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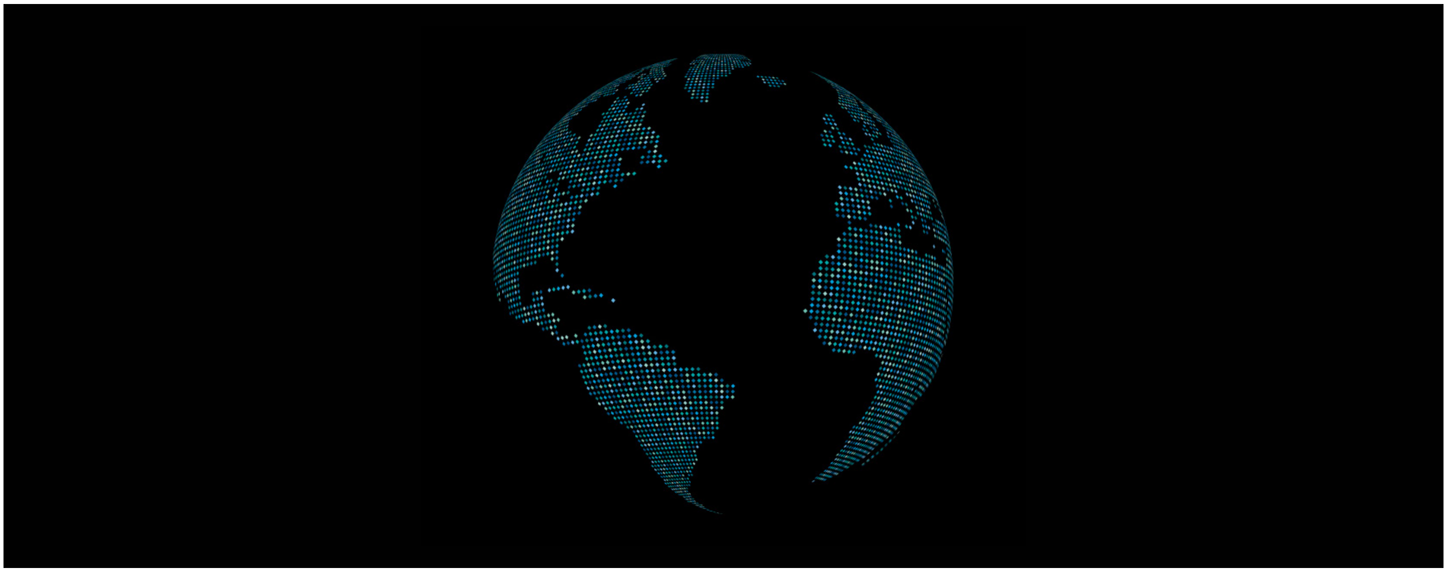

GIPS 20/20: Observations on the approaching standards update

Introduction

The CFA Institute's planned publishing of the GIPS 20/20 Exposure Draft (Draft) in early 2018 will be a milestone in the "updating, revising and reimagining" of the Global Investment Performance Standards (GIPS®).[1] The Draft will provide a first look at the proposed refresh of current GIPS standards adopted in 2010.

The standards provide investment management firms with a framework for the calculation and presentation of investment performance based on the principles of fair presentation and full disclosure. "GIPS 20/20" embodies the institute's intention to present a clear vision for GIPS—and to complete the update by 2020.

In July 2017, the institute closed the industry comment period on the GIPS 20/20 Consultation Paper, a precursor to the pending Draft. Through that paper, the institute sought input from investment managers and asset owners on ways to streamline GIPS standards and facilitate adoption of the upcoming version.

Release of the Draft will trigger a new 90-day comment period. From our review of the consultation paper, we have identified the following provisions and issues that investment managers may want to monitor as they evaluate the draft, and perhaps choose to weigh in.

GIPS adoption is widespread, with gaps

Investment management firms in North America, Europe, Africa, and Asia have adopted the GIPS standards, including 85 of the top 100 asset managers in the world. Uptake has been less robust, however, among alternative investment and pooled fund operations. How the new standards address these market segments' interests will be important to fulfilling the GIPS mission of providing relevant and applicable standards for "all asset managers, regardless of structure, client type, asset class or investment strategy."[2]

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1 https://www.gipsstandards.org/standards/Documents/Guidance/gips_2020_consultation_paper.pdf

2 Ibid

Look for asset-class streamlining

Current GIPS standards have distinct provisions and guidance based on investment structure, such as a closed-end limited partnership, rather than asset class. Many of the requirements are similar across classes. However, the CFA Institute proposes to reduce asset-class-specific guidance where possible for private equity, real estate, alternative investment strategies and structures, and wrap fee/separately managed account (SMA) portfolios. The current private equity and real estate closed-end fund provisions, for example, could be consolidated, and perhaps embrace other strategies that use a similar investment structure.

Return-requirement flexibility is in the offing

GIPS 20/20 proposes to replace the current approach of basing the required return on the investments underlying the portfolio and instead base the calculation methodology decision on the portfolio structure. Time-weighted rates of return (TWRR) would be required for open-end funds and composites with separate accounts. Firms could present internal rates of return (IRR) or TWRR for closed-end, fixed life, fixed commitment funds, for which the investment manager controls the cash flows. Once a firm chooses a methodology, it would create a policy and apply it consistently to the pooled fund or composite. This change would allow firms that offer fixed life, fixed commitment products with investment manager-controlled cash flows to more readily adopt the GIPS standards.

Total assets could embrace adviser assets

Currently, GIPS total firm assets do not include advisory assets such as unified managed accounts (UMAs), model portfolios, and advisory-only portfolios, nor do they include underlying portfolios in overlay strategies not managed by the firm. Recognizing that advisory assets are a growing element of the investment management industry, the CFA Institute is considering whether these assets should be included in compliant presentations differently by creating a new category of assets that includes assets managed, advised, and overlaid. The institute is also considering whether to require or recommend that this information be included in compliant presentations.

GIPS-compliant presentations may extend to asset managers existing clients

Investment management firms are now required to make every reasonable effort to provide a GIPS-compliant presentation to all prospective clients, but no such requirement applies to existing clients. When investment managers of closed-end, fixed life, fixed commitment funds are raising capital for a new fund, there usually is no fund track record available to present because the fund has not yet begun investing. The result is existing clients who invest in that fund may never see a GIPS-compliant fund report with a performance track record. Further, under current requirements prospective clients who become existing clients would never again be required to receive a GIPS-compliant presentation of the composite's performance track record. The same is true for existing pooled fund investors.

The CFA Institute is considering two options for extending such presentations to existing clients: require investment management firms to make every reasonable effort to provide the composite compliant presentation or a pooled fund report, such as an offering document, to existing clients/investors in the composite/pooled fund on an annual basis; or, propose that investment management firms make an offer to provide a composite compliant presentation or pooled fund report to existing clients/pooled fund investors annually. Items in the composite compliant presentation or pooled fund report would include typical required information, such as the investment mandate descriptions, a risk measure, currency used to express performance, and returns on investment in accordance with the measurement method employed. This option will allow firms the ability to leverage regulatory reporting to satisfy the standards.

More options could be available to claim GIPS compliance

The CFA Institute is considering expanding the ways in which firms can demonstrate GIPS compliance beyond the three currently allowed, which are: in a compliant presentation; in an advertisement that is prepared in accordance with the GIPS Advertising Guidelines; and in a GIPS Pooled Fund Claim of Compliance that is included in the official pooled fund document or fund-specific marketing material for a broadly distributed pooled fund. The institute believes expanding the ways that firms are allowed to demonstrate compliance, such as including a statement of GIPS compliance in more marketing materials, would help increase awareness of the standards.

Changes could come to disclosure requirements

Firms are now required to include certain numerical information and disclosures in compliant presentations. The CFA Institute is considering whether items that are not particularly helpful or informative can be eliminated, as well as whether to require inclusion of other items, such as attribution information or asset allocation. The institute is also contemplating whether certain disclosures should be considered relevant only for a certain length of time (e.g., five years) and their removal from compliant presentations be allowed because they are no longer relevant.

Changes for measuring performance are under consideration

The CFA Institute is considering additional performance measurement method input factors. Specifically, possible changes to certain existing requirements are being discussed to accommodate additional methods relevant to firms. These include the frequency of investment valuations, the treatment of non-fee-paying portfolios, and whether estimated trading expenses might be used in the measurement of performance.

GIPS: evolving standards for the dynamic investment industry

The GIPS standards provide a globally recognized symbol of credibility, integrity, and uniformity of investment performance results—a “passport” for firms into the investment management arena. As publication of the GIPS 20/20 Exposure Draft approaches, firms can benefit by staying abreast of the developments discussed here and contemplating how they will respond to the unveiling of the next chapter of the GIPS standards.

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