White Paper

Completing the Puzzle: A Global GIPS Compliant Firm Definition

The case for private markets to adopt the Global Investment Performance Standards (GIPS®).

Contents

Executive summary

One of the key tenants to being GIPS compliant is how an investment manager decides to define the firm. This firm definition will be the foundation for which all other provisions will be built, and ultimately reflects how the GIPS compliant firm presents themselves to the marketplace.

For many firms, this is a straightforward exercise where the registered investment manager is the same as the GIPS compliant defined firm. For larger, more complex firms with multiple legal structures or alternative asset classes, this is a less straight forward exercise.

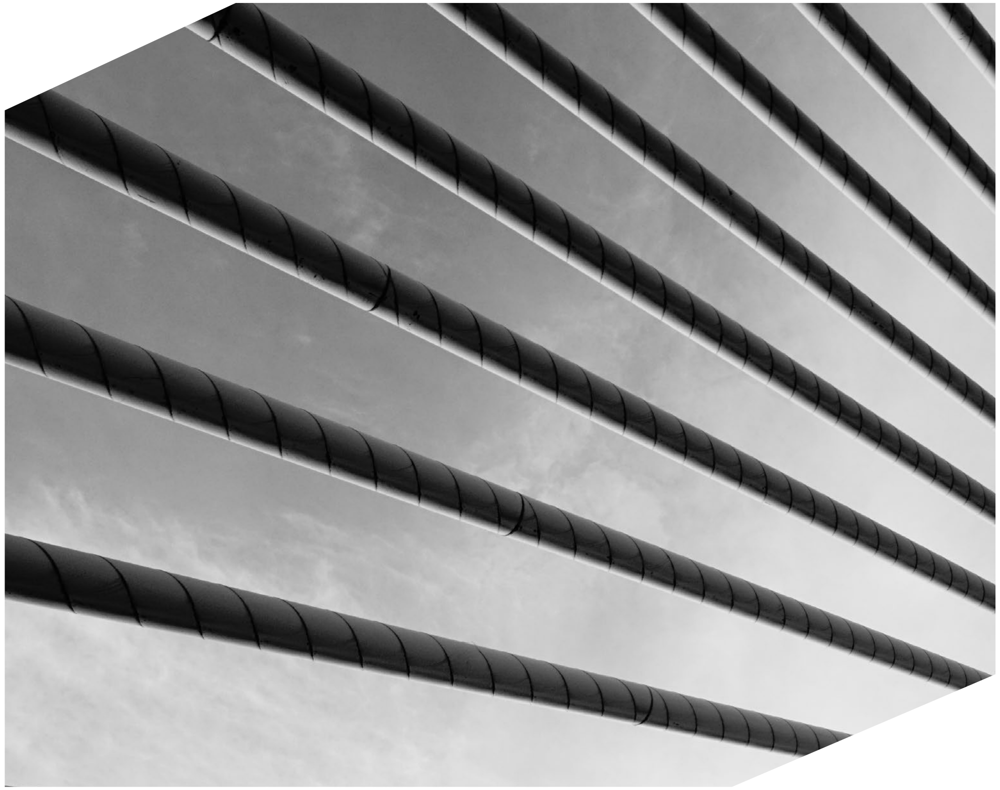
The Global Investment Performance Standards (GIPS®) are a global ethical set of guidelines for calculating and presenting investment performance, rooted in the principles of fairness and transparency. Historically, the GIPS standards were centered around traditional asset class structures. This resulted in many managers carving out the alternative asset classes from their GIPS compliant firm definition.

However, the 2020 GIPS standards marked a significant expansion and standardization for non-traditional asset classes that often use Money Weighted Returns (MWR), increasing relevance and adoption by alternative investment managers, fund managers, and private wealth managers. The welcomed update resulted in managers reassessing whether the previously mentioned carved out assets should be incorporated into their firm definition.

Over the past three years, we have consulted with a dozen firms who have moved from including only certain divisions within an organization into the GIPS compliant firm to adopting a global GIPS compliant firm definition that encompasses all divisions within the investment manager. The trajectory suggests that this trend will persist as investment firms attempt to enhance their competitive edge and consolidate their public image under a unified brand.

This white paper will make the case for your firm to follow this trend by examining:

- pros and cons of this paradigm shift
- common misconceptions
- advantages of the increased trend in GIPS compliance in the alternative asset space
- recent observations in redefining what is captured in the GIPS compliant firm



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Evolution of the GIPS standards for private markets

Within the traditional asset management space, the GIPS standards[1] have long been the recognized standard for calculating and presenting investment performance globally. Adoption of the GIPS standards have historically been driven by investor demand, and while this demand has been low for private markets funds, investors and regulators have been active in increasing expectations for transparency and consistency in the calculation and reporting of investment performance for private funds.

The CFA institute's goal to have GIPS standards as the single standard for the calculation and presentation of performance have well positioned themselves to assist private fund managers with an established framework for calculating and presenting performance results to meet these increased demands.

The 2020 GIPS standards included a significant increase in relevant guidance to private market investments based upon the fixed life and fixed commitment structure. Guidance has moved from being largely asset-class based (e.g. separate sets of provisions for private equity, real estate, and traditional asset classes) to become investment structure based. For example, existing requirements for calculating composites performance still apply to firms that manage segregated accounts. However, firms that manage private equity funds now have provisions available that allow managers to forego composites when investment is only made into the fund. Those firms can now calculate and report individual fund performance in a GIPS Pooled Fund Report.

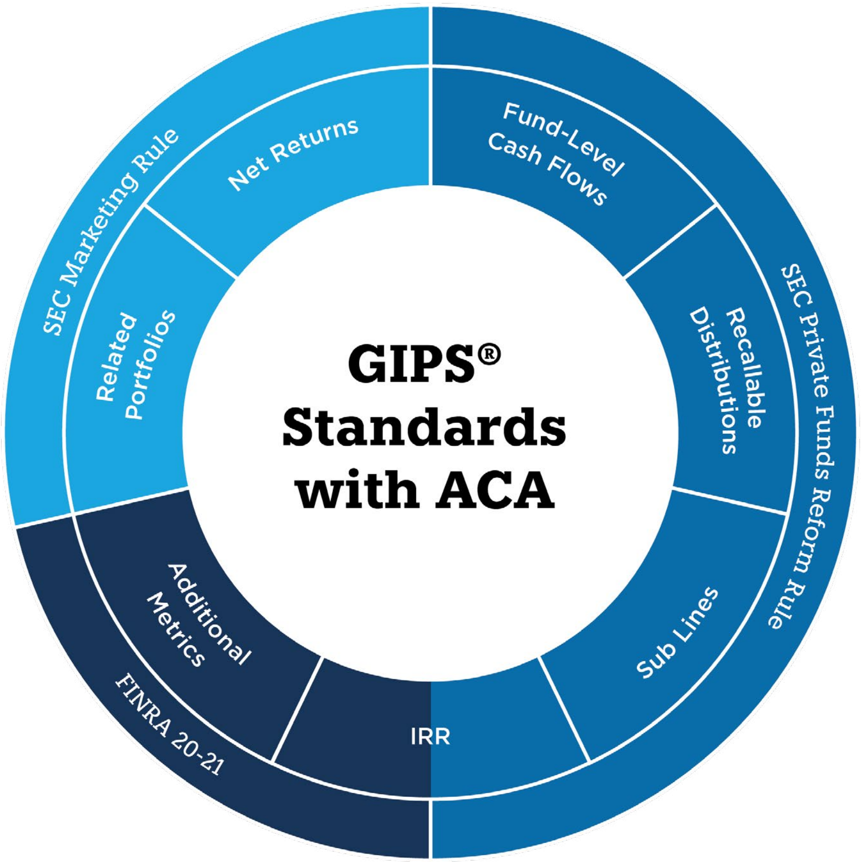
The GIPS standards are promulgated and maintained by CFA Institute, with a comprehensive structure of staff and industry experts that work to keep the GIPS standards relevant as the industry evolves. This has helped make the GIPS standards the de-facto source for best-practice guidance on investment performance methodology.

Other industry groups, such as the Institutional Limited Partners Association (ILPA) and the NCREIF PREA Reporting Standards, as well as regulatory bodies, including the U.S. Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA), have leveraged the GIPS standards to define the underlying performance calculation methodologies that are then utilized within their respective industry guidance and/or regulations, as outlined further.

[1] *CFA Institute. Global Investment Performance Standards (GIPS). Charlottesville: CFA Institute, 2019*

Increasing demand for GIPS compliance

We have observed recent pressures to conform to certain performance provisions that impact marketing, fundraising, and client reporting practices. Industry associations/regulations now reference or rely on the GIPS standards as they look for ways to expand transparency around investment performance and disclosures.



SEC Private Fund Adviser Rules - These rules underscore similarities with the GIPS standards, particularly in terms of return calculations and presentations for varying fund structures. The overlapping requirements around the treatment of recallable distributions, mandated use of investor capital calls and distributions in performance, and the inclusion of performance with and without the use of subscription lines of credit are suggestive of the influence of the GIPS standards.

The SEC Marketing Rule - When discussing related account performance, the rule specifically pointed towards methodologies which are consistent with the GIPS standards. This subtle endorsement signaled the SEC's acknowledgment of the GIPS standards as a reliable benchmark for performance reporting.

FINRA 20-21 – Private fund managers fundraising through intermediaries such as placement agents, bank-platforms, or other types of registered broker-dealers, requires that marketing of an investment rate of return (IRR) for funds that have realized and unrealized investments, is permitted only if the IRR is calculated in a manner consistent with the GIPS standards and includes additional GIPS standards-required metrics such as paid-in-capital, committed capital, and distributions paid to investors.

Such channels, in some cases, are requiring a legal representation for IRR calculations to be consistent with the GIPS standards and to include additional GIPS standards-required metrics.

Fundamentals for claiming compliance - firm definition

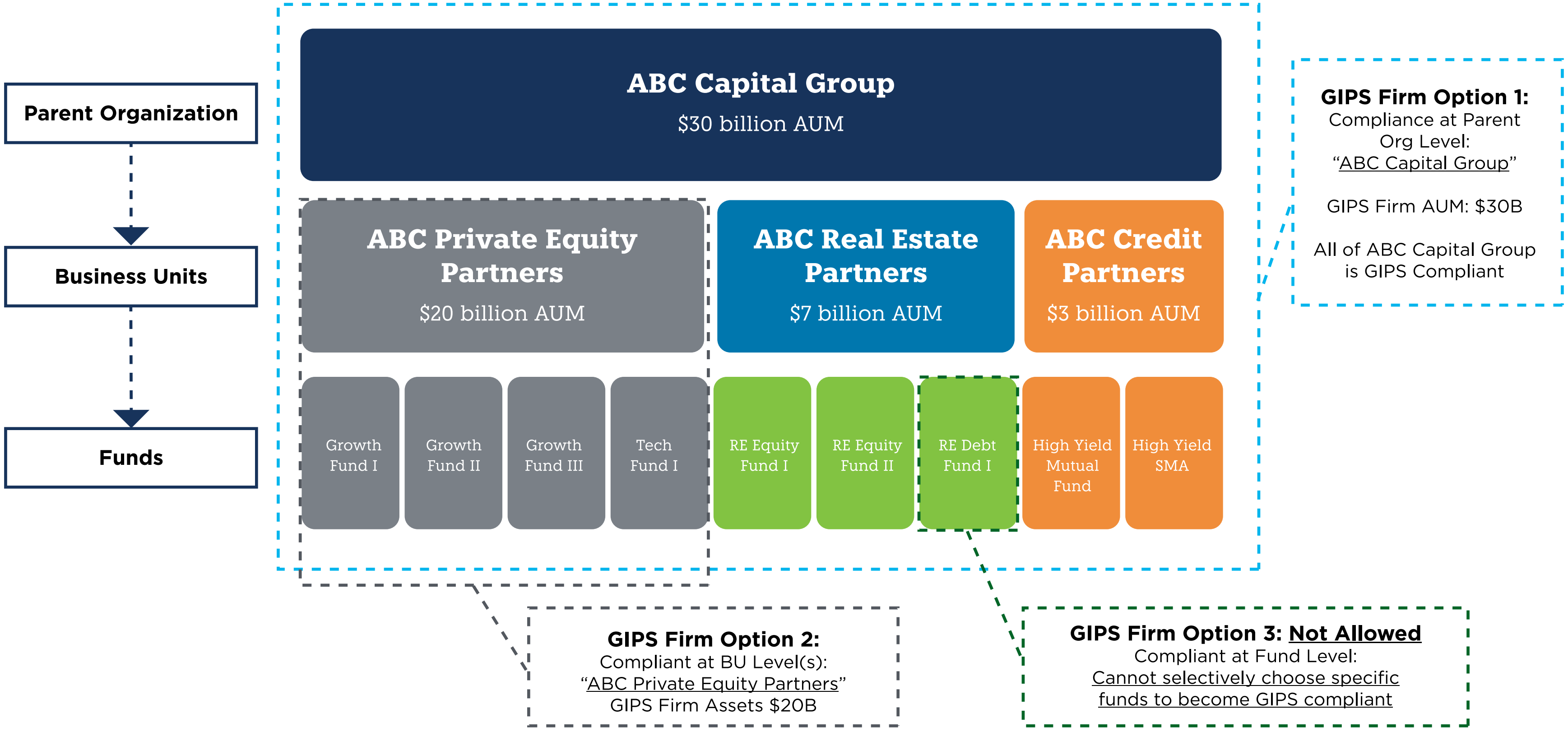
The definition of the firm is one of the fundamental requirements of the GIPS standards. The first step an investment manager must consider when claiming compliance is how to define itself. It is common for the firm definition to mirror the legal definition for SEC, FCA, or other regulatory jurisdictions. Within the GIPS standards, a firm definition should mirror how the manager represents itself in the marketplace. This firm definition will essentially draw a circle around the portfolios to be included in total firm assets under management (AUM). These portfolios are then subject to all provisions of the GIPS standards and will ultimately be represented in the firm AUM shown in a GIPS report.

The GIPS standards recommend that the firm adopt the broadest, most meaningful definition of the firm. In some cases, such as when a firm includes all assets within the legal entity, defining the firm can be simple. In other circumstances, defining the firm is more complex. The latter is common in cases where a parent organization has multiple legal entities and business lines operating under one brand.

These entities and business lines can offer a wide variety of strategies to a variety of client types in the market. Without the ability to have a defined firm that is different from the legal entity, the GIPS standards would not be possible for many of these firms. The 2020 GIPS standards expansion to have applicable, thoughtful provisions around the private market space allows investment managers to move closer to broader adoption of the GIPS standards.

If a firm already claims compliance with the GIPS standards, there should be a process in place to ensure the firm definition remains appropriate. Situations often occur that affect how the firm is defined, potentially resulting in the need for a firm redefinition. This need often arises because of corporate reorganizations or merger-and-acquisition activity.

This illustration provides examples of defining the firm for a more complex investment manager. While the GIPS standards allow some flexibility around the decisions for what is and is not included in a firm definition, cherry picking certain strategies within a distinct business entity without a reasonable basis would not be allowed.



- **Option 1 – Firm is defined as "ABC Capital Group"**. GIPS compliant firm includes the parent organization and all underlying entities. This results in the broadest GIPS firm definition.
- **Option 2 – Firm is defined as "ABC Private Equity Partners"**. GIPS compliant firm includes only the private equity fund management company and excludes the real estate and credit entities. This choice allows for one distinct business unit to claim compliance with the GIPS standards without creating an obligation for other business units.
- **Option 3 – Firm is defined as "RE Debt Fund I"**. Attempts to isolate a single composite strategy or fund as the GIPS compliant defined firm; however, this is not allowed. The firm must not be defined by strategy and must instead be applied at the firm level.

The case for implementing a global GIPS standards defined firm

Option 1 of the prior illustration shows how a complex legal structure may consider a broader defined firm for GIPS compliance. In this example, an entity has determined that the GIPS standards should be applied at the parent organization level and would encompass all underlying entities within the firm definition. As part of our discussions with managers who have gone through this exercise, below are the most common factors when deciding to proceed with a more broadly defined firm as illustrated in Option 1.

1. **Enhanced Cohesion and Public Image:**
   The evolution of a firm definition to be smaller in scope to a globalized firm enables investment firms to present themselves as a unified entity, irrespective of divisions within an organization. This fosters a sense of cohesion, streamlines branding efforts, and simplifies investor perception.

2. **Total Firm AUM:**
   The integration of separate divisions under a single firm definition result in larger total firm assets, bolstering the firm's overall asset value. This potentially attracts investors seeking the stability and breadth of an integrated organization.

3. **Expanded Horizons for Alternative Assets:**
   The 2020 GIPS standards have facilitated compliance for alternative asset managers, streamlining their reporting requirements. This development makes the adoption of a globalized GIPS standards definition more attractive to firms dealing with non-traditional investment classes.

4. **Investor Demand and Regulatory Mandates**:
   Increasingly, investors and Requests for Proposals (RFPs) insist on GIPS compliance. As managers look to complete RFPs at the larger entity level, it can be confusing to parse out which component of the entity is GIPS compliant while providing explanations on why other parts of the business may not be. This has fueled incentive for investment firms to adopt a globalized definition.

Common concerns for implementing a global GIPS standards defined firm

Below dispels the most common challenges when deciding to proceed with a more broadly defined firm as illustrated in Option 1.

1. **Operational Challenges:**
Concerns about operational challenges arising from differences in accounting performance systems within an investment firm can be dispelled by the use of data warehouses or composite performance systems that allow for the aggregation of data from different performance systems to assist in composite construction and composite performance creation. In addition, the presence of third-party verification endorses the reliability of the methodologies employed, mitigating any concerns about incorporating different systems and methodologies into one globalized GIPS compliant firm.

2. **Too many hurdles for Alternative Asset Managers to claim compliance with the GIPS standards:**
The revised 2020 GIPS standards simplify compliance for alternative assets and make the standards more applicable to the types of returns shown for these compliance managers. The streamlining of reporting requirements paves the way for non-traditional investment firms to adopt a globalized GIPS compliant firm definition.

3. **Specific Calculation Requirements for MWRs:**
Often private market track records have been in place for many years, and it can be burdensome to potentially have someone tell you that the calculation needs to be changed resulting in unknown hours of additional work. The GIPS standards outline meticulous calculation requirements for MWRs, including the use of fund-level cash flows, daily cash flows post-January 1, 2020, netting considerations for management fees and other expenses, and treatment of subscription lines of credit. Recent regulatory requirements around the calculation and presentation of private fund performance may already cause managers to make changes to historical track records. The GIPS standards allow for adherence to regulatory requirements while offering a benchmark for uniformity.

Case studies

Case Study One

- **Company:** Large asset manager with ~$490 billion in AUM globally as of 12/31/2022
- **Location:** Global
- **Financial Services Sector:** Alternatives

Client Base: Institutional and individual investors worldwide, across fixed income, equities, listed real estate, listed infrastructure, infrastructure, renewables, agriculture, private credit via public and private funds, hedge funds and multi-asset solutions

Background: As part of an internal corporate restructuring during 2018, the investment manager went through a global rebranding initiative by consolidating several separate groups.

Challenge: With offices located across the globe, operational challenges arose from differences in policies and procedures, different compliance and marketing teams and accounting performance systems.

Solution: As part of the rebranding, it was determined that a single GIPS compliant firm definition was appropriate. Through subsequent acquisitions in 2019 and 2021 the GIPS compliant firm incorporated additional assets into global firm definition. Effective 2022, the firm was redefined to include parts of the investment manager that were excluded during the initial 2018 restructuring. This included the infrastructure and private markets group.

Results: By working with ACA, the firm successfully redefined their GIPS compliant firm to mirror the corporate restructuring. The GIPS compliant firm now markets itself under one unified brand as a global asset manager rather than seven separate entities with little connection to each other. The GIPS report now shows consolidated assets under management which allows the firm to better tell a single story of their total capabilities and scope in the market. This was enhanced with the acquired assets and inclusion of infrastructure and private markets group. With the inclusion of the private markets group into the GIPS standards framework and adherence to provisions around calculation of performance and other required metrics has allowed those private funds to mitigate potential regulatory risk surrounding FINRA-Regulatory Notice 20-21.

Case studies

Case Study Two

- **Company:** Large asset manager with more than $400 billion in AUM globally as of 12/31/2022
- **Location:** Global
- **Financial Services Sector:** Wealth Management

Client Base: Pension plans, foundations, endowments, financial institutions, and other institutional investors worldwide, as well as wealth management and retirement products for affiliates, extending across a broad range of public and private asset classes and other asset allocation solutions

Background: The global GIPS standards defined firm includes six entities that operated under the same brand name globally, across offices in Europe, Japan, Hong Kong, Singapore, Canda, and the United States.

Challenge: Specific calculation requirements for MWR and too many hurdles for alternative asset managers to claim compliance with the GIPS standards.

Solution: With the adoption of the 2020 GIPS standards, the firm decided to fold in the previously excluded private market group in order to have the broadest, most meaningful firm definition as recommended by the GIPS standards.

Results: By working with ACA to redefine their GIPS compliant firm, the adviser was able to align their GIPS compliant firm with marketing efforts to present a single firm to the public. This removes complexities for other departments that previously had different practices for different parts of the firm. With the inclusion of the private markets group into the GIPS standards framework and adherence to provisions around calculation of performance and other required metrics has allowed those private funds to mitigate potential regulatory risk surrounding FINRA-Regulatory Notice 20-

Conclusion

As investment managers evolve to meet the demands of a dynamic market, the trend of adopting a global firm definition for complying with the GIPS standards gains momentum. The pros, including the consolidation of public image, a more reflective asset value of the business, investor demand, and regulatory alignment, outweigh the perceived operational challenges.

Debunking misconceptions clarifies the viability of implementing firm-wide GIPS compliance, bolstered by third-party verification and adherence to calculation requirements. The increased applicability of GIPS compliance for alternative assets further incentivizes firms to make the shift.

As the industry continues to evolve, adopting a globalized GIPS compliant firm definition emerges as a strategic imperative, enabling firms to assert a unified brand and maintain competitiveness within their peer groups.

In this complicated and competitive investment environment, partnering with a reputable third-party performance expert with both technical and regulatory expertise can help investment managers navigate this ever-evolving landscape and provide unparalleled industry knowledge and best practices in risk management and compliance.

How we help

Firms across the industry are challenged not only by becoming GIPS compliant, but also by maintaining such compliance. We can assist your firm with overcoming these challenges by helping build and improve upon your framework as well as by providing firm-wide verifications and performance examinations. Our services include:

Pre-Compliance Consulting: Assisting firms with developing the roadmap and building the framework to claim GIPS compliance. Our pre-compliance consulting addresses:

- calculation methodologies
- policy and procedures development
- composite membership guidelines
- a thorough review of your marketing and advertising disclosures
- GIPS compliance gap analysis

Firm-wide Verification: Independent verifications designed to assess whether your firm is adhering to the GIPS standards. These confirm:

- whether your firm has complied with all the composite-construction requirements of the GIPS standards on a firm-wide basis
- whether your firm's processes and procedures are designed to calculate and present performance results in compliance with the GIPS standards

Third-party verification brings credibility to the claim of compliance and supports the overall guiding principles of full disclosure and fair representation of investment performance. Many asset managers find that consultants and institutional investors require GIPS-compliant firms to be verified before moving forward in any searches.

Performance Examinations: Comprehensive, focused performance examinations of specific composite track records. Our examinations could include:

- whether composite calculations are in compliance with the GIPS standards
- whether the composite's compliant presentation includes all of the required statistics and disclosures of the GIPS standards

A firm cannot claim that a particular composite has been examined unless a performance examination has been completed. A performance examination can only be conducted by a verifier after, or in conjunction with, a firm-wide verification.

In addition, we offer a wide range of investment performance solutions, including:

- Composite-specific performance examinations
- Pre-compliance consulting/gap analysis
- Customized in-house training
- Ongoing consulting
- Independent performance certification
- Focused performance review
- Performance focused SEC mock exam
- Managed Performance Services as an outsourced solution

Our team

ACA brings together the largest team of investment-performance professionals in the world to deliver a comprehensive range of GIPS standard verification and advisory solutions and help firms navigate complex challenges.

The team includes over 90 performance consultants representing in-depth GIPS standards and performance expertise who work with firms of varying sizes and complexities, including traditional investments, private equity, private debt, real estate, Collateralized Loan Obligations (CLOs), and across all vehicle types.

ACA's performance team is part of ACA Group, the leading governance, risk, and compliance (GRC) advisor in financial services. For over 20 years, we've empowered our clients to reimagine GRC to launch, grow, and protect their business. Our global team includes former regulators and practitioners with a deep understanding of the regulatory landscape. Our innovative approach integrates advisory, managed services, distribution solutions, and analytics with our ComplianceAlpha® technology platform.

About ACA Group

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For more information

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