A FIRST LOOK AT THE CFA INSTITUTE'S FINAL 2020 GIPS STANDARDS

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On June 28, 2019, the CFA Institute published the 2020 edition of the Global Investment Performance Standards (the "**2020 Standards**"). The Global Investment Performance Standards ("**GIPS**") are voluntary ethical standards that seek to establish a single set of standards to facilitate the calculation and presentation of investment performance that is readily comparable among investment firms, regardless of geographic location and local conventions.[1] Firms claiming GIPS compliance must prepare GIPS reports for periods ending on or after December 31, 2020 in accordance with the 2020 Standards.[2]

Although a significant number of the largest asset managers in the world claim compliance with GIPS, there has not been widespread adoption among alternative investment managers and other managers of pooled funds. The revisions set forth in the 2020 Standards are designed to facilitate broader adoption of GIPS by these managers. The 2020 Standards reflect the CFA Institute's intent to ensure GIPS is relevant and applicable to all asset managers, regardless of structure, client type, asset class, or investment strategy.[3] While the final 2020 Standards closely follow revisions that were initially proposed in the GIPS 2020 Exposure Draft (the "**Exposure Draft**") released in August 2018, further refinements clarify ambiguities in the Exposure Draft and reduce the burden of compliance, particularly on alternative fund managers. These refinements, which we summarize below, address many concerns voiced by the investment industry since the release of the Exposure Draft.

SIGNIFICANT CHANGES IN THE 2020 STANDARDS

The 2020 Standards revise many fundamental provisions of the 2010 edition of GIPS ("**2010 Standards**"). Prominent changes that were introduced in the Exposure Draft and ultimately adopted in the 2020 Standards include the following:

1. *Introduction of Pooled Fund Reports*. The 2020 Standards permit managers of broad distribution pooled funds ("**BDPF**") (*e.g.*, U.S. registered funds or UCITS) and limited distribution pooled funds ("**LDPF**") (*e.g.*, U.S. private funds and AIFs) to present GIPS-compliant performance reports at the pooled fund level. This represents a significant change from the 2010 Standards, which require firms to create single-fund composites if a pooled fund does not meet the definition of any existing composite. Under the 2020 Standards, managers may avoid preparation of a report for a BDPF entirely if the BDPF's strategy is not offered to separate account clients. Alternatively, if the BDPF's strategy is offered to separate account clients, the BDPF must be included in the applicable composite(s) (which need not be delivered to potential investors in the BDPF).

2. *Portability*. Linking the performance of an acquired firm or investment team to performance at the new firm is now optional under the 2020 Standards. By contrast, the 2010 Standards *require* linking prior performance if certain criteria are met. The 2020 Standards also clarify that the one-year "grace period" applies on a prospective basis only. Thus, firms will no longer be required to ensure that pre-acquisition performance is compliant within one year of an acquisition.
3. *Carve-Outs*. Unlike the 2010 Standards,[4] the 2020 Standards permit firms to include in composites "carve-out" strategies with allocated cash. However, if a firm chooses to include carve-outs in a composite, the firm must create carve-outs with allocated cash from *all portfolios within the firm managed to that strategy*, and must include those carve-outs in the composite. Once a firm maintains standalone portfolios managed in the same strategy as the carve-out(s), the firm must create a separate composite including only the standalone portfolios. The GIPS report for the composite containing carve-outs with allocated cash must also present the returns and composite assets from the GIPS composite report for the standalone portfolios.
4. *Money-Weighted Returns*. The 2010 Standards generally permitted only time-weighted returns, with certain exclusions for alternative asset classes. Under the 2020 Standards, a firm that controls the timing of external cash flows and meets certain other criteria may present an internal rate of return (defined in the 2020 Standards as the "money-weighted return") in lieu of or in addition to time-weighted returns.
5. *Valuation*. Under the 2020 Standards, valuation frequency is primarily determined based on the type of returns presented and whether the portfolio is presented in a GIPS composite report or a GIPS pooled fund report. The 2020 Standards also require real estate investments in a real estate open-end fund to have an external valuation at least once every 12 months; however, this is only a recommendation for other private market investments.

KEY DIFFERENCES FROM THE 2020 EXPOSURE DRAFT

The CFA Institute first proposed revisions to the 2010 Standards in the Exposure Draft, which was released in August 2018. Key differences between the 2020 Standards and the Exposure Draft proposals include the following:

6. *Pooled Fund Definitions*. The final 2020 Standards redefine BDPFs and LDPFs to more clearly classify different types of pooled funds as one or the other. The new BDPF definition includes any pooled fund regulated under a framework that permits the general public to purchase or hold the pooled fund's shares, and that is not exclusively offered in one-on-one presentations. LDPFs are defined as any pooled fund that is not a BDPF. These definitions clarify that an individual fund available to the public is a BDPF, even if it is also marketed to institutions or in private offerings (*e.g.*, funds with retail and institutional share classes and funds that are sold to the public in one jurisdiction, but in private placements in another jurisdiction).
7. *LDPF Pooled Fund Reports*. The Exposure Draft proposals required in all cases that a firm provide prospective investors in an LDPF with a GIPS pooled fund report that included only performance of the LDPF. Unlike for BDPFs, a GIPS report must be provided to prospective investors in an LDPF; however, the final 2020 Standards permit firms to present either the GIPS pooled fund report for the specific pooled fund, or the GIPS composite report that includes the LDPF.

8. *Addition of Fourth Portability Test*. The 2020 Standards include a fourth portability test not specified in the Exposure Draft proposal. This test expressly prohibits linking performance from a prior firm to performance obtained at an acquiring firm if there is a break in the track record. An acquiring firm may still present the prior firm's track record if the other three portability requirements are met, but the track record may not be linked after the break. The adopting release accompanying the 2020 Standards also clarifies that a firm that cannot meet all of the portability tests (*e.g.*, substantially all decision-makers are not employed by the acquiring firm) may present prior firm performance as supplemental information. In all cases, the firm must have the records to support the performance from the prior firm.[5]
9. *Valuation*. The Exposure Draft proposed treating all private market investments equally with respect to the proposed valuation requirements. The final 2020 Standards distinguish between valuation requirements applicable to real estate investments and other private market investments.

PRACTICAL IMPACTS OF THE 2020 STANDARDS

As noted above, one of the CFA Institute's express goals in revising GIPS is to facilitate broader adoption among alternative investment managers, in particular managers of private equity, hedge, real estate, and private credit funds. This effort coincides with increased demands from institutional investors for GIPS compliance in certain alternative asset classes, such as private credit, that have not historically reflected broad adoption of GIPS. While the revisions reflected in the 2020 Standards will impact all firms that claim GIPS compliance, in particular, alternative investment managers that either claim compliance or are considering whether to claim compliance should consider how the 2020 Standards will affect their performance presentations and sales opportunities.

This executive summary addresses only a handful of important revisions included in the 2020 Standards. There are many more substantive changes set forth in the 2020 Standards that will affect how firms claiming GIPS compliance may calculate and present investment performance, and the CFA Institute is preparing additional explanations for each provision of the 2020 Standards, which will be published in the form of a Handbook once complete. Many of these revisions will require substantial and time-consuming overhauls of current performance reporting processes. Before taking action, firms should consider how to best implement the 2020 Standards, and ensure they have a strong understanding of how the 2020 Standards apply to them specifically.

The adoption of the 2020 Standards and expected amendments to the Security and Exchange Commission's Advertising Rule will have a significant impact on the marketing activities of global asset managers in the coming years. K&L Gates will be hosting a series of events and webinars on the 2020 Standards. Visit our Investment Adviser Marketing Resource Center to stay informed of these events and regulatory and marketplace developments, and to learn how K&L Gates' practical insights can help you navigate these changes.

Notes

[1] GIPS® is a registered trademark owned by CFA Institute.
[2] Firms may elect early compliance with the 2020 Standards. However, firms that early adopt must comply with all requirements of the 2020 Standards, including the requirements related to GIPS reports.
[3] The 2020 Standards also include provisions specific to asset owners and provisions specific to verifiers. All three parts of the 2020 Standards were published as separate documents.

[4] The 2010 Standards do not permit the inclusion of carve-outs in composites unless the carve-out is managed separately with its own cash balance. Carve-outs with allocated cash may not be included.
[5] Firms should take care to consider limitations on performance portability imposed by their regulators. For example, firms registered with the U.S. Securities and Exchange Commission ("**SEC**") that fail the GIPS portability tests likely will not satisfy guidance set forth by the SEC staff for including prior firm performance in advertisements.

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