GIPS Adoption Ensures That Managers Properly Select and Present Their Benchmarks

The adoption of GIPS standardizes performance measurement and reporting across the industry. One may argue that GIPS goes too far while others may say that it does not go far enough. This kind of debate is constructive and provides excellent feedback to the industry. Within the North American context we commend US-based managers' GIPS adoption rate. Their fairly pervasive implementation of GIPS enhances industry integrity. US managers appear to comprehend that in order to be a relevant participant at bidding for institutional mandates that they must comply with GIPS. US investors demand manager adherence to GIPS while the very largest Canadian investors also view GIPS as a requirement to manager selection. This article touches on GIPS best practices specifically as it relates to benchmark selection and presentation.

GIPS Significantly Reduces Risk of Benchmark Shenanigans by Manager

To the investor, GIPS provides an added level of comfort that managers are behaving with integrity with respect to both the measurement and presentation of their performance figures. The importance cannot be emphasized enough because the competitive nature of the investment management industry is such that the added control layer of GIPS significantly reduces a manager's temptation to misrepresent performance figures in order to attract capital. Plainly, the fact that most reputable institutional investors are against allocating capital to non-compliant managers is a good thing.

GIPS is very reasonable in its requirements when it comes to proper benchmark selection as it merely demands that the benchmark should match the composite’s strategy. For example, a growth composite is most likely better suited to a growth index, whereas a composite in which the investment style moves between growth and value companies would warrant a broader index that captures both investment styles.

When providing performance returns in presentations, GIPS require that firms disclose the benchmark description. The description must include the name of the benchmark and/or its key features. When advertising the GIPS guidelines require utilized benchmarks to be the same as the ones used in presentations. In addition to presenting benchmark total returns, firm performance advertising must also disclose the benchmark description.

Performance-related supplemental information can be included in compliant presentations in order to enhance required GIPS provisions. For example, a smart beta composite would be benchmarked against a smart beta index and, as such, the compliant presentation would contain information on that index. The firm may decide to enhance the compliant presentation by providing a comparison of the strategy and the smart beta index versus the market index - this would be supplemental information.

Concluding Remarks

In the competitive world of investment management nothing can be assumed to be full proof at guarding against malfeasance and misrepresentation. Though the added level of controls added to performance via GIPS requirements and recommendations go a long way at improving the odds that a manager is acting with utmost integrity. As a matter of commentary our sincere wish is that a preponderance of Canadian managers embrace a change in their mindset. Presently most address the various areas of their operations only upon receiving feedback to do so from regulators and investors. Our strong suggestion is to take a page out of their US counterparts' book where the most successful managers ensure that their operations are at their best on ongoing basis including at the time of regulator audits and investor due diligence. US managers are proof positive that adopting GIPS goes a long way towards capturing a greater share of the institutional market.

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