
# GIPS is Becoming a Must-Have for All Investment Managers: Making it Easy to Adopt and Adhere to the GIPS Standards

By Amy Jones, CIPM, Guardian Performance Solutions LLC, and Thusith Mahanama, Assette*

The Global Investment Performance Standards (**GIPS®**) are a set of standardized, industrywide ethical principles that provide investment management firms with guidance on how to calculate and report their investment results to prospective clients. Investment managers voluntarily choose to abide by the GIPS standards—compliance is not mandated by any law or regulation. For many years, GIPS compliance has been seen as an essential ingredient that can make or break a firm's marketing efforts in terms of winning new mandates and maintaining institutional clients. A decade ago, institutional firms saw claiming GIPS compliance as a differentiator, but now there are so many firms claiming compliance that it has become a disadvantage to *not* adhere to the GIPS standards.

Wealth managers are starting to take an interest as well. In fact, even some smaller wealth managers are now becoming GIPS compliant, as they see complying with the GIPS standards giving them an edge in winning clients. Since GIPS compliance has not been as prevalent in the wealth management space to this point, there are still opportunities for wealth managers to differentiate themselves from their competition through achieving compliance.

A Boston-based wealth advisory firm recently achieved GIPS compliance. The firm's CEO says they "decided to pursue GIPS [compliance] because it is a 'best practice' for all investment advisers, even those who employ an open architecture, outsourced CIO approach. We believe that an objective measure of our investment performance is the first step in holding ourselves accountable for the quality of advice we provide to our clients." As to the benefits of claiming GIPS compliance, he adds, "Internally, [it] was a good test of our internal control policies and procedures ... Externally, the reports provide prospective clients with an objective measure of our investment capabilities, ... [it] also helps us filter our prospect list. Prospects who are able to understand the importance of tangible, long-term GIPS-compliant results tend to be good long-term clients."

Institutional investors know they benefit when their managers comply with the GIPS standards. Private clients are quickly learning the benefits as well. The main advantage is knowing that the manager's performance results are calculated and presented conforming to rigorous standards. GIPS compliance also helps investors compare the results of different managers, since the information is calculated using similar methods and is presented in a standardized manner. If the firm is verified, there is additional peace of mind that an independent third-party has vetted the policies and procedures that the firm follows to calculate performance.

However, adherence to the GIPS standards is not only a marketing tool, it also provides other benefits to managers. By making changes necessary to comply, they are forced to streamline operations and keep all their portfolio accounting data clean. While being "forced" may seem like a headache at the start, it pays huge dividends in the long run.

In fact, at Assette, we have seen a clear difference between GIPS-compliant and noncompliant firms. The compliant firms' return streams are consistently updated, and details such as security types and sectors are always coded. In other words, the data is always clean, which enables these firms to easily produce compliant presentations (**CPs**) and leverage the same data for overall sales and client communications. The noncompliant firms often have holes in their data, requiring them to do multiple rounds of updates before they can use the data to produce sales and client materials.

## What does it take to be GIPS compliant?

In order to claim GIPS compliance, managers must adopt and document policies and procedures that address all of the requirements of the standards. Since GIPS compliance affects many areas of the firm, several departments are often involved with maintaining and supporting the initiative. Operations,

*Continued on page 11*

client service, performance, compliance and marketing departments frequently play a role, depending on the firm's size and complexity. The department with the ultimate responsibility varies across firms, but the job and ownership of the composite calculations and GIPS policies and procedures tends to fall to the group that has the time and/or the required expertise.

The GIPS standards are quite extensive and, while a complete outline of the details associated with achieving compliance is beyond the scope of this article, there are some specific aspects of the GIPS standards that are relevant to this discussion:

- **Compliance with the GIPS standards can only be achieved on a firmwide basis by an investment firm, subsidiary or division that is held out to the public as a distinct business entity.** The manner in which "firm" is defined is the foundation for GIPS compliance. Individual portfolios, funds or composites—or the performance results thereof—do not themselves comply with the GIPS standards and, as a result, cannot be reported as "in compliance." Only if the firm as a whole has adhered to all of the requirements of the GIPS standards—and has a process in place to ensure continued adherence—can the firm publicly claim compliance.

- **A key component of the GIPS standards is the concept of a "composite."** A composite is an aggregate of one or more portfolios managed according to a similar investment mandate, objective or strategy. The composite is then used to represent—in a transparent and comprehensive manner—how the investment strategy performed historically. The GIPS standards require all fee-paying discretionary portfolios managed by the firm to be included in at least one composite.

- **There is a common misperception that the GIPS standards are strictly "performance standards" and, therefore, if the prescribed calculation methodologies are properly followed, then the firm can represent that it is "GIPS compliant."** In reality, there are many more aspects to the GIPS standards than the performance calculations. Ultimately, the accuracy of a claim of GIPS compliance depends not just on how performance results are calculated, but on how those results are communicated to the investing public. In particular, the GIPS standards have detailed requirements that address disclosure and statistical information that must be provided to prospective clients. In addition, all firms that claim GIPS compliance must document policies and procedures for establishing and maintaining compliance with the GIPS standards.

- **The GIPS standards are very specific that, in order to claim compliance, firms must comply with all requirements of the GIPS standards.** In other words, firms cannot pick and choose which parts of the GIPS standards they want to follow. Either they comply completely, or they do not comply at all. In fact, a firm that is not in compliance with the GIPS standards should not make any references to the GIPS standards in the context of reporting performance or performance presentations. "GIPS®" is a trademark owned by CFA Institute, and it is only authorized for use by firms that claim compliance.

## GIPS compliance is an ongoing effort

GIPS compliance is not a one-time event that, once achieved, no longer requires much attention. In fact, maintaining compliance requires significant effort. There are tasks that must be completed on a monthly and annual basis in order for a firm to maintain compliance. For example, each month, portfolio returns have to be calculated, composites have to be updated, and a review of the results and necessary audit checks should be performed. The day-to-day maintenance procedures should either be documented in the GIPS policies and procedures or be separately documented as desktop procedures. At least annually, firms should review and update their GIPS policies and procedures, the firm's list of composite descriptions and the firm's GIPS-compliant presentations.

Having the right technology is critical, but the firm must also have knowledgeable personnel involved to review the output and oversee the process. If the firm does not have internal resources who are knowledgeable about the standards, enlisting the aid of performance experts or outsourcing key aspects of the process could be a good solution. Taking this approach can inject a higher level of expertise into the process, free up internal resources to focus on other tasks and instill confidence that the firm is adhering to industry best practices.

Firms may also choose to undergo third-party verification. Verification is encouraged, but not required, in order to claim compliance with GIPS standards. Verification is defined in the GIPS standards as the "process by which an independent verifier 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."[1] Verification does not ensure the accuracy of any specific composite presentation, nor is it considered equivalent to an audit—it merely validates that the firm has a control structure in place in order to facilitate compliance. The verifier must remain independent and is not allowed to perform calculations or prepare presentation materials.

*Continued on page 12*

 *Continued from page 11*

## Updating compliant presentations and correcting errors

While the GIPS standards only require firms to update GIPS-compliant presentations annually, most firms update the numbers quarterly. Managers often need to provide performance data more current than the last year-end to their prospects. For example, a prospective investor who meets with a manager in October may be reluctant to invest based only on the prior year's numbers.

When updating statistical data in presentations, managers must be careful to ensure accuracy. Generally, composite and benchmark returns are taken from a portfolio accounting system, so there is not much risk in getting these numbers wrong. However, if a manager manually calculates firm AUM, standard deviation and things like dispersion—and especially percentages of non-fee-paying or bundled-fee assets—using spreadsheet technology such as Excel, they need to be very careful indeed.

Even if there are no changes to the firm or composite definitions, a manager must update disclosures with the latest examination and verification dates, if applicable. They must also be sure that all required disclosures are included, keeping in mind that the requirements change regularly.

In addition, any supplemental information must include required disclosures pointing readers to the CP. This includes little details like getting the page number of the CP right—something that can easily slip through the cracks as marketing adds or removes slides from sales presentation decks throughout the year. Finally, compliance staff needs to verify that all sales materials comply with the GIPS standards *as well as* regulatory requirements.

No firm wants to have to restate their CP due to errors. The GIPS error correction requirements are labor- and time-intensive, and restatement can raise a red flag with clients, prospects and their consultants. Fortunately, there are software solutions that take underlying data directly from a manager's accounting or composite maintenance system to automatically calculate statistics, update disclosures and produce a complete CP. Some systems also provide overall compliance benefits by generating required disclosures on supplementary sales slides and putting safeguards in place to make sure the CP is included in every sales presentation.

## GIPS compliance can benefit everyone

Complying with the GIPS standards is good for both investors and managers. While the standards may seem overwhelming at first, with proper guidance and thoughtful execution it is easy to make GIPS compliance part of a firm's operational DNA—especially with new technologies that automate and streamline the entire CP production and compliance process.

Taking the steps to comply allows you to differentiate yourself from your competition and start the conversation with clients about the importance of transparency. The GIPS presentation requirements also create the framework for you to compile your performance and present it in a straightforward way that is easy for investors to understand, and give you peace of mind that you're adhering to industry best practices for calculating and presenting performance returns.

While GIPS compliance may not seem like an urgent need for your firm today, you will be better off being ahead of the curve. Once firms realize they need to be GIPS-compliant in order to win certain mandates, it is often too late to begin the process. If you start laying the foundation today—adopting controls, maintaining records, tracking strategy changes and implementing technology—then you can be well-positioned when your clients inevitably start asking to see performance results.

** Amy Jones, CIPM, can be reached at (916) 282-2161 and Amy@CompliantPerformance.com. She is the Founder and Principal at Guardian Performance Solutions LLC, a specialty compliance consulting firm dedicated to assisting investment advisory firms to implement, maintain and manage compliance with the Global Investment Performance Standards (GIPS®). She holds the CFA Institute's Certificate in Investment Performance Measurement (CIPM).*

*Thusith Mahanama can be reached at (617) 723-6161 or Thusith.Mahanama@assette.com. He is a co-founder and CEO of Assette, a Boston, Massachusetts firm that helps institutional investment management and wealth advisory firms communicate with clients through cloud-based software. Previously, he managed information technology at Frontier Capital Management Company, where he created one of the industry's first online client communications systems designed to provide daily portfolio data to clients.*

*This article is intended to provide general information on the matters discussed herein and should not be relied upon for legal advice on any matter.* ■

[1] Global Investment Performance Standards (GIPS®), As Adopted by the GIPS Executive Committee on 29 January 2010. CFA Institute. (Dec. 2014), Page 38. *Available at* http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n5.1.

*Amy Jones, Founder and Principal, Guardian Performance Solutions LLC*

*Thusith Mahanama, Co-founder and CEO, Assette*