

The Importance of GIPS Compliance and Holistic Investment Manager Evaluation for Public Agencies

Public agencies face increasing pressure to ensure that taxpayer funds and pension assets are managed with the highest levels of transparency, accountability, and fiduciary care. Given the complexities of modern investment strategies, it is essential that public agencies move beyond a singular focus on cost reduction and instead adopt a more comprehensive evaluation framework. This paper was created by Chandler Asset Management, Inc. (Chandler) to highlight the importance of GIPS compliance, independent verification, and risk-adjusted investment performance in the selection of investment managers. By implementing a holistic approach, public agencies can mitigate risks, enhance performance outcomes, and fulfill their fiduciary obligations more effectively.

I. Introduction

Public agencies, including state and local government agencies, are responsible for managing large amounts of public capital with fiduciary obligations to beneficiaries. Ensuring prudent investment management requires selecting managers who uphold the highest standards of transparency, ethical responsibility, and performance integrity. However, many public agencies continue to focus on fees, often at the expense of comprehensive due diligence.¹ While cost efficiency is important, a holistic evaluation framework, including adherence to internationally recognized standards and independent third-party verification, is essential for ensuring long-term financial stability and fiduciary compliance. By considering multiple factors such as risk-adjusted returns, governance standards, and long-term strategy alignment, public agencies can enhance their investment outcomes and protect their stakeholders from unforeseen financial pitfalls.

II. Understanding GIPS Compliance

A. What Does "GIPS Compliant" Mean?

The Global Investment Performance Standards (GIPS®)² are internationally recognized standards established by the CFA Institute to ensure fair, transparent, and comparable investment performance reporting. GIPS compliance requires investment managers to:

- Utilize standardized performance calculation methodologies.
- Disclose all relevant fees, benchmarks, and investment risks.
- Report performance without cherry-picking only high-performing account.

By adhering to GIPS, investment managers ensure transparency and integrity in their performance data, reducing the risk of misleading performance presentations. This promotes fair comparisons between investment firms, allowing public agencies to make more informed decisions when selecting managers.

¹ The Government Finance Officers Association (GFOA) has published a best practice guideline titled "Selection and Review of Investment Advisors," which provides comprehensive recommendations for state and local governments on the prudent selection and ongoing review of investment advisors. This resource emphasizes the importance of defining advisor responsibilities, conducting impartial procurement processes, and implementing continuous evaluation to ensure effective management of public funds. Government Finance Officers Association. "Selection and Review of Investment Advisors." GFOA, 2023.

² The Global Investment Performance Standards (GIPS®) are voluntary, ethical standards developed by the CFA Institute to ensure fair representation and full disclosure in investment performance reporting. The GIPS standards are designed to provide investors with comparable and transparent performance data, promoting integrity in the investment management industry. CFA Institute. *Global Investment Performance Standards Handbook*. CFA Institute, 2023.

B. The Difference Between GIPS Compliance and GIPS Verification

GIPS compliance can be claimed by an investment firm without external oversight. However, GIPS verification is conducted by an independent third-party auditor, which confirms that:

- The firm's performance reporting policies and procedures adhere to GIPS requirements.
- The firm applies these policies consistently across all discretionary accounts.

Independent verification provides investors and public agencies with additional confidence in the accuracy of reported performance data.³ Verified firms demonstrate a higher level of commitment to transparency and ethical investment practices, which ultimately benefits public agencies and the communities they serve.

III. The Risks of Fee-Driven Selection

Public agencies often prioritize low-cost investment managers to demonstrate fiscal responsibility. However, focusing exclusively on fees can lead to significant risks, including:

1. Misleading Performance Reporting

- Investment managers who do not follow GIPS standards may selectively report only top-performing portfolios, creating an incomplete or misleading picture.
- Without standardized methodologies, performance comparisons become unreliable.

2. Weakened Risk Management

- Low-fee managers may underinvest in research, risk management, and compliance, leading to higher exposure to market downturns.
- Public pension funds prioritizing cost-cutting over governance saw higher volatility and weaker downside protection.⁴

3. Governance and Ethical Risks

- Selecting a low-fee manager with poor compliance history can expose public agencies to SEC investigations and fiduciary liability.
- Conflicts of interest, undisclosed trading practices, and unethical behavior are more common among non-GIPS-compliant managers.⁵

Ignoring risks can result in financial instability and public distrust, so it is crucial for agencies to look beyond fees.

³ The U.S. Securities and Exchange Commission (SEC) has been actively enforcing actions against investment advisers for misrepresenting investment performance. In fiscal year 2023, the SEC filed 784 enforcement actions, including cases addressing misleading performance reporting. Notably, the SEC charged nine registered investment advisers for advertising hypothetical performance without implementing required policies and procedures, resulting in a total of \$850,000 in penalties. U.S. Securities and Exchange Commission. "SEC Sweep into Marketing Rule Violations Results in Charges Against Nine Investment Advisers." SEC Press Release 2023-173, September 11, 2023.

⁴ National Institute on Retirement Security (NIRS) from 2023. However, NIRS has published several reports in 2023 that address related topics. For instance, their biannual Pensionomics report analyzes the economic impact of pension expenditures. Additionally, NIRS released studies examining recruitment and retention issues in Alaska, which may touch upon aspects of pension fund governance and oversight. National Institute on Retirement Security. Pensionomics 2023: Measuring the Economic Impact of DB Pension Expenditures. NIRS, 2023. [Higher fees are not a guarantee of better performance.](#)

⁵ In their article "Global Corporate Governance Trends for 2023," the Harvard Business Review explored how board quality and effectiveness can influence corporate performance. Fields, Richard, and Rusty O'Kelley. "Global Corporate Governance Trends for 2023." Harvard Law School Forum on Corporate Governance, March 10, 2023.

IV. The Case for a Holistic Investment Manager Evaluation

A. Key Components of a Comprehensive Evaluation Framework

To reduce fiduciary risks and improve long-term investment outcomes, public agencies should evaluate investment managers based on:

1. GIPS Compliance and Verification

- Ensures standardized, transparent, and verifiable performance reporting.
- Prevents manipulated or cherry-picked investment returns.
- Reduces legal and reputational risks for public agencies.

2. Net Performance vs. Fees

- Public funds should focus on net-of-fee returns, rather than absolute fee levels.
- High-quality investment processes often justify slightly higher fees when they enhance long-term stability.

3. Risk-Adjusted Performance Metrics

- Downside capture metrics should be used in tandem with raw returns.⁶
- Long-term stability and consistency are more critical than short-term performance.

4. Governance and Compliance Oversight

- Public agencies should conduct in-depth reviews of an investment firm's SEC filings, regulatory compliance history, and governance structure.
- Investment managers should demonstrate strong internal compliance policies and ethical governance frameworks.
- These measures help public agencies build a more resilient investment strategy that aligns with long-term financial goals.

B. Implementation Case Study: Chandler Asset Management, Inc.

Chandler has structured its operations to align with best practices in transparency, performance evaluation, and compliance.

1. GIPS Compliance and Verification: Chandler adheres to GIPS standards and undergoes third-party verification annually to confirm that all performance reporting is accurate and comparable across industry standards. By including all discretionary portfolios⁷ within their GIPS-compliant composites, Chandler provides transparent and verifiable performance data, reducing risks of misleading reporting.

2. Net Performance vs. Fees: Instead of positioning itself as the lowest-cost provider, Chandler focuses on delivering strong net-of-fee performance. By investing in robust research capabilities and risk management systems, they frequently achieve above-market risk-adjusted returns, proving that slightly higher management fees can be justified by higher long-term performance stability.

⁶ For example, consider looking at a firm's Sharpe ratio, which is a financial metric that evaluates the performance of an investment by adjusting for its risk. It is calculated by subtracting the risk-free rate of return from the investment's expected return and then dividing this result by the standard deviation of the investment's excess return. This ratio provides insight into how much additional return an investor receives per unit of risk taken. A higher Sharpe ratio indicates a more favorable risk-adjusted return.

⁷ "A Discretionary account" under GIPS refers to an investment account where the investment manager has full authority to make buy, and sell, and allocation decisions in accordance with the client's investment mandate, without requiring prior client approval for each transaction

3. Risk-Adjusted Performance Metrics: Chandler measures performance using downside capture metrics, choosing strategies that minimize risk while enhancing returns. This focus on risk-adjusted performance has resulted in consistent outperformance relative to passive benchmarks, particularly during volatile market conditions.

4. Governance and Compliance Oversight: The firm has established a dedicated compliance team that conducts regular audits and submits quarterly reports to clients on governance structures and investment strategy adjustments. They proactively monitor SEC regulations and fiduciary compliance requirements, ensuring they remain aligned with public agency expectations.

By incorporating these holistic evaluation principles, Chandler demonstrates that transparency, risk management, and strong governance provide greater value to public agencies than simply minimizing fees. Chandler's structure highlights how investment firms can differentiate themselves by prioritizing fiduciary best practices, ultimately benefiting public fund stakeholders and ensuring long-term sustainability.

V. Policy Recommendations for Public Agencies

To achieve sustainable investment success, public agencies should adopt the following policies:

- **Mandate GIPS compliance and Verification** to ensure transparent and standardized performance reporting.
- **Implement Risk-Adjusted Selection Criteria**, including evaluating managers based on downside capture metrics and risk management effectiveness.
- **Strengthen Due Diligence Procedures** by conducting SEC compliance reviews, performance audits, and governance evaluations before selecting an investment advisor.
- **Conduct Annual Investment Manager Reviews** to establish monitoring protocols that detect underperformance or compliance failures before they escalate.

By integrating these policies, public agencies can mitigate risks, optimize long-term investment performance, and ensure adherence to fiduciary responsibilities.

VI. Conclusion

Public agencies must move beyond cost-centric investment manager selection models and adopt a holistic, transparency-driven approach that includes GIPS compliance, independent verification, and robust governance reviews. While fee efficiency is important, it should not come at the expense of fiduciary responsibility, risk management, and ethical oversight. By implementing a comprehensive selection framework, public agencies can enhance financial stability, reduce fiduciary risks, and ensure long-term success in managing public funds.

VII. References

1. **CFA Institute.** *Global Investment Performance Standards Handbook*, 2023.
2. **Callan Associates.** *Institutional Investment Performance Report*, 2023.
3. **Mercer.** *Risk-Adjusted Returns in Public Investment Management*, 2022.
4. **SEC Office of Compliance Inspections and Examinations (OCIE).** *Enforcement Actions in Investment Performance Misrepresentation*, 2023.
5. **SEC Office of Compliance Inspections and Examinations (OCIE).** *SEC Sweep into Marketing Rule Violations Results in Charges Against Nine Investment Advisers*, 2023.
6. **National Institute on Retirement Security (NIRS).** *Pension Fund Governance and Investment Oversight Report*, 2023.
7. **National Association of State Treasurers (NAST).** *Investment Oversight in Public Funds*, 2023.
8. **Harvard Business Review (HBR).** *The Impact of Governance on Investment Performance*, 2023.
9. **Government Finance Officers Association (GFOA).** *Best Practices for Public Investment Manager Selection*, 2023.
10. **Morningstar.** *The Role of GIPS in Institutional Investment Governance*, 2023

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