Trustees, insist on GIPS!

BY GAVIN CALDWELL

Often within the investment management business, consumers are confused by the products on offer, thereby building an unnecessary and unhealthy distrust. But comparing apples with oranges is a large part of the problem.

This problem refers to situations where trustees and those in the investment consultancy community compare performance tables. I really feel for their frustration. It has been, until now, almost impossible to compare relevant funds in a holistic way. Too often, advisers are left to compare the incomparable - that is to compare apples with oranges. Equally the multitude of managed fund surveys in the Irish market allows very little insight into how a manager might perform to a more specialised mandate.

As long as this situation exists, it is difficult for investors to make fully informed decisions. We know that fund managers have the ability to 'cherry pick' their best performing funds to use as their 'shop window' in media advertising. The adoption of the Global Investment Performance Standards (GIPS), and the addition of a set of advertising guidelines under these standards that are currently out for public comment, will hopefully get rid of any rotten fruit and bring the focus back to what we do best, manage money, which is what we are paid to do.

GIPS have their roots in a set of standards produced by the Association for Investment Managers and Research (AIMR) in 1987, initially for the US and Canadian markets. Members of AIMR, now represented in Ireland by the Society of Investment Analysts in Ireland (SIAI), are all investment professionals, who are obliged to comply with a set of ethical standards of practice in their profession.

In order to aid compliance with its members' fundamental responsibilities to the investing public, AIMR developed specific standards for investment professionals to present investment performance data. The standards set for performance presentation gained rapid acceptance as best practice in North America. Investment managers found it difficult to make the short list for new business presentations to institutional clients, without first claiming compliance with the standards and also having had this compliance verified by a third party specialising in that service.

The rapid globalisation of the investment management industry and the proliferation of service providers have heightened the need for a common set of standards for the calculation and presentation of investment performance.

GLOBAL

Recognising this need, AIMR sponsored an effort to develop and publish one global standard. Having started its work back in 1995, the GIPS committee released the GIPS standards in early 1999. US Trustees and consultants now insist almost automatically on GIPS compliance.

The investment management industry has grown rapidly over the past 15 years and there are now many service providers offering products and services across borders.

A common standard for investment performance data holds obvious advantages. Firstly, it requires managers to adhere to standards that will help assure investors that the performance information is both complete and fairly presented. Secondly, it makes comparison that much more easy for investors. One fund manager's performance disclosures can be more readily compared to another.

Under GIPS, a manager presenting a performance return for a particular mandate/strategy is required to give composite returns calculated by capturing all funds that are invested under that mandate within the firm. (A composite is a grouping of funds that follows the same strategy/ mandate).

A composite return is the weighted average return for that group of funds. Presenting in this way ensures that the end customer has sight of the manager's capability in managing a mandate of the type presented.

So why adopt GIPS? It is important that we in the fund management business set and stick to a worldwide acceptable standard for the calculation and presentation of investment performance that is fair, is in a comparable format and provides full disclosure. Internally, GIPS helps to ensure accurate and consistent data for reporting, record keeping, marketing and presenting.

At my firm we are very aware that GIPS helps to promote fair, global competition among investment firms for all markets, without creating barriers to entry for new firms. If GIPS is adopted worldwide, as I am sure it will be, then finally oranges will be compared with oranges when we pitch for business. In addition, I think that it is incumbent on the industry to adopt GIPS to establish a culture of self-regulation on a global basis.

HISTORY

GIPS will mean that a minimum of five years performance history is required in a presentation (or from inception if less than five years); annual returns for each year, and it is recommended that the returns are annualised to the presentation date. A manager must state whether the returns presented are gross or net of fees. The presentation must have an appropriate, and disclosed, benchmark return for each period presented. The number of funds within the composite as well as a measure of dispersion of the returns within the composite is required.

Finally, the value of assets managed within the composite and the total value of assets managed by the firm as a whole must be reported.

And what will the widespread adoption of GIPS give us? It means that prospective investors will get a feel for the capability of the manager to provide a professional service and the numbers will capture all funds managed by the manager for this mandate type. It will show how the manager has performed against the market, giving a composite return versus the benchmark value.

I recognise, but welcome, that we in the industry are cutting some of the camouflage that can be useful in tough times. Now there will be no hiding place.

Our processes will also be exposed. Clients pursuing the same investment mandates will find out if they are being treated the same. It will show the return dispersion within the composite – the tighter the better. Even in the most efficient of firms, there will be some level of dispersion, due in large part to cash flow considerations of some composite constituents. That said, the end investor should expect broadly the same rate of return enjoyed by the majority of clients within the composite.

Consultants will be able to demonstrate other parameters to their clients. They will know how important a certain piece of business is to the manager and how important is this mandate type to the manager. There will be visibility as to the size of the assets managed under this composite relative to the size of assets that a manager has. The consultant will also see the number of funds managed by the firm under this mandate type sometimes demonstrating specialist ability.

Finally, we will also see the asset value of the composite relative to the total assets under management. Arising out of this fuller and more holistic disclosure, it will be right and sensible to compare the results of GIPS compliant fund managers, as they all have to make the same disclosures and quote the same return periods. Remember, non-GIPS compliant firms in the US or Canada are already unlikely to make the first round of the beauty parades.

GIPS is good for the industry and we, in Ireland, have been good to GIPS. We were the first country to sign up for the standards. The governing body of GIPS signed off Ireland's country version of GIPS in May 2001. Now over 20 countries have signed up and have either completed the clearance process or will do so shortly.

All the major financial centres are now on board including the US, Japan, UK and Germany. We are well represented at the upper echelons of the governing body of this standard. Deborah Reidy of the NTMA is an affiliate delegate on the global governing body, and Joe Kavanagh of KBC Asset Management is the Irish representative on the European regional council.

OVERSIGHT BODY

More recently a domestic group of investment managers, pension fund representatives, investment consultants and third party verifiers has been set up as the oversight body in Ireland under the joint sponsorship of the Irish Association of Investment Managers and the SIAI. This group gathers the views of local market participants on developmental proposals on the future of the standards and passes them up the line to the global governing body. There is good information flow here and Ireland can influence how the standards develop from here.

From here, it is up to trustees and consultants to drive home the standards. Whereas the majority of us in fund management are GIPS compliant, it is essential that GIPS is demand-led by the consumer of our services. Trustees, along with their consultants, should insist that firms are GIPS 'stamped' if they wish to be considered for a mandate.

When searching for new managers, trustees are being asked to make big decisions about big money. They need to see the big picture when investment performance is being considered and GIPS provides that big picture. It is up to them to insist on GIPS.

I have noted with interest, the strong contribution the National Association of Pension Funds in the UK has made in this debate in recent months. They have led from the front in updating their numbers on the development of these standards and advised trustee boards to keep GIPS at the centre of their decision-making process when reviewing investment managers. I will borrow a quote from Philip Lambert, Global Head of Pensions, Unilever, which encapsulates perfectly the depth of feeling about these standards within the UK pension trustee community.

"It is essential that pension fund trustees are able to assess the true effectiveness of fund managers they employ. This standard will be the basic rubric to which all portfolio managers conform. I view non-compliance with the standard as operating below best practice level. Non-compliance should trigger suspicion from pension fund trustees and embarrassment from investment managers"

Gavin Caldwell, CEO, KBC Asset Management Ltd.