



GPS INSIGHTS

September 2016

In this edition of GPS Insights: Updates on key GIPS projects and developments regarding new guidance as announced at the 2016 GIPS Standards Annual Conference, including:

- Verifier Independence
- Supplemental Information
- Risk
- Pooled Funds
- Overlay Strategies
- Portability
- Benchmarks
- Drawdown Portfolios
- GIPS 20:20

2016 GIPS® ANNUAL CONFERENCE HIGHLIGHTS

The 20th Annual Global Investment Performance Standards (GIPS®) Conference was held in Boston, Massachusetts, on September 22-23, 2016. The sold-out conference brought delegates from around the world together to learn about the latest developments in the GIPS standards and to network with their fellow investment performance measurement and compliance professionals.

AN ABUNDANCE OF NEW GUIDANCE IS COMING

3 New Guidance Statements Expected to Be Released Soon

Members of several subcommittees and working groups have been hard at work to draft revisions to existing guidance and develop new guidance for underexplored topic areas. It is anticipated that exposure drafts for three of these guidance statements will soon be released for public comment — the

first coming as soon as 4th quarter 2016, with the other two to follow in the first two quarters of 2017. The three expected guidance statements include revisions to the Guidance Statement on Verifier Independence and the Guidance Statement on the Use of Supplemental Information, as well as a brand new Guidance Statement on Risk. There are also several other new and revised guidance statements in the queue that are expected to be released later in the coming year.

Verifier Independence Guidance Statement

The Guidance Statement on Verifier Independence addresses aspects of the verifier/client relationship and how both entities need to maintain independence from each other in order for the verifier to be able to issue an unbiased opinion. The current version of the guidance statement was adopted in 2005 and, while all other GIPS guidance statements were revised following the adoption of the 2010 edition of the GIPS standards, Verifier Independence was left unchanged. However, as the industry has evolved over the last decade, there are now additional details related to verifier independence that need to be clarified. Expect to see an exposure draft of the revised guidance available for public comment in the near future.

Supplemental Information Guidance Statement

The second guidance coming out for public comment is a revision to the Guidance Statement on the Use of Supplemental Information. Because of the ambiguity in the current version of the guidance statement, many firms have applied the guidance more conservatively than was originally intended and liberally labeled items as “supplemental information” throughout their presentation materials. The new version of the guidance is intended to provide clarification around this topic, particularly with respect to whether supplemental information is limited to information included in a compliant presentation or extends to other pages in a presentation deck or other materials. This issue is still open for debate though, and comments will be requested.

Risk Guidance Statement

The third and final guidance statement that is scheduled for imminent release is the new Guidance Statement on Risk. This is a guidance statement that has been in the works for several years and is anticipated to provide clarification on the various aspects of the GIPS standards that touch on risk. Since performance evaluation that relies solely on returns without consideration of risk provides an incomplete assessment, it is appropriate that the GIPS standards would evolve to delve further into the area of risk. This guidance statement is expected to provide clarification regarding the existing risk-related provisions in the GIPS standards, such as presentation of three-year annualized standard deviation, measures of internal dispersion and disclosures regarding use of leverage and/or derivatives, and also provide insight on additional risk measures that firms may elect to include in compliant presentations.

Additional Guidance in Development

Broadly Distributed Pooled Funds Guidance Statement

Earlier this year, the Guidance Statement on Broadly Distributed Pooled Funds was released for public comment. The guidance is intended to clarify the presentation requirements for pool funds. The comment period ended on April 29, 2016 and since then the Pooled Fund Working Group has been reviewing the responses and determining what modifications should be made to the guidance statement before it is finalized. At the conference, it was announced that several changes were being made from the original proposal that should make the guidance easier for firms to implement. The changes are expected to include:

- Eliminating the requirement to present benchmark total returns, as this is not universally required by regulators. Instead, the presentation of benchmark returns will likely be a recommendation.
- Relaxing the requirement to include all required items in both the official pooled fund document required by local regulators and in fund-specific marketing materials that are prepared by the firm for prospective pooled fund investors. Instead, the information will only be required in one document or the other.
- A new “safe harbor” provision for firms subject to regulation that mirrors the requirements of the guidance statement, which would effectively relieve such firms from any further obligation. This would include firms regulated by the SEC and FINRA as well as many other regulatory bodies around the world.

The revised guidance is expected to be presented to the GIPS Technical Committee by the end of the year with the goal of adoption in early 2017, though the effective date of the guidance will likely be no earlier than 2018.

Overlay Guidance Statement

Another new guidance statement that has been in development for some time is the Guidance Statement on Overlay Strategies. This guidance statement is expected to address how overlay assets should be treated for inclusion in composite assets and firm assets, both when the firm manages the underlying portfolio and when it does not. Significant progress has been made on this guidance statement, and it is expected to be released for public comment sometime in 2017.

Portability Guidance Statement

The Guidance Statement on Performance Record Portability provides guidance on how and when an investment performance track record may be ported from one firm to another. A revised version of the guidance statement has been in progress for several years, but it is expected to finally be issued for public comment before the end of 2017. The new version is expected to provide clarification on what needs to occur during the one-year transition period following a merger or acquisition in order for the new assets to be properly assimilated into the compliant firm — regardless of whether performance results from the prior firm are presented by the new firm. It is also expected to relax the requirement to present a prior firm track record to a recommendation only.

Benchmark Guidance Statement

A working group comprised of practitioners from throughout the industry has been formulated in order to address various issues related to benchmarks, such as identifying when a benchmark is considered so widely recognized as to make a description of the benchmark unnecessary. The working group is developing an initial draft of a proposed guidance statement that will be presented to the Technical Committee. As this project is still in the early stages, a target date for public comment has not yet been established.

Guidance on Drawdown Portfolios

The Technical Committee is continuing to evaluate whether the GIPS standards should expand the use of internal rate of return (IRR) for measuring performance to products other than private equity and closed-end real estate funds. The general concept that is currently being explored is that similar guidance should be applied to all investment products with a drawdown structure, where the manager has the ability to call additional capital when attractive investment opportunities are identified. The Technical Committee has blessed this general approach, and the Interpretations Subcommittee is in the process of drafting a guidance statement to address the topic. As with the benchmark guidance, it is too early to accurately predict when this guidance will be released for public comment.

GIPS 20:20 — A Vision for the Future

The conference also offered a glimpse into the GIPS Executive Committee's vision for the next version of the GIPS standards. All of the new and revised guidance that is currently in the works is expected to converge into a new version of the Standards that is being coined "GIPS 2020," both because of the anticipated date of release and the goal of providing additional clarity. In the early stages, GIPS 2020 is envisioned as both consolidating the Standards by compiling all existing guidance into an expanded version of the GIPS Handbook, while also separating the Standards into three distinct pillars which can be viewed based on the asset manager/prospective client relationship and/or distribution method. These pillars are summarized as:

- 1) One-to-one relationships: typically characterized by separate accounts and other portfolios in which the relationship is with a single client who can have input on the mandate and impose restrictions. This can also be viewed as situations where a general strategy is being sold, rather than a specific product. The traditional approach under the GIPS standards of utilizing composites would continue in these situations.
- 2) One-to-many relationships: represented by pooled funds and other collective investment products that are standardized and offered to multiple investors. These are the types of relationships that will be addressed, in part, by the Guidance Statement on Broadly Distributed Pooled Funds, but additional guidance will also need to be developed to address other pooled investment vehicles that are not broadly distributed, such as hedge funds.
- 3) One-to-none relationships: scenarios where no client relationship exists and an asset owner is managing their own proprietary portfolio, as addressed in the Guidance Statement on the Application of the GIPS Standards to Asset Owners.

A paper outlining the GIPS Executive Committee's initial thoughts on this next version of the Standards is expected to be issued for public comment in the next few months so that firms and individuals can provide initial feedback early in the process while the guidance is still being formulated. A full exposure draft of GIPS 2o2o is expected to be released for public comment in 2018.

A link to the recording of the presentation from the GIPS Standards Annual Conference that focused on this topic is available through the CFA Institute website at: <https://livestream.com/livecfa/Bacon16>

Let Your Voice Be Heard!

The CFA Institute is soliciting feedback regarding the challenges in implementing and maintaining GIPS compliance. Anyone who is involved with applying the GIPS standards including RIAs, asset owners, GIPS verifiers, software vendors, investment performance consultants are asked to complete a brief survey on the CFA Institute website. The results will help to confirm and focus the topics that may need further clarification and/or possible revision. The survey takes only 5-10 minutes is located at: https://cfainstitute.qualtrics.com/jfe/form/SV_0BYeGxVICBLBbUh.

OTHER UPDATES

CFA Institute and SSGA Developing Guidelines for Reporting Hypothetical Performance

Separate and distinct from the GIPS standards, the CFA Institute and State Street Global Advisors are collaborating on the development of best practices for calculating and presenting model portfolio performance. The goal of this project is to develop guidance related to the presentation of all the various forms of hypothetical performance, including back-tested results developed with the benefit of hindsight and "synthetic portfolios" that combine the results of unrelated actual portfolios. However, in its initial phase, this initiative will focus on model portfolios that are managed and traded in real time, but without holding or owning the actual investments (i.e., paper portfolios). Based on the early details discussed during the GIPS Standards Annual Conference, the guidance will closely mirror regulatory precedent established in the United States through the 1986 Clover Capital Management, Inc. No-Action letter for presenting model portfolio results, but will also delve much deeper into best practices for maintaining and calculating model portfolios. A draft of the paper is expected to be released in the near future.

ABOUT US

Guardian Performance Solutions LLC (GPS) is a specialty compliance consulting firm dedicated to providing customized solutions to the investment management industry with the objective of helping firms to achieve and maintain compliance with the Global Investment Performance Standards (GIPS®) and facilitating the production of compliant performance advertising materials. Because GPS does not provide verification services, GPS is free from independence concerns and can take a hands-on approach to developing and managing an adviser's GIPS compliance program, which may include constructing composites, calculating and validating performance results, and writing GIPS policies and procedures.

Additional information can be found at www.GuardianPerformanceSolutions.com.