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

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3 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 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** – Should a broadly distributed pooled fund be included in a composite that is being marketed to a client who will have a segregated account?

**Answer** – 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. A composite can include segregated accounts, limited distribution pooled funds, and broad distribution pooled funds.
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.
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
• 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 have not been able to create segregated cash accounts for carve-outs, and we plan to take advantage of the ability to synthetically allocate cash to carve-outs. Can we create these composites retroactively, back to 2010?

**Answer** – Yes, firms may retroactively create carve-outs with allocated cash.

If a firm creates a carve-out with allocated cash and includes it in a composite, it must create carve-outs with allocated cash from all comparable portfolios.

All carve-outs with allocated cash must be included in the composite.
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.
CARVE-OUTS

**Question** – We plan to synthetically allocate cash to carve-outs. Once we obtain a standalone portfolio, we will have two composites for the same strategy. Which composite should we use for marketing purposes?

**Answer** – Once the firm has a composite of standalone portfolios, it must determine which composite will be used for marketing prospectively:

- The composite that includes carve-outs with allocated cash, or
- The composite that includes only standalone portfolios

If the firm wishes to use the composite that includes carve-outs with allocated cash, the GIPS Composite Report for this composite must:

- Indicate carve-out in the composite name
- Include performance and assets of the standalone composite
- Present the % of composite assets represented by carve-outs with allocated cash as of each annual period end
- Disclose that the composite includes carve-outs with allocated cash
- Disclose the policy used to allocate cash to carve-outs
- Disclose that the GIPS Composite Report for the composite of standalone portfolios is available upon request
CARVE-OUTS

**Question** – If we have a composite that only includes one standalone portfolio, and the portfolio closes, can we include carve-outs from broader portfolios in the composite to continue the track record?

**Answer** – Yes. Just as a firm may do today, a firm may redefine a composite to include carve-outs. These carve-outs must include cash, and cash may be segregated or allocated synthetically.

If the firm chooses to create carve-outs with segregated cash, all carve-outs with segregated cash that have been created for that strategy must be included in the composite.

If the firm chooses to allocate cash to a carve-out and include it in the composite, the firm must do the same for all carve-outs managed in that particular strategy.
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.
Question – Is the intent of allowing estimated transaction costs to stop firms from presenting “pure” gross returns as supplemental information in GIPS Composite Reports for wrap fee composites?

Answer – No. Firms that manage wrap fee composites will still be able to include “pure” gross returns as supplemental information. However, we expect that the ability to use estimated transaction costs will allow firms to calculate gross-of-fees returns for wrap fee composites, which many firms wish to do.
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 at quarter end. Does this qualify as control over the cash flows?

**Answer** – No. In this case the clients control the cash flows, but may transact with the fund only at quarter end.
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.
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 firms 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 and 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
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
GIPS ADVERTISING GUIDELINES

• New fundamental provisions applicable to all advertisements, e.g.,
  - Composite returns in a GIPS Advertisement must be derived from the returns included in or that will be included in the corresponding GIPS Composite Report

• If the corresponding GIPS Composite Report includes TWRs, composite advertisements have a new TWR option:
  - The annualized composite return for the total period that includes all periods presented in the corresponding GIPS Composite Report, through either the most recent period end, or the most recent annual period end

• If the corresponding GIPS Composite Report includes MWRs, firms must present the composite since-inception money-weighted return through either the most recent period end, or the most recent annual period end
• A significant change is the inclusion of Broad Distribution Pooled Funds GIPS Advertising Guidelines for firms
• These replace the requirements previously included in the Guidance Statement on Broadly Distributed Pooled Funds
• Firms have no requirement to present performance for an individual broad distribution pooled fund to prospective investors in broad distribution pooled funds
• Firms may voluntarily choose to follow the GIPS Advertising Guidelines for a broad distribution pooled fund
• Firms may also voluntarily choose to prepare a GIPS Pooled Fund Report for a broad distribution pooled fund
GIPS ADVERTISING GUIDELINES FOR BROAD DISTRIBUTION
POOLED FUNDS – REQUIRED ITEMS

• Pooled fund returns according to the methodology and for the periods required by local laws or regulations
  - In the absence of required returns, pooled fund net returns for one of four period options
• Benchmark total returns for the same periods as presented for the pooled fund
• Current expense ratio
• Currency used
• Pooled fund description
• Pooled fund risk information, as required by local laws or regulations
  - In the absence of required risk information, an appropriate risk measure or qualitative disclosure about risk
• Benchmark description
• GIPS Advertising Guidelines Compliance Statement
• How the advertisement conforms with laws or regulations that conflict with the GIPS standards, if applicable
GIPS ADVERTISING GUIDELINES

**Question** – If the firm provides a GIPS Composite Report or GIPS Pooled Fund Report, does it still need to follow the GIPS Advertising Guidelines?

**Answer** – No. A firm that claims compliance with the GIPS standards may choose to prepare an advertisement in accordance with the GIPS Advertising Guidelines, but is not required to do so. When preparing an advertisement, a GIPS-compliant firm may take one of three approaches:

- Prepare the advertisement in accordance with the GIPS Advertising Guidelines.
- Include a GIPS Composite Report or GIPS Pooled Fund Report in the advertisement.
- Make no mention of the GIPS standards in the advertisement.
GIPS ADVERTISING GUIDELINES

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.
GIPS ADVERTISING GUIDELINES

**Question** – For the new option of showing total period annualized return, can you show since inception in the advertisement if inception is more than 10 years ago and the GIPS Composite Report includes only the most recent 10 years of performance?

**Answer** – Yes. The annualized return in the GIPS Advertisement must include all periods presented in the corresponding GIPS Composite Report, but may include additional periods beyond those presented in the GIPS Composite Report.

For example, assume a composite began on 1 January 2005, but the GIPS Composite Report includes annual returns from 2008 - 2017. The firm could choose to present the annualized return from 2008-2017. The firm could also choose to present the annualized return from 2005-2017 in the GIPS Advertisement. Both options include all periods presented in the corresponding GIPS Composite Report.
**GIPS ADVERTISING GUIDELINES**

**Question** – GIPS Advertisements for Broad Distribution Pooled Funds will require benchmark returns. Why is there a new recommendation to disclose why no benchmark is presented?

**Answer** – Firms that choose to prepare a GIPS Advertisement for a Broad Distribution Pooled Fund are required to include benchmark returns for the same periods as presented for the pooled fund, unless the firm determines there is no appropriate benchmark.

When the firm determines that there is no appropriate benchmark for the pooled fund, then it must disclose that there is no appropriate benchmark.
# THE 2020 GIPS STANDARDS TIMETABLE

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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)
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