

2020 GIPS® Standards – Use of Carve-Outs

Under the 2020 GIPS standards, firms are allowed to include carve-outs with allocated cash in composites. This is very positive news as firms often have a desire to demonstrate the performance of sub-strategies that are offered as standalone portfolios or components of multi-strategy portfolios. It is expected that a greater number of advisers, including private wealth managers and firms who manage private market investments, will find the options available to be more favorable than what was available under the 2010 GIPS standards.

A carve-out is a portion of a portfolio that is, by itself, representative of a distinct investment strategy. It may be used to create a track record from multi-strategy portfolios for a narrower mandate. It is common for a firm to manage several asset classes for a client and those assets will be held in one balanced/multiple asset class portfolio. Presenting the track record of these portfolios in one composite doesn't always produce a meaningful representation of the firm's track record since each portfolio often varies significantly. Even when firms have created target asset allocation balanced/multiple asset class composites, the results of such composites do not always represent the strategy that is offered to a prospective client. This is because of the customization that is done for each portfolio to address the specific objectives and needs of the client. In these situations, the construction of carve-out composites is much simpler, more intuitive, and can provide more meaningful information to prospective clients than a composite that represents the combined performance of a mix of blended portfolios with diverse components and allocations.

Under the new guidance, firms will be able to showcase the performance of a specific asset class and create a meaningful track record that is representative of an investment strategy that the firm offers. Types of carve-outs other than those based strictly on asset class could include specific sectors, industries, market cap size ranges or style types. Below is a summary of the requirements and options detailed in the [2020 edition of the GIPS standards](#).

Fundamental Requirements

- Any carve-out included in a composite must be representative of a standalone portfolio managed or intended to be managed according to that strategy.
- Any carve-out included in a composite must include cash and any related income.
- Cash may be:
 - Accounted for separately, or
 - Allocated synthetically to the carve-out on a timely and consistent basis
- When carve-outs are included in a composite, the firm must create carve-outs from all portfolios and portfolios segments within the firm managed to the same strategy and include those carve-outs with allocated cash in the carve-out composite.
- When the firm manages standalone portfolios to the same strategy as the carve-outs, the firm must create a separate composite for the standalone portfolios.
- Firms cannot combine different carve-outs to create a simulated strategy and present it as a composite.

Cash Allocation Options

- Specific methods to allocate cash to carve-outs are not prescribed within the 2020 GIPS standards, though the upcoming revised GIPS Handbook is expected to outline potential options. Among those

will likely be the two options that were allowed prior to January 2010 as outlined in the Guidance Statement on the Treatment of Carve-Outs, which were:

- Beginning-of-Period Allocation: based on the proportionate weight of the carve-out segment to the total portfolio as of the beginning of the period.
- Strategic Asset Allocation: based on the target strategic allocation of the carve-out segment in relation to the total portfolio.

Presentation Requirements

- Include “carve-out” in the composite name
- Disclose that the composite includes carve-outs with allocated cash
- Disclose the policy used to allocate cash to carve-out returns
- Present the percentage of composite assets represented by carve-outs with allocated cash as of each annual period end
- If a composite of standalone portfolios exists, disclose that the GIPS Composite Report for the composite of standalone portfolios is available upon request and present the return for the composite of stand-alone portfolios for each annual period and the composite assets as of each annual period end

Balanced Composites

- If all segments of a multi-asset class portfolio are carved out and included in separate composites, firms will no longer be required to include the combined multi-asset class portfolio in a composite *unless it represents a strategy that is offered to prospective clients as a segregated account.*

Where to Start?

- Determine what sub-strategies the firm manages in a manner that is representative of standalone portfolios dedicated to the particular strategy.
- Confirm that performance is separately tracked and available for any segments of multi-asset class or multi-strategy portfolios for which there is a desire to and the firm determines that it would be appropriate to create carve-outs from.
- If segments of multi-asset class or multi-strategy portfolios are not managed separately with their own cash, determine a cash allocation methodology that will be utilized.
- Create composites that include all portfolios that include a segment that is managed to the carve-out strategy.
- Create separate composites for standalone portfolios managed to the same strategy as each carve-out.
- Note that all policies related to the calculation of portfolio-level performance or composite inclusion will need to be applied at the carve-out level, including minimum account size limits and large and/or significant cash flow policies.
- Contact us and we can help you to determine the best approach for your firm!

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We partner with clients and actively work as a direct extension of their in-house team to document GIPS policies and procedures, determine criteria for composite construction, calculate performance, create the firm’s list of composites, maintain GIPS compliant disclosure presentations, and liaison with the firm’s verifier to oversee an efficient and timely verification project. Additional information can be found at www.GuardianPerformanceSolutions.com.