GPS INSIGHTS

November 2022

BACK IN PERSON! HIGHLIGHTS FROM THE 2022 GIPS® STANDARDS ANNUAL CONFERENCE

After being limited to a virtual event the last two years, the GIPS Standards Annual Conference returned to Boston last month, live and in person. The two-day event was held at the Boston Park Plaza on October 25th and 26th and it did not disappoint. The conference was well attended, based on the circumstances, bringing over 300 investment performance measurement and compliance professionals together from around the world who were eager to finally reconnect in person.

Conference Recap

The conference kicked off with back-to-back hour-long sessions that focused on the SEC's new Marketing Rule. The sessions were led by Michael McGrath, CFA, a Partner with K&L Gates; Christine Schleppegrell, the Acting Branch Chief of the Private Funds Branch of the SEC; and Karyn Vincent, CFA, CIPM, the Senior Head of Global Industry Standards at CFA Institute. These sessions were engaging, inciteful, and – we assume for many – eye opening. Key highlights and takeaways from the sessions are outlined starting on page 3.

The day continued with a discussion on data visualization and how GIPS-compliant firms can use visualization tools. Data visualization transforms information into a format that is easier to understand, including pictures, diagrams, or charts. The panelists, Joe Kavanagh, CFA, the Head of Performance Measurement and Risk Analysis at KBI Global Investors, and Michael Ford, Director, Reporting Enablement at Manulife Investment Management, provided some interesting examples and case studies outlining how data visualization could be used to effectively communicate complicated information.

The following session took a deep dive into some of the technical issues related to the use of IRR for performance measurement, including approaches to calculating gross-of-fees IRRs and accounting for subscription line of credit activity. The panelists outlined many of the challenges associated with calculating IRRs, such as dealing with multiple sets of data that rarely line up (custodial data, consultant data, manager data, etc.).

The next session focused on ESG attribution. The session discussed how firms are attempting to evaluate how ESG factors have contributed to performance and the associated complexities. At this point, it seems managers are taking various approaches and focusing on key factors that they feel are most relevant to them, without much movement toward industry-wide standardization.

The second to last session of the day was an informative discussion with a panel of verifiers and consultants who provided some perspective on how they see GIPS compliance implemented and maintained at different firms. Among other things, the panel offered some good advice related to the elements that should be included in a firm's GIPS compliance policies and procedures, including ensuring all requirements of the GIPS standards are addressed and that a procedure is outlined for every policy.

The day closed with a GIPS Standards Update. The discussion highlighted three Q&A's that were recently published by CFA Institute and are now available in the Q&A database on the GIPS standards website, addressing that:

1) No specific methodology is required when synthetically allocating cash to carve outs.
2) Preliminary performance may be presented in GIPS Reports but is subject to the firm's error correction policy when material changes occur.
3) Benchmark returns included in GIPS Reports may be net of transaction costs, but this fact must be disclosed, including the period for which transaction costs are deducted.

CFA Institute has also recently released a few new tools and resources, including a comprehensive GIPS Report Disclosure Checklist. These are available at www.gipsstandards.org/resources/tools/.

On the second day, our own Amy Jones, CIPM, Founder and Principal of Guardian Performance Solutions, joined a panel discussing model portfolio programs and things participants in these programs need to consider to comply with the GIPS standard and the SEC Marketing Rule. Amy was joined by Lance Dial, a Partner at Morgan, Lewis & Bockius LLP, and Brooks Friederich, Principal Director, Research Strategy, at Envestnet|PMC. The panel discussed whether there is an expectation to provide a GIPS Report to parties that a model delivery strategy is marketed to. The conclusion was that these parties would not be considered "prospective clients" under the GIPS standards if they could never become actual clients of the compliant firm. As a result, parties interested in a model delivery strategy would not necessarily need to be provided a GIPS Report, though firms would not be precluded from doing so if desired.

Another highlight was an entertaining and educational session delivered by Carl Bacon, CIPM titled "Contribution to Performance Analysis – 10 Famous People." The session focused on 10 people who are famous for other reasons, but who also made significant contributions to performance analysis. Carl expertly wove a biographical summary of these individuals into a detailed and fascinating history of performance measurement, building up to the reveal of who (in Carl's esteemed opinion) made the most significant contribution. We won't spoil the ending – you will need to watch the recording or ask Carl!

The second day also included sessions exploring OCIO Performance Issues, Connections Between the GIPS Standards and ESG Standards, and Ethical Questions in Performance.

The conference concluded with GIPS Standards Help Desk Case Studies. This session covered a number of questions that the GIPS Standards Help Desk has received related to specific topics. One we found to be particularly timely addressed whether a change in methodology used to calculate net returns should be considered an error. Unless the prior returns presented were not consistent with the requirements of the GIPS standards, this type of change would be considered a business decision and not an error. However, if the change is significant, it may still warrant disclosure out of an abundance of caution. This is good news as firms are updating GIPS Reports to comply with the SEC Marketing Rule and may find it necessary to change the methodology retroactively for how net returns are calculated.

GIPS Standards Conference In Focus – SEC Marketing Rule

The hottest topic of discussion at this year's GIPS Standards Annual Conference was not actually directly related to the GIPS standards. It was the SEC's new Marketing Rule (the "Rule") and its imminent effective compliance date of November 4, 2022.

- Many of the key questions stemming from the new Rule are related to the requirement to present net performance. If presenting performance for a portfolio (including a group of portfolios aggregated as a composite or portions of a portfolio that are extracted), the performance must be net of fees. Gross performance can be shown as well, but it can be no more prominent than the net returns. While the Rule is clear as to what an adviser needs to do when presenting performance of a portfolio, it is less clear what an adviser's obligations would be when presenting statistics that are derived from performance (performance-related metrics). During the opening session, Mr. McGrath illustrated an argument that risk-adjusted returns, such as Information Ratio, may not be considered "performance" subject to the Rule because they are *describing* the performance rather than directly *expressing* the performance of the portfolio. However, he then cautioned the audience that presenting such measures on a gross basis could introduce some risk. However, Ms. Schleppegrell provided a different, surprisingly less rigid perspective. In her remarks, she acknowledged that certain statistics may not be susceptible to being calculated on both a gross and net basis. Additionally, she explicitly referenced Sharpe Ratios as a performance-related metric that she would not expect to be presented both gross and net, as Sharpe Ratio is not designed to communicate to an investor what they would "take home," but rather how much benefit was obtained for the amount of risk taken.

> **Key Take Away:** If presenting statistics that convey how well a portfolio performed, then such statistics would likely be viewed as "performance" under the Rule and would need to be presented net of fees.

- Specifically with regard to GIPS-required statistics, such as internal dispersion and three-year annualized ex post standard deviation, the panel expressed the view that such measures do not need to be presented on a net-of-fees basis. The rationale being that these statistics do not measure how well an adviser did and, therefore, should not be considered performance subject to the net requirement.

- There was also a lengthy discussion on attribution and whether it qualifies as extracted performance or needs to be presented net of fees. If an adviser were to extract a single sector from a portfolio and present the performance of that sector in an advertisement in isolation, that would clearly be considered extracted performance under the Rule. However, Mr. McGrath illustrated a compelling argument that if all sectors of a portfolio were presented with equal prominence as a means to demonstrate the characteristics of the portfolio, rather than to market the sectors as separate products or investment strategies, that likely would not be considered an extract. Additionally, the view was expressed that attribution would not need to be presented net of fees for each individual sector. Rather, an overall demonstration of the effect of fees at the total portfolio level should be sufficient to satisfy the net requirement under the Rule.

Key Take Away: If presenting performance-related metrics on a gross-of-fees basis, advisers should document how they concluded that doing so was the most appropriate and least misleading way to present the information.

- If using model fees to calculate net returns, the view was expressed that, if fees have increased, it may be necessary to restate returns retroactively to reflect the higher fee. Unlike the GIPS standards, the Marketing Rule is less concerned about consistency over time and is more focused on ensuring the information provided to prospective clients is relevant to them.
- There was also a discussion of presenting multiple net returns (for example, including net returns that reflect fees charged to institutional clients and retail clients separately, but within the same advertisement). Ms. Schleppegrell expressed some concerns about this practice and suggested that the adviser should ensure that the recipient of the advertisement is eligible for all of the different fee rates presented. She conceded that the issue could possibly be cured by disclosure, but care must be taken to ensure the presentation is not misleading.
- In discussing hypothetical performance, the idea was suggested that not all types of hypothetical performance are necessarily created equal. For example, target returns (though deemed hypothetical under the Rule), may be less likely to mislead investor than a backtested track record. With this in mind, the policies and procedures established by an adviser to determine who can receive hypothetical performance may potential be less stringent for targets than for backtests.
- Panelists also discussed complications with submitting performance data to consultant databases and meeting the net requirement. If the goal of submitting information to a database is that it will be disseminated to a broader audience than the consultant itself, then it likely would be viewed as an advertisement, and the data submitted must be net of fees. However, many databases are pushing back and continuing to require gross returns only. Managers are faced with submitting performance in the best way they can or removing themselves from the databases, which puts them at a disadvantage. As a counter to this, the question was asked whether a database could be viewed as a specific request that would be exempt from the requirements for advertisements, but the panel thought that would be too aggressive of an approach.

GIPS Standards Conference Digital Package Still Available

For those who were not able to attend the GIPS Standards Conference, CFA Institute has made available a Digital Content Package which contains all of the resources and session recordings from the conference. Additionally, a separate package limited to the SEC Marketing Rule sessions is available for only $129. Those who are interested in purchasing the digital content can register for access on the CFA Institute website. Please note, the conference session recordings and resources will be available for on-demand viewing until December 2nd.

Your Input is Needed – USIPC Error Correction Survey

The United States Investment Performance Committee (USIPC), together with CFA Institute, is conducting a survey regarding policies and procedures for error correction under the GIPS standards.

The purpose of this survey is to update the 2014 Error Correction survey, to reflect changes in the 2020 edition of the GIPS standards, and to obtain insight about error correction policies covering all information in GIPS Reports. The survey should take no more than 10 minutes to complete. The USIPC and CFA Institute staff greatly appreciate your participation in this survey.

Please note that the information submitted through this survey will be kept confidential. CFA Institute will use this data for statistical purposes only. Any data released will be in aggregate form. Entity-specific information will never be released to any party outside of CFA Institute.

You can find the survey here. The survey will close on November 30th.

Growing the Guardian Performance Solutions Team

We recently made a significant addition to our team with the hiring of Sara DiCostanzo, CIPM as a Senior Compliance Consultant. With over 12 years in the industry, Sara has extensive experience in all aspects of performance measurement and applying the GIPS standards to various types of firms. She has consulted with a broad range of investment advisers ranging in size from $500 million to $800 billion in assets under management, spanning multiple asset classes, including structured credit, hedge funds, private equity, long-only investments, mutual funds, fixed income, overlay, and wrap accounts. Her technical expertise and background in project management allow her to partner with stakeholders from various business units, as well as external providers, to evaluate internal controls, processes, procedures and propose changes to strengthen operations.

We are excited that she made the decision to join us!

ABOUT US

Guardian Performance Solutions LLC (GPS) is a specialty compliance consulting firm dedicated to providing customized solutions to the investment management industry with the objective of helping firms to achieve and maintain compliance with the Global Investment Performance Standards (GIPS®) and facilitating the production of compliant performance advertising materials. Because GPS does not provide verification services, GPS is free from independence concerns and can take a hands-on approach to developing and managing an adviser's GIPS compliance program, which may include constructing composites, calculating and validating performance results, and writing GIPS compliance policies and procedures. Additional information can be found at www.GuardianPerformanceSolutions.com.