GLOBAL INVESTMENT PERFORMANCE STANDARDS (GIPS®) 2020

A NEW IMPETUS FOR GIPS STANDARDS

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The final version of the new Global Investment Performance Standards (GIPS®), known as "GIPS 2020", was published in June 2019. Created in the late 90's, GIPS standards have been completely revised by the CFA Institute and adapted to consider, among other things, the rise of alternative management. This revision has also provided the opportunity to harmoniously integrate the different rules and recommendations issued over the past 10 years. The GIPS 2020 came into effect on 1 January 2020.

GIPS standards were introduced 20 years ago (and already reviewed in 2010) to meet the growing need for institutional investors, including American pension funds, to be able to compare various investment management capabilities. Beyond the sole performance calculation, GIPS standards enable homogeneous investment performance presentations, requiring exhaustiveness in the chosen perimeter (the "Firm") and organized by type of investment management capability and/or asset classes (the "Composites").

Today, over 1,700 investment management firms declare themselves "GIPS compliant" with an increasing proportion in Europe (around 200).

The novelty of the GIPS 2020 stands firstly in a simplified reading of the standards thanks to the publication of three separate handbooks: for asset managers ("firms"), for institutional investors ("asset owners") and the last for verifiers.

Thus, emphasis has been placed on something new from the focus of recent years: the use of the GIPS standards by institutional investors for the presentation (and therefore the calculation) of their own investment performance. Many asset owners already request application of GIPS standards from investment management firms in their tenders so that they can easily and exhaustively study and compare their investment performances.

The revision of GIPS standards follows numerous discussions with various stakeholders. The adjustments implemented since 1 January 2020 meet the need to facilitate the adoption of GIPS standards by both traditional and alternative investment management firms, including private equity and real estate investment managers.

Although the GIPS standards having been international best practice in terms of performance calculation and reporting for the past two decades, GIPS 2020 represents a mini-revolution in the investment management industry. The record number of participants in the last annual CFA Institute's GIPS Conference in September 2019 is a prime example of the continued interest.

This article provides the key points for understanding the changes made in the 2020 version of the GIPS standards.

TO START, A FEW REMINDERS CONCERNING GIPS STANDARDS

By establishing standardized requirements for the calculation and presentation of investment performance, GIPS standards enable:

- For asset managers: competition on an equal footing on all markets
- For asset owners: a comparison of the past performance of asset managers
- For all stakeholders: a sincere and fair presentation of the performance of the invested assets.

In the absence of such a standard, comparing the investment performance of multiple asset managers would be particularly difficult, in a given country, on a world scale. In addition, asset managers can make decisions that result in intentional or unintentional misstatements in investment performance reporting and/or communication. Here are some examples:

- Selective presentation of investment periods and/or portfolios
- Incorrect aggregation of portfolios whose investment strategies have nothing in common
- Use of an inappropriate calculation methodology in order to overestimate investment performance
- Use of a book value that does not represent the fair market value
- Reference to a benchmark that is not representative of the investment strategy.

GIPS standards are a set of rules based on the fundamental principles of full disclosure and fair presentation of investment performance. Asset managers that comply with GIPS standards offer their customers and prospects the opportunity to fairly assess their past performance.

A LEXICON OF KEY CONCEPTS

Firm: The entity defined for compliance with the GIPS standards; an investment management firm, subsidiary, or division presented to clients or prospects as a separate business entity.

Portfolio: An individually managed group of investments that may be:

- A segregated account, owned by a single client; or
- A pooled fund, whose ownership interests may be held by more than one investor.

Composite: An aggregation of one or more portfolios that are managed according to a similar investment mandate, objective, or strategy.

Wrap fee portfolio:
A portfolio for which the sponsor charges investment management services through a bundled fee that is typically all-inclusive, asset-based, and includes a combination of investment management fees, transaction costs not separately identifiable, custody fees, and administrative fees.

Carve-out: A portion of a portfolio that is, by itself, representative of a distinct investment strategy, typically used to create a track record for a narrower mandate from a multiple-strategy portfolio managed to a broader mandate.

Overlay strategy:
A strategy in which the management of a certain aspect of an investment strategy is carried out separately from the underlying portfolio, typically designed either to limit or maintain a specified risk exposure that is present in the underlying portfolio, or to profit from a tactical view on the market by changing a portfolio's specified risk exposure.

Money-weighted return:
The return for a period that reflects the change in value and the timing and size of external cash flows.

Time-weighted return:
A method of calculating period-by-period returns that reflects the change in value and negates the effects of external cash flows.

TIPS FOR READING GIPS 2020

- There are no longer separate sections per asset class for real estate, private equity, and wrap fee portfolios
- Real estate and private equity are now part of a larger category, called "private market investments"
- Each section includes provisions for each specific asset class or type of asset (for example, overlays, carve-outs, wrap fees, private market investments etc.)
- The effective dates of application of the provisions are now mentioned at the bottom of the page
- The terms defined in the glossary are in capital letters.

GIPS FOR FIRMS: MAIN NEW FEATURES, CLARIFICATIONS, AND/OR DEVELOPMENTS

- Firms now have **a maximum of one year** to update their GIPS reports at the end of the most recent period, when no time was previously required.
- **Composites vs. pooled funds:**
  - Firms must create composites for strategies that are managed or intended to be marketed in the form of segregated accounts
  - All discretionary segregated accounts paying management fees must be included in at least one composite
  - All discretionary pooled funds paying management fees must be included in all composites for which they meet the definition
  - Firms are not obliged to create a composite that includes only one or more pooled funds, if the strategy of this fund(s) is not intended to be marketed in the form of segregated accounts
  - Firms may close out composites that include only one or more pooled funds, if the strategy of that fund(s) is not distributed like the strategy of a composite.
- Firms must **classify and list** each of their portfolios in one of the following categories:
  - **Segregated account:** A portfolio owned by a single client
  - **Broad distribution pooled fund:** 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
  - **Limited distribution pooled fund:** Any pooled fund that is not a broad distribution pooled fund.
- Some **changes in terminology** have been made:
  - "Trading costs" are replaced by **"transaction costs"**. Furthermore, if these are not known, they can now be estimated to calculate the net performance (with some required disclaimers)
  - "Wrap fees/separately managed accounts" are renamed **"wrap fee portfolios"**
  - "Compliant presentations" are replaced by **"GIPS reports"**. There are now two types of GIPS reports for firms: GIPS composite reports and GIPS pooled fund reports (required for limited distribution pooled funds and recommended for broad distribution pooled funds).
- **Carve-outs:** GIPS 2020 offers more flexibility in terms of cash management for carve-outs by reintroducing the concept of synthetic cash allocation (applicable retroactively, on the whole track record).
  However, creating a carve-out with independent cash

management remains the preferred option. Thus, as soon as the firm gets a standalone portfolio managed according to the same strategy as the carve-out(s) with a synthetic allocation of cash:
- The firm must create a composite that includes only standalone portfolio(s)
- The GIPS Composite Report of the composite that includes the carve-out(s) with a synthetic allocation of cash must also present the performances and the outstanding amounts of the composite that include only the standalone portfolio(s).

- **Money-weighted returns:** Firms may present money-weighted returns only if the firm has control over the external cash flows into the portfolios in the composite or pooled fund and the portfolios in the composite have or the pooled fund has at least one of the following characteristics:
  - Closed-end
  - Fixed life
  - Fixed commitment
  - Illiquid investments as a significant part of the investment strategy.

  Other developments should be noted for firms that present money-weighted returns.

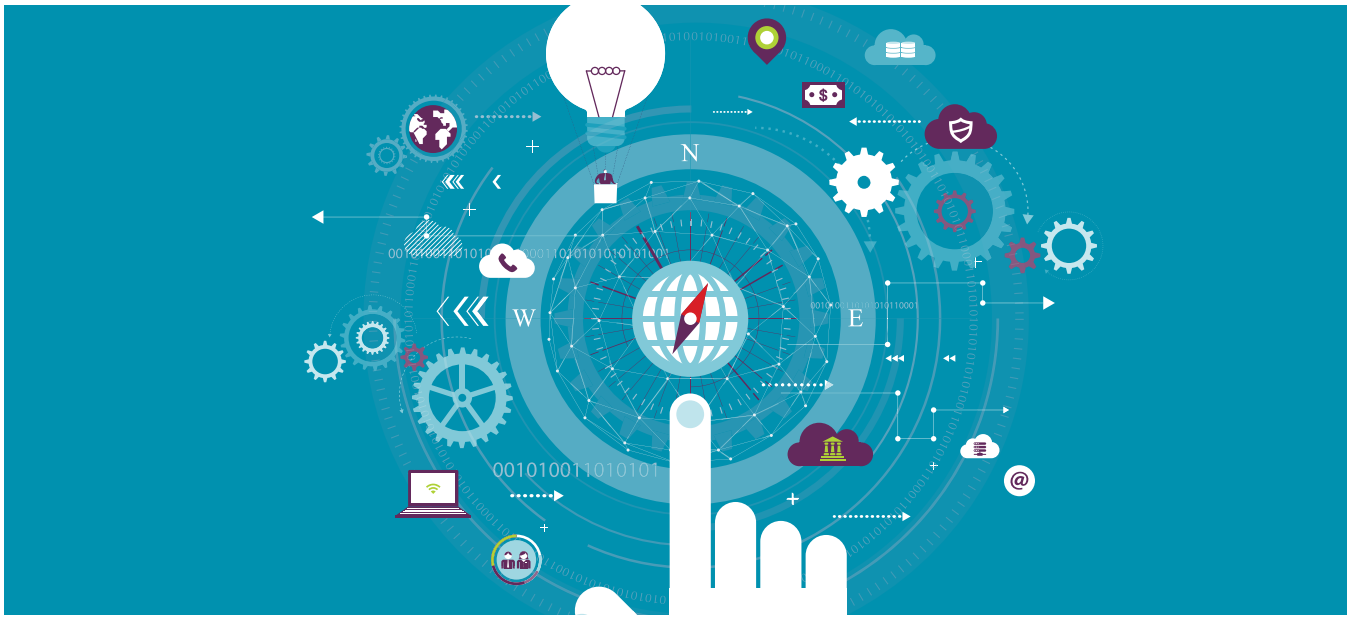
- **Overlay strategies:** More details are provided on the methods for calculating and reporting overlay strategies. Also, for overlay strategy composites, firms can now choose between presenting the firm's total assets or the firm's total overlay exposure.

- **Firms' and composites' assets:**
  - Uncalled committed capital and advisory-only assets must not be included in the firm's total assets. However, it is now possible to present them separately or combined with the firm's total assets, if the latter in the strict sense is presented and that the comments and details necessary for the good understanding of the users are well included
  - It is no longer possible to present the composite's total assets as a percentage of the firm's total assets, unless the firm's total assets are also presented, and this for each period-end.

- **Real estate:**
  - Investments in real estate in open-end funds must benefit from external valuation at least every 12 months
  - Investments in real estate that are not in open-end funds must obtain an external valuation at least every 12 months, unless the contract with the client stipulates another frequency. In this case, the portfolio must benefit from an external valuation at least every 36 months or at the frequency defined in the client's contract if it is less than 36 months
  - Investments in real estate must be accounted for according to the fair value principle and the annual financial statements must be audited by an independent accounting firm.

- **GIPS advertising:** There are three options available to firms when marketing a strategy:
  - Prepare a GIPS Advertisement on a composite, a limited distribution pooled fund, or a broad distribution pooled fund by following the GIPS Advertising Guidelines
  - Prepare a GIPS Advertisement and include a GIPS report
  - Do not mention GIPS standards.

  The GIPS Advertising Guidelines have been broadly expanded in GIPS 2020. The main points to remember are that:
  - The returns of the composites/pooled funds presented in the GIPS Advertisement must be derived from the returns included in the GIPS reports
  - Requirements differ depending on the type of returns presented in the GIPS Composite Report (money-weighted returns vs. time-weighted returns)
  - The concept of broadly distributed pooled fund is now included in the GIPS Advertising Guidelines and replaces the obligations



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previously included in the Guidance Statement on Broadly Distributed Pooled Funds.

- **Sunset provision:** Some disclaimers must be included for a minimum of one year and can now be withdrawn if the firm determines that the disclaimer is no longer relevant for interpreting the performances presented, such as:
  - Significant events that help a prospective client or investor interpreting a GIPS report
  - Changes in the name of a composite or a pooled fund
  - Retroactive change of a benchmark
  - Corrections of material misstatements
  - Change in the type of returns presented (money-weighted returns vs. time-weighted returns).

EFFECTIVE DATE

GIPS 2020 is effective as of 1 January 2020:

- GIPS Reports that include performance for **periods ending on or after 31 December 2020 must be prepared in accordance with GIPS 2020**.
- GIPS Reports that include performance for **periods ending before 31 December 2020** (for instance 30 June 2020) **may still be** prepared in accordance with the **2010 edition** of the GIPS standards.
- Firms can choose to adopt GIPS 2020 early, but only full adoption is possible i.e. **no cherry picking** due to early or progressive adoption.

Some new GIPS 2020 provisions are subject to interpretation, so they have been gradually explained through communications from the CFA Institute since the beginning of 2020.

CONCLUSION

Technical aspects of GIPS standards are important to consider, but their adoption must come from a desire for openness and transparency. If integrated into a reliable and fluid reporting process, their implementation is generally not a source of concern or does it bear excessively high costs.

Upstream, the definition of the firm and composites will be cause for reflection on the proposed range as well its strengths and weaknesses.
Reliable technology and data are essential for the calculation and presentation of GIPS compliant investment performances, but this must always be the case regardless of the size of the investment management firm, if only to satisfy requests from clients and other third parties.
Compliance with GIPS standards is essential for an asset manager that offers its services, but also for an asset owner that must answer for its investment management, including and especially when it is delegated to third party managers, vis-à-vis the stakeholders who are their principal concern and their representatives within an oversight body..

TO GO FURTHER... USEFUL LINKS:

2020 GIPS standards:

- **For firms:** https://www.cfainstitute.org/en/ethics/codes/gips-standards/firms
- **For verifiers:** https://www.cfainstitute.org/en/ethics/codes/gips-standards/verifiers
- **For asset owners:** https://www.cfainstitute.org/en/ethics/codes/gips-standards/asset-owners

Presentations from the 23rd Annual Conference on GIPS standards:

- **2020 GIPS standards update:** http://cfainstitute.gallery.video/gips2019/detail/video/6085332667001/gips-2020-update?autoStart=true
- **Topics for high net worth firms:** http://cfainstitute.gallery.video/gips2019/detail/video/6085332667001/gips-2020-update?autoStart=true
- **Alternative investments:** http://cfainstitute.gallery.video/gips2019/detail/

TO THE POINT

- GIPS standards were introduced 20 years ago to meet institutional investors' growing needs to be able to compare various investment management capabilities.
- The adjustments implemented since 1 January 2020 meet the need to facilitate the adoption of GIPS standards by both traditional and alternative investment management firms, including private equity and real estate investment managers.
- Technical aspects of GIPS standards are important to consider, but their adoption must come from a desire for openness and transparency. If integrated into a reliable and fluid reporting process, their implementation is generally not a source of concern or does it bear excessively high costs.
- Compliance with GIPS standards is essential for an asset manager that offers its services, but also for an asset owner that must answer for its investment management, including and especially when it is delegated to third party managers, vis-àvis the stakeholders who are their principal concern and their representatives within an oversight body.