Time is Almost Up – Has Your Firm Adopted the 2020 GIPS® Standards?

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CFA Institute's Global Investment Performance Standards (GIPS®) are generally accepted, ethical principles for calculating and presenting investment performance. As firms that claim compliance with the GIPS standards know well, the GIPS standards are not a stagnant set of rules. They evolve over time to keep up with the changing landscape of the investment management industry. The most recent revisions are encapsulated in the **2020 edition of the GIPS standards**, which was adopted in 2019 and became effective on January 1, 2020. Though the underlying input data and calculation requirements must be applied from January 1, 2020 forward, performance presentation materials are not required to be prepared in accordance with the new guidelines until performance information for periods ending on or after December 31, 2020 is included. As a result, some firms have delayed fully adopting the 2020 edition of the GIPS standards.

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Compared to previous times when substantial changes were made to the GIPS standards, the 2020 edition does not impose many new requirements on firms that are already claiming compliance. Instead, in many instances new options have been introduced without removing the old ones. However, that does not mean that converting to the 2020 edition is a simple exercise. For firms that are still following the 2010 edition of the GIPS standards, there are several steps that need to be taken and decisions that need to be made in order to ensure ongoing compliance – many of which need to be completed long before getting to the stage of updating presentation materials. Following are some key items that all GIPS-compliant firms need to be aware of and should be addressing as we flip the calendar to 2021.

GIPS Compliance Policies & Procedures

A firm's GIPS compliance policies and procedures memorialize how the firm has met all of the requirements of the GIPS standards. One of the most important tasks that firms claiming GIPS compliance should do now is review and revise their existing policies and procedures to ensure they address all of the requirements of the 2020 edition. While doing this, firms should also confirm that what is documented in the policies and procedures aligns with the firm's actual business practices.

There are a number of new options introduced in the 2020 edition of the GIPS standards and firms will need to evaluate how they will approach each option. 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, firms are 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 (in contrast to a product offered to multiple investors, like a pooled fund). This change does not mean that firms will need to remove all of their pooled funds from composites – though they have the option of doing so if the fund strategy is not offered as a segregated account. As a result, each firm that manages pooled funds needs to consider what the best approach is

Continued on page 21

Continued from page 20

for them, and document its decision in its GIPS policies and procedures.

Expanding Composite Descriptions

One key change in the 2020 edition of the GIPS standards that has largely floated under the radar is the additional elements that are required to be included in composite descriptions. A composite description explains the investment mandate, objective, or strategy of the composite. **Composite descriptions** must be disclosed in GIPS Composite Reports and must be compiled in a list maintained by the firm that is made available upon request to prospective clients.

The 2010 edition of the GIPS standards included some general examples of what type of information should be included in a composite description, but the guidance was not overly prescriptive. The 2020 edition, however, details three specific items that must be addressed:

- The material risks of the composite's strategy;
- How leverage, derivatives, and short positions may be used if they are a material part of the strategy; and
- If illiquid investments are a material part of the strategy.

While the latter two items will only be applicable to certain composites – and may not apply at all to some firms – every firm will need to consider the material risks associated with its strategies and update its composite descriptions to ensure they are properly addressed. Notably, the intention of this requirement is not to mandate that composite descriptions cover every potential risk associated with the strategy. For example, it is not expected that a composite description will describe general risks associated with investing. Rather, the risks identified within the description should be specific to the strategy. These may include investment-specific, concentration, interest rate, liquidity, counterparty, or currency risks. Firms should review all of their composite descriptions and expand them as necessary to meet this requirement. When assessing whether the composite description includes adequate disclosure, a firm should start by reviewing its marketing materials, investment policy statements, and Item 8 of the Form ADV Part 2 Brochure.

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Another change to consider related to composite descriptions is that firms are no longer permitted to define composites based on portfolio type. If a firm has established composites that separate pooled funds and segregated accounts that are managed to the same strategy, such composites will need to be discontinued or redefined to either: (i) include all portfolios managed to the strategy going forward; or (ii) address other differentiating details related to the implementation of the investment strategy rather than portfolio type alone (*e.g.,* diversification or liquidity constraints that impact the manner in which the strategy is implemented).

Pooled Fund Lists

In addition to maintaining the list of composite descriptions, GIPS-compliant firms that manage pooled funds are now required to maintain a list of **limited distribution pooled funds (LDPFs)** and/or a list of **broad distribution pooled funds (BDPFs)**, depending upon the type of funds that the firm manages. BDPFs are defined as pooled funds that are regulated under a framework that would permit the general public to purchase or hold the pooled fund's shares and are exclusively offered in one-on-one presentations. LDPFs, on the other hand, are defined simply as any pooled funds that are not broad distribution pooled funds. The list of LDPFs must include descriptions for each limited distribution pooled fund, similar to the list of composite descriptions. However, the list of BDPFs is not required to include descriptions. For both pooled fund lists, only active funds are required to be included on the list – funds that have closed can be excluded.

The pooled fund lists must be made available upon request to prospective pooled fund investors, though the lists may be tailored to only include funds in which that particular prospective investor would qualify to invest. With regard to the list of BDPFs, it is acceptable for the list 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. Additionally, if desired, the firm can aggregate the two lists of funds, along with the list of composite descriptions, into a single list of strategies that indicates the type of portfolios (segregated accounts or pooled fund variations) in which the strategy is offered.

For firms that manage a large number of pooled funds, the process of creating the pooled fund lists – particularly the list of descriptions for LDPFs – may be an extensive project. With that in

Continued on page 22

Continued from page 21

mind, firms that have not already started the process of creating the pooled fund lists should begin as soon as possible.

GIPS Reports for Pooled Funds

The GIPS standards continue to require compliant firms to make every reasonable effort to provide GIPS Reports to all prospective clients. Expanding on this concept, the 2020 edition introduced a new requirement to also provide GIPS Reports to certain **prospective pooled fund investors**. While firms are not required to send GIPS Reports to BDPF prospective investors, an appropriate GIPS Report must now be delivered to LDPF prospective investors. Firms are given the option of providing to prospective LDPF investors either a GIPS Pooled Fund Report or a GIPS Composite Report for the composite that includes the specific pooled fund being offered. Firms that have already included their LDPFs in composites have the option of continuing to maintain the composites, or they could decide to discontinue the pooled fund composites as long as the strategy is not also offered to segregated accounts. If the firm discontinues those composites, GIPS Pooled Fund Reports specific to each fund will need to be created and distributed going forward to prospective LDPF investors. If composites with pooled funds continue to be maintained, the firm can present prospective LDPF investors with the GIPS Composite Report for the composite that includes the pooled fund.

While choosing to continue to only produce GIPS Composite Reports and initiating a process to provide them to prospective LDPF investors may seem like the simplest approach to meeting this requirement, this option still has its challenges. In particular, a GIPS Composite Report that is provided to a prospective pooled fund investor needs to be tailored to include the **pooled fund's fee schedule** (rather than the separate account fee schedule typically presented in GIPS Composite Reports) as well as the **current expense ratio** for the fund. This may lead the firm to creating and maintaining multiple versions of each GIPS Report, which can create various operational complexities.

Alternatively, if GIPS Pooled Fund Reports are going to be created, the firm 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.

Key Changes to GIPS Reports

- ✔ Comply with revised compliance statement for verified firms.
- ✔ Include CFA Institute trademark disclaimer.
- ✔ Disclose that a list of pooled fund descriptions for limited distribution pooled funds (LDPF) and a list of broad distribution pooled funds (BDPF) are available, if applicable.
- ✔ Disclose the composite inception date in addition to the creation date.
- ✔ Present total firm assets rather than the composite assets as a percentage of firm assets.
- ✔ Disclose whether risk measures are calculated using gross-of-fees or net-of-fees returns.
- ✔ Customize the fees schedule to be appropriate to the intended audience (or disclose all fee options).
- ✔ Disclose how leverage, derivatives, and short positions have been used historically (in addition to disclosing how these instruments may be used, which must now be included in the composite description).

Tracking Distribution of GIPS Reports

Another new requirement that has created significant challenges for some firms is the necessity to be able to demonstrate that every reasonable effort has been made to provide GIPS Reports to prospective clients and prospective LDPF investors. Meeting this requirement essentially requires firms to track how and when GIPS Reports are distributed. As firms often have various communication channels through which they interact with prospects and disseminate marketing collateral – including one-on-one marketing, responses to RFPs, submissions to consultant databases, and arrangements with wrap sponsors and other intermediaries – tracking all of these interactions and confirming if and when a GIPS Report was provided can be difficult. Effectively demonstrating proper delivery of GIPS Reports may also require coordination across multiple departments. Some of the ways in which firms are managing this requirement is by utilizing their Customer Relationship Management (CRM) systems, developing custom technology solutions, or simply maintaining Excel spreadsheets. Each firm's approach will likely be somewhat unique, but the end result needs to be the same – establishing a process that will demonstrate that GIPS Reports were **properly delivered** to the parties required to receive them.

GIPS Trademark Usage

With the implementation of the 2020 edition of the GIPS standards, new requirements have been established to protect the use of the term "GIPS," which

Continued on page 23

 Continued from page 22

is a registered trademark owned by CFA Institute. Specific disclaimers must be included whenever the GIPS standards are referenced in marketing materials or other forms of communication. These requirements are outlined in detail in the GIPS Trademark Usage guidelines, which are posted on CFA Institute's website. A key consideration is that these requirements are not limited to GIPS Reports – they apply to any materials that reference the GIPS standards, including articles, newsletters, advertisements, or websites. Firms should review all of their materials that mention the GIPS standards and ensure the proper disclaimers have been added.

Verifier Independence

Verification is a process by which an independent third-party verifier conducts an assessment of a firm's GIPS compliance program. Though verification is not required, it is strongly recommended and brings credibility to a firm's claim of GIPS compliance. For a verifier to issue an unbiased opinion, it is essential that they maintain independence from the firm being verified. Though independence is primarily the responsibility of the verifier, the 2020 edition of the GIPS standards establishes certain expectations of the firm to **confirm independence** is maintained. First, the firm should obtain a summary of the verifier's policies for ensuring independence and have sufficient discussions with the verifier to understand the policies. Additionally, the firm must gain an understanding of any issues encountered and the conclusions reached by the verifier regarding independence.

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Prior to the beginning of each verification, firms should request and receive from their verifier the summary of the verifier's **independence policy** along with acknowledgement of any issues identified with respect to the specific verification engagement. If potential independence conflicts are identified, the verifier and the firm must determine whether the potential issues can be resolved such that independence can be achieved. If independence issues cannot be resolved, the firm must not proceed with the verification and, if desired, begin the process of identifying an alternate verifier.

Conclusion

This article addresses only a small subset of the recent changes to the GIPS standards. Firms need to fully assess all of the changes to ensure they are able to confidently and accurately continue to claim compliance. Notably, when it comes time to update your GIPS Reports, there will be more significant changes which will need to be addressed once year-end 2020 performance is included.

For more information, you can download a free PDF copy of the 2020 edition of the GIPS standards as well as the full 566-page 2020 GIPS Standards Handbook for Firms – which aggregates the 2020 edition of the GIPS standards, related discussion, Guidance Statements, and selected Q&As into a single volume – from the CFA Institute website.

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