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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.

A. **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).

B. **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.

<u>Additional Considerations</u>
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).

<u>Inception of the Firm/Redefinition of the Firm</u>
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.