2013 GIPS® CONFERENCE HIGHLIGHTS

The Global Investment Performance Standards (GIPS®) Annual Conference was held on September 19-20, 2013 at the Westin Copley Place in Boston, Massachusetts. The conference was well attended and, for the first time, two of the conference sessions were webcast live. For those who may have missed the live presentations, these webcasts are available for viewing on the CFA Institute website (www.gipsstandards.org). Below are some of the highlights from the conference.

New Guidance on the Horizon

It was announced that several new guidance statements are in development and are expected to be released as exposure drafts for public comment in 2014.

Pooled Funds

The Pooled Fund Working Group (PFWG) is currently in the process of drafting a new guidance statement that will address presentation and disclosure requirements for pooled funds, including possible disclosures that GIPS compliant firms will be required to deliver to underlying fund investors. The PFWG is tasked with addressing the complexities associated with applying the GIPS standards to pooled funds from a global perspective given the varying local laws and regulations that may prevent certain information from appearing in the fund’s official document, such as a mutual fund prospectus.

Risk

Another guidance statement that is also in the works will seek to explore how the GIPS standards should address the concept of risk. Historically, the GIPS standards have focused on the presentation of performance results without giving much consideration to the amount of risk taken in order to achieve those results. That began to change when the 2010 edition of the GIPS standards introduced the requirement for firms to include the three-year annualized standard deviation of the composite and benchmark returns in their compliant presentations. This new guidance will now go further down the path of comparing risk and return. While not expected to introduce additional specific risk disclosure requirements, the guidance will provide examples of generally recognized risk measures that will be recommended components of a compliant presentation.
New Guidance on the Horizon Continued…

Portability
Firms often have difficulties when applying the current Guidance Statement on Performance Record Portability. Members of the United States Investment Performance Council (USIPC) are working in conjunction with the Interpretations Subcommittee to draft a revised version of the guidance statement to help provide more clarity. The presenters at the conference explained that the objective behind rewriting the guidance statement is not to introduce new requirements, but rather to illustrate how firms should properly apply the existing principals. The key issues that the new guidance will attempt to address include clarification on terminology, performance breaks, grace periods for bringing non-compliant assets into compliance, the role of legal and compliance departments, and common obstacles that firms have encountered when attempting to port a track record.

Overlay Strategies
Currently, the only guidance in the GIPS standards related to overlay strategies is delivered through a single Q&A on the topic. There are many questions that this Q&A does not address, including how to define discretion for overlay strategies, how to construct composites, and how to identify appropriate benchmarks. A formal Overlay Working Group has been organized and is about to start working on these specific issues.

Data Analytics in SEC Investigations
Carolyn O’Brien, SEC exam manager, and Sofia Hussain, SEC senior forensic accountant, provided insight regarding the tools, techniques and analytics used by the SEC during investigations. During the session, they discussed how the SEC is proactively identifying anomalies within the performance of investment advisers and private fund managers. They explained how they are conducting performance attribution analysis and looking for aberrational performance and suggested that firms should also look closely at what factors are driving their performance.

Ms. Hussain reinforced that the SEC has enhanced the surveillance tools and methods that are being used during investigations, including those used for insider trading cases. She explained how sophisticated technology is being used to compare phone records to the timing of stock purchases.

Speaking specifically to GIPS compliance, Ms. O’Brien noted that GIPS verification offers some comfort that policies and procedures have been reviewed by a third-party. Even more so, she explained that she is able to reach a higher level of comfort when composite performance examinations are also conducted.

The discussion was interesting and provided a deeper level of insight into the SEC’s examination process than has been typically conveyed in the past and it reinforced the efforts of the SEC to enhance the effectiveness of their exams.

Performance and compliance professionals should be asking:

1) How is performance being derived, and what factors are driving the performance?
2) Are there major spikes or drops in performance? If so, are the changes rational?
3) Is the portfolio manager stepping away from the investment strategy?
4) Is there style drift and, if so, is disclosure warranted?
5) Are cash levels appropriate to the client guidelines?
SEC Update

Andrew Bowden, the director of the SEC Office of Compliance Inspections and Examinations (OCIE), discussed OCIE’s current focus areas, he explained the methods used to determine which advisers are considered “high risk,” and he touched on the issues their exam teams are observing in the field surrounding performance and GIPS compliance.

Mr. Bowden highlighted OCIE’s use of risk-based methods and quantitative analysis that drive the exam program. He outlined that the SEC’s risk assessment includes gathering information reported on Form PF, performance posted to third-party databases, ADV filings, prior exam history, as well as information posted online or noted in the press. This information is then run through various algorithms which look for risks and improprieties to determine which advisers to examine. Specific areas of concern that he noted included a CCO resigning, rapid growth of AUM over time, disproportionate AUM ratios compared to number of employees, and changes in auditors. As for the number of investigations that are not based on a firm’s “risk score,” he estimates that 10-15% of exams are initiated by a tip, complaint or referral.

Mr. Bowden explained that examiners are looking closely at non-portable prior firm results, hypothetical performance, and representative account information (all of which are considered supplemental information under the GIPS standards). He reminded the audience that SEC registered investment advisers who advertise performance need to closely review no-action letters related to performance advertising and ensure that presentations are consistent with the guidance in those letters. Copies of relevant no-action letters are available on the SEC’s website, sorted by topic area.

As a general matter, Mr. Bowden expressed support for the GIPS standards. Before working at the SEC, he worked in a variety of roles including serving on a composite committee at an advisory firm, so he has an appreciation for the GIPS compliance process. He highlighted that during examinations the staff is looking at firms’ GIPS compliance programs and occasionally finding that firms are falsely claiming compliance and sometimes even fraudulently indicating that a verification has been conducted. He believes that most often firms are not trying to misrepresent themselves; they just lack the technical expertise, knowledge, and experience to fully embrace the requirements of the GIPS standards.

He concluded that since investors are putting more reliance on GIPS compliant firms and verification that it raises questions that the industry should consider addressing, such as: 1) whether verification should be required, 2) whether third-party verifiers should have to meet additional requirements in order to conduct verifications, and 3) whether sufficient information has been provided to the marketplace regarding the differences between verification and performance examination.

ABOUT US

Guardian Performance Solutions is a specialty compliance consulting firm dedicated to providing customized solutions to the investment management industry with the objective of assisting advisers to create compliant performance advertising materials. We help investment advisers achieve their goals of marketing their services and growing their business, while also meeting their regulatory obligations and adhering to industry accepted standards and best practices.

One of our focus areas is helping asset managers to implement GIPS® compliance programs. Because we don’t provide verification services, we are free from independence concerns and can take a hands-on approach to developing and managing the GIPS compliance process. Additional information can be found at www.GuardianPerformanceSolutions.com.