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The 2020 GIPS® Standards for Alternative Asset Managers

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SPEAKERS



Shivani Choudhary, CFA, CIPM

Senior Principal Consultant,
Alternative Assets Practice Specialist

ACA Performance Services



Michael McGrath, CFA

Partner, US Investment
Performance Committee (USIPC)

K&L Gates



DISCUSSION TOPICS

- Regulatory and investor focus on investment performance
- GIPS Compliance 101
- Current market data on rates of compliance
- GIPS compliance requirements in RFPs
- Common implementation considerations, including:
 - Options for defining a GIPS-compliant firm
 - Acceptable GIPS-compliant calculation methodologies
 - Subscription lines of credit, net of fees calculations, and the impact to fundraising
 - Timing and costs for implementation
- Project time to completion assumptions

The background of the slide is split into two horizontal sections. The top section features a dark blue background with numerous thin, light blue lines radiating from a central point on the left, creating a starburst or network effect. The bottom section features a golden-yellow background with a glowing, pixelated globe of the Earth. The globe is composed of many small, bright dots that form the continents and oceans.

Current Adoption of the GIPS Standards

GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS®)

- Voluntary, ethical principles for the reporting of investment performance
- Fair representation and full disclosure
- Ensure accurate and consistent data
- Promote fair competition
- Foster industry-wide best practices and self-regulation

WHY CLAIM GIPS COMPLIANCE?

- Provides additional credibility in presenting performance numbers in the marketplace
- Reinforces existing client relationships and opens doors to consultants and more potential clients
- Fosters comparability of investment results
- Often required to be considered for institutional mandates
- Demonstrates commitment to best practices/“industry standard”
- Facilitates a solid operational foundation for performance calculation and advertising

GIPS COMPLIANCE ADOPTION

1,711

firms claimed GIPS
compliance in 2018

86%

undergo a third-party GIPS
compliance verification

57%

of GIPS verified firms
choose ACA for third-party
verification

29%

of firms reported less than
\$1 billion in assets under
management (AUM)

84

of the top 100 asset
management firms claim
GIPS compliance

46

Countries adopt the
GIPS standards

Source: CFA Institute (October 2018)

2018 MANAGER AND CONSULTANT SURVEY HIGHLIGHTS

74%

of **traditional asset managers** claim GIPS compliance

87%

of firms that claim GIPS compliance receive **verification**

75%

of consultants expect to require **alternative asset managers** to comply with the GIPS standards

94%

of consultants/investors believe more pension funds, foundations, endowments and other asset owners will claim GIPS compliance when the 2020 GIPS Standards are released

75%

of consultants/investors **exclude managers from searches** some or all of the time if they do not claim GIPS compliance

60%

of alternative asset managers expect to see the industry start **voluntarily complying** with the GIPS standards

2020 GIPS STANDARDS IN THE NEWS

- **GIPS 2020: The Push for Compliance by Alternative Asset Managers** (Private Funds CFO, July 2019)
- **CFA Institute Makes a Big Play for Private Fund Advisers in New GIPS Standards** (Regulatory Compliance Watch, July 2019)
- **Will GIPS Compliance Become the Norm for Alt Asset Managers in 2020?** (ValueWalk, January 2019)
- **New GIPS Standards Take Aim at Private Equity** (FundFire, May 2019)
- **New Performance Standards Crafted to Win Over Private-Equity Firms** (WSJ Pro, March 2019)

News & Analysis

GIPS 2020: The push for compliance by alternative asset managers

How the 2020 GIPS Standards have bent themselves towards the managers of alternative assets.

By Connor Hussey - 1 day ago

A- A+ 100%



VW

FRONTPAGE NEWS VALUE INVESTING PREMIUM

ECONOMICS

Will GIPS Compliance Become The Norm For Alt Asset Managers In 2020?

FUNDfire

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New GIPS Standards Take Aim at Private Equity

By Tom Stabile May 29, 2019

A new Global Investment Performance Standards (GIPS) update set for release June 30 will ushe compliar conventi

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<https://www.wsj.com/articles/new-performance-standards-crafted-to-win-over-private-equity-firms-11553770803>

REGULATION | FINANCIAL SERVICES

New Performance Standards Crafted to Win Over Private-Equity Firms

A new edition of the global investment performance standards aims to give private-equity investors a more consistent view of fund results

e Standards) public comment period
e world are preparing to comply with the
lobal consulting firm ACA recently
vestment, which found that alternative
e expected to increase their adoption of
to do so. Key findings include:

GIPS TRENDS / RFP RESEARCH

Investor	Date of Issuance / Deadline	Mandate Name	Mandate (Millions)	GIPS Compliance Requirement
New York State Insurance Fund (NYSIF)	10/29/2019 deadline	High Yield Corporate Bond, Bank Loan & CLO Asset Manager Search	\$1,000	"Candidate firms must have a minimum of five years of verifiable GIPS-compliant performance history actively managing the proposed product for institutional clients." Source
LACERA	4/5/19 issued	Syndicated Bank Loan Mandate	~\$500	"Must comply with the Global Investment Performance Standards" Source – Note: RFP also requests a copy of Verification report
Louisiana Municipal Police Employees' Retirement System (MPERS)	4/5/19 issued	Intermediate-Term Investment Grade Fixed Income	\$50	"The track record must be calculated in full compliance with the CFA Institute's Global Investment Performance Standards (GIPS)." Source
LACERS	4/12/2019 deadline	High Yield and Bank Loan Mandate	\$50	"The Proposer must have a minimum of five years of verifiable GIPS-compliant performance history actively managing the proposed product for institutional clients." Source
LACERS	12/10/2018	Private Credit Mandate	\$670	"As outlined in the RFP, the submitted track record must conform to GIPS. There is no flexibility around the 5-year track record requirement." Source

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Goals for the 2020 GIPS Standards

2020 GIPS STANDARDS TIMELINE

2010

- Release of the *2010 GIPS Standards*

2018

- Release of the *Exposure Draft of the 2020 GIPS Standards*
- Comment period closed **December 31, 2018**

2019

- Final version of the 2020 edition released **June 28, 2019**

2020

- The *2020 GIPS Standards* will be effective **January 1, 2020**



EFFECTIVE DATE

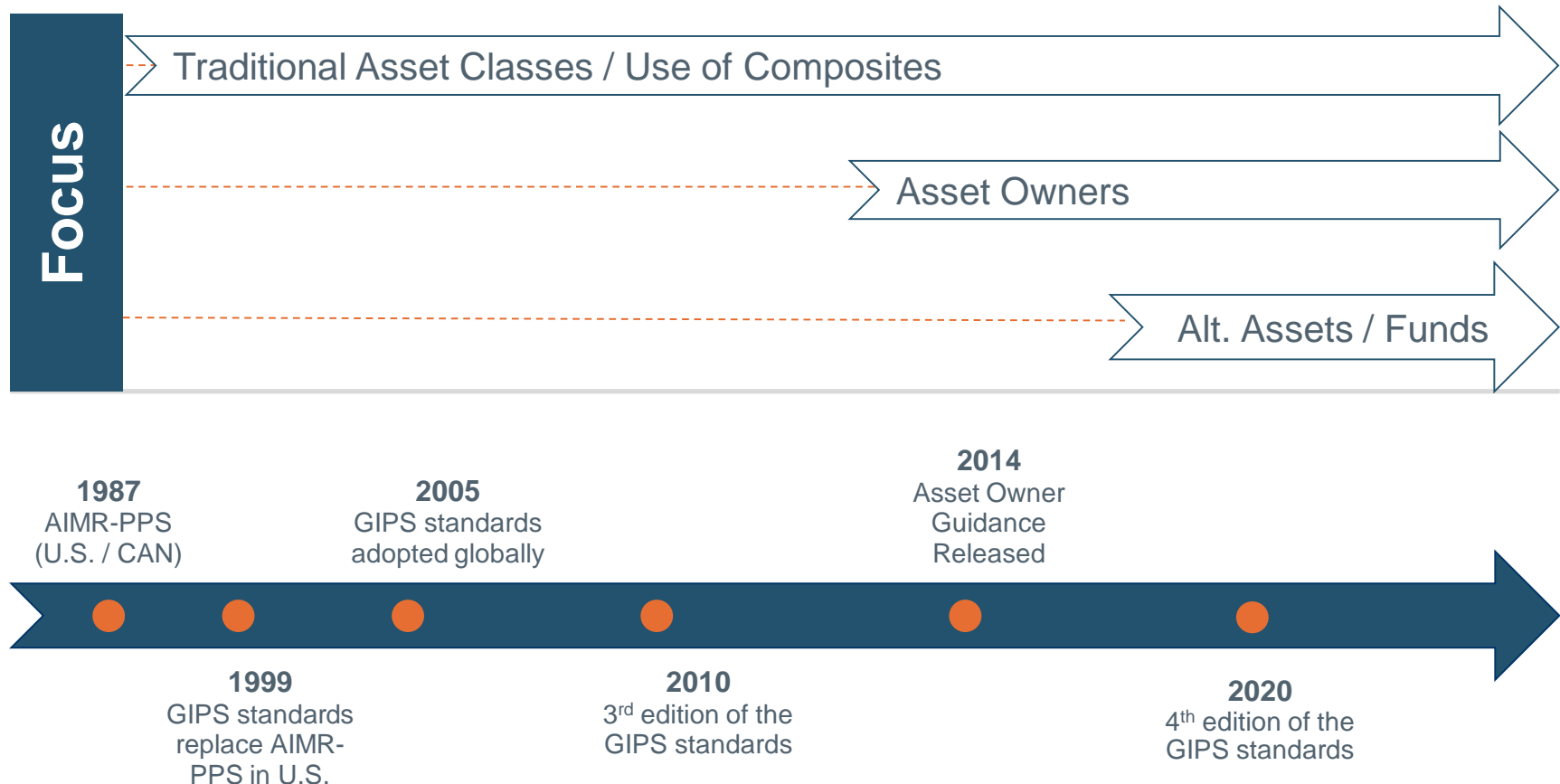
Effective Date January 1, 2020

- Input data must be compliant as of that day
- Reports that include performance on or after December 31, 2020 must be prepared in accordance with 2020 edition of the GIPS standards
- Reports that include performance prior to December 31, 2020 may follow 2010 standards
- Early adoption
 - Can adopt anytime, but must comply with all new requirements, including GIPS Reports

WHY CHANGE THE GIPS STANDARDS?

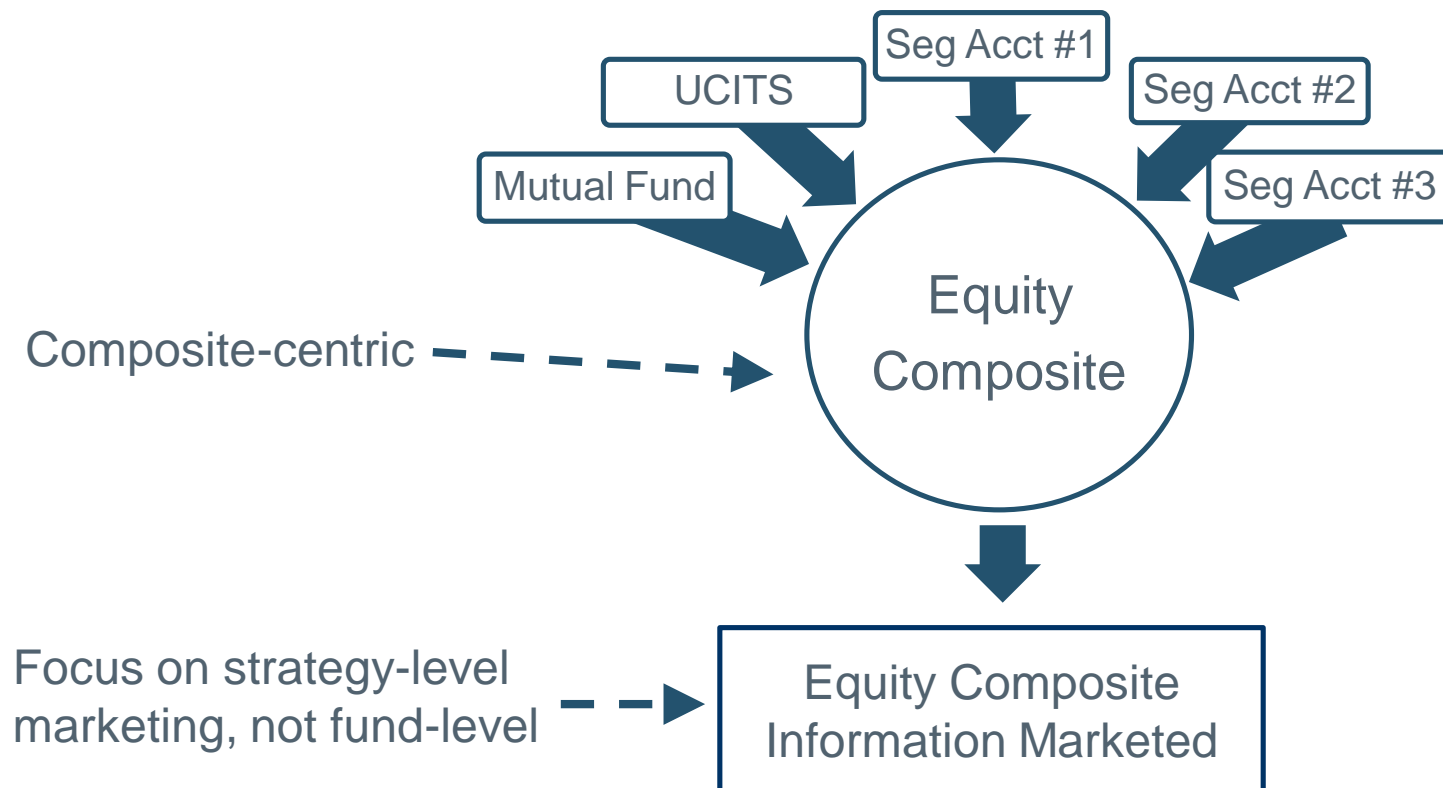
- Composites are the foundation of the GIPS standards, but composites are not always appropriate for products and vehicles
- Pooled funds do not fit neatly into current composite construction or GIPS reporting framework
- To increase relevance and adoption by alternative investment managers, fund managers, and private wealth managers
- To better address applicability for asset owners
- To consolidate standards that have expanded since 2010 and streamline the structure of the GIPS standards

FOCUS OF GIPS COMPLIANCE: PAST, PRESENT, FUTURE



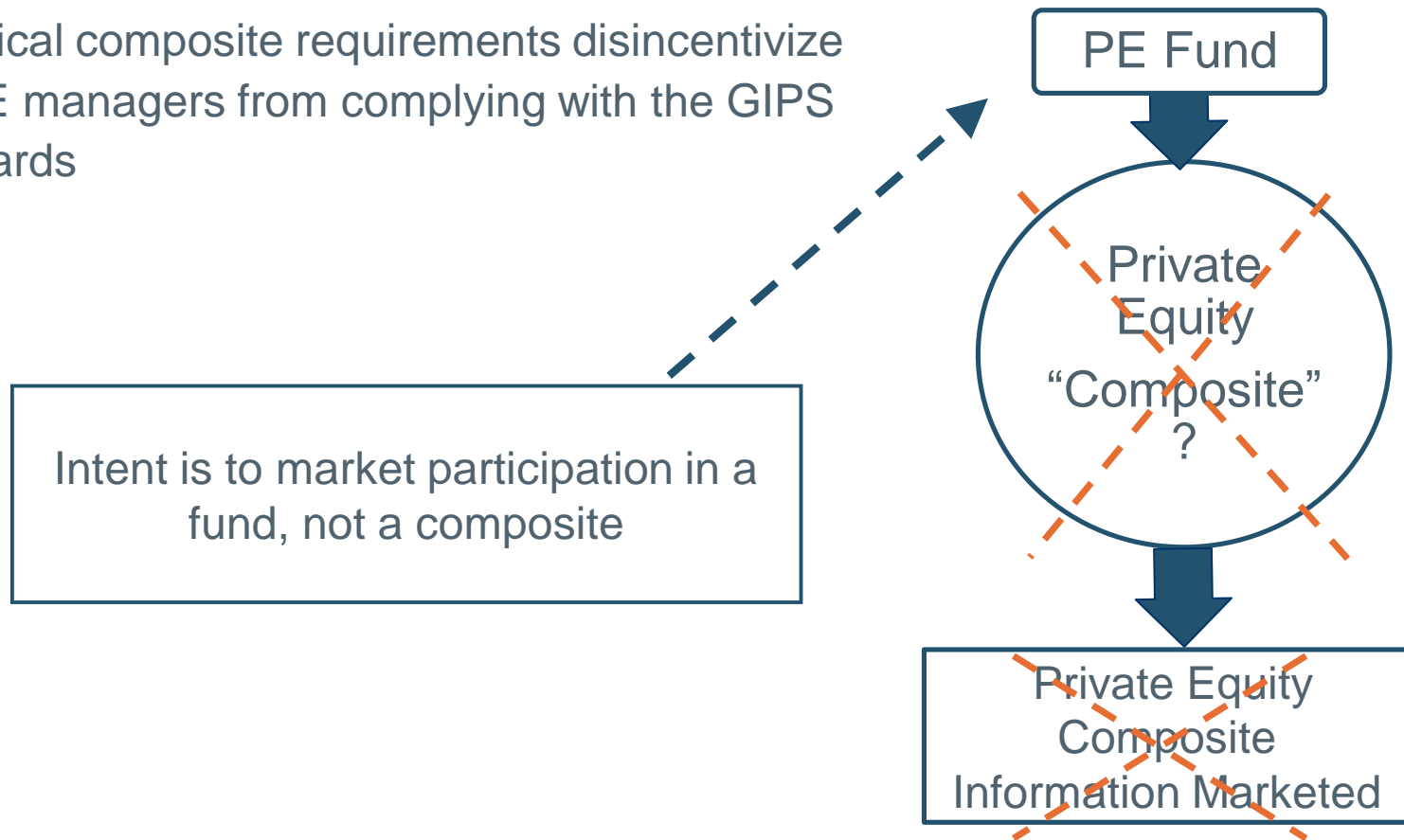
MOVING BEYOND COMPOSITES

Historical GIPS Standards Focus:



MOVING BEYOND COMPOSITES

Historical composite requirements disincentivize HF/PE managers from complying with the GIPS standards



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2020 GIPS Standards for Alternative Asset Managers

MAJOR IMPACT AREAS FOR ALTERNATIVE MANAGERS

- Marketing of composites vs. marketing of individual funds
- Return calculation
 - Time-weighted versus money-weighted
 - Deal/property level vs fund level
 - Impact of leverage – subscription lines, etc.
 - Side pockets
- Valuation requirements – frequency and type

ARE COMPOSITES APPLICABLE?

New provisions make composites optional in certain circumstances

Investment Vehicle	Composite Required?	Reason
Seg Acct(s) + Pooled Fund(s)	Yes	All discretionary, fee-paying seg accts must be in composite. Pooled fund(s) also included if meet composite definition
Only Seg Acct(s)	Yes	All discretionary, fee-paying seg accts must be in composite
Only Pooled Fund(s)	No	Composite not required if strategy only offered through pooled fund(s)

COMPOSITES AND POOLED FUNDS

- Composites must be created for firm's strategies that are ***managed for or offered*** as segregated account
- 2020 GIPS Standards clarify the two types of pooled funds:
 - 1. Broad Distribution Pooled Funds (BDPF):** (e.g. UCITS, mutual funds) any pooled fund regulated under framework that would permit general public to purchase or hold pooled fund's shares ***and*** is not exclusively offered in one-one-presentation
 - 2. Limited Distribution Pooled Funds:** (e.g. hedge funds, private equity, real estate, other "private funds") any pooled fund that is not a broad distribution fund

COMPOSITES AND POOLED FUNDS

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

MONEY WEIGHTED RETURNS

- Greater allowance for using money-weighted returns (MWR) rather than time-weighted returns
 - MWRs can be used if manager controls external cash flows **and** at least one of the following is true:
 - Closed end
 - Fixed life
 - Fixed commitment
 - Significant part of investment strategy is in illiquid investments

STANDARDIZING IRR

2020 GIPS Requirements

- Fund-level returns – Use LP cash flows or aggregate deal-level cash flows?
- Cash flow assumptions – Daily, monthly or quarterly cash flows utilized
- Subscription Lines of Credit- Lack of disclosure and quantification of impact
- What is a “Net IRR”? Is carry included? What about fund operating expenses?
- Recycled (Recalled) Capital – gross or net treatment for LP multiples?

Historical Practices Varied

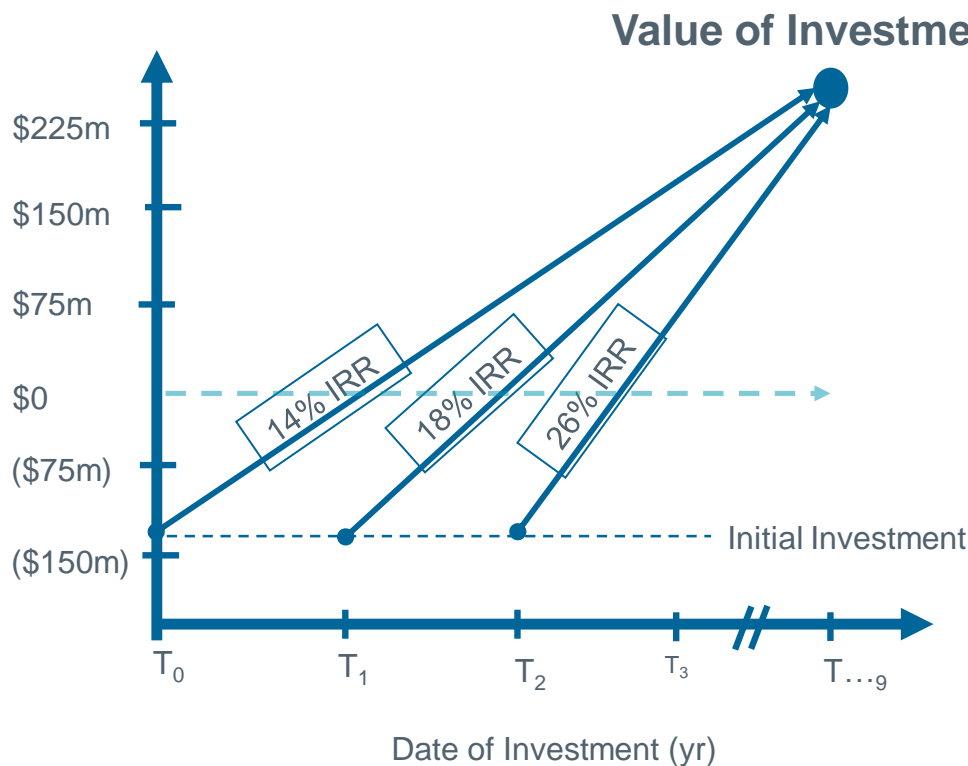
- Fund level returns use LP cash flows (i.e. CFs between LPs and fund)
- Daily cash flows required (starting 1/1/2020)
- Standardized disclosure requirements. Requirement to quantify impact if long-term in use (>120 days)
- Net IRR required to be net of base fee, carry and all fund expenses
- Must be treated as distribution and subsequent paid-in capital (impacts LP multiples)

SUBSCRIPTION LINES OF CREDIT

- If used, must include SI-IRR both with and without impact of sub line
 - “With” means to include cash flows, value and associated costs for any sub line
 - Shows return over entire period investment was “at risk”
 - “Without” must include the cash flows from the subscription lines
 - Not required to calculate if principal repaid within 120 days and not used to fund redemptions
- Must disclose purpose and, as of the most recent period end, size and amount outstanding

SUBSCRIPTION LINES OF CREDIT

Impact of Investment Period Length on IRR

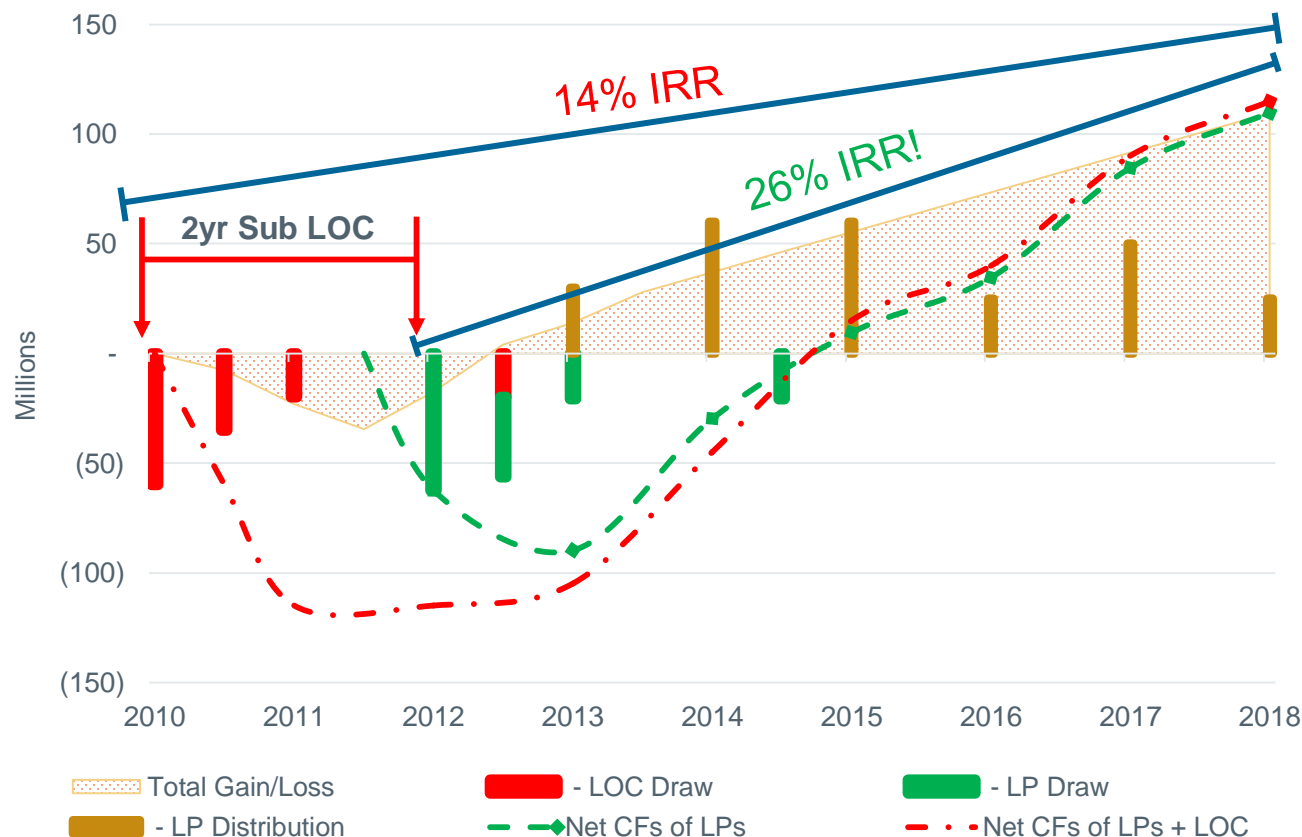


IRRs are typically quoted as *annualized* returns using LP cash flows.

For a given gain, decreasing the period between LP contributions and distributions increases the IRR, all else equal.

SUB LINE EXAMPLE

Hypothetical Fund with 2-year Subscription Line of Credit



With LOC:
 IRR: 26%
 MOIC: 1.78x

Without LOC:
 IRR: 14%
 MOIC: 1.85x

SUB LINE EXAMPLE – BY THE NUMBERS

	LP Cash Flows	LP + Sub LOC Cash Flows	Comparison
Initial Draw Date:	2012	2010	LOC delays LP draws by 2yrs
Terminal Value Date:	2018	2018	No Impact
Initial Draw to TV:	7 yrs	9 yrs	LOC shortens total period 2yrs
Total LP Draws:	\$140.4M	\$140.4M	No impact
Total LP Distributions:	\$225M	\$230.4M	\$5.4M in LOC interest payments
2018 NAV:	\$25M	\$25M	No impact
IRR:	26%	14%	LOC increases IRR by 12%
MOIC:	1.78x	1.85x	LOC interest <u>reduces</u> MOIC
Sub LOC Interest Paid*:	\$5.4M	\$0	No interest paid if no LOC used
*Assumes 2% p.a. interest rate. Higher rates further decrease MOIC			

SUB LINE EXAMPLE

26% IRR

Which is accurate?

14% IRR

Both calculations are mathematically accurate but are telling different (but important) stories. Neither should be relied on exclusively.

GIPS compliance facilitates manager selection through standardizing performance metrics (TWRs, IRRs, LP multiples) and enhancing relevant disclosure.

HARMONIZING VALUATION

Valuation Frequency (No Composite)

- Pooled Fund TWRs at least annually (as of calendar or fiscal year-end)
 - When there are subscriptions/redemptions
- Pooled Fund MWRs at least annually
 - As of any period-end for which performance is calculated

Valuation Frequency (Portfolios In Composites)

- Composite TWRs
 - Public Market Investment Portfolios monthly + for “large” cash flows (same as current requirement)
 - Private Market Investment Portfolios at least quarterly
- Composite MWRs at least annually
 - As of any period-end for which performance is calculated

EXTERNAL VALUATIONS

- Limited to real estate investments
- Open ended fund – at least once every 12 months
- Not open-ended
 - At least once every 12 months unless client stipulates otherwise,
 - At least once every 36 months, or
 - Annual financial statement audit
- Must be performed by independent third party
 - Must not use if appraisers fee is contingent on value

NON-COMPLIANT PERFORMANCE

Linking Compliant and Non-Compliant Returns

- GIPS Reports: may not link after minimum effective compliance date
- Outside GIPS Reports: may link
- *Example: Firm decides in 2020 to become GIPS compliant from 2015-2019. Firm is not GIPS compliant prior to 2015.*
 - In GIPS Report, only show returns beginning 2015
 - Outside GIPS report, may link returns prior to 2015

NON-COMPLIANT PERFORMANCE

Theoretical Performance

- Must not link actual performance to historical theoretical performance
- Same concept as 2010 but new term intended to be more comprehensive
 - Performance not derived from portfolio or composite with actual assets
 - *Examples: model, backtested, hypothetical, simulated indicative, ex ante, and forward-looking performance*

HIGHLIGHTS

The 2020 GIPS Standards are...

- removing previous **hurdles** for Hedge Fund/Private Equity/Real Estate compliance
- providing **guidance** and **standardization** on current hot topics in the hedge fund/private equity/Real Estate space, such as a use of subscription lines which benefits investors

CONTACT

Shivani Choudhary, CFA, CIPM

Senior Principal Consultant

ACA Performance Services

schoudhary@acacompliancegroup.com

Michael McGrath, CFA

Partner

K&L Gates

Michael.McGrath@klgates.com



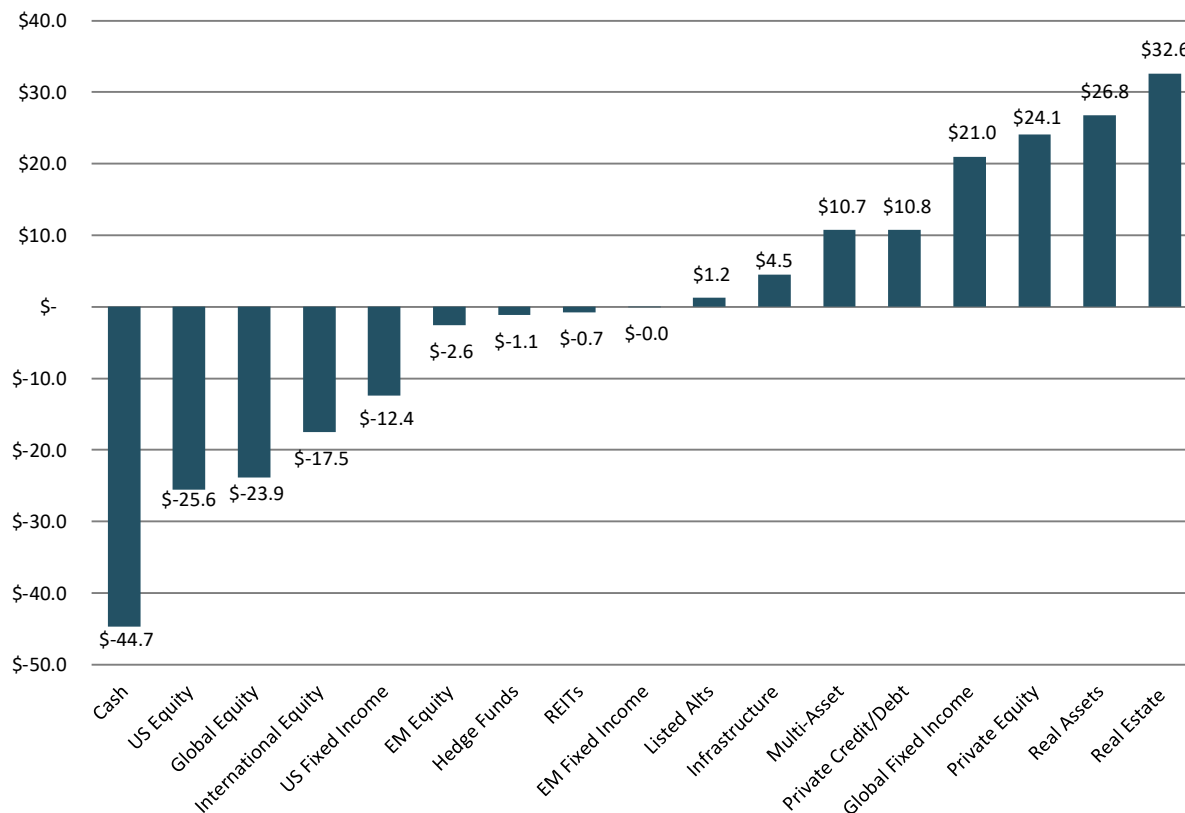
Supplemental Information

REAL ESTATE RFP RESEARCH

Investor	Date of RFP	Mandate Name	Mandate (Millions)	GIPS Compliance Requirement
State of Alaska	1/10/2019	Real Estate Consulting Services	N/A - \$5B invested in defined RE program	"The return calculations must conform to the Global Investment Performance Standards (GIPS).“ Source
Unnamed Asset Owner	9/14/2019	Opportunistic Real Estate Fund	\$160	Detail your standards for investment performance reporting (eg. carve-out GIPS or other levels of compliance/verification). Source
Rockford Police Pension Fund	7/19/2018	Consulting for: FI:35% US-Equity32.5% Non US Equity: 17.5% Real Estate: 10% Global Tactical: 5%	N/A - \$196 AUM	Mentions in technical questionnaire: "Specify if these returns comply with the CFA Institute – GIPS performances presentation standards.“ Source
Indiana Public Retirement System (INPRS)	3/19/2018	Passive Investment Management Services Mandate	N/A- Roughly \$7.5B invested in passive investment products	"The Portfolio Manager must have a minimum five year verifiable GIPS compliant performance history passively managing securities.“ Source
Teacher's Retirement System of the State of Illinois	2/8/2018	Investment Consulting Services	N/A	Are all performance reports compliant with the CFA Institute Global Investment Performance Standards (GIPS)? Source

EARLY SIGNALS OF ASSET MOVEMENT

Based on current vs. target allocations for 146 large U.S. public plans



Movement Into Private Equity

- 88 plans are increasing allocations to Private Equity
- Cumulatively, plans aim to allocate an additional \$24.1B to Private Equity
- Average planned increase is \$337M