



CFA Institute[®]

Global Investment Performance Standards

BRIDGING THE GAP: GIPS[®] STANDARDS AND FINRA'S REGULATORY NOTICE 20-21



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Bridging the Gap: GIPS® Standards and FINRA’s Regulatory Notice 20-21

Firms that wish to comply with FINRA’s Regulatory Notice 20-21 may be looking to the Global Investment Performance Standards (GIPS®) for guidance on how to calculate an internal rate of return (IRR) for their private funds. While firms are not required to comply with the GIPS standards in order to comply with FINRA’s Regulatory Notice 20-21, CFA Institute has received inquiries about what it would take for a firm to comply with the GIPS standards once it is calculating IRRs in accordance with the calculation requirements of the GIPS standards.

This document is designed to provide guidance and clarity on the additional steps a firm would need to take in order to achieve firm-wide compliance with the GIPS standards.

These firms may have already completed a significant amount of the effort necessary to achieve compliance with the GIPS standards. Below is a roadmap to GIPS compliance for firms that manage only pooled funds and are complying with FINRA’s IRR requirements.

Background: FINRA Regulatory Notice 20-21 and IRR

In July 2020, FINRA issued Regulatory Notice 20-21 (Notice), which, among other things, allows retail communications concerning private placement offerings to include internal rates of returns (IRRs) for funds that are ongoing (i.e., have not fully liquidated) under certain conditions. When including IRRs within retail communications, the IRR must be calculated in a manner consistent with the GIPS standards and the communication must include additional metrics required under the GIPS standards.

The retail communication must include the following numerical information:

- Since-inception internal rate of return (SI-IRR)
- Since-inception paid-in capital
- Since-inception distributions
- Cumulative committed capital
- Total value to since-inception paid-in capital (investment multiple or TVPI)
- Since-inception distributions to since-inception paid-in capital (realization multiple or TVPI)
- Since-inception paid-in capital to cumulative committed capital (PIC multiple)
- Residual value to since-inception paid-in capital (unrealized multiple or RVPI)

Although the GIPS standards generally prohibit firms from making any statement referring to the calculation methodology as being “in compliance” with the GIPS standards, CFA Institute has created a limited exception for firms and their agents to use in retail communications concerning private placement offerings that are prepared in a manner consistent with FINRA Regulatory Notice 20-21, as long as the statement is true.

Firms are not required to comply with the GIPS standards in order to comply with Regulatory Notice 20-21. Compliance with the GIPS standards involves more than just the use of a particular calculation methodology.

GIPS Standards Introduction

The GIPS standards are ethical standards for calculating and presenting investment performance based on the principles of fair representation and full disclosure. They are voluntary industry standards that provide transparency and global comparability in a world where regulations and market practices differ significantly from jurisdiction to jurisdiction. Compliance with the GIPS standards can be achieved only by a firm, on a firm-wide basis. Portfolios, pooled funds, composites, and portfolio managers cannot claim compliance with the GIPS standards.

Additional Steps Firms Must Complete to Attain GIPS Compliance

1. Define the Firm
 - The firm must be defined as an investment firm, subsidiary, or division held out to the public as a distinct business entity. This definition will determine the population of portfolios that are included in total firm assets.
 - For firms managing only pooled funds, defining the firm may be straightforward.
2. Create GIPS Standards Policies and Procedures
 - Policies and procedures document how a firm complies with the requirements of the GIPS standards, as well as any recommendation the firm has chosen to adopt.
 - This includes documentation of firm definition, calculation and valuation methodologies, and GIPS Report creation and distribution policies.
3. Create and Maintain List and Descriptions of Pooled Funds
 - Pooled fund descriptions include general information regarding the investment mandate, objective, or strategy of the pooled fund.
 - Firms can use information from private placement memorandums or other offering documents when creating pooled fund descriptions.
4. Create and Distribute GIPS Reports:
 - GIPS Reports are used to communicate GIPS-compliant information to prospective investors.
 - Firms must make every reasonable effort to provide a GIPS Report to all prospective investors.
 - Numerical information presented within GIPS Reports will be substantially similar to what is already prepared under FINRA 20-21 or for financial statement purposes.
 - Disclosures will need to be included in GIPS Reports, many of which are already drafted and used for other reporting purposes.

Benefits of GIPS Compliance

- Signals that the firm has designed and implemented policies and procedures to fully disclose and fairly present past performance.
- Ensures that firms are evaluated on their actual record and that calculation and presentation methods do not result in unfair competition.
- Improves consistency of data processes and governance.
- Leads to improved internal controls in addition to increased operational efficiency.
- Provides for scalable processes that enable quicker responses to incoming requests.
- Promotes a culture of best practice.
- Demonstrates to current and prospective investors and the general public a voluntary commitment to follow ethical standards.
- Increases marketing opportunities as GIPS compliance may be a criterion for investment.

Resources

- Video explaining how to comply with the GIPS standards calculation requirements: <https://players.brightcove.net/pages/v1/index.html?accountId=1183701590001&playerId=rkcysOOFe&videoId=6251046394001&autoplay=true>
- Memo Re: FINRA'S Regulatory Notice 20-21 and References to the GIPS Standards: <https://www.gipsstandards.org/wp-content/uploads/2021/07/memo-finra-reg-20-21-references-gips-standards.pdf>
- For a list of 19 items that must be followed to comply with FINRA Regulatory Notice 20-21, see CFA Institute Checklist for FINRA Reg Notice 20-21 and the GIPS Standards: <https://www.gipsstandards.org/resources/tools/>
- For IRR calculation templates, see CFA Institute Checklist for FINRA Reg Notice 20-21 and the GIPS Standards: <https://www.gipsstandards.org/resources/tools/>
- GIPS Standards for Firms: https://www.gipsstandards.org/wp-content/uploads/2021/03/2020_gips_standards_firms.pdf