EXPOSURE DRAFT OF THE 2020 GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS®)
Q&A SESSION – ALTERNATIVE INVESTMENTS

Ken Robinson, CFA, CIPM
Director, Global Industry Standards, CFA Institute

Karyn D. Vincent, CFA, CIPM
Head, Global Industry Standards, CFA Institute

4 October 2018
AGENDA

• Review questions from the September 2018 GIPS Standards Annual Conference
• Review questions submitted from webinar participants in advance
• 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 firm, and assist you with writing your comment letter
DIFFERENTIATE COMPOSITES VERSUS POOLED FUNDS

• In the 2020 GIPS standards, firms need to consider what is being offered
• Composites – firm is selling a strategy to a segregated account client
  - Segregated account is a portfolio owned by a single client
• Limited distribution pooled funds – firm is selling participation in a specific fund
  - Typically sold in a one-on-one meeting
• Broad distribution pooled funds – firm is selling participation in a specific fund
  - Typically no direct contact between the firm and the pooled fund investor
LIMITED DISTRIBUTION VERSUS BROAD DISTRIBUTION
POOLED FUNDS

Question – “Limited distribution” can be subject to interpretation. Can firms define what they consider limited and broad?

Answer - Firms must consider the typical marketing practice for each pooled fund.
If the typical marketing practice involves contact between the firm and the prospective fund investor, the pooled fund is considered a limited distribution pooled fund.
   e.g., hedge funds, private equity funds, limited partnerships, collective investment trusts
If the typical marketing practice does not involve contact between the firm and the prospective fund investor, the pooled fund is considered a broad distribution pooled fund.
   e.g., 1940 Act funds, UCITS funds
Firms must document how each fund is classified, and the basis for the classification.
LIMITED DISTRIBUTION VERSUS BROAD DISTRIBUTION
POOLED FUNDS

**Question** – If within a single pooled fund there are classes aimed at retail and classes aimed at institutional, which would the fund be classified as? Broad or limited distribution?

**Answer** – Firms need to consider the typical marketing practices for a specific fund. In some cases, a fund could qualify as both limited distribution and broad distribution.

Firms must document how each fund is classified, and the basis for the classification.
COMPOSITE CONSTRUCTION

• Currently, all actual, fee-paying, discretionary portfolios must be included in at least one composite

• In the 2020 GIPS standards, all actual, fee-paying, discretionary segregated accounts must be included in at least one composite

• In the 2020 GIPS standards, all actual, fee-paying, discretionary pooled funds must be included in at least one composite, if they meet a composite definition

• A composite must include all portfolios that meet the composite definition

• In the 2020 GIPS standards, firms will not be required to create a composite that includes only one or more pooled funds, if the strategy of the fund(s) is not being sold as a composite strategy offered to segregated accounts
  - May terminate composites that were created to include only one or more pooled funds when the firm does not offer the pooled fund strategy as a composite strategy
COMPOSITE CONSTRUCTION

**Question** – Are firms only required to create composites for strategies that the firm “offers as a segregated account” and not do so for strategies that the firm is not actively marketing?

**Answer** – All actual, fee paying, discretionary segregated accounts must be included in at least one composite.

If the firm is managing a segregated account in a specific strategy, the firm is assumed to offer that strategy as a segregated account, even if the firm is not actively marketing the strategy.

All actual, fee-paying, discretionary pooled funds must be included in at least one composite, if they meet a composite definition.
COMPOSITE CONSTRUCTION

**Question** – Our commingled funds and mutual funds are managed the same as our separately managed accounts. Can we continue to include them all in one composite?

**Answer** – Yes. Firms must create a composite for each strategy that is offered to segregated accounts. A composite must include all segregated accounts and pooled funds that meet the composite definition. If the pooled funds are managed like segregated accounts, in a composite’s strategy, they must be included in the composite.
COMPOSITE CONSTRUCTION

**Question** – We manage a limited distribution pooled fund in a strategy that is not offered to segregated accounts. We included this pooled fund in a composite. May we terminate this composite?

**Answer** – Firms may terminate any composite that includes only one or more pooled funds, if the strategy of the pooled funds is not offered to prospective clients as a segregated account.

Under the 2020 GIPS standards, firms will report the performance of a limited distribution pooled fund following pooled fund reporting requirements, versus composite reporting requirements.
COMPOSITE CONSTRUCTION

**Question** – We manage a limited distribution pooled fund in a strategy that is not offered to segregated accounts. We will present this fund’s performance in a GIPS Pooled Fund Report. If in the future we decide to offer this pooled fund’s strategy to segregated accounts, what must we do?

**Answer** – The firm must create a composite that includes all portfolios managed in the strategy. In this instance, the only portfolio in the firm is the limited distribution pooled fund, which must be included in the composite.

If the firm obtains segregated accounts in this strategy, these portfolios must also be included in the composite.
GIPS REPORTS

• Currently, firms are required to make every reasonable effort to provide a compliant presentation to all prospective clients

• A prospective client is any person or entity that has expressed interest in one of the firm’s composite strategies and qualifies to invest in the composite

• “Compliant presentations” are renamed
  - GIPS Composite Reports – for composites
  - GIPS Pooled Fund Reports – for pooled funds

• Firms must make every reasonable effort to:
  - Provide a GIPS Composite Report to all prospective clients
  - Provide a GIPS Pooled Fund Report to all limited distribution pooled fund prospective investors

• Firms may provide a GIPS Pooled Fund Report to broad distribution pooled fund prospective investors, but are not required to do so

• Firms must be able to demonstrate how they met the requirements to distribute these reports
GIPS REPORTS

Question – We include a small cap pooled fund in the Small Cap Composite. Can we use the GIPS Composite Report for the Small Cap Composite for both prospective clients for segregated accounts, and for prospective investors in the small cap pooled fund?

Answer – When presenting performance to prospective clients for segregated accounts, the firm must provide a GIPS Composite Report.
- This report includes performance of the Small Cap Composite, and may include gross only, net only, or both gross and net returns (subject to regulatory requirements).

When presenting performance to prospective investors in the Small Cap Fund, the firm must provide a GIPS Pooled Fund Report.
- This report includes performance of only the Small Cap Fund, and must include returns that are net of all fees and expenses.
NEW LIMITED DISTRIBUTION POOLED FUND

- If the firm is selling participation in a brand new limited distribution pooled fund, this pooled fund will not have a track record to present to prospective investors.
- The firm must present the most appropriate track record for the new limited distribution pooled fund, if available.
- The most appropriate track record may be from a composite or another pooled fund that is managed according to the same or similar strategy as the new limited distribution pooled fund.
NEW LIMITED DISTRIBUTION POOLED FUND

**Question** – We are starting a new closed-end pooled fund with a new strategy that is based on social media-based investments that we have made in multiple funds. How can we create a track record for our social media investments across different funds?

**Answer** – Firms can use carve-outs to calculate a track record that uses performance from other portfolios. In this instance, the firm may use carve-outs to aggregate performance of social media investments across multiple portfolios. Carve-outs must include cash and cash equivalents.
CARVE-OUTS

• Prior to 1 January 2010, firms were able to allocate cash to carve-outs
• As of 1 January 2010, firms are prohibited from allocating cash to carve-outs and including those carve-outs in composites
  - As of that date, to be included in a composite, a carve-out must be managed with its own dedicated cash
• In the 2020 GIPS standards, we allow firms to once again allocate cash to carve-outs
  - Firms may do so retroactively
• Any carve-out included in a composite must include cash and any related income. Cash may be:
  - Accounted for separately, or
  - Allocated synthetically
CARVE-OUTS WITH ALLOCATED CASH

• If the firm chooses to allocate cash to a carve-out and include it in a composite, it must create carve-outs with allocated cash for all carve-outs managed in the same strategy
  - All carve-outs with allocated cash must be included in the composite
• Once the firm obtains a standalone portfolio managed in the same strategy as the carve-out(s) with allocated cash, it must create a composite that includes only standalone portfolios
• The GIPS Composite Report for the composite that includes the carve-out(s) with allocated cash must include information about the standalone composite as well
  - Several additional required disclosures about the treatment of carve-outs
CARVE-OUTS

Question – We segregate cash for our carve-outs. Under the 2020 GIPS standards can we continue to do this, or must we begin to allocate cash? Also, do we have to create composites that include only standalone portfolios?

Answer – Firms that have created carve-outs with segregated cash may continue to do so under the 2020 GIPS standards.

Under the 2020 GIPS standards, firms may create carve-outs with segregated cash, or may instead synthetically allocate cash to carve-outs.

The requirements relating to standalone portfolios apply only when a firm creates carve-outs with allocated cash. Firms that have created carve-outs that meet the requirements specified in the current GIPS standards are not required to make any changes with respect to the treatment of carve-outs.
CARVE-OUTS

**Question** – We plan to synthetically allocate cash to carve-outs. Once we obtain a standalone portfolio, what must we do with this standalone portfolio and the composite that includes carve-outs with allocated cash?

**Answer** – Once a firm obtains a standalone portfolio that is managed in the same strategy as the composite that includes carve-outs with allocated cash, the firm must create a composite that includes only standalone portfolios.

The firm may also include the standalone portfolio in the composite that includes carve-outs with allocated cash, but is not required to do so.

The firm may decide to terminate the composite that includes carve-outs with allocated cash, but is not required to do so.
TRANSACTION COSTS
(FORMERLY TRADING EXPENSES)

• Currently, firms are required to calculate returns after the deduction of actual trading expenses during the period.

• In the 2020 GIPS standards, firms may use estimated transaction costs for portfolios included in composites if the firm or asset owner can determine that estimated transaction costs are greater than or equal to actual transaction costs.
TRANSACTION COSTS

**Question** – How can firms estimate transaction costs and confirm they are conservative?

**Answer** – If a firm wishes to use estimated transaction costs, it must establish policies and procedures for estimating transaction costs, including ensuring that using estimated transaction costs results in returns that are equal to or lower than those that would have been calculated if actual transaction costs were used.

We expect that most firms would determine estimated transaction costs by analyzing transaction costs incurred by portfolios that pay actual transaction costs. Firms typically carefully track and monitor actual transaction costs.
TRANSACTION COSTS

**Question** – We manage real estate portfolios, and consider disposition fees to be part of transaction costs. We accrue these fees, but in some cases the actual disposition fees are higher than the accrual. Will we violate the requirement that estimated transaction costs must be equal to or lower than actual transaction costs?

**Answer** – No. In such a case, the accrual could be adjusted when actual disposition fees are determined. Alternatively, the actual disposition fees that exceeded the accrual could be reflected in performance once the actual amount becomes known.
EXTERNAL VALUATION

• Currently only real estate investments are required to receive an external valuation
  - External valuation are required once every 12 months
  - When client agreements state otherwise, external valuations are instead required at least once every 36 months
• In the 2020 GIPS standards, we 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
PRIVATE MARKET INVESTMENTS

• 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
PRIVATE MARKET INVESTMENTS

Question – The 2020 GIPS standards do not include any real estate-specific provisions. Why did you eliminate these provisions?

Answer – Our goal was to accommodate portfolios that are not invested in a single asset class. While analyzing all of the provisions, we realized that several of the real estate-specific concepts should not be limited to real estate.

For example, we expanded the concept of independent valuations currently required for real estate to all private market investments.

We also expanded the ability to use MWRs versus TWRs beyond real estate closed-end funds and private equity.
GIPS REPORTS FOR FIRMS

• Four GIPS report options
  - Composite time-weighted returns – section 4
  - Composite money-weighted returns – section 5
  - Pooled Fund time-weighted returns – section 6
  - Pooled Fund money-weighted returns – section 7
• Each section is self-contained, and includes all required and recommended provisions for creating the respective GIPS report
• Firms must determine which returns will be presented for each composite and limited distribution pooled fund, and must consistently present the selected returns
  - The same is true for any broad distribution pooled fund the firm chooses to present in a GIPS Pooled Fund Report
RETURNS IN GIPS REPORTS

• Composite returns – firms may choose which returns to present
  - Gross only, net only, or both
  - Subject to regulatory requirements
• Limited distribution pooled fund returns – must present returns that are net of all fees and expenses
  - Not just transactions costs and investment management fees
  - Firms are recommended to also present gross returns
• Broad distribution pooled fund returns – same options as for limited distribution pooled funds
  - Presenting a broad distribution pooled fund in a GIPS Pooled Fund Report is optional, not required
MONEY-WEIGHTED RETURN (MWR) CRITERIA
(FORMERLY INTERNAL RATES OF RETURN – IRR)

• Firms may choose to present MWRs versus time-weighted returns (TWRs) if, for the composite or pooled fund:
  - The firm has control over external cash flows, and
  - Each composite portfolio has, or the pooled fund has, at least one of the following characteristics:
    - It is closed – end
    - It has a fixed life
    - It has a fixed capital commitment
    - Illiquid investments are a significant part of the composite’s or pooled fund’s investment strategy
REQUIRED MONEY-WEIGHTED RETURNS

• In the 2020 GIPS standards, GIPS reports that include MWRs must include MWRs for only one period – from inception through the most recent annual period end
  - Firms are recommended to present MWRs for additional periods

• In the 2020 GIPS standards, GIPS reports that include MWRs for composites and pooled funds that have committed capital, must present information about committed capital, distributions, and related multiples only as of the most recent annual period end
  - Firms are recommended to include this information for additional periods

• In the 2020 GIPS standards, composites and pooled funds that use a subscription line of credit must present MWRs both with and without the subscription line of credit activity
MONEY-WEIGHTED RETURNS

**Question** – We manage a hedge fund that allows subscriptions and redemptions only at quarter end. Does this qualify as the firm having control over the external cash flows?

**Answer** – No. In this case the clients control the external cash flows, but may transact with the fund only at quarter end.
MONEY-WEIGHTED RETURNS

**Question** – Should you present MWR performance from the perspective of the fund, the General Partner (GP) or the limited partners (LPs)?

**Answer** – The GIPS standards do not specify which assets should be used to calculate MWRs. However, if the pooled fund has a partnership structure, firms are required to disclose on which assets the pooled fund net returns are calculated.

The same answer applies when TWRs are used.
MONEY-WEIGHTED RETURNS

Question – For MWR in the 2020 GIPS standards, does a contribution/distribution of any size require a valuation of a portfolio? Or only if it’s considered a large cash flow?

Answer – When calculating MWRs, portfolios must be valued only as of the period end. When calculating MWRs, there is no requirement to value a portfolio at the time of a large cash flow.
MONEY-WEIGHTED RETURNS

**Question** – What other money weighted return (MWR) calculation methods are acceptable other than IRR?

**Answer** – Two acceptable calculation methods are Modified BAI and Modified Dietz.

- Modified BAI is an iterative approach for calculating MWRs.
- Modified Dietz is a non-iterative approach for calculating MWRs.

All MWR calculation methods use as inputs cash flows and the ending portfolio value.
MONEY-WEIGHTED RETURNS

**Question** – We manage a closed end fund for which we were required to present TWRs. We meet the requirements for presenting MWRs for this fund. Can we retroactively calculate and present MWRs for all periods? Would this be considered an error correction?

**Answer** – If a firm meets the requirements for presenting MWRs versus TWRs for a specific composite or pooled fund, the firm may change to using MWRs in GIPS Composite or Pooled Fund Reports.

A firm must disclose if it changes the type of return that is presented in the GIPS Report, e.g., changes from TWRs to MWRs.

This is not considered an error.
MONEY-WEIGHTED RETURNS

**Question** – How should we think about appropriate calculation methodology (MWR vs. TWR) to present performance for a vehicle that has changed over its life? For example: a privately held closed-end fund (which meets the criteria for MWR at inception) that later IPOs and no longer meets the criteria for MWR.

**Answer** – It may be appropriate for a firm to treat an individual fund differently over the fund’s life. In this case, it would be appropriate for the firm to use MWRs for the closed-end fund until the point when the firm no longer controls the external cash flows. After the IPO, when the firm no longer controls the external cash flows, and if the fund continues, then the firm would change to presenting TWRs, prospectively.
TOTAL FIRM ASSETS

• Total firm assets is the aggregate fair value of all discretionary and non-discretionary assets managed by the firm.

• Currently, firms must present, as of each annual period end:
  - Total firm assets, or
  - Composite assets as a percentage of total firm assets.

• In the 2020 GIPS standards, for periods beginning on or after 1 January 2020, firms must present total firm assets.

• The 2020 GIPS standards also clarify that:
  - Advisory-only assets must not be included in total firm assets.
  - Uncalled committed capital must not be included in total firm assets.

• Firms may present advisory-only assets and uncalled committed capital separately from total firm assets.
TOTAL FIRM ASSETS

**Question** – We manage assets for some clients where we do not have discretion to trade without permission. We provide recommendations and the client approves or does not approve the recommendation. Under the 2020 GIPS standards will we still be able to include these assets in total firm assets?

**Answer** – Yes. Total firm assets includes assets for which the firm has either conditional or unconditional authority to trade the assets.
Question – We manage closed end funds, and therefore have uncalled committed capital. We have included uncalled committed capital in total firm assets. Under the 2020 GIPS standards will we still be able to include uncalled committed capital in total firm assets?

Answer – No. Under the 2020 GIPS standards, firms would not be allowed to include uncalled committed capital in total firm assets.

There have been different practices with the treatment of uncalled committed capital. Given the differing practices, firms would not include uncalled committed capital in total firm assets for periods beginning on or after 1 January 2020. No restatement of total firm assets is required.

While not required, firms should consider disclosing that uncalled committed capital was included in total firm assets for periods prior to 1 January 2020.
RISK MEASURES

• Currently, firms are required to present the three-year annualized ex-post standard deviation for the composite and benchmark, unless monthly composite returns are not available
  - If the firm believes that the three-year annualized standard deviation is not relevant or appropriate, the firm must also present an additional risk measure
  - This requirement has been deleted

• Firms are now recommended to present additional risk measures

• In the 2020 GIPS standards, for those composites or pooled funds that do not have monthly returns, for periods ending on or after 1 January 2020, firms must present one of the following:
  - An appropriate ex-post risk measure for the composite/pooled fund and benchmark
    - For TWRs, as of each annual period end
    - Must be the same measure for both the composite/pooled fund and benchmark
  - A qualitative narrative describing the key risks of the composite/pooled fund strategy
RISK MEASURES

**Question** – Is there a requirement to present a risk measure when MWRs are used? There are no monthly returns.

**Answer** – For periods ending on or after 1 January 2020, firms must present:

- An appropriate ex-post risk measure for the composite/pooled fund and benchmark. The risk measure must be the same measure for both the composite/pooled fund and benchmark.

Or

- A qualitative narrative describing the key risks of the composite/pooled fund strategy

The firm may choose if a qualitative or quantitative measure is presented.

If the firm chooses to present an ex-post quantitative risk measure, the firm may choose which ex-post risk measure is presented.
GIPS ADVERTISING GUIDELINES

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

• Firms are not required to prepare GIPS advertisements, but if a firm chooses to do so, it must meet all the requirements of the GIPS Advertising Guidelines

• GIPS Advertising Guidelines options for:
  - Firm composites
  - Firm limited distribution pooled funds
  - Firm broad distribution pooled funds
    - These replace the requirements previously included in the Broad Distribution Pooled Funds Guidance Statement
Question – Are the requirements for line of credit different in GIPS Advertisements versus GIPS Reports?

Answer – Yes, the requirements are different.

When a composite or pooled fund has a line of credit and MWRs are presented in the GIPS Composite Report or GIPS Pooled Fund Report, the firm must present MWRs both with and without the line of credit.

When preparing a GIPS Advertisement for a composite or pooled fund that has a line of credit and MWRs are presented in the GIPS Advertisement, the firm may present returns with or without the line of credit, but must disclose if returns do or do not reflect the line of credit.

The requirements differ because a GIPS Advertisement is not the only information that a reader of the advertisement that ultimately decides to hire the firm will receive. The reader of the advertisement that becomes a prospective client or investor will be required to receive a GIPS Composite Report or GIPS Pooled Fund Report, which will include returns both with and without the line of credit.
# THE 2020 GIPS STANDARDS TIMETABLE

<table>
<thead>
<tr>
<th>Event</th>
<th>Dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exposure Draft Issued</td>
<td>31 August 2018</td>
</tr>
<tr>
<td></td>
<td>31 October 2018 (Verification)</td>
</tr>
<tr>
<td>Comment Period End Date</td>
<td>31 December 2018</td>
</tr>
<tr>
<td>Final Version Issued</td>
<td>30 June 2019</td>
</tr>
<tr>
<td></td>
<td>31 August 2019 (Verification)</td>
</tr>
<tr>
<td>Effective Date</td>
<td>1 January 2020</td>
</tr>
<tr>
<td>GIPS Reports Prepared per the 2020</td>
<td>GIPS Reports that include performance results</td>
</tr>
<tr>
<td>GIPS Standards Requirements</td>
<td>for periods ending on or after 31 December 2020</td>
</tr>
</tbody>
</table>
WHAT DO YOU THINK?

We Want To Hear From You!

YOUR OPINION MATTERS

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
CONTACT INFORMATION

Ken Robinson, CFA, CIPM
Director, Global Industry Standards, CFA Institute
kenneth.robinson@cfainstitute.org

Karyn D. Vincent, CFA, CIPM
Head, Global Industry Standards, CFA Institute
karyn.vincent@cfainstitute.org