



An Investment Adviser Association and K&L Gates
Webinar Presentation

2020 GIPS Standards

*Market Impact and Views from the
Inside*

Presented on July 24, 2019

Speakers



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Michael S. Caccese is K&L Gates' chairman of the Management Committee and practice area leader of the financial services practice. K&L Gates maintains one of the most prominent financial services practices in the United States – with more than 150 lawyers practicing from Australia, Asia, Europe and the United States, representing diversified financial services institutions and their affiliated service providers. Michael focuses his practice in the areas of investment management, including mutual funds, closed-end funds, registered fund of hedge funds, hedge funds and separately managed accounts, in addition to advising on investment management and broker-dealer regulatory compliance. Michael also advises on structuring investment management professional team “lift-outs” and “placement”, “soft dollar” compliance, investment performance, the Global Investment Performance Standards (“GIPS”), and the CFA Soft Dollar Standards and the Trade Management (Best Execution) Guidelines, along with other investment management industry standards of practice.



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Raymond Lee is a Vice President and the Manager of Performance at Jennison Associates. Prior to joining Jennison, Raymond was the head of performance and analytics at First Eagle Investment Management. Prior to First Eagle, he was a senior portfolio analyst at Colonial Consulting, LLC. He was previously a performance analyst at J.P. Morgan Asset Management and AllianceBernstein L.P. Raymond received a BA in economics from the University of Michigan. He is a member of The New York Society of Security Analysts and CFA Institute. Raymond is a member of the CFA's USIPC GIPS committee.

Speakers



Michael W. McGrath, CFA

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Michael McGrath, CFA is a partner in the firm's Boston office. He practices in the areas of investment management, securities, and commodities law, including the representation of institutional investment firms, registered investment companies, private equity and hedge funds. Michael counsels SEC, CFTC, NFA, and FINRA regulation. His practice is focused on helping financial institutions design their compliance programs, supporting trading and investment management issues including best execution, soft dollars, control of nonpublic information, and derivatives trading, and assisting with SEC and NFA staff examinations. Michael also has extensive experience counseling clients on regulatory matters that relate to strategic business decisions. Michael has been appointed to serve on the CFA's USIPC GIPS committee.



Kristen Murray

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Kristen L. Murray is the Vice President and Manager, Performance at Wellington Management. As the GIPS team manager within Performance, Kristen has nine years of oversight responsibilities with respect to the firm's policies and procedures for compliance with the Global Investment Performance Standards (GIPS®), including composite management and analysis. She works closely with the Investment Products and Strategies Group, Legal and Compliance, and the Global Relationship Group to interpret new guidance statements and address client solutions. Kristen is a member of the firm's GIPS Working Group, GIPS Oversight Group and New Product Working Group. Kristen joined the firm in 2005 as a trust administration analyst overseeing the Wellington Trust Company pools until 2010. Prior to joining Wellington Management, she held a variety of fund accounting positions within State Street Corporation. Kristen earned her BA in economics from the University of Rhode Island.



Paul D. Glenn

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Moderator

Paul D. Glenn is Special Counsel for the IAA. Previously, he worked for 12 years at the SEC as a trial attorney and special counsel in the Division of Enforcement and the Office of General Counsel, respectively. He also worked at the Office of the Comptroller of the Currency (OTS), U.S. Treasury, as Deputy Chief Counsel and Special Counsel. Paul also served as VP and Director of Compliance for PNC Bank N.A. in Washington, DC and Sandy Spring Bank. He holds an LL.M from Georgetown University Law and his J.D. and B.A. from Case Western Reserve University. Paul is a member of the CFA's USIPC GIPS committee.

AGENDA

- Overview of the GIPS Standards
- Goals of the CFA Institute for the 2020 GIPS Standards
- Material Changes to the GIPS Standards
 - Changes from the 2010 edition to 2020 edition
 - Changes from the Exposure Draft
- Impact of the 2020 GIPS Standards on Different Market Segments
- Next Steps

Polling question 1

Attendees, do you consider yourself representing
(select all that apply):

- A. A GIPS compliant firm
- B. A firm considering GIPS compliance
- C. A non GIPS compliant firm
- D. An asset manager
- E. A GIPS expert (earning your money by GIPS employment)
- F. Nothing applicable

Polling question 2

Does your firm plan early compliance with the 2020 GIPS Standards?

- A. Yes
- B. No
- C. Haven't decided
- D. What does that mean?
- E. Not applicable

Polling question 3

Is your firm considering for GIPS purposes advisory-only-assets (select all that apply)?

- A. Yes, at the firm level
- B. No, at the firm level
- C. Yes, at the strategy level
- D. No, at the strategy level
- E. Not applicable

The background features a dark blue upper section with thin, radiating lines and a dotted arc. The lower section is a golden-yellow field with a grid of small dots and flowing, particle-like trails.

Overview of the GIPS Standards

GIPS STANDARDS OVERVIEW

- Voluntary ethical principles for the reporting of investment performance results administered by the CFA Institute
- Purposes of the GIPS Standards:
 - Facilitate apples-to-apples comparison
 - Fair representation & full disclosure
 - Ensure accurate & consistent data
 - Foster industry-wide best practices and self-regulation
 - Enhanced internal controls as well as marketing benefits

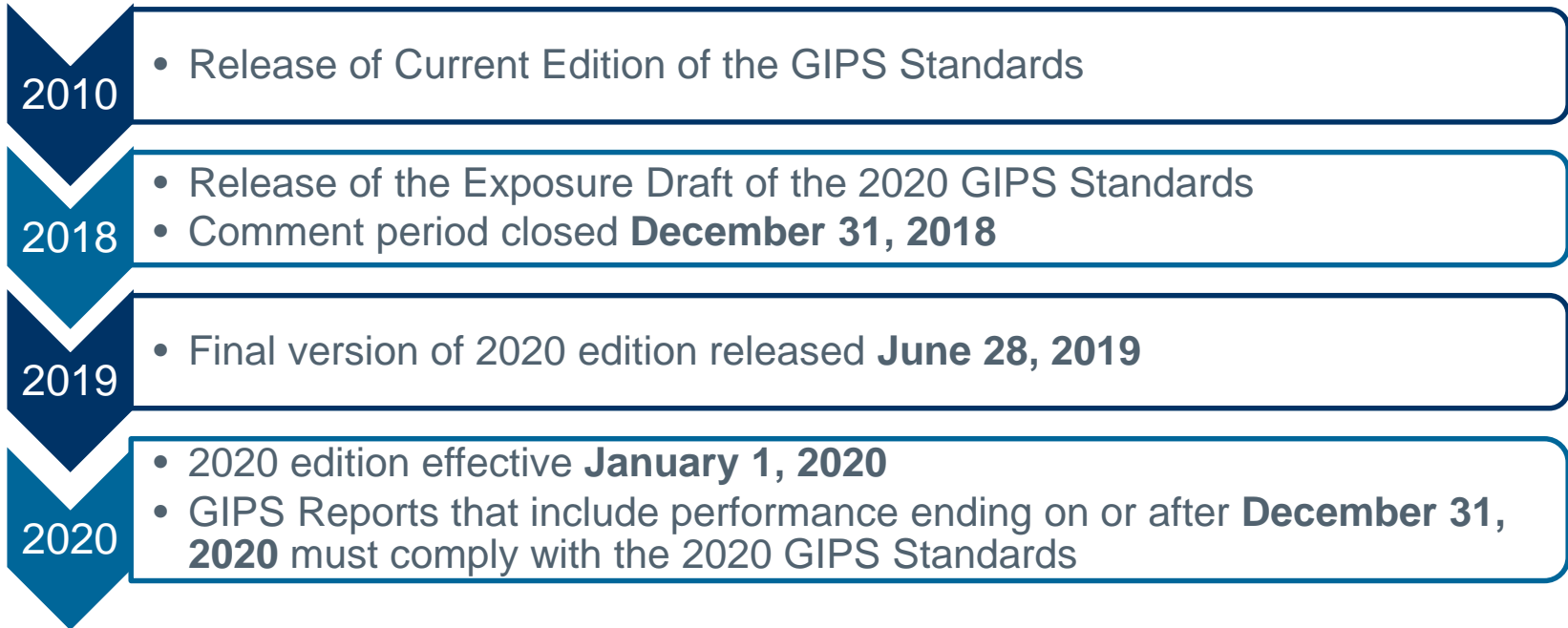
GIPS STANDARDS OVERVIEW CONTINUED

- Two historical sources of requirements regarding compliance
 - GIPS Standards (last revised and published in 2010)
 - Interpretive Guidance (Guidance Statements, Q&As, GIPS Handbook discussion)
- The 2020 GIPS Standards codify many of the requirements previously set forth in Interpretive Guidance
- Fundamentals of compliance:
 - Input data
 - Calculation methodology
 - Composite construction
 - Disclosures
 - Presentation and reporting
 - Detailed policies and procedures, verification (recommended)

The background features a dark blue upper section with fine, radiating white lines. Below this is a solid blue horizontal band containing the title text. The bottom section shows a golden globe with a grid of dots, overlaid with glowing, swirling particle trails in shades of gold and yellow.

Goals of the CFA Institute for the 2020 GIPS Standards

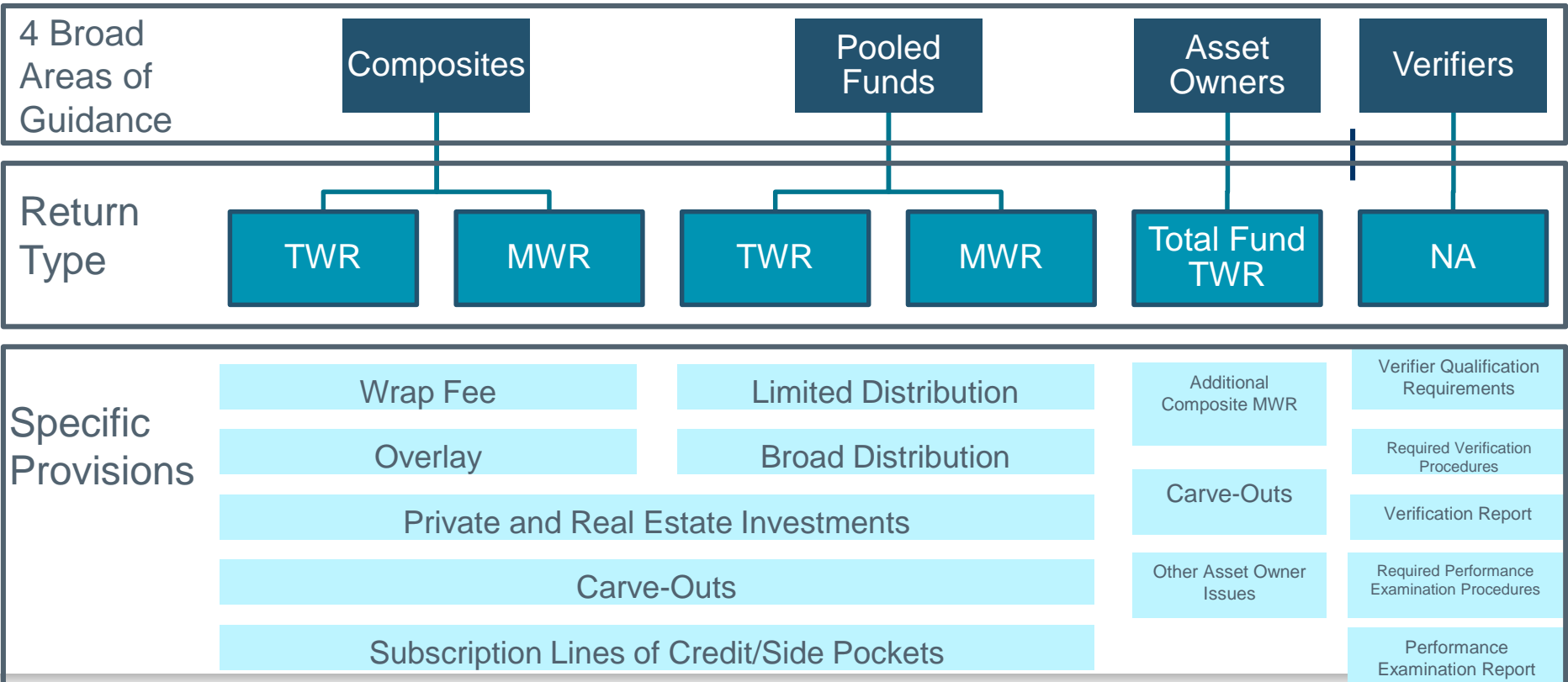
GIPS STANDARDS TIMELINE



WHY CHANGE THE GIPS STANDARDS?

- Composites are the foundation of the GIPS Standards, but composites are not always appropriate for private funds and similar vehicles
- Many pooled funds do not fit neatly into the current composite construction or GIPS reporting framework
- To make the GIPS Standards more relevant for all asset classes, including alternative funds/strategies
- To better address applicability for asset owners
- To consolidate standards that have expanded through interpretive guidance issued since 2010

NEW LAYOUT OF THE 2020 GIPS STANDARDS





Material Changes to the 2020 GIPS Standards

COMPOSITES VS. POOLED FUNDS

- Composites will continue to be required for strategies **managed or offered** in a separate account format
- What if the strategy is **only** offered through a pooled fund?
 - No longer required to maintain “composites of one” if the strategy is only offered through one or more pooled funds
- Must continue to include pooled funds in composites for the pooled fund strategy that are also marketed as a separate account
- **Broad Distribution Pooled Funds** are not required to maintain a separate GIPS Pooled Fund Report
- **Limited Distribution Pooled Funds** must present prospective investors with either:
 - A GIPS Composite Report for the pooled fund’s strategy; or
 - A GIPS Pooled Fund Report

COMPOSITES VS. POOLED FUNDS CONTINUED

- In response to Exposure Draft comments, the 2020 GIPS Standards clarify the two types of pooled funds:
 - **Broad Distribution** (e.g. UCITS, mutual funds) – any pooled fund regulated under a framework that permits purchase by the general public, and that is not exclusively offered in one-on-one presentations
 - **Limited Distribution** (e.g. LPs, “private funds”) – any pooled fund or share class that is not a broad distribution fund
- The Exposure Draft required Limited Distribution Pooled Funds to present performance in the GIPS Pooled Fund Report format
- The 2020 GIPS Standards permit firms to present either a GIPS Pooled Fund Report or a GIPS Composite Report to Limited Distribution Pooled Fund prospects

INTRODUCING THE “GIPS REPORT”

- New name for “GIPS Compliant Presentation”
 - For Composites: GIPS Composite Report
 - For Pooled Fund: GIPS Pooled Fund Report
 - For Asset Owners: GIPS Asset Owner Report
 - (Collectively, “**GIPS Report**”)
- Must make every reasonable effort to:
 - Provide GIPS Composite Report to separate account prospects
 - Provide either the GIPS Pooled Fund Report or, if a Limited Distribution Pooled Fund is in a composite, the GIPS Composite Report, to all Limited Distribution Pooled Fund prospects
- The 2020 GIPS Standards require the GIPS Report be updated within twelve months of each annual period end
 - The Exposure Draft proposed requiring firms to update the GIPS Report within six months of each annual period end

GIPS POOLED FUND REPORT

- Requires similar statistics and disclosures of a GIPS Composite Report
 - For TWRs: 5 years of annual returns, building to 10 years
 - For MWRs: SI-IRR through most recent period-end
 - Fund assets, firm assets, 3-yr standard deviation (if valued monthly)
 - Similar disclosure requirements to a GIPS Composite Report

GIPS POOLED FUND REPORT CONTINUED

- When calculating net returns, firms must use either actual management fees or a model fee appropriate to the prospective client fee
 - Both the 2010 GIPS Standards and the Exposure Draft required the highest appropriate investment management fee
 - Returns calculated using the model fee must still be equal to or lower than returns that would have been presented if actual fees were used
 - U.S. firms must comply with the JP Morgan (1996) and AIMR (1996) no-action letters
- Unlike the Exposure Draft, which required firms present pooled fund net returns, the 2020 GIPS Standards permit presentation of either gross or net returns
- The 2020 GIPS Standards recommend firms include in GIPS Pooled Fund Reports for new Limited Distribution Pooled Funds that do not have a track record the most appropriate track record for the new Limited Distribution Pooled Fund
 - The Exposure Draft required firms present the most appropriate track record for the new Limited Distribution Pooled Fund, if available

MONEY WEIGHTED RETURNS

- The 2020 GIPS Standards permit more frequent use of money-weighted returns (MWR) rather than time-weighted returns
 - MWRs can be used if the manager controls external cash flows AND at least one of the following is true
 - Closed end
 - Fixed life
 - Fixed commitment
 - Significant part of the investment strategy is in illiquid investments
- This is a significant enhancement, as many strategies are now being offered via commitment-based funds (not only private equity)

MONEY WEIGHTED RETURNS CONTINUED

- The 2020 GIPS Standards require presentation of annualized since-inception MWR through the most recent annual period end
 - Previously RE/PE guidance required SI-IRR through each year-end → 2020 GIPS Standards now require inclusion of a single MWR
- In addition, the 2020 GIPS Standards require use of daily cash flows when calculating MWRs as of January 1, 2020, but permit firms to use quarterly cash flows prior to January 1, 2020
 - The 2010 edition requirement to calculate SI-IRR using daily cash flows was limited to private equity
- If subscription lines of credit are used, must show since-inception MWR both with and without the subscription line of credit activity through the most recent annual period end
 - Including the cash flows, value and associated costs for any Subscription Lines of Credit

EXTERNAL VALUATIONS

Changes from the 2010 edition:

- Real estate investments in an open end fund must receive an external, independent valuation at least once every 12 months
- Real estate investments not in a real estate open end fund must either:
 - Receive an external, independent valuation at least once every 12 months unless client agreements stipulate otherwise; or
 - Receive an annual financial statement audit

Changes from the Exposure Draft:

- The 2020 GIPS Standards do not require other private market investments (e.g., private equity, credit) to obtain external, independent valuations

TOTAL FIRM ASSETS, UNCALLED COMMITTED CAPITAL AND ADVISORY-ONLY ASSETS

- Advisory-only assets
 - Include “model-delivery,” “UMA,” or other situations where investment recommendations (e.g. a model) are provided, but firm has no control of investment decisions and no trading authority for assets
- Uncalled committed capital
 - Pledges of capital to an investment vehicle by investors that have not yet been called by the investment vehicle
- Advisory-only assets (AOA) and uncalled committed capital (UCC) can be included in GIPS Report, but not added to firm AUM

Year	Required	Permitted	Permitted		Prohibited
	GIPS Firm Assets (A)	AOA and/or UCC (B)	Total Assets (A+B) \$12 Billion		“Total Assets” (A+B)
2019	\$10 Billion	\$2 Billion	AOA /UCC (A) \$2 Billion	GIPS Firm Assets (B) \$10 Billion	\$12 Billion

ESTIMATED TRANSACTION COSTS

- Transaction costs: costs of buying or selling investments
 - Brokerage commissions
 - Exchange fees/taxes/local regulator fees
 - Bid/offer spreads
 - Portfolio company acquisition expenses
- May use estimated transaction costs only where the actual transaction costs are not known
 - This effectively removes much of the wrap fee guidance currently in place
 - The Exposure Draft requirement that estimated transaction costs must be lower than actual transaction costs was removed; further guidance on how to determine estimated transaction costs is expected

TRACK RECORD PORTABILITY

- If portability tests are met, firms are now allowed to choose if they will link to performance from a prior firm on a composite-specific or pooled fund-specific basis
 - This change is a recognition that firms that do not want to port performance would miraculously fail to meet the criteria
- 2020 GIPS Standards add a **fourth portability test** - There must be no break in the track record between the past firm and the new firm
 - If there is a break, performance before the break cannot be linked to performance after the break

TRACK RECORD PORTABILITY CONTINUED

- 2020 GIPS Standards clarify the one-year “grace period”
 - Assets of an acquired non-compliant firm or affiliation must meet all the requirements of the GIPS Standards within one year of the acquisition date, on a prospective basis only
- No limit on when firms may port history from the prior firm or affiliation
 - Example: If it takes a firm 3 years to get the required records to support prior firm performance, may port the performance at that time
 - Can use information as supplemental information

RETURN OF CARVE OUTS

- Carve out: portion of a portfolio that by itself is representative of a distinct investment strategy
- Cash Treatment Methods
 - Accounted for separately
 - Allocated synthetically on a timely and consistent basis
 - There is no specified method for allocating cash
- A composite with carve outs must include all carve outs across the firm that represent the same strategy—No cherry picking!

RETURN OF CARVE OUTS CONTINUED

- Carve-outs must be representative of a standalone portfolio managed according to that strategy
- Firms must create a separate composite for standalone portfolios (once/if they are obtained)
 - Cannot include carve outs in a standalone portfolio Composite (*i.e.*, cannot link model and actual)
- Additional disclosures
 - Include “carve out” in composite name
 - Establish a methodology for cash allocation
 - Disclose standalone GIPS Composite Report is available upon request
 - Disclose that composite includes carve-outs with allocated cash
- Must present returns and assets of the standalone portfolio composite in the GIPS Composite Report for carve-outs with allocated cash (but not the full standalone portfolio composite’s GIPS Composite Report)

ASSET OWNER AND VERIFICATION STANDARDS

- **Asset Owners** – entities that manage investments, directly and/or through the use of external managers, on behalf of participants, beneficiaries, or the organization itself
 - Asset Owners marketing their services must follow the 2020 GIPS Standards for Firms
- **Verification Standards** impose detailed requirements that conform to current best practices
 - Verification procedures expanded & more detailed
 - Verification report language includes statements of independence and no assurance
 - Terms of engagement



Impact of the 2020 GIPS Standards
Proposals on Different Market Segments

GIPS ADVERTISING GUIDELINES

- Three Options:
 - 1) Delivery of a GIPS Report
 - Composite
 - Pooled Fund
 - 2) Advertisement that complies with Advertising Guidelines
 - 3) Advertisement that does not reference the GIPS Standards (at all)
 - Performance does not need to comply with the GIPS Standards (as long as it is not prohibited)
- Advertisements may include:
 - Website
 - Fact sheets
 - Newspaper/Magazine
 - Social Media
 - PPMs
 - White Papers
 - TV Ads

CONSIDERATIONS BY MARKET SEGMENT

- Registered Fund managers (Broad Distribution Pooled Funds)
 - Potential reduction in the composite universe of certain managers
 - May promote GIPS compliance in two ways:
 - 1) GIPS Pooled Fund Report to all prospective investors (not required)
 - 2) GIPS Advertisement prepared in accordance with GIPS Advertising Guidelines
- Institutional Managers have the flexibility to present performance through a GIPS Composite Report, GIPS Pooled Fund Report or GIPS Advertisement
 - Firms that primarily present “strategy” performance will likely continue to do so

CONSIDERATIONS BY MARKET SEGMENT

CONTINUED

- Wrap/SMA Managers may continue to show “pure” gross performance (as Supplemental Information)
 - Sponsor-specific composites now viewed as client reporting, not marketing (and not subject to the GIPS Standards)
- Hedge, PE, and Credit managers may now use Pooled Fund Reports rather than composites
 - In the U.S., fund-specific materials still subject to FINRA rules and ‘33 Act securities offering rules and guidelines

CONSIDERATIONS BY MARKET SEGMENT

CONTINUED

- The 2020 GIPS Standards provide 3 important incentives to private equity/credit managers
 - GIPS Pooled Fund Reports
 - Flexible return calculation options (MWRs!)
 - Relaxed carve out provisions
- If subscription lines of credit are used, firms must present since-inception money weighted returns both with and without the subscription line of credit activity
 - Unless the principal is repaid within 120 days using LP capital, and no principal was used to fund distributions

The background is a composite of abstract digital and particle effects. The top half features a dark blue gradient with numerous thin, light blue lines radiating from a central point on the left, creating a starburst or fan effect. The bottom half is dominated by a golden-yellow glow, featuring a grid of small, bright dots that form a faint world map. Overlaid on this are several curved, glowing lines of varying thickness, suggesting motion or data paths. The overall aesthetic is futuristic and high-tech.

Next Steps

UNDERSTAND THE STANDARDS

- Take the time to develop a strong understanding of the 2020 GIPS Standards – there are many material changes that will impact each firm’s performance measurement and marketing activities
- The CFA Institute intends to issue an updated GIPS Handbook with additional guidance regarding the 2020 GIPS Standards
 - Handbook will contain material guidance regarding several provisions, *e.g.*, estimated transaction costs, performance portability, methodology for carve-out cash allocation
 - Release date has not yet been announced but release is expected by year end

ASSESS THE IMPACT ON YOUR FIRM

- Firms that currently claim compliance
 - How will you present pooled funds moving forward?
 - Disclose updates to existing GIPS-compliant presentations
 - Wrap composites
- Firms contemplating compliance
 - Talk to clients, consultants, and peers
 - Reconsider costs in light of the 2020 GIPS Standards (particularly GIPS Pooled Fund Reports)
- Involve Legal and Compliance
 - 2020 GIPS Standards can impact PPM disclosure, FINRA compliance, Advisers Act compliance, etc.
 - Transition should not be led by performance management group in a silo



Q&A

SPEAKERS



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Thank You



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