

Pressure for alternatives firms to adopt GIPS grows

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Following the recent lacklustre performance across much of the alternatives industry, there is more reason than ever to increase transparency through the highest standards of performance measurement.



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After the recent turmoil in financial markets, the need to improve transparency and corporate governance has become more urgent. Confidence in performance data is at the core of this, making it likely that pressure will grow for alternative investment managers to adopt the Global Investment Performance Standards (“GIPS®” or the “Standards”), a code of ethics governing the measurement and presentation of investment performance.

Regulators have been discussing the wider use of GIPS by private equity and hedge funds for some time. In the UK, a Financial Services Authority discussion paper has noted the need for private equity to reduce opacity, and the body has referred to the role GIPS could play in raising standards. In the US, the Investors Committee of the President’s Working Group on Financial Markets recommended that, where practicable and applicable, investors should require hedge fund and fund of hedge fund performance to conform to GIPS.

While large traditional investment firms have increasingly complied with GIPS, alternatives firms’ interest remains tepid. Yet these ethical standards confer a badge of transparency and integrity. They provide a global passport for presentations, and enable a firm to establish effective internal controls for measuring performance. By choosing to comply with GIPS, investment managers assure clients that historical performance track records are both complete and fairly presented.

Originally introduced in the United States in 1991 as the AIMR Performance Presentation Standards (AIMR-PPS®), the global version of the Standards was formally endorsed in 1999. The latest version, effective since 1 January 2006, results from close co-operation between professional bodies and sponsors around the world. As many as 30 countries in Europe, Africa and the Asia Pacific have now adopted GIPS.



Adapting to alternatives

It is anticipated that the forthcoming redraft of GIPS, due for release in 2010, will specifically address the characteristics of alternative asset classes, with drafting committees developing the existing Standards to encourage take up.

As interest in, and pressure for, GIPS compliance grows, so might investment managers seek to cut corners in their haste to comply and incorrectly claim compliance. One check against this is the involvement of the independent verifier in the process.

In order to ensure GIPS is correctly applied, its Executive Committee strongly encourages independent verification, although this is not mandatory. As Jonathan Boersma, Executive Director of the GIPS Standards, notes, “the Executive Committee’s decision not to require mandatory verification reflects the

view that verification should be a market-driven decision – if it is important to investors, they will demand that their investment managers be verified.”

Verification involves a comprehensive assessment by an independent third party of a firm’s performance measurement processes and procedures. It covers the whole firm’s performance, rather than its individual portfolios, and the whole period over which the firm claims to have been in compliance. Typically, each subsequent year is annually verified.

The quality of performance data has been a grey area for decades, presenting a multiplicity of methodologies, styles and standards, but the issue has become more pressing as the industry has grown and, more recently, as market conditions become more turbulent. Perhaps compliance with GIPS is the answer.

Investment Management and Real Estate contacts

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