



K&L GATES



ACA
COMPLIANCE GROUP
PERFORMANCE SERVICES

A First Look at the Final 2020 GIPS® Standards

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SPEAKERS



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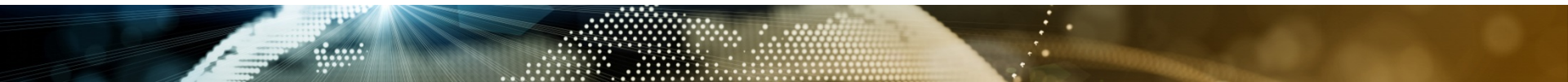
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AGENDA

1. The GIPS Standards: Are You Ready for 2020?
2. Material Changes to the GIPS Standards
 - New Format
 - Composites and Pooled Funds
 - Fundamentals for All Firms
 - Fundamental for Alternative Asset Managers
 - GIPS Reports
 - GIPS Advertising Guidelines
 - Verification
3. Next Steps

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The GIPS Standards: Are You Ready for 2020?

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

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Material Changes to the 2020 GIPS Standards

The background is a complex digital composition. The top half features a dark blue gradient with numerous thin, light blue lines radiating from a central point on the left, creating a fan-like effect. The bottom half is dominated by a golden-yellow glow, with a grid of small, bright dots forming a pattern that resembles a stylized globe or a data visualization. The overall aesthetic is futuristic and high-tech.

New Format

NEW FORMAT: “CHAPTERS”

Firms

- General Provisions
- Composite Report
 - TWR
 - MWR
- Pooled Fund Reports
 - TWR
 - MWR
- Advertising Guidelines

Asset Owners

- General Provisions
- Total Fund and Composite Reports
 - TWR
- Composite Reports
 - MWR
- Advertising Guidelines

Verifiers

- Verification
- Performance Examination

- Numbering system allows for expansion of each chapter
- Comprehensive guidance in each chapter
 - Self-contained depending on the relevant report

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Composites and Pooled Funds

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

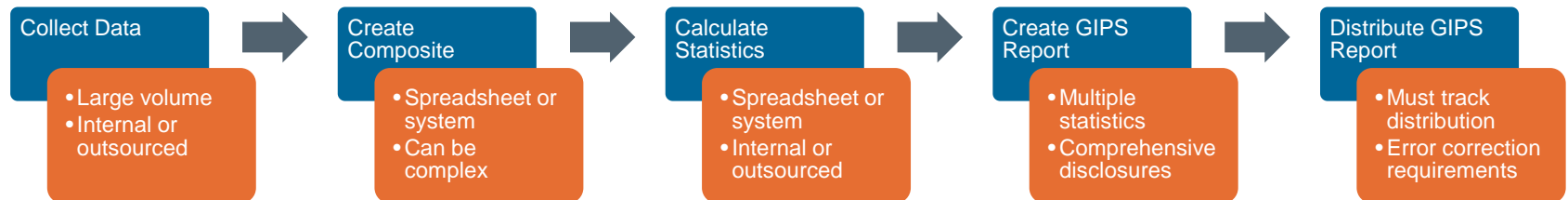
- Composites must be created for firm's strategies that are *managed for or offered* as segregated account
- 2020 GIPS Standards clarify the two types of pooled funds:
 - 1. Broad Distribution Pooled Funds (BDPF):** (e.g. UCITS, mutual funds) any pooled fund regulated under framework that would permit 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

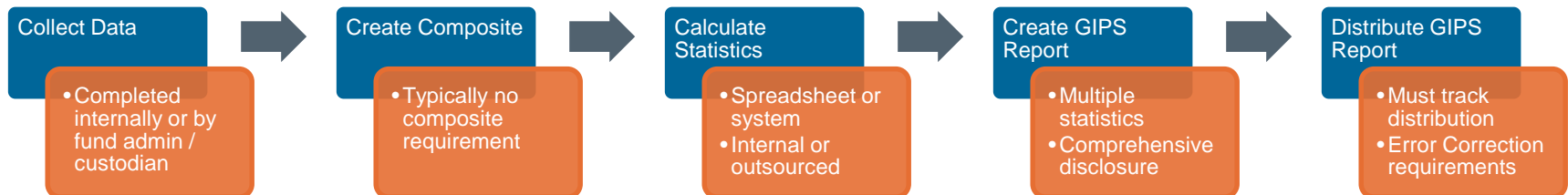
COMPOSITES AND POOLED FUNDS

GIPS for Composites



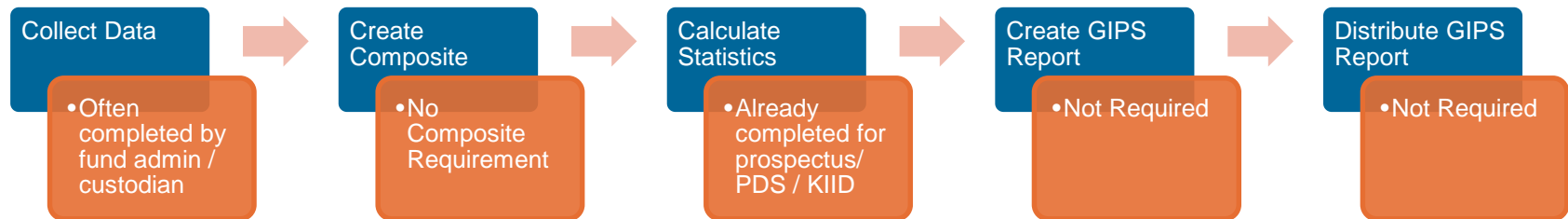
Similar process for limited distribution pooled funds, just decreased scope

GIPS for Limited Distribution Funds



COMPOSITES AND POOLED FUNDS

GIPS for Broad Distribution Funds



- If local laws or regulations mandate specific pooled fund returns, firms must adhere to methodology
 - If none, net returns are recommended by the GIPS standards
- Key takeaways
 - 1940 Act / UCITS / similar requirements will prevail
 - Most jurisdictions will need minimal effort to comply with broad distribution pooled fund requirements

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Fundamentals for All Firms

RETURNS

- Model Fees
 - Use model fee that is appropriate to prospective investor
 - No longer highest fee
 - Must still pass conservative test
 - If not presenting gross, must disclose fee used to calculate net returns
 - Must disclose methodology used to calculate net composite returns
- When presenting composite performance to prospective pooled fund investor, must disclose pooled fund's current fee schedule and expense ratio
- U.S. firms must comply with JP Morgan (1996) and AIMR (1996) no-action letters

RETURNS

- Portfolios invested in pooled funds
 - Returns must reflect the deduction of all fees and expenses charged at the underlying pooled fund level, unless the firm controls the investment management fees
 - If firm has control, can calculate gross returns that do not reflect the underlying fund management fees
- Net returns must reflect any performance-based fee clawback in period in which it is repaid
- Present fee schedule that is appropriate to prospective investor
 - Must match prospective investor's investment vehicle:
 - Stand-alone account
 - Pooled fund
 - Wrap fee
 - Multi-asset (carve-outs)

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
 - Use when actual transaction costs are unknown
- Must disclose:
 - Use of
 - Estimated trading cost
 - How it was determined
 - Not intended to replace wrap guidance, but may impact wrap managers
 - Benefit to firms that include accounts with unidentifiable transaction costs in composites with accounts where transaction costs are known

FIRM ASSETS

- Includes discretionary and non-discretionary as before
 - No advisory only
 - No uncalled committed capital – guidance was not clear and not applied consistently before January 1, 2020
- May present non-managed assets as well – UMA, Model, uncalled committed capital
 - Separately or combined
 - If combined, must show non-managed assets separately for same periods as combined and clearly label each set of assets
- Same requirements if presenting composite level assets
- Must disclose total firm assets
 - No longer allowed to choose between presenting composite assets as percentage of firm assets or total firm assets

FIRM ASSETS

	Required	Permitted	Permitted	Prohibited	
Year	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

PORTABILITY

- Linking performance from past firm or affiliation
 - Now optional to link if tests are met
 - Firms that do not want to port performance would miraculously fail to meet the criteria
 - Fourth test added – no break in track record
 - May present performance before break, but not link
- 2020 GIPS Standards clarify **one-year “grace period”** from acquisition date to bring non-compliant assets into compliance on prospective basis
- No limit on when firms may port history from prior firm or affiliation

RETURN OF CARVE OUTS

- **Carve Out:** portion of portfolio that by itself is representative of distinct investment strategy
- Previously allowed prior to January 1, 2010
- Benefit to private wealth managers and alternative managers
- Top-down only
 - Can't combine composites, pooled funds, or carveouts to create simulated strategy and present as composite
- Several additional disclosures

RETURN OF CARVE OUTS

- Allowed to allocate cash to create segment returns
 - No mandated method – must be consistent
 - Must include cash and any related income from carved-out securities
- Must represent standalone strategy
- Must be applied to **all carve outs** across firm that represent same strategy – **No cherry picking!**
- If/when standalone accounts are managed, must create standalone composite for same strategy
 - Must present composite returns and assets of stand-alone accounts on presentation of carve-out accounts

MULTI-STRATEGY/ALLOCATION ACCOUNTS

- Total account does not have to be included in composite if each segment of account is included in composite
 - *Example: Balanced account (total) = Equity and fixed income*
- If contract allows manager discretion to change allocation, client directed documentation is not required to move account to new composite
 - PM documentation is sufficient

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Fundamentals for Alternative Asset Managers

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

MONEY WEIGHTED RETURNS

- Significant enhancement, as many strategies are now offered via commitment-based funds outside of standard private equity funds
- Single annualized since-inception IRR required to be shown through most recent annual period end
 - Using daily external cash flows (beginning January 1, 2020)*
 - Stock distributions external cash flows
 - Must be aggregate of portfolio-level information when presenting composite returns

**Prior effective date was January 1, 2011*

SUBSCRIPTION LINES OF CREDIT

- If used, must include SI-MWR 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 cash flows from subscription lines
 - Not required to calculate if principal repaid within 120 days and not used to fund redemptions
 - Must disclose purpose and, as of most recent period end, size and amount outstanding

OVERLAY EXPOSURE

- Firm overlay exposure must include all discretionary and non-discretionary strategies for which firm has investment responsibility
 - Not required to be presented, may present total firm assets
- Use notional exposure of overlay strategy portfolios, value of underlying portfolios being overlaid, or specified target exposure
 - Must be consistent within composite
 - Use as denominator when calculating portfolio returns
 - Must disclose methodology
- Composite overlay exposure – required as of each annual period end
 - Do not have to show composite assets

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
 - Professionally designated or certified commercial property valuer or appraiser
 - If not available in market, firm must determine qualified
 - Must not use if appraisers fee is contingent on value
- Other private market investments (e.g., private equity, credit) not required to obtain external, independent valuations

OTHER ALT RELATED ITEMS

- Side pockets – only discretionary side pockets must be included in performance calculations
- Component returns
 - Now recommendation
 - May be derived from total return and one of calculated returns
- Committed Capital – must present applicable statistics as before but only as of most recent period end instead of each period end

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GIPS Reports

GIPS REPORTS

- New name for compliant presentation:
 1. GIPS Composite Report
 2. GIPS Pooled Fund Report
 3. GIPS Asset Owner Report
- Collectively **“GIPS Report”**
- Update GIPS Reports within 12 months after most recent annual period end
- More frequent updates (i.e. quarterly) do not require updates to all numerical information

GIPS REPORTS

- Must choose which type of returns will be presented and must be presented consistently
 - Can't switch back and forth between MWR and TWR
- If marketing materials include GIPS Report, must indicate in marketing materials
- Must make every reasonable effort to provide GIPS Report to prospective clients when they *initially* become prospect
 - Must also be able to **demonstrate** every reasonable effort was made to all prospective investors who are required to receive GIPS Report

GIPS POOLED FUND REPORT

Requires similar statistics and disclosures of GIPS Composite Report

- **TWRs:** 5 years of annual returns, building to 10 years
- **MWRs:** SI-MWR through most recent period-end
- Fund assets, firm assets, 3-yr standard deviation (if valued monthly)
- May include gross and/or net returns (reduced by all fund fees & expenses)
 - Actual or model
 - If fund has multiple share classes and one share class is used to calculate net returns, must disclose the share class used
- Similar disclosure requirements as in GIPS Composite Report

GIPS REPORT DISCLOSURES

- Introduction of “sunset” provisions – keep for one year and as long as it is relevant to interpreting track record
 - Significant events
 - Composite name changes
 - Retro benchmark changes
- Composite creation date: When portfolios are grouped together
- Composite inception: When composite performance started
 - May be different than strategy inception and/or composite creation
- Slight change to wording of GIPS compliance statements
 - Removed separate statement for composites that were examined more than 24 months ago

GIPS REPORT DISCLOSURES

- Added trademark disclosure and CFAI disclaimer
 - *GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.*
- Percentage of non-fee paying accounts—only required if actual fees are used to calculated net composite returns
- All required and recommended information in GIPS Composite Report must be presented in same currency
- If gross or net returns are used to calculate risk statistics
- Leverage, derivatives, short positions – clarification that disclosure is of historical use, if material. Not what may happen in the future.

WRAP FEE COMPOSITES

- Wrap fee composites that present pure gross returns:
 - Must clearly label returns as pure gross returns when presenting pure gross of fees for wrap composites, and
 - Identify pure gross returns as supplemental information
- The concept of sponsor-specific composites has been removed
 - Now viewed as client reporting, not marketing to a prospect (and not subject to the GIPS standards)
- Estimated transaction costs may facilitate composites with institutional accounts and wrap-fee accounts

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*

NON-COMPLIANT PERFORMANCE

Supplemental Information

- Only information on GIPS Report – Anything outside is not considered supplemental
- If presented on GIPS Report, must directly relate to pooled fund or composite presented
- Some information previously considered supplemental information is no longer considered as such
 - Non-managed assets
 - Ported track record prior to a break in performance

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GIPS Advertising Guidelines

GIPS ADVERTISING GUIDELINES

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

ADVERTISING GUIDELINES

If No Performance

- GIPS Advertising Guidelines compliance statement
- CFA Institute registered trademark and disclaimer
- How to obtain GIPS-compliant performance information for firm's strategies and products

If Performance

- Advertisements for composites are similar, but streamlined
- LDPF requirements similar to composites; BDPF requirements defer to local laws

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Verification

VERIFICATION

- Previously three different guidance statements
 1. Verification
 2. Verifier Independence
 3. Performance Examinations
- Purpose of revised standards:
 - Promote **consistency** across verification firms by listing specific expectations for verification and performance examinations
 - Combine previously separate guidance into one document for **ease of application**
 - Increase **comprehension** by making it clear what work must be completed and higher level of detail

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Next Steps

WHAT'S NEXT?

- Develop a strong understanding of the 2020 GIPS Standards
- CFA's Handbook for the 2020 GIPS Standards
 - Additional guidance and detailed explanation of each provision
 - ETA – December 31, 2019
- Determine when firm will comply with the 2020 GIPS standards
 - Document in policy manual
- Assess current GIPS compliance framework to determine impact
 - Pooled Funds
 - GIPS Reports
 - P&P
- 2020 GIPS Compliance Gap Analysis

ASSESS THE IMPACT

- Firms that currently claim GIPS compliance
 - How will you present pooled funds moving forward?
 - Disclose updates to existing GIPS-compliant presentations
 - Wrap fee composites
- Firms contemplating GIPS compliance
 - Talk to clients, consultants, and peers
 - Reconsider costs in light of the 2020 GIPS Standards (particularly GIPS Pooled Fund Reports)
- Private Markets Managers
 - Do the 2020 GIPS Standards make GIPS compliance more attractive to my firm?
 - Will LP interest in GIPS compliance endure (e.g., credit)?

ESTABLISH A TIMELINE

- Existing Managers – Any benefit to early adoption?
 - Managers of registered funds
 - Firms with single-portfolio composites
- New Managers
 - No apparent benefits to claiming compliance with 2010 GIPS Standards and then switching to 2020 edition
- 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

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