

The benefits for investors

The first version of the Global

Investment Performance Standards (GIPS™) was introduced in 1999, after nearly four years of work by many volunteers from across the industry. The Standard was designed to replace a growing number of national standards, which had the same objectives but took slightly different approaches. This led to a difficult environment for

What are the benefits to investors and investment managers alike for complying with Global Performance Standards, asks *Brian Chapman* at KPMG?



investment managers seeking to provide their services in multiple countries and for clients trying to compare their outputs.

GIPS was sponsored by organisations in each country where they were adopted, including the NAPF in the UK, and they substantially achieved the primary objective of providing a Standard which leads to presentations of investment performance that:

- present performance results that are readily comparable among investment managers, without regard to geographic location; and
- facilitate a dialogue between investment managers and their prospective clients about the critical issues of how the manager achieved performance results and future investment strategies.

When the NAPF decided to sponsor GIPS, they used the new standard to replace the existing NAPF Investment Performance Code, which had been in operation for many years and had similar objectives, albeit with a different approach to achieving them.

GIPS have since grown, such that it is now recognised in 23 countries around the world, with more seeking to adopt the Standard. Version two has been in use since January 2006.

The key principles of GIPS

GIPS has been established as an ethical standard, rather than a prescriptive rule-book, for the

purposes of ensuring full disclosure and fair presentation of a firm's performance track record. In order to achieve this, firms are required to satisfy some minimum requirements:

Scope of compliance

- Firms are required to define themselves in a way which is consistent with how they present themselves to the market. Once they have done so then they must include all products and accounts managed on a discretionary basis within that firm, including any accounts which have subsequently been lost;
- firms must present performance history for a minimum of five years, or since inception if that is a shorter period;
- firms must calculate performance using a standardised methodology and consistent accounting and valuation practices.

Presentation of composites

Firms must construct composites made up of all similarly managed funds to provide a total population performance, rather than selecting individual accounts, which may not be truly representative of the entire population.

This approach also includes all lost accounts for those periods when they were managed, eliminating survivor bias from the performance history.

Firms also have to provide scope information, which details the number of accounts and amount of assets within the composite, to provide further insights into the significance of the product being presented to their overall business.

Application to alternative investment classes

GIPS were originally designed for traditional long-only managers where much of the data for calculation of returns is readily available. However, they are increasingly being applied to emerging asset classes, such as private equity, real estate and hedge funds, as these become more mainstream for institutional investors. Some of the requirements, however, can be more problematic, particularly valuation and treatment of leverage, derivatives and hedging. Where firms establish robust procedures for these areas the benefits for their clients and prospective clients are significant.

The benefits to investors

The introduction of a standardised approach to the presentation of historic performance has removed one of the key variables from the investment manager selection process.

Before Standards were produced, managers could present their performance in a variety of ways to present it in the best possible light, through use of 'representative'

accounts, selective time periods and different calculation methodologies.

The adoption of GIPS has largely eliminated the opportunity for such variation, meaning that prospective clients comparing the history of a number of firms can do so on a truly like for like basis.

The use of GIPS compliant presentations facilitates taking the discussion with prospective managers to the next level, according to the performance history credibility; this allows more time for discussion around the strategies and processes designed to achieve future performance.

While GIPS is designed primarily for the presentation of historic performance to prospective clients, most firms also achieve greater consistency of reporting of account returns for existing clients as a result, which is an ongoing benefit in their relationship with such firms.

Additional benefits

The benefits of GIPS go beyond the needs of the initial stakeholders. Many investment managers have discovered that GIPS provides a framework for better understanding and control of their business. The analysis required to establish GIPS structures, the consistency of information available and the discipline required to maintain compliance can help to establish structures which inform product control and internal

review processes during the investment process.

It can be argued that firms that embrace GIPS within their day to day operations are positioning themselves to deliver more consistently across their product base.

Verification

GIPS provides for independent verification of a firm's claim of compliance and indeed this was mandatory in the original UK version of the Standard as sponsored by the NAPF (UKIPS). In order to achieve global convergence within the current version of GIPS, the UK gave up mandatory verification as a requirement; however, this is expected to return in the next version, which is due out in 2010.

Verification needs to be undertaken by an organisation that is independent of the firm and it involves a review of how a firm has operated within its own policies and procedures designed to implement GIPS. Verifiers review the way that an investment manager has interpreted the Standards and help to achieve even greater consistency.

In reviewing firms' GIPS-compliant track records it would be reasonable to afford greater credibility to a verified firm than a non-verified one.

Why should firms be GIPS compliant?

GIPS compliance creates structures for the calculation

and presentation of performance, which removes most potential sources of inconsistency of presentations. It also indicates that a firm which is compliant has good controls over the classification and reporting of performance across their composites, which can be shown to create greater consistency across clients within such composites.

As compliance creates benefits for both prospective and existing clients then a better question might be: "Why is an investment manager *not* GIPS compliant?" If a firm is genuinely compliant then they can be reasonably expected to be verified, for their own benefit as well as their clients'.

Finally, when seeking a new manager, funds could reasonably require candidates to be verified GIPS compliant and if this criterion does become established then it would ultimately be to the benefit of investors and managers alike.

Brian Chapman is a Director in KPMG's Financial Sector Advisory practice, with over 25 years experience of performance measurement, including nine years working on GIPS verifications.

**NAPF Annual Conference
& Exhibition 2007**

Thursday 24 May, 09.10
*Overview of the current
pensions scene*