G·I·P·S

Global Investment Performance Standards

GIPS® Guidance Statement on Definition of the Firm

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Guidance Statement on Definition of the Firm (Revised)

Introduction

Three of the most fundamental issues that a firm must consider when becoming compliant with the GIPS® standards are the definition of the firm, the firm's definition of discretion, and the firm's composite definition principles and guidelines. The definition of the firm is the foundation for firm-wide compliance and creates defined boundaries whereby total firm assets can be determined. The firm's definition of discretion establishes criteria to judge which portfolios should be in a composite to accurately reflect the application of the firm's investment strategy. Once the firm and discretion have been defined, composites can be constructed based on the strategies implemented by the firm.

The GIPS standards must be applied on a firm-wide basis. As the first step in complying with the Standards, the firm must be defined fairly and appropriately. Compliance with the GIPS standards relies on a clear and consistent definition of the firm. The Standards require that the definition of the firm be disclosed on the composite presentations, and the verification principles require that verifiers determine if the firm is, and has been, appropriately defined.

In addition, the definition of the firm delineates the universe of "all" portfolios that must be included in total firm assets under management. Fundamental to the Standards is the premise that all actual, fee-paying discretionary portfolios must be included in at least one composite.

As merger and acquisition activity can affect the definition of the firm, the Guidance Statement on Performance Record Portability should also be considered.

Guiding Principles

When defining the firm, it is important to consider the following:

- How the firm holds itself out to the public.
- The firm definition must be appropriate, rational and fair.
- Firms are encouraged to adopt the broadest, most meaningful definition of the firm.
- Firms must not use the definition of the firm as a substitute for defining composites, (e.g., defining the firm too narrowly, as to only encompass one product).

Defining the Firm

The Standards require that firms must be defined as an investment firm, subsidiary, or division held out to clients or potential clients as a distinct business entity.

A distinct business entity is a unit, division, department, or office that is organizationally and functionally segregated from other units, divisions, departments, or offices and retains discretion over the assets it manages and should have autonomy over the investment decision-making process.

Possible criteria that can be used to determine this include:

- being a legal entity,
- having a distinct market or client type (e.g., institutional, retail, private client, etc.), or
- using a separate and distinct investment process.

As previously stated, firms are encouraged to adopt the broadest, most meaningful definition of the firm and consider how it is held out to the public. The scope of this definition should include all geographic (country, regional, etc.) offices operating under the same brand name regardless of the actual name of the individual investment management company. These include, but are not limited to:

- All offices operating under the same brand name (e.g. XYZ Asset Management),
- Other names resulting from mergers, acquisitions, etc., trading under a different name for branding purposes,
- Financial service holding companies defined as one global firm with multiple brands, several legal entities, multiple offices, investment teams, and investment strategies,
- An investment management firm with one brand, but multiple strategies and investment teams,
- All offices trading under a globally recognizable trading name with regional/country specific additions (e.g. XYZ Asset Management Asia),
- Investment management firms in most countries must register with one or more governmental agencies or regulators. The GIPS standards recognize a regulatory registration as a possible definition of a firm for purposes of compliance, but also require firms consider the manner in which they are holding themselves out to the public when determining the firm definition.

Additional Considerations

In addition to the Guiding Principles listed above, firms should consider the following when defining the firm:

- The Standards require that when the firm jointly markets with other firms, the firm claiming compliance with the GIPS standards must be sure that it is clearly defined and separate relative to any other firms being marketed and that it is clear which firm is claiming compliance.
- The Standards recommend that if a parent company contains multiple defined firms, each firm within the parent company is encouraged to disclose a list of the other firms contained within the parent company.
- The use of a third party (e.g., custodian, broker/dealer, etc.) to perform record keeping or performance measurement is not a valid reason for excluding assets from the definition of the firm.
- Systems incompatibilities cannot be used as a reason for excluding assets from the definition of the firm (i.e., a firm cannot make the claim of compliance for only those assets that are measured and monitored on compatible systems).

Inception of the Firm/Redefinition of the Firm
In some cases, due to corporate restructuring and merger and acquisition activities, the changes within the firm may be so significant that it is held out to the public as a new firm. The new firm must determine if there is a continuation from the prior firm or if the restructuring is so substantial that it is essentially a new firm.

Changes in investment style or personnel are not valid reasons for redefining the firm, unless the changes are such that the firm is held out to the public in a significantly different way. A simple name change is not sufficient reason to redefine the firm and restart the performance record. In some cases, a firm definition may change without the firm losing its performance history. Please refer to the Guidance Statement on Performance Record Portability for related guidance. In all cases, the underlying principles of the Standards must be considered: fair representation and full disclosure. If a firm is redefined, Provision 4.A.21 requires that the firm disclose the date and reason for the redefinition. The Standards require that changes in a firm's organization are not permitted to lead to alteration of historical composite results.

Total Firm Assets
The definition of the firm also determines the boundaries for determining total firm assets. This includes all assets for which a firm has investment management responsibility and includes assets managed outside the firm (e.g., by subadvisors) for which the firm has discretionary authority. The Standards state that total firm assets must be the aggregate of the market value of all discretionary and non-discretionary assets under management within the defined firm. This includes both fee-paying and non-fee-paying assets.

Assets to which the Standards cannot be applied are not to be considered by firms when claiming compliance and are not to be included in total firm assets. Such assets include investment vehicles that are based on cost or book values rather than market values.

Subadvisors
Some firms utilize a subadvisor to manage part or all of a particular strategy. For example, if a firm specializes in managing equities, it might hire a subadvisor to manage the fixed income portion of its balanced portfolios. The Standards require that firms must include the performance of assets assigned to a subadvisor in a composite provided the firm has the authority to allocate the assets to a subadvisor.

If a firm has discretion over the selection of the subadvisor (i.e., can hire and/or fire), the firm must claim the subadvisor's performance as part of its performance history and include the assets in the firm's total assets. Because the subadvisor has discretion over the actual investment of the assets and the firm has discretion over the selection of the subadvisor, both the firm and the subadvisor are able to claim the performance of the assets as their own. The firm is able to claim this performance because the sub-advised portion of the portfolio is essentially viewed as an asset (similar to purchasing a mutual fund within the portfolio) and the firm must be held responsible for its decision to utilize a subadvisor. The firm can only include the subadvisor's performance record relevant to those assets assigned by the firm. If a firm does not have discretion over subadvisor selection, it must not include the subadvisor's performance in its performance history.

The Standards require that beginning 1 January 2006, firms must disclose the use of a subadvisor(s) and the periods a subadvisor(s) was used.

Effective Date

This Guidance Statement was originally effective 1 April 2002 and was revised to reflect the changes to the GIPS standards effective as of 1 January 2006.

Firms claiming compliance prior to 1 January 2006 were required to retroactively apply the original guidance for all periods prior to 31 December 2005; however, the revisions to this guidance (effective 1 January 2006) are not required to be retroactively applied. Firms have until 1 January 2006 to redefine themselves as necessary to comply with this Guidance Statement.

All firms coming into compliance on or after 1 January 2006 must apply this revised guidance to all periods.

Key GIPS Provisions Specifically Applicable to Definition of the Firm:

0.A Definition of the Firm — Requirements

0.A.1 The GIPS standards must be applied on a firm-wide basis.

0.A.2 Firms must be defined as an investment firm, subsidiary, or division held out to clients or potential clients as a distinct business entity.

0.A.3 Total firm assets must be the aggregate of the market value of all discretionary and nondiscretionary assets under management within the defined firm. This includes both fee-paying and non-fee-paying assets.

0.A.4 Firms must include the performance of assets assigned to a subadvisor in a composite provided the firm has discretion over the selection of the subadvisor.

0.A.5 Changes in a firm's organization are not permitted to lead to alteration of historical composite results.

0.B Definition of the Firm — Recommendations

0.B.1 Firms are encouraged 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.

0.A Document Policies and Procedures — Requirements

0.A.6 Firms must document, in writing, their policies and procedures used in establishing and maintaining compliance with all the applicable requirements of the GIPS standards.

Applications:

1. *An investment management firm uses a subadvisor to manage a portion of the assets for a strategy that the firm manages. Should the assets managed by the subadvisor be excluded from the composite performance?*

If the firm has discretion over the selection of the subadvisor, then the assets managed by a subadvisor on behalf of the firm must be included in the firm's composite performance and total firm assets. Once the assets are given to a sub-adviser to manage, the firm will not have control over exactly how those assets are invested by the subadvisor. Nevertheless, the firm chose to invest the assets by placing them with a subadvisor and has the discretion to hire or fire the subadvisor.

The firm can only include the subadvisor's performance record relevant to those assets assigned by the firm.

2. *According to this Guidance Statement, "Assets to which the Standards cannot be applied are not to be considered by firms when claiming compliance and are not to be included in total firm assets. Such assets include investment vehicles that are based on cost or book values rather than market values." Does this mean that cash substitutes, such as CDs and money market funds held in portfolios, are not to be considered by firms when claiming compliance and are not to be included in total firm assets?*

Money market funds, CDs and other cash substitutes ARE to be considered by firms when claiming compliance and are to be included in total firm assets. A market value for these assets can be determined.

3. *Previously, our firm was a department within a larger organization. Recently, the department was able to complete a buy-out, and we are now an independent investment advisor. What must the firm do in order to continue the claim of compliance?*

A firm's definition reflects how it holds itself out to the public. As the department was previously within the larger organization, if the department claimed compliance as a separate firm without the parent organization being included in that firm definition, there may not need to be any changes. The department may have been and may continue to be a distinct business entity held out to the public as such. It may be necessary for the department to disclose any significant events that would help prospective clients interpret the performance record.

However, if the department and parent organization were historically combined in the same firm definition for purposes of claiming compliance, the definition of the firm has changed with the buy-out and the claim of compliance with the Standards must be reevaluated.

4. *An investment management firm has a Euro-zone fixed income composite that contains the following three portfolios:*
    a. *a fund that is invested in European bonds with net assets of 20,*

b. a fund that is invested in bonds of one country of the Euro-zone with net assets of 30, and
c. a private portfolio invested entirety in the 2 above mentioned funds. Net assets of this portfolio are 10.

How should GIPS 5.A.1.c be interpreted?

- *Is it correct to say that the number of portfolios of the composite described above is 3?*
- *Is it correct to say that the amount of assets in the composite is 20+30+10=60?*
- *Is it correct to say that the total firm's assets is 50 or that the total firm's assets is 60 (in the case this firm only owns that one composite)?*

The question is that of eliminating double counting assets. Is it correct to say that showing the above composite's asset level of 60 is not misleading to the reader? (The firm will also disclose what % the composite represents of the firm's assets, therefore showing 110% of firm's assets means that some assets are counted more than once. For example, because the management of the private portfolio above is not geared towards choosing the securities in the portfolio, but rather geared towards realizing the proper asset allocation between both funds.)

The GIPS standards are based on the principles of fair representation and full disclosure. Double counting assets would not fairly represent the firm's assets. The composite would have 3 portfolios and have net assets of 50. If there are no other assets within the firm, then total firm assets would be 50.