



Understanding the new GIPS® 2020 standards

InFocus: A guide to Global Investment Performance Standards

Top takeaways



The CFA Institute released final, approved 2020 Global Investment Performance Standards (GIPS^{®1} 2020) on June 28, 2019, for an effective date of January 1, 2020. GIPS 2020 updates the existing GIPS 2010 standards.



Investment Management (IM) organizations should be mindful of new GIPS 2020 requirements and key changes from GIPS 2010, especially in the alternatives and pooled fund spaces.



Complying with the GIPS standards can help IM firms compete for new assets globally, strengthen their internal controls and governance processes, and focus more on client expectations and strategic fit during due diligence reviews.

What is GIPS?

Developed by the CFA Institute, the voluntary GIPS standards are based on the fundamental principles of full disclosure and fair representation of investment performance results. These standards give investors around the world the additional transparency they need to make an “apples to apples” comparison of fund performance and evaluate investment managers.² As a result, most investors believe they can place greater confidence and trust in the performance presentations of GIPS-compliant firms.³

GIPS is a de facto requirement in the institutional investment management arena. To claim compliance, firms must demonstrate adherence to comprehensive rules governing input data; calculation methodologies (not just performance, but other required metrics); construction of meaningful composites and disclosures; and presentation and reporting of investment performance results. Under GIPS 2020, there are three different types of GIPS reports, depending on what is being presented: GIPS composite report, GIPS pooled fund report (required for limited distribution pooled funds but recommended for broad distribution pooled funds), and GIPS asset owner report.⁴

Of the top 100 asset management firms globally, approximately 85 percent claim compliance with GIPS,⁵ and the number is growing. As of December 31, 2018, 1,711 firms and asset owners claimed compliance with the current GIPS standards, a four percent increase since the prior year-end.⁶ Compliant firms and asset owners come from 46 markets.⁷ Complying with the GIPS 2020 standards can provide investment managers with a competitive advantage by helping them compete for new assets globally.⁸ In addition, maintaining policies and procedures for GIPS compliance typically strengthens internal controls and governance processes. This often helps IM firms focus more on client expectations and strategic fit during due diligence reviews, rather than performance data integrity.⁹

GIPS 2020: What's new and notable

2020 vs. 2010: Key changes to the GIPS standards



Differentiated reporting for composites versus pooled funds



More focus on the portfolio structure and less on asset classes



More flexibility for using money-weighted returns versus time-weighted returns



Ability to present carved-out performance with allocated cash



Expanded options for advertising GIPS compliance¹⁰

GIPS 2020 aims to streamline the standards across multiple asset classes; acknowledge other reporting practices that may be better suited for firms (i.e., composite reporting versus pooled fund reporting); and better address the adoption and applicability of GIPS to asset owners. **Here is what's new and notable in the updated standards:**

New pooled fund provisions

GIPS 2020 introduces new concepts specific to pooled funds. There are two types:



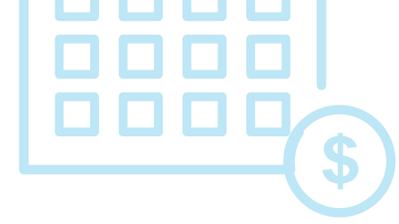
- ▶ **Broad distribution pooled fund (BDPF):** A fund available for purchase to general investors that is regulated under an existing framework.
- ▶ **Limited distribution pooled fund (LDPF):** Any other fund that is *not* a BDPF. These would generally be pooled funds that are offered/made available in one-on-one presentations (i.e., private funds).

New compositing considerations for pooled funds:



- ▶ Pooled funds *do not* need to be included in a composite if the representing strategy is solely offered through the pooled fund structure.
- ▶ If the pooled fund's representative strategy is made available to prospective/current investors as a segregated account, then the pooled fund(s) would need to be included in the same composite.





New reporting requirements



- ▶ Firms will continue to prepare and present GIPS composite reports to prospective segregated (separate) account clients.
- ▶ Firms will now be able to prepare and present a GIPS pooled fund report to prospective investors of a pooled fund.
- ▶ Firms will not be required to present a GIPS pooled fund report to BDPF investors.
- ▶ Firms will not be required to present a GIPS pooled fund report to LDPF investors if the LDPF is included in a composite and a GIPS composite report is used.

New return calculation requirements



- ▶ Firms will be able to use money-weighted returns (MWR) (e.g., an internal rate of return [IRR]) for more scenarios providing greater flexibility in addition to the current use of time-weighted returns.
- ▶ MWR will be allowed if the firm has control over external cash flows and at least ONE of the following:
 - Closed-end portfolio
 - Fixed life
 - Fixed commitment
 - Significant part of the strategy held in illiquid investments
- ▶ Under the new MWR requirements, firms will only be required to show a since-inception IRR through the most recent annual period end.



Firm assets



- ▶ Non-managed assets that are advisory-only in nature and uncalled capital commitments are not permitted to be included in the total firm assets.
- ▶ Firms can, but are not required to, present firmwide, advisory-only, and/or uncalled capital commitments—either as a separate data point in the GIPS report or combined with total firmwide assets so long as the latter is shown separate from the combined value.

Required frequency to update GIPS reports



- ▶ Firms must now update GIPS reports within 12 months as of the most recent annual period end.



Maintaining lists of composites and pooled funds



- ▶ Firms must maintain the following:
 - A description of composites including terminated composites, for the last five years after termination date.
 - A description of LDPFs.
 - A list of BDPFs (not description).
- ▶ Firms will not be required to include terminated pooled funds on the list.

Use of model investment management fees for calculating net returns



- ▶ Firms will no longer be required to use the highest investment management fee in calculating net returns; rather, they can use a model investment management fee appropriate to a prospective client.
- ▶ When calculating composite net returns using a model fee, the return must be equal to or lower than those returns that would have been calculated if actual fees were used.





Modified external valuation requirements



- ▶ Real estate investments in real estate open-end funds are the only private market asset that will be required to have an external valuation conducted once every 12 months.
- ▶ Other real estate investments, such as those in closed-end funds, will be required to have an external valuation conducted at least once every 12 months unless the client agreement stipulates otherwise, or the fund is subject to an annual financial statement audit.
- ▶ For real estate investments not in an open-end fund, if a client opts out of the valuation frequency, then the external valuation must take place once every 36 months (or between 12 and 36 months if the investor requires such frequency).
- ▶ Non-real estate private assets are **recommended** to have an external valuation conducted once every 12 months.

Allowance of carve-outs with allocated cash



- ▶ Allowing firms to use carve-outs with allocated cash is intended to enable a greater number of alternative/private wealth managers to become GIPS-compliant.
- ▶ A carve-out included in a composite must be representative of a standalone portfolio managed or intended to be managed according to that strategy. This applies to carve-outs with allocated cash as well as those with their own cash (i.e., a sub-portfolio).
- ▶ When the firm presents the performance of a composite that includes carve-outs with allocated cash and also has a composite of standalone portfolios managed according to the same strategy, the firm must present the composite since-inception money-weighted return through the most recent annual period end and the composite assets of the composite of standalone portfolios as of the most recent annual period end in the GIPS composite report of the composite that includes carve-outs with allocated cash.
- ▶ Currently, a specific methodology for allocating cash to carve-outs is not defined.

Considerations and next steps

The GIPS standards are a de facto requirement in the institutional IM sector; those firms that have not yet complied—especially in the alternatives and pooled fund space—have the opportunity to do so with the onset of GIPS 2020. Although GIPS compliance is a voluntary standard, it is acknowledged and expected by many investors. Since planning and marshalling resources may take significant time prior to implementation, IM firms should consider starting now to prevent having to play catch-up.

If your IM organization currently is GIPS-compliant and you want to learn more about the updated standards and suggested steps you can take to maintain compliance—or if you are interested in becoming GIPS-compliant—we should talk.





Endnotes

1. "GIPS® is a registered trademark of CFA Institute. CFA Institute has not been involved in the preparation or review of this report/ advertisement," <https://www.gipsstandards.org/about/policies/Pages/index.aspx>.
2. <https://www.cfainstitute.org/en/ethics/codes/gips-standards>.
3. GIPS® 20/20: *The way forward: Analyzing industry feedback on the performance standards*, Deloitte Center for Financial Services, 2018, <https://www2.deloitte.com/us/en/pages/financial-services/articles/global-investment-performance-standards-compliance.html>.
4. "The 2020 GIPS Standards: The Top Changes You Need to Know," ACA Compliance Group, July 1, 2019, <https://www.acacompliancegroup.com/blog/2020-gips-standards-top-changes-you-need-know>, accessed August 9, 2019.
5. "Out of Top 100 Asset Management Firms Globally, 85 Claim GIPS Compliance," Market Integrity Insights, CFA Institute, February 6, 2017, <https://blogs.cfainstitute.org/marketintegrity/2017/02/06/out-of-top-100-asset-management-firms-globally-85-claim-gips-compliance/>.
6. GIPS Standards Newsletter, CFA Institute, February 2019, <https://www.gipsstandards.org/news/Documents/february2019.pdf>.
7. Ibid.
8. Brenda Di Leo and Rich Doyle, "Global Investment Performance Standards," Deloitte, 2017.
9. GIPS® 20/20: *The way forward: Analyzing industry feedback on the performance standards*, Deloitte Center for Financial Services, 2018, <https://www2.deloitte.com/us/en/pages/financial-services/articles/global-investment-performance-standards-compliance.html>.
10. <https://www.cfainstitute.org/en/ethics/codes/gips-standards/firms>, accessed July 24, 2019.

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