Comment: It is unclear in the draft what happens after 2005 for those firms defining themselves by base currency. There is a possibility that the firm could be redefined at that point along the more favorable of the two other criteria.

From 2005 there should be no distinction made on the basis of regulatory registration but rather that a single, more prescriptive definition similar to criteria b should become the only criteria for firm definition. (UKIPC)

The GIPS standards currently allow firms to define themselves according to how they are registered with a local regulator. In most cases, defining the firm according to how it is held out to the public is consistent with the most meaningful definition of the firm. As this issue deals with the interpretation and clarification of an existing GIPS provision, this comment will be passed to the Investment Performance Council for consideration as part of the further evolution of the GIPS standards.

Revision: None.

Comment: The Guidance Statement on Definition of Firm states: “The firm must be a distinct entity with its own distinct investment process.”

This guiding principle should be removed as it contradicts the option of a firm being held out as a separate entity if it has a distinct market or client type and will prohibit and/or discourage many firms from becoming compliant.

Many firms have already achieved compliance for some of their business units that have a distinct market (e.g., Europe, North America, institutional, retail, etc.). However, these entities do not always have an autonomous investment process as it is shared between the different firms.

This guiding principle introduces an impractical and unnecessary complication into the current Firm Definition that if applied would involve many asset managers in expensive re-work and may cause a lack of confidence in the standards going forward. (HSBC)

The Investment Performance Council agrees that the Guiding Principle should be removed and will be considered for the future evolution of the GIPS standards.

Revision: Removed Guiding Principle.

Comment:

While I understand the goal of the Statement is to make sure that there is substance behind firms that hold themselves out to the public, I am concerned that the wording used to define the distinct business unit is too restrictive as to effectively reduce the ability of asset managers to continue to define themselves as a firm in an historical context.

I believe it would be better to leave more judgment to the managers in describing and utilizing the definition of a firm. As an alternative, I would remove the statement that "if a firm holds itself out as a separate entity yet does not maintain its own autonomous investment process, it cannot be defined as a firm." I also suggest a change to the paragraph "B. Defined according to Distinct Business Entity held out to the public" to include historical firm definition, management structure, compensation structure, physical location of the business, investment process, and research groups. (Anonymous)

Comment: *One of the possible criteria suggested to determine if the firm is a distinct business entity held out to the public included "using a separate and distinct research process". We would suggest rephrasing this to "using a separate and distinct investment management and decision-making process which may include such functions as research" because limiting this only to research may not be practical as some firms outsource research to a certain extent from third parties while still managing assets at their own discretion. (PWC, SBA)*

Comment: *The statement "if a firm holds itself out as a separate entity yet does not maintain its own autonomous investment process, it cannot be defined as a firm" is rather obscure. We suggest deleting the sentence for the following reason: the Standards do not provide a clear definition of the term "investment process", which leaves it prone to interpretation. Furthermore, the definition may not be applicable to multinational firms. (SBA)*

As noted in these comments, the research functions can be shared or outsourced and is not necessarily a critical element of the firm definition. The Investment Performance Council agrees that the research function should not be the sole defining element of the firm. Investment discretion is a critical component and the firm must maintain discretionary management of the assets.

Revision: ***Removed recommendation for the use of a separate and distinct research process.***

Comment: *We consider the guidance that "firms are strongly encouraged to adopt the broadest possible definition of the firm" and that the scope of this definition should include "all geographic offices (country, regional, etc.) operating under the same parent company..." as difficult to implement. While agreeing with this proposition in general, we believe that it is not feasible for globally-operating multinational companies in many cases. In particular, the need to include all geographic locations of the entity into one firm may slow down or even hamper the process of implementation of the Standards (the first entities to be compliant will have to wait for the others becoming compliant). (SBA, HSBC, UKIPC)*

Comment: We believe the draft wording should be revised to indicate that firms should adopt the most meaningful definition in the spirit of the Standards. Often, this involves judgment as to how best define the firm. In those gray situations, firms are encouraged to adopt the broadest sensible definition instead of just adopting another acceptable smaller definition simply because it would require less work for the firm and let the firm come into compliance with the Standards more quickly. (PWC)

The Guidance Statement does not require firms to define themselves as broadly as possible, but instead recommends a broad application. It is recognized that due to practical limitations, it may be more reasonable for some entities to define themselves in smaller firms to achieve compliance. It is expected, however, that as the smaller firms come into compliance that they will, at some point, redefine the larger entity as one firm. The goal should be for firms to define themselves as broadly as possible while determining the most meaningful definition within the spirit of the Standards.

Revision: ***Modified wording to encourage the broadest, most meaningful definition.***

Comment: We suggest that the option to define the firm according to base currency be removed from the Standards with immediate effect for the following reasons:

The use of a base currency for the definition of a firm is not in line with the philosophy of the Standards (e.g. broadest definition of a firm). The base currency is not a more decisive factor for a firm definition than, for example, a standard investment product or a strategy. However, the Standards do not provide an option to define a firm on the basis of standard investment products. We believe that a base currency as a criterion for the definition of a firm creates room for ambiguity and cherry-picking. (SBA)

As indicated, this provision will no longer be valid after 1 January 2005. This provision is included in the current edition of the GIPS standards and will not be changed via this Guidance Statement. It is expected that firms will be required to redefine themselves as of 1 January 2005 if they are currently defined according to base currency. For this reason, firms are strongly encouraged not to use base currency as a basis for defining the firm.

Revision: ***None.***

Comment: The Statement that “changes in investment style or personnel are not valid reasons for re-defining the firm” should be clarified. A change in investment style or the investment team may well be as significant as if a new firm had been created. This aspect is closely related to the problem of inception of the firm. (SBA)

The Investment Performance Council acknowledges that changes in style or personnel could be significant enough to change the way that the firm is held out to the public. The changes must be significant enough that the firm is actually held out to the public differently.

Revision: *Clarified wording regarding redefining the firm.*

3. Comments on Total Firm Assets and Sub-Advisors

Comment: *Please address how to calculate total firm assets and specify which assets should not be included in the definition of the firm. In addition, please clarify the role of sub-advisors and specify if and when a portfolio may be included in the performance and assets of multiple firms. (NSAF, SAAJ)*

Total firm assets equal the market value of all discretionary and non-discretionary assets under management within the defined firm. Assets to which the Standards cannot be applied are not to be considered by firms when claiming compliance and are not to be included in total firm assets. Such assets include investment vehicles that are based on cost or book values rather than market values.

Firms that utilize sub-advisor relationships must include all assets assigned to a sub-advisor, provided the firm has discretion over the selection of the sub-advisor.

If a firm has discretion over the selection of the sub-advisor (i.e., can hire and/or fire), the firm can claim the sub-advisor's performance as part of its performance history. Because the sub-advisor has discretion over the actual investment of the assets and the firm has discretion over the selection of the sub-advisor, both the firm and the sub-advisor are able to claim the performance of the assets as their own. The firm is able to claim this performance because the sub-advisor is essentially viewed as an asset (similar to purchasing a mutual fund within the portfolio).

If a firm does not have discretion over sub-advisor selection and the amount of assets allocated to the sub-advisor, it must not include the sub-advisor's performance in its performance history.

Revision: *Added definition of Total Firm Assets and added section on Sub-Advisors and how they relate to the defined firm.*

Comment: *The final version should refer to the Guidance Statement on Performance Record Portability in the beginning of the Guidance Statement on Definition of the Firm, and not at the end because the Guidance Statement on Performance Record Portability is vital when defining the current firm. (NSFA)*

Revision: *Added additional reference to the Guidance Statement on Performance Record Portability.*

4. Comments on the Inception of a Firm

Comment: The Standards should address another fundamental issue: the inception of a firm. The current Standards do not provide clear criteria for the definition of the inception date of a firm. The guidance should address how to determine an inception date for firms that retroactively claim compliance, that have undergone corporate restructuring, or have achieved compliance regionally and are now attempting to achieve global compliance. (SBA, PWC, UBS)

The firm inception is typically the date at which the entity begins to manage assets. In some cases, changes within the firm may be significant enough to justify the redefinition of the firm as it is actually held out to the public differently. In cases of restructuring due to mergers and acquisitions, the firm must determine if there is one clear surviving firm or whether the restructuring results in a new firm (see Guidance Statement on Performance Record Portability).

***Revision:** Added additional guidance regarding the inception date of the firm.*

5. Comments on Proposed Effective Date

Comment: More specific guidance is necessary regarding the applicability of the guidance (e.g., if existing firms are to be grand-fathered). (PWC)

Comment: Requiring organisations to have the broadest firm definition from 1 April 2002, as stated in the guidance statement, will be difficult (and costly) to achieve and will involve many organisations revisiting their current firm definitions. Equally important, some organisations are in the middle of compliance projects to bring firms into compliance on a regional or market type basis. In both situations firms will not be compliant with GIPS from 1 April 2002 and organisations will have wasted a considerable amount of time, effort and money. (HSBC)

Comment: We recommend a 1 April 2002 effective date. (NSFA)

Comment: We recommend a 1 January 2003 effective date. (SAAJ, SBA, UKIPC)

Comment: The proposed implementation date for this far-reaching guidance note is too short, especially given the considerable amount of GIPS material that was issued in the last part of this year. I would therefore recommend a 12-month period before it becomes effective (UBS)

As this Guidance Statement simply clarifies the existing GIPS Standards relating to defining the firm and applies to all firms retroactively from the effective date, 1 April 2002. Firms whose definition conflicts with this guidance have until 1 April 2003 to redefine themselves and must do so historically.

***Revision:** Clarified Effective Date and application of the Guidance Statement.*

III. Guidance Statement on Definition of the Firm

Adoption Date: 13 March 2002

Effective Date: 1 April 2002

Retroactive Application: Yes

INVESTMENT PERFORMANCE COUNCIL (IPC)

Guidance Statement on Definition of Firm

Introduction

Three of the most fundamental issues that a firm must consider when becoming compliant with the GIPS® standards are the definition of the firm, the firm's definition of discretion, and the firm's composite definition principles and guidelines. 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 should be in a composite to accurately reflect the application of the firm's investment strategy. Once the firm and discretion have been defined, composites can be constructed based on the strategies implemented by the firm.

The GIPS standards must be applied on a firm-wide basis. Compliance and verification with the GIPS standards rely on a clear, consistent, and fair definition of the firm. It is the responsibility of the firm to define itself for purposes of complying with the Standards. The GIPS standards clearly state in Section I.12 the three criteria a firm can use to define itself for purposes of claiming compliance with the Standards. Specifically, a firm may define itself as:

- a. an entity registered with the appropriate national regulatory authority overseeing the entity's investment management activities; or
- b. an investment firm, subsidiary, or division held out to clients or potential clients as a distinct business unit (e.g., a subsidiary firm or distinct business unit managing private client assets may claim compliance for itself without its parent organization being in compliance);
- c. (until January 1, 2005), all assets managed to one or more base currencies (for firms managing global assets).

As the first step in compliance, it is the firm's responsibility to ensure that it is fairly and appropriately defined. The GIPS standards require that firms disclose the definition of the firm that is used to determine firmwide compliance and total firm assets. In addition, the verification principles require that verifiers determine if the firm is, and has been, appropriately defined.

Fundamental to the Standards is the premise that all fee-paying discretionary portfolios of a firm be included in one or more composites. The definition of the firm delineates the universe of "all" portfolios that must be included in total firm assets under management.

As merger and acquisition activity can affect the definition of the firm, firms should also refer to the Guidance Statement on Performance Record Portability.

Guiding Principles

When defining the firm, it is important to consider the following:

- The firm definition must be meaningful, rational, and fair.
- It is recommended that firms adopt the broadest, most meaningful definition of the firm.
- Firms must not use the definition of the firm as a substitute for defining composites, (e.g., defining the firm too narrowly, as to only encompass one product).

Criteria

As stated above the Standards require a firm to define itself by one of three criteria. They are:

- A. if it registers with an appropriate national regulatory authority,
- B. by the way it holds itself out to clients or potential clients as a distinct business unit,
or
- C. by the assets it manages in one or more base currencies.

A firm must comply with all of the required provisions of the GIPS standards to claim compliance with the GIPS standards.

- Defined according to Regulator Registration.** Investment management firms in most countries have to register with one or more governmental agencies or regulators. The GIPS standards recognize a regulatory registration as an appropriate definition of a firm for purposes of compliance, but also recommend that firms consider the manner in which they are holding themselves out to the public when determining the firm (see point B. below).
- Defined according to Distinct Business Entity held out to the Public.** A distinct business entity is a unit, division, department, or office that is organizationally and functionally segregated from other units, divisions, departments, or offices, retains discretion over the assets it manages and should have autonomy over the investment decision-making process.

A business entity should be separate, distinct and held out to the public as a separate firm. Possible criteria for determining these points include, but are not limited to:

- being a legal entity
- having a distinct market or client type (e.g., institutional, retail, private client, etc.)
- using a separate and distinct investment process

These criteria can only be applied in light of the Guiding Principles as well as being a separate and distinct business entity held out to the public as a separate firm.

It is recommended that firms adopt the broadest, most meaningful definition of the firm and consider how it is viewed by the public. The scope of this definition should include all geographic (country, regional, etc.) offices operating under the same parent company regardless of the actual names of the individual investment management companies. These include, but are not limited to:

- All offices operating under the same trading name (e.g. XYZ Asset Management)

- Financial service holding companies defined as one global firm with multiple brands, several legal entities, multiple offices, investment teams, and investment strategies.
- An investment management firm with one brand, but multiple strategies and investment teams.
- All offices trading under a globally recognizable trading name with regional/country specific additions (e.g. XYZ Asset Management Asia).
- Other names resulting from mergers, acquisitions, etc., trading under a different name for branding purposes.

C. Defined according to Base Currency. Until January 1, 2005, a firm may define itself based upon the currency the assets of the entity are managed to, meaning the currency of the client's assets or the clients preferred currency. For firm entities defined as such, all assets managed to the selected base currency in fee-paying discretionary accounts must be included and presented in composites that meet compliance requirements.

Base Currency refers to the currency in which the client has specified the portfolio should be managed. It is the currency that is used to determine the portfolio's valuation and is not necessarily the local currency of the investor. For example, a company that is domiciled in the U.S. may incur liabilities denominated in Japanese yen and, therefore, may request that an account be managed with a base currency of Yen.

After 1 January 2005, firm will no longer be able to be defined by base currency. Accordingly, as of 1 January 2005, any firm that is defined by base currency will be required to be redefined according to one of the other acceptable definitions.

Additional Considerations

In addition to the Guiding Principles listed above, firms should consider the following when defining the firm:

- When jointly marketing with other firms, the firm should be sure that it is clearly defined relative to the other firms being marketed and apparent which firm is claiming compliance.
- If a parent company contains multiple defined firms, it is recommended that each firm within the parent company disclose a list of the other firms contained within the parent company.
- The use of a third party (e.g., custodian, broker/dealer, etc.) to perform record keeping or performance measurement is not a valid reason for excluding assets from the definition of the firm.
- Systems incompatibilities cannot be used as a reason for excluding assets from the definition of the firm (i.e., a firm cannot make the claim of compliance for only those assets that are measured and monitored on compatible systems).

Inception of the Firm/Redefinition of the Firm

In some cases, due to corporate restructuring and merger and acquisition activities, the changes within the firm may be so significant that it is held out to the public as a new firm. The new firm must determine if there is a continuation from the prior firm or if the restructuring is so substantial that it is essentially a new firm.

Changes in investment style or personnel are not valid reasons for redefining the firm, unless the changes are such that the firm is held out to the public in a significantly different way. A simple name change is not sufficient reason to redefine the firm and restart the performance record. In some cases, a firm may change its definition without losing its performance history. Firms should refer to the Guidance Statement on Performance Record Portability for related guidance. In all cases, firms should remember the underlying principles of the Standards: fair representation and full disclosure. If a firm is redefined, it should disclose the reasoning for the redefinition as long as the information remains material.

Total Firm Assets

The definition of the firm also determines the boundaries for determining total firm assets. Total firm assets are equal to the market value of all discretionary and non-discretionary assets under management within the defined firm. Firms that utilize sub-advisor relationships must include all assets assigned to a sub-advisor, provided the firm has discretion over the selection of the sub-advisor (see below). Assets to which the Standards cannot be applied are not to be considered by firms when claiming compliance and are not to be included in total firm assets. Such assets include investment vehicles that are based on cost or book values rather than market values.

Sub-Advisors

Some firms utilize a sub-advisor to manage part or all of a particular strategy. For example, if a firm specializes in managing equities, it might hire a sub-advisor to manage the fixed income portion of its balanced portfolios.

If a firm has discretion over the selection of the sub-advisor (i.e., can hire and/or fire), the firm must claim the sub-advisor's performance as part of its performance history and include the assets in the firm's total assets. Because the sub-advisor has discretion over the actual investment of the assets and the firm has discretion over the selection of the sub-advisor, both the firm and the sub-advisor are able to claim the performance of the assets as their own. The firm is able to claim this performance because the sub-advised portion of the portfolio is essentially viewed as an asset (similar to purchasing a mutual fund within the portfolio) and the firm must be held responsible for its decision to utilize a sub-advisor. The firm can only include the sub-advisor's performance record relevant to those assets assigned by the firm. If a firm does not have discretion over sub-advisor selection, it must not include the sub-advisor's performance in its performance history.

In the spirit of fair representation and full disclosure, it is recommended that firms disclose the use of sub-advisors.

Effective Date

This Guidance Statement clarifies the meaning of the existing GIPS standards. Firms that currently claim compliance with the Standard have until 1 April 2003 to redefine themselves as necessary to comply with this Guidance Statement and must apply the guidance retroactively. All new firms that claim compliance with the Standards after 1 April 2002 must be defined in accordance with this Guidance Statement.