

Global Investment Performance Standards (GIPS®)

Fundamentals of Compliance

Webinar
22 April 2015



CFA Institute

Agenda for Fundamentals of Compliance Webinar

1. GIPS Standards Objectives
2. Benefits of GIPS Compliance
3. Principles of Compliance
4. Fundamental Building Blocks
 - Definition of Firm
 - Defining Discretion
 - Composites Definitions
5. Verification
6. Resources
7. Upcoming Webinars

The Global Investment Performance Standards (GIPS®)

Objectives

- Ensure accurate and consistent data
- Obtain worldwide acceptance of a single standard for calculating and presenting performance
- Promote fair, global competition among investment firms
- Promote industry self-regulation on a global basis
- Promote investor interests and instill investor confidence

Benefits....

Why GIPS Compliance Matters

- Investors
 - Trust
 - Confidence
 - Full Disclosure and Transparency
- Investment Managers
 - Recognized Industry Best Practice
 - Global passport
 - Internal Controls and Risk Management

Provisions of the GIPS Standards

0. Fundamentals of Compliance

1. Input Data

2. Calculation Methodology

3. Composite Construction

4. Disclosure

5. Presentation and Reporting

6. Real Estate

7. Private Equity

8. Wrap Fee/Separately Managed Accounts (SMA)

Principles of Compliance with the GIPS Standards

- Compliance is voluntary
- Compliance must be on a firm-wide basis
- Any investment management firm with actual assets under management
- Must comply with all applicable requirements
 - Including updates, Guidance Statements, interpretations, Q&As, or clarifications
 - Information is available on the GIPS standards website (www.gipsstandards.org)
- Ethical principles of fair representation and full disclosure

Principles of Compliance

- Must comply with all applicable laws and regulations regarding the calculation and presentation of performance
- Must not present performance or performance-related information that is false or misleading

Poll: Principles of Compliance

How long of a performance history must a firm have to claim compliance with GIPS:

- A. One year
- B. Five years
- C. 10 years
- D. Since the inception of the firm



Principles of Compliance

- Initially, must have a compliant track record of at least five years (or since firm inception, if less than five years)
- Must build towards a minimum 10-year track record



Poll: Principles of Compliance

Which of the following performance presentation practices are prohibited for firms claiming GIPS compliance :

- A. Use of representative accounts
- B. Excluding terminated accounts
- C. Showing model results
- D. Annualizing partial year returns
- E. All of the above



Principles of Compliance

- Must document policies and procedures used in establishing and maintaining compliance with the GIPS standards, including ensuring the existence and ownership of client assets, and must apply them consistently
 - Ensure all requirements are addressed
 - Must include both policies and procedures



Principles of Compliance

- All data and information necessary to support all items included in a compliant presentation must be captured and maintained
 - More than accounting records used to support the returns
 - Support for composite assignment (contracts and guidelines)
 - Support for portfolio-level returns
 - Support for composite-level returns
 - Support for all other numerical items, such as firm assets, internal dispersion, etc.



Definition of Firm

- How to define the firm is the first key decision in the compliance process
- When defining the firm, consider the following guiding principles:
 - Firm definition must be appropriate, rational, and fair
 - Adopt the broadest, most meaningful definition of the firm, and reflect how the firm holds itself out to the public and should
 - Cannot use the definition of the firm as a substitute for defining composites



Poll: Definition of a Firm

Firm ABC manages global assets and various investment vehicles. Can the firm define itself only on its U.S. based investment vehicles that have performed particularly well over the past 5 years?

Is this an appropriate definition of a firm under GIPS?

Yes / No



Definition of Firm

- The firm must be defined as an investment firm, subsidiary, or division held out to clients or prospective clients as a distinct business entity
- 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 assets it manages
 - Should have autonomy over the investment decision-making process



Definition of Firm

- Possible criteria for being a distinct business entity
 - Being a legal entity
 - Having a distinct client type
 - Using a separate and distinct investment process.
- The firm must document and disclose how it is defined for the purpose of complying with the GIPS standards
- Firm definition determines the assets that must be used to calculate total firm assets



Poll: Definition of Firm Total Assets

Which of the following types of assets/accounts can be excluded from assets covered by GIPS?

- A. Non-fee paying accounts
- B. Non-discretionary accounts
- C. Assets managed by a sub-advisor
- D. Pooled vehicles
- E. None of the above
- F. All of the above



Total Firm Assets

- Must include all assets for which the firm has investment management responsibility
- Includes assets assigned to a sub-advisor when the firm has discretion over the selection of the sub-advisor
- Includes fee-paying and non-fee-paying assets
- Aggregate of the fair value of all discretionary and non-discretionary assets managed by the firm



Defining Discretion

- No standard definition of discretion
 - What is discretionary to one firm may be non-discretionary to another
 - The firm must document its definition of discretion
 - Discretion must be defined at the firm level, but should also be defined at the composite level
- Firm must determine if the portfolio can be managed in “its style”



Poll: Defining Discretion

Which of the following characteristics can make a portfolio “non-discretionary” and therefore exempt from including in a composite:

- A. Tax considerations
- B. Client pre-approval before trading
- C. Below a minimum size
- D. All the above



Defining Discretion

- Restrictions
 - Only ESG assets
 - Tax considerations
 - Minimum size
 - Selected securities that cannot be sold
 - Must place all trades through client directed brokerage firm



Composite Definitions

- It is the primary vehicle for presenting performance to prospective clients
- The definition of the firm determines the universe of portfolios that must be considered for inclusion in a composite
- From the firm's "universe" of portfolios, all actual, fee paying, discretionary portfolios must be included in at least one composite



Poll: Composite Definitions

Composites are created primarily based on:

- A. Account size
- B. Investment strategy
- C. Length of time assets are under management
- D. Level of investment discretion
- E. Definitions established by GIPS



Composite Definitions

- Composites must be defined based on strategies/objectives/mandates
 - Consider how the firm actually manages money
 - Consider how the firm markets itself
- Firms must create composite definitions
 - The detailed criteria that determine the assignment of portfolios to composites
 - Composite definitions must be documented in the firm's GIPS policies and procedures
 - The full composite definition must be made available on request



Poll: Composite Definitions

What is the minimum number of portfolios that must be included in each composite?

- A. One
- B. Five
- C. Ten
- D. It depends on amount of assets in the portfolios



Composites Definitions

- All fee-paying portfolios must be considered for inclusion in composites
- Non-fee-paying, discretionary portfolios may be included in firm's composites
 - May not be held to the same standard as fee paying portfolios
- Non-fee-paying portfolios may be included in composites
 - With additional disclosures



What is a Compliant Presentation?

Year	Composite Gross Return (%)	Composite Net Return (%)	Custom Benchmark Return (%)	Composite 3-Yr St Dev (%)	Benchmark 3-Yr St Dev (%)	Number of Portfolios	Internal Dispersion (%)	Composite Assets (\$ M)	Firm Assets (\$ M)
2002	-10.5	-11.4	-11.8			31	4.5	165	236
2003	16.3	15.1	13.2			34	2.0	235	346
2004	7.5	6.4	8.9			38	5.7	344	529
2005	1.8	0.8	0.3			45	2.8	445	695
2006	11.2	10.1	12.2			48	3.1	520	839
2007	6.1	5.0	7.1			49	2.8	505	1,014
2008	-21.3	-22.1	-24.9			44	2.9	475	964
2009	16.5	15.3	14.7			47	3.1	493	983
2010	10.6	9.5	13.0			51	3.5	549	1,114
2011	2.7	1.7	0.4	7.1	7.4	54	2.5	575	1,236

Sample 1 Investment Firm claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Sample 1 Investment Firm has been independently verified for the periods 1 January 2000 through 31 December 2010. The verification report is available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

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What is a Compliant Presentation?

(continued)

Notes:

- **Sample 1 Investment Firm is a balanced portfolio investment manager that invests solely in U.S.-based securities.**
- **Sample 1 Investment Firm is defined as an independent investment management firm that is not affiliated with any parent organization. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.**
- **The Balanced Growth Composite includes all institutional balanced portfolios that invest in large-cap U.S. equities and investment-grade bonds with the goal of providing long-term capital growth and steady income from a well-diversified strategy. Although the strategy allows for equity exposure ranging between 50–70%, the typical allocation is between 55–65%. The account minimum for the composite is \$5 million.**
- **The custom benchmark is 60% YYY U.S. Equity Index and 40% ZZZ U.S. Aggregate Bond Index. The benchmark is rebalanced monthly.**



What is a Compliant Presentation?

(continued)

Notes (continued)

- **Valuations are computed and performance is reported in U.S. dollars.**
- **Gross-of-fees returns are presented before management and custodial fees but after all trading expenses. Composite and benchmark returns are presented net of non-reclaimable withholding taxes. Net-of-fees returns are calculated by deducting the highest fee of 0.83% from the monthly gross composite return. The management fee schedule is as follows: 1.00% on the first \$25 million; 0.60% thereafter.**
- **This composite was created in February 2000. A complete list of composite descriptions is available upon request.**
- **Internal dispersion is calculated using the equal-weighted standard deviation of annual gross returns of those portfolios that were included in the composite for the entire year.**
- **The three-year annualized standard deviation measures the variability of the composite and the benchmark returns over the preceding 36-month period. The standard deviation is not presented for 2002 through 2010 because monthly composite and benchmark returns were not available, and is not required for periods prior to 2011.**

Poll: GIPS Compliance Statement

Firms claiming compliance with GIPS may state in its presentation:

“Our firm complies with the GIPS standards for calculating and presenting investment performance.”

- A. Correct statement of compliance
- B. Incorrect statement of compliance

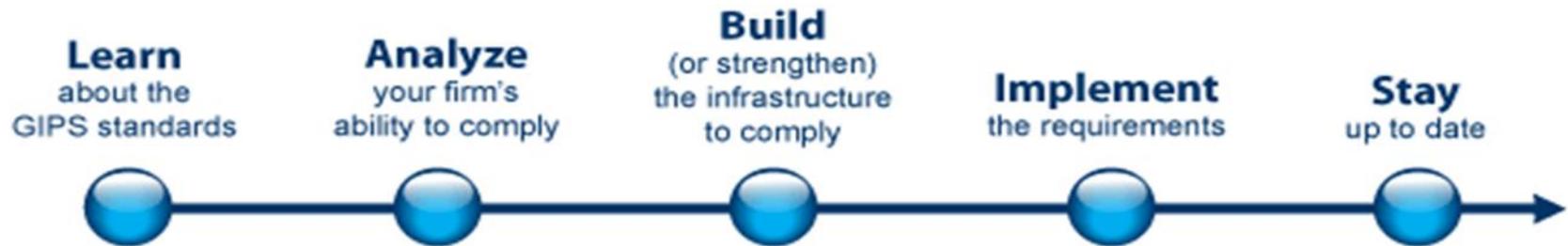


Claiming Compliance

- Firms must meet **all** of the requirements of the GIPS standards in order to claim compliance
- The GIPS claim of compliance may only be included in a compliant presentation
 - **Compliant presentation:** A presentation for a composite that contains all of the information required by the GIPS standards, and may also include additional information or supplemental information



Basics of Becoming GIPS Compliant



What is Verification?

- It's the review of performance measurement policies and procedures by an independent third party, testing whether
 - The firm has complied with all the composite construction requirements on a firm-wide basis
 - The firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards
- Applies to the **entire** "firm", not specific composites (does not ensure the accuracy of any composite presentation)



GIPS Handbook, 3rd edition

- Released December 2012
- Most comprehensive review and revisions to date

- 449 pages
- Free download
- Purchase hardcopy
- PDF and eBook
- Available at:

<http://www.gipsstandards.org/standards/current/Pages/2010EditionGIPS.aspx>



Resources

- Visit www.gipsstandards.org
 - Complete list of Guidance Statements
 - New Q&A Database
 - Brochures & Webcasts
 - Newsletter Archive
- Helpdesk (gips@cfainstitute.org)
- GIPS Newsletter
<http://www.gipsstandards.org/news/Pages/newsletter.aspx>
- Twitter: [@gips](https://twitter.com/gips)
- Certificate in Investment Performance Measurement (CIPM): cfainstitute.org/cipm

GIPS Webinars

13 May 2015

Ethical Decision Making

18 May 2015

GIPS Firm Notification Requirement

20 May 2015

Asset Manager Code Overview

27 May 2015

Assistance with Implementing the GIPS Standards

10 June 2015

Ethical Decision Making