GPS INSIGHTS

September 2017

2017 GIPS® ANNUAL CONFERENCE HIGHLIGHTS

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The 21st Annual Global Investment Performance Standards (GIPS®) Conference was held in San Diego, California, on September 14-15, 2017. The conference brought together delegates from around the world. In some instances, people traveled more than 30 hours to learn about the latest developments in the GIPS standards and to network with their fellow performance measurement and compliance professionals.

During the conference, we celebrated the 30th anniversary of the performance presentation standards — a legacy that started in 1987 with the publication in the *Financial Analysts Journal* of an initial draft of what would become the AIMR Performance Presentation Standards. The conference kicked off with a look back at the history of the Standards with three of the men who were instrumental in their development: Mr. Lee Price, Mr. Ronald Peyton, and Mr. R. Charles Tschampion. They were involved with the very first committees that established standards around performance measurement and created a foundation for the industry based on a consistent approach to calculation and presentation of performance results. Those principles continue to be the foundation of the GIPS standards today.

Other sessions during the conference focused on GIPS 20/20, as outlined in more detail below, as well as various topics related to the GIPS standards, including applying the GIPS standards to private wealth managers and how the Outsourced Chief Investment Officer (OCIO) model fits within a GIPS-compliance framework. There was also an interesting presentation on sustainable, responsible and impact investing (SRI) and environmental, social and corporate governance (ESG) and how organizations such as CalPERS are tailoring their reporting and risk monitoring to focus on environmental concerns.

Additionally, after 17 years at CFA Institute, Jonathan Boersma, the Executive Director of the GIPS Standards, announced that he would be stepping down from his position following the end of the conference. We would like to take this opportunity thank him for his contribution to the GIPS standards and wish him well in his future endeavors.

GIPS 20/20 Update

A significant focus at the conference was on GIPS 20/20, the next version of the GIPS standards that is currently in development. Two sessions were dedicated to the topic — one focusing on pooled funds and the other on composites — and the underlying themes of GIPS 20/20 ran through many of the other presentations as well. In addition, during the GIPS Executive Committee Open Meeting that preceded the conference, an update was provided on the feedback received from the GIPS 20/20 consultative paper.

While very little has been finalized so far, a clear direction on where the Standards are going is beginning to take shape. For firms that currently claim compliance and only manage separate accounts, the expectation at this point is that the impact should be quite minimal. Where the most significant changes are occurring are related to pooled funds, both broadly distributed and privately offered.

A suggestion being offered is that firms managing pooled funds may no longer be required to include them in composites. Firms would still have the option of including them if desired, but would no longer be obligated to include them in composites — similar to the current treatment for non-fee-paying accounts. For many firms, this would eliminate the need for a vast number of single account composites. Note, however, that the proposal is not expected to carry over to unique separate account mandates — if a separate account does not fit into one of the firm's existing composites, it would still require the creation of a new composite.

The flipside of granting this new level of flexibility on the composite side is that new fund-specific requirements are expected to be implemented. Specifically, it is being suggested that compliant firms would need to maintain a complete list of funds that are managed by the firm — similar to the currently required list of composite descriptions — and make this list available to prospective fund investors. In addition, prospective investors for directly marketed products (i.e., funds that are not broadly distributed) will need to be provided with what is being referred to as a "GIPS Fund Report." The specific content of this report has not yet been determined, but it is expected to be a streamlined, fund-specific version of a GIPS-compliant composite presentation.

An update on the timeline for GIPS 20/20 was also offered. An exposure draft is expected to be released to the public by the end of second quarter 2018 for an approximately four-month comment period. Following revisions based on the public comments, the goal is to have the final version approved and adopted by the GIPS Executive Committee by the end of secondary quarter 2019, with an effective date of January 1, 2020.

For more information, a recording of the GIPS 20/20: Pooled Funds session from the conference is available via the following link: https://livestream.com/livecfa/Putallaz17

STATUS UPDATE ON NEW GIPS GUIDANCE STATEMENTS

As a reminder, the new Guidance Statement on Broadly Distributed Pooled Funds and the revised Guidance Statement on the Application of the GIPS Standards to Asset Owners were both recently adopted with an effective date of January 1, 2018. In addition, the comment period for the revised Guidance Statement of the Use of Supplemental Information has closed and the guidance is expected to be finalized in the near future.

Though your chance to comment on those guidance statements has past, there are plenty more opportunities for you to have to your voice heard with three more guidance statements currently open for comment and one more on the way.

Guidance Statements Open for Public Comment

Guidance Statement on Risk – open for comment until September 26, 2017

The Guidance Statement on Risk is intended to provide clarification regarding the existing risk-related provisions in the GIPS standards. One of the key changes it proposes is the elimination of the requirement to disclose if the firm determines that the three-year annualized ex-post standard deviation is not a relevant risk measure for the composite, as well as the related requirement to present an additional risk measure. These requirements often confused compliant firms, so the removal of the provisions will likely to be well received. In addition, the guidance statement provides examples of different risk measures that firms may elect to present and gives examples of appropriate risk-related disclosures that firms should include in their composite descriptions and compliant presentations. Please note that the window for comment on this guidance statement is closing quickly, so if you have feedback we urge you to submit it soon.

Guidance Statement on Verifier Independence – open for comment until October 26, 2017

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. This revised version of the guidance statement shifts the emphasis for assessing independence from just the verification service provider to now include both the verifier and the firm being verified. The new guidance proposes to require verifiers to adopt policies and procedures that address independence at both the firm and employee level. Verified firms will also be encouraged to adopt similar policies. Lastly, the guidance statement provides more specific examples of services that may be provided by a verifier that would clearly create an independence issue.

Guidance Statement on Overlay Strategies – open for comment until November 27, 2017

The third guidance statement currently open for your comments is the Guidance Statement on Overlay Strategies. Guidance on this topic has long been awaited by firms that manage overlay assets. One of the key questions it addresses is how overlay assets should be treated for inclusion in composite assets and firm assets, which it accomplishes through the introduction of the concept of overlay exposure. This exposure value would also be the same value that is used in the denominator in an overlay portfolio return calculation. Another interesting concept introduced in the guidance statement is the idea that if exposure is constant over time, returns must be arithmetically linked, rather than the typical process of geometric linking. While theoretically sound, this concept may result in an administrative burden for managers whose systems are only designed to geometrically link returns.

More Guidance Coming Soon

Guidance Statement on Benchmarks

During the September 12, 2017, GIPS Executive Committee Meeting, the Guidance Statement on Benchmarks was approved to be released for public comment. The public comment period is expected to begin in the next few weeks, following some minor modifications. This guidance statement is intended to address the various issues

related to benchmarks that should be considered by GIPS-compliant firms. It is expected to describe the different types of benchmarks currently available and provide guidance on how to select an appropriate benchmark. Additionally, it is anticipated to provide further guidance on what actions should be taken by a firm when benchmarks change or when multiple benchmarks are presented.

TAKEAWAYS FROM SEC RISK ALERT ON PERFORMANCE ADVERTISING

On September 14, 2017, a National Exam Program Risk Alert was issued by the Office of Compliance Inspections and Examinations ("OCIE") that lists compliance issues relating to Rule 206(4)-1 (the "Advertising Rule"). The compliance issues that were most frequently identified in deficiency letters sent to SEC-registered investment advisers related to:

1) Misleading performance results in advertisements
   - Compared results to a benchmark, but did not disclose the limitations inherent in such comparisons and did not disclose that the advertised strategy materially differed from the composition of the benchmark.
   - Contained hypothetical and back-tested performance results, but did not explain how these returns were derived and did not include other potentially material information regarding the performance results.
2) Misleading one-on-one presentations
   - Included gross-only results in certain one-on-one presentations, but without including relevant disclosures such as that performance results did not reflect the deduction of advisory fees and that client returns would be reduced by such fees and other expenses.
3) Misleading claim of compliance with voluntary performance standards
   - Claimed that performance results complied with a certain voluntary performance standard (i.e., the GIPS standards) when it was not clear to staff that the performance results in fact adhered to the performance standard's guidelines.
4) Cherry-picked profitable stock selections
   - Included only profitable stock selections in presentations, client newsletters, and on websites without meeting the conditions set forth in the Advertising Rule.
   - OCIE takes the position that any advertisement that refers only to one or more profitable recommendations and ignores unprofitable ones is inherently misleading and deceptive.
5) Misleading selection of recommendations
   - Disclosed only certain past specific investment recommendations and not all recommendations.
   - Discussed profits realized by specific recommendations.
   - Did not make all representations required within the TCW Group and Franklin No-Action letters such as:
     - Presenting best-performing holdings, but not simultaneously including an equal number of the worst-performing holdings.
     - Not disclosing that the specific recommendations did not represent all securities purchased, sold, or recommended to clients during that period.
6) Insufficient advertising and performance policies and procedures
   - Inadequate processes for reviewing and approving advertising materials prior to their publication or dissemination.

- Parameters for which accounts were included or excluded from performance calculations (i.e., composite construction) was not documented or applied consistently. Regardless of whether the firm claims GIPS compliance there is an expectation that the firm has documented the process for composite construction.
- Lacked a process to confirm the accuracy of performance results in compliance with the Advertising Rule.

In addition, the Risk Alert highlighted certain findings from an initiative where OCIE focused on advisers' use of accolades in their marketing materials ("Touting Initiative"). OCIE observed advisers using lapsed professional designations and instances where the minimum qualifications required were not explained in materials. OCIE also found that certain advisers made references to awards and rankings without disclosing the material facts related to such awards, such as the date received, if the adviser paid to participate, or the number of other advisers who also received the ranking or award.

The National Exam Program Risk Alert can be found at: https://www.sec.gov/files/risk-alert-advertising.pdf.

CFA CERTIFICATIONS GAINING TRACTION: CIPM® AND INVESTMENT FOUNDATIONS™

The CFA Institute is primarily known for the CFA charter designation; however, they also offer two other certification programs, the Certificate in Investment Performance Measurement (CIPM) and the Investment Foundations, which have both been building momentum. As of the most recent exam cycle, the CIPM has been awarded to over 1,600 certificate holders. The CIPM curriculum includes performance evaluation and ethical and professional standards. Registration for the March 2018 exam opens October 1, 2017.

The CFA Institute Investment Foundations program is designed to appeal to a broader segment of our industry and covers the essentials of finance, ethics, and investment roles. With a global pass rate of 85%, there are now over 10,000 Investment Foundations certificate holders across many job functions including operations, technology, accounting, marketing, relationship management, administrative support, compliance and legal. To encourage people to consider this certificate, the CFA Institute has made all seven modules —20 chapters — of the study course available online for free. To learn more visit:

https://www.cfainstitute.org/programs/investmentfoundations/Pages/index.aspx.

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.