



Association of British Insurers



Mandatory, independent verification of investment performance: why it matters

A statement on behalf of investors by the ABI, IMA and NAPF

Mandatory verification has long been relied on by UK institutional investors. It was a cornerstone of the UK's 1990's investment performance standards that compliant performance figures be externally calculated. With the advent of the Global Investment Performance Standards (GIPS) this became referred to as being externally verified. Such verification provides assurance that investment performance figures generated under GIPS are accurate and consistently reliable. This facilitates meaningful comparisons of performance.

The reasons for mandatory, independent verification are as valid today as they were then. Set out below are some of the principal reasons why verification is still important and necessary.

- GIPS is a world standard applying to today's global investment management business. Investment managers compete for business across geographic locations. It is absolutely essential therefore that investors be assured that they are comparing like with like across borders e.g. Europe with Australia, US with Hong Kong etc. It is self-evident that where a global standard seeks to cover different countries with different levels of sophistication, different levels of financial market quality and capability, then it is essential for the long term viability of the standard that a system of quality control, such as verification, is required. Only then can the credibility and consistency of the standard over the long term be maintained.
- Independent verification adds credibility to a firm's claim of compliance. Consequently, this means that the recipients of a verified firm's performance track record will have more confidence that it is accurate and representative.
- Verification helps to enhance the quality, content and utility of performance presentations. This will enable potential investors to make comparisons of performance and better-informed decisions.
- Verification helps asset managers protect their reputations. It reduces the risks of errors and of making false or misleading claims.
- Verification assists firms in the process of gaining compliance by raising awareness of the firm's policies and procedures among employees.
- Verification is helpful to fund management firms. There is empirical evidence that it improves internal procedures and controls around the production of performance measurement information. The involvement of an independent verifier ensures that robust procedures are in place. Verifiers are a valuable source of advice and best practice based on a wide market perspective. They can assist on interpretation on the 'grey' areas of the standards.

- To do their job, the standards rely on strict application by those involved. If the standards are seen to be weak, or they develop a reputation for uneven application or promoting gaming, their use to investors is reduced and in time they become discredited. Verification protects the standards in use and promotes investor confidence in them.

The experience in the UK suggests that comparatively few firms get GIPS compliance right if they are left to their own devices. Difficult issues range from the mundane and immaterial to more serious missing or misinterpretation of key requirements of the standards. Verification by independent, competent experts protects against accidental non-compliance as a result of key GIPS requirements not being met.

The principal objection to mandatory verification is largely centred on one of cost. It can not be denied that for firms there is a significant initial cost to gaining GIPS accreditation and there are also annual costs associated with maintaining it. But this is not the whole story. A verification exercise should simplify the internal process that a firm must go through in order to remain in compliance with GIPS. Thus one of the side benefits of verification is that it results in the outsourcing of work that would be completed by the manager when ensuring compliance is maintained. Thus verification may reduce the cost of compliance. Similarly verifiers will be up to date with changes e.g. new or amended Guidance Statements and can therefore offer their clients guidance on how to comply.

A further issue affecting some markets may be a lack of qualified personnel and a lack of quality standardisation. This can be overcome by the availability of a core of professional verifiers. Markets respond to developments. Announcement of the planned inclusion of external verification in the next release of GIPS will kick start the establishment of verifiers in markets currently poorly served.

It is important that there is an investor-led demand for mandatory, independent verification. In the sophisticated UK market there is such a demand from investors. The NAPF, the IMA and the ABI strongly support mandatory, independent verification. NAPF advise their pension fund members to ask if the presenter of performance information is GIPS compliant and independently-verified. If not the question "why not?" follows. It is common practise in the UK for example to ask not just "are you GIPS compliant?" question but additionally who conducted the verification, when and over what periods. Thus in the UK, there is a presupposition that the claim is backed by independent verification. Disparate responses to these questions are viewed in a negative light.

Mandatory, independent verification of performance data is now part of the institutional investment infrastructure in the UK and the fund management industry is in better shape and more highly regarded than in many places elsewhere.

Association of British Insurers
Investment Management Association
National Association of Pension Funds
Co-sponsors of the UK Investment Performance Committee – UK sponsors of GIPS.
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