LM04 · ETHICS & PROFESSIONAL STANDARDS · CFA LEVEL I

Introduction to the Global Investment Performance Standards (GIPS)

How firms present investment performance fairly, comparably, and with full disclosure

What GIPS Is

GIPS = *Global Investment Performance Standards*. They are **ethical standards for investment performance presentation** that ensure **fair representation** and **full disclosure**. Widespread use of GIPS makes performance comparisons across firms meaningful, avoids misrepresentations, and gives oversight bodies a clearer view of returns achieved and risks taken.

What This Reading Covers

Why	The historical problems with performance reporting that GIPS was built to stop
Who	Which parties may claim compliance (and which may not)
What	How the firm is defined, what a composite is, and what discretion means
Structure	The eight sections of the GIPS standards for firms, and the role of verification
Goal	Standardized calculation and presentation of investment performance so prospective clients can fairly evaluate firms

Exam Tip: GIPS is **voluntary** — a firm chooses to claim compliance. But once claimed, the firm **must comply fully and on a firm-wide basis**, not on a cherry-picked set of composites. Partial compliance is not permitted.

WHY GIPS WERE CREATED

The Problems GIPS Was Built to Solve

Before GIPS, firms chose their own methodologies for reporting performance — and they tended to choose methodologies that made their own results look good. Questions about the accuracy and credibility of the data made **comparisons across firms difficult** for prospective clients.

THREE COMMON MISLEADING PRACTICES BEFORE GIPS

REPRESENTATIVE ACCOUNTS	SURVIVORSHIP BIAS	VARYING TIME PERIODS
Show only the best-performing portfolio as representative of the firm	Exclude accounts that performed poorly and were terminated	Pick the time windows during which the fund had exceptional returns
Makes the firm look uniformly excellent	*Removes the losers from the track record*	*Cherry-picks the best stretches only*

What GIPS Was Designed to Do

1. Establish an **industry-wide, standardized approach** to the calculation and presentation of investment performance.
2. **Prevent misrepresentation** of performance — remove the selective presentation practices above.
3. Make **performance comparisons across firms meaningful** for prospective clients.
4. Give **oversight bodies** a clearer understanding of returns achieved and risks taken by the firms they supervise.

GIPS Objectives (Mind-Map Summary)

Establish industry best practice · achieve global acceptance of calculation and presentation standards (fair, comparable format, full disclosure) · ensure consistent and accurate performance data · promote fair competition · promote global industry **self-regulation** · remove misleading practices (representative accounts, survivorship bias, varying time periods).

PARTIES & SCOPE OF GIPS

Who Can Claim Compliance — and Who Cannot

The One-Line Rule

GIPS only applies to firms that actually manage assets. Compliance is voluntary, but any firm that does manage assets may claim compliance once it has satisfied all GIPS requirements *fully and on a firm-wide basis*.

PARTY	MAY CLAIM GIPS COMPLIANCE?	WHY / QUALIFIER
Investment management firms	**Yes**	They actually manage assets — the core target of GIPS
Asset owners (e.g., pensions, endowments)	**Conditional**	May claim compliance if they *compete for business*. If they do not compete but report to an oversight body, they may choose to comply with the GIPS standards for asset owners.
Software vendors, consultants, plan sponsors not managing assets	**No**	May *endorse* GIPS but **may not claim compliance** — they do not actually manage assets.

Who Benefits from Compliance

Asset managers & their prospective clients

Standardized presentation allows prospective clients to fairly compare firms; compliant firms gain credibility.

Asset owners & their oversight bodies

Oversight bodies get a clearer view of returns achieved and risks taken by the asset owners they supervise.

Exam Tip: A classic distractor: "a pension plan sponsor that selects external managers can claim GIPS compliance." **False** — unless the plan itself manages assets and competes for business (or reports under the asset-owner standards), it cannot claim compliance. Consultants and software firms are also excluded.

QUIZ 1 · CHECKPOINT

Test Your Understanding: Why GIPS & Who It Applies To

Q1. Which of the following was *not* one of the misleading practices GIPS was created to stop?

Q2. GIPS compliance can *most likely* be claimed by:

Q3. A firm that claims GIPS compliance must comply:

Q4. Which statement about asset owners under GIPS is *most accurate*?

KEY CONCEPTS OF THE GIPS STANDARDS FOR FIRMS

Ethical Foundation of the Standards

GIPS Are Ethical Standards

GIPS are **ethical standards for investment performance presentation**. Their purpose is to ensure **fair representation** and **full disclosure** of investment performance.

Six Key Principles

1. **Requirements vs. recommendations.** Meeting the objectives of fair representation and full disclosure is likely to require more than simply adhering to minimum requirements. Firms *should* also follow the recommendations to achieve best practice.
2. **All applicable requirements apply.** Firms must comply with all Guidance Statements, interpretations, and Q&As published by CFA Institute and the GIPS standards governing bodies.
3. **GIPS is not exhaustive.** GIPS does not address every aspect of performance measurement and will continue to evolve over time.
4. **Composites are required.** Firms must create and maintain composites for all strategies for which the firm manages segregated accounts or markets to segregated accounts.
5. **Integrity of input data.** GIPS relies on the accuracy of input data. Underlying portfolio valuations drive performance; firms must ensure inputs are accurate.
6. **Standardized calculation methodology.** Firms must adhere to specific calculation methodologies so performance is *comparable* across firms.

Exam Tip: Memorize the phrase **"fair representation and full disclosure"** — it is the recurring answer to "what is the purpose of GIPS?" questions. GIPS is about *how* performance is shown, not about *what* returns are achieved.

FUNDAMENTALS OF COMPLIANCE · DEFINITIONS

Defining the Firm & Defining Discretion

Definition of the Firm

For GIPS compliance, the firm is defined as the **corporation, subsidiary, or division held out to clients as a business entity**. The GIPS standards direct firms to adopt the **broadest, most meaningful** definition of the firm.

> *"The scope of this definition should include all geographical (country, regional, etc.) offices operating under the same brand name, regardless of the actual name of the individual investment management company."*

Consequence: The firm definition includes *all* of its geographic locations and their clients. You cannot carve out a single geography or legal entity to improve reported performance.

Definition of Discretion

Discretion means the firm is **actually managing the assets** in a portfolio — implementing its own investment strategy. The firm's definition of discretion sets the criteria for which portfolios must be included in a composite.

Discretionary

The firm can carry out its intended investment strategy. Portfolio **must** be assigned to a composite.

Non-Discretionary

Client-imposed restrictions interfere with the implementation of the strategy. Portfolio **must not** be included in a composite.

Example: A client demands specific stock-level buy/sell instructions that override the manager's strategy — the account is non-discretionary and is excluded from composites.

The Compliance Foundation

Fundamentals of Compliance rest on four pillars: (1) **properly defining the firm**, (2) **providing compliant presentations to all prospective clients**, (3) **adhering to applicable laws and regulations**, and (4) **ensuring information is not false or misleading**.

THE CORE CONSTRUCT OF GIPS

Composites — Grouping Portfolios by Strategy

Definition

A **composite** is a grouping of individual **discretionary, fee-paying portfolios** that a firm manages using a **similar investment strategy, objective, or mandate**. Reporting composite performance gives prospective clients information about the firm's success in managing each style.

PORTFOLIOS GROUPED INTO COMPOSITES BY STRATEGY

Firm managing 100 accounts across 2 strategies

COMPOSITE A
Large Cap Value Stocks

70 fee-paying discretionary portfolios managed in this style

Report composite A performance separately

COMPOSITE B
Small Cap Growth Stocks

30 fee-paying discretionary portfolios managed in this style

Report composite B performance separately

Composite Construction Rules

1. A composite representing a strategy **must include *all* fee-paying, discretionary portfolios (current and past)** managed with that strategy.
2. Every fee-paying, discretionary account the firm manages must be included in **at least one composite**.
3. The criteria for classifying portfolios into composites **must be decided *before* the composite's performance is known** — not retroactively.
4. This forward-looking rule is what **prevents firms from cherry-picking** only their best-performing portfolios for display.

Which Portfolios Are Excluded?

Non-fee-paying accounts	Excluded (e.g., charity pro-bono mandates where the firm charges no fee)

Non-discretionary accounts	Excluded (e.g., client dictates trades, overriding the manager's strategy)
Past terminated accounts managed under the strategy	**Included** — exclusion would be survivorship bias

Exam Tip: Three "must"s to memorize: composites must include **all fee-paying, discretionary portfolios** (including past/terminated), criteria must be set **before performance is known**, and every qualifying account must be in **at least one composite**.

FUNDAMENTALS OF COMPLIANCE

The Foundation Principles

Several core principles form the foundation for the GIPS standards:

PRINCIPLE 1

Properly Defining the Firm

Adopt the broadest, most meaningful definition — include all geographic offices operating under the same brand name.

PRINCIPLE 2

Provide Compliant Presentations

Compliant presentations must be provided to *all* prospective clients (not a subset).

PRINCIPLE 3

Adhere to Laws & Regulations

Firms must follow all applicable laws and regulations in each jurisdiction where they operate.

PRINCIPLE 4

No False or Misleading Information

Information presented must not be false or misleading — this is the overarching ethical constraint.

Firm-Wide Compliance — the Non-Negotiable

A firm may only claim compliance with GIPS if it **complies fully and on a firm-wide basis**. There is no partial or selective compliance. A firm cannot claim "GIPS-compliant for U.S. equity composites but not for fixed-income composites" — compliance is all-or-nothing.

Exam Tip: The phrase **"firm-wide basis"** is the GIPS shibboleth. It appears in questions about compliance, about verification, and about scope. When an answer option restricts GIPS to a single composite, product line, or geography, that option is almost always wrong.

QUIZ 2 · CHECKPOINT

Test Your Understanding: Firm, Discretion & Composites

Q5. A GIPS-compliant firm must define itself using:

Q6. A client instructs the firm to avoid tobacco and alcohol stocks, but does not otherwise restrict strategy. Another client dictates the specific securities to buy and sell on every trade. Under GIPS, these accounts are treated how?

Q7. A composite formed under GIPS must include:

Q8. Under GIPS, the criteria a firm uses to classify portfolios into a composite must be determined:

VERIFICATION OF GIPS COMPLIANCE

Verification — Voluntary, but Firm-Wide

Core Idea

Firms that claim compliance with GIPS **self-regulate**. To increase confidence in that claim, a firm *may voluntarily* hire an independent third party to perform **verification**.

What Verification Tests

1. Whether the firm has **complied with all composite construction requirements on a firm-wide basis**; and
2. Whether the firm's **policies and procedures are designed to calculate and present performance in compliance** with the GIPS standards.

Verification Requirements

REQUIREMENT	DETAIL
Scope	Verification applies to the **entire firm**, not selected composites. It is firm-wide, full-stop.
Who performs	An **independent third party** must perform verification. A firm **cannot** verify itself.
Mandatory?	No — verification is **voluntary**. Firms are encouraged but not required to pursue it.
Effect on compliance claim	Does not grant GIPS compliance (the firm must still meet all requirements); it provides independent assurance that compliance is firm-wide and that policies are in place.

Three Claims That Are Wrong

- "Verification is required to claim GIPS compliance." **Wrong** — voluntary.
- "A firm may verify a single composite." **Wrong** — verification is firm-wide.
- "A firm's internal compliance team can perform verification." **Wrong** — must be an independent third party.

Exam Tip: Memorize the two "musts" of verification: **firm-wide** and **independent third party**. Every exam question on verification turns on one of these two facts.

STRUCTURE OF THE GIPS STANDARDS FOR FIRMS

The Eight Sections

The GIPS standards for firms consist of **eight sections** covering the full lifecycle of performance measurement — from defining the firm, through calculating returns, to presenting and advertising them.

SECTION 1

Fundamentals of Compliance

Defining the firm, providing compliant presentations to prospective clients, following laws/regulations, ensuring information is not false or misleading.

SECTION 2

Input Data and Calculation Methodology

Integrity of input data (valuations drive performance) and standardized calculation methodology so results are comparable across firms.

SECTION 3

Composite and Pooled Fund Maintenance

How composites and pooled funds are created, maintained, and updated over time.

SECTION 4

Composite Time-Weighted Return Report

Reports for composites using time-weighted returns — the default return methodology for most strategies.

SECTION 5

Composite Money-Weighted Return Report

Reports for composites using money-weighted (IRR-based) returns — used where the firm controls cash flows (e.g., closed-end structures).

SECTION 6

Pooled Fund Time-Weighted Return Report

Reports for pooled funds using time-weighted returns.

SECTION 7

Pooled Fund Money-Weighted Return Report

Reports for pooled funds using money-weighted returns.

SECTION 8

GIPS Advertising Guidelines

Rules governing how GIPS-compliant performance may be advertised (as distinct from the full compliant presentation).

Why This Structure Matters

The standards separate **composite** reporting from **pooled fund** reporting, and **time-weighted** from **money-weighted** return reports. Advertising has its own section because an ad is not a full compliant presentation — different disclosure rules apply.

Exam Tip: If asked "how many sections do the GIPS standards for firms have?" — the answer is **eight**. The separation of time-weighted and money-weighted, and of composite and pooled fund, creates 4 of the 8 sections.

COMPLIANT PRESENTATION — CONCEPTUAL LAYOUT

What a GIPS Composite Report Shows

The GIPS standards prescribe how the firm presents composite performance. The layout below synthesises the required ingredients from the fundamentals and input-data sections — composite identity, periods shown, gross/net returns, benchmark, firm/composite assets, and number of portfolios in the composite.

Example Firm, LLC

Large-Cap Value Composite · GIPS-Compliant Presentation (Illustrative Layout)

YEAR	GROSS RETURN (%)	NET RETURN (%)	BENCHMARK RETURN (%)	# PORTFOLIOS	COMPOSITE ASSETS ($MM)	FIRM ASSETS ($MM)	INTERN DISPER (%)
20X5	12.8	11.9	12.1	72	980	4,250	0.9
20X4	−4.2	−5.0	−4.6	70	870	3,910	1.1
20X3	9.6	8.8	9.9	68	910	3,620	0.8
20X2	15.1	14.2	14.8	65	850	3,380	1.0
20X1	7.4	6.6	6.9	62	780	3,100	0.7

Required disclosures include: firm definition and scope; composite description and strategy; creation/inception dates; fee schedule; benchmark description; definition of discretion; treatment of non-fee-paying accounts; the statement that policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request; and the GIPS compliance statement.

What Each Column Does

Gross / Net Return	Return before and after investment management fees — both are typically shown so clients can isolate the fee impact.
Benchmark Return	Consistent benchmark across the entire reporting period; benchmark must be disclosed and justified.
# of Portfolios	Shows the depth of the composite. Many portfolios → more representative. Few portfolios → the return reflects a narrow set.
Composite & Firm Assets	Lets prospects see the strategy's share of firm AUM and whether the firm is stable.

Internal Dispersion	Measures the return spread *within* the composite — a signal of how consistently the strategy was applied across portfolios.

The GIPS Compliance Statement

"[Firm name] claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards." Without this statement (and full backing), a firm cannot assert compliance.

QUIZ 3 · CHECKPOINT

Test Your Understanding: Verification, Sections & Presentation

Q9. Which of the following statements about GIPS verification is *most accurate*?

Q10. The GIPS standards for firms consist of how many sections?

Q11. Which of the following is *least likely* a stated objective of the GIPS standards?

Q12. A compliant GIPS presentation for a composite would *least likely* include:

Q13. To comply with GIPS, the criteria used to assign portfolios to a composite must be established before the reporting period because:

MODULE COMPLETE

Your Scorecard

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LM04 Key Takeaways — Exam-Ready Cheat Sheet

Why & Who

1. **Why GIPS:** stop three misleading practices — *representative accounts, survivorship bias, varying time periods* — and make cross-firm comparisons meaningful.
2. **Who may claim:** only *firms that actually manage assets*. Software vendors, consultants, and plan sponsors that don't manage assets may *endorse* but not claim compliance. Asset owners may claim only if they compete for business.
3. **Compliance is voluntary** — but once claimed, it must be **full and firm-wide**.

Core Concepts

4. **Firm definition:** broadest, most meaningful — all geographic offices under the same brand name.
5. **Discretion:** firm can implement its strategy. Client restrictions that interfere → non-discretionary → *excluded* from composites.
6. **Composite:** grouping of *all fee-paying, discretionary* portfolios (current + past) managed with the same strategy. Every such account must be in at least one composite. Classification criteria set **before** performance is known.

Fundamentals of Compliance (Four Pillars)

7. Properly **define the firm** · provide **compliant presentations to all prospects** · **adhere to applicable laws/regulations** · ensure **no false or misleading information**.

8. **Purpose (memorize):** fair representation and full disclosure.

Verification

9. **Voluntary · firm-wide · independent third party.** Tests (a) firm-wide compliance with composite construction and (b) that policies/procedures are designed to calculate and present performance per GIPS.

Eight Sections of the GIPS Standards for Firms

1. Fundamentals of Compliance
2. Input Data and Calculation Methodology
3. Composite and Pooled Fund Maintenance
4. Composite Time-Weighted Return Report
5. Composite Money-Weighted Return Report
6. Pooled Fund Time-Weighted Return Report
7. Pooled Fund Money-Weighted Return Report
8. GIPS Advertising Guidelines

Last-Minute Exam Checklist

Purpose: fair representation & full disclosure

Who claims: only firms that manage assets; endorse ≠ comply

Scope of claim: full and firm-wide (never selective)

Composites: all fee-paying, discretionary portfolios; past included; criteria set before performance

Firm definition: broadest, most meaningful — all offices under same brand

Verification: voluntary, firm-wide, independent third party

Three misleading practices GIPS stops: representative accounts, survivorship bias, varying time periods

Sections: eight

Step 1 of 14