

Wednesday, November 14, 2018, at 4 P.M. Eastern
Advisors4Advisors Webinar Series

Why GIPS® Standards Are Now More Important to Wealth Advisors

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Guardian Performance Solutions LLC is a specialty compliance consulting firm established to help investment managers to comply with the Global Investment Performance Standards (GIPS®).

GIPS Compliance Program Implementation

Performance Advertising Compliance

Performance Validation

Project Management

Education & Training

Agenda

- ▶ Overview of the GIPS Standards
- ▶ GIPS Challenges for Wealth Advisors
- ▶ Broadening the Scope: 2020 GIPS Standards
 - GIPS Fund Reporting
 - More Flexibility for Carve-Outs
 - More Performance Measurement Options
 - Less Asset Class Guidance
- ▶ Common GIPS Misconceptions



Global Investment Performance Standards (GIPS®)

- Industry accepted standard for calculating and presenting performance results to prospective clients
- Based on ethical principles of fair representation and full disclosure
- Created and administered by CFA Institute
- Compliance is voluntary but often expected
- Investment managers and asset owners can each claim compliance with the GIPS standards

Overview of GIPS Framework



POLICIES AND
PROCEDURES



INPUT DATA



CALCULATION
METHODOLOGIES



COMPOSITE
CONSTRUCTION



PRESENTATION
AND REPORTING



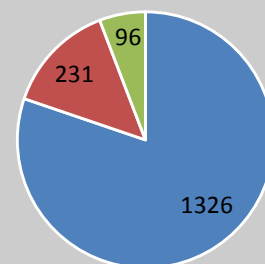
RECORD KEEPING



VERIFICATION

Rates of GIPS Compliance

- Firms that claim GIPS compliance must notify CFA Institute on an annual basis
- CFA Institute reported in 2018 that 1,685 firms claimed compliance with the GIPS standards
- Of those firms, 1,440 opted to undergo an independent GIPS verification
- ~85% of the firms that claim compliance elect to have the name of their firm listed on the GIPS website to publicly display their commitment to industry best practices for performance presentation
- 84 of the top 100 global asset management firms claim GIPS compliance (Cerulli Associates)



■ Americas ■ EMEA
■ Asia Pacific

First I wanted to give an update on the number of firms that are adhering to the GIPS standards.

Earlier this year, it was reported that more than **1,685** firms notified CFA Institute that they are claiming GIPS compliance. We have only had statistics about the number of firms that comply since 2015 as before then the CFA Institute was not collecting this information. Firms now are required to notify the CFA Institute annually if they are complying.

Of the firms who are compliant about **87%** of the firms have received a GIPS verification which is about 1,440 firms

And **85%** of the firms who notified elected to have the name of their firm listed on the GIPS website

Additionally, it was also reported that all or a portion of 84 of the top 100 global asset management firms claim GIPS compliance

The mission and goal of the GIPS standards is for universal adoption by asset managers and investment advisors. In order to accomplish this is to ensure the Standards are applicable to all assets classes and types of investment managers.

GIPS Challenges for Wealth Advisors

- ▶ Goals based advice vs. standardized strategies
- ▶ Customized mandates for individual investors don't fit cleanly into the standard composite construction framework required by the GIPS standards
- ▶ Constraints on the use of asset class or portfolio segment results (carve-outs)
- ▶ Multi-asset class required, even if segments are captured in other composites

More Deterrents for Wealth Advisors

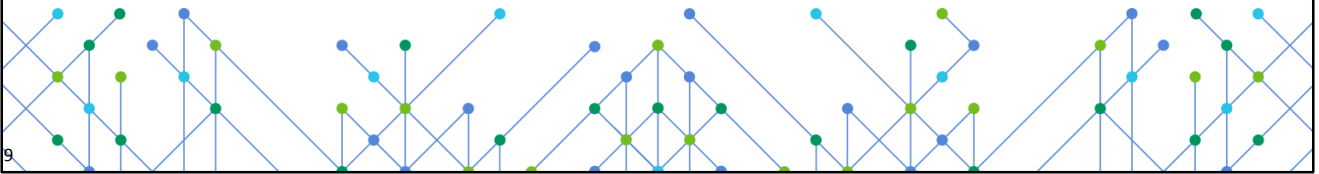
- ▶ Difficulty tracking strategy changes
- ▶ Identifying client directed changes vs. manager directed changes
- ▶ Treatment of legacy positions, tax loss harvesting, and other client directed constraints
- ▶ Treatment of fees when paid from outside of the portfolio
- ▶ Determining appropriate benchmarks
- ▶ Obligation to provide composite performance to prospective clients

ROI to GIPS-Compliant Wealth Advisors

Differentiate yourself from your competition by demonstrating adherence to high ethical standards and industry best practices

Mitigate risk by implementing robust internal policies and procedures

Present standardized reporting of historical investment returns in comparable performance presentations



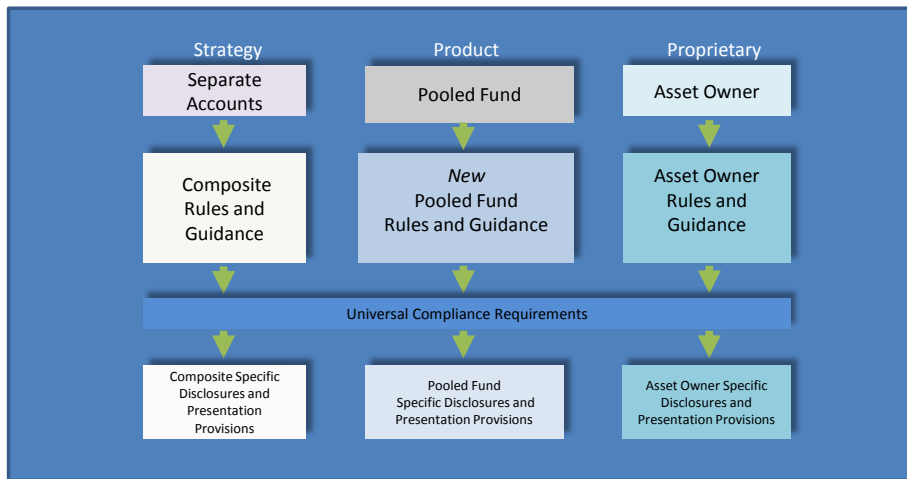
Firms gain a competitive advantage on RFPs because compliance fulfills key screening criteria by many institutional investors and consultants screening for multiple clients. The Standards help mitigate risk by implementing robust investment performance policies and procedures. The GIPS standards also allow firms to create and present historical investment performance reports globally in a consistent, transparent, and comparable manner. And it demonstrates the firm's commitment to being trustworthy, ethical, and professional.



2020 GIPS® Standards

- The first full redraft of the GIPS standards in a decade
- Goal was to allow for more options and have fewer strict requirements
- Exposure draft has been released for public comment and is available on the GIPS website
- Comment window closes on December 31, 2018
- Final version expected to be adopted on June 30, 2019 and become effective on January 1, 2020
- Firms will need to assess the state of their GIPS compliance program and make necessary updates before the effective date

2020 Structural Changes



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Two types of entities can claim compliance with the GIPS standards:

- Investment Managers
- Assets Owners

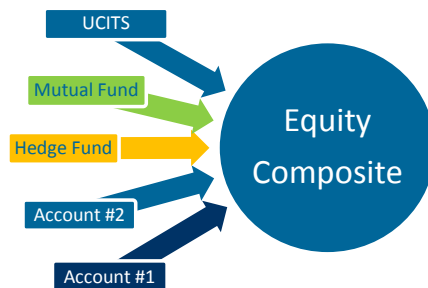
Selling a strategy then a composite is appropriate that includes all the constituents that are managed to the same strategy

Selling investment in a Pooled Fund

- Limited Distribution Pooled Funds Report (TWR or MWR)
- Broadly Distributed Pooled Funds (often sold to general public):

GIPS Composite Reports

- Composite-centric
- Focused on “strategy-level” marketing, not “product-level”
- Composite information is used when the firm is selling a strategy to a segregated account prospect
 - Segregated account = a portfolio owned by a single client, such as a separately managed account or fund-of-one



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The **GIPS compliant presentation** that is used today is being replaced by the **GIPS Composite Report**

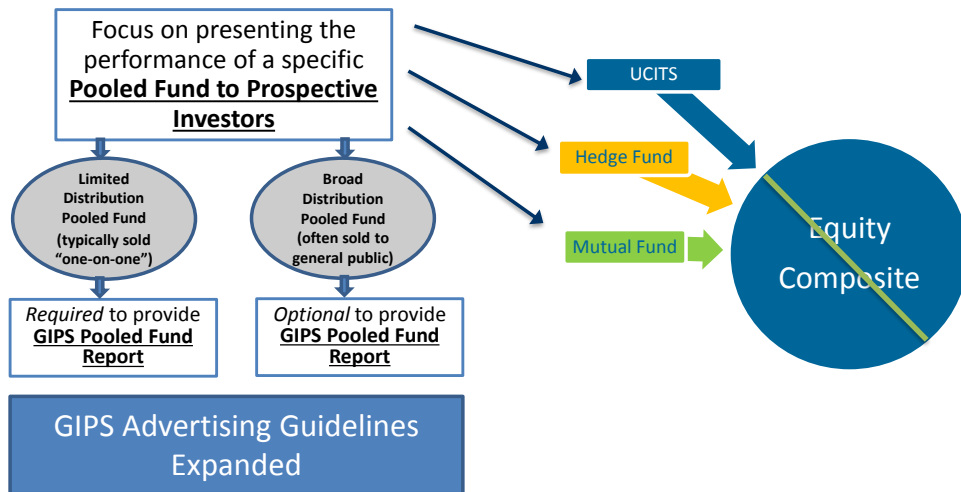
- GIPS Composite Reports are used for prospective clients who are interested in a strategy and the strategy is offered to a segregated account client
 - Segregated account is a portfolio owned by a single client

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

Under the 2020 GIPS standards, all actual fee-paying, discretionary **SEGREGATED ACCOUNTS** must be including in at least one composite, they meet a composite definition.

The firm is selling a strategy to a segregated client which is a portfolio owned by a single client

GIPS Pooled Fund Reports



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A GIPS Pooled Fund

- 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

Broad vs. Limited Distribution

- ▶ Limited distribution pooled funds are defined as funds that are not publicly available to multiple investors and the typical marketing practice involves contact between the firm managing the pooled fund and prospective investors
- ▶ Broad distribution pooled funds are defined as funds that are publicly available to multiple investors and the typical marketing practice involves no or minimal person contact between the firm managing the pooled fund and prospective investors

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Since a composite doesn't make sense to report to a pooled fund investor, the standards have expanded to cover pooled funds.

Under the 2020 edition of the GIPS standards, firms who managed pooled funds will have to determine.

Two categories of funds being defined

1. Limited Distribution Pooled Fund

- A limited distribution fund is not publicly available to multiple investors, the typical marketing practice involves contact between the FIRM managing the fund and prospective investors (sold in one-on-one presentations).
- Hedge funds, private equity funds, and other limited offering commingled products. **These funds are often not highly regulated**

2. Broad Distribution Pooled Fund

- A pooled fund that is publicly available to multiple investors, for which the typical marketing practice involves no or minimal contact between the firm managing the fund and prospective investors (the firm may not know or have a direct relationship with the investors).
- This category would typically include 40 Act funds, ETFs, and UCITS funds which are typically sold to the general public, and the firm may not know the pooled investor. **These funds are typically highly regulated.**

GIPS Reporting no longer limited to composites

GIPS Compliant Presentation being replaced by 2 distinct reports:

1. GIPS Composite Reports

Mirrors traditional GIPS Compliant Presentation, includes composite-specific disclosures and statistics

2. GIPS Pooled Fund Reports

Includes information specific to a particular pooled fund

More Flexibility for Carve-Outs

- ▶ Carve-outs are segments of portfolios that are, by themselves, representative of a distinct investment strategy
- ▶ Typically, carve-outs are based on asset class, geographic region, or industry sector
- ▶ Currently, carve-out segments must be managed separately with their own dedicated cash component
- ▶ Under the 2020 GIPS standards, allocating cash to carve-outs on a timely and consistent basis is proposed to again be permitted

Proposed Carve-Out Requirements

- ▶ Must create carve-outs with allocated cash from all portfolios and portfolio segments within the firm managed to the strategy
- ▶ Include the term “Carve-Out” in the composite name
- ▶ Disclose that the composite includes carve-outs with allocated cash
- ▶ Disclose the policy used to allocate cash to carve-outs
- ▶ Report the percentage of composite assets represented by carve-outs with allocated cash as of each annual period end
- ▶ Accounts fully dedicated to strategy (standalone portfolios) may be combined with carve-outs, but must also be included in their own dedicated composites
- ▶ Report the returns and assets of the composite of standalone portfolios in the GIPS Composite Report of the composite that includes carve-outs with allocated cash
- ▶ Disclose that the GIPS Composite Report for the composite of standalone portfolios is available upon request

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Carve-outs

Prior to 2010, firms could allocate cash to carve out segments of portfolios. Then in 2010 this changed and firms were prohibited from allocating cash to carve-outs and including those carve-outs in composites

Under the 2020 GIPS standards, firms are being offered the option to allocate cash to carve-outs, but must do the following:

- ▶ Must carve-out all portfolio segments managed to the strategy and include those carve-outs with allocated cash in the composite

- ▶ Include the term “Carve-Out” in the composite name

- ▶ Once the firm obtains a standalone portfolio managed in the same strategy as the carve-out(s) with allocated cash, the firm must create a composite that includes only standalone portfolios

- ▶ Performance and assets from the composite of standalone portfolios must be included in the GIPS Composite Report for the carve-out composite

Performance Measurement Options

- ▶ The GIPS standards currently require time-weighted returns (TWRs) in most instances
- ▶ 2020 GIPS standards offer more flexibility for presenting money-weighted returns (MWRs), including the internal rate of return (IRR)

Required MWR Criteria:

A) The firm must control the timing of cash inflows

B) One of the following:

- 1) closed-end structure
- 2) fixed life
- 3) fixed commitment
- 4) Illiquid investment significant part of strategy

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Expanded Performance Measurement Options

Firms will now have the option if certain criteria is met to present Money-weighted Returns (MWR) also known as IRR. It is thought that in some instances MWR is more meaningful returns when the mgr controls the CF b/c the return reflects the timing of when the cash flows are made. MWR more accurately measures the returns of the portfolio. Where a Time-weighted return reflects the return of the manager. accurately measures the returns of the portfolio.

MWR/IRR currently is only allowed for private equity and closed-end real estate products

Under the 2020 GIPS standards, there is a more broad use of MWR that likely will be permitted if certain requirements are met, including:

The firm controlling the timing of cash flows AND

One of the following additional criteria must be met:

the vehicle must have a closed-end structure
fixed life

fixed commitment

illiquid investments must be a significant part of the
strategy

Firms must determine which returns will be presented for each composite and limited distribution pooled fund and must consistently present the selected returns.

Asset Class Guidance Removed

- ▶ Sections dedicated to real estate and private equity being removed
 - Reporting requirements recast based on vehicle and general asset class characteristics
- ▶ Annual valuation requirements for private market investments including private equity, real estate, infrastructure and other real assets
 - Independent assessment of value performed by an external third party
 - Review of valuation inputs and assumptions performed by an external third party
 - Financial statement audit

Valuation Changes for Private Market Investments

Annual external valuation requirement is being expanded to all **private market investments**, which will include real estate, private equity, infrastructure, and other real assets.

Rather than receiving a full appraisal, the firm could have one of the following:

A review conducted of their valuation inputs and assumptions by an external third party (e.g., review by an external party of a firm's internal discounted cash flow calculation for a real estate property)

A financial statement audit performed by an independent, qualified public accounting firm that includes within its scope the process for fair valuing the private market investments

GIPS Report Changes Highlights



3-YEAR
ANNUALIZED
RETURNS FOR
COMPOSITE/
FUND AND
BENCHMARK



FIRM ASSETS
REQUIRED
(% OF FIRM
NO LONGER
AN OPTION)



CREATION
DATE
REPLACED BY
INCEPTION
DATE



OPTION TO
RETIRE
DISCLOSURES
THAT ARE NO
LONGER
RELEVANT



PERCENTAGE
OF
COMPOSITE
ASSETS
VALUED
USING
SUBJECTIVE
UNOBSERV.
INPUTS



GIPS REPORTS
WILL NEED TO
BE UPDATED
WITHIN SIX
MONTHS OF
THE ANNUAL
PERIOD END



DISCLOSE IF
GIPS REPORTS
ARE
INCLUDED IN
MARKETING
MATERIALS



MODIFIED/
EXPANDED
COMPLIANCE
STATEMENT

- GIPS reports will need to be updated within 6 months of the annual period so basically by June 30 the firm will need to have their GIPS reports updated through the most recent year-end
- They are proposing to require, in addition to at least 5-years of annual performance results, the presentation will also need to include the **3-year annualized returns** for the composite and the benchmark.
 This is a recommendation under the current edition of the standards, but it is being elevated to a requirement.
 The purpose of requiring this information is to provide a better comparison against the 3-year annualized standard deviation figures that are also required.
- % of Firm Assets will no longer be an option by itself – firms will need to report firm AUM – this is to make reporting consistent across firms
- Create Date is no longer required but inception date is being proposed
- Firms will have the option to retire some disclosures such as a composite name change, a benchmark change for a period that isn't reflected in the presentation. Things that are not reflected in the piece.
- Presentation materials that include GIPS reports will need to indicate that the GIPS report is included in the presentation deck. They have suggested that firms can do this in the presentation's table of contents
- They are also modifying the GIPS compliance statement which will be highlighted next...

2020 GIPS Standards Timetable

2020 GIPS Exposure Draft Issued	August 31, 2018
2020 Verification Exposure Draft Issued	October 31, 2018
Comment Period End Date	December 31, 2018
2020 GIPS Final Version Issued	June 30, 2019
2020 Verification Final Version Issued	August 31, 2019
Effective Date	January 1, 2020
Reports Prepared per 2020 GIPS Standards Requirements	June 30, 2021

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- The GIPS 2020 Exposure Draft was released for public comment on **August 31, 2018** (comment period ends YE 2018)
- GIPS 2020 final version expected to be issued **June 30, 2019** with an effective date of **January 1, 2020**
- GIPS reports will need to be prepared per the GIPS 2020 Reporting requirements by **June 30, 2021**

GIPS Compliance Misconceptions

GIPS compliance is expensive

GIPS compliance increases a firm's regulatory risks

Firms must have a 5-year track record before they can comply

GIPS compliance is only valuable as a marketing tool

Clients don't understand or know what GIPS compliance is

The GIPS standards are performance calculation standards

Composites can be GIPS compliant

A portfolio can only be included in one composite

Only marketed strategies need to have a composite

The GIPS standards are performance calculation standards

A firm claiming compliance must be a legal entity

Software can make a firm GIPS compliant

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Resources

- ▶ [GIPS Compliance Workshop](#) Houston, TX - November 29th
 - ▶ A full day of sessions have been organized that cover GIPS fundamentals and how to create and maintain a GIPS compliance program. Topics include composite construction and calculations, GIPS policies and procedures, GIPS reports, and error correction.
- ▶ [GIPS standards website](#)
- ▶ [3rd Edition of the GIPS Handbook \(current\)](#)
- ▶ [2020 GIPS Standards Exposure Draft \(proposed\)](#)
- ▶ [US Investment Performance Committee](#)
- ▶ Helpdesk: gips@cfainstitute.org