Global Investment Performance Standards (GIPS®) Guidance Statement on Benchmarks for Asset Owners
Adopting Release

The Exposure Draft of the Global Investment Performance Standards (GIPS®) Guidance Statement on Benchmarks for Asset Owners (Exposure Draft) was available for public comment from 23 June 2022 through 22 August 2022. We received comment letters from 10 groups and individuals, and 6 of these gave permission to have their comment letters posted online. We evaluated and considered every comment, resulting in a recommendation for several changes to the Guidance Statement.

The proposed changes were then reviewed with the GIPS Standards Asset Owner Subcommittee and the GIPS Standards Technical Committee (TC), and ultimately approved by the TC.

This Adopting Release includes the following key topics and describes the rationale for the changes made to the Exposure Draft:

1. Expanded guidance on what is expected to be included in a benchmark description

Asset owners are required to disclose a description of each benchmark included in a GIPS Asset Owner Report. The benchmark description is general information regarding the investments, structure, and characteristics of the benchmark, and it must include the key features of the benchmark. In the case of a widely recognized benchmark, such as the S&P 500® Index, the name of the benchmark will satisfy this requirement. (S&P 500® is a registered trademark of Standard & Poor's Financial Services LLC.) We determined that the Guidance Statement should include examples of language that is expected to be included in a benchmark description for certain types of benchmarks, including:

- Peer Groups
  - Whether the peer group benchmark is gross or net of fees.
- Fixed Income
  - Characteristics such as duration, credit quality, and yield.
- Currency Hedging
  - If a hedged or partially hedged benchmark is used, the hedging criteria for the benchmark. The asset owner should also disclose material differences between the benchmark and the total fund's or composite's investment mandate, objective, or strategy. If the hedging criteria of the total fund or composite materially differ from the benchmark, asset owners should disclose this fact.

2. Lagged benchmarks

The Exposure Draft asked if asset owners should be allowed to present a lagged benchmark to match the date of lagged valuations in the asset class of a total fund or additional composite and, if so, which disclosures are necessary to accompany a lagged or partially lagged benchmark. There was broad agreement that presenting lagged benchmarks should be allowed. As stated in the Exposure Draft, when lagging one or more asset classes of a total fund benchmark, the asset owner would disclose that there is a difference in valuation dates for those asset classes. In response to comments, we also added guidance stating that the portfolio and benchmark timing should be synchronized to prevent differences due to timing mismatches.

If an appropriate asset class benchmark is not available in a timely fashion for an additional composite, the asset owner may choose not to include an asset class benchmark return in the GIPS Asset Owner Report and must disclose why no asset class benchmark is presented. The asset owner may label the benchmark returns as preliminary and then update the GIPS Asset Owner Report when the benchmark returns are available. If the total fund policy benchmark has an asset class benchmark that is not available in a timely fashion, the asset owner might choose to use the actual return of that asset class or the target return of that asset class when calculating the total fund benchmark return. When using the asset class return or the target return as a component of the total fund benchmark calculation, the asset owner would disclose this fact as part of the benchmark description.

3. Custom benchmark with leverage

In the Exposure Draft, the question was asked if benchmarks adjusted for leverage should be allowed to be presented in GIPS Asset Owner Reports and which disclosures are necessary to accompany this type of benchmark.

Most respondents agreed with allowing a benchmark to be leveraged if the total fund or composite strategy was also leveraged. Therefore, we added guidance stating that when leverage is embedded within asset class expectations, and that asset class has a levered return expectation, the asset owner may determine that it is appropriate to use a levered benchmark as a basis of comparison. Leverage may also be applied at the total fund level, where the strategic asset allocation includes asset exposure in excess of the total fund's net assets. In both instances, the asset owner should systematically incorporate into the benchmark the additional asset exposure as well as the cost to finance that additional exposure. We also added language stating that the cost of financing is expected to be a part of the custom benchmark calculation methodology disclosure; however, it may be more challenging to isolate the cost of financing when using derivatives. When using derivatives, the asset owner should attempt to determine the cost of financing and disclose this amount. We also recommend presenting an unlevered benchmark alongside the custom benchmark with leverage.

4. Asset allocation transition

When an asset owner is transitioning from one asset allocation to another, it may wish to present the policy benchmark using weightings that change incrementally during the transition period, adhering to a predefined schedule. In the Exposure Draft, we asked if asset owners should be allowed to change asset class weightings incrementally to include interim weightings in order to match the total fund weights in GIPS Asset Owner Reports, rather than using a policy weight benchmark, and if so, which disclosures are necessary to accompany this type of benchmark.

Most respondents agreed with this approach, as long as the asset owner discloses information about the rebalancing. The rebalancing would be included as part of the custom benchmark description, which includes the benchmark components, weights, and rebalancing process. There were different views, however, as to whether the change in benchmark weights should be done using a predefined schedule. The Exposure Draft stated, "asset owners may wish to calculate a benchmark that reduces tracking error between the total fund or composite and the benchmark during periods of rebalancing using a predefined schedule." We concluded that rebalancing on a predefined schedule should be a recommendation. An asset owner may have good intentions to stick to a predefined schedule, but market events may not allow for them to keep to the schedule.

5. Actual-weight benchmarks

In the Exposure Draft, we asked if asset owners should be able to present an actual-weight benchmark in GIPS Asset Owner Reports instead of a policy-weight benchmark and, if so, which disclosures are necessary to accompany actual-weight benchmarks.

There were some mixed comments and significant concerns about whether actual-weight benchmarks should be allowed to be presented. We balanced those concerns with the practical reality that many asset owners experience when dealing with illiquid asset classes. It can be difficult to change allocations to illiquid asset classes in a timely manner, particularly for a large allocation. This may mean that there is an over-weight or under-weight to that asset class for an extended amount of time while the rest of the markets are moving on a more frequent basis. This would create an outsized relative return (either positively or negatively) to the total fund policy-weight benchmark for an extended period Therefore, we decided to allow the use of actual-weight benchmarks, but we added additional guidance, which states:

> When an actual-weight benchmark is used, asset owners must disclose that the benchmark reflects actual weights rather than policy weights. The benchmark description should include the fact that the actual-weight benchmark eliminates the impact of asset allocation decisions. The decision to use actual weights, the benchmark components, the rebalancing schedule, and rebalancing methodology (e.g., using beginning-of-period weights) should be determined in advance. If actual-weight benchmarks are used, the term "actual-weight" should be used in the name of the benchmark to indicate it is a custom benchmark. The asset owner must also disclose details about the calculation methodology of the benchmark, which is expected to include the frequency of calculation. The policy-weight benchmark should also be included in the GIPS Asset Owner Report alongside the actual-weight benchmark.