

Revised Global Investment Performance Standards: Highlights and Recommendations

by Michael S. Caccese and Christina H. Lim

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In February 2005, the CFA Centre for Financial Market Integrity,¹ a division of the CFA Institute (formerly, the Association for Investment Management and Research, or AIMR), issued a revised version of the Global Investment Performance Standards (GIPS, or, as revised, Gold GIPS), which creates a single global standard of investment performance reporting. The Gold GIPS standards will replace the AIMR Performance Presentation Standards (AIMR-PPS or Standards), the US and Canadian version of GIPS, on January 1, 2006. All performance presentations of investment firms claiming AIMR-PPS compliance that include performance results for periods after December 31, 2005, must meet all of the requirements of the revised GIPS standards. Performance presentations that include results through December 31, 2005, may still be prepared in compliance with the 1999 version of the GIPS standards. Firms that currently claim compliance with AIMR-PPS may consider AIMR-PPS compliance as equivalent to GIPS compliance for periods prior to December 31, 2005.

Although some of the new standards in Gold GIPS were derived from various informal interpretations by the CFA Institute and Guidance Statements issued by the Investment Performance Council, a number of new provisions have been added that will call for certain operational modifications by firms wishing to claim GIPS compliance for performance periods beginning January 1, 2006. Although there have been numerous modifications, deletions, and additions to the current version of AIMR-PPS, the below emphasizes the more significant changes that will impact firms currently claiming AIMR-PPS compliance and attempts to highlight those actions that may be necessary for firms to prepare for the effective date of the revised GIPS standards.

Fundamentals of Compliance

In order to highlight the most “fundamental” concepts of GIPS compliance, the revised GIPS standards include a new

section entitled the “Fundamentals of Compliance.” This section includes the following concepts: firm definition, GIPS policies and procedures, appropriate uses of claims of GIPS compliance, firm fundamental responsibilities, and verification.

Firm Definition

ACTION REQUIRED: Revise firm definition unless the firm definition is consistent with the distinct business entity approach. If redefinition of the firm is required, confirm/that the new firm is capable of firm-wide compliance with the revised GIPS standards.

The definition of the firm is one of the three most fundamental issues that a firm must consider when becoming compliant with GIPS or AIMR-PPS because the firm definition is “the foundation of firmwide compliance and creates defined boundaries whereby total firm assets can be determined.”² Prior to the adoption of Gold GIPS, firms were permitted to define themselves in one of

Michael S. Caccese is a partner at Kirkpatrick & Lockhart Nicholson Graham LLP in Boston, MA. He works extensively with investment firms on compliance issues, including all of the GIPS and AIMR standards. He can be reached at 617.261.3133 and mcaccese@klngr.com. Christina H. Lim is an associate at the firm and may be reached at 617.261.3243 and clim@king.com. © 2005 Kirkpatrick & Lockhart Nicholson Graham LLP. This article is for information purposes and does not contain or convey legal advice. The information herein should not be used or relied on in regard to any particular facts or circumstances without first consulting a lawyer.

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two primary ways: (1) an entity registered with the appropriate national regulatory authority overseeing the entity's investment management activities; or (2) an investment firm, subsidiary or division held out to existing or potential clients as a distinct business unit.³ Firms that currently define themselves as an entity registered with an appropriate regulatory authority but hold themselves out to the public in another way must revise their firm definition for purposes of the GIPS standards. For instance, if Company AB is a multinational investment firm held out to potential and existing clients as a distinct business unit, and only its US office is defined as the firm under the registration approach, Company AB must redefine itself as the firm for purposes of GIPS beginning January 1, 2006. For a detailed analysis of how a firm defines itself as a separate subsidiary or division, see Appendix A.

GIPS Written Policies and Procedures

ACTION REQUIRED: Adopt written GIPS policies and procedures or modify existing policies and procedures to conform to the requirements of the revised GIPS standards.

The preamble to AIMR-PPS states that “[i]mplicit in an investment firm’s claim of compliance is the need for the firm to document, in writing, its policies and procedures used in establishing and maintaining compliance with all the applicable requirements of the AIMR-PPS standards.”⁴ One of the fundamentals of compliance under Gold GIPS is the requirement that firms “document, in writing, their policies and procedures used in establishing and maintaining compliance with all the applicable requirements of the GIPS standards.”⁵ Such policies and procedures may include the following:

- Criteria used to define the firm
- Criteria used to define discretion
- Valuation policies
- Calculation methodologies
- How large cash flows are handled
- How new and terminated portfolios are handled
- Policies for using a minimum portfolio size.⁶

Firms that are registered under the Investment Advisers Act of 1940 (the Advisers Act) are also required by that act to adopt and implement written policies and procedures reasonably designed to pre-vent violation of the Advisers Act and the rules there-under by the adviser and its supervised persons.⁷ For additional criteria of the minimum requirements of a firm’s policies and procedures under the GIPS standards, see Appendix B.

GIPS Compliance Statement

ACTION REQUIRED: Firms currently claiming compliance with AIMR-PPS must revise their compliance statements to claim compliance with the revised GIPS standards beginning January 1, 2006.

Beginning January 1, 2006, firms that previously claimed compliance with AIMR-PPS and meet all of the requirements of the revised GIPS standards must modify their compliance statement to the following: “[Name of firm] has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®).”⁸

Compliant Presentations

ACTION REQUIRED: Each firm must be prepared to do the following:

1. Make every reasonable effort to provide a GIPS compliant presentation to all prospective clients who have not received a compliant presentation within the previous 12 months;
2. On request, provide a list and description of composites to any prospective client; and
3. On request, provide a compliant presentation for any composite listed on the firm’s list and description of composites.

Although it was initially proposed that firms be required to provide compliant presentations to all prospective clients, the final version of Gold GIPS only requires that firms make “every reasonable effort to provide a compliant presentation to all prospective clients” if the client has not received a GIPS compliant presentation within the previous 12 months.⁹ In addition, although firms have always been, and continue to be, subject to the requirement that they disclose the availability of a complete list and description of all the firm’s composites,¹⁰ the revised GIPS standards expressly require that firms provide prospective clients, upon request, a list and description of their composites that contains discontinued composites for at least five years after discontinuation.¹¹ Moreover, if a client requests that it receive a compliant presentation for any composite on that list, the firm must fulfill that request.¹²

Certification, Guidance and Interpretation of the GIPS Standards

ACTION REQUIRED: Understand and adhere to all updates, reports, guidance statements, interpretations, or clarifications published by CFA Institute and the Investment Performance Council, which is available on the CFA Institute website and in the GIPS Handbook.

Prior to the adoption of Gold GIPS, the Standards did not expressly mandate that firms adhere to the Guidance Statements issued by the Investment Performance Council or any interpretations issued by the CFA Institute that were published on its web-site. Standard 0.A.15 of Gold GIPS now requires that firms not only comply with the requirements in GIPS, but also “any updates, reports, guidance statements, interpretations, or clarifications published by CFA Institute and the Investment Performance Council, which will be made available via the CFA Institute Web site (www.cfainstitute.org) as well as the GIPS Handbook.”¹³ This new requirement is of great consequence to firms because the CFA Institute has imposed significant obligations on firms claiming AIMR-PPS and/or GIPS compliance through its Guidance Statements and its “Questions and Answers” interpretations on its Web site.

Input Data

Valuation Frequency

ACTION REQUIRED: For periods beginning January 1, 2010, value portfolios as of calendar month-end or the last business day of the month. Disclose whether month-end valuations or valuations on the last business day of the month are not used prior to January 1, 2010. In addition, for periods beginning January 1, 2010, value portfolios on the date of all large external cash flows.

In order to ensure that all portfolios are valued on the same date for purposes of having a basis for comparison, firms must value portfolios as of the calendar month-end or the last business day of the month for periods beginning January 1, 2010.¹⁴ Prior to this date, this requirement is a recommendation.¹⁵ However, if a firm does not adhere to this recommendation prior to January 1, 2010, it must disclose that it does not use calendar month-end portfolio valuations or valuations on the last business day of the month.¹⁶ In addition, for periods beginning January 1, 2010, firms are required to value their portfolios on the date of all large external cash flows.¹⁷ The revised GIPS standards do not specify the amount of cash or percentage that constitutes a large external cash flow, but leaves it to the discretion of firms to define a composite-specific size (either amount or percentage) that constitutes a large external cash flow.¹⁸

Beginning and Ending Valuation Dates

ACTION REQUIRED: Confirm that beginning and ending valuation dates are consistent, which must be calendar year-end (or the last business day of the year) unless the composite is reported on a non-calendar fiscal year.

As a result of the Guidance Statement on Composite Definition, for periods beginning January 1, 2006, each firm’s

composites must have consistent beginning and ending annual valuation dates.¹⁹ The beginning and ending valuation dates must be at calendar year-end (or on the last business day of the year) unless the composite is reported on a non-calendar fiscal year.²⁰

Calculation Methodology

ACTION REQUIRED: Calculate composite returns by asset-weighting member portfolios at least quarterly until January 1, 2010, at which time composite returns must be calculated by asset-weighting member portfolios at least monthly.

Although the proposed Gold GIPS contained a new requirement that firms calculate composite performance by asset-weighting portfolio returns at least monthly for periods beginning January 1, 2006, the final version of Gold GIPS only required that portfolio returns be asset-weighted at least quarterly for periods beginning January 1, 2006, and at least monthly for periods beginning January 1, 2010.²¹ Until this date, Gold GIPS recommends that firms calculate composite returns by asset-weighting the member portfolios at least monthly.²²

Composite Construction

ACTION REQUIRED: Be prepared to provide clients with full composite definitions on request. Include such composite definitions in the firm’s GIPS policies and procedures.

Beginning on January 1, 2006, each firm must be prepared to provide clients with the full definition of any of its composites on request.²³ Each composite definition must describe the detailed criteria that determine the allocation of portfolios to a particular composite.²⁴ In addition, these definitions must be documented in the firm’s GIPS policies and procedures.

With respect to firms that carve out returns from multiple asset class portfolios, beginning January 1, 2010, firms may not include carved-out returns in single asset class composite returns unless the carved-out segment is managed separately with its own cash balance.²⁵ This standard was revised to move the effective date from January 1, 2005 to January 1, 2010 because it was deemed overly burdensome for firms to implement this requirement by that date.²⁶

Disclosures

ACTION REQUIRED: Prepare new disclosures relating to composite descriptions, dispersion measures, policies for calculating and reporting returns, deducted fees relating to returns presented on a gross or net basis, and fee schedules for purposes of inclusion in presentations for periods after December 31, 2005. Review revised GIPS standards to determine whether any of the disclosure

requirements that are particular to certain circumstances are applicable to the firm and prepare such disclosures as necessary (e.g., redefinition of the firm).

The revision of the GIPS standards has resulted in the addition of new disclosure requirements, modifications of old disclosure requirements, and the elimination of several disclosure requirements. Although some disclosures are classified as requirements, the revised GIPS expressly state that some disclosures may not be required when they are specific to certain circumstances.²⁷ If a situation does not apply to the firm or is not applicable to a particular composite, no disclosure is required and no “negative assurance” language is necessary.²⁸ The disclosure requirements that are specific to a particular situation are noted with an asterisk (*).

The following are new disclosure requirements under the revised GIPS standards:

1. *Changes to Minimum Asset Level.* * Firms must disclose any changes to the minimum asset level (if any) below which portfolios are not included in a composite.
2. *Bundled Fees.* * If a composite contains portfolios with bundled fees, the firm must disclose: (i) for each period shown, the percentage of composite assets that are bundled fee portfolios;²⁹ and (ii) the various types of fees included within the bundled fee.³⁰
3. *Fees (Gross-of-Fees).* If returns are presented gross-of-fee, the firm must disclose whether any other fees are deducted in addition to the direct trading expenses.³¹
4. *Fees (Net-of-Fees).* If returns are presented net-of-fee, the firm must disclose whether any other fees are deducted in addition to the investment management fee and direct trading expenses.³²
5. *Fee Schedule.* Firms must disclose the fee schedule, which reflects the firm’s current investment management fees or bundled fees, which is appropriate to the presentation.³³
6. *Subadviser.* * Beginning January 1, 2006, the use of a subadviser(s) and the periods during which the subadviser(s) was used must be disclosed if applicable.³⁴
7. *Composite Description.* Each firm must provide a composite description, which includes general information regarding the strategy of the composite.³⁵
8. *Firm Redefinition.* * If the firm definition has been redefined for any reason, including as a result of the revised GIPS standards on firm definition requirements, the firm must disclose the date and reason for the redefinition.³⁶
9. *Composite Redefinition.* * If a composite has been redefined, the date and nature of the change must be disclosed.³⁷
10. *Composite Name Change.* * A firm must disclose changes to a composite’s name, if applicable.³⁸
11. *Dispersion Method.* Each firm must disclose which dispersion measure is presented (e.g., high/low, inter-quartile range, standard deviation).³⁹
12. *Policies on Return Calculations.* Each firm must disclose that additional information regarding policies for calculating and reporting returns is available upon request.⁴⁰
13. *Significant Events.* * All significant events that assist a prospective client interpret the firm’s performance record must be disclosed, if any.⁴¹ Examples of such events that must be disclosed include events that affect the firm’s operations and/or investment process such as changes in ownership of the firm, mergers or acquisitions, and departures of key investment personnel.⁴²

The following disclosure requirements have been modified:

1. *Leverage.* * Firms need only to disclose the presence, use and extent of leverage or derivatives if such use is material.⁴³
2. *Allocating Cash to Carve-Outs.* * If a single asset class is carved out of a multiple asset portfolios and the returns are presented as part of a single asset composite, the policy used to allocate cash to the carve-out returns must be disclosed for periods prior to January 1, 2010.⁴⁴
3. *Exchange Rates.* In addition to any inconsistencies in exchange rates used between the composite and the benchmark, the firm must disclose and describe any known inconsistencies among portfolios within a composite.⁴⁵

The following disclosures that were previously required under AIMR-PPS have been removed under Gold GIPS:

1. *Settlement-Date Valuation.* Firms no longer need to disclose whether settlement-date valuation is used by the firm.⁴⁶
2. *Percentage of Regions Outside Benchmark.* For composites managed against specific bench-marks, firms no longer need to disclose the percentage of composites invested in countries or regions not included in the benchmark.⁴⁷

Presentation and Reporting

Contrary to the 1999 version of GIPS, firms claiming compliance with AIMR-PPS were subject to the more stringent requirement that they present at least 10 years of annual investment performance or since firm inception if inception is

less than 10 years.⁴⁸ Gold GIPS has eliminated the discrepancy between AIMR-PPS and GIPS in this respect and requires that at least five years of GIPS-compliant performance (or from firm or composite inception if either was in existence less than 5 years).⁴⁹ After five years of performance has been presented, each year of additional performance must be added until 10 years of performance is presented.⁵⁰

Portability

ACTION REQUIRED: Firms must link the performance results of a past firm to the ongoing results of a new firm if (i) substantially all the investment decisionmakers are employed by the new firm; (ii) the staff and decisionmaking process remain intact and independent; and (iii) records have been retained that document and support the reported performance.

In order to provide consistency with the CFA Institute's interpretations and Guidance Statement on Performance Record Portability, the GIPS standards have been revised to incorporate such guidance and now expressly require (rather than merely permit) that performance results of a past firm or affiliation be linked to or used to represent the historical record of a new firm or affiliation if:

1. Substantially all the investment decisionmakers are employed by the new firm;
2. The staff and decisionmaking process remain intact and independent within the new firm; and
3. The new firm has records that document and support the reported performance.⁵¹

The firm must disclose that performance results have been linked.⁵² If one firm joins another existing firm, the firm is subject to the additional requirement that substantially all the assets from the past firm's composite transfer to the new firm in order to link the composite performance of both firms to the ongoing returns.⁵³ Firms that acquire non-compliant firms still have one year under the revised GIPS to bring non-compliant assets into compliance.⁵⁴

Carve-Outs

ACTION REQUIRED: Firms whose composites include carved-out returns from multiple asset class portfolios no longer need to include in their presentations lists of the underlying composites from which the carved-out segments were drawn.

Prior to the revised GIPS, firms that formed a composite using single-asset carve-outs from multiple asset class composites had to include in the presentation a list of the underlying composites from which the carve-out was drawn, and the percent-age of

each composite that the carved-out segment represents. The revised GIPS eliminated the former requirement; beginning January 1, 2006, if a composite includes or is formed using single asset class carve-outs from multiple asset class portfolios, the firm need only include in its presentation the percentage of the composite that is composed of carve-outs prospectively for each period.⁵⁵

Firm Assets

ACTION REQUIRED: Firms must report either the percentage of total firm assets represented by the composite or the amount of total firm assets at the end of each annual period, but no longer need to report both. Composites that contain less than five portfolios do not need to reflect the number of portfolios in the composite or a measure of dispersion of individual portfolio returns.

AIMR-PPS and GIPS previously required that firms report the number of portfolios and amount of assets in the composite and the percentage of total assets represented by the composite at the end of each period. In addition, firms were required to disclose the total firm assets for each period. Although firms are still required to report the number of portfolios and amount of assets in each composite presented, if the composite contains less than five portfolios, the firm does not need to report the number of portfolios in the composite⁵⁷ nor does it have to report a measure of dispersion of individual portfolio returns for each annual period. Moreover, firms now have the option of reporting either the percentage of total firm assets represented by the composite or the amount of total firm assets at the end of each annual period.⁵⁸

Verification

Although the proposed version of the revised GIPS standards stated that verification will be mandatory effective January 2010 and gave firms until December 31, 2011, to complete an initial verification, the final version of the revised GIPS standards does not provide a hard date at which time verification will be mandatory.⁵⁹ However, the revised GIPS standards do warn that verification is likely to be mandatory in the future, and the IPC will reevaluate the issue by 2010.⁶⁰

Summary of Action Items

New Requirements

All firms claiming compliance with the Gold GIPS standards for performance periods after December 31, 2005 must perform the following action items:

- Ensure that composites have consistent beginning and ending valuation dates for periods beginning January 1, 2006;

- Calculate composite returns by asset weighting the individual portfolio returns at least quarterly for periods beginning January 1, 2006;
- Prepare full composite definitions so that they are available upon request;
- Prepare disclosures that additional information on the firm's policies for calculating reporting returns is available upon request;
- Prepare disclosures on all significant events that would assist a client in interpreting the firm's performance record;
- Prepare disclosures of the composite description;
- Prepare disclosures on whether the portfolios in a composite are valued at calendar month-end or the last business day of the month;
- Prepare disclosure on which dispersion measure is presented;
- Adopt written GIPS policies and procedures, or modify existing policies and procedures, to conform to the requirements of the Gold GIPS standards; and
- Revise the AIMR-PPS compliance statements to claim compliance with the Gold GIPS standards;
- Review all applicable updates, reports, guidance statements, interpretations or clarifications published by CFA Institute and incorporate them into the firm's GIPS policies and procedures; and
- Link the performance results of past firms if the portability requirements under Gold GIPS are satisfied.

Firms must perform the following action items to the extent applicable:

- Modify the firm definition unless it is currently defined under the distinct business entity approach;
- Prepare disclosure of inconsistencies, if any, in the exchange rates used among the portfolios within a composite;
- Prepare disclosure, for composites containing portfolios with bundled fees, the percentage of composite assets that are bundled fee portfolios for each period shown and the types of fees included within the bundled fee;
- Prepare disclosure regarding the use of subadvisers, if any, and the periods of use;
- Prepare disclosure of changes to a composite's name, if applicable; and
- If carve outs are included in a composite, pre-prepare

disclosure on the percentage of the composite that is composed of carved-out returns.

Discontinued Requirements

Firms may discontinue the following practices:

- Firms no longer need to use accrual accounting for dividends for periods beginning January 1, 2005, since this is now a recommendation;
- Firms must report either the percentage of total firm assets represented by the composite or the amount of total firm assets at the end of each annual period, but no longer need to report both;
- Firms do not have to disclose the use of settlement date accounting;
- Firms do not have to disclose the percentage of the composite invested in countries or regions outside of the benchmark; and
- If carved-out returns are in a composite, firms do not have to present a list of the underlying composites from which the carve-out was drawn.

Notes

- ¹ The CFA Centre is composed of three policy groups, each of which address issues relating to capital markets and investor protection: (1) Capital Markets Policy Group, which establishes policies and standards relating to investor protection, functioning of global capital markets, licensing of investment professionals, financial reporting and corporate disclosure, investment-decisionmaking processes, and responsibilities of investment personnel and their employees; (2) Investment Performance Standards Policy Group, which establishes and interprets GIPS and AIMR-PPS; and (3) Standards of Practice Policy Group, which establishes and interprets the CFA Institute's Code of Ethics and Standards of Professional Conduct, and other ethical standards or recommended practices applicable to the investment industry.
- ² Investment Performance Council (IPC) Guidance Statement on Definition of the Firm, (Revised), p.1 (effective Jan. 1, 2006).
- ³ Introduction, AIMR-PPS Paragraph 12. See also IPC Guidance Statement on Definition of the Firm, p.1 (effective April 1, 2002). Prior to January 1, 2005, firms that managed global assets were also permitted to define themselves as all assets managed to one or more base currencies.
- ⁴ AIMR-PPS, I.B.
- ⁵ Gold GIPS Standard 0.A.6.
- ⁶ CFA Institute, "Questions and Answers on the Revised GIPS Standards," p.4 (effective Jan 1, 2006).
- ⁷ Rule 206(4)-7 under the Investment Advisers Act of 1940, as amended.
- ⁸ Gold GIPS Standard 0.A.7.
- ⁹ Gold GIPS Standard 0.A.11 (emphasis added).
- ¹⁰ AIMR-PPS Standard 4.A.3.; Gold GIPS Standard 4.A.2.
- ¹¹ Gold GIPS Standard 0.A.12.
- ¹² Gold GIPS Standard 0.A.13.
- ¹³ Gold GIPS Standard 0.A.15.

- ¹⁴ Gold GIPS Standard 1.A.4. The proposed version of Gold GIPS mandated that firms value portfolios as of calendar month-end for periods beginning January 1, 2006.
- ¹⁵ Gold GIPS Standard 1.B.3.
- ¹⁶ Gold GIPS Standard 4.A.25.
- ¹⁷ Gold GIPS Standard 1.A.3.
- ¹⁸ Gold GIPS Glossary, “Large External Cash Flow.”
- ¹⁹ Gold GIPS Standard 1.A.7.
- ²⁰ Gold GIPS Standard 1.A.7.
- ²¹ Gold GIPS Standard 2.4.6.
- ²² Gold GIPS Standard 2.B.2.
- ²³ Gold GIPS Standard 3.A.2.
- ²⁴ See Gold GIPS Glossary, “Composite Definition.”
- ²⁵ Gold GIPS Standard 3.A.7.
- ²⁶ CFA Institute, “Comparison Matrix: Comparison of Proposed v. Existing GIPS Standards,” p.10.
- ²⁷ Gold GIPS, p.6.
- ²⁸ Gold GIPS, p.6; see also CFA Institute, “Questions and Answers on the Revised GIPS Standards,” p.4.
- ²⁹ Gold GIPS Standard 4.A.13.
- ³⁰ Gold GIPS Standard 4.A.14.
- ³¹ Gold GIPS Standard 4.A.15.
- ³² Gold GIPS Standard 4.A.16.
- ³³ Gold GIPS Standard 4.A.12. Although this is a new requirement for GIPS, AIMR-PPS has always required that firms disclose their fee schedule that is appropriate to the presentation. AIMR-PPS Standard 4.A.16. The fee schedule is typically listed by asset level ranges. Gold GIPS recommends but does not require that this schedule be appropriate to the particular prospective client. See Gold GIPS Glossary, “Fee Schedule.”
- ³⁴ Gold GIPS Standard 4.A.18.
- ³⁵ Gold GIPS Standard 4.A.20. The composite description may be shorter than the composite definition, but it must include all salient features of the composite.
- ³⁶ Gold GIPS Standard 4.A.21.
- ³⁷ Gold GIPS Standard 4.A.22.
- ³⁸ Gold GIPS Standard 4.A.23.
- ³⁹ Gold GIPS Standard 4.A.26.
- ⁴⁰ Gold GIPS Standard 4.A. The current version of the Standards recommend, but do not require, that firms disclose the calculation method and the portfolio valuation sources and methods used by the firm. See AIMR-PPS Standards 4.B.1 and 4.B.2.
- ⁴¹ Gold GIPS Standard 4.A.19. Under AIMR-PPS, this requirement is a recommendation. See AIMR-PPS Standard 4.B.5.
- ⁴² CFA Institute, “Questions and Answers on the Revised GIPS Standards,” p.4.
- ⁴³ Gold GIPS Standard 4.A.5.
- ⁴⁴ Gold GIPS Standard 4.A.11.
- ⁴⁵ Gold GIPS Standard 4.A.11.
- ⁴⁶ AIMR-PPS Standard 4.A.4. Both AIMR-PPS and Gold GIPS require that firms use trade date accounting for periods beginning January 1, 2005. See AIMR-PPS Standard 1.A.4 and Gold GIPS Standard 1.A.5.
- ⁴⁷ AIMR-PPS Standard 4.A.10.
- ⁴⁸ AIMR-PPS Standard 5.A.1(a).
- ⁴⁹ Gold GIPS Standard 5.A.1(a). The revised GIPS standard does not differ materially from the original GIPS requirement, other than the clarification that the record can be reported from composite inception if the composite has been in existence for less than five years.
- ⁵⁰ *Id.*
- ⁵¹ Gold GIPS Standard 5.A.4(a).
- ⁵² Gold GIPS Standard 5.A.4(b).
- ⁵³ Gold GIPS Standard 5.A.4(c).
- ⁵⁴ Gold GIPS Standard 5.A.4(d).
- ⁵⁵ Gold GIPS Standard 5.A.6.
- ⁵⁶ Gold GIPS Standard 5.A.1.c.
- ⁵⁷ Gold GIPS Standard 5.A.1.d.
- ⁵⁸ Gold GIPS Standard 5.A.1.c.
- ⁵⁹ CFA Institute, “Comparison Matrix: Comparison of Proposed v. Existing GIPS Standards,” pp.1-2.
- ⁶⁰ Gold GIPS, p.21.

Appendix A

Firm Definition: Distinct Business Entity Approach

Beginning January 1, 2006, each firm (Firm) that claims compliance with the revised Global Investment Performance Standards (GIPS) must define the firm for purposes of GIPS as an entity that is held out to existing and potential clients as a distinct business unit. In order for a Firm to define itself as an entity held out to the public as a distinct business unit, it must: (1) be organizationally and functionally segregated from other units, divisions, departments, or offices under the same parent company; (2) retain discretion over the assets it manages; and (3) be separate, distinct, and held out to the public as a separate firm.

Background

One of the three most fundamental issues under GIPS is how an investment firm defines itself.¹ The GIPS standards specifically state that an investment firm claiming GIPS compliance must define itself for investment performance purposes as a firm, subsidiary or division that holds itself out to clients or potential clients as a distinct business unit.² Defining the firm is both the responsibility of the entity in question and the “foundation for firmwide compliance,”³ and creates defined boundaries for determining total firm assets.⁴ The firm definition must be fairly and appropriately defined and also be “meaningful, rational, and fair.”⁵ Firm definitions may not be defined too narrowly such that they serve as a substitute for defining composites.⁶ The GIPS standards recommend that a compliant firm adopt the broadest, most meaningful definition of the firm, and consider how it is viewed by the public.⁷ For instance, the scope of this definition should include all geographic offices operating under the same company regardless of the actual name of the individual investment management companies.⁸

In order for an entity to be appropriately defined as a firm under the GIPS standards, it must:

- Be organizationally and functionally segregated from other units, divisions, departments or offices;
- Retain discretion over the assets it manages and should have autonomy over the investment decisionmaking process;⁹ and
- Hold itself out to the public as a separate firm.

Whether a business entity is “separate and distinct,” and deemed to be held out to the public as a separate firm is a factual determination that may be affected by factors such as whether the business entity is a legal entity, has a distinct market or

client type, or whether it uses a separate and distinct investment process.¹⁰ However, whether the Firm is a legal entity or utilizes a separate investment process is not necessarily dispositive of the issue of whether the firm is appropriately defined.¹¹ The Guidance Statement on Definition of the Firm explicitly states that the scope of the definition of the firm may include “[f]inancial service holding companies defined as one global firm with multiple brands, several legal entities, multiple offices, investment teams, and investment strategies.”¹²

Analysis

A Firm is appropriately defined under the GIPS standards so long as it is “an autonomous investment firm, subsidiary, or division held out to the public as a separate entity.”¹³ In order for a Firm to be defined as a distinct business entity that is held out to the public as a separate firm, at minimum the Firm’s marketing and sales practices must clearly present the Firm to potential clients as a separate and distinct entity. If the Firm promotes itself as a distinct business unit, and its existing and potential clients perceive the Firm as a distinct business unit, the Firm’s approach to defining the firm is proper under GIPS.

In order for a Firm to promote itself as a separate and distinct entity, the Firm should carry a separate and distinct brand from other units, divisions, departments, or offices under the same parent company and be organizationally and functionally separate. For instance, all letterhead, business cards, employee titles, and marketing materials, including the Form ADVs of the advisers within the Firm, brochures and internet sites, should reflect the Firm as a distinct business entity when practicable. Furthermore, Requests for Proposals, when possible, should be replied to separately by the Firm. All contracts governing institutional accounts entered into after the date the Firm defines itself as a “firm” for GIPS compliance purposes should be clear that such clients are contracting with the GIPS defined Firm. Schedule F of each adviser’s Form ADV must disclose the Firm and represent the Firm as organizationally and functionally separate from other units, divisions, departments or offices within the parent company.¹⁴ Although the aforementioned factors are critical to any analysis as to whether a business entity promotes itself as a distinct business unit, this determination is largely dependent on the particular facts and circumstances. However, if the aforementioned factors are consistently applied, it is reasonable to assume that a Firm’s approach to defining the firm for GIPS purposes is permissible.

Disclosures

If an entity redefines its firm definition from a single investment adviser to multiple investment advisers operating under the same parent company, it should disclose the date and rationale behind the redefinition.¹⁵ Consistent with GIPS' recommendation for expansive firm definitions, GIPS recognize the need for a multiple defined firm to clearly disclose the firms included within a parent company.¹⁶ Accordingly, GIPS recommends that each firm: (1) disclose a list of the other firms within the parent company; and (2) clearly state which firm claims GIPS compliance.¹⁷ In addition, when jointly marketing with other firms, whether within an organization or externally, "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."¹⁸

Conclusion

A Firm may define itself as a distinct business entity under GIPS so long as it: (1) is organizationally and functionally segregated from other units, divisions, departments, or offices under its parent company; (2) retains discretion over the assets it manages; and (3) is separate, distinct, and held out to the public as a separate firm.

NOTES

¹ Investment Performance Council (IPC) Guidance Statement on Definition of Firm (Revised) (hereinafter, "Firm Definition Guidance Statement") (effective Jan. 1, 2006), p.1.

² Global Investment Performance Standards (2006) Standard 0.A.2.

³ Firm Definition Guidance Statement, p.1.

⁴ Id.

⁵ Id. at 1.

⁶ Id.

⁷ Id.

⁸ Id. at 2.

⁹ If all of the investment research and trading functions are carried out in another division outside of the entity defining itself as a separate firm, the entity may not be considered a distinct business unit under the Standards. See 3-2 Definition of the Firm in Global Investment Performance Standards Handbook, Application No. 4 (1st ed. 2002) (hereinafter cited as Handbook). However, the IPC expressly stated in its adopting release to the Firm Definition Guidance Statement that "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." See Investment Performance Council Adoption of the Guidance Statement on the Definition of the Firm, p.5 (hereinafter, Firm Definition Guidance Statement (Adopting Release)).

¹⁰ Firm Definition Guidance Statement, p.2.

¹¹ The IPC ultimately rejected the notion that a firm that holds itself as a separate entity yet does not maintain its own distinct investment process may not be defined as a firm. The proposed Firm Definition Guidance Statement initially had a guiding principle that required the firm to be a "distinct entity with its own distinct investment process." See Firm Definition Guidance Statement (Adopting Release), p.4. The IPC ultimately removed this principle in response to commenters' opposition to the principle.

¹² Firm Definition Guidance Statement, p.2.

¹³ AIMR Performance Presentation Standards Handbook, 3 (1997 edition).

¹⁴ Schedule F of Form ADV (Continuation Sheet for Form ADV Part II).

¹⁵ GIPS Standard 4.A.21. In some cases, a redefinition of the firm may result in the loss of performance history. See Guidance Statement on Performance Record Portability (Revised) (effective Jan. 1, 2006).

¹⁶ Firm Definition Guidance Statement, p.5.

¹⁷ Id. at 2-3. ("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.")

¹⁸ Firm Definition Guidance Statement (Adopting Release), p.2.

Appendix B

GIPS Model Policies and Procedures

The following is an outline of the minimum areas that should be addressed in the policies and procedures of a firm claiming compliance with the Global Investment Performance Standards (the Standards). The outline is drafted for a domestic investment firm with limited international investing and assumes that such firm does not: (1) participate in wrap-fee/SMA programs, (2) invest in non-traditional asset classes and real estate, (3) report performance on an after-tax basis, and (4) have any investment performance portability issues. The policies can give discretion to the investment firm in making certain decisions. However, such discretion must be implemented pursuant to objective standards. In addition, once the policies and procedures are

created, they must, at all times, be consistently applied firm-wide across all accounts. Any exception needs to be documented, in writing, and supported by evidence that the exception is made not to enhance performance but within the ethical principles of the Standards.

- I. Introduction** – Describes the Standards, the investment firm's commitment to comply with the Standards and the need for firm-wide commitment and compliance.
- II. The Firm** – Defines the Firm for purposes of compliance with the Standards and presentation of performance along with the rationale for the definition.

III. Discretion – Defines how the firm defines discretion for all types of accounts. This could include temporary non-discretionary accounts created as a result of unanticipated client actions.

IV. Valuations and Accounting Measurements – This section includes:

- Pricing sources,
- Timing of pricing,
- Process flows,
- Trade date v. settlement date accounting,
- Accrued dividends calculations,
- Withholding tax calculations,
- Exchange rates, and
- Leverage and margin usage and affect on performance.

V. Performance Calculation Methodologies – This section includes:

- Processes used,
- Frequency,
- Methodology,
- Gross and net-of-fees, and
- Total firm assets.

VI. Composite Requirements – This section includes:

- Criteria to define,
- Reasons for account inclusion/exclusion,
- Reasons for changes,
- List and description of composites,
- Definition of fee paying accounts,
- Inclusion/exclusion of non-fee paying accounts, and
- Composite maintenance requirements.

VII. Composite Calculation Principles – This section includes:

- Timing of inclusion /exclusion of accounts in composites,
- Treatment of closed accounts,
- Total return calculations formulas,
- Frequency of calculations,
- Composite dispersion calculation, and
- Risk measurements.

VIII. Benchmarks – This section includes:

- Selection criteria,

- Reasons for changes, and
- Differences from composite makeup.

IX. Presentation Requirements – This section includes:

- Presentation formats,
- Required disclosures,
- Scope and usage,
- Use of supplemental performance,
- RFPs,
- Flash reports, and
- Internet.

X. Verification – This section includes:

- Verifier selection,
- Frequency,
- Usage of verification report, and
- Verification v. performance examination.

XI. Responsibilities – This section includes:

- Responsible compliance person,
- Method for reporting violations or errors,
- Exception reporting/ documentation,
- Recordkeeping reports,
- Senior oversight,
- Responding to regulatory inquiries/inspections,
- Regular review of CFA Institute interpretations, Guidance Statements, updates, and reports,
- Updating procedures, presentations and methodologies to comply with CFA Institute positions, changed business/investment practices, and
- Regulatory review and compliance (there may need to be a separate procedure on this aspect of performance calculation and presentation independent of the Standards policies and procedures.)

XII. Attachments – This section includes:

- List of composites,
- Composite performance and applicable disclosures,
- Sample model presentation,
- Presentation compliance checklist,
- Exception report forms,
- Responsible person in each relevant area, and
- Standards.