Global Investment Performance Standards (GIPS®) for Firms

Adopting Release

The Exposure Draft of the 2020 Global Investment Performance Standards (GIPS®) was available for public comment from 1 September 2018 through 31 December 2018. We received more than 5,200 comments from more than 120 organizations. Every comment was evaluated and considered, resulting in a recommendation for any needed changes to the provisions. The proposed changes were then reviewed with and approved by the GIPS Standards Technical Committee and the GIPS Standards Executive Committee. This Adopting Release includes key topics and describes our rationale for changes we made, or did not make, to the provisions. We are creating an explanation for each of the provisions, which will be issued upon completion, and we refer to these explanations as the "Handbook."

New Structure for 2020

The 2010 edition of the GIPS standards focused solely on firms, although both firms and asset owners are able to comply with the GIPS standards. In 2014, we issued the Guidance Statement on the Application of the GIPS Standards to Asset Owners, and we updated this document in 2017. This Guidance Statement explained how to apply the GIPS standards to an asset owner. With the 2020 edition of the GIPS standards, we took the opportunity to create provisions specific to asset owners. In the Exposure Draft of the 2020 GIPS Standards (2020 Exposure Draft), we included sections 1 through 7 for firms, sections 8 through 12 for asset owners, section 13 for GIPS Advertising Guidelines that covered both firms and asset owners, and a glossary. We also combined existing verification and performance examination guidance into a separate document for verifiers.

Rather than having one document that included the provisions for both firms and asset owners, as well as guidance for verifiers, we divided the GIPS standards into three separate documents (chapters): one for firms, one for asset owners, and one for verifiers.

- The GIPS Standards for Firms include sections 1 through 8 and a glossary applicable to firms. Sections 1 through 7 include the same content as they did in the 2020 Exposure Draft. Section 8 includes the GIPS Advertising Guidelines that are applicable to firms, and the glossary includes only those defined terms (those that appear in small capitals in the provisions) that apply to firms. We added appendices that include samples of GIPS Composite Reports, GIPS Pooled Fund Reports, GIPS Advertisements, and lists of composite and pooled fund descriptions.

- The GIPS Standards for Asset Owners start with section 21. We started the section numbering for the GIPS Standards for Asset Owners at section 21 to allow for expansion of the GIPS Standards for Firms. Sections 21 through 25 include the same content as sections 8 through 12 of the 2020 Exposure Draft. Section 26 includes the GIPS Advertising Guidelines that are applicable to asset owners, and the glossary includes only those defined terms (those that appear in small capitals in the provisions) that apply to asset owners.
- The GIPS Standards for Verifiers constitute the third chapter of the 2020 GIPS standards. This chapter includes guidance that verifiers must follow when conducting verifications and performance examinations, and it replaces the existing Guidance Statements on Verification and Performance Examinations. A glossary includes only those defined terms (those that appear in small capitals) that appear in this chapter. This chapter does not include the Verifier Independence Guidance Statement, which we plan to finalize in the near future.

We believe the new structure will allow for future expansion of the GIPS standards, as well as the addition of other types of standards in the future.

Comments on Key Topics

1. Carve-Outs with Allocated Cash

Prior to 1 January 2010, firms were allowed to include carve-outs with allocated cash in composites. Effective 1 January 2010, firms were no longer allowed to do so. Firms could still include carve-outs in composites but only if the carve-out had its own cash balance. In the 2020 Exposure Draft, we proposed once again allowing firms to include carve-outs with allocated cash in composites (provision 3.A.15). We believed that doing so would make it possible for a greater number of private wealth managers and managers of private market investments to come into compliance.

Slightly more than half of the respondents supported allowing firms to include carve-outs with allocated cash in composites. Firms had very strong opinions, however, on whether or not carve-outs with allocated cash should be allowed. Many firms supported the inclusion of carve-outs with allocated cash as a way of bringing more firms into compliance with the GIPS standards. Those that were opposed felt that carve-outs would not be representative of a standalone portfolio. One example given was the creation of a carve-out that included only 2 French stocks carved out from a 500-stock portfolio to create a French Equity composite. To address this concern, in the 2020 Exposure Draft we proposed that if a firm has or obtains standalone portfolios managed in the same strategy as the carve-outs with allocated cash, the firm must create a separate composite that includes only the standalone portfolios (provision 3.A.18), and it must present the performance of this standalone composite along with the composite that includes carve-outs with allocated cash (provision 4.A.10). Although many respondents felt that a composite with standalone portfolios was not needed, many who strongly opposed the inclusion of carve-outs with allocated cash in composites felt this should be required if we were going to allow carve-outs with allocated cash.

Provision 3.A.16 requires that a carve-out included in a composite must be representative of a standalone portfolio managed or intended to be managed according to that strategy. This requirement applies to carve-outs with allocated cash as well as those that have their own cash (i.e., a sub-portfolio). A carve-out that includes only the two French stocks described earlier would probably not meet this requirement, regardless of the treatment of cash.

We concluded that allowing firms to include carve-outs with allocated cash would result in a greater number of private wealth managers and managers of private market investments coming into compliance. Hearing the concerns of those opposed to allowing carve-outs with allocated cash, we also agreed that firms must create and maintain composites that include only standalone portfolios managed in the same strategy as the carve-outs with allocated cash. The returns and composite assets from the GIPS Composite Report for the standalone portfolios must be included in the GIPS Composite Report for the composite that includes carve-outs with allocated cash (provisions 4.A.13 and 5.A.14).

In the 2020 Exposure Draft, we asked whether firms should be required to use a specific method to allocate cash to carve-outs. Roughly half of the respondents believed that the GIPS standards should specify one or more methods for how cash must be allocated to carve-outs, while the other half believed that specific methods should not be required, although Handbook guidance should include possible methods. We agree that we should not require specific methods for allocating cash to carve-outs. We will include guidance in the Handbook regarding possible methods for allocating cash.

2. Composites

Composite Creation for Strategies Offered as a Segregated Account

In the 2020 Exposure Draft, provision 3.A.1 said that the firm must create composites that represent the firm's strategies "offered" as a segregated account. Some respondents explained that they read this to mean that a firm is required to create only “marketed composites” and is not required to create any composite for strategies that are not marketed. This is not the case, and we agree that the term “offered” could lead some to interpret this provision as applying to marketed strategies only. We modified this provision to state the following: “The firm must create composites for the firm’s strategies that are managed for or offered as a segregated account.”

Disclosure of Composite Creation and Inception Dates

In the 2020 Exposure Draft, we changed disclosure of the composite creation date from a requirement to a recommendation. We also added a new requirement to disclose the composite inception date (provisions 4.C.11 and 5.C.10). We did so because of confusion about the difference between a composite creation date and a composite inception date. Although we did not include a specific request for comment on changing the composite creation date from a required item to a recommended item, numerous respondents suggested retaining the composite creation date as a required item. In most cases, respondents believed the composite creation date was an important item because it allowed the reader of a GIPS Composite Report to know if the composite was created with the benefit of hindsight. This was the reason the composite creation date was originally included as a requirement. We agreed to re-include the composite creation date as a requirement (provisions 4.C.14 and 5.C.13). Requiring the inclusion of both the composite creation date and inception date will also compel firms to understand the difference between the two dates.

Moving Portfolios between Composites

Provision 3.A.10 states that portfolios must not be moved from one composite to another unless documented client-directed changes to the portfolio’s investment mandate, objective, or strategy or the redefinition of the composite make it appropriate. We received a comment that provision 3.A.10 does not align with the manner in which many, if not most, private wealth managers do business, along with a recommendation that the “client-directed” terminology be deleted.

We agree that this provision and historical guidance do not seem to work for private wealth managers who are given full discretion to manage client assets in the way they believe is most appropriate for current market conditions. Often the portfolio manager is managing a multi–asset class or multi-strategy portfolio and has control over the asset allocation. The allocation to equity, for example, may be increased or decreased at various times by the portfolio manager, making the portfolio more suitable to one balanced composite versus another. Additionally, current market conditions may change, causing the portfolio manager to believe that it will be advantageous to move some portfolio assets from a small-cap equity strategy to a large-cap equity strategy. The firm's contract with the client does not require a new set of investment guidelines to be obtained for this tactical change. The same is true when a firm has the ability to make strategic changes in response to changes in the client's circumstances. For example, a firm may decide to change a client portfolio from aggressive allocations to more-moderate allocations as the client ages. We believe that if the client contract allows the firm to change the portfolio's strategic allocation, that is effectively a client-directed change.

We also think it is important to include the phrase "client-directed" in the provision so that firms do not think they can move portfolios from one composite to another based on short-term tactical changes to a portfolio that would not be considered client-directed.

We will include Handbook guidance for this provision to address the case of a multi-asset class or multi-strategy portfolio in which the client has contractually given the portfolio manager authority over asset allocation. In such cases, the portfolio manager's documentation of the allocation change should be considered "client-directed" documentation for the change when combined with a client contract that assigns the portfolio manager complete authority over asset allocation. The documentation of the change must include the timing of and reason for the change and must be recorded in the firm's records (e.g., in a memo to the client file or in the client management system).

3. Error Correction

In the 2020 Exposure Draft, we created error correction–related provisions to include requirements from the existing Guidance Statement on Error Correction. Provision 1.A.17 stated that the firm must correct material errors in GIPS Composite Reports and must:

a. Provide a corrected GIPS Composite Report to existing clients that received the erroneous GIPS Composite Report.
b. Make every reasonable effort to provide the corrected GIPS Composite Report to all prospective clients and other parties that received the erroneous GIPS Composite Report.

Provision 1.A.18 had similar language for material errors in GIPS Pooled Fund Reports.

It was not intended that there be any change to the meaning of the requirements from the Guidance Statement. Unlike the Guidance Statement on Error Correction, however, the provisions related to error correction neglected to state that firms are not required to provide a corrected GIPS Report, with a disclosure regarding the correction of a material error, to those that did not receive the GIPS Report with the material error. We therefore made edits to those provisions to clarify this point.

In addition, the proposed provision required that “other parties” that received the GIPS Report with the material error must receive a corrected GIPS Report. We received questions about who is considered an “other party” that must receive a corrected GIPS Report. In response, we edited provisions 1.A.20 and 1.A.21 to specify that firms must:

- Provide the corrected GIPS Report to the current verifier;
- Provide the corrected GIPS Report to current clients, current investors, and former verifiers that received the GIPS Report that had the material error; and
- Make every reasonable effort to provide the corrected GIPS Report to current prospective clients and current prospective investors that received the GIPS Report that had the material error.

We also clarified that the firm is not required to provide a corrected GIPS Report to former clients, former investors, former prospective clients, or former prospective investors.

We will address materiality in the Handbook guidance.

4. Estimated Transaction Costs

In the 2020 Exposure Draft, the term “trading expenses” was changed to “transaction costs” to reflect a broader concept of such costs. In addition, we proposed allowing firms to use estimated transaction costs for composites if returns calculated using estimated transaction costs are equal to or lower than those that would have been calculated using actual transaction costs. Comments were generally supportive of allowing the use of estimated transaction costs, with several respondents stating that this option may be very helpful for managers of wrap fee portfolios. Some respondents expressed concern about how estimated transaction costs should be calculated or determined, and others challenged the concept that firms would be able to determine that returns calculated using estimated transaction costs were more conservative than those that would have been calculated had actual transaction costs been used. Other respondents commented that estimated transaction costs should be allowed only if actual transaction costs are not available.

Provision 2.A.13 has been edited to explicitly state that estimated transaction costs may be used only for those portfolios for which actual transaction costs are not known. The requirement for calculating returns that are more conservative when using estimated transaction costs was deleted. Guidance on determining estimated transaction costs will be included in the Handbook.

5. GIPS Reports

Trademark Disclosure

In the 2020 Exposure Draft, a sentence stating "GIPS® is a trademark owned by CFA Institute" was included as part of the claim of compliance. We removed this language from the claim of compliance. Instead, firms will be required to include the following disclosure language in the GIPS Report: "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." As with all disclosures, there is no requirement to include this disclosure in any particular order relative to other disclosures.

Updating GIPS Reports

In the 2020 Exposure Draft, we proposed requiring firms to update GIPS Reports to include information through the most recent annual period end within six months of that annual period end. We received multiple comments stating that six months is not enough time to update all GIPS Reports within a firm, particularly when the firm is large and has hundreds of composites that are not marketed. It was not our intent to require firms to update non-marketed GIPS Reports when these non-marketed GIPS Reports are not provided to any prospects. We also heard from respondents that six months was not long enough for firms with alternative strategies for which the firm relies on a third party for valuations (e.g., a firm that is a limited partner in private equity funds). Many firms suggested 12 months as a reasonable amount of time to update GIPS Reports. We agree that 12 months is a reasonable amount of time. As a result, when providing GIPS Reports to prospective clients and prospective investors, the GIPS Report must include information updated through the most recent annual period end within 12 months of that annual period end (provision 1.A.16).

In the 2020 Exposure Draft, we also recommended that firms update GIPS Reports with performance information on a quarterly basis. We did not ask for comments on this provision because it was a recommendation and not a requirement. We subsequently considered whether firms should be required to update all the information normally found in the table of the GIPS Report on a more frequent basis than annually. We concluded that if a firm provides more-frequent updates to a GIPS Report, it is not necessary for the firm to update all required numerical information. We will provide Handbook guidance for provision 1.B.2 clarifying that, when updating GIPS Reports with quarterly or monthly information, firms will not be required to update all information. We will specify what information must be updated.

6. Minimum Effective Dates: Linking

To allow for comparability, the 2020 Exposure Draft contained the requirement that firms must not link non-GIPS-compliant performance for periods beginning on or after the applicable minimum effective compliance date to GIPS-compliant performance (provision 1.A.26). Provision 1.A.27 stated that firms must not present non-GIPS-compliant money-weighted returns for periods ending on or after the minimum effective compliance date. We received a comment that the prohibition against linking non-compliant performance should be limited to information included in a GIPS Report. Firms initially coming into compliance may have extensive track records that include performance that has been constructed and maintained in the same manner as required under the GIPS standards but occurred prior to the period for which the firm has been able to claim firm-wide compliance with the GIPS standards.

We agree with this comment and have modified the provisions accordingly. Allowing firms to link non-compliant performance to compliant performance outside of a GIPS Report will allow firms to continue to present and link the full history of their track record in other marketing materials. This option is particularly important for firms that manage pooled funds. We have also included this concept as a new provision in the GIPS Advertising Guidelines (provisions 8.A.5 and 8.A.6).

7. Model Investment Management Fees and the Calculation of Net Returns

The 2020 Exposure Draft included conflicting guidance with respect to the use of model investment management fees. Using guidance from the Guidance Statement on Alternative Investment Strategies and Structures, we stated in provisions 2.A.32 and 2.A.34 that the investment management fee used to calculate composite or pooled fund net returns must be either the actual investment management fees or the “highest investment management fee appropriate” to prospective clients or prospective investors. Numerous comments pointed out that an appropriate model fee may not always be the highest possible fee. We agree. Firms should have flexibility in determining the model fee that is used. Provisions 2.A.30 and 2.A.32 no longer require that the highest investment management fee be used as the model fee. No matter what model fee is used, however, the firm still must meet the requirement that net-of-fees returns calculated using model fees must be equal to or lower than those that would have been calculated had actual fees been used (provisions 2.A.31 and 2.A.33).

8. Money-Weighted Returns (MWRs)

Expanded Use of MWRs

In the 2010 edition of the GIPS standards, firms are required to present time-weighted returns (TWRs) for all asset classes with the exception of private equity, for which firms were required to present a since-inception internal rate of return (SI-IRR). Real estate closed-end fund composites require the presentation of both a TWR and an SI-IRR. Over the years, we have heard from many firms that felt SI-IRRs were more appropriate than TWRs for strategies beyond private equity and real estate. We proposed allowing firms to present MWRs for those composites and pooled funds for which firms have control over external cash flows into the portfolios in the composite or into the pooled fund and that have at least one of the following characteristics: (a) closed-end, (b) fixed life, (c) fixed commitment, or (d) illiquid investments as a significant part of the investment strategy (provision 1.A.31). Note that the term SI-IRR has been replaced with MWR in the 2020 edition of the GIPS standards. The GIPS standards do not specify a specific method for calculating money-weighted returns, and both modified Dietz or SI-IRR are acceptable methods.

Most comments supported expanding the permitted use of MWRs when the firm controls the external cash flows and meets at least one of the aforementioned four characteristics. Some respondents thought that the only requirement for the presentation of MWRs should be whether the firm has control over the external cash flows, and we considered this approach.

It was decided that we should keep the requirement to meet one of the four characteristics in addition to firms having control over external cash flows (provision 1.A.35). This decision was based on the need to ensure that firms that should be using a TWR for liquid strategies will do so.

Some comments also expressed concern about the lack of comparability of returns if some firms choose to present TWRs while others choose to present MWRs. We believe that the marketplace will dictate the appropriate return measure. Firms may still present TWRs if they think TWRs are most appropriate, but now have the added option to present MWRs if they meet the criteria for doing so.

Presentation of a Single MWR versus Since-Inception MWRs as of Each Annual Period End

Another significant proposed change in the 2020 Exposure Draft was the presentation of a single MWR (the annualized since-inception MWR through the most recent annual period end) rather than requiring since-inception MWRs as of each annual period end. A motivation for this change was the goal of decreasing the quantity of information required to be included in a GIPS Report that includes MWRs. Many firms felt that the quantity of information required by the 2010 edition of the GIPS standards is excessive and confusing. Most respondents were in favor of moving to a single since-inception MWR. The most common concern of those against showing a single since-inception MWR was that the prior annual history would not be shown and there would be a loss of understanding of the track record. Firms that wish to show additional prior year since-inception MWRs are recommended to do so, but this will not be a requirement.

The Use of Daily Cash Flows When Calculating MWRs

In the 2010 edition of the GIPS standards, firms are required to use daily cash flows, as of 1 January 2011, when calculating MWRs. In the 2020 Exposure Draft (provision 2.A.31), firms would be required to use daily cash flows in MWR calculations as of 1 January 2020 but would no longer be required to use daily cash flows prior to 1 January 2020. Some comments indicated that this change was unfair to firms that currently claim compliance because they had been required to use daily cash flows as of 1 January 2011, whereas firms that newly attain compliance following the 2020 edition of the GIPS standards do not have to use daily cash flows until 1 January 2020. It is true that those firms that currently claim compliance had to apply a higher standard than firms that will be claiming compliance following the 2020 edition. The compliance rate for alternatives managers, however, significantly lags that of traditional managers. To encourage more firms to claim compliance, including alternatives managers, we did not change provision 2.A.29, which requires daily cash flows as of 1 January 2020. The Handbook guidance for this provision will indicate that firms should use daily cash flows if they are available for periods prior to 1 January 2020.

9. Multi–Asset Class and Multi-Strategy Portfolios

In the 2010 edition of the GIPS standards, we require that all actual, fee-paying, discretionary portfolios be included in at least one composite. In December 2013, a Q&A was issued stating that a discretionary multi–asset class or multi-strategy portfolio is required to be included in a multi-asset class or multi-strategy composite. This was true even if each of the portfolio’s asset class or strategy segments was included in the relevant composite for that segment. We will not carry forward this Q&A as guidance for the 2020 edition. This change is significant but does not show up explicitly in any provision. It will be addressed in the Handbook guidance for provisions 3.A.2 and 3.A.5.

10. Overlay Exposure

The 2020 Exposure Draft included a requirement for firms to present total firm overlay exposure in GIPS Composite Reports for overlay strategies as of each annual period end. In addition, a firm could choose to not present total firm assets if it did not consider total firm assets to be meaningful. We heard from several large firms that calculating total firm overlay exposure would be difficult and would necessitate manual calculation.

We acknowledge that firms that are primarily overlay managers will be happy to be able to report total firm overlay exposure instead of total firm assets. However, we did not wish to impose a reporting burden on larger managers for which overlay is not a significant part of their business. We therefore agreed that firms should be able to present either total firm assets or total firm overlay exposure in GIPS Composite Reports for overlay strategies (provision 4.A.15).

11. Pooled Funds

<u>Definition of a Broad Distribution Pooled Fund (BDPF) and Limited Distribution Pooled Fund (LDPF)</u>

Firms that offer pooled funds must be able to correctly classify their pooled funds as either BDPFs or LDPFs to determine the relevance to their firm of various provisions pertaining to pooled funds in the 2020 edition of the GIPS standards.

Given the definitions for a BDPF and LDPF provided in the 2020 Exposure Draft, respondents generally agreed that it was clear that a retail pooled fund should be classified as a BDPF. Many questions arose, however, about how to classify pooled funds in other situations. For example, suppose that a pooled fund had both retail and institutional share classes, with the institutional share classes marketed only in one-on-one presentations. Would the retail share classes be classified as a BDPF while the institutional classes were classified as an LDPF? It was not our intent to have some share classes of a pooled fund be classified as broad distribution and others as limited distribution. After many discussions and iterations, definitions for BDPFs and LDPFs were developed that provided greater clarity regarding the classification of different types of pooled funds. These definitions appear in the glossary.

- A Broad Distribution Pooled Fund (BDPF) is a pooled fund that is regulated under a framework that would permit the general public to purchase or hold the pooled fund's shares and is not exclusively offered in one-on-one presentations.
- A Limited Distribution Pooled Fund (LDPF) is any pooled fund that is not a Broad Distribution Pooled Fund.

In the situation described above, the pooled fund would be classified as a BDPF. We will provide additional examples in the Handbook.

Inclusion of Pooled Funds in Composites

In the 2010 edition of the GIPS standards, firms are required to include all discretionary, fee-paying portfolios (segregated accounts and pooled funds) in a composite. For some investment firms with large numbers of broad distribution pooled funds, this requirement often meant creating many composites that included only one pooled fund whose strategy was not managed for or offered as a segregated account. In the 2020 Exposure Draft, we proposed that firms would no longer be required to include pooled funds in a composite if the pooled fund's strategy was not managed for or offered as a segregated account. This proposal (provision 3.A.3) was viewed favorably, and there has been no change to it. The result is that firms that created composites that hold only one or more pooled funds may be terminated, if the strategy of those composites is not offered as a segregated account.

Creation of a GIPS Pooled Fund Report for LDPFs

The 2020 Exposure Draft required that a GIPS Pooled Fund Report that includes performance of only the LDPF be provided to prospective investors for that LDPF. Numerous firms that currently claim compliance expressed the view that requiring a GIPS Pooled Fund Report to be provided to LDPF investors would be burdensome, costly, and would not add value for a prospective investor.

Based on the comments received, the requirement has been changed. The firm is not obligated to provide a GIPS Pooled Fund Report for the respective LDPF if the LDPF is included in a composite. The firm may provide either the GIPS Pooled Fund Report for the specific fund or the GIPS Composite Report that includes the LDPF. Firms that currently include LDPFs in composites and present compliant presentations for composites to prospects may continue with this policy (provision 1.A.13). They will not be required to create GIPS Pooled Fund Reports for individual LDPFs.

It is important for firms to remember that all pooled funds, both BDPFs and LDPFs, must be included in at least one composite if they meet the composite definition.

<u>Type of Return Presented in a GIPS Pooled Fund Report</u>

In the 2020 Exposure Draft, we proposed requiring that returns net of all fees and expenses be presented in GIPS Pooled Fund Reports. We did so thinking that investors interested in a pooled fund should receive a report that included the performance of the fund net of all fees and expenses that a pooled fund investor would be expected to pay.

We asked the following question in the 2020 Exposure Draft regarding the requirement to present pooled fund net returns:

"Investors in a pooled fund will be impacted by all fees and costs incurred by the fund. Therefore, we require firms to present pooled fund returns that are net of all fees and expenses. Do you agree that firms should be required to present pooled fund returns that are net of all fees and expenses?"

Although many respondents supported this idea, those that did not included firms that are directly affected by this provision. We also had meetings and calls with numerous large institutional managers that did not provide comment letters but voiced very strong opposition to this proposed requirement. Some firms were concerned about the multiple net return streams available for each fund and questioned which return stream would be appropriate to use. Finally, in several non-US jurisdictions, including Canada and the United Kingdom, LDPFs are marketed using gross-of-fees returns, and there is no legal or regulatory requirement to show net-of-fees returns. The same is true for BDPFs. Some firms stated that being required to present net returns, when firms that did not comply with the GIPS standards presented only gross returns, would put them at a competitive disadvantage.

We concluded that firms should be allowed to present gross returns or net returns in a GIPS Pooled Fund Report, along with requiring disclosure of the appropriate expense ratio(s) (provisions 6.A.5 and 7.A.7). Permitting firms to present either gross returns or net returns will allow firms to present returns customary to the requirements and practices of the region in which they market. We therefore changed the presentation of pooled fund net returns from a requirement to a recommendation (provisions 6.B.1 and 7.B.1).

Pooled Fund Lists and Terminated Pooled Funds

Currently, firms are required to include terminated composites on the list of composite descriptions for at least five years. We proposed the same concept for LDPFs, requiring firms to include terminated LDPFs on the list of LDPF descriptions for at least five years. We took the same approach for BDPFs, requiring terminated BDPFs to be included on the list of BDPFs. A slight majority of comments agreed with this approach. Among the reasons given for including terminated pooled funds on the list of pooled fund descriptions were that it would help prospective investors understand the history of the firm's pooled funds and that investors would benefit from the point of view of consistency and completeness. The respondents that disagreed with requiring the inclusion of terminated pooled funds on a firm's lists noted that, once a fund is closed, the fund is no longer available for investment and can no longer be offered. In contrast, a terminated composite may be restarted, so it makes sense to include a terminated composite on the list of composite descriptions.

We appreciate that including closed pooled funds on required pooled fund lists would give a prospect insight into a firm's pooled funds that may not have performed well. However, we do not think this is a strong enough reason for requiring firms to include on these lists terminated pooled funds in which a prospective investor would never be able to invest. We also acknowledge that firms rarely, if ever, are asked to provide the currently required list of composite descriptions. This list is usually requested only by verifiers and regulators. We therefore agreed that firms would not be required to include terminated pooled funds on the list of LDPF descriptions or the list of BDPFs (provisions 1.A.22.b and 1.A.22.c).

Providing Pooled Fund Lists to Prospective Investors

Provision 1.A.23 addresses the lists that a firm must provide to prospects that make such a request. The 2020 Exposure Draft stated that firms must provide a list of LDPF descriptions or a list of BDPFs appropriate to any prospective investor who requests it. Most firms acknowledged that local laws and regulations would dictate which funds should be included on the list provided to a specific prospective investor, but they also noted that firms should not be required to tailor the list to each prospect. Firms generally felt that requiring such tailoring would be administratively burdensome and costly. A few firms suggested providing a list with all funds and adding a disclosure that not all funds are available in all jurisdictions. It was also noted that many regulatory regimes have exemptions from registration and permit "reverse solicitation," which would allow an investor to request to invest in a particular fund even if the fund was not registered in that jurisdiction. Other firms noted that, in their experience, clients have not requested lists of composites, so creating multiple pooled fund lists would be an unnecessary burden.

Provision 1.A.23.b was modified to indicate that a firm may tailor the list of LDPF descriptions for a prospective investor but is not required to do so. Provision 1.A.23.c was modified to indicate that a firm may tailor its list of BDPFs but is not required to do so.

Because firms must first comply with local laws and regulations, a firm would not be required to provide a list that includes pooled funds the firm is prohibited from including. We will address this point in the Handbook guidance.

We originally proposed that firms provide the complete list of BDPFs to any BDPF prospective investor who makes such a request. We heard from several firms that they disagreed with the requirement because that information is typically already available via the firm's website. We agreed and modified provision 1.A.23.c so that, if a firm maintains a complete list of BDPFs on its website, the firm may fulfill this requirement by directing the prospective investor to the firm's website.

Track Record for a New Limited Distribution Pooled Fund (LDPF)

In the 2020 Exposure Draft, we proposed requiring firms selling participation in a new LDPF that does not have a track record to present the most appropriate track record for the new LDPF, if available. Comments showed that firms thought it would be challenging to determine what qualifies as the most appropriate track record. Rather than forcing firms to present a track record that might not be appropriate, we decided that, instead of a requirement, this provision should be a recommendation (provision 1.B.7).

Pooled Funds and the GIPS Advertising Guidelines

Consistent with the decision that firms will not be required to include net returns in GIPS Pooled Fund Reports, we will allow firms to present either gross or net returns for LDPFs and BDPFs in GIPS Advertisements.

In the 2020 Exposure Draft, we proposed requiring firms to include benchmark returns in a GIPS Advertisement for a BDPF that includes performance. This information is not currently required by the Guidance Statement on Broadly Distributed Pooled Funds, so we specifically asked about this proposed requirement. Most respondents agreed with requiring benchmark returns. Those that did not agree pointed out that the licensing cost for a benchmark could be a deterrent to claiming compliance in an advertisement. Because compliance with the GIPS Advertising Guidelines is voluntary, firms that do not want to comply with the GIPS Advertising Guidelines are not required to do so and therefore would not have to include a benchmark in their advertisements. Therefore, there is no change to the requirement that firms include benchmark returns in GIPS Advertisements for BDPFs (provision 8.G.6).

Firms that currently comply with the Guidance Statement on Broadly Distributed Pooled Funds may continue to do so until they adopt the 2020 GIPS standards. Once firms adopt the 2020 GIPS standards they will need to follow the GIPS Advertising Guidelines applicable to Broad Distribution Pooled Funds if they would like to advertise the BDPF and include the claim of compliance.

12. Portability

Provision 5.A.8 in the 2010 edition of the GIPS standards requires that performance from a past firm or affiliation must be linked to or used to represent the historical performance of a new or acquiring firm if, on a composite-specific basis, three specific criteria are met. We have received feedback over the years that firms that do not want to meet the criteria will not do so, and portability will not be achieved. In the 2020 Exposure Draft, we proposed that firms would be allowed, but would not be required, to port returns if certain criteria are met (provision 1.A.29). A majority of comments supported this change in approach.

A fourth portability test was added to the 2020 Exposure Draft: If the firm wishes to link to performance from the past firm, there must be no break in the track record between the past firm and the acquiring firm. Most respondents agreed with including this condition as a portability test and this was added to provision 1.A.32. Some were concerned, however, that adding that fourth portability test would prevent a firm from using a track record from a past firm if there was such a break. Currently, nothing stops a firm from using a track record from a past firm when there is a break in performance as long as the other portability tests are met. If the firm wishes to use the track record from the past firm, and it meets all of the portability requirements except for the requirement that there is no break in the track record, the firm may present the performance from the past firm, as long as it is not linked with performance after the break in the track record (provision 1.A.33).

If the firm wishes to use the track record from the past firm but does not meet all of the portability tests, the firm may present the performance from the past firm as supplemental information. In all cases, the firm must have records to support the performance from the past firm if the performance is presented in a GIPS Report. The Handbook guidance for provisions 1.A.32 and 1.A.33 will make this clear.

Grace Period

Currently, firms have a one-year grace period to bring any acquired non-compliant assets into compliance. The grace period is intended to allow a compliant firm to not immediately fall out of GIPS compliance because it has acquired a non-compliant firm or non-compliant assets. We proposed no change to the one-year grace period. In the 2020 Exposure Draft we clarified that assets of the 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 (provision 1.A.30). Although most respondents agreed with the one-year grace period, some commented that it could take a large firm more time to bring a non-compliant firm into compliance, and they suggested grace periods ranging from 18 months to three years. No changes were made to the length of the grace period, which remains at one year (provision 1.A.34). We believe that our clarification that compliance for the acquired firm must be met at the end of the grace period on a prospective basis only will ease these concerns.

Definition of Linking

It became clear to us during our discussion of the portability provisions (1.A.32 and 1.A.33) that there is confusion about what it means to "link" to the past firm's track record. We believe that this confusion was caused by the glossary definition of the term "link" in the 2010 edition, which includes both mathematical and presentational linking. We researched all of the instances in which the provisions use the term "link" and found that, in the vast majority of instances, we are referring to mathematical linking. We believe the right way forward is to use the term "link" to refer only to mathematical linking and to describe in guidance any instance in which we refer to presentational linking. We changed the definition of "link" in the glossary so that it no longer references both mathematical and presentational linking. Linking now refers only to mathematical linking unless stated otherwise.

13. Private Market Investments/Real Estate

In the 2020 Exposure Draft, we removed the private equity and real estate–specific provisions and instead proposed provisions that would apply to all private market investments, including real assets, private equity, and similar investments that are illiquid, not publicly traded, and not traded on an exchange. We proposed requiring all private market investments to have an external valuation, a valuation review, or be subject to a financial statement audit at least once every 12 months. We received significant pushback from respondents who opposed expanding external valuation beyond real estate to all private market investments. It was pointed out that the use of external valuations is not as prevalent in other areas of private market investments, and there was concern that qualified individuals were not available in all markets to conduct this type of work. Respondents also pointed out that there may not be a financial statement audit of many portfolios that hold private market investments, or the financial statement audit may not be done on a fair value basis. Because it would be costly and a large administrative burden to comply with the proposed requirement, investment managers of non–real estate private market investments might choose not to comply with the GIPS standards.

In contrast, the use of external valuations is general industry practice for most real estate product types, and numerous real estate firms requested real estate–specific independent valuation requirements.

Based on the comments received, we included real estate–specific independent valuation requirements and removed the proposed independent annual valuation requirement for non–real estate private market investments. We believe, however, that the use of independent valuations is best practice. The provision regarding independent valuation is now a recommendation (provision 2.B.8) for non–real estate private market investments.

<u>Real Estate Investments</u>

We separated real estate into two groups: (1) real estate investments in a real estate open-end fund and (2) real estate investments not in an open-end fund (e.g., real estate closed-end funds, real estate segregated accounts, and real estate investments included in a portfolio with non–real estate investments).

With respect to real estate open-end funds, the consensus from many of the comments we received is that the work that may be performed during an annual financial statement audit or in a valuation review does not provide the comfort that investors demand when they frequently go in and out of a fund. It was also pointed out that, in recent years, many real estate open-end funds have moved to obtain external valuations more frequently than annually. We met with both accounting and performance representatives, who told us that we would be lowering the bar too much by not requiring annual external valuations for real estate open-end funds. Therefore, for real estate open-end funds, an external valuation at least once every 12 months will be required (provision 2.A.43).

With respect to real estate investments that are not in a real estate open-end fund (e.g., real estate closed-end funds, real estate segregated accounts, and real estate investments in other portfolios), we heard that many investors do not want to pay for external valuations once every 12 months. Also, external valuations for opportunity funds are not considered valuable because the value changes constantly as the property is built. There was a strong view that firms should be allowed to value real estate investments through either an external valuation, as required in the 2010 edition of the GIPS standards, or an annual financial statement audit accounted for at fair value.

As a result of the comments received, real estate investments that are not in a real estate open-end fund will be required to have an external valuation or be subject to a financial statement audit. If the firm chooses the external valuation option, such valuation must take place at least once every 12 months unless client agreements stipulate external valuations less frequently. In all cases, however, an external valuation must occur at least once every 36 months. If the firm opts to have a financial statement audit, the audit must be performed by an independent public accounting firm. The real estate investments must be accounted for at fair value, and the most recent audited financial statements available must contain an unmodified opinion issued by an independent public accounting firm (provision 2.A.44). This requirement applies to all real estate investments that are not in a real estate open-end fund, including real estate assets held in a multi–asset class portfolio.

14. Real Estate Component Returns

In the 2010 edition of the GIPS standards, firms are required to present income and capital component returns for real estate composites and benchmarks. As part of the move to eliminate asset class provisions, we proposed eliminating all real estate–specific requirements. We also changed the concept of component returns from a requirement to a recommendation, and we expanded this recommendation to apply to all composites and pooled funds. We also changed the calculation requirement for component returns to allow firms to derive one of the component returns as the difference between the total return and one of the calculated component returns.

Given our change to include real estate–specific valuation requirements, we realized that we would need to re-include some other real estate–specific provisions. Because component returns are primarily used in real estate markets, we decided to include the terms and definitions for component returns used in the 2010 edition of the GIPS standards (i.e., Capital Employed, Capital Return, and Income Return) and make the presentation of component returns a recommendation for real estate composites and real estate pooled funds only (provisions 4.B.9 and 6.B.9). We therefore removed the recommendation that component returns be presented for non–real estate composites and pooled funds.

Although component returns were a requirement for real estate in the 2010 edition of the GIPS standards, we decided to leave them as a recommendation in the 2020 GIPS standards and have the marketplace dictate whether or not they should be presented (provisions 4.B.9 and 6.B.9). We also are not requiring component returns to be calculated separately, as is required in the 2010 edition.

15. Research Costs

In the 2020 Exposure Draft, we asked whether firms should be required or recommended to treat research costs in a specific way. Respondents were split on this question. We discussed the fact that research costs are evolving in the market and whether perhaps we are trying to be too prescriptive. Research costs are only one type of cost, fee, or expense that a firm may charge to a client over and above the management fee. We concluded that the GIPS standards should not dictate how to treat non-management-fee items that are separately charged to clients. Instead, it was agreed that disclosure of all material non-management, non-transaction fees, costs, and expenses that are separately charged to clients will be required. This disclosure will not be limited to research costs. It was also decided, however, to recommend that firms disclose how research costs are reflected in returns.

16. Returns in GIPS Reports (Three-Year Annualized Return)

In the 2020 Exposure Draft, we proposed requiring firms to present the three-year annualized returns for the composite and benchmark for each period for which the three-year annualized ex post standard deviation of the composite or pooled fund and benchmark are presented. We received many comments stating that this item did not add value and that this return could be calculated easily using the information in the GIPS Report. We agree and have deleted this proposed requirement and added a recommendation to present the corresponding annualized return for all periods for which an annualized ex post standard deviation is presented (provisions 4.B.3 and 6.B.3).

17. Risk Measures

In the 2020 Exposure Draft, for those composites or pooled funds that do not have monthly returns, it was proposed that firms be required to present either an ex post risk measure or a qualitative narrative describing the composite or pooled fund strategy's key risks.

One respondent correctly pointed out that firms are already required to include information about the composite's or pooled fund's risks in the composite or pooled fund description (i.e., a qualitative narrative). Because all firms will meet the proposed requirement by including a qualitative narrative of risks as part of the composite description, it will not be either required or recommended that firms present an appropriate ex post risk measure for composites or pooled funds for which monthly returns are not available.

In the case of composites and pooled funds for which money-weighted returns are presented, we found that it was a challenge to identify potential ex post risk measures. Comparability would not be achieved because firms could use different risk measures, including proprietary or relative risk measures that would not be comparable to other firms. We concluded that nothing would be lost by changing this requirement to a recommendation (provisions 5.B.5 and 7.B.4).

18. Side Pockets

In the 2020 Exposure Draft, we included a new requirement that composite and pooled fund returns must include the impact of any side pockets (provision 2.A.50). This provision was an attempt to simplify the guidance currently included in the Guidance Statement on Alternative Investment Strategies and Structures. We received many comments that agreed with this new requirement, provided that we make the distinction that only discretionary side pockets must be included in composite and pooled fund returns. As a result, we added the word "discretionary" to provision 2.A.49, to indicate that the requirement applies only to discretionary side pockets.

19. Subscription Lines of Credit

Subscription lines of credit are not addressed in the 2010 edition of the GIPS standards, but they are now being used by more firms and for longer periods. These lines of credit can affect returns significantly. As has been widely discussed in the industry, there is a lack of consistency in return calculations when lines of credit are used. For comparability and transparency, we proposed that, whenever any line of credit has been used, firms must present money-weighted returns both with and without the subscription line of credit activity. A MWR with the line of credit reflects cash flows beginning with the first capital call from investors. The firm is able to delay calling capital from investors because it has a line of credit in place—that is, the return is calculated with the line of credit in place. The MWR without the line of credit reflects cash flows to and from the line of credit as an external cash flow. If the line of credit did not exist, the firm would have had to call capital from the investors—that is, the returns reflects the cash flows that would have happened if the firm was investing without the line of credit in place.

Comments on the requirement that firms present returns with and without the subscription line of credit were split fairly evenly. Those opposed to presenting performance both with and without the subscription line of credit often stated that the calculation would be operationally burdensome. We do not believe this is a good reason for not requiring firms to present MWRs both with and without the subscription line of credit.

Many comments expressed the view that firms should not be required to present returns without the subscription line of credit when the subscription line of credit is used only for short periods to help manage cash flows. We agreed and amended provisions 5.A.2 and 7.A.2. Firms are not required to present returns without the subscription line of credit when the subscription line of credit has all of the following characteristics:

a. The principal was repaid within 120 days using committed capital drawn down through a capital call.
b. No principal was used to fund distributions.

20. Total Firm Assets—Treatment of Advisory-Only Assets and Uncalled Committed Capital

In the 2020 Exposure Draft, we proposed requiring firms to exclude uncalled committed capital from total firm assets, and we included a recommendation that firms present total firm-wide uncalled committed capital as of the most recent annual period end. We also proposed allowing firms to present advisory-only assets (assets for which the firm provides only investment recommendations) but requiring these assets to be presented separately from total firm assets. We asked whether firms agreed that total firm assets should not include advisory-only assets or uncalled committed capital. Most respondents agreed that neither advisory-only assets nor uncalled committed capital should be included in total firm assets but supported allowing them to be shown in addition to total firm assets. We will continue to require firms to not include advisory-only assets or uncalled committed capital in total firm assets (provision 2.A.1). Firms will be allowed to present firm-wide advisory-only assets as a separate value, however, and may also present the combination of firm-wide advisory-only assets and total firm assets as long as the information is clearly labeled. We will also allow firms to present firm-wide uncalled committed capital or the combination of firm-wide uncalled committed capital and total firm assets, as long as the information presented is clearly labeled.

Because we will now allow firms to present firm-wide advisory-only assets and firm-wide uncalled committed capital in addition to total firm assets, it made sense to allow comparable treatment for composite advisory-only assets and composite uncalled committed capital. In addition to presenting composite assets, the firm may present advisory-only assets that reflect the composite's investment mandate, objective, or strategy, or the combination of composite assets and advisory-only assets that reflect the composite's investment mandate, objective, or strategy, as long as the information is clearly labeled. The firm may also present composite uncalled committed capital or the combination of composite uncalled committed capital and composite assets as long as the information is clearly labeled.

21. Wrap Fee Composites

Currently, firms are allowed to create wrap fee sponsor-specific composites, which include only a specific sponsor's wrap fee portfolios, when presenting performance to that sponsor. We proposed removing the concept of a sponsor-specific wrap fee composite. Respondents overwhelmingly agreed with this proposal. Firms may still present sponsor-specific performance, but we view such information as client reporting rather than composite reporting to a prospective client. In all instances, when presenting performance to a wrap fee prospective client, the composite must include the performance of all wrap fee portfolios managed to the composite strategy, regardless of the wrap fee sponsor (provision 4.A.16).

Effective Date

The 2020 edition of the GIPS standards has an effective date of 1 January 2020. GIPS Reports that include performance for periods ending on or after 31 December 2020 must be prepared in accordance with the 2020 edition of the GIPS standards. GIPS Reports that include returns for periods ending prior to 31 December 2020 (e.g., year-to-date returns through 30 September 2020) may be prepared in accordance with the 2010 edition of the GIPS standards.

Firms may choose to early adopt the 2020 GIPS standards. If firms choose to early adopt, they must not pick and choose which provisions they adopt. They must comply with all requirements of the 2020 edition of the GIPS standards, including the requirements related to GIPS Reports.