2020 GLOBAL INVESTEMENT PERFORMANCE STANDARDS

WHAT YOU NEED TO KNOW

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September 20, 2019

Overview

- “Major” and not-so-major changes for asset managers
- Key proposed changes that didn’t make it into GIPS 2020
- Looking ahead: Steps and deadline for firms’ compliance and early adoption
- Questions & Answers

Will we cover <u>all</u> of the changes?

- **No.**
- **There's simply too much to cover in a single session like this.**
- **We'll review the "major" changes, along with many of the minor**
- **And, of course, we will try to answer any questions you may**

THE MAJOR

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A NEW STRUCTURE

Rather than having a single document for the Standards, they've been *trifurcated* into individual chapters:

- "Firm" (essentially asset managers)
- Asset Owners
- Verifiers

THE ABILITY TO ALLOCATE CASH FOR CARVE-OUTS

First, what are “carve-outs”?

A carve-out is the segregation of components of a portfolio into one or more composites.

For example, taking the fixed income securities from a balanced portfolio and putting them into a fixed income composite.

Ability to allocate cash

- With the 2010 version, firms had to manage the cash separately
- With the 2020 version, firms are able to *allocate* the cash, as they could under the pre-2010 version of GIPS (and the old AIMR-PPS®)

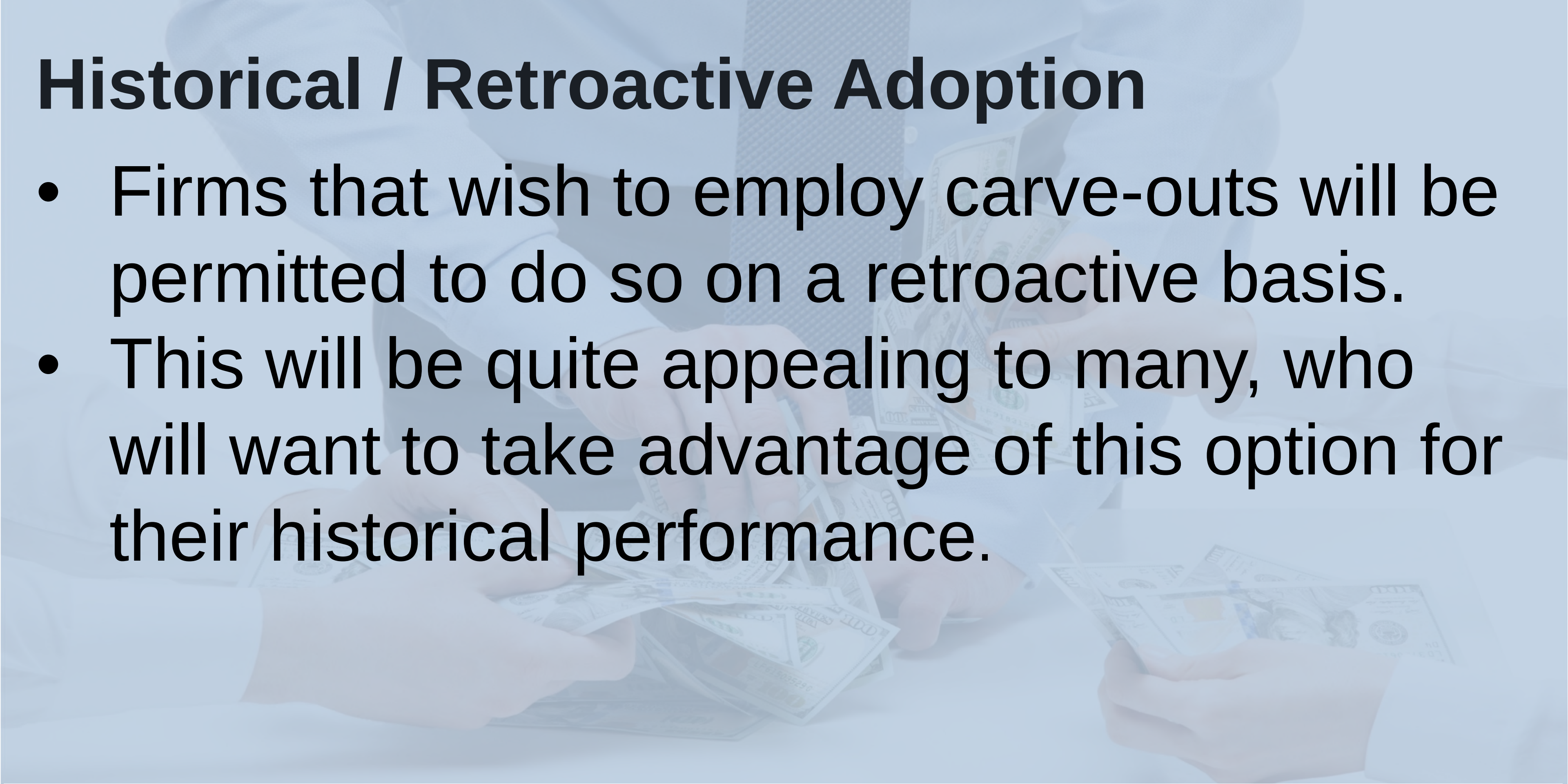
Three important points

- Returns must include cash.
- The carved-out segment must be representative of the composite it goes into.
- The firm cannot "pick and choose" which portfolios to carve out.
  - I.e., If it elects to carve out from a certain type of balanced portfolio, we would expect all portfolios to participate.

Removal of a Q&A

- An existing Q&A, that mandates that firms that use carve-outs still include the entire portfolio into a composite, even if the entire underlying components have been assigned to one or more composite, is being removed going forward.
- This means that firms that use carve-outs can avoid placing the entire portfolio into a composite, unless it is deemed appropriate to do so.

Historical / Retroactive Adoption



- Firms that wish to employ carve-outs will be permitted to do so on a retroactive basis.
- This will be quite appealing to many, who will want to take advantage of this option for their historical performance.

Additional Requirements

If the firm has or obtains standalone portfolios [i.e., portfolios that were not derived from carve-outs] managed in the same strategy as the carve-outs, the firm must create a separate composite for the standalone portfolios

Additional Requirements

If a firm provides a prospect with a composite that consists of carve-outs with allocated cash, the composite presentation must include, from the composite of standalone portfolios:

- **the composite returns for each annual period for which the composite of standalone portfolios exists**
- **the composite assets as of each annual period end for which the composite of standalone portfolios exists**

This must be included in the GIPS composite report of the composite that includes carve-outs with allocated cash

Additional Requirements

In addition, if the firm uses carve-outs <u>with allocated cash</u>, they must:

- **indicate carve-out in the composite's name**
- **indicate that the composite includes carve-outs with allocated cash**
- **disclose the policy used to allocate the cash to the carve-outs**
- **disclose that the GIPS composite report for the composite of standalone portfolios is available upon request [if applicable]**

As is currently required, firms must also disclose the % of the composite assets that come from carve-outs.

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Cash Allocation Disclosure Requirement

If the carve-out presentations are being used to a prospect for a multi-asset strategy portfolio, then the fee schedule needs to reflect the fees for a multi-asset strategy portfolio managed according to that strategy. Our take:

- **You carve-out the equity and fixed income parts of a balanced composite to create two carve-out composites**
- **You now are making a presentation to a prospect who will have a balanced strategy**
- **You'll need to reflect what the fees will be for this multi-asset strategy**

Estimated Transaction Costs

- Gross-of-fee returns must be calculated net of transaction costs, while net-of-fee returns must be net of both advisory fees and transaction costs. The 2010 version of the Standards requires firms to use only <u>actual</u> transaction costs.
- The 2020 version allows compliant firms to use estimated transaction costs.
- Note: you cannot use estimated transaction costs for accounts where the costs are known.

Estimated Transaction Costs

- When planning to estimate transaction costs, you must address:
  - What will the actual estimated transaction costs be?
  - How will you implement it.
- Our February 2019 newsletter provides a method to implement.
- And, an upcoming *JPM* article goes into some detail on this
- Our "Ultimate Guide III" on the 2020 version will also provide details

Extension of money-weighted returns

Firms will be able to use money-weighted instead of time-weighted if the manager controls the external cash flows and meets one of the following characteristics:

- Closed-end
- Fixed life
- Fixed commitment
- Illiquid investments as a significant part of the investment strategy

Big changes for pooled funds!

- Firms that created composites that hold only one or more pooled funds may be terminated, if the strategy of those composites is not offered as a segregated account.
- This applies to both “limited distribution pooled funds” (LDPFs) and “broad distributed pooled funds” (BDPFs)

Definitions

- Broad Distribution Pooled Fund (BDPF): A regulated pooled fund under a framework that permits the general public to purchase or hold the fund's shares and is not exclusively offered in one-on-one presentations
- Limited Distribution Pooled Fund (LDPF): Any pooled fund that is not a broad distribution pooled fund

Broad Distribution Pooled Funds

- Firms <u>may</u> provide a GIPS pooled fund report or a GIPS composite report that includes the broad distribution pooled fund to broad distribution pooled fund prospective investors, but is not required to do so.

- If the BDPF falls under regulatory advertising requirements, those rules are to be followed. Otherwise, the Standards provides certain requirements to advertise BDPFs.

Broad Distribution Pooled Funds

- The key point here is that firms that have many BDPFs in strategies that are never offered to separate accounts can discontinue the composites.

- And, for firms that have held off on complying because of the perceived onerous task to create dozens or hundreds of composites can adopt the Standards and not have to create the composites (except in cases where the strategy <u>is</u> offered to separate accounts).

Limited Distribution Pooled Funds

- Firms must make every reasonable effort to provide a GIPS report (either a GIPS Composite Report or a GIPS Pooled Fund Report) to all limited distribution pooled fund prospective investors when they initially become prospective investors.

GIPS Pooled Fund Report for LDPFs

- Firms with LDPFs are not required to provide a GIPS Pooled Fund Rport for LDPFs if it is in a composite. Thus, the firm may provide the associated composite report or a GIPS Pooled Fund Report.
- Firms with LDPFs will not be required to create GIPS Pooled Fund Reports for individual LDPFs.

Pooled Fund Lists (LD & BD)

Firms must maintain:

- A complete list of pooled fund descriptions for LDPFs. The firm is not required to include terminated LDPFs on this list.
- A complete list of BDPFs. The firm is also not required to include terminated BDPFs on this list.

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Portability Rule Changes

- Portability rules have been both ambiguous and controversial over the past 2+ decades
- As a result of a merger, acquisition, lift-out, if the “rules of portability” apply, firms will now have a <u>choice</u> whether to “port” the history across from the old to the new firm
- In addition, a new criteria has been added: that there be no gap in performance from the old to the new firm

Asset Owners can now have a <u>single</u> firm to represent both their “asset owner” and “asset manager” composites

Not so <u>big</u> changes

Changes in the wording!

If the firm has been verified or composite examined:

“[Insert name of firm] claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. [Insert name of firm] has been independently verified for the periods [insert dates]. The verification report(s) is/are available upon request.”

No change here …

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If the firm has been verified:

“A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm’s policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.”

If the composite has been examined:

"A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The [insert name of composite] has had a performance examination for the periods [insert dates]. The verification and performance examination reports are available upon request."

MARKETED vs. NON-MARKETED COMPOSITES

MARKETED vs. NON-MARKETED COMPOSITES

- Some confusion over the years as to whether firms needed composites and presentations for "non-marketed" composites
- **The 2020 version sets the record straight!**
- "The firm must create composites for the firm's strategies that are managed for or offered as a segregated account."
- And, therefore able to provide presentations in a timely fashion

Some new flexibility in terms of moving accounts to/from composites

- As long as the manager has been given the authority (written) to change the portfolio’s direction (strategy, objective, mandate, etc.), they can switch composites w/o obtaining written instructions to do so.
- This will have appeal to private wealth managers, where such capabilities are often included in investment agreements


DEADLINE
12 MONTHS

Hedge funds & side pockets

Hedge funds & side pockets

- Returns w/o side pockets no longer required; only returns w/side pockets
- In addition, there’s a slight change in wording: “discretionary side pockets”

Subscription lines of credit

- Many private equity managers obtain lines of credit, based on committed capital
- As a result, the IRRs may be inflated
- Compliant firms must report returns both *with* and *without* the effect of the lines of credit
- Not required to report w/o the LOC if has <u>both</u> these characteristics are met:
  - Principal repaid within 120 days using committed cap'l draw down through capital call
  - No principal was used to fund distributions

Reporting advisory assets

- Firms will be permitted to report the amount of assets under advisement, as well as firm assets and, if they wish, “firm and advisory assets”
- This is especially important given the significant increase in UMA (Unified Management Accounts) business that we have seen over the past few years

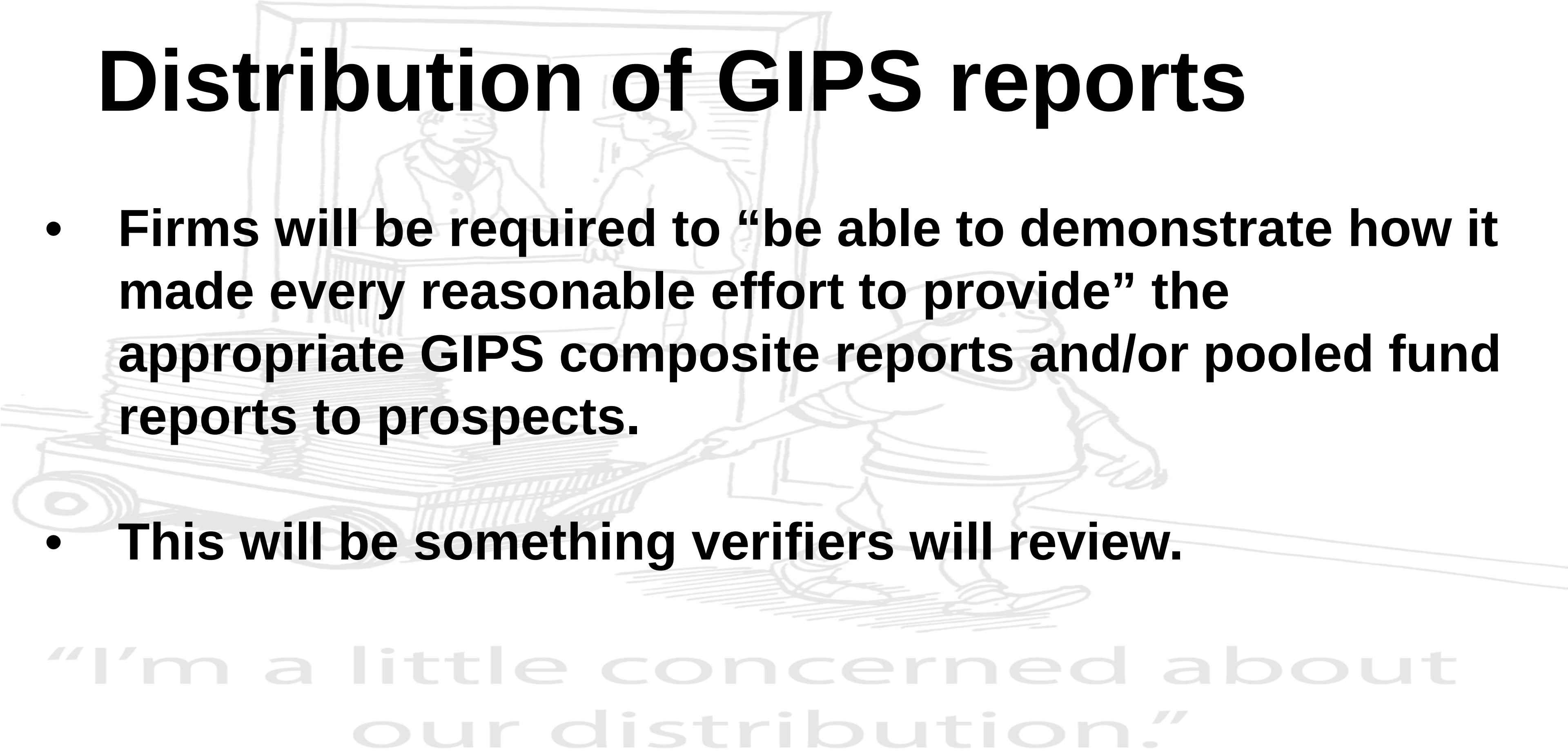
Material Errors: a new requirement!

- **Firms will be required to provide their verifier with corrected materials.**
- **In addition, if the correction covers a period(s) that was (were) handled by a different verifier, then <u>that</u> verifier must be sent the corrected materials.**

Distribution of GIPS reports

- Firms will be required to "be able to demonstrate how it made every reasonable effort to provide" the appropriate GIPS composite reports and/or pooled fund reports to prospects.

- This will be something verifiers will review.



Where's the GIPS report?

If the GIPS materials are included in the firm's marketing materials or "pitch books," they will be required to indicate that the materials are included.

- **Perhaps in a Table of Contents**
- **Or in a cover letter**
- **Or, with tabs**
- **Or, ???**

Verifier independence

- Firms must gain an understanding of the verifier’s policies for maintaining independence and must consider the verifier’s assessment of independence
- This means verifiers will have to make available:
  - Their policies for maintaining independence
  - Their assessment of independence to their clients.

Benchmarks

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Secondary Benchmarks

- Firms that employ "primary" and "secondary" (or even more) benchmarks will be have to report "all required information for all benchmarks."
- E.g., the 36-month *ex post* annualized standard deviation!

Changing Benchmarks

- Under the 2010 edition, firms must disclose the date, description and reason for the change
- Under 2020, no longer need to report the reason

Custom / Blended Benchmarks

- If use a custom or blended b/m, must disclose the calculation methodology and clearly label the benchmark as being custom

Portfolio-Weighted Benchmarks

If use, firm must disclose:

- That the benchmark is rebalanced using the weighted average returns of the benchmarks of all the portfolios included in the composite
- The frequency of rebalancing
- The components and their weights, as of the most recent annual period end
- That the components and weights of each component are available for prior periods upon request.

Clarity on large external cash flows

- Must revalue for large external flows <u>only if use</u> a monthly, day-weighted method.
- If use daily, then the firm does not have to revalue, since they're revaluing for all flows.
- Question: can the firm revalue when the external flow is <u>not</u> large?
- The 2020 version clarifies this:
    - No!

Model fees

A new requirement:

- Model fees used in net-of-fee returns cannot be lower than the actual fees
- The wording is: “the returns calculated must be equal to or lower than those that would have been calculated using the actual management fees.”

The fees charged for carve-outs "must be representative of the investment management

fees charged or that would be charged to the prospective client."

In addition to indicating if net-of-fee performance includes performance-based fees

must also indicate if it's net of carried interest!

If model fees are used and the firm is not disclosing gross-of-fee returns, then

the model fee that was used to calculate the net-of-fee returns must be disclosed!

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The firm now has to disclose which fees and expenses, other than management fees,

(e.g., research costs) are separately charged by the firm to clients, *if material.*

A slight change regarding currency

- “The firm must disclose *or otherwise indicate* the reporting currency.”
- This presumably means that to show USD or £ or € or US$ or similar notation, rather than specifying the currency, will be permitted.
- This is a bit of simplification.

Sunset provisions

- The Standards have been modified to allow firms to discontinue reporting if it is no longer deemed relevant to interpret the track record.
- E.g., “significant events.”

36-month standard deviation disclosure

For composites with at least three annual periods of performance, the firm must disclose if the three-year annualized ex post standard deviation of the composite and/or benchmark is not presented because 36 monthly returns are not available.

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terminology changes

- “composite presentations” replaced by “GIPS composite reports”
- [there are also now GIPS pooled fund reports”]
- “linking” now only means “mathematical” [no longer “presentation”]

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DISCLOSURES

- “Trademark disclosure”: must now include the following in presentations:
- “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.”
- Composite inception date now required (in addition to creation date)
- Say goodbye to “% of firm assets.” Must show “firm assets” w/the 2020 version!

- If the firm uses estimated transaction costs, they must disclose:
  - That they were used
  - The estimated transaction costs used, and how they were determined

- If the firm has opted <u>not</u> to report # of portfolios or internal dispersion because there are < 5 portfolios in the composite:
  - Must disclose the measure is not applicable or similar language (i.e., can't just leave it blank)

- For risk measures (e.g., 36-month standard deviation), we recommend using gross-of-fee, though net-of-fee is allowed. Now,
  - Will be required to disclose which return was used.

Looking ahead!

Effective Date

- The “effective date” for the 2020 edition is 1 January 2020.
- However, firms are not required to adopt the changes until they begin to report their 31 December 2020 information (most likely in 1Q2021)

- Regardless of whether firms "early adopt" or adopt after the effective date, they technically cannot "pick-and-choose" what they wish to adopt
- That said, firms can adopt certain things without full adoption.
- A simple "rule of thumb": if it's not permitted in the 2010 version, then you cannot adopt unless you fully adopt
- Please see our recent newsletter

Important point!

Read, reflect, research

- It probably makes sense for you to become more acquainted w/these changes
- We will come out with the 3rd edition of the Ultimate Guide shortly; this will help
- Review what we present today
- You'll want to decide *which* of these new requirements apply to you
- And, where there are options, how you want to address them

Begin to develop your "2020 GIPS Implementation Plan"

- What changes will affect you?
  - Your P&P
  - Your GIPS Composite Report
- What are you expecting to be addressed by your vendor?
  - Speak with your vendor about their plans
- What changes will you adopt prior to "full adoption"?
- Develop an implementation schedule

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He consults to clients throughout the world on investment performance and risk issues. In addition, he teaches classes on performance measurement and attribution, and regularly conducts GIPS® verifications.

Dave is a prolific writer, having written numerous articles for various publications. He's also the author of four books: Measuring Investment Performance (McGraw-Hill, 1997), Investment Performance Attribution (McGraw-Hill, 2003), The Handbook of Investment Performance (TSG Publishing, 2005),and The Handbook's second edition (2011); co-author of The Spaulding Group's Guide to the Performance Presentation Standards: Second Edition (TSG Publishing, 2012); contributing author of Performance Measurement in Finance (Butterworth-Heinemann, 2002); and is a co-editor and contributing author of Readings in Fixed Income Attribution (TSG Publishing, 2007) and Classics in Investment Performance Measurement (TSG Publishing, 2009).

He has served on numerous industry committees including the USIPC (United States Investment Performance Council, formerly the North American Investment Performance Committee; and prior to that, the AIMR-PPS Implementation Subcommittee), the Investment Performance Council (IPC), the IPC's Interpretations Subcommittee, and the Performance Measurement Forum's Hedge Fund and IIR Working Groups.

Dave served in the United States Army for five years, where he earned the rank of Captain. He held various leadership positions with the Field Artillery while serving with the 25th Infantry Division (Schofield Barracks, HI) and the Field Artillery School (Ft. Sill, OK). In addition, he served as an operations research analyst at the Field Artillery School (Ft. Sill, OK).

He earned a BA in Mathematics from Temple University, an MS in Systems Management from the University of Southern California, an MBA in Finance from the University of Baltimore, and a doctorate in Finance and International Economics from Pace University.

Dave spent six years in local politics including a four-year term as Mayor for the Township of North Brunswick (NJ), a community of 38,000 people. As the chief executive officer for the township, he was responsible for over 250 employees and a budget in excess of $30 million.

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Steve advises major US broker-dealers in the private wealth and private client businesses that offer investment advice and brokerage services to high-net-worth clients as well as broker-dealers serving self-directing clients. He also works as counsel on various matters to the Securities Industry and Financial Markets Association's (SIFMA) private client committee and represents most of the best-known US broker-dealers in this area. He also advises broker-dealers and investment advisers in the managed account or wrap fee area, and serves as counsel to the Money Management Institute, the principal trade association focused on managed accounts. Steve also counsels various institutional investment advisers and banks on investment management issues, including conflicts, trading, disclosure, advertising, distribution, and other ongoing regulatory compliance matters.

Steve's practice includes counseling clients on varied regulatory and transactional matters including the development of innovative products and services; regulation and operation of managed account (or wrap fee) programs and hedge funds; trading issues affecting broker-dealers and investment advisers; soft dollar arrangements; interpretive and no-action letter requests; insider trading issues; and related matters. He guides clients through SEC, Financial Industry Regulatory Authority (FINRA), and state investigations and enforcement actions. Additionally, he counsels clients on mergers, acquisitions, and joint ventures involving broker-dealers and investment advisers.

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Jack sits on the board of directors of Philadelphia VIP Inc., which coordinates the provision of civil legal services to low-income individuals and families.

Our Global Reach

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Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

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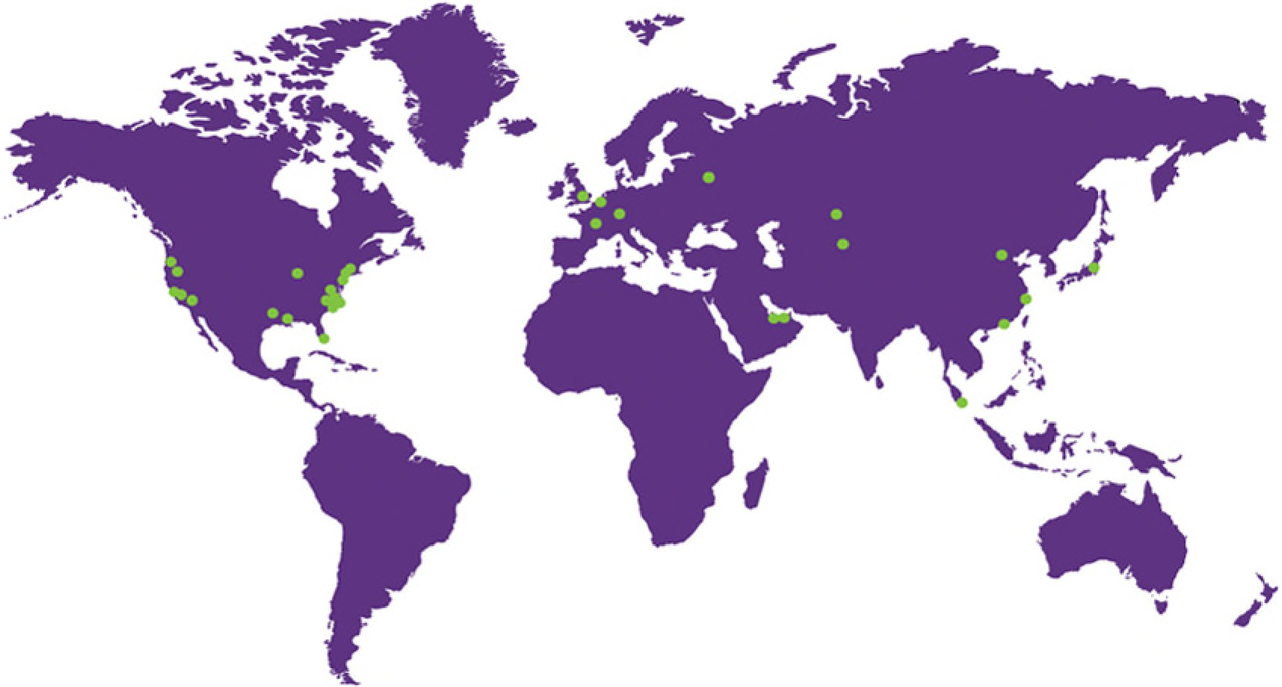

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