

GIPS 2020: What Compliance Officers Should Know

By Amy Jones and Arin Stancil

CFA Institute's Global Investment Performance Standards (GIPS®) are the industry-accepted standard for investment management firms and asset owners to use when calculating and presenting investment performance results. It has been nearly 10 years since the industry has been given the opportunity to provide feedback on a complete edition of the GIPS standards, but that wait is over. The Exposure Draft of the 2020 Global Investment Performance Standards,¹ commonly referred to as "GIPS 2020," was released for public comment on August 31, 2018, with the comment window extending through December 31, 2018. The final version is expected to be released in mid-2019 and to become effective on January 1, 2020. GIPS 2020 includes countless revisions, additions and modifications, but following are some of the key proposed changes that we feel compliance officers should be particularly aware of. Keep in mind that all of these items are still subject to change based on public comment.

Little Change for Traditional Advisors

First off, the changes proposed in GIPS 2020 will affect all investment advisers that claim compliance with the GIPS standards to a degree. However, for firms that invest their clients' assets solely in marketable securities in generally liquid markets through separate accounts, the impact should be minimal. Such firms will still need to be aware of the coming changes, and some updates to their GIPS-compliance programs will be inevitable, but the Exposure Draft does not suggest imposing many new requirements that will require material revisions to their current processes. For the most part, the changes will introduce more options for these firms, as opposed to more rigid requirements. However, fund managers and firms that invest in privately traded assets will face more material changes.

Funds Exempt from Composite Inclusion Requirements

Compliance officers at firms that claim compliance with the GIPS standards are likely familiar with the fundamental requirement that all actual, fee-paying, discretionary portfolios managed by the firm must be included in at least one composite. The GIPS standards currently do not distinguish between account types when determining which portfolios must be included in composites—the current requirement applies to any individually managed group of investments, including separately managed accounts and pooled investment vehicles. The requirement to include all pooled funds in a composite has often been questioned, since composite information may not be meaningful to prospective pooled fund investors. It also seems unnecessarily burdensome to require firms to create single-account composites for each of their uniquely managed pooled funds. To resolve this issue, GIPS 2020 is considering relaxing this core composite construction requirement.

Under GIPS 2020, firms will still be required to allocate all actual, fee-paying, discretionary "segregated accounts" to at least one composite—with a segregated account being defined as a portfolio that is owned by a single client. Pooled funds, on the other hand, would only be required to be included in a composite if the fund strategy is being offered as a strategy available to segregated accounts. If so, a composite containing the fund and any other accounts managed to that composite strategy would need to be created and maintained. However, if the pooled fund's strategy is not offered to segregated accounts, then the fund would not need to be included in a composite. This exemption applies even if the firm manages multiple funds to the same strategy. Firms would still have the option to create single-fund composites, if desired, but would no longer have the obligation to do so.

Takeaways for compliance professionals:

From a compliance officer's perspective, this change will be an important consideration when conducting annual reviews of your firm's GIPS-compliance program in the future. Assuming this change is ratified, you may find instances where discretionary portfolios managed by your firm are not included in composites. While in the past

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1. https://www.gipsstandards.org/standards/Documents/gips_2020_exposure_draft.pdf

this would have been a clear violation of the GIPS standards, under GIPS 2020 it may be acceptable—assuming the portfolio in question is a pooled investment vehicle that is offered to multiple investors and the strategy is not offered to segregated accounts. However, as noted previously, there may be instances where funds are still included in composites. This change does not require firms to remove funds from existing composites—no alterations to current composite construction will be required. In any event, the firm’s GIPS policies and procedures will need to reflect how the firm intends to approach composite construction for pooled funds once GIPS 2020 becomes effective.

GIPS Reporting Extended to Fund Materials

Closely aligned with the proposed partial exemption of pooled funds from the composite inclusion requirements is a new proposal that will potentially require integrating GIPS reporting requirements into your firm’s presentation materials that are prepared for prospective pooled fund investors. Specifically, GIPS 2020 introduces the concept of a “GIPS Pooled Fund Report” that would be provided to prospective investors in limited distribution pooled funds. This document will be similar to the traditional GIPS Compliant Presentation—which is being rebranded as a “GIPS Composite Report.” A GIPS Composite Report includes disclosures and statistics specific to a particular composite, while a GIPS Pooled Fund Report will reflect only information for a particular pooled fund.

This requirement is being imposed for two reasons: 1) to eliminate the confusion as to whether GIPS-compliant firms are required to provide composite information to prospective pooled fund investors; and 2) to introduce a more appropriate mechanism for communicating GIPS-compliant information to prospective investors in pooled funds. Under GIPS 2020, it will be clear that prospective pooled fund investors do not need to receive composite information or a GIPS Composite Report. However, if the fund being offered is considered a “limited distribution” fund, then the firm will have an obligation to make every reasonable effort to provide prospective fund investors with a GIPS Pooled Fund Report. A limited distribution pooled fund is characterized in the Exposure Draft as a pooled fund that is not publicly available to multiple investors and where the typical marketing practice involves contact between the firm managing the pooled fund and the pooled fund prospective investor. Typically, this would include privately offered funds where the firm has a direct relationship with the fund’s prospective investors. It would not include broad distribution funds such as mutual funds, where the firm typically has little or no contact with the end investor.

Takeaways for compliance professionals:

Compliance officers will need to be aware of this change as it may require more closely aligning your firm’s fund reporting and presentation review procedures with your GIPS-compliance program. In most cases, it is likely that firms will be able to leverage existing materials to serve as their GIPS Pooled Fund Reports rather than creating new materials, but that may not always be the case. Additionally, we see this proposed requirement as potentially creating an additional compliance burden for private fund managers, who will need to initiate a process for reviewing their fund materials to ensure they meet the GIPS 2020 requirements. With that in mind, this is one area that private fund managers may want to comment on.

Broader Application of GIPS Advertising Guidelines

The GIPS Advertising Guidelines, included in Chapter III of the current edition of the GIPS standards², are an aspect of GIPS compliance that has routinely caused advisers to stumble and led to regulatory deficiencies. One reason for this is that the GIPS Advertising Guidelines offer a definitive list of requirements that must be met when firms reference their claim of GIPS compliance in an advertisement. Because the requirements are clearly specified, failing to meet one of them can create an issue that is easily identified by regulators. While the GIPS Advertising Guidelines remain voluntary, firms increasingly want to tout their investment performance and acknowledge their claim of compliance across various platforms such as websites or social networks, so it is important for compliance officers to know what is acceptable.

Like the rest of the GIPS standards, under GIPS 2020 the GIPS Advertising Guidelines are being expanded to go beyond composite reporting. Specifically, the guidance is being divided into sections dedicated to composites, limited distribution funds, broad distribution funds, and asset owners. Of particular note for firms that manage broad distribution pooled funds, the revised GIPS Advertising Guidelines outline options for referencing GIPS compliance in fund offering documents, such as a prospectus, or in fund-specific marketing materials. Firms would not be required to mention GIPS compliance in these materials but would be permitted to do so if the requirements of the GIPS Advertising Guidelines are met.

² <https://www.gipsstandards.org/standards/Pages/currentedition.aspx>

Takeaways for compliance professionals:

Once GIPS 2020 is finalized, managers of broad distribution 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 applicable requirements of the GIPS Advertising Guidelines, and compliance officers who review fund materials will need to ensure that the appropriate disclosures and statistics are included. If the firm elects not to follow the GIPS Advertising Guidelines, materials for broad distribution funds must make no reference to GIPS compliance.

Asset-Class-Specific Provisions Removed

One of the stated objectives of the GIPS 2020 initiative was to minimize asset-class-specific guidance. As a result, the existing provisions related to real estate and private equity have been removed from GIPS 2020. It is anticipated that the guidance statements focused on these topics will also be retired and the reporting requirements for portfolios that invest in such assets will fall back under the core provisions of the GIPS standards, which will generally be vehicle-specific rather than asset-class specific.

Part of the fallout from this decision was the need to reevaluate the requirement that real estate investments obtain external valuations. Specifically, under the current GIPS standards, real estate investments must have an external valuation completed at least once every 12 months—with the caveat to extend to as long as 36 months if the client agreement stipulates that less frequent valuations should be performed—by an independent, external, professionally designated, certified, or licensed commercial property valuer or appraiser.

Rather than eliminating the external valuation requirement for real estate, the decision was actually made to expand it. This concept is now proposed to extend to all private market investments, which are defined to include real estate, private equity, infrastructure, and other real assets. GIPS 2020 is proposing that all assets that fall within this category would need to obtain some form of third-party validation of valuations on an annual basis. However, the options for the type of validation being performed will not be limited to a comprehensive external valuation. It is being suggested that firms would also have additional options of either relying on a review of valuation inputs and assumptions performed by an external third party or relying on a financial statement audit.

This change would allow real estate managers to potentially relax the frequency of appraisals on their investments, which should be a welcome relief due the significant expense associated with them. Although this change would expand the scope of the investments subject to some form of external valuation, it is not likely to create an additional burden for managers of private market investments who typically receive annual financial statement audits.

Takeaways for compliance professionals:

From a compliance perspective, this change would likely necessitate performing an assessment on the type of assurance your firm currently receives regarding the valuation of privately held assets and whether existing procedures would satisfy the proposed requirements. This assessment should include an evaluation of the financial statement audits received for the applicable funds and whether they sufficiently cover the procedures for fair valuing the private market assets held by the fund. If the procedures being performed are found to be adequate, the firm may be able to scale back the type or frequency of other valuation procedures being performed.

Deadline for Updating GIPS Materials

Currently, the GIPS standards do not impose a strict deadline for when GIPS-compliant presentation materials need to be updated. Materials need to be updated with information as of the most recent year end, but how quickly after year end the information must be included is not specified. This has led to inconsistent industry practices, with some firms updating their materials in a more timely manner than others. GIPS 2020 seeks to introduce more standardization with regard to the timing of updates. The Exposure Draft proposes that GIPS Composite Reports and GIPS Pooled Fund Reports would need to be updated with information through the most recent annual period end within six months of that annual period end.

Takeaways for compliance professionals:

If this requirement remains following the comment period, compliance officers will need to implement procedures for ensuring that their GIPS Composite Reports and GIPS Pooled Fund Reports are all being updated prior to June 30th of each year.

Portability Reverts to Optional

The requirements for investment portability—the ability of an investment management firm to present a performance track record that was produced at a prior firm—differ somewhat in the GIPS standards from what is typically expected by regulators. In particular, established U.S. regulatory precedent holds that portability is permissible if certain parameters are met, though going through the process of porting a track record is not required. However, under the GIPS standards, if the portability requirements are satisfied, the firm has an obligation to port the associated investment track records.

GIPS 2020 is taking the approach that mandating firms to port investment track records is unnecessary, because the requirements for portability are stringent and firms will generally only satisfy them if there is a desire to do so. Therefore, under GIPS 2020, portability is not required, but is permissible if the applicable criteria are met.

Takeaways for compliance professionals:

This change should help simplify the compliance efforts associated with mergers and acquisitions. Firms will no longer have an obligation to assess each track record maintained at the prior firm and determine whether it satisfies the portability requirements. Rather, the firm will be allowed to focus on the track records that they have an interest in porting. This approach also better aligns with established regulatory precedent.

GIPS Assets Diverge from Regulatory AUM

The GIPS standards require firms to report their total firm assets as of each year end. The GIPS glossary defines total firm assets as the sum of all discretionary and non-discretionary assets for which a firm has investment management responsibility. This figure may be the same as what your firm reports as Regulatory Assets Under Management (RAUM), but it may also be different for several reasons, including the manner in which the firm has been defined for GIPS-compliance purposes. Under GIPS 2020, the level of divergence between RAUM and GIPS total firm assets may increase, particularly as it relates to the treatment of uncalled commitments.

Per the instructions for Form ADV, RAUM should include the contractual amount of any uncalled commitment pursuant to which a person is obligated to acquire an interest in, or make a capital contribution to, a private fund.³ In direct contrast, GIPS 2020 is proposing that total firm assets presented in GIPS Reports must not include uncalled committed capital. This is an unusual approach for the GIPS standards to take, as it deviates from established regulatory precedent and common industry practice. GIPS 2020 is trying to introduce a consistent practice here, as this issue is not directly addressed in the current edition of the GIPS standards, but commenters may want to provide feedback if they feel the chosen approach is a misstep.

Takeaways for compliance professionals:

Regardless of the ultimate decision on this item, compliance officers should keep in mind that it is not uncommon for a firm's GIPS total firm assets to be different from RAUM. The reasons why the figures differ should be documented, and support should be maintained for both figures.

Verification

Verification is a voluntary process where a GIPS-compliant firm can engage an independent third-party to assess whether the firm has complied with the requirements of the GIPS standards on a firm-wide basis and has developed policies and procedures designed to achieve compliance. A verification is conducted on the entire firm, not a particular composite or fund. In addition to verification, a GIPS-compliant firm may also elect to have a performance examination conducted on a particular composite. A performance examination is the detailed testing of a composite and its associated compliant presentation for adherence to the requirements of the GIPS standards.

Currently, the guidance on verification and performance examinations is spread out over several documents including Chapter IV of the GIPS standards⁴ and multiple guidance statements. GIPS 2020 attempts to consolidate the guidance related to verification. To that end, a document outlining all of the verification and performance examination procedures is being prepared which will be released for public comment separate from GIPS 2020. This document is expected to be made available to the public on October 31, 2018, and like GIPS 2020, will be open for comment until December 31, 2018.

3. <https://www.sec.gov/about/forms/formadv-instructions.pdf>

4. <https://www.gipsstandards.org/standards/Pages/currentedition.aspx>

Takeaways for compliance professionals:

Compliance officers will want to be familiar with any proposed revisions to the required verification procedures before they become effective. It is possible that the new guidance will be somewhat more prescriptive and detailed, which may result in verifiers requesting different information from what they have in the past.

Timelines

The Exposure Draft including the core provisions of GIPS 2020 is now available on the GIPS standards website⁵. Additionally, the verification and performance examination procedures sections are expected to be available for comment on October 31, 2018. The comment window for both documents ends on December 31, 2018. The comments will then be evaluated and changes will be incorporated into the final version of GIPS 2020, which is targeted to be issued to the public on June 30, 2019. GIPS 2020 is then scheduled to become effective on January 1, 2020.

Following the release of the final version of GIPS 2020 and leading up to the effective date, firms should begin the process of updating their GIPS policies and implementing new procedures to address all amendments to the GIPS standards. Firms should complete this process prior to year-end 2019 so they are ready to comply with any new requirements related to input data, performance calculations, or composite maintenance by the start of 2020.

Though the effective date of GIPS 2020 will be January 1, 2020, information included in a firm's GIPS Reports will not necessarily need to be presented and reported in accordance with the new reporting requirements until results for periods beginning on or after January 1, 2020 are included in the materials. If the firm elects to adhere to the minimum requirements of updating GIPS Reports with annual results within six months after the calendar year end, they would then have until July 1, 2021 to incorporate all new GIPS 2020 presentation and reporting requirements.

GIPS 2020 Key Dates

- **NOW:** GIPS 2020 Exposure Draft available for comment
- **October 31, 2018:** Verification procedures exposure draft expected to be released
- **December 31, 2018:** Window for public comment closes
- **June 30, 2019:** Target release date of final version of GIPS 2020
- **December 31, 2019:** Deadline for compliant firms to amend GIPS-compliance program, including the firm's GIPS manual
- **January 1, 2020:** GIPS 2020 becomes effective
- **July 1, 2021:** YE 2020 results must be included in GIPS Reports and meet GIPS 2020 reporting requirements

Invitation to Comment⁶

Prior to these proposed changes becoming effective, the Exposure Draft gives us all the opportunity to provide feedback on the direction the GIPS standards are moving toward. It is paramount that this feedback includes the perspective of compliance professionals who will play a key role in ensuring their firms are able to continue to comply with the GIPS standards or who hope to comply in the future. If you disagree with any of the proposed changes, make sure your voice is heard. Alternatively, if you agree with certain items, make sure that is communicated as well. The Exposure Draft has various comments and questions imbedded in it in order to elicit feedback on particular topics. When considering whether you or your firm will submit comments on the Exposure Draft, keep in mind that you do not need to respond to each of these items. In fact, your response can be limited to a specific element of the draft that you have the strongest opinion about. If your firm has policies against making public comments, you can request that your feedback be kept private.

5. https://www.gipsstandards.org/standards/Documents/gips_2020_exposure_draft.pdf

6. <https://www.gipsstandards.org/news/Pages/detail.aspx?ID=85>