



ASSETTE 

Are Your Firm's GIPS® Materials Current?

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Background

The Global Investment Performance Standards (GIPS®) are a set of standardized, industry wide ethical principles that provide investment management firms with guidance on how to calculate and report their investment results to prospective clients.

Under the GIPS standards, a “compliant presentation” is a presentation for a composite that contains all the information required by the GIPS standards and may also include additional or supplemental information. The GIPS standards require firms to make every reasonable effort to provide a compliant presentation to all prospective clients.

The GIPS standards define a “prospective client” to include any person or entity that has expressed interest in one of the firm’s composite strategies and qualifies to invest in the composite. In addition, a prospective client includes existing clients who are provided information for a strategy that is different from their current investment strategy. Investment consultants and other third parties are also generally considered to be prospective clients when they represent investors who qualify as prospective clients.

Updating Compliant Presentations

At a minimum, GIPS-compliant firms are required to update compliant presentations with year-end information. While it may appear that adding the most recent year’s annual returns to the presentation is all this entails, there are many other elements of the presentation that are subject to change over time and may require attention to ensure presentations remain complete and accurate. Below are some of the best practices that should be considered when updating compliant presentations.

Firm AUM

For some firms, the assets under management reported for GIPS compliance purposes is different from the AUM reported in regulatory filings such as Form ADV. This is because the requirements related to the accounts that must be included — and how the value of those accounts are measured — differ for a number of reasons. For example, GIPS AUM must be presented net of leverage and is not allowed to be grossed up as if the leverage did not exist, which conflicts with some regulatory filing requirements.

Also, when updating compliant presentations, it is important to confirm that the firm’s AUM is consistent with the scope of the definition of the firm and doesn’t include accounts outside of that scope. In addition, be sure that advisory-only assets — assets that the firm doesn’t have authority to execute trades for — are excluded from the firm AUM that is reported for GIPS compliance purposes.

TIP: Create and maintain a list of all accounts with the corresponding market values used to calculate the year-end firm AUM. It is important to maintain this list as part of the firm’s books and records, as data may change in a firm’s system and the list can be used to support the AUM total reported.

Partial-year Returns

Confirm if any composites have an initial period of less than a full year. If so, then present composite returns from inception through the initial annual period-end. This is required for composites with an inception date of January 1, 2011 or later.

TIP: Be sure the benchmark return for the initial partial-year period is shown for the same time period as the composite return.

Treatment of Fees

Review and confirm that fee schedules and disclosure related to fees are accurate. Consider comparing the fee schedules outlined in Part 2 of Form ADV and in marketing related materials to confirm consistency. Compliant presentations that include net-of-fees returns must disclose:

- If any fees, such as custodian fees, are deducted in addition to the investment management fees and trading expenses;
- Whether model or actual investment management fees are used; and
- Whether returns are net of applicable performance-based fees.

TIP: If net-of-fees returns are calculated based on actual management fees, be sure to confirm if any accounts in the composite pay fees from an outside account, such as a separate brokerage account or by check. If the account's performance is not adjusted to reflect these management fees, the composite's net-of-fees returns could be overstated.

If net-of-fees returns are calculated based on model fees, be sure that the results presented are not higher than what would have been produced using actual fees.

Non-fee-paying Accounts

Confirm if the composite includes non-fee-paying portfolios. If so, ensure that the percentage of composite assets represented by non-fee-paying portfolios is presented as of each annual period-end.

Bundled/Wrap-fee Accounts

If the composite includes accounts that have bundled-fee or wrap-fee arrangements, make sure the percentage of composite assets represented by these accounts is disclosed. Also, disclosure indicating the extent to which results have been reduced by other fees and expenses in addition to investment management fees and trading costs will need to be included.

Three-year Annualized Ex-post Standard Deviation

If the composite has 36 monthly returns available, then confirm that the three-year annualized ex-post standard deviation of the composite and the benchmark are presented in the compliant presentation. If the composite has less than three years of performance through the most recent calendar-year-end, then disclose that 36 monthly returns are not available for the composite.

TIP: If your systems do not calculate the three-year annualized ex-post standard deviation for the composite and the benchmark then be sure to maintain spreadsheets to support the calculations.

Composite Description

Confirm that composite descriptions are accurate and give enough information for a prospective client to understand the difference between each of the firm's composites. The composite description needs to include general information regarding the investment mandate, objective or strategy of the composite. The composite description must also include all key features of the composite and must include enough information to allow a prospective client to understand the key characteristics of the composite's investment mandate, objective or strategy.

If illiquid securities are a significant part of the composite strategy or if there is a strategic intent to invest in illiquid investments, firms must disclose this in the composite description.

TIP: Review the composite descriptions collectively to ensure that not only the characteristics of the investment mandate, objective or strategy are clear, but that a reader can also determine how the composites differ from one another. This can be challenging if the firm has strategies and composites that are similar. If the firm is not careful, composite definitions may appear to overlap — for example, if some accounts seem to qualify for inclusion in multiple composites — when that is not the intent.

Verification

If the firm undergoes verification, ensure that the disclosure regarding verification is outlined correctly with accurate start and end dates. Be sure that the verification is not described in any materials as an “audit” as this would be inappropriate.

SEC Performance Disclosures

The GIPS standards remind firms to comply with all applicable laws and regulations. The SEC doesn't provide a specific list of required disclosures when advertising performance; there are, however, no-action letters that do provide guidance. SEC-registered advisers should consider the following when presenting performance to prospective clients:

- Disclosing whether and to what extent the performance results reflect the reinvestment of dividends and interest.
- Disclosing the effect of material market or economic conditions on the performance results.
- Disclosing all material relevant factors when comparing results to an index.
- Disclosing that past performance is not a guarantee of future results.
- If gross-of-fees returns are presented unaccompanied by net-of-fees returns, then:
 - Label the presentation as “for one-on-one use only.”
 - Disclose that the client's return will be reduced by advisory fees and other expenses the client may incur.
 - Disclose a representative example like a table, chart, graph or narrative that shows the effect an investment advisory fee, compounded over a period of years, could have on the value of a client's portfolio.

Leveraging Technology

Streamline the process by automating as much as possible. There is software available that can calculate the GIPS statistical data and automatically update the GIPS-compliant presentation slides in sales books. This type of software application gathers the composite returns and account market values from your portfolio accounting or composite management system to create the compliant presentations. You can even specify non-fee-paying accounts or accounts with bundled/wrap-fees so the associated disclosures can be automatically produced. The verification period and composite examination dates can also be updated based on entries you make in the software.

Automating the process of producing compliant presentations can also help facilitate updating the presentations more frequently than the annual requirement. Firms can choose to update their compliant

presentations on a quarterly basis — a useful practice, since prospective clients usually require the latest quarterly performance in some format. This can become a significant burden, however, if the firm has a large number of composites and doesn't have an automated system in place.

Leveraging technology to create and update sales materials allows for efficiencies and centralization of data, and minimizes the chances of errors, but there is still a need for someone to review the materials. To streamline the review process, firms can leverage software applications to track the workflow process, which allows users to initiate a review request, track input, and record rejections and approvals.

Review Process

The process of updating performance-related materials should include a comprehensive disclosure checklist that addresses applicable disclosures related to both GIPS and regulatory requirements. See Appendix A for a sample checklist.

No matter how you produce the compliant presentations, manually or using software, best practices include having a person who is independent from the production process — potentially the firm's compliance department or a third-party consultant — review the compliant presentations for accuracy. If the presentation is updated manually, accuracy of statistics should be double-checked for reasonableness and disclosures should be confirmed for appropriateness. It is also a good idea to have an outside party assess your entire GIPS process at least annually, including making sure the GIPS manual is up to date and reflects the firm's actual business practices. Finally, a solid process for updating compliant presentations includes a procedure that ensures — and tracks — delivery to prospective clients.

Conclusion

Compliance with the GIPS standards is not a one-time exercise that, once completed, can be permanently checked off a firm's to-do list. Once GIPS compliance has been achieved, it is essential to maintain compliance on an ongoing basis. One important aspect of this is updating the firm's compliant presentations.

Appendix A.

GIPS® Compliant Presentation Disclosure Checklist

Following is a list of the disclosures and statistics required to be included within a compliant presentation. There are also several recommended items outlined in the GIPS standards which are not included here.

DISCLOSURE REQUIREMENTS:

Firm-wide (All Presentations)

Claim of Compliance Statement:

"*[Firm Name]* claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. *[Firm Name]* has not been independently verified."

OR (if the firm has been verified, the below compliance statement must be used instead)

"*[Firm Name]* claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. *[Firm Name]* has been independently verified for the period *[insert start and end dates]*. The verification report is available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation."

- The definition of the "firm" used to determine total firm assets and firm-wide compliance
- If the firm has been redefined, disclose the date of, description of, and reason for the redefinition
- That the firm's list of composite descriptions is available upon request
- That policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request

DISCLOSURE REQUIREMENTS:

Composite Specific (All Presentations)

- The composite description
- The name and a description of the composite benchmark
- The fee schedule appropriate to the presentation
- The composite creation date
- Which measure of internal dispersion is presented
- The currency used to express performance
- Clearly label performance results as gross-of-fees or net-of-fees

DISCLOSURE REQUIREMENTS:

Composite Specific (If Applicable)

- If a firm-wide verification and performance examination has been conducted, include the following as the compliance statement instead of the one noted above:

"[Firm Name] claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. [Firm Name] has been independently verified for the periods [insert start and end dates]. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The [insert name of COMPOSITE] composite has been examined for the periods [insert start and end dates]. The verification and performance examination reports are available upon request."

- Changes to the name of a composite
- If illiquid securities are a significant part of the composite strategy or if there is a strategic intent to invest in illiquid investments include disclosure in the composite description
- If the composite has been redefined, disclose the date of, description of, and reason for the redefinition
- All significant events that would help a prospective client interpret the compliant presentation
- The minimum asset level, if any, below which portfolios are not included in a composite, as well as any changes to the minimum asset level
- If any other fees are deducted from gross-of-fees returns other than trading expenses
- If any other fees are deducted from net-of-fees returns other than trading expenses and investment management fees
- If model or actual investment management fees are used to calculate net-of-fees returns
- If returns are net of any performance-based fees
- The presence, use, and extent of leverage, derivatives, and short positions (if material), including a description of the frequency of use, and characteristics of the instruments sufficient to identify risk
- If the benchmark has changed, disclose the date of, description of, and the reason for change
- If a custom benchmark or combination of multiple benchmarks is used, describe the benchmark components, weights, and rebalancing process
- Relevant details of the treatment of withholding tax on dividends, interest income, and capital gains (if material)
- If information is available, that benchmark returns are net of withholding taxes
- Any known material differences in exchange rates or valuation sources used by portfolios within a composite, and between the composite and the benchmark
- If the composite has less than three years of performance through the most recent calendar year-end, then disclose that 36 monthly returns are not available for the composite
- If it is determined that the three-year annualized ex-post standard deviation is not relevant or appropriate, describe why it is not relevant or appropriate, and describe the additional risk measure presented and why it was selected (*Note: regardless if the firm believes it is relevant or appropriate, the three-year*

annualized ex-post standard deviation must be presented if the composite has a minimum of 36 months of performance)

- If the presentation conforms with local laws and/or regulations that conflict with the requirements of the GIPS standards, disclose this fact and disclose the manner in which the local laws and/or regulations conflict with the GIPS standards
- If the firm has adopted a significant cash flow policy for a specific composite, disclose how the firm defines a significant cash flow for the composite and for which periods
- The use of a sub-advisor and the periods a sub-advisor was used
- If, prior to January 1, 2010, calendar month-end portfolio valuations or valuations on the last business day of the month are not used
- For periods beginning on or after January 1, 2011, the use of subjective unobservable inputs for valuing portfolios if the portfolio investments valued using subjective unobservable inputs are material to the composite
- For periods beginning on or after January 1, 2011, if the composite's valuation hierarchy materially differs from the recommended GIPS hierarchy as outlined in the GIPS Valuation Principles
- For periods prior to January 1, 2010, if the composite includes carve-outs from multiple asset class portfolios, the policy used to allocate cash to carve-out returns
- If the composite contains bundled/wrap fee portfolios, the various types of fees that are included in the bundled/wrap fee
- If the performance track record from a prior firm or affiliation is linked to the performance of the firm
- If non-compliant performance is presented for periods prior to January 1, 2000, disclose the periods of non-compliance and how the presentation is not in compliance with the GIPS standards (*Note: firms must not link non-GIPS-compliant performance for periods beginning on or after January 1, 2000 to their GIPS-compliant performance*)

STATISTICAL REQUIREMENTS:

Composite Specific (All Presentations)

- At least five (5) years of annual composite performance starting from the firm's inception date (or since the composite inception if the composite has less than 5 years of performance history) that meet the requirements of the GIPS standards. After each year-end, an additional year of performance must be presented, building up to a minimum of 10 years of GIPS-compliant performance.
- The total return for the benchmark that reflects the investment strategy or mandate represented by the composite for each annual period (*Note: if no benchmark is presented, the reason why must be disclosed*)
- The number of portfolios in the composite as of each year-end
- The composite assets as of each year-end
- Either the percentage of the total firm assets represented by the composite or the amount of total firm assets at the end of each annual period
- A measure of internal dispersion of individual portfolio returns for each annual period (*Note: if the composite contains five or fewer portfolios for the full year, a measure of internal dispersion is not required*)

- For periods ending on or after January 1, 2011, three-year annualized ex-post standard deviation (using monthly returns) of both the composite and the benchmark (*Note: if applicable, disclose that the three-year annualized ex-post standard deviation is not presented because 36 monthly returns are not available*)

STATISTICAL REQUIREMENTS:

Composite Specific (If Applicable)

- For composites with an inception date of January 1, 2011 or later, when the initial period is less than a full year, returns must be presented from inception through the initial annual period end (*Note: returns for periods of less than one year must not be annualized*)
- For composites with a termination date of January 1, 2011 or later, returns from the last annual period end through the termination date must be presented
- If the composite contains any non-fee-paying portfolios, the percentage of the composite assets that is comprised of non-fee-paying portfolios as of each year-end
- If the composite contains bundled/wrap fee portfolios, the percentage of the composite assets that is comprised of bundled/wrap fee portfolios as of each year-end
- If the composite contains carve-outs from multiple asset class portfolios, the percentage of the composite that is comprised of carve-outs as of each year-end

SUPPLEMENTAL INFORMATION

Composite Specific (If Applicable)

- If the presentation includes any of the items identified as supplemental information as outlined in the GIPS Guidance Statement on the Use of Supplemental Information, then this information must be labeled as supplemental to an appropriate compliant presentation. Examples of supplemental information include, but are not limited to:
 - Model, hypothetical, backtested, or simulated returns (not linked)
 - Representative portfolio information, such as:
 - Portfolio-level country weightings
 - Portfolio-level sector weightings
 - Portfolio-level risk measures
 - Composite or portfolio-level specific holdings
 - Peer group comparisons
 - Attribution
 - Carve-out returns that exclude cash
 - Non-portable returns (not linked)
 - Ex ante risk and ex ante risk-adjusted return measures

ADDITIONAL DISCLOSURE CONSIDERATIONS:

- Disclose whether and to what extent the performance results reflect the reinvestment of dividends and interest
- Disclose the effect of material market or economic conditions on the performance results
- Disclose all material relevant factors when comparing results to an index
- Disclose that past performance is not a guarantee of future results

Note: This checklist is prepared solely for educational purposes. It is not legal or professional advice. Readers must not rely on it to provide such advice, either generally or with respect to a particular question or issue. You should reference this overview in conjunction with the GIPS® standards and applicable regulatory rules and regulations.

About the Author

Amy Jones, CIPM is the Founder and Principal at Guardian Performance Solutions LLC, a specialty compliance consulting firm dedicated to assisting investment advisory firms to implement, maintain and manage compliance with the Global Investment Performance Standards (GIPS®) as well as reviewing performance advertising materials for adherence with SEC requirements. Mrs. Jones is a recipient of the Certificate in Investment Performance Measurement (CIPM), a credential awarded by CFA Institute that focuses on performance evaluation and the GIPS standards.