



# PERFORMANCE INSIGHT

## Highlights from the 20<sup>th</sup> Annual GIPS® Standards Conference

The October 2016 edition of *Performance Insight* covers the 20th Annual GIPS Standards Conference. The conference was held in Boston on September 22-23 with over 400 attendees from more than 25 countries. The following are highlights from several sessions.

### GIPS Technical Committee Update

*The GIPS Technical Committee, the committee responsible for technical oversight of the GIPS standards, has many key projects currently underway. Karyn D. Vincent, Chair of the GIPS Technical Committee, provided an update on several of these projects. Please keep in mind that the discussion below includes proposed technical guidance and is subject to change prior to the issuance for public comment.*

### Portability Guidance Statement

The Guidance Statement on Performance Record Portability provides interpretation of Provision 5.A.8, which includes the tests that **must be** met to port a composite track record from one firm to another. As it is currently drafted, Provision 5.A.8 states that composite performance from a prior firm or affiliation must be linked to performance at the new or acquiring firm, if the portability tests are met. The rationale is that a firm should not be allowed to exclude poor prior performance. However, the decision has been made to revert to the prior approach, which sets out tests that must be met if the firm **chooses to** port a

track record. Clarification is also needed on Provision 5.A.8.b, which says that a firm has one year to bring any non-compliant assets into compliance – the “grace period”. The revised guidance statement will address what must happen within the grace period and when the grace period starts. A working group is busy incorporating discussions from the Technical Committee meetings that occurred in conjunction with the GIPS conference. The goal is to have the guidance statement available for public comment in 2017.

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## Supplemental Information Guidance Statement

Dealing with supplemental information is a struggle for many firms, primarily because the guidance on this topic is not consistent. Supplemental information is defined as any performance-related information included as part of a compliant presentation that supplements or enhances the required and/or recommended provisions of the GIPS standards. Supplemental information must be clearly labeled and identified as supplemental to a particular compliant presentation. Examples of supplemental information include pure gross returns for wrap composites, asset class returns excluding cash, and representative portfolio information. The Supplemental Information Guidance Statement says that firms are required to provide a compliant presentation prior to or accompanying any supplemental information. This implies that supplemental information can be located outside of a compliant presentation, but this is inconsistent with the definition, which says that supplemental information must be part of a compliant presentation. This contradictory guidance leaves firms having to interpret whether supplemental information is limited to only what is contained within the compliant presentation or if it also applies to information presented outside of the compliant presentation. For example, if a firm includes equity-only returns on page 5 of a 40 page pitch book, and the compliant presentation is Appendix A in the pitch book, are the equity-only returns included on page 5 considered supplemental information? The Technical Committee has determined that supplemental information will be limited to information within the compliant presentation only. Information that would qualify as supplemental information if it is included in a compliant presentation will not be considered as such if it is presented in other marketing materials. Going back to our equity-only returns example, these returns on page 5 of the pitch book would not be considered supplemental information because they are presented outside of the compliant presentation. If those same returns are included in the compliant presentation, they would need to be labeled as supplemental information.

The reason for this change is twofold. First, when the Guidance Statement on Supplemental Information was created, compliant presentation was not a defined term. A compliant presentation is now defined as a

presentation for a composite that contains all of the information required by the GIPS standards, and may include other information as well. Second, Provision 0.A.3 was added in 2010 and prohibits firms from presenting performance or performance-related information that is false or misleading. This provision applies to all performance and performance-related materials on a firm-wide basis and is not limited to those materials that reference the GIPS standards. Considering our example again, the equity-only returns on page 5 must be clearly identified as such, to ensure the reader is not misled to believe that the returns include cash. This is true whether the returns are identified as supplemental information or not.

The revised guidance statement will also address representative portfolio information. If a firm includes representative portfolio information in compliant presentations, it will be required to create policies and procedures for choosing and presenting representative portfolio information. It is recommended that firms establish objective criteria for selecting representative portfolios and disclose the selection criteria. Finally, the guidance statement will also address theoretical performance. Theoretical performance is a broad term that encompasses different types of performance that is not based on a portfolio or composite with actual assets, and would include model, hypothetical, and ex-ante performance. When theoretical performance is included in a compliant presentation or other marketing materials outside of the compliant presentation, firms must disclose:

- Results are theoretical and not based on actual portfolios;
- A basic description of the model assumptions, and inputs necessary to interpret the results;
- The limitations inherent in model returns; and
- If results do not reflect fees, trading costs, or other charges that a client portfolio would have paid.

The Supplemental Information Guidance Statement has been approved for public comment and is expected to be released for public comment later this year or early Q1 2017.

### Overlay Guidance Statement

An Overlay Working Group was created to provide guidance for how the GIPS standards can and should be applied to overlay composites. Common types of overlay strategies include currency overlay, asset allocation overlay, interest rate overlay, and option overwrite overlay. In these strategies, the overlay manager might not, and probably does not, manage the underlying portfolio. The underlying portfolio could be an actual portfolio managed by the overlay manager or another firm, or could be a notional amount. Current GIPS guidance says that overlay assets must not be included in composite assets or firm assets. This presents a big issue for firms whose overlay strategies represent a significant portion of

their assets because their composite and firm assets don't truly represent the amount of assets they are actually overseeing. The Overlay Guidance Statement will require overlay managers to present composite and firm overlay exposure versus composite assets and firm assets in compliant presentations for overlay composites. Firms will also have additional disclosure requirements including the methodology used to calculate portfolio and composite returns, including how the denominator is calculated. The guidance statement is close to being finalized with the goal to present a final draft to the Technical Committee at their in-person meeting in April 2017. Once it is approved, it will be issued for public comment.

### Verifier Independence Guidance Statement

Verification is the review of performance measurement policies and procedures by an independent third party, testing whether 1) the firm has complied with all the composite construction requirements of the GIPS standards, and 2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. This guidance statement addresses what it means to be independent - the verifier must perform its work in an unbiased manner and must not verify its own work. In the revised guidance statement, stronger language is used to make it more clear what creates verifier independence issues. The guidance statement lists specific activities that if performed by the verifier

would create an independence issue. Examples include establishing policies and procedures, assigning portfolios to composites, and collating or creating underlying data required to calculate portfolio-level returns. A verifier and its employees must also consider their personal and financial relationships with their clients to determine if they could be influenced by such relationships. Mere disclosure of a personal or financial relationship does not resolve an independence issue. The revised guidance statement has been approved by the Technical Committee for public comment so we can expect to see it available for public comment later this year or early 2017.

### Benchmark Guidance Statement

A Benchmark Subcommittee was created in 2015 to address the benchmark-related provisions of the GIPS standards. The subcommittee is working on a new benchmark guidance statement that will include guidance on:

- Determining what is an appropriate benchmark for less traditional strategies, such as absolute return, liability-driven investing, or downside protection strategies

- Determining what is a "widely recognized" benchmark that does not require a benchmark description
- If more than one benchmark is presented, does one have to be identified as a primary benchmark?
- Use of net-of-tax versus gross-of-tax benchmarks

The guidance statement is in its early stages. The next step is for the Benchmark Subcommittee to present principles to the Technical Committee which is expected to occur later this year.

### Other Projects:

Ms. Vincent also touched on two other projects that are currently being discussed by the Interpretation Subcommittee. They are working to identify topics associated with performance-based fees and multi-asset class portfolios that need to be addressed.

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## GIPS 2020

*Carl Bacon, chair of the GIPS Executive Committee, and Jonathan Boersma, Executive Director, GIPS, at CFA Institute, provided some insight into the next edition of the GIPS standards, currently being referred to as GIPS 2020.*

Mr. Boersma reviewed the GIPS Mission Statement:

Promote ethics and integrity and instill trust through the use of the Global Investment Performance Standards by achieving:

- Universal demand for compliance by asset owners,
- Universal adoption by asset managers, and
- Universal support from regulators

For the ultimate benefit of the global investment community.

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The GIPS standards continue to be adopted worldwide, with 37 countries endorsing the GIPS standards and 8 more countries considering doing so. As of the date of the conference, 1,560 firms have notified CFA Institute of their claim of compliance. These firms include 74% of the largest 100 asset managers and represent 60% of total global assets. However, despite this success, meeting the mission statement's goal of universal adoption of the standards requires further evolution.

There are several reasons why the GIPS standards need to change. Currently composites are the foundation of the GIPS standards, but composites are not appropriate for all investment products. Pooled funds also do not fit well in the current composite-oriented framework. The next edition of the GIPS standards will be product driven rather than composite driven. This will allow firms that are product versus composite focused to apply the GIPS standards to the types of products they are managing versus trying to sift through the current GIPS standards to determine what is applicable for a particular product or fund. Conceptually, GIPS 2020 will have 3 buckets of guidance;

- Strategy, for traditional separate account management, where composites are used;
- Product, for pooled funds and structured products, where participation in a specific pooled fund is sold; and
- Proprietary, for asset owners.

Each bucket will have its own set of comprehensive guidance to follow.

Other goals for GIPS 2020 include making the GIPS standards as simple as possible, removing unnecessary complexity and perceived barriers to compliance, and ensuring they are relevant for all asset classes and all types of managers. GIPS 2020 will also be streamlined to incorporate requirements and recommendations found in guidance statements into the provisions of the GIPS standards. But there are many unanswered questions, such as how to make guidance for non-traditional, alternative assets generic and widely applicable? Or where do wrap fee and UMA accounts fit in? The most important issue is ensuring the GIPS standards maintain their cohesiveness and integrity.

A consultation paper soliciting feedback is expected to be issued within the next few months. The goal is to have an exposure draft available in early 2018 and a final version of GIPS 2020 issued in early 2019 with a 1 January 2020 effective date. Firms are encouraged to participate in the evolution of the GIPS standards by providing feedback on the consultation draft, joining GIPS committees, or sending comments directly to CFA Institute via the GIPS Helpdesk. Firms are also encouraged to participate in a GIPS survey sponsored by CFA Institute to understand challenges firms face in complying with the GIPS standards. The survey can be accessed via the following link and is open through October 21, 2016: [https://cfainstitute.qualtrics.com/jfe/form/SV\\_0BYeGxVICBLBbUh](https://cfainstitute.qualtrics.com/jfe/form/SV_0BYeGxVICBLBbUh)

## Swimming Lessons: An Update on Pooled Funds

*Ann F. Putallaz, CIPM, Chair of the Pooled Fund Working Group and recent Chair of the GIPS Executive Committee, provided an update on the Guidance Statement on Broadly Distributed Pooled Funds.*

Ms. Putallaz stated that the purpose of this guidance is to clarify a firm's responsibilities with respect to the content and delivery of information to prospective pooled investors. The key question is whether prospective pooled fund investors must receive a compliant presentation.

Since the formation of the Pooled Fund Working Group in 2012, numerous versions of this guidance have been drafted and submitted to both the GIPS Executive Committee and the GIPS Technical Committee. The draft Guidance Statement went out for public comment in January 2016 and now a small group is reviewing public comments and modifying the pooled fund guidance. Thirty-nine public comments were received, 35 of which are posted on the GIPS website, with four asking not to be posted. There was wide diversity in responses among countries, fund companies, industry groups, country sponsors, and individuals. Ms. Putallaz said that many respondents were comfortable with the general approach, but suggested some modifications, while others wanted guidance that was voluntary with no requirements, and some suggesting that guidance should only be applied where there was no local regulation regarding pooled funds.

The Exposure Draft of the Guidance Statement on Broadly Distributed Pooled Funds presented defined terms and proposed guidance, and asked respondents to answer questions such as "Are the explanations of the defined terms sufficiently clear?" Ms. Putallaz said that clarification was asked for on a number of points, including which funds were within the scope of this guidance statement, what does it mean to be "responsible" for preparing fund marketing materials, and which marketing materials were within the scope of this guidance statement. She also noted that people found the term "Pooled Fund Net/Net Return" confusing, and this term may be removed from the final draft.

The exposure draft included five required items that must be included in both official pooled fund offering documents and marketing materials for

prospective pooled fund investors: 1) Description of strategy; 2) Indication of risk; 3) Pooled fund returns; 4) Benchmark returns; and 5) Currency used to express performance. In the public comments only the requirement to include benchmark returns generated significant pushback.

With respect to the question on location of required items, more respondents thought required items should be only in marketing materials rather than official documents. Some respondents thought required items should be in either official offering documents or marketing materials, but not both.

There was widespread agreement that the claim of compliance should be a recommendation and not a requirement, and there was also widespread agreement that a fund company should not have to offer or provide a compliant presentation unless requested to do so.

Based on public comments, six major concepts were developed. Three of the concepts represented no change from the exposure draft, while the other three represented changes. All six concepts were reviewed and approved by the GIPS Technical Committee prior to the GIPS Annual Conference. The three concepts that did not change were: 1) The GIPS claim of compliance for pooled funds remains a recommendation; 2) The offer of a compliant presentation in the official pooled fund document and the fund-specific marketing material is neither required nor recommended, unless requested; and 3) If local regulations prohibit the inclusion of required items in materials for prospective investors, the firm must document this in their policies and procedures, but there is no requirement to disclose conflicts in official offering documents or marketing materials.

The three concepts that did change are: 1) The benchmark returns requirement was changed to a recommendation, though it is strongly recommended that appropriate benchmark returns are included. According to Ms. Putallaz, there was a lot of pushback on this requirement, and in many jurisdictions a



benchmark is not required except for index funds, or when the benchmark is mentioned in the strategy description; 2) The location of required items was changed from being required in both the official fund documents and fund-specific marketing materials, to being required in at least one document that will be given to prospective pooled fund investors. This is in line with regular GIPS guidance and will allow the firm to decide where the required items will be included; and 3) There will be a “Safe Harbor” provision. If a firm falls under local regulations that mandate the four required items in a document) that will be given to prospective pooled fund investors, they are assumed to have complied with the pooled fund guidance and nothing more is required (e.g. 1940 Act Funds would qualify for Safe Harbor).

Four of the five required items in the exposure draft remain: These are as follows: 1) Description of the pooled fund’s strategy; 2) An indication of the pooled fund’s risk, as either a qualitative or quantitative metric, as mandated by the local regulators. If no local regulations exist, the firm may choose the risk measure

to present; 3) Pooled fund returns for the periods required by local laws and regulations. If no local regulations exist, the firm may present fund returns in accordance with one of the options included in the GIPS Advertising Guidelines; and 4) The currency used to express performance, which must be clear. Ms. Putallaz stated that this requirement would be considered fulfilled if in the local area the currency is assumed.

There are continuing discussions on a number of issues, including seeking greater clarity in language, the funds and firms within scope, and pooled fund return requirements. Ms. Putallaz said she anticipates that completed guidance will be provided by the GIPS Technical Committee by the first quarter of 2017.

Ms. Putallaz also noted that this guidance is focused on one aspect of pooled funds: A firm’s responsibility with respect to the content and distribution of materials to broadly distributed pooled fund investors. The discussions around this guidance pointed to a number of other issues surrounding other pooled funds. GIPS 2020 are expected to address many of these issues.

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## Upcoming Events

ACA Performance looks forward to seeing you at the following events.

### [ACA Fall Compliance Conference](#)

October 26-28, 2016  
Ritz Carlton  
Marina del Rey, CA

### [NEW! Senior Management Bootcamp](#)

The ACA Fall 2016 Compliance Conference introduces a new half-day, pre-conference session on Wednesday, October 26: Senior Management Bootcamp.

As regulatory requirements increase and compliance budgets shrink, Chief Compliance Officers are expected to take on more responsibilities with fewer resources. Simply having compliance expertise is no longer sufficient for today’s CCO – you must also have effective managerial and supervisory skills to successfully lead your department while meeting your firm’s regulatory obligations.

For more information on the conference, and to register, click [here](#).



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## Complimentary Webcasts

### Minimizing Risk with Non-Standard Track Records

Wednesday, October 19, 2016, 11:00a.m.-12:00p.m. EST

**Speakers:**

Charlie Stout, CAIA, CIPM, Partner, ACA Performance Services

James Hendricksen, CAIA, CIPM, Senior Principal Consultant, ACA Performance Services

You can find an archive of complimentary ACA Compliance Group webcasts [here](#).

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