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Global Investment
Performance Standards

EXPOSURE DRAFT

GUIDANCE STATEMENT ON COMPOSITES FOR FIDUCIARY MANAGEMENT PROVIDERS TO UK PENSION SCHEMES

Effective Date:	TBD
Public Comment Period:	20 July 2023 – 20 September 2023

CFA Institute

INVITATION TO COMMENT

Exposure Draft of the Guidance Statement on Composites for Fiduciary Management Providers to UK Pension Schemes

CFA Institute established the GIPS Standards Fiduciary Management Provider Technical Committee (FMP TC) as the governing body for the Global Investment Performance Standards (GIPS®) for Fiduciary Management Providers to UK Pension Schemes. The FMP TC, which is responsible for the technical oversight of the GIPS standards for FMPs to UK Pension Schemes, seeks comment on the proposal set forth herein regarding the Guidance Statement on Composites for Fiduciary Management Providers to UK Pension Schemes.

Questions are positioned throughout the document to elicit feedback on specific issues. In addition to responding to specific questions, please provide feedback on the entire document, including items you support. All comment letters will be considered carefully and are greatly appreciated.

Comments must be received no later than 20 September 2023. Please submit your comments as early as possible to facilitate the review process. Unless otherwise requested, all comments and replies will be made public on the GIPS standards website (www.gipsstandards.org). Comments may be submitted by email to standards@cfainstitute.org.

Introduction

The GIPS standards for Fiduciary Management Providers to UK Pension Schemes ("GIPS standards for FMPs") are ethical standards for calculating and presenting investment performance based on the principles of fair representation and full disclosure.

The GIPS standards for FMPs require Fiduciary Managers (FMs) to include discretionary schemes in composites following a required composite structure. Schemes are generally classified as either unconstrained or having hedge restrictions and are further classified by return objectives. We understand that there is some ambiguity on how some Provisions in the GIPS standards for FMPs should be interpreted. For example, how should a scheme be classified when the FM advises on a hedge target versus when it does not, or should a scheme be included in a hedge restriction composite if the FM sets the hedge target?

This exposure draft of the Guidance Statement on Composites for the GIPS standards for FMPs seeks to provide clarity on some of the issues that have been brought before the FMP Technical Committee.

Composite Assignment

Many scenarios could arise where it might be unclear as to how a Fiduciary Manager (FM) should classify schemes for composite assignment purposes. To assist FMs in this endeavor, we provide some broad guidance as well as some specific scenarios. Generally, the objective of the GIPS standards for FMPs is to include as many schemes as possible in unconstrained composites (i.e., to consider schemes as unconstrained except where the client imposes an asset restriction or specifies a hedge target that is materially different from what the FM would choose to implement, given the discretion to do so). This approach will allow more comparability between FMs. Where the FM has accepted a scheme with a hedge target that is in the hedge range that the FM would consider to be appropriate, whether implicitly or explicitly, the scheme should be classified as unconstrained.

Some guiding principles that apply across all composites include:

- Where the client has selected a hedge target (e.g., 75%) or hedge range (e.g., between 70% and 80%) that is not materially different from the hedge target or hedge range that the FM would choose to implement, the scheme should be considered unconstrained.
- Where the FM has recommended a hedge target or hedge range that the client has agreed to, the scheme should be considered unconstrained.
- A scheme should not be considered hedge restricted solely because the hedge target or hedge range is specified in the investment management agreement (IMA).
- At times there may be changes in laws or regulations that will require the FM to change the return objective for a scheme, but the scheme is still considered unconstrained. When there are changes in laws or regulations that restrict an FM's ability to meet the return objective for a scheme (e.g., there is a reduction in leverage allowed by regulation), the FM should discuss the return objective with the client and document any agreed-upon changes. The agreed-upon changes may necessitate moving a scheme to a different composite. As an example, assume a scheme has a target return of liabilities +2%, but due to the decrease in allowed leverage, the new target return is liabilities +1%. In this case, the scheme should be moved from the unconstrained liabilities + 1.5% $< x \leq$ 2.5% composite to the unconstrained liabilities + 0.5% $< x \leq$ 1.5% composite.
- Decisions on composite assignment must be made on an ex-ante basis. Schemes should not be assigned to composites with the benefit of hindsight or based on how the scheme performed.

The following scenarios and guidance are intended to help FMs better understand how certain situations should be handled.

1. Scenario: The FM has recommended a hedge target (e.g., 75%), and the hedge target is specified in the IMA. Because the hedge target is specifically listed in the IMA, should this scheme be considered hedge restricted?

   Guidance: Where the FM has recommended a hedge target, and the hedge target that is specified in the IMA is the same as the hedge target that is recommended by the FM, the scheme should be considered unconstrained.

2. Scenario: The FM has recommended a hedge target of 80%. However, the client specifies a hedge target of 60%, which is materially different from the hedge target recommended by the FM. How should this scheme be classified?

   Guidance: Where the FM has recommended a hedge target and the client insists on a hedge target that is materially different, the FM should consider this scheme to be hedge restricted.

3. Scenario: The FM has recommended a hedge target of 85%. However, the client selects a hedge range that does not include the hedge target (e.g., a range of 75-80%). How should this scheme be classified?

   Guidance: Where the FM has recommended a hedge target or a hedge range that is different from the hedge range specified by the client, the FM should consider whether the difference between what the FM recommended and what the client specified is material. If the FM determines that the difference is immaterial, the FM should consider the scheme to be unconstrained. If the FM determines that the difference is material, the FM should consider the scheme to be hedge restricted.

4. Scenario: The FM has advised on the hedge target for a mandate with a high return target and liquidity constraints and has full discretion over the investment mandate. Given that higher return mandates and mandates with liquidity constraints often limit the amount of hedging that may be possible, how should this scheme be classified?

   Guidance: Where the FM has advised on the hedge target given the client's higher return mandate and liquidity constraints, and has full discretion to implement the mandate, the FM should consider the scheme as unconstrained.

5. Scenario: A scheme is currently classified as hedge restricted because the FM's hedge target recommendation was materially different from the hedge target specified by the client. Over time, the FM's hedge target recommendation has changed and now it is consistent with the client's specified hedge target. How should the scheme be classified?

   Guidance: If the FM has changed its recommended hedge target over time and its recommendation is now consistent with the client's specified hedge target, then the FM should consider the scheme unconstrained as of the date for which the FM's recommendation and the client's hedge target are consistent. The scheme should be moved from the hedge-restricted composite to an unconstrained composite on a prospective basis. The historical performance of the scheme must remain with the hedge-restricted composite.

6. Scenario: The FM acquired a new scheme, and the hedge target was determined by the prior FM. The hedge target is within the hedge target range that the FM would have recommended. How should this scheme be classified?

Guidance: Where the FM has acquired a scheme that has a pre-established hedge target that falls within the hedge range that the FM would have recommended, the FM should consider the scheme as unconstrained.

7. Scenario: The FM does not recommend a specific hedge target but recommends a hedge range. The scheme adopts a hedge target that falls within the recommended hedge range. How should this scheme be classified?

   Guidance: When the FM recommends a hedge range and the scheme adopts a hedge target that falls within the recommended hedge range, the scheme should be classified as unconstrained.

8. Scenario: The client allows for a hedge between 50% and 100%. The FM has recommended a hedge target of 60%. How should this scheme be classified?

   Guidance: Where the FM has recommended a hedge target that is within the hedge range allowed by the client, the scheme should be considered unconstrained.

9. Scenario: The client allows for a hedge range between 50% and 100%. The FM has recommended a hedge target of 70%, which is within the allowed hedge range, and the FM considers the scheme to be unconstrained. Due to market conditions, the FM makes tactical changes that cause the scheme's hedge % to move away from the 70% hedge target. How should tactical changes be treated?

   Guidance: Schemes should not be moved between composites due to tactical decisions. See the discussion for Provision 33.A.8 in the GIPS Standards Handbook for FMPs.

10. Scenario: The client imposes a hedge range between 70% and 90%, which is outside the range recommended by the FM. The FM considers the scheme to be hedge restricted. Because the hedge target spans two hedge-restricted composites, should the scheme be included in the hedge restriction 60% ≤ x < 80% composite or the hedge restriction 80% ≤ x ≤ 100% composite?

    Guidance: Occasionally a scheme that is considered to be hedge restricted will have a hedge range that spans more than one hedge-restricted composite. In such cases, if the scheme also has a specific hedge target, the FM should include the scheme in the hedge-restricted composite based on the specific hedge target. If the scheme does not have a specific hedge target, the FM will have to use its judgment to determine which hedge-restricted composite is the most appropriate. The FM should document its reasoning for why it believes the selected composite is the best fit.

11. Scenario: The client's guidelines in the IMA limit the position in an issuer to 5% of net assets. How should the FM classify schemes with these types of restrictions?

    Guidance: A client's investment policy statement (IPS) may include a number of restrictions or asset class limitations (e.g., a limit on holding more than 5% in one issuer, a limit on the percentage of foreign investments, a limit on the percentage of bonds rated below investment grade, a limit on the percentage of illiquids the scheme may hold, or a limit on the strategic allocation to property), which the FM must consider when taking on a client. The FM must determine if such restrictions and limitations will impact its ability to manage the scheme to the intended mandate. If the FM can reasonably manage around these restrictions and limitations, the scheme should be considered unconstrained. If the FM determines that the restrictions and limitations have a material impact on its management of the scheme, the FM may classify the scheme as asset restricted.

12. Scenario: The FM tendered and won a strategy for a scheme that is targeting a buyout in 5 years. The FM and the client agreed on a target return using only liquid assets. Should the FM classify the scheme as asset restricted?

    Guidance: The scheme is being managed within the specifications of the mandate, which reflect the planned buyout in 5 years and is not a specific client restraint per se. If the FM is able to manage to the target return using only liquid investments, the FM should consider the scheme to be unconstrained.

13. Scenario: The FM acquired legacy private equity assets. Should the FM classify the scheme as asset restricted?

    Guidance: There will be times when an FM acquires assets from another FM that cannot be liquidated for a period of time, or even on a longer-term basis. The high cost of disposing of some legacy assets may also cause the FM to keep assets it would otherwise wish to sell. FMs should consider whether the legacy assets represent a material amount of assets and whether the FM can manage around these assets. FMs are encouraged to classify such schemes as unconstrained unless the amount of legacy assets is so large that it has a material effect on the FM's ability to manage the scheme to its intended strategy.

14. Scenario: A client wished to review and approve strategic asset allocations falling outside the range of asset allocation parameters delegated to the FM provider. How should the FM treat this situation?

    Guidance: There is no clear answer here. The FM should consider whether such a client request results in the scheme being considered non-discretionary. If the FM determines that the client request materially impacts its investment discretion and therefore considers the scheme to be non-discretionary, the FM should document its decision and the reasons for considering the scheme to be non-discretionary.

Question: Do you agree with the guidance above? Are there any scenarios that you do not agree with or that you think require additional guidance? Are there any scenarios that should be added? Please provide comments on any specific scenarios.

Liability Benchmark

We understand that further clarification may be needed regarding the definition of liability benchmark.

15. Scenario: A scheme has a hedge target of 80%. The liability benchmark included within the IMA reflects the liabilities scaled by the hedge target (80% of full liabilities). How should we determine the liability benchmark in this situation?

    Guidance: The FM must present performance relative to the liability benchmark. A liability benchmark may be:
    - 100% of full liability cash flows;
    - a liability proxy benchmark constructed from gilts or swaps to represent the cash flow liabilities; or
    - a gilt of similar duration to the liabilities if neither the full liability cash flows nor a liability proxy benchmark constructed from gilts or swaps exists.

    This is true whether the scheme is included in an unconstrained or hedge-restricted composite. The hedge target or ratio is not a factor when calculating the liability benchmark.

    If the scheme is included in a hedge-constrained composite, then the FM must also calculate a hedge ratio–adjusted benchmark and present performance relative to both the liability benchmark and the hedge ratio–adjusted benchmark.

Question: Does the guidance on liability benchmark clarify what is meant by liability benchmark? If not, please let us know where further guidance is needed.

Effective Date and Application of Guidance Statement

The FMP Technical Committee recognizes that any proposed guidance that is adopted would likely result in FMs needing to make changes to composite membership. We propose requiring FMs to implement any changes required by this Guidance Statement no later than six months from the effective date of the final guidance statement. FMs may apply the changes on a prospective basis or retroactively if they choose. Any changes that affect composite assignment, whether prospective or retrospective, would require disclosure of the change in the GIPS Composite Report (e.g., effective 1 January 2024, some schemes that were previously included in a hedge-restricted composite were reclassified to the unconstrained composite on a prospective basis).

Question: Do you agree that FMs should be required to make changes only on a prospective basis, or do you think FMs should be required to make any changes retroactively? If you agree with requiring changes on a prospective basis only, should FMs be allowed to make changes retroactively, provided they disclose that the changes were made retroactively?

Other

Question: Given the changes in the liability-driven investing (LDI) market and collateral requirements, are there any additional situations that we should address?