EXPOSURE DRAFT OF THE 2020 GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS®) HIGHLIGHTS AND Q&A SESSION FOR ASSET OWNERS

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9 October 2018
AGENDA

• The 2020 GIPS standards update process and rationale
• The 2020 GIPS standards structure
• Questions from the September 2018 GIPS Standards Annual Conference
• Questions submitted from webinar participants in advance
• The 2020 GIPS standards timeline
WARNING!

• All answers assume that the final version of the 2020 GIPS standards is consistent with the Exposure Draft
• Everything is subject to change, based on public comments
• This session is to help you understand how the 2020 GIPS standards might impact your organization, and assist you with writing your comment letter
WHY CHANGE THE GIPS STANDARDS?

• While composites are the foundation of the GIPS standards, composites are not appropriate for all investment products
• Pooled funds do not fit neatly into the current composite construction or GIPS reporting framework
• Make the GIPS standards more relevant for all asset classes, including alternative investment funds/strategies
• Better address applicability for asset owners
FIRST STEP – THE 2020 GIPS STANDARDS CONSULTATION PAPER

• Receive feedback on key issues being considered for inclusion in the 2020 GIPS standards, e.g.,
  - Differentiate selling participation in a specific fund versus a composite strategy
  - Remove the strict rules prohibiting the use of internal rates of return except in limited circumstances
  - Determine if any currently required information in GIPS reports should be eliminated

• Identify any key topics that were missing and should be included
  - No significant missing items were identified
SECOND STEP – INPUT FROM VOLUNTEERS

- GIPS Executive Committee
- GIPS Technical Committee
- Interpretations Subcommittee
- Investment Manager Subcommittee
- Asset Owner Subcommittee
- Verification Subcommittee

- Alternative Strategies Working Group
- Benchmark Working Group
- Overlay Working Group
- Pooled Funds Working Group
- Risk Working Group
NEW STRUCTURE IN THE 2020 GIPS STANDARDS

• No separate asset-class sections for real estate, private equity, or wrap fee portfolios
  - Real estate and private equity are now included in a broader category of “private market investments”
• Each section includes any asset-class or asset-type specific provisions
  - E.g., overlay, carve-outs, wrap-fee, private market investments
• Dates have been removed from provisions and are included in footnotes
• Verification guidance will be issued as a separate document for public comment – planned issue date is 31 October 2018
NEW STRUCTURE (SECTIONS) IN THE 2020 GIPS STANDARDS

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<th>Firms</th>
<th>Asset Owners</th>
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</thead>
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<td>General Provisions</td>
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<td>2. Input Data and Calculation Methodology</td>
<td>9. Input Data and Calculation Methodology</td>
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<td>Asset Owner Reports</td>
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<td>4. Time-Weighted Returns</td>
<td>11. Time-Weighted Returns</td>
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<td>Pooled Fund Reports</td>
<td></td>
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<td>6. Time-Weighted Returns</td>
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<tr>
<td>7. Money-Weighted Returns</td>
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</tbody>
</table>
NEW STRUCTURE IN THE 2020 GIPS STANDARDS

13. GIPS Advertising Guidelines
   - Firm Composite Advertising Guidelines
   - Firm Limited Distribution Pooled Fund Advertising Guidelines
   - Firm Broad Distribution Pooled Fund Advertising Guidelines
   - Asset Owner Advertising Guidelines

14. Glossary
   - For both firms and asset owners
WHY ASSET OWNERS CHOOSE TO CLAIM COMPLIANCE

• Demonstrates a commitment to follow global industry standard and best practice for
  - Valuation
  - Performance calculation
  - Performance presentation
• Requires the establishment of robust performance policies and procedures
• Demonstrates a commitment to consistent, transparent, and comparable methods of calculating and presenting performance
• Demonstrates a commitment to adopt the same principles that may be required of external investment managers
FIRMS VERSUS ASSET OWNER

• Firms are entities that manage assets on behalf of clients
  - Firms market their services

• An asset owner is an entity that manages investments, directly and/or through the use of external managers on behalf of participants, beneficiaries, or the organization itself. These entities include, but are not limited to, public and private pension funds, endowments, foundations, family offices, provident funds, insurers and reinsurers, sovereign wealth funds, and fiduciaries.
  - Asset owners do not market their services

• Asset owners must have discretion over total asset owner assets, either by managing assets directly or by having the discretion to hire and fire external managers.

• Asset owner provisions are based on the firm guidance, but tailored to asset owners

• Asset owner provisions incorporate many of the concepts from the Asset Owner Guidance Statement, but go even further
  - Guidance is specific to total funds and composites
FIRMS VERSUS ASSET OWNER

• Some asset owners compete for business by marketing to prospective clients, as is done by traditional investment managers.

• If an asset owner markets its services and acts as an asset manager, the part of the organization acting as an asset manager must be defined as a separate firm, and adhere to the GIPS requirements for firms (sections 1-7).
  - E.g., an organization that manages its own assets but also competes against firms for managing assets of other asset owners.
  - E.g., an insurance company that launches an asset management firm using expertise developed by managing its own assets.
FIRMS VERSUS ASSET OWNER

**Question** – Some asset owners act as both an asset owner and an asset manager. Why do the GIPS standards require asset owners to be split for firm definition purposes? Why can’t the asset owner comply with asset owner guidance for asset owner assets, and firm guidance for firm assets?

**Answer** – Because asset owners are not competing for business, and are only reporting the entity’s own performance, the GIPS standards have been relaxed or modified to reflect this fact. However, if an asset owner is competing against asset managers, the asset owner must comply with the same requirements as firms against which the asset owner may be competing. Asset owners should not have an advantage when competing against firms.
PERIOD OF COMPLIANCE

- Firms must initially claim compliance with the GIPS standards for a minimum of five years, or since the firm’s inception if inception is less than five years ago.
- Because of the unique nature of asset owners – they do not compete for clients – asset owners must initially claim compliance for a minimum of one year.
- Asset owners must then build toward a minimum of ten years of GIPS compliance.
TOTAL FUND

• A total fund is a pool of assets managed by an asset owner according to a specific investment mandate, which is typically composed of multiple asset classes.

• The total fund is typically composed of underlying portfolios, each representing one of the strategies used to achieve the asset owner’s investment mandate.

• If the asset owner manages one total fund, the asset owner must report the performance of the total fund to the oversight board.

• If the asset owner manages more than one total fund according to the same investment mandate, all total funds managed according to the same investment mandate must either be:
  - Presented to the relevant oversight boards separately, or
  - Included together in a composite

• If the asset owner manages multiple total funds with different investment mandates, these must be presented separately to the relevant oversight board.
ADDITIONAL COMPOSITES

• Asset owners may create additional groupings of portfolios, representing a particular strategy or asset class
  - e.g., domestic equities within the total fund
• If this additional grouping meets the requirements of the GIPS standards, it may be presented as a composite
GIPS ASSET OWNER REPORTS

• In the 2020 GIPS standards, the term “compliant presentation” is replaced with GIPS Asset Owner Report

• A GIPS Asset Owner Report is a presentation for a total fund or composite that contains all the information required by the GIPS standards
  - It may also include recommended information or supplemental information

• An asset owner claims compliance in a GIPS Asset Owner Report

• Only performance for the period for which the asset owner claims compliance is allowed to be presented in a GIPS Asset Owner Report

• Asset owners must make every reasonable effort to provide a GIPS Asset Owner Report to those who have direct oversight responsibility for total fund assets, such as a Board of Trustees

• An updated version of the GIPS Asset Owner Report must be provided at least once every 12 months

• GIPS Asset Owner Report excerpt is on next slide
## Centerville Police and Fire Retirement System
### Total Fund Composite
#### 1 January 2004 through 31 December 2013

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Return %</th>
<th>Net Return %</th>
<th>Benchmark Return %</th>
<th>% of Externally Managed Assets</th>
<th>Total Composite Assets (Equals Total Firm Assets) ($ millions)</th>
<th>3 Yr. Annualized Std. Deviation</th>
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<tbody>
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<td>21.65</td>
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</table>

Centerville Police and Fire Retirement System (“CPFRS”) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. CPFRS has been independently verified for the periods from 1 January 2008 through 31 December 2013.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm’s policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Total Fund Composite has been examined for the periods from 1 January 2006 through 31 December 2013. The verification and performance examination reports are available upon request.

### Accompanying Notes

1. For the purpose of complying with the GIPS standards the firm is defined as the Centerville Police and Fire Retirement System (“CPFRS”), which was established in 1985 by the municipality of Centerville and is the manager of the assets of the Centerville Police and Fire Retirement System. The Total Fund was created and inceptioned in 1985.
GIPS ASSET OWNER REPORTS

• Two versions of GIPS Asset Owner Reports
  - Time-weighted returns (Section 11)
  - Money-weighted returns (Section 12)
• Required numerical information
• Recommended numerical information
• Required disclosures
• Recommended disclosures
GIPS ASSET OWNER REPORTS

**Question** – Our pension plan began in 1972. We report performance since the plan’s inception in 1972 to our board. We have determined that we will be able to attain compliance with the GIPS standards going back to 2014. Does that mean we have to stop reporting performance since inception?

**Answer** – No. An asset owner report may include only performance for the period for which the asset owner claims compliance. In this case, the asset owner would include performance beginning in 2014 in the GIPS Asset Owner Report.

However, the asset owner may continue to report performance that includes periods prior to 2014, but that information may not be included in the GIPS Asset Owner Report.
CALCULATING PERFORMANCE

• Time-weighted returns are required for total funds
  - Returns that negate the effect of external cash flows
  - Represent the performance of the asset owner

• Money-weighted returns are recommended for total funds when the asset owner believes money-weighted returns are helpful and important in understanding the performance of the total fund
  - Returns that do not negate the effect of external cash flows
  - Represent the combination of the asset owner’s performance and the impact of cash flows

• Asset owners may present either time-weighted returns or money-weighted returns for additional composites

• All returns must reflect the deduction of transaction costs
INDEPENDENT VALUATION

• In the 2020 GIPS standards, expanded the concept of obtaining independent valuations to private equity, infrastructure, and other real assets, including real estate (i.e., private market investments), and also expanded the types of independent valuations

• For periods beginning on or after 1 January 2020, at least once every 12 months, private market investments must:
  - Have an external valuation, or
  - Have a valuation review*, or
  - Be subject to a financial statement audit**.

  * A valuation review is a review of valuation inputs and assumptions performed by a qualified external third party
    e.g., review by an external party of a firm’s internal discounted cash flow calculation for a real estate property

  ** The financial statement audit must be performed by an independent, qualified public accounting firm
VALUATION FREQUENCY

Time-weighted returns (TWR)
- Portfolios in composites (except private market investment portfolios) and total funds
  - At least monthly
  - At the time of large cash flows
- Private market investment portfolios in composites
  - At least quarterly
  - No requirement to value at the time of large cash flows

Money-weighted returns (MWR)
- Portfolios in composites and total funds
  - Annually
  - Whenever returns are calculated
PORTFOLIO-LEVEL/TOTAL FUND CALCULATIONS

**Time-weighted returns (TWR)**

- Portfolios in composites (except private market investment portfolios) and total funds
  - At least monthly
  - Sub-period returns at the time of large cash flows
  - Use daily-weighted cash flows
- Private market investment portfolios in composites
  - At least quarterly
  - Use daily-weighted cash flows

**Money-weighted returns (MWR)**

- Portfolios in composites and total funds
  - Annualized since-inception MWR
  - Or, if the asset owner does not have records since inception, for the longest period for which the asset owner has records
  - Use daily cash flows as of 1 Jan 2020, and quarterly cash flows before then
MWR VERSUS TWR

**Question** – We manage one total fund. Can we present only a since-inception money-weighted return for the total fund, versus a time-weighted return, in the GIPS Asset Owner Report?

**Answer** – No. Asset owners must present time-weighted returns for total funds in GIPS Asset Owner Reports. Asset owners may also present money-weighted returns for total funds in GIPS Asset Owner Reports, but these must be in addition to time-weighted returns.
ADDITIONAL COMPOSITE MONEY-WEIGHTED RETURNS

**Question** – We have managed private equity for several decades, and we want to create a private equity composite and present money-weighted returns in a GIPS Asset Owner Report. However, we don’t have records to support cash flows prior to a system conversion on 30 June 2000. Does that mean we can’t present a private equity composite in a GIPS Asset Owner Report?

**Answer** – No. If an asset owner does not have records for all periods since inception, the asset owner must determine the longest period for which it has records. The asset owner must use this period to calculate the MWR, and present this MWR in the GIPS Asset Owner Report.

In this instance, the asset owner would present a MWR through the most recent annual period end, using 30 June 2000 as the inception date.
FAIR VALUE

• All assets must be fair valued, at least monthly and at the time of large cash flows
  - As defined for the total fund or composite
• All assets must be valued, including private market investments
• For less liquid assets, asset owners often roll forward prior valuations, adjusted for external cash flows, and use these as an approximation of fair value
• If the asset owner uses the last available, historical price or preliminary, estimated values as fair values, the asset owner must consider these estimates to be the best approximation of fair value
  - When final values are received, the asset owner must assess the difference between preliminary, estimated values and final values, and the impact on total fund assets or composite assets, and performance, and make any needed adjustments
FAIR VALUE

**Question** – We make investments in investment partnerships, and have no ability to independently value these investments. May we place reliance on the values we receive from the general partners?

**Answer** - Asset owners must establish policies and procedures for placing reliance on information from third parties, including external managers. Asset owners must assess to what extent the estimated values provided from third parties can be used for GIPS compliance purposes, and how the estimated values will fit within the asset owner’s total fund-specific and portfolio-specific valuation policies and procedures.

Asset owners must always adjust for external cash flows since the last valuation.
GROSS AND NET RETURNS

• Gross returns must reflect the deduction of transaction costs
• Net returns must reflect the deduction of transaction costs and investment management fees
• Applying these concepts to asset owners can be challenging, given that asset owners typically do not charge investment management fees as a % of assets under management
• Asset owners also typically incur a wide variety of costs and expenses that are related either directly or indirectly to the management of the assets
• Externally managed pooled funds – values are typically net of imbedded investment management fees
• Externally managed separate accounts - values may include or exclude investment management fees paid by the asset owner to the external investment managers
GROSS AND NET RETURNS

• Investment management costs – determining these costs for internally managed assets is not straightforward

• Investment management costs must:
  - Include all investment management costs for portfolio management
  - Include other related costs and fees, such as data valuation fees, custodian fees, and performance measurement
  - Include a pro-rata share of overhead, such as building and utilities
  - Include a pro-rata share of non-departmental expenses, such as human resources and technology
RETURNS

• Net returns are required for total funds
  - Reflects performance after all costs associated with the management of the assets
• Other returns may be presented, but they are not required
• Full gross return – the return on investments that reflects the deduction of only transaction costs
  - Does not reflect the deduction of investment management fees that are embedded in the externally
    managed pooled fund asset values or paid from assets outside of the pooled fund
  - May be presented as supplemental information only
• Gross return – the return on investments reduced by embedded investment management fees for
  externally managed pooled funds and any other investment management fees paid for the management of
  the pooled funds
  - Investment management fees paid to externally managed separate accounts are not deducted
• Net of external costs only return – the gross return reduced by all costs for externally managed separate
  accounts
CASH AND CASH EQUIVALENTS

• Cash and cash equivalents that are considered discretionary and part of the investable assets of the total fund or composite must be included in all total fund assets and composite assets and performance calculations.

• Asset owners often maintain a number of cash accounts
  - Some are held within the total fund and available for investment

• Operating cash accounts that are not available for investment, such as accounts used for payments to beneficiaries, should not be included in total fund assets and performance

• If a cash account is used for both investments and as an operating cash account, then the account should be assumed to be available for investment and included in assets and performance calculations
Question – We have a cash operating account that is used for receiving contributions from user agencies and from which beneficiary payments are made. Each month we determine if we will have excess cash that is available for investment, or if we need to add cash to the account to cover beneficiary payments. How should we treat this cash account for performance calculation purposes?

Answer – Because this account is not available for investment, this cash account should be excluded from assets and performance calculations.

Any cash that is transferred from this account to the investment account should be reflected as an external cash flow into the investment account on the date of the cash flow.

Any cash that is contributed to this account from the investment account should be reflected as an external cash flow from the investment account on the date of the cash flow.
RELIANCE ON THIRD PARTIES

- Asset owners often use third parties for outsourced functions and management
- Asset owners must ensure that the records and information provided by any third party on which the asset owner relies meet the requirements of the GIPS standards
- The asset owner is responsible for ensuring that the data received from various external sources is accurate and must be able to aggregate information that may be supplied by external service providers as needed
**RELIANCE ON THIRD PARTIES**

**Question** – We hire external managers to manage some of our assets. If we want to claim compliance with the GIPS standards, does this mean we can only hire firms that claim compliance with the GIPS standards?

**Answer** – No. If the asset owner places reliance on information provided by external third parties, such as custodians or external managers, the asset owner must establish policies and procedures to ensure that the information adheres to the requirements of the GIPS standards.

If the information does not adhere to the requirements of the GIPS standards, then the asset owner may not place reliance on it. Instead, the asset owner will need to determine how the information from the third party could be used.

For example, an asset owner may be able to use positions and activity from an external manager, but not the valuations, so the asset owner values the holdings internally.
REPORTING ADDITIONAL COMPOSITES

**Question** – We want to report asset class performance from our total fund to our oversight board, e.g., for domestic equities, international equities, fixed income, etc. Are we required to create additional composites for each of these asset classes and prepare a GIPS Asset Owner Report for each, so we may report asset class performance?

**Answer** – Asset owners may create additional composites and prepare a GIPS Asset Owner Report for these additional asset class composites.

Alternatively, an asset owner could choose to present asset class performance as supplemental information in the GIPS Asset Owner Report for the total fund.
REPORTING ADDITIONAL COMPOSITES

**Question** – We want to create an additional composite for our private equity asset class and present it in a GIPS Asset Owner Report. When we carve out private equity from the total fund, are we required to include cash and cash equivalents?

**Answer** – No. Because asset owners are not competing for business, and are reporting performance of their own assets to the oversight board, there is no requirement to include or allocate cash and cash equivalents to the carve-out. Asset owners may choose to include cash and cash equivalents in the carve-out returns, but they are not required to do so.

Although not explicitly required, asset owners should disclose that composite returns do not include cash and cash equivalents.
GIPS ADVERTISING GUIDELINES

• A GIPS Advertisement is an advertisement by a GIPS-compliant firm or asset owner that adheres to the requirements of the GIPS Advertising Guidelines

• Asset owners are not required to prepare GIPS Advertisements, but if an asset owner chooses to do so, it must meet all the requirements of the GIPS Advertising Guidelines
GIPS ADVERTISING GUIDELINES

Question – Asset owners do not market their services. If they did, they would follow the GIPS standards for firms, not asset owners. So why are there Advertising Guidelines for asset owners?

Answer – An advertisement includes any materials that are distributed to or designed for use in newspapers, magazines, brochures, pooled fund fact sheets, etc., that are distributed to more than one party, and there is no contact between the asset owner and the reader of the advertisement.

The GIPS Advertising Guidelines allow an asset owner to claim compliance with the GIPS standards in materials that are broadly distributed, or that it may post on its website.

For example, in the U.S., many asset owners include their Comprehensive Annual Financial Report (CAFR) on their website. The CAFR includes performance information, and the asset owner may wish to voluntary include GIPS-compliant performance in the CAFR and prepare the information in accordance with the GIPS Advertising Guidelines, so that it may claim compliance with the GIPS standards.
RECORDKEEPING

• All data and information necessary to support all items included in GIPS Asset Owner Reports and GIPS Advertisements must be captured, maintained, and readily available, for all periods presented in GIPS Asset Owner Reports and GIPS Advertisements

• These records must allow asset owners to recalculate their performance history as well as substantiate all other information, including supplemental information included in a GIPS Asset Owner Report or GIPS Advertisement for all periods shown
**RECORDKEEPING**

**Question** – We changed custodians as of 1 January 2016. We did not keep duplicate records, and when we changed custodians we did not obtain the data from the prior custodian. What does this mean for our ability to claim compliance with the GIPS standards?

**Answer** – Asset owners must have records to substantiate all information included in GIPS Asset Owner Reports. You may claim compliance only for the period for which you have records. In this instance, you may initially claim compliance for a period that begins no earlier than 1 January 2016.
**THE 2020 GIPS STANDARDS TIMETABLE**

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<thead>
<tr>
<th>Event</th>
<th>Date/Date (Verification)</th>
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<tbody>
<tr>
<td>Exposure Draft Issued</td>
<td>31 August 2018</td>
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<tr>
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<td>31 October 2018 (Verification)</td>
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<td>Comment Period End Date</td>
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<tr>
<td>GIPS Reports Prepared per the 2020 GIPS Standards Requirements</td>
<td>GIPS Reports that include performance results for periods ending on or after 31 December 2020</td>
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What do you think?

We want to hear from you!

Positive and negative feedback
THE 2020 GIPS STANDARDS RESOURCES

• The GIPS standards website: gipsstandards.org
  - The 2020 GIPS standards Exposure Draft
  - GIPS Reports for Asset Owners Comparison Table
  - GIPS Reports for Firms Comparison Table
  - Questions for Public Comment Summary
  - Pre-recorded webinar
• Submit Your Comments (standards@cfainstitute.org)
• GIPS Helpdesk (gips@cfainstitute.org)
• GIPS newsletter
  - To subscribe, email info@cfainstitute.org
• Twitter: @MarketIntegrity
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