NSCP
NATIONAL SOCIETY OF COMPLIANCE PROFESSIONALS
Currents
September 2019

Preparing for 2020: Steps to Implementing the 2020 Edition of the GIPS® Standards

By Amy Jones and Arin Stancil

After years of development, the 2020 edition of the Global Investment Performance Standards[1] ("GIPS® standards") has been finalized. The 2020 GIPS standards become effective on January 1, 2020, which means that firms that voluntarily elect to claim compliance with the GIPS standards need to be prepared to implement policies and procedures that address the new requirements prior to that date. The reporting requirements have a longer timeline though – reports that satisfy the new requirements will not need to be created in most cases until 2021.

For firms that currently comply with the 2010 edition of the GIPS standards, there are several decisions that will need to be made as they convert to the 2020 edition. We organized a summary of the significant items that firms should consider as they perform their own gap analysis. This list is not comprehensive and firms that claim compliance with the GIPS standards should familiarize themselves with the full version of the 2020 GIPS standards. In addition, an Adopting Release letter[2] was organized by CFA Institute and is available on their website which serves as a useful tool for understanding the rationale for changes that were made and also provides some clarifying guidance.

GIPS Policies & Procedures

The most important task that firms that claim compliance with the GIPS standards should start with is reviewing their existing policies and procedures and preparing to make changes in order to align them with the 2020 GIPS standards by January 1, 2020.

A firm's policies and procedures must document how the firm has met all of the requirements of the GIPS standards. With respect to adopting the 2020 edition, this would include documenting policies for how the firm will address the new requirements. However, a firm is not obligated to establish policies to address requirements that are not applicable to them. For example, if the firm does not manage overlay portfolios, it is not necessary for them to outline procedures related to the calculation of overlay exposure.

Many of the changes introduce new options for firms to consider, rather than imposing strict new requirements. As a result, there are not many mandated changes that will require changing existing processes, but firms will need to evaluate all of the changes to ensure that their GIPS program reflects how the firm decides to approach each applicable provision. For example, under the 2010 edition of the GIPS standards, firms are required to include all actual, fee-paying, discretionary "portfolios" in at least one composite. However, under the 2020 edition of the GIPS standards, firms will be required to include all actual, fee-paying, discretionary "segregated accounts" in at least one composite – with a segregated account being defined as a portfolio owned by a single client (i.e., not a pooled fund that is offered to multiple investors). This change does not mean that firms will need to remove all of their pooled funds from composites by January 2020, though firms will have the option of

Many of the changes introduce new options for firms to consider, rather than imposing strict new requirements.

About the Authors

Amy Jones, CIPM, is the founder and a principal at Guardian Performance Solutions LLC.
She can be reached at amy@guardianperformancesolutions.com.

Arin Stancil, CFA, CIPM, is a principal at Guardian Performance Solutions LLC.
He can be reached at arin@guardianperformancesolutions.com.

1. https://www.cfainstitute.org/-/media/documents/code/gips/2020-gips-standards-firms.ashx
2. https://www.cfainstitute.org/-/media/documents/code/gips/adopting-release-firms.ashx

doing so if the fund's strategy is not offered to segregated accounts. There are several other changes made to provisions where firms are provided with additional flexibility and options; each firm will need to consider what the best approach is for them, then memorialize their decisions in their GIPS policies and procedures.

In addition, when reviewing policies and procedures, firms should also make amendments to terminology in order to mirror the 2020 edition. For example, "compliant presentations" are now referred to as "GIPS Reports." Firms should also update any references to specific GIPS provisions to reflect any changes in wording and to use new reference identifiers. For example, the concepts outlined in provision 0.A.9 of the 2010 edition are now included in provision 1.A.11 of the 2020 edition. Additionally, if the firm has incorporated disclosure checklists or other reference materials as part of their GIPS policies and procedures, these will need to be updated in order to match the revised requirements.

Takeaways for compliance professionals:

Compliance officers should confirm who at the firm is taking responsibility for updating the firm's GIPS policies and procedures and ensure that a timeline is established to finalize the updates prior to January 1, 2020 so that the firm is prepared to adopt the 2020 GIPS standards once they become effective. Firms may also choose to adopt the 2020 GIPS standards early – they do not need to wait until the year 2020 arrives. However, if a firm chooses to adopt the new GIPS standards early, they cannot selectively adhere to certain changes and not others.

Total Firm Assets

The 2020 GIPS standards clarify a couple of points with regard to the calculation of total firm assets (defined as the aggregate total of all discretionary and non-discretionary assets for which the firm has investment management responsibility). The first area of clarification is that total firm assets must not include advisory-only assets, which was previously not explicitly outlined in the GIPS provisions but was addressed through guidance published outside of the core GIPS standards and is already common practice throughout the industry. The other area that has been clarified relates to uncalled committed capital – assets that have been committed by investors but have yet to be called or drawn down by the investment manager. Beginning January 1, 2020, firms will no longer be permitted to include uncalled committed capital in total firm assets. The exclusion of uncalled committed capital has been applied less universally by firms to this point, so imposing this as a requirement will demand that some firms change their current practices. In any event, all firms should confirm how they have treated advisory-only assets and uncalled capital commitments for the purpose of calculating total firm assets historically and ensure that their practices align with the new requirements going forward.

Though advisory-only assets and uncalled committed capital cannot be included in the official total firm assets value that is reported in GIPS Reports beginning January 1, 2020, the 2020 GIPS standards introduce some new provisions that allow these figures to be presented as complements to or even combined with total firm, composite, or pooled fund assets. When combined totals are presented, the component figures must also be presented separately. For example, if a firm presents a combination of total firm assets and firm-wide advisory-only assets, the firm must also separately present total firm assets and firm-wide advisory-only assets for the same time periods.

Takeaways for compliance professionals:

Compliance officers should confirm if the firm is excluding advisory-only assets and uncalled capital commitments from the total firm assets values reported in GIPS Reports. Also, if these additional asset figures are presented separately, compliance officers should confirm that it is done in a manner that is consistent with the requirements of the GIPS standards.

Return Measures (TWR or MWR)

Up to this point, the GIPS standards have required the use of time-weighted returns (TWRs) in almost all cases, with the limited exceptions of private equity and closed-end real estate products. However, there are many instances where money-weighted returns (MWRs) are more commonly demanded by clients and investors, particularly for presenting performance of private funds. The need to align the reporting of such products more closely with standard business practice has been recognized and addressed in the 2020 GIPS standards, which allow much more flexibility for firms to report MWRs than previous iterations of the GIPS standards.

Going forward, the use of MWRs will not be limited to specific products or asset classes. Firms will have the option of reporting MWRs instead of TWRs in situations where the firm has control over the timing of external cash flows into the portfolios in the composite (or the specific pooled fund, if reporting on the pooled fund alone) and the portfolios also have one of the following characteristics: (1) closed-end, (2) fixed life, (3) fixed commitment, or (4) illiquid investments are a significant part of the investment strategy.

Firms that manage funds or strategies that satisfy these requirements will need to assess whether MWRs or TWRs are a more appropriate return measure to be presented. If the firm later decides to change the type of return presented for a particular composite or pooled fund, disclosure will need to be made in the GIPS Report regarding the change.

Additionally, for pooled funds and composites for which the firm is able to and chooses to report MWRs, the firm will also need to determine if a subscription line of credit – a revolving line of credit typically used by private funds to delay calling capital from investors – has been utilized. If so, performance will typically need to be presented both with and without the subscription line of credit. An MWR without the subscription line of credit assumes that capital was called to make investments rather than using the line of credit, so the calculation of the MWR begins with the first flow from the credit line rather than waiting for the first actual capital call. An exception to the requirement to present both sets of returns is allowed in instances where the principal borrowed from the subscription line was repaid within 120 days using committed capital and no principal was used to fund distributions, in which case only performance including the impact of the subscription line needs to be presented. For some firms, results without the subscription line of credit may not currently be calculated as a standard practice, so these firms will need to take steps to ensure that both sets of returns are readily available.

Takeaways for compliance professionals:

Compliance officers should confirm if there are any instances where the firm will present MWRs instead of TWRs in GIPS Reports. If so, then compliance officers who review these materials will need to confirm that disclosure checklists address the reporting requirements for presenting MWRs in GIPS Reports.

Lists of Pooled Funds

Under the 2010 edition of the GIPS standards, firms must maintain and make available to prospective clients a complete list of composite descriptions. Under the 2020 GIPS standards, firms will also need to create a list of limited distribution pooled fund descriptions and a list of broad distribution pooled funds, if the firm manages such funds. These lists have to be made available to prospective pooled fund investors upon request. Though the list of composite descriptions must include terminated composites for at least five years, the lists of funds do not need to include terminated funds.

Notably, unlike the other two lists, the list of broad distribution pooled funds does not need to include descriptions – it can be limited to just the names of the individual funds. The Adopting Release accompanying the 2020 GIPS standards also makes it clear that it is acceptable for the list of broad distribution pooled funds to be posted to a website and for the firm to direct prospective investors to the website if they request a copy of the list.

One aspect of the process of creating the fund lists is determining which funds managed by the firm qualify as "broad distribution" and which qualify as "limited distribution." In the glossary of the 2020 GIPS standards, broad distribution pooled funds are defined as 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. On the other hand, a limited distribution pooled fund is simply any pooled fund that is not a broad distribution pooled fund. Limited distribution pooled funds were deliberately defined in this manner so that broad and limited distribution funds would be mutually exclusive – no funds managed by the firm should be considered both broad and limited distribution.

Takeaways for compliance professionals:

For firms that manage a large number of pooled funds, the process of creating the lists of funds – particularly the list of limited distribution pooled fund descriptions – may be an extensive exercise. With that in mind, compliance officers might be able to assist with compiling these lists by leveraging fund regulatory filings. Firms should determine the workload necessary to compile the list of broad pooled funds and the list of limited distribution pooled fund descriptions with the goal of having them completed prior to the end of 2019.

Firms should determine the workload necessary to compile the list of broad pooled funds and the list of limited distribution pooled fund descriptions with the goal of having them completed prior to the end of 2019.

Pooled Fund Reporting

Under previous editions of the GIPS standards, there were no specific reporting requirements related to prospective pooled funds investors, only prospective clients interested in a particular composite strategy. That has changed under the 2020 GIPS standards, which introduce a new requirement to make every reasonable effort to provide GIPS Reports to limited distribution pooled fund investors. If a firm manages limited distribution pooled funds, the firm will have a reporting obligation to provide prospective investors with either a GIPS Pooled Fund Report (which is a new concept under the 2020 GIPS standards) or a GIPS Composite Report for the composite that includes the pooled fund. Firms that have included their limited distribution pooled funds in composites will need to decide if they will continue to maintain composites for strategies that are not offered to segregated accounts. If so, they have to decide if the firm will produce a GIPS Composite Report or GIPS Pooled Fund Report for each of those strategies going forward.

When preparing for the production of GIPS Pooled Fund Reports, firms will need to determine who will be responsible for producing the reports. At some organizations, the fund and composite teams may be functionally or departmentally separated, so it may not be feasible or appropriate to have one team be responsible for creating both GIPS Composite Reports and GIPS Pooled Fund Reports.

When it comes to broad distribution pooled funds, firms do not have any obligation to provide GIPS-compliant information to prospective investors. Delivering GIPS Reports to prospective investors in broad distribution pooled funds is optional and not even explicitly recommended.

Takeaways for compliance professionals:

Firms that manage limited distribution pooled funds will need to confirm if a GIPS Pooled Fund Report will be provided to prospective investors or a GIPS Composite Report for a composite that includes the fund will be provided. In any event, a process will need to be established so that one or the other is provided. Compliance officers should confirm how these new reporting requirements will be implemented.

Firms that manage broad distribution pooled funds will need to make a business decision as to whether they will reference their claim of GIPS compliance in fund materials. If they elect to do so, they will need to follow the requirements of the GIPS Advertising Guidelines or provide a GIPS Pooled Fund Report – otherwise the materials should make no reference to GIPS compliance. Compliance officers should review materials to ensure they meet these requirements, when applicable, and that inappropriate references to the GIPS standards are not included in fund materials.

GIPS Reports

Once we move into the new year, firms will need to establish processes for creating GIPS Composite Reports and GIPS Pooled Fund Reports that meet the 2020 requirements. GIPS Reports do not need to be produced that meet the requirements of the 2020 GIPS standards until performance for periods ending on or after December 31, 2020 is included. However, it is anticipated that some firms will elect to implement the new reporting requirements earlier. Each firm should assess and determine at what point they will switch over to following the 2020 reporting requirements.

Following is a summary of amendments that will need to be addressed in existing presentations to meet the new requirements of the 2020 GIPS standards. This is not a comprehensive list and is only intended to highlight some of the changes that would be applicable to a majority of firm's GIPS Reports. In particular, there are several situational specific disclosures that firms will need to consider which are not captured below.

- New compliance statement for Verified Firms:
  - *[Firm Name]* claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. *[Firm Name]* has been independently verified for the period *[Dates]*. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.

- CFA Institute trademark disclaimer:
  - GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.
- In addition to disclosing that a l*ist of composite descriptions is available upon request, disclose that a list of pooled fund descriptions for limited distribution pooled funds and a list of broad distribution pooled funds* are available, if applicable.
- Confirm total firm assets are reported as of each annual period end (presenting the composite assets as a percentage of firm assets is no longer an acceptable alternative).
- Disclose the composite inception date in addition to the creation date.
- Disclose whether internal dispersion (and any other risk measures presented) is calculated using gross-of-fees or net-of-fees returns.
- Ensure composite descriptions address each of the following, if applicable: (1) the material risks of the composite's strategy, (2) how leverage, derivatives, and short positions may be used, if they are a material part of the strategy, and (3) if illiquid investments are a material part of the strategy.
- Fee schedules must be customized to the intended audience, whether presenting to a prospective client for a standalone portfolio, a prospective client for a multi-asset strategy portfolio, a wrap fee prospective client, or to a prospective investor in a pooled fund. Specific to pooled funds, when presenting a GIPS Composite Report to a prospective investor for a pooled fund included in the composite, disclose the pooled fund's current fee schedule and expense ratio.

Additionally, several disclosure requirements were removed or relaxed, including:

- Firms may now indicate the reporting currency, rather than disclosing it (including the currency symbol would be sufficient).
- No longer required to disclose reasons for redefinitions to the firm or composites.
- No longer required to disclose reasons for changing a benchmark.
- Presenting the percentage of non-fee-paying assets is no longer required if using model fees to calculate net-of-fees returns.
- For composites that include wrap-fee portfolios, disclosing the various types of fees included in the wrap fee has been moved from a requirement to a recommendation.
- For composites that include wrap-fee portfolios, presenting the percentage of composite assets represented by wrap-fee portfolios is only required when presenting performance to a wrap fee prospective client.
- One-year sunset periods added allowing for the removal of disclosures related to:
  - Changes to composite names
  - Prospective benchmark changes
  - Significant events

Takeaways for compliance professionals:

Compliance officers who review presentation materials will need to confirm that the appropriate disclosures and statistics are included in GIPS Reports. This includes reviewing the disclosure requirements listed in the 2020 GIPS standards and updating disclosure checklists to reflect the requirements of the 2020 GIPS standards.

(continued)

Where to Start-Implementing the 2020 GIPS-Standards

GIPS Policies & Procedures

- [ ] Perform a gap analysis of the firm's existing GIPS-compliance program compared to the 2020 GIPS standards and reconcile any differences.
- [ ] Implement new policies and procedures to address new requirements that are applicable to the firm.
- [ ] Make decisions regarding new options introduced in the 2020 GIPS standards and memorialize those decisions in the firm's policies and procedures.
- [ ] Update terminology that has changed (e.g., compliant presentations should be referred to as GIPS reports).
- [ ] Update references to specific GIPS provisions to reflect any changes in wording and to use new reference identifiers (e.g., 2010 GIPS provision 0.A.9 equates to 2020 GIPS provision 1.A.11).

Total Firm Assets

- [ ] Determine whether advisory-only assets are currently being included in total firm assets.
- [ ] Determine whether uncalled committed capital is currently being included in total firm assets.

Return Measures (TWR or MWR)

- [ ] Determine whether the firm manages any portfolios where the firm has control over the timing of external cash inflows.
- [ ] For portfolios where the firm has control over the timing of external cash inflows, determine whether the portfolio also has one of the following characteristics: (1) closed-end, (2) fixed life, (3) fixed commitment, or (4) illiquid investments are a significant part of the investment strategy.
- [ ] For portfolios where the firm has control over the timing of external cash inflows and also has one of the characteristics noted above, determine whether money-weighted returns (MWR) or time-weighted returns (TWR) are a more appropriate return measure for the product or strategy.
- [ ] For funds and composites that will report MWR, determine whether subscription lines of credit have been utilized and if returns both with and without the line of credit are available.

Lists of Pooled Funds

- [ ] Determine whether funds managed by the firm qualify as "limited distribution" or "broad distribution" pooled funds.
- [ ] Create a complete list of the firm's active broad distribution pooled funds.
- [ ] Create a complete list of the firm's active limited distribution pooled funds, including descriptions for each fund (general information regarding the investment mandate, objective, or strategy of the pooled fund).

Pooled Fund Reporting

- [ ] Determine which pooled funds managed by the firm represent strategies that are managed for or offered as segregated accounts.
- [ ] Determine if composites will be maintained for pooled funds that do not represent strategies that are not managed for or offered as segregated accounts.
- [ ] For limited distribution pooled funds that are not included in composites, establish procedures for creating GIPS Pooled Fund Reports.
- [ ] For limited distribution pooled funds that are included in composites, determine whether the firm will produce GIPS Pooled Fund Reports, GIPS Composite Reports or both for the particular strategy.
- [ ] Implement process for providing GIPS Reports to prospective investors in limited distribution pooled funds.
- [ ] Establish procedures for determining whether new pooled funds will be included in composites prospectively

GIPS Reports

- [ ] Determine when the firm will convert to following the 2020 reporting requirements (for reports that include performance for periods ending on or after December 31, 2020 or earlier)
- [ ] Update your disclosure checklists to capture the new disclosure requirements that are outlined under the 2020 GIPS standards