Global Investment Performance Standards (GIPS®) for Asset Owners

Adopting Release

The Exposure Draft of the 2020 Global Investment Performance Standards (GIPS®) was available for public comment from 1 September 2018 through 31 December 2018. We received more than 5,200 comments from more than 120 organizations. Every comment was evaluated and considered, resulting in a recommendation for any needed changes to the provisions. The proposed changes were then reviewed with and approved by the GIPS Standards Technical Committee and the GIPS Standards Executive Committee. This Adopting Release includes key topics and describes our rationale for changes we made, or did not make, to the provisions. We are creating an explanation for each of the provisions, which will be issued upon completion, and we refer to these explanations as the "Handbook."

New Structure for 2020

The 2010 edition of the GIPS standards focused solely on firms, although both firms and asset owners are able to comply with the GIPS standards. In 2014, we issued the Guidance Statement on the Application of the GIPS Standards to Asset Owners, and we updated this document in 2017. This Guidance Statement explained how to apply the GIPS standards to an asset owner. With the 2020 edition of the GIPS standards, we took the opportunity to create provisions specific to asset owners. In the Exposure Draft of the 2020 GIPS Standards (2020 Exposure Draft), we included sections 1 through 7 for firms, sections 8 through 12 for asset owners, section 13 for GIPS Advertising Guidelines that covered both firms and asset owners, and a glossary. We also combined existing verification and performance examination guidance into a separate document for verifiers.

Rather than having one document that included the provisions for both firms and asset owners, as well as guidance for verifiers, we separated the GIPS standards into three separate documents (chapters): one for firms, one for asset owners, and one for verifiers.

- The GIPS Standards for Firms include sections 1 through 8 and a glossary applicable to firms. Sections 1 through 7 include the same content as they did in the 2020 Exposure Draft. Section 8 includes the GIPS Advertising Guidelines that are applicable to firms, and the glossary includes only those defined terms (those that appear in small capitals in the provisions) that apply to firms. We added appendices that include samples of GIPS Composite Reports, GIPS Pooled Fund Reports, GIPS Advertisements, and lists of composite and pooled fund descriptions.

- The GIPS Standards for Asset Owners start with section 21. We started the section numbering for the GIPS Standards for Asset Owners at section 21 to allow for expansion of the GIPS Standards for Firms. Sections 21 through 25 include the same content as sections 8 through 12 of the 2020 Exposure Draft. Section 26 includes the GIPS Advertising Guidelines that are applicable to asset owners, and the glossary includes only those defined terms (those that appear in small capitals in the provisions) that apply to asset owners.
- The GIPS Standards for Verifiers constitute the third chapter of the 2020 GIPS standards. This chapter includes guidance that verifiers must follow when conducting verifications and performance examinations, and it replaces the existing Guidance Statements on Verification and Performance Examinations. A glossary includes only those defined terms (those that appear in small capitals) that appear in this chapter. This chapter does not include the Verifier Independence Guidance Statement, which we plan to finalize in the near future.

We believe the new structure will allow for future expansion of the GIPS standards, as well as the addition of other types of standards in the future.

Comments on Key Topics

1. Competing for Business

Some asset owners have the authority to compete for business by marketing to prospective clients, as traditional investment managers do. These asset owners would follow the guidance and requirements of the GIPS Standards for Firms rather than the GIPS Standards for Asset Owners. It is also possible that an organization may act as both an asset owner, whose investment authority and ownership are vested with the organization itself, as well as a firm, which competes for assets from external clients. In the 2020 Exposure Draft, we stated that asset owners that market some or all their strategies are required to split their assets between two entities: an asset owner that complies with the GIPS Standards for Asset Owners and a firm that complies with the GIPS Standards for Firms. This guidance was consistent with a Q&A issued in August 2017. Several respondents commented that it would be extremely difficult, if not impossible, to split the assets between two entities. We decided that a better solution is to offer the asset owner choices to define itself for the purpose of complying with the GIPS standards.

The options include the following:

- The asset owner bifurcates the assets into two entities: one defined as an asset owner and one defined as a firm.
- The asset owner does not bifurcate the assets and instead defines itself as both an asset owner and a firm. When calculating and presenting performance to its oversight body, the asset owner follows the GIPS Standards for Asset Owners. When calculating and presenting performance to prospective clients, the asset owner follows the GIPS Standards for Firms.
- The asset owner chooses to comply with the GIPS Standards for Firms for all assets when calculating and presenting performance to both prospective clients and its oversight body.

We will explain the options for defining the asset owner versus a firm when the asset owner markets some or all of its strategies and wishes to claim compliance for all assets in the Handbook.

2. Error Correction

In the 2020 Exposure Draft, we created error correction–related provisions to include requirements from the existing Guidance Statement on Error Correction. Provision 8.A.15 stated that the asset owner must correct material errors in GIPS Asset Owner Reports and must:

a. Provide a corrected GIPS Asset Owner Report to those who have direct oversight responsibility for total fund assets and total asset owner assets and that received the erroneous GIPS Asset Owner Report.
b. Make every reasonable effort to provide the corrected GIPS Asset Owner Report to all other parties that received the erroneous GIPS Asset Owner Report.

It was not intended that there be any change to the meaning of the requirements from the Guidance Statement. Unlike the Guidance Statement on Error Correction, however, the provisions related to error correction neglected to state that asset owners are not required to provide a corrected GIPS Asset Owner Report, with a disclosure regarding the correction of a material error, to those that did not receive the GIPS Asset Owner Report with the material error. We therefore made edits to this provision to clarify this point.

In addition, the proposed provision required that “other parties” that received the GIPS Asset Owner Report with the material error must receive a corrected GIPS Asset Owner Report. Although no comments were received on provision 8.A.15 in the 2020 Exposure Draft, we received comments on the equivalent provision for firms (1.A.17), asking who is considered to be an “other party”. We agreed that this provision should explicitly state who must receive the corrected GIPS Asset Owner Report. The provision on error correction, now provision 21.A.16 in the GIPS Standards for Asset Owners, was revised to state that the asset owner must correct material errors in GIPS Asset Owner Reports and must do the following:

a. Provide the corrected GIPS Asset Owner Report to the current verifier.
b. Provide the corrected GIPS Asset Owner Report to any former verifiers that received the GIPS Asset Owner Report that had the material error.
c. Provide the corrected GIPS Asset Owner Report to any oversight body that received the GIPS Asset Owner Report that had the material error.

We will address materiality in the Handbook guidance.

3. Estimated Transaction Costs

In the 2020 Exposure Draft, the term “trading expenses” was changed to “transaction costs” to reflect a broader concept of such costs. In addition, we proposed allowing firms and asset owners to use estimated transaction costs if returns calculated using estimated transaction costs are equal to or lower than those that would have been calculated using actual transaction costs. Although we received no comments on this specific point for asset owners, a similar concept in the firm sections of the 2020 Exposure Draft generated comments that generally supported allowing the use of estimated transaction costs. There was some concern about how estimated transaction costs should be calculated or determined, and some respondents challenged the concept that firms (and assets owners) would be able to determine that returns calculated using estimated transaction costs were more conservative than those that would have been calculated had actual transaction costs been used. Other respondents commented that estimated transaction costs should be allowed only if actual transaction costs are not available.

Similar to the edits made for firms, we revised provision 22.A.10 to state that estimated transaction costs may be used only for those portfolios for which actual transaction costs are not known. The requirement for calculating returns that are more conservative when using estimated transaction costs was deleted. Guidance on determining estimated transaction costs will be included in the Handbook.

4. Fee Schedule

Provisions 11.C.9 and 12.C.9 in the 2020 Exposure Draft required firms to disclose the fee schedule if the asset owner is compensated in a manner similar to a firm. Although we received no comments on them, we believe these provisions could cause confusion. Given that we created a separate GIPS Standards for Asset Owners chapter, we did not want to refer to a requirement applicable to firms that is included in a separate document—the GIPS Standards for Firms. Unlike a firm, an asset owner typically will not have an asset-based investment management fee schedule. The meaningful investment management fee information for an oversight body is the total costs incurred for managing the assets. In several jurisdictions, regulators require disclosure about the total costs of the total fund, including the costs paid for externally managed assets. We understand that in certain countries, it may take a long time for asset owners to be able to meet the requirement to report this information. Given this experience, we felt we could not require disclosure because doing so could prevent some asset owners from complying with the GIPS standards. We ultimately decided to revise this provision to instead recommend that asset owners disclose information about the investment management fees and investment management costs of the total fund or composite that were incurred during the most recent annual period (provisions 24.D.7 and 25.D.7).

5. GIPS Asset Owner Reports

<u>Trademark Disclosure</u>

In the 2020 Exposure Draft, a sentence stating “GIPS® is a trademark owned by CFA Institute” was included as part of the claim of compliance. We removed this language from the claim of compliance. Instead, asset owners will be required to include the following disclosure in the GIPS Asset Owner Report: “GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.” As with all disclosures, there is no requirement to include this disclosure in any particular order relative to other disclosures.

<u>Committed Capital</u>

In the 2020 Exposure Draft, provisions 11.B.11 and 12.B.4 stated that if the asset owner has committed capital, the asset owner should present total asset owner–wide uncalled committed capital as of the most recent annual period end.

The concept of committed capital is different for an asset owner because asset owners do not call capital. Firms call capital, but asset owners have capital called by their external managers. Given this difference, we decided to delete these provisions for asset owners.

6. Initial Claim of Compliance

Firms that initially claim compliance with the GIPS standards must attain compliance for a minimum of five years or for the period since firm inception. After initially claiming compliance, firms must present an additional year of compliant performance building up to a minimum of 10 years. In contrast, when asset owners initially claim compliance with the GIPS standards, they must present at least one year of GIPS-compliant performance. Subsequently, they must present an additional year of compliant performance building to 10 years. This decision to require asset owners to initially comply for only one year versus five years was made during the creation of the Guidance Statement on the Application of the GIPS Standards to Asset Owners in 2014. The reason for this decision results from the fact that an asset owner is not competing for clients. We concluded that this approach was correct and made no change. The ability to initially claim compliance with the GIPS standards for a one-year period applies only to those asset owners that do not compete for business.

7. Linking Non-Compliant Performance

In the Exposure Draft, provision 8.A.22 stated that asset owners must not link non-GIPS-compliant performance with GIPS-compliant performance in GIPS Asset Owner Reports. Provision 8.A.23 stated that asset owners must not present money-weighted returns for periods ending prior to when GIPS-compliant returns are first presented. As we looked further at these two provisions, we realized that the issue is not the linking of compliant or non-compliant performance as much as it is the fact that non-GIPS-compliant performance cannot be presented in GIPS Asset Owner Reports. Therefore, we deleted the originally proposed provisions 8.A.22 and 8.A.23, instead substituting provision 21.A.23, which states that the asset owner must not present non-GIPS-compliant performance in GIPS Asset Owner Reports. Because this prohibition is limited to GIPS Asset Owner Reports, asset owners are able to present their entire performance history, which may include non-compliant performance, as long as it is outside of the GIPS Asset Owner Report.

8. Portfolio Definition

For asset owners, a portfolio is defined as an account representing one of the strategies in or components of the asset owner's total fund. Although no respondents commented on the definition of "portfolio" for asset owners, comments made for firm provisions related to sub-advised segregated accounts prompted us to edit the definition. We did so to ensure that asset owners understand that any portfolios managed by external managers must be treated in a manner similar to how portfolios managed internally are treated. In the GIPS Standards for Asset Owners, a portfolio is now defined as an account representing one of the strategies in or components of the asset owner's total fund, including assets managed by external managers for which the asset owner has discretion over the selection of the external manager.

9. Private Market Investments/Real Estate

In the 2020 Exposure Draft, we removed the private equity and real estate–specific provisions and instead proposed provisions that would apply to all private market investments, including real assets, private equity, and similar investments that are illiquid, not publicly traded, and not traded on an exchange. We proposed requiring all private market investments to have an external valuation, a valuation review, or be subject to a financial statement audit at least once every 12 months. We received significant pushback from respondents who opposed expanding external valuation beyond real estate to all private market investments. It was pointed out that the use of external valuations is not as prevalent in other areas of private market investments, and there was concern that qualified individuals were not available in all markets to conduct this type of work. Respondents also pointed out that there may not be a financial statement audit of many portfolios that hold private market investments, or the financial statement audit may not be done on a fair value basis. Because it would be costly and a large administrative burden to comply with the proposed requirement, investment managers of non–real estate private market investments might choose not to comply with the GIPS standards.

In contrast, the use of external valuations is general industry practice for most real estate product types, and numerous real estate firms requested real estate–specific independent valuation requirements.

Based on the comments received, we included real estate–specific independent valuation requirements and removed the proposed independent annual valuation requirement for non–real estate private market investments. We believe, however, that the use of independent valuations is best practice. The provision regarding independent valuation is now a recommendation (provision 22.B.8) for non–real estate private market investments.

We added provision 22.A.33, which states that real estate investments that are directly owned by the asset owner must:

a. Have an external valuation at least once every 12 months unless the oversight body stipulates otherwise, in which case real estate investments must have an external valuation at least once every 36 months or per oversight body instructions if the oversight body requires external valuations more frequently than every 36 months; or
b. Be subject to an annual financial statement audit performed by an independent public accounting firm. The real estate investments must be accounted for at fair value, and the most recent audited financial statements available must contain an unmodified opinion issued by an independent public accounting firm.

10. Real Estate Component Returns

In the 2010 edition of the GIPS standards, asset owners are required to present income and capital component returns for real estate composites and benchmarks. As part of the move to eliminate asset class provisions, we proposed eliminating all real estate–specific requirements. We also changed the concept of component returns from a requirement to a recommendation and expanded this recommendation to apply to all composites and total funds. In addition, we changed the calculation requirement for component returns to allow asset owners to derive one of the component returns as the difference between the total return and one of the calculated component returns.

Given our change to include real estate–specific valuation requirements, we realized that we would need to re-include some other real estate–specific provisions. Because component returns are primarily used in real estate markets, we decided to include the terms and definitions used in the 2010 edition of the GIPS standards for component returns (i.e., Capital Employed, Capital Return, and Income Return) and make the presentation of component returns a recommendation for real estate composites only. We therefore removed the recommendation that component returns be presented for non–real estate composites.

Although component returns were a requirement for real estate in the 2010 edition of the GIPS standards, we decided to leave them as a recommendation in the 2020 GIPS standards and have the marketplace dictate whether or not they should be presented (provision 24.B.10). We also do not require component returns to be calculated separately, as is required in the 2010 edition.

11. Returns in GIPS Asset Owner Reports (Three-Year Annualized Return)

In the 2020 Exposure Draft, we proposed requiring asset owners to present the three-year annualized return for the total fund or the composite and benchmark for each period for which the three-year annualized ex post standard deviation of the total fund or composite and benchmark are presented (provision 11.A.1.l). We received many comments stating that this item did not add value and that this return could be calculated easily using the information in the GIPS Asset Owner Report. We agree and have deleted this proposed requirement and added a recommendation to present the corresponding annualized return for all periods for which an annualized ex post standard deviation is presented (provision 24.B.5).

12. Risk Measures

In the 2020 Exposure Draft, for those composites that do not have monthly returns, it was proposed that asset owners be required to present either an ex post risk measure or a qualitative narrative describing the composite strategy's key risks.

One respondent correctly pointed out that asset owners are already required to include information about the composite's risks in the composite description (i.e., a qualitative narrative). Because all asset owners will meet the proposed requirement by including a qualitative narrative of risks as part of the composite description, it will not be either required or recommended that asset owners present an appropriate ex post risk measure for composites for which monthly returns are not available.

In the case of composites for which money-weighted returns are presented, we found that it was a challenge to identify potential ex post risk measures. We concluded that nothing would be lost by changing this requirement to a recommendation.

Provisions 24.B.7 and 25.B.4 state that the asset owner should present relevant ex post risk measures for the total fund or composite and the benchmark. The same ex post risk measure should be presented for the total fund or composite and the benchmark.

13. Subscription Lines of Credit

Subscription lines of credit are not addressed in the 2010 edition of the GIPS standards, but they are now being used by more firms and for longer periods. These lines of credit can affect returns significantly. As has been widely discussed in the industry, there is a lack of consistency in return calculations when lines of credit are used. Asset owners often invest with external managers that use subscription lines of credit.

In the 2020 Exposure Draft, we proposed that in GIPS Advertisements, asset owners would be required to clearly label or identify if returns do or do not reflect the subscription line of credit activity. This information would be required only if a subscription line of credit was used by the external manager. Although subscription lines of credit are very important to understand when evaluating money-weighted rates of return, we concluded that it is not always possible for asset owners to calculate returns with and without the subscription line of credit, because they are not the party that initiates the line of credit and thus would not have the information available to calculate the appropriate returns. Therefore, we decided against including the concept of subscription lines of credit in the GIPS Standards for Asset Owners.

Effective Date

The 2020 edition of the GIPS standards has an effective date of 1 January 2020. GIPS Asset Owner Reports that include performance for periods ending on or after 31 December 2020 must be prepared in accordance with the 2020 edition of the GIPS standards. GIPS Asset Owner Reports that include returns for periods ending prior to 31 December 2020 (e.g., year-to-date returns through 30 September 2020) may be prepared in accordance with the 2010 edition of the GIPS standards.

Asset owners may choose to early adopt the 2020 GIPS standards. If asset owners choose to early adopt, they must not pick and choose which provisions they adopt. They must comply with all requirements of the 2020 edition of the GIPS standards, including the requirements related to GIPS Asset Owner Reports.