

Global Investment Performance Standards (GIPS®) for Firms

Explanation of the
Provisions in Section 4

March 2020



CFA Institute®
Global Investment
Performance Standards

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INTRODUCTION

The Explanation of the Provisions in Section 4 provides interpretation of each provision that is included in Section 4—Composite Time-Weighted Return Report. Firms that choose to comply with the Global Investment Performance Standards (GIPS®) must comply with all applicable requirements of the GIPS standards, including any Guidance Statements, interpretations, and Questions and Answers (Q&As) published by CFA Institute and the GIPS standards governing bodies.

Section 4 includes the requirements and recommendations for preparing a GIPS Composite Report that includes time-weighted returns. Firms that prepare a GIPS Composite Report that includes time-weighted returns must include the required numerical information and disclosures specified in Section 4, if applicable to the specific composite.

Each provision is included in a grey text box. Within the provisions are words appearing in small capital letters. This indicates defined terms that can be found in the GIPS Standards Glossary. Below each provision is a discussion that provides interpretive guidance to help readers understand the provision.

4. COMPOSITE TIME-WEIGHTED RETURN REPORT

Firms that prepare a GIPS Composite Report that includes time-weighted returns must include the following required numerical information and disclosures, if applicable to the specific composite.

4.A. Presentation and Reporting—Requirements

Provision 4.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- a. At least five years of performance (or for the period since the COMPOSITE INCEPTION DATE if the COMPOSITE has been in existence less than five years) that meets the REQUIREMENTS of the GIPS standards. After the FIRM presents a minimum of five years of GIPS-compliant performance (or for the period since the COMPOSITE INCEPTION DATE if the COMPOSITE has been in existence less than five years), the FIRM MUST present an additional year of performance each year, building up to a minimum of 10 years of GIPS-compliant performance.

Discussion

To claim compliance, a firm is required to meet all applicable requirements of the GIPS standards on a firm-wide basis for at least a five-year period, or since inception of the firm if the firm has been in existence for less than five years. When initially claiming compliance with the GIPS standards, a firm must present a minimum of five years of composite performance or performance since the inception of the composite if the composite has been in existence for less than five years.

Once the firm has its initial minimum five years of GIPS-compliant history, the firm must continue to add annual returns to each GIPS Composite Report, so that five years after initially claiming compliance with the GIPS standards, the firm will have a 10-year performance record for its composites. It is recommended that firms present a composite's history for more than the minimum required periods. (See Provision 4.B.6.)

Provision 4.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- b. COMPOSITE returns for each annual period.

Discussion

The GIPS standards require the presentation of annual composite returns. Firms must clearly label the annual presentation periods. Firms must define the annual reporting period on a composite-by-composite basis and apply it consistently. For purposes of comparability, best practice would be for a firm to report composite performance on a calendar year-end basis.

Within each GIPS Composite Report, the annual periods must be consistent. For example, a firm that reports a composite's performance annually as of 30 June must consistently report data for years ending 30 June for that composite. The firm may decide in the future to change to a 31 December valuation and reporting date; however, the firm may not mix 30 June and 31 December valuation and reporting dates in the same GIPS Composite Report.

Although the GIPS standards require the presentation of annual returns, it is recommended that firms present more frequent returns, such as quarterly or monthly returns. (See Provision 4.B.2.c.) More frequent returns help prospective clients evaluate a composite's track record.

Composite returns may be presented either gross-of-fees or net-of-fees, with one exception. Wrap fee composite returns must be presented net of the entire wrap fee. Firms may also choose to present both gross-of-fees and net-of-fees composite returns in a GIPS Composite Report.

Provision 4.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- c. When the initial period is less than a full year, the return from the COMPOSITE INCEPTION DATE through the initial annual period end.²⁹

Discussion

When a composite has an initial period that is less than a full year, the GIPS standards require that the return be presented for the partial year from the composite inception date through the initial

²⁹REQUIRED for COMPOSITES with a COMPOSITE INCEPTION DATE of 1 January 2011 or later.

annual period end. This is required for composites that begin on or after 1 January 2011. Although not required to do so for composites that begin prior to this date, firms should consider presenting the initial partial year of performance for all composites.

For example, assume that a firm presents composite returns for annual periods ended 31 December, and a new composite is created with a track record beginning 1 April 2018. The initial GIPS Composite Report for this composite must include the composite return for the period from 1 April 2018 through 31 December 2018. Subsequently, the firm must add annual returns, building up to a minimum 10-year track record.

Partial-year returns must not be annualized. As an example, a composite that began on 1 December 2020 and has a one-month initial return through 31 December 2020 of 3% (which equates to an annualized return of 42.6%) would be required to present that 3% as the partial year's performance. The annualized return of 42.6% must not be presented. Some spreadsheet and software applications automatically annualize all returns, and firms are reminded that for periods of less than a year, the firm must "de-annualize" any annualized returns that are calculated.

The method chosen to de-annualize a return is at the discretion of the firm, but it must be a geometric calculation. In the situation just presented, the 42.6% annualized return could be de-annualized by one of the following formulas:

$$\left\{ \left[\left(1 + 0.426 \right)^{\left(\frac{1}{12} \right)} \right] - 1 \right\} \times 100 = 3\% \quad \text{or} \quad \left\{ \left[\left(1 + 0.426 \right)^{\left(\frac{31}{365} \right)} \right] - 1 \right\} \times 100 = 3\%,$$

both resulting in a non-annualized one-month return of 3%.

Provision 4.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- d. When the COMPOSITE terminates, the return from the last annual period end through the COMPOSITE TERMINATION DATE.³⁰

Discussion

The GIPS standards require that returns from the last annual period end through the composite termination date be presented for composites with a termination date of 1 January 2011 or later. Assume that a firm presents composite returns for annual periods ended 31 December and a composite terminates so that the track record ends 31 August 2017. The GIPS Composite Report

³⁰REQUIRED for COMPOSITES with a COMPOSITE TERMINATION DATE of 1 January 2011 or later.

for this composite must include the composite return for the period from 1 January 2017 through 31 August 2017. Partial-year returns must not be annualized. As an example, a composite that terminates on 31 January 2020 and has a one-month return for January 2020 of 3% (which equates to an annualized return of 42.6%) would be required to present that 3% as the partial year’s performance. The annualized return of 42.6% must not be presented. Some spreadsheet and software applications automatically annualize all returns, and firms are reminded that for periods of less than a year, the firm must “de-annualize” any annualized returns that are calculated.

The method chosen to de-annualize a return is at the discretion of the firm, but it must be a geometric calculation. In the situation just presented, the 42.6% annualized return could be de-annualized by one of the following formulas:

$$\left\{ \left[(1 + 0.426)^{\left(\frac{1}{12}\right)} \right] - 1 \right\} \times 100 = 3\% \quad \text{or} \quad \left\{ \left[(1 + 0.426)^{\left(\frac{31}{365}\right)} \right] - 1 \right\} \times 100 = 3\%,$$

both resulting in a non-annualized one-month return of 3%.

Provision 4.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- e. The TOTAL RETURN for the BENCHMARK for each annual period and for all other periods for which COMPOSITE returns are presented, unless the FIRM determines there is no appropriate BENCHMARK.

Discussion

Benchmarks are important tools that aid in the planning, implementation, and evaluation of a portfolio’s investment policy. They also help facilitate discussions with prospective clients regarding the relationship between risk and return. As a result, firms are required to present a total return for the benchmark that reflects the composite’s investment mandate, objective, or strategy for each annual period. A firm may choose to present more than one benchmark in a GIPS Composite Report and, if it does so, it must include all required information for all benchmarks included in a GIPS Composite Report.

In addition to the required annual benchmark returns, firms must also present benchmark returns for the same periods for which composite returns are presented. For example, if the GIPS Composite Report includes quarterly composite returns, quarterly benchmark returns must also be included.

Because the GIPS standards require that the total return for the benchmark be presented, a price-only index would not satisfy the requirements of the GIPS standards. This scenario also applies to benchmarks that are components of a blended benchmark. A price-only benchmark may be

presented in a GIPS Composite Report as supplemental information only if it is presented in addition to a total return benchmark. It must be labeled as a price-only benchmark, and there must be sufficient disclosures so that a prospective client understands the difference between the return of a price-only benchmark and the return of a total return benchmark. Firms must not present only a price-only benchmark even if no appropriate total return benchmark is available for a specific strategy. If a firm determines that no appropriate benchmark for the composite exists, it must not present a benchmark and must disclose why no benchmark is presented. (See Provision 4.C.31.)

Some benchmarks, such as commodity benchmarks, may not have income because the asset class does not create income, but they are still considered to be total return benchmarks. Target returns, such as an 8% hurdle rate, may also not have income, but this is not considered a price-only return.

Provision 4.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- f. The number of PORTFOLIOS in the COMPOSITE as of each annual period end. If the COMPOSITE contains five or fewer PORTFOLIOS at period end, the number of PORTFOLIOS is NOT REQUIRED.

Discussion

Each GIPS Composite Report must include information about the number of portfolios included in the composite. These figures must be presented as of the end of each annual period that is included in the GIPS Composite Report. This requirement provides information to prospective clients on whether the composite is composed of a small number of portfolios or many. In cases where there are five portfolios or fewer in a composite at period end, the firm may choose to not present the number of portfolios in the composite. The firm might choose to do this to protect the identity and confidentiality of its clients. Because firms must present information about the number of portfolios in the composite, however, firms must either (1) state that the composite contains “five or fewer portfolios,” “less than six portfolios,” or use similar language, or (2) present the actual number of portfolios in the composite. (See Provision 4.C.39.)

Note that “five or fewer portfolios in the composite” refers to the number of portfolios in the composite at the annual period end and not the number of portfolios in the composite for the full year. For example, if there were four portfolios in the composite for the full year but eight portfolios in the composite at year end, the firm would present eight, the actual number of portfolios in the composite at year end. The number of portfolios in the composite also must not include those portfolios that are joining the composite as of the next period. For example, assume a firm reports performance on a calendar year basis. A new portfolio that is funded during December and will be included in the composite beginning 1 January must not be included in the number of portfolios in the composite as of 31 December.

Provision 4.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- g.** COMPOSITE assets as of each annual period end.

Discussion

Each GIPS Composite Report must include the amount of composite assets as of the end of each annual period that is included in the GIPS Composite Report. This requirement provides information to prospective clients on the size of the composite, measured by the amount of assets it contains. When the composite strategy uses discretionary leverage, composite assets must be presented net of the discretionary leverage and not grossed up as if the discretionary leverage did not exist. Discretionary leverage refers to loans taken at the discretion of the firm. In contrast, non-discretionary leverage refers to borrowings that are mandated by the client. For example, if a composite has \$200 million in assets, including \$50 million of assets borrowed by the firm, the composite's net assets are \$200 million and its gross assets are \$250 million. When calculating composite assets, the firm must use \$200 million.

If a portfolio is temporarily excluded from a composite because of the composite's minimum asset size policy or significant cash flow policy, or is excluded for any other reason, the portfolio's assets would not be included in composite assets for the period(s) for which the portfolio was excluded. However, the portfolio's assets would be included in total firm assets for all periods for which the portfolio is under management, whether or not it is excluded from the composite. Composite assets do not include assets of those portfolios that are joining the composite as of the next period. For example, assume a firm reports performance on a calendar year basis. A new portfolio that is funded during December and will be included in the composite beginning 1 January must not be included in composite assets as of 31 December.

Provision 4.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- h.** TOTAL FIRM ASSETS as of each annual period end.³¹

Discussion

For annual periods ending on or after 31 December 2020, the firm must present total firm assets as of each annual period end. For annual periods ending prior to this date, the firm must present

either total firm assets or composite assets as a percentage of total firm assets. Discretionary leverage must be deducted when calculating total firm assets. Discretionary leverage refers to loans taken at the discretion of the firm. In contrast, non-discretionary leverage refers to borrowings that are mandated by the client. For example, if a composite has \$200 million in assets, including \$50 million borrowed by the firm, the firm must use \$200 million when calculating total firm assets, not \$250 million. The inclusion of both composite assets and total firm assets in a GIPS Composite Report will help a prospective client understand the composite size in relation to total firm assets.

Non-discretionary portfolios that are excluded from composites are included in total firm assets. Portfolios that are temporarily excluded from a composite because of the composite's minimum asset size policy or significant cash flow policy, or are excluded for any other reason, are also included in total firm assets.

Firms must be sure that assets are not double-counted because counting assets more than once would not fairly represent total firm assets.

See the discussion of Provision 2.A.1 for additional guidance on the calculation of total firm assets.

Provision 4.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- i. A measure of INTERNAL DISPERSION of individual PORTFOLIO annual returns for each annual period. If the COMPOSITE contains five or fewer PORTFOLIOS for the full year, a measure of INTERNAL DISPERSION is NOT REQUIRED.

Discussion

Internal dispersion is a measure of the spread of the annual returns of individual portfolios within a composite. It allows prospective clients to determine how consistently the firm implemented its strategy across the portfolios in the composite for the full annual period. Internal dispersion measures include high–low, range, quartiles, interquartile range, or standard deviation (asset weighted or equal weighted) of portfolio returns as well as other statistical measures.

The GIPS standards do not require or recommend a specific measure to calculate internal dispersion. Instead, the firm is permitted to choose a measure for each composite and apply it consistently. The firm may change which internal dispersion measure is presented for a specific composite but should apply a measure consistently once it is adopted. A widely used internal dispersion measure is standard deviation. Firms are required to disclose which internal dispersion measure is presented.

Because the internal dispersion measure represents the spread of annual returns of individual portfolios within the composite for the full year, only the portfolios that have been managed for the full annual period are included in the internal dispersion calculation. Firms must identify the portfolios in the composite that have been included for the full annual period and calculate the annual return for each of those portfolios. Firms must use those annual returns to calculate the composite's internal dispersion. The GIPS standards acknowledge that, by using only portfolios that have been included in the composite for the full year in the annual internal dispersion calculation, the internal dispersion number will not precisely correlate with the actual composite performance but will inform a prospective client of the dispersion of annual returns of those portfolios included in the composite for the year.

If the firm presents only gross-of-fees returns in the GIPS Composite Report, the firm should use gross-of-fees returns to calculate the internal dispersion measure. If the firm presents only net-of-fees returns in the GIPS Composite Report, the firm should use net-of-fees returns to calculate the internal dispersion measure. If the firm presents both gross-of-fees and net-of-fees returns, it is recommended that the firm use gross-of-fees returns to calculate the internal dispersion measure. (See Provision 2.B.7.) The firm must disclose which returns (gross-of-fees or net-of-fees) are used to calculate the internal dispersion measure. (See Provision 4.C.44.)

The internal dispersion of the individual portfolio returns must be presented for each annual period that is included in the GIPS Composite Report. In cases where there are five or fewer portfolios in a composite for the full annual period, the measure of internal dispersion is not required to be presented. Because firms must include information about the internal dispersion of individual portfolio returns, however, firms must indicate that the internal dispersion measure is not applicable or include other similar language. (See Provision 4.C.40.)

The following are explanations of commonly used measures of internal dispersion.

Equal-Weighted Standard Deviation

A widely used measure of internal dispersion is the standard deviation across equal-weighted annual portfolio returns. The formula is as follows:

$$\text{Equal-weighted standard deviation} = \sqrt{\frac{\sum [R_{PORTi} - MEAN(R)]^2}{n}}$$

where R_{PORTi} is the annual return on the i th portfolio that has been in the composite for the full annual period, n is the number of portfolios in the composite for the full annual period (the use of n is best practice and preferable, but either n or $n - 1$ in the denominator of the standard deviation calculation is acceptable), and $MEAN(R)$ is the equal-weighted mean return of the portfolios in the composite for the full annual period, where

$$MEAN (R) = \frac{R_{PORT1} + R_{PORT2} + \dots + R_{PORTn}}{n},$$

where R_{PORT1} is the time-weighted return for the first portfolio in the composite for the full annual period, R_{PORTi} is the time-weighted return for the i th portfolio in the composite for the full annual period, and n is the number of portfolios in the composite for the full annual period. Because only portfolios that are included in the composite for the full annual period are included in the internal dispersion calculation, n may be different from the number of portfolios at period end shown in the GIPS Composite Report.

Asset-Weighted Standard Deviation

Another widely used measure of internal dispersion is the asset-weighted standard deviation of annual portfolio returns. The formula is as follows:

$$\text{Asset-weighted standard deviation} = \sqrt{\sum W_i [R_{PORTi} - (\sum W_i R_{PORTi})]^2},$$

where W_i is the individual portfolio weight and R_{PORTi} is the individual portfolio annual return.

High-Low and Range

The high–low and the range are the simplest and most easily understood measures of internal dispersion. Their key advantages are simplicity, ease of calculation, and ease of interpretation. One disadvantage of these measures is that one extreme value or outlier can skew the internal dispersion measure.

Interquartile Range

Another measure of internal dispersion is the interquartile range, which measures the difference between the median value of ranked data sets Q_1 and Q_3 .

$$\text{Interquartile range: } Q_R = Q_1 - Q_3$$

where

Q_1 = first or upper quartile return

Q_3 = third or lower quartile return

The following is an example of the calculation of the various internal dispersion measures.

Firm A has a composite that consists of 15 portfolios. Ten of the portfolios have been in the composite for the entire year.

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A	B	C	D	E	F	G	H	I	J
1	Portfolio	BMV	Annual Return	Weight (BMV)	Contribution (BMV)	Difference to Equal Weighted Mean	Squared Difference (equal weighted mean)	Difference to Asset Weighted Mean	Squared Difference (asset weighted mean)
2	1	100,000	5.2%	3.85%	0.20%	0.07%	0.0000%	0.02%	0.0000%
3	2	300,000	4.9%	11.54%	0.57%	-0.23%	0.0005%	-0.28%	0.0008%
4	3	200,000	5.5%	7.69%	0.42%	0.37%	0.0014%	0.32%	0.0010%
5	4	500,000	5.6%	19.23%	1.08%	0.47%	0.0022%	0.42%	0.0018%
6	5	100,000	5.1%	3.85%	0.20%	-0.03%	0.0000%	-0.08%	0.0001%
7	6	250,000	4.7%	9.62%	0.45%	-0.43%	0.0018%	-0.48%	0.0023%
8	7	450,000	5.2%	17.31%	0.90%	0.07%	0.0000%	0.02%	0.0000%
9	8	200,000	4.8%	7.69%	0.37%	-0.33%	0.0011%	-0.38%	0.0014%
10	9	300,000	5.3%	11.54%	0.61%	0.17%	0.0003%	0.12%	0.0001%
11	10	200,000	5.0%	7.69%	0.38%	-0.13%	0.0002%	-0.18%	0.0003%
12	Sample formulas for portfolio 10			=B11/\$B\$13	=C11*D11	=(C11-\$D\$16)	=F11^2	=(C11-\$E\$13)	=H11^2
13	Sum (Portfolios 1-10)	2,600,000		100.00%	5.18%				=D11*111
14	Asset Weighted Mean			5.18%	=E13				0.0009%
15	Equal Weighted Mean			5.13%	=AVERAGE(C2:C11)				
16	Count of Portfolios			10	=COUNT(C2:C11)				
17	Sum of Squared Differences (to equal weighted mean)			0.0076%	=SUM(G2:G11)				
18	Sum of Squared Differences (to asset weighted mean)			0.0078%	=SUM(I2:I11)				
19	Equal Weighted Standard Deviation			0.2759%	=SQRT(D18/D17)				
20	Asset Weighted Standard Deviation			0.2976%	=SQRT(J13)				
21	High			5.6%	=MAX(C2:C11)				
22	Low			4.7%	=MIN(C2:C11)				
23	Range			0.9%	=D22-D23				
24	First Quartile Return			5.3%	=QUARTILE(C2:C11,3)				
25	Third Quartile Return			4.9%	=QUARTILE(C2:C11,1)				
26	Interquartile Range			0.4%	=D25-D26				

Provision 4.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- j. For COMPOSITES for which monthly COMPOSITE returns are available, the three-year annualized EX POST STANDARD DEVIATION (using monthly returns) of the COMPOSITE and the BENCHMARK as of each annual period end.³²

Discussion

Evaluating past performance requires an understanding of the risks taken to achieve the results. Standard deviation is universally defined as a measure of the variability of returns. For composites for which monthly returns are available, the GIPS standards require the presentation of ex post standard deviation, often referred to as external standard deviation. Ex post standard deviation is a measure of the volatility of a strategy and benchmark over time, and it is intended to measure the risk of investing in the strategy. In contrast, internal standard deviation, discussed in Provision 4.A.1.i, is used to measure the dispersion of portfolio returns within a composite. For periods ending on or after 1 January 2011, firms must present, as of each annual period end, the three-year annualized ex post standard deviation using monthly returns for both the composite and the benchmark.

Standard deviation for both the composite and the benchmark must be calculated using 36 monthly returns. The same formula must be used to calculate standard deviation for the composite and the benchmark.

Some composites, such as those for private market investments, may not have monthly returns. For these composites, if the composite has at least three annual periods of performance, firms 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. (See Provision 4.C.36.)

Ex Post Standard Deviation (External)

Ex post standard deviation is calculated as follows:

$$\text{Composite or benchmark ex post standard deviation} = \sqrt{\frac{\sum [R_i - \text{MEAN}(R)]^2}{n}}$$

where R_i is the return on the i th monthly composite or benchmark return, n is the number of monthly returns used for the external standard deviation calculation (the use of n is best practice and preferable, but either n or $n - 1$ in the denominator of the standard deviation calculation is

³²REQUIRED for periods ending on or after 1 January 2011.

acceptable), and $MEAN(R)$ is the mean monthly return of the composite or the benchmark over the period for which the external standard deviation is being calculated, where

$$MEAN(R) = \frac{R_1 + R_2 + \dots + R_i}{n},$$

where R_1 is the time-weighted return for the first monthly composite or benchmark return, R_i is the i th monthly composite or benchmark return, and n is the number of returns used in the calculation (required to be 36 monthly returns to satisfy this requirement).

Firms are required to select a methodology (i.e., the use of n or $n - 1$) on a composite-specific basis, document it in their policies and procedures, and consistently apply that methodology.

To annualize the three-year ex post standard deviation calculated using monthly returns, the result of the foregoing standard deviation formula must be multiplied by the square root of 12.

If the firm presents only gross-of-fees returns in the GIPS Composite Report, the firm should use gross-of-fees returns to calculate the external standard deviation. If a firm presents only net-of-fees returns in the GIPS Composite Report, the firm should use net-of-fees returns to calculate the external standard deviation. If the firm presents both gross-of-fees and net-of-fees returns, it is recommended that the firm use gross-of-fees returns to calculate the external standard deviation. (See Provision 2.B.7.) The firm must disclose which returns (gross-of-fees or net-of-fees) were used to calculate the external standard deviation. (See Provision 4.C.44.)

Provision 4.A.2

The FIRM MUST present the percentage of the total FAIR VALUE of COMPOSITE assets that were valued using subjective unobservable inputs (as described in Provision 2.B.6.e) as of the most recent annual period end, if such investments represent a material amount of COMPOSITE assets.

Discussion

Markets are not always liquid, and investment prices are not always objective and/or observable. As the last level of the recommended valuation hierarchy indicates (see Provision 2.B.6), it may be necessary for a firm to use subjective unobservable inputs to value an investment for which markets are not active at the measurement date. Examples of subjective unobservable inputs include an assumed discount rate, an assumed occupancy rate for a commercial building, and the default rate used for the valuation of a security in default. Examples related to insurance-linked securities include assumptions regarding hurricane damage and mortality rates. Unobservable inputs should be used to measure fair value only when observable inputs and prices are not

available or appropriate. Unobservable inputs reflect the firm’s own assumptions about the assumptions that market participants would use in pricing the investment and should be developed based on the best information available under the circumstances.

Firms must present the percentage of the total fair value of composite assets that were valued using subjective unobservable inputs as of the most recent annual period end, if such investments represent a material amount of composite assets. The amount of composite assets valued using subjective unobservable inputs would be considered material if it would likely influence a reader’s judgment regarding the reliability of the valuation. The firm must decide on the criteria it will use to determine when subjective unobservable inputs represent a material amount of composite assets, include these criteria in its policy and procedures, and apply these criteria consistently.

Sample Disclosure:

“As of 31 December 2020, 29% of composite assets were valued using subjective, unobservable inputs. These inputs are not supported by market activity and instead are based on internal proprietary pricing models.”

Provision 4.A.3

The FIRM MUST clearly label or identify:

- a. The periods that are presented.
- b. If COMPOSITE returns are GROSS-OF-FEES OR NET-OF-FEES.

Discussion

All periods presented in a GIPS Composite Report must be clearly labeled or identified. This includes annual periods, partial-year periods, and any additional periods presented.

Firms may present either gross-of-fees composite returns or net-of-fees composite returns in a GIPS Composite Report and may also choose to present both gross-of-fees and net-of-fees returns. For prospective clients to understand the nature of the returns being presented, all returns presented must be clearly labeled or identified as gross-of-fees or net-of-fees.

Provision 4.A.4

If the FIRM includes more than one BENCHMARK in the GIPS COMPOSITE REPORT, the FIRM MUST present and disclose all REQUIRED information for all BENCHMARKS presented.

Discussion

It is permissible to include more than one benchmark in a GIPS Composite Report. All benchmarks included in a GIPS Composite Report must adhere to the requirements of the GIPS standards that are applicable to benchmarks. Firms may label benchmarks as primary and secondary benchmarks, but the same requirements and recommendations apply to all benchmarks included in a GIPS Composite Report. For example, a GIPS Composite Report must include:

- a description for all benchmarks
- a disclosure of changes to (or deletion of) any benchmark
- the three-year annualized ex post standard deviation of all benchmarks

If the firm designates benchmarks as primary and secondary benchmarks, it must disclose when these designations change (e.g., if a primary benchmark becomes a secondary benchmark), because such a change in designation is considered a benchmark change. In all instances, if multiple benchmarks are presented in a GIPS Composite Report and one or more of the benchmarks is removed from the GIPS Composite Report, the firm must disclose this fact.

An appropriate benchmark for a composite reflects the investment mandate, strategy, or objective of the composite. Additional benchmarks beyond appropriate benchmarks may be presented in a GIPS Composite Report as supplemental information. There must be sufficient disclosure so that a prospective client or prospective investor understands the nature of the benchmark and why it is being presented. Disclosure, however, does not necessarily prevent information from being false or misleading. An additional benchmark must never be presented for the sole purpose of providing a favorable comparison to the performance of the composite. To do so would be misleading, regardless of the disclosures accompanying the benchmark.

Provision 4.A.5

If the COMPOSITE loses all of its member PORTFOLIOS, the COMPOSITE track record MUST end. If PORTFOLIOS are later added to the COMPOSITE, the COMPOSITE track record MUST restart. The periods both before and after the break in track record MUST be presented, with the break in performance clearly shown. The FIRM MUST NOT LINK performance prior to the break in track record to the performance after the break in track record.

Discussion

If all of the portfolios in a composite are either terminated or removed from the composite for some other reason, such as the application of a minimum account size or significant cash flow policy, the composite's performance record would come to an end. After a period of time, portfolios

may move above the minimum or new portfolios may be added to the composite, and the composite's performance record would begin again. In such a case, there will be a break in the composite's performance record. The composite's prior performance history must not be linked to the ongoing composite performance results. A firm must not use the performance of a benchmark to link the performance track record from before and after the break in the composite's track record. Any performance table in a GIPS Report must clearly indicate the break.

For firms that claim compliance for a period longer than 10 years, if the break in performance occurred more than 10 years ago, the performance prior to the break does not need to be presented. In all other cases, the firm must present the performance both prior to and after the performance break.

If a firm is also presenting a since-inception money-weighted return (SI-MWR) and there is a break in performance, the SI-MWR must not be calculated across the break. A current SI-MWR must be calculated using only the performance after the break. If the break in performance occurred less than 10 years ago, and it occurred during the period for which the firm claims compliance, an SI-MWR from the beginning of the track record up until the break must also be presented. The current SI-MWR and the SI-MWR representing performance prior to the break must not be linked and must be presented separately. The SI-MWRs before and after the break in performance must be clearly labeled so a prospective client or prospective investor can understand the periods reflected in the two returns.

Consider the following example for a firm that calculates performance on a monthly basis:

The firm has a composite that temporarily lost all of its portfolio members, resulting in a break in performance. The inception date for the composite is 1 January 2014, and there were four portfolios in the composite on 31 July 2015. During August 2015, two portfolios were liquidated and two fell below the minimum account size, leaving the composite with no portfolios. During April 2016, the two portfolios that had previously fallen below the composite minimum finally exceeded the minimum account size and were added back to the composite as of 1 May 2016, effectively reinstating the composite's performance. During 2017, three new portfolios were added to the composite.

Because all of the portfolios in the composite were either terminated or fell below the minimum level and, according to the firm's policies, were removed from the composite, the performance record of the composite comes to an end as of 31 July 2015. The performance record begins again on 1 May 2016 when two portfolios again met the minimum size criterion and were added back to the composite. When presenting the performance of this composite, the prior performance history of the composite through 31 July 2015 must be shown but must not be linked to the ongoing composite performance results beginning 1 May 2016.

For the purpose of performance presentation, as of 31 December 2017, the composite had an uninterrupted performance track record from 1 January 2014 to 31 July 2015, a performance break from 1 August 2015 to 30 April 2016, and an uninterrupted performance track record from 1 May 2016 to 31 December 2017.

Under the principles of fair representation and full disclosure, the GIPS standards require firms to handle such cases with the highest transparency. In this instance, the firm must present both periods of performance. The periods before and after the break must be presented separately. The GIPS Composite Report could present the information in this scenario as follows:

Period	Period Returns (%)			Number of Portfolios as of Period End	Assets as of Period End (USD millions)	
	Composite (gross of fees)	Benchmark	Internal Dispersion (%)		Composite	Total Firm
1 Jan–31 Dec 2017	X%	X%	X%	5	X	X
1 May–31 Dec 2016*	X%	X%	–	2	X	X
1 Jan–31 Jul 2015*	X%	X%	–	–	–	–
1 Jan–31 Dec 2014	X%	X%	X%	4	X	X

* There were no portfolios in the composite from 1 August 2015 through 30 April 2016.

It is important that the composite data is presented in a way that makes it clear that there were no portfolios in the composite from 1 August 2015 through 30 April 2016 and that the performance presented in the GIPS Composite Report is not linked across the break. The periods presented must be clearly labeled.

Although the firm may present a cumulative return for the period from 1 January 2014 through 31 July 2015, it must not link periods across performance breaks and present a cumulative and/or annualized return over such periods (e.g., from 1 January 2014 to 31 December 2017). The same would apply to the presentation of any required or recommended risk measures based on cumulative periods (e.g., three-year annualized ex post standard deviation).

The firm may not choose to omit performance for the incomplete years (e.g., for 2015 and 2016 in the previous example) because they are not annual returns. Such an interpretation would not meet the goals of fair representation and full disclosure.

Provision 4.A.6

If the COMPOSITE includes CARVE-OUTS with allocated cash, the FIRM MUST present the percentage of COMPOSITE assets represented by CARVE-OUTS with allocated cash as of each annual period end.

Discussion

A carve-out is a portion of a portfolio that is, by itself, representative of a distinct investment strategy, such as the domestic equity portion of a balanced portfolio. A carve-out may have its

own dedicated cash balance, or cash may be allocated to the carve-out synthetically. With the issuance of the 2020 edition of the GIPS standards, firms are once again allowed to include carve-outs that include cash that has been allocated synthetically in composites. (Doing so was prohibited from 1 January 2010 through 31 December 2019.)

A composite that includes carve-outs with allocated cash may also include carve-outs with their own cash balance and standalone portfolios. (A standalone portfolio is a portfolio that is not a portion of a larger portfolio.) Because prospective clients should have sufficient information to understand the nature of the portfolios included in a composite, a firm must, therefore, present the percentage of composite assets represented by carve-outs with allocated cash as of each annual period end. Carve-outs with their own dedicated cash are not included in this percentage. This approach allows prospective clients to understand how much of the composite's assets are represented by standalone portfolios and/or by carve-outs with their own cash and how much of the composite's assets are represented by carve-outs with allocated cash. Provision 4.A.6 applies only to carve-outs with allocated cash. It does not apply to carve-outs with their own dedicated cash.

Provision 4.A.7

If the COMPOSITE includes non-fee-paying PORTFOLIOS, the FIRM MUST present the percentage of COMPOSITE assets represented by non-fee-paying PORTFOLIOS as of each annual period end when NET-OF-FEES returns are presented and are calculated using actual INVESTMENT MANAGEMENT FEES.

Discussion

A firm may choose whether or not to include non-fee-paying portfolios in composites. This decision may be made on a composite-by-composite basis. If the firm has chosen to include a non-fee-paying portfolio in a composite, it must also include all other non-fee-paying discretionary portfolios meeting the definition of the composite. (See Provision 3.A.4 for further guidance on non-fee-paying portfolios.)

If a firm has included non-fee-paying portfolios in a composite and is presenting net-of-fees returns that are calculated using actual investment management fees, the firm is required to present the percentage of composite assets represented by non-fee-paying portfolios as of each annual period end. This may be done as a written disclosure, such as “This composite contained 15% non-fee-paying portfolios as of 31 December 2015, 17% as of 31 December 2016, 5% as of 31 December 2017, and 2% as of 31 December 2018.” Alternatively, the firm could add a column to its performance table titled “% composite assets composed of non-fee-paying portfolios” and list the percentage at the end of each annual period.

If the composite contains non-fee-paying portfolios but only gross-of-fees returns are presented, or if model fees are used to calculate composite net-of-fees returns, this information is not required to be presented. This guidance differs from the requirement in the 2010 edition of the GIPS standards, which required this information to be presented whenever a composite included non-fee-paying portfolios. Firms may apply this current guidance to all periods presented in GIPS Composite Reports.

Provision 4.A.8

If the FIRM chooses to present COMPOSITE uncalled COMMITTED CAPITAL or a combination of COMPOSITE assets and COMPOSITE uncalled COMMITTED CAPITAL, the FIRM MUST:

- a. Present COMPOSITE uncalled COMMITTED CAPITAL for the same periods for which the combination of COMPOSITE assets and COMPOSITE uncalled COMMITTED CAPITAL is presented.
- b. Clearly label COMPOSITE uncalled COMMITTED CAPITAL as such.
- c. Clearly label the combination of COMPOSITE assets and COMPOSITE uncalled COMMITTED CAPITAL as such.

Discussion

Committed capital is defined as pledges of capital to an investment vehicle by investors (limited partners and the general partner) or the firm and is typically drawn down over a period of time. Uncalled committed capital is the amount of capital that has not yet been drawn. Because uncalled committed capital is not considered actual composite assets, composite uncalled committed capital must not be included in the calculation of composite assets as of 1 January 2020. This is consistent with the requirement to not include uncalled committed capital in total firm assets for periods beginning on or after 1 January 2020. (See Provision 2.A.1.) A firm may report composite uncalled committed capital in addition to the required presentation of composite assets, if it wishes to do so. The inclusion of information on composite uncalled committed capital provides prospective clients with a more complete picture of the firm's investments and the amount of capital that is currently committed to a future investment. If a firm chooses to present information on composite uncalled committed capital, it may present composite uncalled committed capital as either:

- a separate value, or
- the combination of composite assets and composite uncalled committed capital.

If a firm chooses to present composite uncalled committed capital as a separate value, the information must be clearly labeled.

If a firm chooses to present the combination of composite assets and composite uncalled committed capital, the firm must present composite uncalled committed capital for the same periods

for which the combination of composite assets and composite uncalled committed capital is presented. Both composite uncalled committed capital and the combination of composite assets and composite uncalled committed capital must be clearly labeled as such.

Provision 4.A.9

If the FIRM chooses to present FIRM-wide uncalled COMMITTED CAPITAL or a combination of TOTAL FIRM ASSETS and FIRM-wide uncalled COMMITTED CAPITAL, the FIRM MUST:

- a. Present FIRM-wide uncalled COMMITTED CAPITAL for the same periods for which the combination of TOTAL FIRM ASSETS and FIRM-wide uncalled COMMITTED CAPITAL is presented.
- b. Clearly label FIRM-wide uncalled COMMITTED CAPITAL as such.
- c. Clearly label the combination of TOTAL FIRM ASSETS and FIRM-wide uncalled COMMITTED CAPITAL as such.

Discussion

Committed capital is defined as pledges of capital to an investment vehicle by investors (limited partners and the general partner) or the firm and is typically drawn down over a period of time. Uncalled committed capital is the amount of capital that has not yet been drawn. For periods beginning on or after 1 January 2020, uncalled committed capital must not be included in total firm assets. (See Provision 2.A.1.) Although firm-wide uncalled committed capital must not be included in the calculation of total firm assets as of 1 January 2020, a firm may report firm-wide uncalled committed capital in addition to the required presentation of total firm assets, if it wishes to do so. The inclusion of information on firm-wide uncalled committed capital provides prospective clients with a more complete picture of the firm's investments and the amount of capital that is currently committed to a future investment. If a firm chooses to present information on firm-wide uncalled committed capital, it may present firm-wide uncalled committed capital as either:

- a separate value, or
- the combination of total firm assets and firm-wide uncalled committed capital.

If a firm chooses to present firm-wide uncalled committed capital as a separate value, the information must be clearly labeled.

If a firm chooses to present the combination of total firm assets and firm-wide uncalled committed capital, the firm must present firm-wide uncalled committed capital for the same periods for which the combination of total firm assets and firm-wide uncalled committed capital

is presented. Both firm-wide uncalled committed capital and the combination of total firm assets and firm-wide uncalled committed capital must be clearly labeled as such.

Provision 4.A.10

If the FIRM chooses to present ADVISORY-ONLY ASSETS that reflect the COMPOSITE's investment mandate, objective, or strategy, or a combination of COMPOSITE assets and ADVISORY-ONLY ASSETS that reflect the COMPOSITE's investment mandate, objective, or strategy, the FIRM MUST:

- a. Present ADVISORY-ONLY ASSETS that reflect the COMPOSITE's investment mandate, objective, or strategy for the same periods for which the combination of COMPOSITE assets and ADVISORY-ONLY ASSETS that reflect the COMPOSITE's investment mandate, objective, or strategy is presented.
- b. Clearly label ADVISORY-ONLY ASSETS that reflect the COMPOSITE's investment mandate, objective, or strategy as such.
- c. Clearly label the combination of COMPOSITE assets and ADVISORY-ONLY ASSETS that reflect the COMPOSITE's investment mandate, objective, or strategy as such.

Discussion

Advisory-only assets are assets for which the firm provides investment recommendations in line with the composite strategy but for which the firm has no control over implementation of investment decisions and no trading authority for the assets. Although composite advisory-only assets must not be included in the calculation of composite assets because the firm does not manage these assets, a firm may wish to provide information on composite advisory-only assets in addition to the required presentation of composite assets. The inclusion of information on composite advisory-only assets provides prospective clients additional information about a firm's business model and the types of investment-related services that it provides. If a firm chooses to present information on composite advisory-only assets, it may present composite advisory-only assets as either:

- a separate value, or
- the combination of composite assets and composite advisory-only assets.

If a firm chooses to present composite advisory-only assets as a separate value, the information must be clearly labeled.

If a firm chooses to present the combination of composite assets and composite advisory-only assets, the firm must present composite advisory-only assets for the same periods for which the combination of composite assets and composite advisory-only assets is presented. Both composite advisory-only assets and the combination of composite assets and composite advisory-only assets must be clearly labeled as such.

Provision 4.A.11

If the FIRM chooses to present FIRM-wide ADVISORY-ONLY ASSETS or a combination of TOTAL FIRM ASSETS and FIRM-wide ADVISORY-ONLY ASSETS, the FIRM MUST:

- a. Present FIRM-wide ADVISORY-ONLY ASSETS for the same periods for which the combination of TOTAL FIRM ASSETS and FIRM-wide ADVISORY-ONLY ASSETS is presented.
- b. Clearly label FIRM-wide ADVISORY-ONLY ASSETS as such.
- c. Clearly label the combination of TOTAL FIRM ASSETS and FIRM-wide ADVISORY-ONLY ASSETS as such.

Discussion

Advisory-only assets are assets for which the firm provides investment recommendations but for which the firm has no control over implementation of investment decisions and no trading authority for the assets. Although firm-wide advisory-only assets must not be included in the calculation of total firm assets because the firm does not manage these assets, a firm may wish to provide information on firm-wide advisory-only assets in addition to the required presentation of total firm assets. The inclusion of information on firm-wide advisory-only assets provides prospective clients additional information about a firm's business model and the types of investment-related services that it provides. If a firm chooses to present information on firm-wide advisory-only assets, it may present firm-wide advisory-only assets as either:

- a separate value, or
- the combination of total firm assets and firm-wide advisory-only assets.

If a firm chooses to present firm-wide advisory-only assets as a separate value, the information must be clearly labeled.

If a firm chooses to present the combination of total firm assets and firm-wide advisory-only assets, the firm must present firm-wide advisory-only assets for the same periods for which the combination of total firm assets and firm-wide advisory-only assets is presented. Both the firm-wide advisory-only assets and the combination of total firm assets and firm-wide advisory-only assets must be clearly labeled as such.

Provision 4.A.12

All REQUIRED and RECOMMENDED information in the GIPS COMPOSITE REPORT MUST be presented in the same currency.

Discussion

Firms must present all required and recommended information in a GIPS Composite Report in the same currency (e.g., composite and benchmark returns, composite assets, and risk and internal dispersion measures). This requirement is not applicable to the fee schedule. Supplemental information should also be presented in the same currency. If it is not, that fact must be disclosed. Not disclosing this fact could be misleading.

If a firm chooses to present a composite in a different currency, the firm must convert all of the required information into the new currency. If the firm chooses to present performance in multiple currencies in the same GIPS Composite Report, the firm must convert all of the required information into each of the currencies and ensure it is clear in which currencies performance is reported. The firm must also convert any recommended information it chooses to present in the GIPS Composite Report containing the converted information.

In cases where a composite contains portfolios with different currencies, the firm must convert the individual portfolio returns to a single currency in order to calculate a composite return. It is not permissible to do so by applying the exchange rate as of the current period end to historical data.

The GIPS standards do not require or recommend a particular method for converting portfolio performance from one currency to another. Two possible options for converting returns into a different currency are as follows:

- When using the aggregate method of composite calculation, convert the underlying data (values and external cash flows) into the selected currency using the exchange rate on the date of each cash flow and valuation, and then calculate the composite returns based on the converted data; or
- When using the weighted average method of composite calculation, first calculate the individual portfolio returns, then convert the portfolio returns into the selected currency, and calculate the weighted average composite return using the converted returns.

A firm may instead convert composite returns. Starting with composite returns calculated in its base currency, a composite return can be converted using the movement in the exchange rate between the base currency and the reporting currency over the period of the return. The following example illustrates this method:

Suppose that the return of a composite in euros for the year 2018 is +5.00%. The exchange rate for 1 euro to the US dollar at the start of the year was 1.2008, and at the end of the year it is 1.14315. First calculate the movement in the exchange rate over the year:

$$FX \text{ return} = \frac{FX_{end}}{FX_{start}} - 1$$

$$FX \text{ return} = \frac{1.14315}{1.2008} - 1 = -0.0480 \text{ or } -4.80\%$$

The exchange rate movement and the euro composite return are then multiplied to determine the USD composite return:

$$USD \text{ Composite Return} = (1 + 0.05) \times (1 - 0.0480) - 1 = (1.05 \times 0.952) - 1 = -0.00041 \text{ or } -0.041\%$$

It is not acceptable to convert returns by applying the exchange rate as of the current period end to the historical data, including cash flows and valuations, used to calculate returns.

It is up to the firm to determine the composite-specific conversion method. Policies and procedures for converting returns must be established, documented, and applied consistently.

Provision 4.A.13

When the FIRM presents the performance of a COMPOSITE that includes CARVE-OUTS with allocated cash and also has a COMPOSITE of standalone PORTFOLIOS managed according to the same strategy, the FIRM MUST present for the COMPOSITE of standalone PORTFOLIOS:

- a. The COMPOSITE returns for each annual period for which the COMPOSITE of standalone PORTFOLIOS exists, and
- b. The COMPOSITE assets as of each annual period end for which the COMPOSITE of standalone PORTFOLIOS exists.

This information MUST be included in the GIPS COMPOSITE REPORT of the COMPOSITE that includes CARVE-OUTS with allocated cash.

Discussion

A carve-out is a portion of a portfolio that is by itself representative of a distinct investment strategy, such as the domestic equity portion of a balanced portfolio. A carve-out may have its own dedicated cash balance, or cash may be allocated to the carve-out synthetically. If a firm has created carve-outs with allocated cash, the firm is likely, at some point, to obtain standalone portfolios managed in the same strategy as the carve-outs with allocated cash. (A standalone portfolio is a portfolio that is not a portion of a larger portfolio.) The firm must then create a separate composite that contains only the standalone portfolios. (See Provision 3.A.18.) If such a composite of standalone portfolios exists, the returns and assets of the composite that includes only standalone portfolios must be presented in the GIPS Composite Report for the composite that

includes carve-outs with allocated cash. This will allow a prospective client to compare the returns and assets of the composite that includes carve-outs with allocated cash to the returns and assets of the composite that contains only standalone portfolios managed in the same strategy. If there are significant performance differences between the two composites, the prospective client has a chance to ask questions about the difference in returns between the two composites.

This provision applies only to carve-outs with allocated cash. It does not apply to carve-outs with their own cash.

Provision 4.A.14

FOR OVERLAY STRATEGY COMPOSITES, the FIRM MUST present COMPOSITE OVERLAY EXPOSURE as of each annual period end. For those periods for which the FIRM presents COMPOSITE OVERLAY EXPOSURE, the FIRM may choose not to present COMPOSITE assets.³³

Discussion

An overlay strategy is one in which the management of a certain aspect of an investment strategy is carried out separately from the underlying portfolio and it is offered as a separate strategy. If the overlay element is part of the overall portfolio, it may be carved out to represent the overlay strategy, but this is not required. Overlay strategies are typically designed to either limit or maintain a specified risk exposure that is present in the underlying portfolio or to profit from a tactical view on the market by changing a portfolio's specified risk exposure. There are also overlay strategies that seek to add value against a specified target allocation or allocated capital at risk. Common types of overlay strategies include, but are not limited to, currency overlay, asset allocation overlay, interest rate overlay, and option overwrite overlay.

Overlay exposure is the economic value of the assets underlying the overlay portfolios for which a firm has investment management responsibility. For periods beginning on or after 1 January 2020, overlay exposure must be calculated using one of the following approaches: (1) the notional value of the overlay strategy being managed, (2) the value of the underlying portfolios being overlaid, or (3) a specified target exposure as of the beginning of the period, which can either be defined as a target exposure or determined by a formula used to calculate the target exposure for each period. The same method for calculating overlay exposure must be used for all portfolios within a composite. (See Provision 2.A.6.) For periods ending on or after 31 December 2020, it is required that firms present composite overlay exposure as of each annual period end in a GIPS Composite Report for overlay strategy composites.

Overlay strategies are often unfunded and are implemented by using derivatives, which can lead to the fair value of overlay portfolios being very small, negative, or even zero. For those periods

³³REQUIRED for periods ending on or after 31 December 2020.

for which the firm presents composite overlay exposure, the firm may choose not to present composite assets because the amount of composite assets may be immaterial or may not be a good indication of the volume of overlay assets being managed.

Provision 4.A.15

For OVERLAY STRATEGY COMPOSITES, the FIRM is not REQUIRED to present TOTAL FIRM ASSETS and may instead choose to present total FIRM OVERLAY EXPOSURE as of each annual period end.

Discussion

Overlay exposure is the economic value of the assets underlying the overlay portfolios for which a firm has investment management responsibility. For periods beginning on or after 1 January 2020, overlay exposure must be calculated using one of the following approaches: (1) the notional value of the overlay strategy being managed, (2) the value of the underlying portfolios being overlaid, or (3) a specified target exposure as of the beginning of the period, which can either be defined as a target exposure or determined by a formula used to calculate the target exposure for each period.

Overlay strategies are often unfunded and are implemented by using derivatives, which can lead to the fair value of overlay portfolios being very small, negative, or even zero. Total firm assets for an overlay manager may therefore be quite small. The more meaningful information for an overlay manager would be total firm overlay exposure. Therefore, firms may choose not to present total firm assets because the amount may not be material or may not be a good indication of the volume of assets being managed by the firm. The firm may instead present total firm overlay exposure. However, total firm assets or total firm overlay exposure must be presented as of each annual period end. Firms may also choose to present both total firm assets and total firm overlay exposure.

Provision 4.A.16

For WRAP FEE COMPOSITES, when the FIRM presents performance to a WRAP FEE PROSPECTIVE CLIENT, the FIRM MUST present:

- a. The COMPOSITE that includes the performance of all actual WRAP FEE PORTFOLIOS, if any, managed according to the COMPOSITE investment mandate, objective, or strategy, regardless of the WRAP FEE sponsor.
- b. COMPOSITE performance that is net of the entire WRAP FEE.
- c. The percentage of COMPOSITE assets represented by WRAP FEE PORTFOLIOS as of each annual period end.

Discussion

A wrap fee is a type of bundled fee specific to a particular investment product. The wrap fee is charged by a wrap fee sponsor for investment management services and typically includes associated transaction costs that cannot be separately identified. Wrap fees can be all-inclusive, asset-based fees and may include a combination of investment management fees, transaction costs, custody fees, and/or administrative fees.

The GIPS standards require firms to define composites according to investment mandates, objectives, and/or strategies. To facilitate the comparability of performance results and prevent firms from cherry-picking their best-performing portfolios for presentation, firms must group all appropriate wrap fee portfolios in a composite managed according to a specific investment objective, mandate, or strategy (creating a style-defined composite) regardless of the wrap fee sponsor. If the firm has no actual wrap fee portfolios under management for the specified strategy, this style-defined composite will include only non-wrap fee portfolios managed to the specified strategy. (See Provision 3.A.14 for a more detailed discussion of the creation of wrap fee composites.)

The 2010 edition of the GIPS standards included the concept of a sponsor-specific composite that included only the wrap fee portfolios managed for a specific wrap fee sponsor in the composite strategy. The concept of a sponsor-specific wrap fee composite was removed in the 2020 edition of the GIPS standards. Sponsor-specific performance may still be used when creating materials for the use of a specific wrap fee sponsor, but such materials are considered to be client reporting and not a GIPS-compliant composite.

When presenting performance to a wrap fee prospective client, performance must be shown net of the entire wrap fee. This is required whether the composite includes wrap fee portfolios or non-wrap fee portfolios. This is because a wrap fee is a bundled fee that includes transaction costs that cannot be separately identified, and the prospective client must pay the total wrap fee. Firms may present gross-of-fees returns in addition to returns that are net of the entire wrap fee. A gross-of-fees return must reflect the deduction of transaction costs. To calculate a gross-of-fees return, firms may deduct the portion of the wrap fee that includes transaction costs, if this is known. Firms may also deduct estimated transaction costs, if actual transaction costs are not known and they have the ability to determine a reasonable estimate of transaction costs. (For the treatment of estimated transaction costs in bundled fee portfolios, please see Provision 2.A.14.) Pure gross-of-fees returns may be presented as supplemental information. A pure gross-of-fees return is one that is not reduced by any transaction costs incurred during the period. It is common, however, for wrap fee managers to present returns that are net of the entire wrap fee and pure gross-of-fees returns—and to not present a gross-of-fees return. See Provision 2.A.48 for information about calculating wrap fee portfolio returns.

It is also required that when a firm presents performance to a wrap fee prospective client, the GIPS Composite Report for the wrap fee composite must include the percentage of composite assets represented by wrap fee portfolios as of each annual period end. This allows prospective clients to understand how much of the composite's assets is represented by actual wrap fee portfolios.

Provision 4.A.17

For WRAP FEE COMPOSITES, when the FIRM presents PURE GROSS-OF-FEES returns, the FIRM MUST:

- a. Clearly label returns as PURE GROSS-OF-FEES.
- b. Identify PURE GROSS-OF-FEES returns as SUPPLEMENTAL INFORMATION.

Discussion

The GIPS standards require that transaction costs be deducted when calculating both gross-of-fees and net-of-fees returns. A pure gross-of-fees return is the return on investments that is not reduced by any transaction costs incurred during the period. If a firm presents pure gross-of-fees returns for a wrap fee composite, the returns must be clearly labeled as pure gross-of-fees returns and must also be identified as supplemental information. Supplemental information is any performance-related information included as part of a GIPS Composite Report that supplements or enhances the requirements and/or recommendations of the GIPS standards. The required labeling of a pure gross-of-fees return and its designation as supplemental information helps prospective clients distinguish pure gross-of-fees returns, which do not reflect the deduction of transaction costs, and gross-of-fees returns, which do reflect the deduction of transaction costs. (See Provision 4.A.18 for a discussion of supplemental information.)

Provision 4.A.18

Any SUPPLEMENTAL INFORMATION included in the GIPS COMPOSITE REPORT:

- a. MUST relate directly to the COMPOSITE.
- b. MUST NOT contradict or conflict with the REQUIRED or RECOMMENDED information in the GIPS COMPOSITE REPORT.
- c. MUST be clearly labeled as SUPPLEMENTAL INFORMATION.

Discussion

Supplemental information is any performance-related information included as part of a GIPS Composite Report that supplements or enhances the requirements and/or recommendations of the GIPS standards. Performance-related information includes:

- information expressed in terms of investment return and risk, and
- other information and input data that directly relate to the calculation of investment return and risk (e.g., portfolio holdings), as well as information derived from investment return and risk input data (e.g., performance contribution or attribution).

Supplemental information should provide users of the GIPS Composite Report with the proper context in which to understand the performance results. Common examples of supplemental information include the following:

- segment returns that do not include cash,
- after-tax returns,
- money-weighted returns (MWRs) when the firm does not meet the tests for presenting only MWRs, and
- pure gross-of-fees returns for wrap fee composites.

Supplemental information must relate directly to the composite and must not contradict or conflict with the required or recommended information in the GIPS Composite Report. Examples of information that relates directly to the composite and would be considered supplemental information include segment returns (e.g., country or sector), performance attribution, and composite or portfolio-level holdings. An example of information that would conflict with the GIPS standards is a non-portable track record from a past firm that is linked to composite performance of the new firm.

The following is a more complete list of the principles that apply when supplemental information is presented. Supplemental information must:

- satisfy the spirit and principles of the GIPS standards—fair representation and full disclosure,
- comply with all applicable laws and regulations regarding the calculation and presentation of performance,
- not include performance or performance-related information that is false or misleading,
- relate directly to the composite and supplement or enhance the required or recommended information included in the composite's GIPS Composite Report,
- not contradict or conflict with the required or recommended information in the GIPS Composite Report,
- be clearly labeled as supplemental information, and
- not be shown with greater prominence than the required composite information.

4.B. Presentation and Reporting—Recommendations

Provision 4.B.1

The FIRM SHOULD present both GROSS-OF-FEES and NET-OF-FEES COMPOSITE returns.

Discussion

For all composites except wrap fee composites, a firm may choose to present either gross-of-fees or net-of-fees composite returns in a GIPS Composite Report. For wrap fee composites, firms are required to present composite returns that are net of the entire wrap fee. Each type of return provides important information to prospective clients.

Because a gross-of-fees return is the return on investments reduced by any transaction costs, it is the best measure of the firm's investment management ability and can be thought of as the "investment return." In addition, because fees are sometimes negotiable, presenting gross-of-fees returns shows the firm's expertise in managing assets without the effect of the firm's or client's negotiating skills. Gross-of-fees returns also allow prospective clients to better compare performance between firms.

Net-of-fees composite returns reflect the deduction of transaction costs and investment management fees. Net-of-fees returns therefore provide the best indication to prospective clients of the returns that the firm's clients received or would have received over time, after taking into account the effect of investment management costs.

Because both gross-of-fees and net-of-fees returns provide important information to prospective clients, it is recommended that firms present both gross-of-fees and net-of-fees composite returns in a GIPS Composite Report.

Provision 4.B.2

The FIRM SHOULD present the following items:

- a. Cumulative returns of the COMPOSITE and the BENCHMARK for all periods.

Discussion

Cumulative returns of the composite and benchmark provide additional useful information to prospective clients by indicating the total rate of return for a defined period of performance. It is

therefore recommended that cumulative returns for all periods be provided in addition to the required annual returns.

To calculate cumulative returns of a composite for any period, the historical daily, monthly, quarterly, or annual sub-period returns are geometrically linked according to the following formula:

$$R_{CUM} = [(1 + R_1) \times (1 + R_2) \times \dots \times (1 + R_n)] - 1,$$

where R_1 is the composite return for Period 1 and R_n is the composite return for the most recent period.

Example:

Firm ABC has the following annual returns that were calculated from monthly composite returns:

	Composite	1 + R_n
2015	2.3%	1.023
2016	-4.7%	0.953
2017	6.9%	1.069
2018	3.2%	1.032
2019	0.9%	1.009
Jan 2020–Jun 2020	-3.1%	0.969

To calculate the composite cumulative return for the period from January 2015 through June 2020, the returns are linked:

$$\begin{aligned} \text{Composite cumulative return} &= [(1.023) \times (0.953) \times (1.069) \times (1.032) \times (1.009) \times (0.969)] - 1 \\ &= 0.052, \text{ or } 5.2\%. \end{aligned}$$

If the composite experiences a break in the track record, the periods before and after the break must not be linked. Therefore, in such a case, a cumulative return may be calculated up to the break and a separate cumulative return may be calculated for the performance period that begins after the break. However, the firm must not calculate a cumulative return across the periods that include the break. Additional guidance on how to calculate performance if there is a break in the track record is included in the discussion of Provision 4.A.5.

Provision 4.B.2

The FIRM SHOULD present the following items:

- b. Equal-weighted COMPOSITE returns.

Discussion

The GIPS standards require that composite time-weighted returns be calculated by asset-weighting the individual portfolio returns or by using the aggregate method. (See Provision 2.A.36.) This allows for a larger portfolio to have more weight on a composite's return than a smaller portfolio. Equal-weighted composite returns, however, provide another useful perspective on composite performance. The simple average, together with a measure of internal dispersion, provides a measure of the manager's ability to obtain consistent returns for all portfolios regardless of size. It is therefore recommended that firms also include equal-weighted composite returns in a GIPS Composite Report.

The formula for the equal-weighted composite return, R_{EQUAL} , is

$$R_{EQUAL} = \frac{R_{PORT1} + R_{PORT2} + \dots + R_{PORTi}}{n},$$

where R_{PORT1} is the time-weighted return for the first portfolio in the composite, R_{PORTi} is the time-weighted return for the i th portfolio in the composite, and n is the number of portfolios in the composite.

Provision 4.B.2

The FIRM SHOULD present the following items:

- c. Quarterly and/or monthly returns.

Discussion

Although the GIPS standards require the presentation of annual returns for the composite and benchmark (Provisions 4.A.1.b and 4.A.1.e), it is recommended that firms present more-frequent returns, such as quarterly or monthly returns. More-frequent returns help prospective clients evaluate a composite's track record. Firms must present benchmark returns for the same periods for which composite returns are presented. If the GIPS Composite Report includes annual and quarterly composite returns, annual and quarterly benchmark returns must also be presented.

Provision 4.B.2

The FIRM SHOULD present the following items:

- d. Annualized COMPOSITE and BENCHMARK returns for periods longer than 12 months.

Discussion

It is recommended that firms show the results of both the composite and the benchmark for periods longer than 12 months in annualized terms to help prospective clients in the evaluation of the composite's track record. Annualized returns are created by calculating the geometric mean, not the arithmetic mean, and represent the geometric average annual compound return achieved over the defined period of more than one year. Sub-period returns during the investment period are geometrically linked to calculate the cumulative return. Then the n th root of the cumulative return is calculated, where n is the number of years in the period. Annualized performance is permitted only for periods of one year or more.

The formula for calculating annualized performance is as follows:

$$\text{Annualized return (\%)} = [(1 + R)^{1/n}] - 1,$$

where R is the cumulative return for the period and n is the number of years in the period.

For example, assume a composite's cumulative return for a five-year period is 150.0%. It has a five-year average annual compound return, or annualized return, of 20.11%, which is calculated as:

$$\left[(1 + 1.5)^{\frac{1}{5}} \right] - 1 = 0.2011 = 20.11\%.$$

If instead the 150% is achieved over 12.5 years, the 12.5-year average annual compound return, or annualized return, is 7.61%, which is calculated as:

$$\left[(1 + 1.5)^{\frac{1}{12.5}} \right] - 1 = 0.0761 = 7.61\%.$$

If the composite experiences a break in the track record, the periods before and after the break must not be linked, and annualized returns must not be calculated across the break in performance.

Provision 4.B.3

For all periods for which an annualized EX POST STANDARD DEVIATION of the COMPOSITE and the BENCHMARK are presented, the FIRM SHOULD present the corresponding annualized return of the COMPOSITE and the BENCHMARK.

Discussion

To provide context so that the prospective client can better understand the ex post standard deviation, it is recommended that firms present annualized returns for the composite and

benchmark for the same periods for which annualized standard deviation is presented. For example, if a firm chooses to present the 5-year, 7-year, and 10-year annualized standard deviations in addition to the required 3-year annualized standard deviation, firms are encouraged to also present the corresponding 3-year, 5-year, 7-year, and 10-year annualized returns for the composite and the benchmark. This will help prospective clients to better interpret risk and return in the context of the return distribution for all periods for which an annualized standard deviation is presented.

Provision 4.B.4

For all periods greater than three years for which an annualized return of the COMPOSITE and the BENCHMARK are presented, the FIRM SHOULD present the corresponding annualized EX POST STANDARD DEVIATION (using monthly returns) of the COMPOSITE and the BENCHMARK.

Discussion

To provide context so that the prospective client can interpret the annualized composite and benchmark returns, it is recommended that firms present the annualized ex post standard deviation (using monthly returns) for both the composite and benchmark for the same periods that annualized composite and benchmark returns are presented. For example, if a firm chooses to present the 5-year, 7-year, and 10-year annualized composite and benchmark returns, firms are encouraged to also present the corresponding 5-year, 7-year, and 10-year annualized ex post standard deviation of the composite and benchmark. This will help prospective clients to assess and compare risk and return for all periods for which annualized returns are presented.

Provision 4.B.5

The FIRM SHOULD present relevant EX POST ADDITIONAL RISK MEASURES for the COMPOSITE and the BENCHMARK.

Discussion

For composites for which monthly composite returns are available, firms must present the three-year annualized ex post standard deviation (using monthly returns) of the composite and the benchmark as of each annual period end. This is required for periods ending on or after 1 January 2011. (See Provision 4.A.1.j.) Additional risk measures are risk measures included in a GIPS Composite Report beyond those required to be presented. It is recommended that firms present relevant ex post additional risk measures for the composite and benchmark in a GIPS Composite Report. Currently, there is no single risk measure that comprehensively and

consistently captures every risk to which an asset class, product, or strategy is exposed or sensitive. Also, there may be additional risk measures that would be especially helpful to prospective clients when interpreting a composite's return. There are many risk and quantitative measures that are routinely calculated to help a reader evaluate and understand the return and risk characteristics of a particular investment strategy. Determining which risk measures are relevant to a strategy requires an understanding of the characteristics and limitations of each measure and insight into the portfolio construction process and investment strategy. Several risk measures are commonly used within the industry, but there is less of a consensus over what constitutes relevant risk measures when evaluating portfolios containing derivatives, alternatives, and/or illiquid assets. Some firms have developed proprietary measures, which, despite providing insight into the strategy, make comparisons across managers problematic.

A number of factors should be considered when selecting relevant risk measures, including the following:

- **Comparability:** The risk measure selected should allow objective comparisons across firms to be made.
- **Computational transparency:** All inputs to the calculation should be readily available and understood.
- **Interpretational transparency:** In isolation as a single figure or presented as a time series, the risk measure should aid interpretation and provide context to the performance figures presented.
- **Investment process or strategy consistency:** The risk measure should provide insight into the underlying investment process.
- **Risk measure stability:** The selected risk measure should be sensitive to market and portfolio movements but should not exhibit excessive range swings such that interpretation of the absolute and relative values is compromised.

Provision 4.B.6

The FIRM SHOULD present more than 10 years of annual performance in the GIPS COMPOSITE REPORT.

Discussion

Once the composite has its initial minimum 5-year (or since-inception) compliant history, the firm must continue to add annual returns to each GIPS Composite Report for the next 5 years, at a minimum, so that the firm will build up to a 10-year compliant performance record for its composites.

At some point, a firm will have a minimum 10-year compliant track record for a specific composite. When the firm eventually adds an additional annual return to a 10-year track record in a GIPS Composite Report, the firm may delete the information for the oldest year included or may instead present a longer track record. It is recommended that firms include more than the minimum 10 years of annual performance in a GIPS Composite Report to provide more information to prospective clients. If any performance is presented that does not comply with the GIPS standards (only allowed for periods prior to 1 January 2006 for wrap fee, real estate, and private equity composites and prior to 1 January 2000 for all other composites), firms must disclose the period(s) of non-compliance.

Provision 4.B.7

The FIRM SHOULD present PROPRIETARY ASSETS as a percentage of COMPOSITE assets as of each annual period end.

Discussion

Proprietary assets are assets owned by the firm, the firm's management, and/or the firm's parent company that are managed by the firm. Knowing how much of a composite's assets are proprietary and how much are managed for external clients provides prospective clients with additional insight regarding the composite, especially when a significant percentage of the composite's assets are proprietary assets. If a composite includes proprietary assets, it is recommended that firms present proprietary assets as a percentage of composite assets as of each annual period end.

Provision 4.B.8

If the FIRM uses preliminary, estimated values as FAIR VALUE, the FIRM SHOULD present the percentage of assets in the COMPOSITE that were valued using preliminary, estimated values as of each annual period end.

Discussion

The use of preliminary, estimated values as fair value is common for some alternative strategies, including those that invest in underlying funds for which the firm relies on valuations provided by the underlying fund managers. When using preliminary, estimated values as fair value, it is important to remember the underlying principles of the GIPS standards: fair representation and full disclosure. If using preliminary, estimated values, firms must disclose this fact in the relevant

GIPS Composite Report (Provision 4.C.41). It is recommended that the firm also present the percentage of assets in the composite that were valued using preliminary, estimated values as of each annual period end. This provides important information that allows prospective clients to better assess the valuations and performance record presented.

Provision 4.B.9

FOR REAL ESTATE COMPOSITES, the FIRM SHOULD present COMPOSITE and BENCHMARK COMPONENT RETURNS for all periods presented.

Discussion

For real estate composites, it is recommended that firms also present composite and benchmark component returns in addition to total returns. Component returns separate the total return into a capital return and an income return. Component returns provide additional information to prospective clients regarding the sources of the total return and the nature of the investment strategy. The income return is generally viewed as more stable than the capital return. Real estate investors typically want to know the contribution from the income and capital returns.

The following are examples of formulas that may be used to calculate the income return and capital return for a real estate investment. The formulas presented use the following terms:

r_t^{GFI} = gross-of-fees income return for period t

r_t^{NFI} = net-of-fees income return for period t

r_t^{GFC} = gross-of-fees capital return for period t

r_t^{NFC} = net-of-fees capital return for period t

r_t^{GFT} = gross-of-fees total return for period t

r_t^{NFT} = net-of-fees total return for period t

NI_t = net investment income (after interest expense, advisory fees, and any performance-based fees allocated to the income component for performance calculation purposes) for period t

AF_t = advisory fee (asset-based portion of investment management fee expensed, including any acquisition and disposition fees that are included as an advisory fee and excluding any performance-based fees) for period t

PF_t^C = performance-based fees allocated to the capital component (for performance calculation purposes) for period t

PF_t^I = performance-based fees allocated to the income component (for performance calculation purposes) for period t

V_t^B = the beginning value of the portfolio for period t

V_t^E = the ending value of the portfolio for period t

FC_t = fees charged by the firm and capitalized for accounting purposes but treated as an investment management fee for performance purposes for period t (including acquisition and disposition fees)

j = the number of external cash flows (1, 2, 3, . . . , J) in period t

$CF_{j,t}$ = the value of cash flow j in period t

$W_{j,t}$ = the weight of cash flow j in period t (assuming the cash flow occurred at the end of the day) as calculated according to the following formula:

$$w_{j,t} = \frac{D_t - D_{j,t}}{D_t},$$

where

$w_{j,t}$ = the weight of cash flow j in period t , assuming the cash flow occurred at the end of the day

D_t = the total number of calendar days in period t

$D_{j,t}$ = the number of calendar days from the beginning of period t to cash flow j

Acquisition, disposition, and financing services performed by the firm, an affiliate of the firm, or a third party on a particular transaction are considered transaction costs and must be deducted from both gross-of-fees and net-of-fees returns. These items (also referred to as “brokerage expenses”) are direct costs incurred upon implementation of a particular investment transaction and are considered transaction costs. It is recommended that these transaction costs be accounted for through the capital returns. Please note that the acquisition and disposition transaction costs described earlier are different from investment management fees specifically associated with acquisition and disposition services performed by the firm. It is common practice in the real estate industry to have investment management agreements separate the investment management fee into one or more of the following components: base investment management, acquisition, disposition, and financing. In this scenario, the fees specifically relating to acquisition and disposition are typically considered to be part of the investment management fee because these relate to the investment management responsibilities performed by the firm in formulating its investment decisions as part of the normal investment decision-making process. Financing fees, if applicable, are typically identified separately in the investment management agreement and are classified as transaction costs because they are usually related to post-acquisition refinancing.

The term “net investment income” is intended to reflect the effect of ownership and financing structures and includes all underlying property-level activity. Investment-level returns are distinct from property-level returns. Investment-level returns reflect the effect of ownership and financing structures and include all underlying property-level activity. Property-level returns exclude all of the non-property (investment-level) balance sheet items, as well as income and expenses,

and include only those income and expenses that directly relate to the operation of the property. Property-level returns are not used for reporting performance in compliance with the GIPS standards, although they may be shown as supplemental information.

Income Return

The income return measures the investment income earned on all investments (including cash and cash equivalents) during the measurement period, net of all non-recoverable expenditures, interest expense on debt, and property taxes. The income return is computed as a percentage of the capital employed. Capital employed is defined as the “weighted average equity” (weighted average capital) during the measurement period. Capital employed does not include any income return or capital return earned during the measurement period. Beginning capital is adjusted by weighting the external cash flows that occurred during the period.

The numerator in the gross-of-fees income return represents the investment income for the portfolio during the period, including any income earned during the period at the investment level, and also reflects all income, fees, and expenses at the property level.

The formula for gross-of-fees income return is as follows:

$$r_t^{GFI} = \frac{NII_t + AF_t + PF_t^I}{V_t^B + \sum_{j=1}^J (CF_{j,t} \times W_{j,t})}$$

The numerator in the net-of-fees income return represents the net investment income for the portfolio during the period. This figure would include any income earned and expenses and fees deducted at the investment level and all income, fees, and expenses at the property level.

The formula for net-of-fees income return is as follows:

$$r_t^{NFI} = \frac{NII_t}{V_t^B + \sum_{j=1}^J (CF_{j,t} \times W_{j,t})}$$

Capital Return

The capital return is the change in value of the real estate investments and cash and/or cash equivalent assets held throughout the measurement period, adjusted for all capital expenditures (subtracted) and net proceeds from sales (added). The capital return is computed as a percentage of the capital employed. Capital return is also known as “capital appreciation return” or “appreciation return.”

The capital return numerator reflects the change (increase or decrease) in investment value adjusted for capital improvements, sales, refinancing, and net investment income activity.

The numerator includes both realized gains/losses and the change in unrealized gains/losses from the prior period.

The net-of-fees capital return reflects the deduction of any performance-based (incentive) fees attributable to the capital component for performance calculation purposes. This figure would exclude any performance-based fees attributable to the income component for performance calculation purposes.

The formula for gross-of-fees capital return is as follows:

$$r_t^{GFC} = \frac{V_t^E - V_t^B - \sum_{j=1}^J CF_{j,t} - NII_t + PF_t^C + FC_t}{V_t^B + \sum_{j=1}^J (CF_{j,t} \times W_{j,t})}$$

The formula for net-of-fees capital return is as follows:

$$r_t^{NFC} = \frac{V_t^E - V_t^B - \sum_{j=1}^J CF_{j,t} - NII_t}{V_t^B + \sum_{j=1}^J (CF_{j,t} \times W_{j,t})}$$

Total Return

The total return is the percentage change in value of real estate investments, including all capital return and income return components, expressed as a percentage of the capital employed over the measurement period. The total return numerator measures the change (increase or decrease) in investment value from both income (loss) and realized and unrealized gains and losses.

The formula for total return gross-of-fees is as follows:

$$r_t^{GFT} = \frac{V_t^E - V_t^B - \sum_{j=1}^J CF_{j,t} + AF_t + PF_t^I + PF_t^C + FC_t}{V_t^B + \sum_{j=1}^J (CF_{j,t} \times W_{j,t})}$$

The formula for total return net-of-fees is as follows:

$$r_t^{NET} = \frac{V_t^E - V_t^B - \sum_{j=1}^J CF_{j,t}}{V_t^B + \sum_{j=1}^J (CF_{j,t} \times W_{j,t})}$$

All performance results, both total returns and component returns, must be clearly identified so that prospective clients can properly interpret and compare performance. To interpret performance data, prospective clients need to know what the performance results represent.

Provision 4.B.10

If the FIRM has COMMITTED CAPITAL, the FIRM SHOULD present FIRM-wide uncalled COMMITTED CAPITAL as of each annual period end.

Discussion

Committed capital is defined as pledges of capital to an investment vehicle by investors (limited partners and the general partner) or the firm and is typically drawn down over a period of time. Uncalled committed capital is the amount of capital that has not yet been drawn. If a firm has committed capital, it is recommended that the firm present total firm-wide uncalled committed capital as of each annual period end. This information provides prospective clients a more complete picture of the capital that is currently committed to a future investment. If the firm chooses to present firm-wide uncalled committed capital, it may present this amount separately from total firm assets. The firm may also choose to present the combination of total firm assets and firm-wide uncalled committed capital. Provision 4.A.9 discusses the requirements relating to the presentation of firm-wide uncalled committed capital in a GIPS Composite Report.

4.C. Disclosure—Requirements

Provision 4.C.1

Once the FIRM has met all the applicable REQUIREMENTS of the GIPS standards, the FIRM MUST disclose its compliance with the GIPS standards using one of the following compliance statements. The compliance statement for a COMPOSITE MUST only be used in a GIPS COMPOSITE REPORT.

a. For a FIRM that is verified:

“[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.”

“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.”

b. For COMPOSITES of a verified FIRM that have also had a PERFORMANCE EXAMINATION:

“[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].”

“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.”

The compliance statement for a FIRM that is verified or for COMPOSITES of a verified FIRM that have also had a PERFORMANCE EXAMINATION is complete only when both paragraphs are shown together, one after the other.

c. For a FIRM that has not been verified:

“[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 not been independently verified.”

The FIRM MUST NOT exclude any portion of the respective compliance statement. Any modifications to the compliance statement MUST be additive.

Discussion

A firm meeting all the requirements of the GIPS standards must use one of the three compliance statements in each of its GIPS Composite Reports. The English version of the compliance statements is the controlling version. If a firm chooses to translate the claim of compliance into a language for which there is no official translation of the GIPS standards, the firm must take care to ensure that the translation used reflects the required wording of the claim of compliance used in Provisions 4.C.1.a, 4.C.1.b, or 4.C.1.c.

It is acceptable to combine both paragraphs of the claim of compliance for a verified firm (Provision 4.C.1.a) into a single paragraph. If the paragraphs are not combined, the claim of compliance for a verified firm is complete only when both paragraphs are shown together, one after the other. A firm may not separate the two required paragraphs from each other.

The same is true for the claim of compliance for a composite that has also had a performance examination (Provision 4.C.1.b). Both paragraphs of the claim of compliance may be combined into a single paragraph. If the paragraphs are not combined, the claim of compliance is complete only when both paragraphs are shown together, one after the other. A firm may not separate the two required paragraphs from each other.

When preparing the GIPS Composite Report for a composite that has had a performance examination, the firm may choose to use either the verification or performance examination claim of compliance. For example, a firm might choose to use the verification claim of compliance for all GIPS Reports, including GIPS Reports for composites and pooled funds that have had a performance examination, if it wishes to standardize the claim of compliance for all GIPS Reports throughout the firm. In this situation, the firm may also disclose that a specific composite or pooled fund has had a performance examination.

The language in each compliance statement must not exclude any portion of the respective compliance statement, with one exception. In the second paragraph of both 4.C.1.a and 4.C.1.b, there is a reference to “composite and pooled fund maintenance.” The firm may delete the words “and pooled fund” if no broad distribution pooled funds or limited distribution pooled funds are included within the definition of the firm.

There may also be instances where it may be appropriate for a firm to modify the language slightly. For example, a firm may modify the language to include the name of the firm’s verifier, if the firm wishes to disclose this information. A firm may also need to modify the language to add more details about the name of the firm that has been verified or the dates of the verification if the verification period was not continuous. Any modifications must be additive and must not result in a claim of compliance that is false or misleading.

Provision 4.C.2

The FIRM MUST disclose the following: “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.”

Discussion

“GIPS®” is a registered trademark of CFA Institute, and firms are required to acknowledge this in all GIPS Composite Reports. The required disclosure may appear in the body of the GIPS

Composite Report or in a footnote to the report. The term “this organization,” which is included in the required disclosure, refers to any entity associated with the GIPS Composite Report, either the firm or the verifier.

CFA Institute (owner of the GIPS® trademark) may take appropriate action against any firm that misuses the mark “GIPS®” or any compliance statement, including false claims of compliance with the GIPS standards. CFA Institute members, CFA Program charterholders, CFA candidates, CIPM Program certificants, and CIPM candidates who misuse the term “GIPS” or any compliance statement, misrepresent their performance history or the performance history of their firm, or falsely claim compliance with the GIPS standards are also subject to disciplinary sanctions under the CFA Institute Code of Ethics and Standards of Professional Conduct. Possible disciplinary sanctions include public censure, suspension of membership, and revocation of the CFA charter or CIPM certificate.

Regulators with jurisdiction over firms claiming compliance with the GIPS standards may also take enforcement actions against firms that falsely claim compliance with the GIPS standards.

Firms may also use the following language to replace the first sentence in this required disclosure: “GIPS® is a registered trademark owned by CFA Institute.” See the GIPS Standards Trademark Usage Guidelines on the CFA Institute website (www.cfainstitute.org) for additional guidance on the proper use of “GIPS”.

Provision 4.C.3

The FIRM MUST disclose the definition of the FIRM used to determine TOTAL FIRM ASSETS and FIRM-wide compliance.

Discussion

To claim compliance with the GIPS standards, a firm must comply with all applicable requirements of the GIPS standards on a firm-wide basis. Accordingly, the firm must determine exactly how it will be defined for the purpose of compliance. The GIPS standards require that a firm must be defined as an investment firm, subsidiary, or division held out to the public as a distinct business entity.

A distinct business entity is a unit, division, department, or office that is organizationally and functionally segregated from other units, divisions, departments, or offices, that retains discretion over the assets it manages, and that should have autonomy over the investment decision-making process.

Possible criteria that can be used to determine this status include:

- being a legal entity,
- having a distinct market or client type (e.g., institutional, retail, private client), and
- using a separate and distinct investment process.

See Provision 1.A.2 for a more detailed discussion of defining the firm.

Because there are often a number of closely related units or divisions within larger investment management entities, it is critical to disclose the precise definition of the firm that is presenting the performance results and would be responsible for the management of the prospective client's assets. This provision requires the firm to disclose sufficient details of the entity that is presenting investment performance such that the firm is clearly identified.

Sample Disclosures:

Example 1:

Firm A is a multinational investment firm with offices around the world, including in Japan, Australia, the United Kingdom, and the United States. Although all of its offices are part of the global parent company, each office is registered with the appropriate national regulatory authority, and each is held out to clients and prospective clients as a distinct business entity. The firm has defined its offices in Japan, Australia, the United Kingdom, and the United States as separate firms for the purpose of complying with the GIPS standards. The offices in Japan, the United Kingdom, and the United States claim compliance with the GIPS standards. Firm A's Australia office, however, does not claim compliance with the GIPS standards.

Sample Disclosure for Firm A—US:

“For the purpose of complying with the GIPS standards, the firm is defined as Firm A—US, which serves US clients and investors and is a subsidiary of Firm A, a multinational investment firm with offices globally. Firm A also has subsidiaries in the United Kingdom, Australia, and Japan, which are not included in the definition of the firm for purposes of compliance with the GIPS standards.”

Example 2:

Firm B has two divisions, each of which serves a distinct client type. Firm B Institutional Investment Management manages institutional assets. Firm B Retail Investors manages retail assets. The firm has determined that it will create two separate firms for the purpose of complying with the GIPS standards.

Sample Disclosure for Firm B Institutional Investment Management:

“For the purpose of complying with the GIPS standards, the firm is defined as Firm B Institutional Investment Management, the institutional asset management division of Firm B.”

Example 3:

Firm C is an investment management firm that offers both active and passive (indexed) investment strategies. For the purpose of complying with the GIPS standards, the firm has decided to

create two separate firms: one that offers active investment strategies and one that offers indexed investment strategies.

Sample Disclosure for Firm C—Indexed Investing:

“For the purpose of complying with the GIPS standards, the firm is defined as Firm C—Indexed Investing. Firm C—Indexed Investing is the division of Firm C that offers indexed investment strategies to clients.”

Provision 4.C.4

The FIRM MUST disclose the COMPOSITE DESCRIPTION.

Discussion

The composite description is defined as general information regarding the investment mandate, objective, or strategy of the composite. The composite description may be more abbreviated than the composite definition but must 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, including:

- the material risks of the composite’s strategy,
- how leverage, derivatives, and short positions may be used, if they are a material part of the strategy, and
- if illiquid investments are a material part of the strategy.

The composite definition goes a step further than the composite description and includes the detailed criteria that determine the assignment of portfolios to composites, such as investment constraints or restrictions. Although the composite description is a required disclosure, the composite definition is not a required disclosure. (See the discussion of Provision 3.A.5 for additional information regarding composite definitions and composite descriptions.)

The required disclosure of the composite description provides information about the composite’s investment strategy that is intended to help a prospective client who is considering an investment product or strategy and is reviewing a GIPS Composite Report for that product or strategy. The composite description should provide sufficient information to prospective clients to allow them to differentiate the significant features of the strategy from other strategies within the firm and to compare products across firms. The disclosed strategy features will likely affect both the historical and expected risk and returns. Along with the required benchmark description (see Provision 4.C.5), the GIPS Composite Report will allow prospective clients to understand

both the investment strategy employed and the benchmark against which the composite's performance is evaluated. This will help prospective clients to compare investments across firms.

If leverage, derivatives, and short positions may be used, and they are a material part of the strategy, this must be disclosed in the composite description. Provision 4.C.17 requires that the firm disclose how leverage, derivatives, and short positions have been used historically, if material. Taken together, these two required disclosures provide a more complete picture about the presence, use, and extent of leverage, derivatives, and short positions. When determining what would be material, the firm must consider whether the disclosure of how leverage, derivatives, and/or short positions may be used and/or have been used historically is likely to affect a prospective client's or prospective investor's view of the risk involved in the strategy. If so, it would be misleading for the firm to fail to disclose their use to these prospective clients or prospective investors when describing the strategy.

Generally, all investment products or strategies have some degree of inherent risk (e.g., market risk), but it is not intended that the composite description identifies every risk of the strategy. Instead, firms must identify those material risks of the strategy, if any, and must disclose those risks. For example, investment concentration, correlation (or lack thereof), liquidity, and exposure to counterparties are features that may need to be included in the composite description.

The key characteristics of some strategies may change given market events. Firms should periodically review composite descriptions to ensure they are current.

Sample Disclosures:

"The Large Cap Equity Growth Composite includes all institutional portfolios that invest in large-capitalization US stocks that are considered to have growth in earnings prospects that is superior to that of the average company within the benchmark, the XYZ Large Cap Growth Index. The targeted tracking error between the composite and the benchmark is less than 3%."

"The Leveraged Bond Composite includes all segregated accounts invested in a diversified range of high-yield corporate and government bonds with the aim of providing investors with a high level of income while seeking to maximize the total return. The portfolios are invested in domestic and international fixed income securities of varying maturities. The strategy allows investment in exchange-traded and OTC derivative contracts (including, but not limited to, options, futures, swaps, and forward currency contracts) for the purposes of risk, volatility, and currency exposure management. The strategy allows leverage up to but not exceeding twice the value of a portfolio's investments through the use of repurchase financing arrangements with counterparties. Inherent in derivative instrument investments is the risk of counterparty default. Leverage may also magnify losses as well as gains to the extent that leverage is employed. The benchmark is the XYZ Capital Global Aggregate Bond Index."

A Sample List of Composite Descriptions can be found in Appendix D of the GIPS standards.

Provision 4.C.5

The FIRM MUST disclose:

- a. The BENCHMARK DESCRIPTION, which MUST include the key features of the BENCHMARK or the name of the BENCHMARK for a readily recognized index or other point of reference.
- b. The PERIODICITY of the BENCHMARK if BENCHMARK returns are calculated less frequently than monthly.

Discussion

Firms are required to disclose a description of each benchmark included in a GIPS Composite Report. The benchmark description is defined as general information regarding the investments, structure, and/or characteristics of the benchmark, and it must include the key features of the benchmark. In the case of a widely recognized benchmark, such as the S&P 500[®] Index, the name of the benchmark will satisfy this requirement. (S&P 500[®] is a registered trademark of Standard & Poor's Financial Services LLC.) Each firm must decide for itself whether a benchmark is widely recognized. If the firm is not certain as to whether the benchmark is widely known, the firm must include the benchmark description.

If the benchmark returns are calculated less frequently than monthly, the periodicity of the benchmark must be disclosed.

Sample Disclosure for a Widely Recognized Benchmark:

“The benchmark is the S&P 500[®] Index.”

Sample Disclosure for a Benchmark That Is Not Widely Recognized:

“The benchmark is the XYZ World Index, which is designed to measure the equity market performance of developed market countries. The benchmark is market-cap weighted and is composed of all XYZ country-specific developed market indices.”

Sample Disclosure for an Index with Returns Calculated Less Frequently than Monthly:

“The ABC Property Index (API) is a quarterly, unleveraged composite total return for private commercial real estate properties held for investment purposes only. All properties in the API have been acquired, at least in part, on behalf of tax-exempt institutional investors.”

Provision 4.C.6

When presenting GROSS-OF-FEES returns, the FIRM MUST disclose if any other fees are deducted in addition to TRANSACTION COSTS.

Discussion

A gross-of-fees return is the return on investments reduced by any transaction costs. If a firm presents a gross-of-fees return in a GIPS Composite Report, the firm must disclose if any other fees are deducted in addition to transaction costs (e.g., custody fees). In cases where fees other than transactions costs have been deducted from the gross-of-fees returns, this disclosure helps prospective clients understand the gross-of-fees returns being presented and therefore compare performance across firms.

In some markets, brokers offer zero-commission trades. If a portfolio is paying zero commissions, then it is appropriate to calculate portfolio gross-of-fees returns that reflect zero transaction costs. When a composite includes portfolios that pay zero commissions, firms should disclose this fact. Not disclosing this fact could be misleading.

Sample Disclosure:

“Gross-of-fees returns reflect the deduction of transaction costs and custodian fees but do not reflect the deduction of investment management fees.”

Provision 4.C.7

When presenting NET-OF-FEES returns, the FIRM MUST disclose:

- a. If any other fees are deducted in addition to INVESTMENT MANAGEMENT FEES and TRANSACTION COSTS.
- b. If NET-OF-FEES returns are net of any PERFORMANCE-BASED FEES OR CARRIED INTEREST.
- c. If model or actual INVESTMENT MANAGEMENT FEES are used.
- d. If model INVESTMENT MANAGEMENT FEES are used, and COMPOSITE GROSS-OF-FEES returns are not presented, the model INVESTMENT MANAGEMENT FEE used to calculate NET-OF-FEES returns.³⁴
- e. If model INVESTMENT MANAGEMENT FEES are used, the methodology used to calculate NET-OF-FEES returns.

³⁴REQUIRED for periods ending on or after 31 December 2020.

Discussion

When presenting returns, it is important that there are sufficient disclosures so that prospective clients can understand what the returns actually represent.

Net-of-fees returns for composites are required to reflect only the deduction of transaction costs and investment management fees. Investment management fees include both asset-based fees and performance-based fees or carried interest. Other expenses may also be deducted (e.g., custody fees). If other fees are deducted from the net-of-fees returns, this must be disclosed to help prospective clients understand the net-of-fees returns presented and to compare performance across firms. If the net-of-fees returns are net of any performance-based fees or carried interest, that must be disclosed as well.

In some markets, brokers offer zero-commission trades. If a portfolio is paying zero commissions, then it is appropriate to calculate portfolio net-of-fees returns that reflect zero transaction costs. When a composite includes portfolios that pay zero commissions, firms should disclose this fact. Not disclosing this fact could be misleading.

A firm must also disclose whether model or actual investment management fees are used to calculate net-of-fees returns. (See Provision 2.A.31 for an explanation of when model investment management fees may be used.) If gross-of-fees returns are presented along with the net-of-fees returns, prospective clients can easily determine the model fee used by deducting the net-of-fee returns from the gross-of-fee returns. For periods ending on or after 31 December 2020, however, if model investment management fees have been used and composite gross-of-fees returns are not presented, the firm must disclose the model fee used to calculate net-of-fees returns. The methodology used in the calculation of net-of-fees returns must be disclosed if model investment management fees are used.

Sample Disclosure for Actual Fees:

“Net-of-fees returns are calculated using actual management fees, which include performance fees. These fees are accounted for on an accrual basis.”

Sample Disclosure for Model Fees:

“Net-of-fees returns are calculated by reducing monthly composite returns by a model fee of 0.0830%. This equates to a model annual fee of 1.0%, which is the highest tier of the standard fee schedule.”

Provision 4.C.8

The FIRM MUST disclose which fees and expenses other than INVESTMENT MANAGEMENT FEES (e.g., research costs) are separately charged by the FIRM to clients, if material.

Discussion

Clients typically bear investment management fees and transaction costs. In some cases, however, firms may charge fees or expenses, such as investment research costs, directly to clients. When any fees or expenses other than investment management fees are separately charged by the firm to clients, and these fees or expenses are material, the firm must disclose which fees and expenses are separately charged. When determining if additional fees or expenses would be considered material, a firm must consider whether the additional fees or expenses are significant enough to reduce a prospective client's assessment of the attractiveness of the expected returns of the strategy relative to total fees charged. If so, the firm's failure to disclose these additional fees or expenses would violate the principle of full disclosure.

Sample Disclosure:

"In addition to investment management fees and transaction costs, certain investment research costs are charged directly to clients, as stipulated in client agreements."

Provision 4.C.9

The FIRM MUST disclose or otherwise indicate the reporting currency.

Discussion

The GIPS standards require that firms disclose the currency used to report the numerical information presented in a GIPS Composite Report. If the firm presents performance in multiple currencies in the same GIPS Composite Report, the firm must ensure it is clear which currencies are used to calculate and report performance and assets.

Labeling the columns within a GIPS Composite Report with the appropriate currency symbol would satisfy this requirement, as would a written disclosure. If firms market the strategy outside their home market, they should consider whether the currency symbol alone is sufficient. For example, a Canadian firm marketing only in Canada may decide to present only the \$ symbol. If the firm markets the strategy in both the United States and Canada, the firm must disclose whether the currency is USD or CAD, because both currencies use the same currency symbol.

All required and recommended information presented in a GIPS Composite Report must be presented in the same currency. (See Provision 4.A.12.)

Sample Disclosures:

"Valuations are computed and all information is reported in Canadian dollars."

“All numerical information is reported in Japanese yen.”

Provision 4.C.10

The FIRM MUST disclose which measure of INTERNAL DISPERSION is presented.

Discussion

The GIPS standards do not mandate that a specific measure of a composite’s internal dispersion must be included in a GIPS Composite Report. Instead, firms are permitted to choose a measure for each composite and apply it consistently. (See Provision 4.A.1.i.) Because firms may choose which measure of internal dispersion to present, disclosure of the chosen measure is required in the GIPS Composite Report to help prospective clients understand which measure of internal dispersion is being presented.

Sample Disclosure:

“Internal dispersion is calculated using the equal-weighted standard deviation of the annual gross returns of those portfolios that were included in the composite for the entire year.”

Provision 4.C.11

The FIRM MUST disclose the current FEE SCHEDULE appropriate to PROSPECTIVE CLIENTS OR PROSPECTIVE INVESTORS.

- a. When presenting performance to a PROSPECTIVE CLIENT for a standalone PORTFOLIO, the FEE SCHEDULE MUST reflect the FEE SCHEDULE for a standalone PORTFOLIO managed according to that strategy.
- b. When presenting performance of a COMPOSITE that includes CARVE-OUTS to a PROSPECTIVE CLIENT for a multi-asset strategy PORTFOLIO, the FEE SCHEDULE MUST reflect the FEE SCHEDULE for a multi-asset strategy PORTFOLIO managed according to that strategy.
- c. When presenting a WRAP FEE COMPOSITE to a WRAP FEE PROSPECTIVE CLIENT, the FEE SCHEDULE MUST reflect the total WRAP FEE.
- d. When presenting a GIPS COMPOSITE REPORT to a PROSPECTIVE INVESTOR for a POOLED FUND included in the COMPOSITE, the FIRM MUST disclose the POOLED FUND’S current FEE SCHEDULE and EXPENSE RATIO.

Discussion

Firms must disclose the current fee schedule that is applicable to prospective clients or prospective investors for the specific composite. The fee schedule can be asset based, performance based, or a combination of both. Determining which fee schedule is appropriate depends on the recipient of the information.

Prospective Client for a Standalone Portfolio

A standalone portfolio is a portfolio that is not a portion of a larger portfolio. If the performance of a composite is being presented to a prospective client for a standalone portfolio, the fee schedule must reflect the fee schedule for a standalone portfolio managed according to that strategy.

Prospective Client for a Multi-Asset-Class Strategy Portfolio When the Composite Includes Carve-Outs

If the performance of a multi-asset-class strategy model composite that includes carve-outs is being presented to a prospective client as supplemental information to the single-asset-class composites that represent the “building blocks” for the strategy, the fee schedule must reflect the fee schedule for a multi-asset-class portfolio managed according to the strategy, not the fees associated with the individual building blocks. The same is true if the building blocks do not include carve-outs. The firm may provide the fee schedules for the individual building blocks for the strategy, in addition to the fee schedule for the multi-asset-class strategy, if it wishes to do so. Note that the firm must also present the GIPS Composite Reports for the underlying, building block composites to the prospective client. (See Provision 3.A.2.)

Wrap Fee Prospective Client

If a wrap fee composite is being presented to a wrap fee prospective client, the fee schedule must reflect the total wrap fee that will be charged to the wrap fee prospective client. The firm may also present the fee schedule that it charges for managing the wrap fee portfolios, which is a component of the total wrap fee, but this disclosure must be in addition to the total wrap fee schedule. Firms should also consider disclosing when clients are expected to incur significant trade away fees. Trade away fees, also known as step-out fees, are fees charged on trade orders that a portfolio manager for a wrap fee portfolio places with a broker/dealer other than the broker/dealer designated by the wrap fee sponsor.

Prospective Investor for a Pooled Fund Included in the Composite

When presenting performance to a prospective investor for a pooled fund, a firm may provide a GIPS Pooled Fund Report that includes performance of that pooled fund. If the pooled fund is

included in a composite, the firm may instead provide a GIPS Composite Report to the prospective investor. If the firm provides a GIPS Composite Report to the prospective investor, the firm must include the fee schedule that is appropriate to the pooled fund, rather than (or in addition to) the fee schedule for the composite. If the pooled fund has multiple fee schedules, the firm may use the highest fee schedule as the appropriate fee that can be used for all prospective investors. The firm may also include multiple fee schedules in the GIPS Composite Report.

Firms must present the total expense ratio that is applicable to prospective investors for the specific pooled fund. The pooled fund expense ratio is the ratio of total pooled fund expenses to average net assets. The expense ratio should not reflect transaction costs. The expense ratio gives prospective investors important insight into the total fees and expenses involved in an investment in the fund. For example, a pooled fund expense ratio of 2% indicates that an investor will pay \$20 in expenses each year for every \$1,000 invested, in addition to transaction costs. An expense ratio also helps investors compare expenses across funds, because even a small difference in fees can have a significant effect over time.

If the pooled fund has multiple share classes, the firm may present multiple expense ratios or may present only the expense ratio appropriate to the prospective investor. The firm may also use the highest expense ratio as the expense ratio that can be used for all prospective investors of the fund. Expense ratios must reflect any performance-based fees or carried interest, if accrued or charged to the pooled fund.

Because expense ratios can change over time, firms must determine which expense ratio to present. A firm might choose to present the expense ratio as of the most recent annual period end, or the last known expense ratio. When the expense ratio has had a material change resulting from a change in assets or costs, the firm should present a more current expense ratio that reflects what a prospective investor is likely to pay at the current time.

Pooled fund expense ratios that are calculated for periods of less than one year must be annualized. For example, assume that a pooled fund starts on 1 April, and the firm calculates an expense ratio of 0.75% for the period from 1 April 2019 through 31 December 2019. The firm must present an annualized rate of 1.00%, representing a pooled fund expense ratio for the entire year, rather than the 0.75% that represents an expense ratio for only nine months. Presenting an annualized expense ratio facilitates the comparison of expense ratios across funds and firms. Firms may also present the non-annualized expense ratio but must clearly disclose or indicate that the expense ratio is not annualized.

When a firm uses a single GIPS Composite Report for prospective investors for multiple pooled funds that are included in the composite, it must disclose fee schedules and expense ratios for each pooled fund. The firm may instead choose to tailor the GIPS Composite Report to include the fee schedule and expense ratio that are appropriate for the prospective investor.

The fee schedule presented to a prospective client or prospective investor is typically listed by asset level ranges and should be appropriate to the particular prospective client or prospective

investor. The fee schedule must be current. Although a current fee schedule may not assist a prospective client or prospective investor when interpreting historical performance because the actual fees paid may differ from the fee schedule disclosed, it is the most relevant to the prospective client or prospective investor. The actual fee that the prospective client or prospective investor may pay (if it hires the firm) could also differ from the fee schedule disclosed in the GIPS Composite Report. For example, a prospective client or prospective investor may be able to negotiate a lower fee.

This disclosure requirement is not satisfied if the firm does not include the fee schedule and expense ratio, if applicable, in the GIPS Composite Report and instead makes reference to another document that includes the fee schedule or expense ratio, such as Form ADV, which is a US regulatory document, or a fund prospectus. The fee schedule and expense ratios may be an exhibit attached to the GIPS Composite Report.

Sample Disclosure for a Composite to a Prospective Client for a Segregated Account:

“The annual fee schedule is as follows:

First €10 million	0.80%
Next €40 million	0.60%
Above €50 million	0.30%”

Sample Disclosure for a Model Composite That Includes Carve-Outs or Other "Building Blocks" to a Prospective Client for a Multi-Asset-Class Strategy Portfolio:

“The current standard management fee schedule for a segregated account managed to the Balanced strategy, which is a blend of the Large-Cap Equity Composite and the Intermediate-Term Fixed Income Composite, is as follows:

- 0.70% on the first \$25 million
- 0.55% on the next \$75 million
- 0.45% on all assets above \$100 million.

The fee schedules for the Large-Cap Equity Composite and the Intermediate-Term Fixed Income Composite are as follows:

<i>Large-Cap Equity Composite</i>	<i>Intermediate-Term Fixed Income Composite</i>
0.90% on the first \$25 million	0.50% on the first \$25 million
0.70% on the next \$75 million	0.40% on the next \$75 million
0.60% on all assets above \$100 million	0.30% on all assets about \$100 million”

Sample Disclosure for a Wrap Fee Composite:

“The standard wrap fee schedule in effect is 3.00% of total assets. The wrap fee includes transaction costs, investment management fees, custody fees, and other administrative fees.”

Sample Disclosure for a Composite That Includes a Pooled Fund:

“The investment management fee schedule for Global Equity segregated accounts is as follows: 1.00% on the first \$25 million; 0.75% thereafter. The investment management fee schedule for the Global Equity Pooled Fund, which is included in the Global Equity Composite, is 0.80% on all assets. The total expense ratio as of 31 December 2019 for the Global Equity Pooled Fund was 0.95%.”

Sample Disclosure for a Composite That Includes Two Pooled Funds:

Vehicle	Fee Schedule	Expense Ratio
Segregated account	0.50% on all assets	n/a
Limited partnership	0.45% on all assets	0.75%
Collective fund	0.40% on all assets	0.68%

Provision 4.C.12

If the FEE SCHEDULE includes PERFORMANCE-BASED FEES OR CARRIED INTEREST, the FIRM MUST disclose the PERFORMANCE-BASED FEE DESCRIPTION OR CARRIED INTEREST DESCRIPTION.

Discussion

Sufficient information must be included with any fee schedule included in a GIPS Composite Report to allow prospective clients to understand the nature of the firm’s compensation. If performance-based fees or carried interest are included in the fee schedule, the firm must disclose a description of the performance-based fees and/or carried interest. Relevant information for a performance-based fee includes the performance-based fee rate, hurdle rate, clawback, high watermark, reset frequency, accrual frequency, crystallization schedule, and on what basis fees are charged. Relevant information for carried interest includes the hurdle rate, crystallization schedule, and high watermark.

Sample Disclosures:

“The standard fee schedule is as follows:

Management fee is 0.75% per annum, charged on a quarterly basis on the period-end value of the portfolio assets.

Performance fee:

The performance fee is earned when the portfolio’s total return, reduced by the pro rata accrued fixed management fee, exceeds the benchmark return (the excess return) and the portfolio’s net asset value is above the high watermark, which is the portfolio’s net asset value as of the last year end when the performance fee crystallized. The performance fee is 10% of the excess return, which is calculated arithmetically, accrued daily, and crystallizes annually. Further details of the performance fee calculation are available upon request.”

Provision 4.C.13

The FIRM MUST disclose the COMPOSITE INCEPTION DATE.

Discussion

When reviewing the performance data in a GIPS Composite Report, it is important that prospective clients have sufficient information regarding the length of the composite track record to put the performance presented in the GIPS Composite Report in perspective. Therefore, the inception date of the composite being presented in the GIPS Composite Report must be disclosed. Prospective clients can then compare the periods of performance presented in the GIPS Composite Report with the length of the composite’s track record, and they can request additional information for historical periods not included in the GIPS Composite Report. If there has been a break in the performance record of a composite, the initial inception date before the break is the date that would be disclosed.

Sample Disclosures:

“The Small Cap Value Composite has an inception date of 1 May 2010, the date on which the first portfolio in the composite was fully invested.”

“The Global Fixed Income Composite has an inception date of 1 November 2015. There was a break in performance from 1 March 2019 through 30 November 2019. During that period, there were no portfolios in the composite. Composite performance began again on 1 December 2019.”

“The Asia Pacific Equities Composite has an inception date of 1 March 1998. Returns for periods prior to the 10-year track record presented in this report are available upon request.”

Provision 4.C.14

The FIRM MUST disclose the COMPOSITE CREATION DATE.

Discussion

Firms must disclose the composite creation date, which is the date on which the firm first grouped one or more portfolios together to create the composite. The composite creation date is not necessarily the same as the composite inception date. The composite inception date is the initial date of the composite's performance record and is a required disclosure. (See Provision 4.C.13.) The composite creation date can be significantly after the composite inception date, depending on when the firm first grouped the individual portfolios together to create the composite. This information allows prospective clients to compare the composite creation date with the composite inception date to determine whether the firm grouped portfolios together into a composite retroactively or created the composite at the beginning of the composite's performance track record. The intent of this disclosure is to enable prospective clients to determine if the composite was created with the benefit of hindsight.

For those firms that created composites many years ago, it may be impossible to know the specific day a composite was created. Some firms disclose a composite creation date as a month, or even a year, when the composite was created in the very distant past. Newly created composites should have more-precise composite creation dates.

Sample Disclosures:

"The Growth Opportunities Composite was created on 17 July 2019. This is the date on which portfolios were first grouped together to create the composite."

"The Core Fixed Income Composite was created in November 2009."

Provision 4.C.15

The FIRM MUST disclose that the following lists are available upon request, if applicable:

- a. List of COMPOSITE DESCRIPTIONS.
- b. List of POOLED FUND DESCRIPTIONS for LIMITED DISTRIBUTION POOLED FUNDS.
- c. List of BROAD DISTRIBUTION POOLED FUNDS.

Discussion

In each GIPS Composite Report, firms must disclose that a list of composite descriptions and a list of pooled fund descriptions for limited distribution pooled funds (LDPFs) are available upon request, if applicable to the firm. The firm must also disclose that a list of broad distribution pooled funds (BDPFs) is available upon request, if BDPFs are included within the definition of the firm. The required list of LDPF descriptions and of BDPFs is at the fund level and not the share class level.

If the firm does not sell participation in a fund (e.g., the firm manages the assets but another legal entity distributes the fund and the firm does not sell shares in the fund), the firm must consider the portfolio a segregated account and would include the portfolio in a composite. This would include sub-advised pooled funds. The segregated account would not be included on the list of LDPF descriptions or the list of BDPFs. In addition, a portfolio with a pooled fund wrapper, (i.e., a single-investor pooled fund), which is unitized but is not available to other investors, is also considered a segregated account, would be included in a composite, and would not appear on a list of LDPF descriptions or a list of BDPFs.

As noted in Provision 1.A.22, if a pooled fund is included in a composite but the firm offers participation in the fund, either directly or through an agent, the pooled fund must still appear on the required list of LDPF descriptions or the list of BDPFs, as appropriate.

The firm may combine its list of composite descriptions, its list of LDPF descriptions, and its list of BDPFs into one document if it wishes to do so. The firm may also prepare a list of all the strategies that it offers and may indicate, as part of the strategy description, the types of portfolios (segregated account, LDPF, or BDPF) in which the strategy is available. This list of strategies can be in narrative or table format.

This requirement exists to provide prospective clients with a complete picture of the firm's composites and pooled funds. Prospective clients may then request information that will allow them to evaluate whether the GIPS Composite Report they have received is the most appropriate and to determine if there are any other GIPS Composite Reports or GIPS Pooled Fund Reports that they should also request to see.

a. List of COMPOSITE DESCRIPTIONS.

The firm must disclose, in each GIPS Composite Report, that the firm's list of composite descriptions is available upon request. The list of composite descriptions itself does not need to be included in each GIPS Composite Report but must be available upon request. The list of composite descriptions must include the composite description for each current composite, as well as a description for all composites that have terminated in the past five years. The composite descriptions disclosed in GIPS Composite Reports must be consistent with the descriptions included in the list of composite descriptions.

An explanation of composite descriptions can be found in the discussion of Provision 1.A.22. A Sample List of Composite Descriptions can be found in Appendix D of the GIPS standards.

b. List of POOLED FUND DESCRIPTIONS for LIMITED DISTRIBUTION POOLED FUNDS.

If LDPFs are included within the definition of a firm, the firm must disclose, in each GIPS Composite Report, that the firm's list of descriptions of LDPFs is available upon request. An LDPF is any pooled fund that is not a BDPF. A BDPF is any pooled fund that is regulated under a framework that would permit the general public to purchase or hold the pooled fund's shares and is not exclusively offered in one-on-one presentations. LDPFs are often referred to as "private funds." These funds are typically sold in one-on-one presentations and may not be highly regulated. The list of LDPF descriptions does not need to be included in each GIPS Composite Report but must be available upon request. The list of LDPF descriptions must include the pooled fund description for each current pooled fund but does not have to include terminated funds. Terminated LDPFs are treated differently from terminated composites because, although a firm can restart a composite strategy when a prospective client hires the firm for a strategy that was previously closed, the firm does not have the same ability to restart a pooled fund. The pooled fund descriptions disclosed in GIPS Pooled Fund Reports must be consistent with the descriptions included in the list of pooled fund descriptions.

The list of LDPF descriptions may be tailored to include only those LDPFs for which a prospective investor is eligible, but the firm is not required to do this.

An explanation of LDPF descriptions can be found in the discussion of Provision 1.A.22. A Sample List of Pooled Fund Descriptions can be found in Appendix D of the GIPS standards.

c. List of BROAD DISTRIBUTION POOLED FUNDS.

In addition to the lists of composite descriptions and LDPF descriptions, firms must also disclose, in each GIPS Composite Report, that a list of BDPFs is available upon request, if applicable to the firm. A BDPF is any pooled fund that is regulated under a framework that would permit the general public to purchase or hold the pooled fund's shares and is not exclusively offered in one-on-one presentations. These funds are typically sold to the general public and are highly regulated.

Note that the required list of BDPFs is a list of the names of the firm's BDPFs only. No descriptions of the BDPFs are required. The list of BDPF names does not need to be included in each GIPS Composite Report but must be available upon request. The list of BDPFs must include the names of all current BDPFs but does not need to include terminated BDPFs. Terminated BDPFs are treated differently from terminated composites because, although a firm can restart a composite strategy when a prospective client hires the firm for a strategy that was previously closed, the firm does not have the same ability to restart a pooled fund. If a firm includes information about all of its BDPFs on its website, the firm may provide a link to the website to fulfill the requirement to provide the list of BDPFs upon request.

This list may be tailored to include only those BDPFs for which a prospective investor is eligible, but the firm is not required to do this.

Sample Disclosures:

For Firms with Composites Only

“A list of composite descriptions is available upon request.”

For Firms with Composites and Limited Distribution Pooled Funds

“A list of composite descriptions and a list of limited distribution pooled fund descriptions are available upon request.”

For Firms with Composites, Limited Distribution Pooled Funds, and Broad Distribution Pooled Funds

“A list of composite descriptions, a list of limited distribution pooled fund descriptions, and a list of broad distribution pooled funds are available upon request.”

For Firms That Offer Strategies in Multiple Vehicles

“A list of all composite and pooled fund investment strategies offered by the firm, with a description of each strategy, is available upon request. The type of portfolios in which each strategy is available (segregated account, limited distribution pooled fund, or broad distribution pooled fund) is indicated in the description of each strategy.”

Provision 4.C.16

The FIRM MUST disclose that policies for valuing investments, calculating performance, and preparing GIPS REPORTS are available upon request.

Discussion

In each GIPS Composite Report, firms must disclose the availability of policies for valuing investments, calculating performance, and preparing GIPS Reports. The policies are not required to be included in each GIPS Composite Report but must be available upon request. Firms are not required to provide the related procedures, in addition to the policies, but may do so.

Sample Disclosure:

“Firm XYZ’s policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.”

Provision 4.C.17

The FIRM MUST disclose how leverage, derivatives, and short positions have been used historically, if material.

Discussion

Firms must provide enough information in a GIPS Composite Report to allow a prospective client to understand how leverage, derivatives, and short positions have been employed historically and may be used going forward. Although the composite description includes disclosure of the firm’s ability to use leverage, derivatives, and short positions (See Provision 4.C.4), Provision 4.C.17 requires that the firm disclose the leverage, derivatives, and short positions that have been used historically, if material. Taken together, these two required disclosures provide a more complete picture of the presence, use, and extent of leverage, derivatives, and short positions.

For example, assume a firm discloses in the composite description that the strategy may employ up to 200% leverage. To satisfy the disclosure requirement in Provision 4.C.17, the firm might state, “Since the inception of the strategy, the leverage has averaged 110% of the composite’s value; however, during 2019 the leverage averaged 160%, which greatly increased the sensitivity to market volatility and the potential for realized gains and/or losses.”

No disclosure is required if leverage, derivatives, and short positions have not been used or if their use has not been material. When determining what would be material, the firm must consider whether the disclosure of how leverage, derivatives, and/or short positions have been used historically is likely to affect a prospective client’s view of the risk involved in the strategy. If so, it would be misleading for the firm to fail to disclose their use to these prospective clients when describing the strategy.

Provision 4.C.18

If estimated TRANSACTION COSTS are used, the FIRM MUST disclose:

- a. That estimated TRANSACTION COSTS were used.
- b. The estimated TRANSACTION COSTS used and how they were determined.

Discussion

Gross-of-fees and net-of-fees composite returns must reflect the deduction of transaction costs, which are the costs of buying or selling investments. Firms may use either actual or estimated transaction costs when calculating returns. Estimated transaction costs may be used only for portfolios for which the actual transaction costs are not known. Provision 2.A.13 provides guidance on the use of estimated transaction costs.

If estimated transaction costs are used in calculating returns, there must be a disclosure that estimated transaction costs were used. A firm must also disclose the estimated transaction costs used and how they were determined. A firm might, for example, determine estimated transaction costs based on other portfolios whose transaction costs are known.

In some markets, brokers offer zero-commission trades. If a portfolio is paying zero commissions, then it is appropriate to calculate portfolio gross-of-fees returns and net-of-fees returns that reflect zero transaction costs. When a composite includes portfolios that pay zero commissions, firms should disclose this fact. Not disclosing this fact could be misleading.

Sample Disclosures:

“Some portfolios in the composite do not pay explicit transaction costs for security purchases and sales. Estimated transaction costs for these portfolios are used, and these are determined based on the average transaction cost per share incurred by portfolios in the composite that pay explicit transaction costs. The average transaction cost was determined to be \$0.031 per share. We apply a model transaction cost per share of \$0.04 to each investment transaction.”

“The transaction costs for some portfolios in the composite are not known and must be estimated. The estimated transaction costs for these portfolios is 12 Swiss francs per trade.”

“Effective 1 January 2020, a majority of portfolio trades are made through brokers that no longer charge commissions on standard equity trades. Portfolios that trade options and futures continue to pay transaction costs for options/futures contract trades.”

Provision 4.C.19

The FIRM MUST disclose all significant events that would help a PROSPECTIVE CLIENT interpret the GIPS COMPOSITE REPORT. This disclosure MUST be included for a minimum of one year and for as long as it is relevant to interpreting the track record.

Discussion

The GIPS standards are based on the principles of fair representation and full disclosure. Meeting these objectives requires a good faith commitment on the part of the firm to adhere to the spirit of the GIPS standards. The GIPS standards cannot foresee and cover every situation that might occur. Therefore, this provision requires that firms disclose all significant events that would help explain the firm's GIPS Composite Report to a prospective client. The primary goal of this requirement is to provide relevant information to prospective clients so that they can understand the potential effect of the significant event on the composite's investment strategy and the firm.

Significant events are determined by the firm and would include, as examples, a material change in personnel responsible for investment management, significant changes to the investment management process, the loss of historical records resulting from a catastrophic event, or a change in firm ownership. The acquisition of a new entity or selling off part of a firm would also qualify as a significant event, as would the departure of someone who was the single investment decision maker for a strategy.

Depending on the situation, a general statement describing the significant event that has occurred may be sufficient. Other situations may require firms to disclose specific information pertaining to the significant event. The disclosure regarding the significant event must be included in the GIPS Composite Report for a minimum of one year and for as long as it is relevant to interpreting the performance track record. As an example, a firm that acquires another firm, resulting in a large increase in total firm assets, may disclose this significant event for as long as the large change in total firm assets is included in the GIPS Composite Report. In contrast, a change in a firm's chief investment officer (CIO) is a change that a firm may believe should be disclosed for one year only.

The firm must consider the underlying principles of the GIPS standards, which are fair representation and full disclosure, when determining how long the disclosure will be included in the GIPS Composite Report.

Sample Disclosures:

"In June 2017, Firm G determined that the custodian bank used by all of the firm's proprietary mutual funds had failed to file reclaimable withholding tax refund requests with the appropriate authorities. At that time, all accrued reclaimable withholding taxes were written off, decreasing the composite's monthly return by 1.06%."

"On 15 April 2018, the quantitative asset management division of Firm Z was sold, resulting in the 2018 decrease in Firm Z's assets."

"In February 2020, the parent company of Firm M announced plans to exit the investment management business and sell Firm M. As of April 2020, a tentative sale of Firm M has been agreed upon but not yet finalized."

Provision 4.C.20

For any performance presented for periods prior to the MINIMUM EFFECTIVE COMPLIANCE DATE that does not comply with the GIPS standards, the FIRM MUST disclose the periods of non-compliance.

Discussion

Firms may link non-GIPS compliant performance to their GIPS-compliant performance provided that only GIPS-compliant performance is presented for periods beginning on or after the minimum effective compliance date, which is 1 January 2006 for private equity and real estate composites and pooled funds and wrap fee composites, and 1 January 2000 for all other composites and pooled funds. If the firm chooses to present non-compliant performance for periods prior to the minimum effective compliance date, the firm must disclose which periods are not in compliance. Prospective clients and existing clients can then inquire about the reasons why the periods prior to the minimum effective compliance date are not compliant and consider the effects of non-compliance on the historical performance.

If non-compliant performance is included in a GIPS Composite Report after the minimum effective date, it must be labeled as supplemental information and must not be linked to the GIPS-compliant performance.

Sample Disclosure:

“The performance record for 1995 through 1999 is not in compliance with the GIPS standards.”

Provision 4.C.21

If the FIRM is redefined, the FIRM MUST disclose the date and description of the redefinition.

Discussion

A firm redefinition occurs when something changes with how the firm is held out to the public or when any of its distinct business entity criteria significantly change. Changes in investment style or personnel are not events that typically cause a firm redefinition. A simple firm name change is also not a sufficient reason to redefine the firm. Corporate restructuring may cause a change with how the firm is held out to the public. As an example, a firm that was defined to include only the institutional division would be redefined when it consolidated the institutional division with

the mutual fund/retail division. A merger or acquisition may cause a change in the definition of the firm, but that is not always the case.

Suppose that a firm defines itself as an investment management firm offering active equity strategies to clients. An acquisition that expanded the firm's offerings to include fixed-income strategies would result in a redefinition of the firm, because there would be a change in how the firm holds itself out to the public. An acquisition that simply added additional equity strategies to the firm's offerings would not result in a redefinition of the firm. However, the acquisition is likely to be a significant event that must be disclosed in a GIPS Composite Report. (See Provision 4.C.19.)

In some cases, as a result of a significant alteration in a firm's structure or organization, a change can be so great that it creates a new firm. See Provision 1.A.2 for guidance on firm definitions.

The GIPS standards require that changes in a firm's organization must not lead to alteration of historical performance (see Provision 1.A.28).

Sample Disclosures:

"As of 1 August 2019, XYZ Firm was redefined to include both the London and Tokyo office of XYZ Company. Previously, the firm was defined to include only the London office."

"As of 1 January 2020, XYZ Investment Management was redefined to include the wrap division."

"Effective 1 January 2019, ABC Capital Management was redefined as an investment management firm offering both equity and fixed-income strategies. Prior to the 31 December 2018 acquisition of Curtone Capital Management, an investment firm offering fixed-income strategies, ABC Capital Management offered only equity strategies."

Provision 4.C.22

If the COMPOSITE is redefined, the FIRM MUST disclose the date and description of the redefinition.

Discussion

Investment strategies can change over time. In some cases, such a change results in the termination of one composite and the creation of a new composite. In other cases, it may be appropriate to redefine the composite. If a composite is redefined, the firm must disclose the date and description of the redefinition. See Provision 3.A.5 for guidance on composite definitions.

Sample Disclosures:

“Effective 1 January 2018, the Small Cap Composite was redefined to exclude mutual funds from the composite because of liquidity constraints; subsequently, only institutional portfolios are included.”

“As of 1 July 2019, the fixed-income strategy includes the use of interest rate futures to modify duration and manage interest rate risk. Prior to this date, the Composite’s strategy did not involve the active management of interest rate risk.”

Provision 4.C.23

The FIRM MUST disclose changes to the name of the COMPOSITE. This disclosure MUST be included for a minimum of one year and for as long as it is relevant to interpreting the track record.

Discussion

When prospective clients are evaluating composites over time and across firms, it is important that they understand exactly which composites they are assessing. If a firm changes the name of a composite, the change must be disclosed in the GIPS Composite Report. The name change must be disclosed for a minimum of one year and potentially for more than one year if the firm determines the disclosure is still relevant and meaningful. The firm must consider the underlying principles of the GIPS standards, which are fair representation and full disclosure, when determining how long the disclosure will be included in the GIPS Composite Report.

Sample Disclosure:

“As of 1 January 2016, the XYZ Index Composite was renamed the US Equity Large Cap Composite.”

Provision 4.C.24

The FIRM MUST disclose:

- a. The minimum asset level, if any, below which PORTFOLIOS are not included in the COMPOSITE.
- b. Any changes to the minimum asset level.

Discussion

The firm may establish a minimum asset level for a composite to exclude portfolios that are too small to be representative of the intended strategy. Firms must disclose the minimum asset level of the composite, if one exists, in each respective GIPS Composite Report. If any changes have been made to the minimum asset level of a composite, the firm must document and disclose changes to the minimum asset level and must not retroactively apply the new limit. See the discussion of Provision 3.A.11 for additional guidance on composite minimums.

Sample Disclosure:

“The minimum portfolio size for inclusion in the LMN Composite is €500,000. Prior to 2018, portfolios with assets below €400,000 were not included in the LMN Composite.”

Provision 4.C.25

The FIRM MUST disclose if COMPOSITE returns are gross or net of withholding taxes, if material.

Discussion

Global investing requires recognition of the tax consequences of investing in different countries. The GIPS standards do not require firms to reflect withholding taxes, either reclaimable or non-reclaimable taxes, in a certain manner. Firms may choose whether or not to reflect the effect of withholding taxes when calculating performance. The GIPS standards do recommend that performance be reported net of non-reclaimable withholding taxes on dividends, interest, and capital gains and also recommend that reclaimable foreign withholding taxes be accrued (see Provision 2.B.5). If withholding taxes are material, firms must disclose how withholding taxes are treated when calculating performance. A firm must determine the level at which withholding taxes become material, document this level in its policies and procedures, and apply it consistently.

Sample Disclosure:

“Portfolio returns are net of all foreign non-reclaimable withholding taxes. Reclaimable withholding taxes are reflected as income if and when received.”

Provision 4.C.26

The FIRM MUST disclose if BENCHMARK returns are net of withholding taxes if this information is available.

Discussion

Global investing requires recognition of the tax consequences of investing in different countries. The GIPS standards do not require firms to reflect withholding taxes, either reclaimable or non-reclaimable taxes, in a certain manner. Firms may choose whether or not to reflect the effect of withholding taxes when calculating composite performance and, similarly, whether or not to use a benchmark that reflects the effect of withholding taxes.

As Provision 4.C.25 indicates, if withholding taxes are material, firms must disclose how withholding taxes are treated when calculating performance. To facilitate the comparison of composite returns and benchmark returns, firms must also disclose if the benchmark returns are net of withholding taxes if this information is available. If the benchmark name indicates that the benchmark is net of withholding taxes, no additional disclosure is necessary.

Sample Disclosure:

“Benchmark returns are net of withholding taxes.”

Provision 4.C.27

If the GIPS COMPOSITE REPORT conforms with laws and/or regulations that conflict with the REQUIREMENTS of the GIPS standards, the FIRM MUST disclose this fact and disclose the manner in which the laws and/or regulations conflict with the GIPS standards.

Discussion

Firms must comply with all applicable laws and regulations regarding the calculation and presentation of performance. Compliance with applicable laws and regulations, however, does not necessarily result in compliance with the GIPS standards. Firms must also comply with all of the applicable requirements of the GIPS standards. In the rare cases where laws and regulations conflict with the GIPS standards, firms are required to comply with the laws and regulations and disclose the manner in which the laws and/or regulations conflict with the GIPS standards.

This disclosure will assist prospective clients in comparing GIPS Composite Reports among firms where reporting requirements may differ because of local laws or regulations.

Sample Disclosure:

“Local laws do not allow the presentation of returns of less than one year to prospective clients, which is in conflict with the GIPS standards. Therefore, no performance is presented for

this composite for the period from 1 July 2018 (the inception date of the composite) through 31 December 2018.”

Provision 4.C.28

If CARVE-OUTS with allocated cash are included in the COMPOSITE, the FIRM MUST:

- a. Indicate CARVE-OUT in the COMPOSITE name.
- b. Disclose that the COMPOSITE includes CARVE-OUTS with allocated cash.
- c. Disclose the policy used to allocate cash to CARVE-OUTS.
- d. Disclose that the GIPS COMPOSITE REPORT for the COMPOSITE of standalone PORTFOLIOS is available upon request, if the COMPOSITE of standalone PORTFOLIOS exists.

Discussion

With the issuance of the 2020 edition of the GIPS standards, firms are once again allowed to include carve-outs with cash that has been allocated synthetically in composites. (This was prohibited from 1 January 2010 through 31 December 2019.) In the spirit of fair representation and full disclosure, it is important that prospective clients have sufficient information to understand the nature of the portfolios included in a composite. If carve-outs with allocated cash are included in a composite, the name of the composite must include “carve-out” or otherwise indicate this. In addition to “carve-out” being indicated in the name of the composite, there must be a disclosure that the composite includes carve-outs with allocated cash. These two requirements signal to prospective clients that there are assets in the composite that do not represent standalone portfolios and for which they might want to request additional information. (A standalone portfolio is a portfolio that is not a portion of a larger portfolio.) Firms are not required to indicate “carve-out” in the composite name if the composite includes carve-outs with allocated cash that were created in compliance with prior editions of the GIPS standards.

Because the methodology for allocating cash to carve-outs can have a significant effect on a composite’s return, it is required that the firm disclose the policy used to allocate cash to the carve-outs in the composite. See the discussion of Provision 3.A.15 for methods that may be used to allocate cash.

Once a firm obtains one or more standalone portfolios managed in the same strategy as the carve-outs with allocated cash, the firm must create a separate composite that includes only the standalone portfolios. (See Provision 3.A.18.) The returns and composite assets of the composite that includes only standalone portfolios must be presented in the GIPS Composite Report for the composite that includes carve-outs with allocated cash. In addition, in the GIPS Composite Report for the composite that includes carve-outs with allocated cash, the firm must disclose that the GIPS

Composite Report for the composite of standalone portfolios managed in the same strategy as the composite with carve-outs with allocated cash is available upon request. This disclosure will inform prospective clients that they can compare the GIPS Composite Reports for the composite with carve-outs with allocated cash and the composite with only standalone portfolios if they wish to do so. This disclosure is required only when the firm has standalone portfolios managed in the same strategy as the composite with carve-outs with allocated cash and has therefore created the required composite of standalone portfolios.

Once a firm has obtained standalone portfolios managed in the same strategy as the carve-outs with allocated cash, the firm may present prospective clients with the GIPS Composite Report that includes only the standalone portfolios, rather than the GIPS Composite Report that includes carve-outs with allocated cash.

Sample Disclosure:

“The Large-Cap Carve-Out Equity Composite includes carve-outs with allocated cash. Cash and cash returns are allocated to carve-outs based on each carve-out’s size relative to its total portfolio, using beginning-of-month values. A GIPS Composite Report for the Large-Cap Equity Composite that includes only standalone portfolios is available upon request.”

Provision 4.C.29

The FIRM MUST disclose the use of a SUB-ADVISOR and the periods a SUB-ADVISOR was used.³⁵

Discussion

Some firms use a sub-advisor to manage part or all of a particular strategy. For example, if a firm specializes in managing equities, it might hire a sub-advisor (a third-party investment manager) to manage the fixed income portion of its balanced portfolios. The GIPS standards require that firms include the performance of assets assigned to a sub-advisor in a composite provided the firm has the authority to allocate the assets to a sub-advisor. In the spirit of full disclosure, a firm must disclose the fact that a sub-advisor was used in the management of the composite strategy and the periods for which a sub-advisor was used. It is not necessary to disclose the name of the sub-advisor. This is required for periods beginning on or after 1 January 2006.

³⁵REQUIRED for periods beginning on or after 1 January 2006.

Sample Disclosures:

“A sub-advisor is used to manage the international equity allocation of the Asia Growth Balanced Composite.”

“A sub-advisor was used for the management of the Targeted Duration Fixed Income Composite from its inception in 2001 through 31 December 2018.”

Provision 4.C.30

The FIRM MUST disclose if the COMPOSITE’s valuation hierarchy materially differs from the RECOMMENDED valuation hierarchy. (See Provision 2.B.6 for the RECOMMENDED valuation hierarchy.)³⁶

Discussion

Firms must establish policies and procedures for determining portfolio valuations. For periods beginning on or after 1 January 2011, those valuations must be determined in accordance with the definition of fair value. Provision 2.B.6 includes a recommended valuation hierarchy that firms should incorporate into their policies and procedures for determining fair value for portfolio investments. Firms must establish a valuation hierarchy on a composite-specific basis. It is acceptable for firms to apply a different valuation hierarchy to specific composites provided the valuation methodology conforms to the definition of fair value. If the valuation hierarchy materially differs from the recommended valuation hierarchy, the firm must disclose this fact. Prospective clients will be informed and then may request additional information about the firm’s valuation policies.

Sample Disclosure:

“All portfolio investments are valued using the firm’s proprietary valuation models to determine fair value. Our valuation procedures materially differ from the recommended valuation hierarchy in the GIPS standards.”

Provision 4.C.31

If the FIRM determines no appropriate BENCHMARK for the COMPOSITE exists, the FIRM MUST disclose why no BENCHMARK is presented.

³⁶REQUIRED for periods beginning on or after 1 January 2011.

Discussion

Benchmarks are important tools that aid in the planning, implementation, and evaluation of an investment strategy. They also help facilitate discussions with prospective clients regarding the relationship between composite risk and return. As a result, the GIPS standards require firms to provide benchmark total returns in all GIPS Composite Reports. The benchmark must reflect the investment mandate, objective, or strategy of the composite. Although there is typically an appropriate benchmark for traditional strategies, it is more common for managers of alternative strategies to determine that no appropriate benchmark for the composite exists. If this is the case, the firm must disclose why no benchmark is presented.

Sample Disclosure:

“Because the composite’s strategy is absolute return where investments are permitted in all asset classes, no benchmark is presented because we believe that no benchmark that reflects this strategy exists.”

Provision 4.C.32

If the FIRM changes the BENCHMARK, the FIRM MUST disclose:

- a. For a prospective BENCHMARK change, the date and description of the change. Changes MUST be disclosed for as long as returns for the prior BENCHMARK are included in the GIPS COMPOSITE REPORT.
- b. For a retroactive BENCHMARK change, the date and description of the change. Changes MUST be disclosed for a minimum of one year and for as long as they are relevant to interpreting the track record.

Discussion

Firms must disclose the date and description of any changes to the benchmark over time. A benchmark change can take two forms:

- The benchmark is changed from one benchmark to another on a prospective basis only.
- The benchmark is changed for all periods (i.e., retroactively).

In most cases, the firm should only change the benchmark going forward and not change the benchmark retroactively.

If the firm changes the benchmark prospectively and presents benchmark returns that combine two different benchmarks, the date and description of the change must be disclosed for as long as

returns for the prior benchmark are included in the GIPS Composite Report. For example, assume a firm changes the benchmark for a composite in June 2015, and the change is made prospectively. As long as benchmark returns from 2015 or prior periods are included in the GIPS Composite Report, the firm must include this disclosure. Firms must also carefully identify the benchmark as a custom benchmark in the GIPS Composite Report and must make clear that the benchmark returns are not those of the current benchmark for all periods. It would not be appropriate to label the benchmark returns with the name of the current benchmark. The firm must provide information, including labeling of the benchmark, that is sufficient to allow a prospective client to distinguish the prior benchmark returns from the current benchmark returns.

There may be times when a firm determines that it is appropriate to change the benchmark for a given composite retroactively. For example, because benchmarks are continually evolving, if the firm finds that a new benchmark is a better comparison for an investment strategy, the firm may consider changing the benchmark retroactively. In the case of a retroactive benchmark change, there must be a disclosure of the date and description of the benchmark change, including the fact that the benchmark was changed retroactively. Disclosures related to a retroactive change in a benchmark must be included in the respective GIPS Composite Report for a minimum of one year and for as long as the disclosures are relevant to interpreting the performance track record. The firm must consider the underlying principles of the GIPS standards, which are fair representation and full disclosure, when determining how long this disclosure will be included in the GIPS Composite Report.

When a firm changes a benchmark retroactively, the firm is encouraged to continue to also present the old benchmark.

This provision applies to a fundamental change in the benchmark—for example, a change in an index used in calculating the benchmark—rather than to periodic minor changes in benchmark weights and components. If a firm uses a custom benchmark that is a blend of one or more benchmarks, a change in the weights of the constituent benchmarks is not considered a benchmark change within the scope of this provision. For example, the benchmark may change every quarter as part of the normal procedure. In this instance, it is appropriate to disclose that the benchmark is rebalanced quarterly using the weights of the asset classes in the composite’s model portfolio. A firm is not required to disclose how the asset class weights have changed each quarter but may do so.

Changes to the benchmark primarily intended to make performance look better by lowering the benchmark return violate the spirit of the GIPS standards.

Sample Disclosure for a Prospective Change:

“Benchmark results presented are a combination of two indices. ABC Index was used prior to 30 September 2015; ABC Value Index is used subsequently.”

Sample Disclosure for a Retroactive Change:

“In January 2017, the benchmark was changed from ABC Index to XYZ Index for all periods.”

Provision 4.C.33

If a custom BENCHMARK or combination of multiple BENCHMARKS is used, the FIRM MUST:

- a. Disclose the BENCHMARK components, weights, and rebalancing process, if applicable.
- b. Disclose the calculation methodology.
- c. Clearly label the BENCHMARK to indicate that it is a custom BENCHMARK.

Discussion

When custom benchmarks are used, the firm must disclose the benchmark components, weights, and rebalancing process, if applicable, as well as the calculation methodology. For example, if the firm combines two indices, WW Index and XX Index, to create the WWXX benchmark for the composite, the following would be an appropriate disclosure:

“The WWXX benchmark is a combination of 50% WW Index and 50% XX Index, calculated by weighting the respective index returns on a monthly basis.”

It is also required that the benchmark be clearly labeled to indicate that it is a custom benchmark. For example, the label for the benchmark returns in a GIPS Report would read “Custom Benchmark.” The benchmark description and required disclosures might read as follows:

“*Custom Benchmark:* The benchmark is 100% hedged. The benchmark is based on a zero-cost one-month rolling hedge, whereby mid spot rates and one-month bid–offer forward points are applied.”

In some markets, it has become more common to use benchmarks that reflect the deduction of model fees or other expenses. These net benchmarks are considered custom benchmarks. A firm must not present net benchmark returns compared with only gross-of-fees composite returns. For example, assume the firm wishes to include a custom benchmark that reflects the deduction of model or actual investment management fees, but the firm presents only gross-of-fees composite returns in the GIPS Composite Report. The firm must not present net benchmark returns when only gross-of-fees composite returns are presented. The firm may use net benchmark returns only when composite net-of-fees returns are presented. The use of net benchmark returns when only gross-of-fees composite returns are presented is one instance where disclosure is not sufficient to prevent the information presented from being false and misleading. When a firm includes net

benchmark returns in a GIPS Composite Report, the firm must clearly label the benchmark as a custom net benchmark and disclose the calculation methodology.

It is becoming more common for exchange-traded funds (ETFs) to be used as benchmarks. An ETF is a pooled fund that tracks a specific investment universe that is expressed by an index or a basket and that is listed on an exchange. Unlike a market index, an ETF incurs trading costs and other charges, including taxes. Because of the incurred costs, an ETF may underperform the market index that it tracks. If an ETF is chosen as the benchmark for a strategy, the firm should present net-of-fees composite returns. As part of the benchmark description for an ETF, the firm must disclose the following items:

- if ETF returns are gross or net of fees and other costs, including transaction costs;
- the ETF expense ratio, if ETF net returns are presented;
- if ETF returns are based on market prices or net asset values (NAVs);
- the timing of the market close used to determine the ETF's valuations; and
- if ETF returns are gross or net of withholding taxes, if this information is available.

If the firm also presents composite gross-of-fees returns, it should present ETF returns that are grossed up, but it is not required to do so.

Sample Disclosures:

“Benchmark returns are a customized version of the XYZ Index, which is calculated monthly by XYZ Company. The benchmark reflects the deduction of a model fee of 1.00% per annum, which is calculated monthly by deducting 1/12 of 1% from the benchmark return.”

“The benchmark is the Special ETF, which tracks the securities included in the Special Index. The ETF returns reflect the deduction of all expenses and transaction costs incurred by the Special ETF and are net of withholding taxes. As of 31 December 2019 the expense ratio was 0.14%. The Special ETF returns reflect market prices, which are determined by the midpoint between the bid and ask prices as of the closing time of the New York Stock Exchange.”

Provision 4.C.34

If a PORTFOLIO-WEIGHTED CUSTOM BENCHMARK is used, the FIRM MUST disclose:

- a. That the BENCHMARK is rebalanced using the weighted average returns of the BENCHMARKS of all of the PORTFOLIOS included in the COMPOSITE.
- b. The frequency of the rebalancing.

- c. The components that constitute the PORTFOLIO-WEIGHTED CUSTOM BENCHMARK, including the weights that each component represents, as of the most recent annual period end.
- d. That the components that constitute the PORTFOLIO-WEIGHTED CUSTOM BENCHMARK, including the weights that each component represents, are available for prior periods upon request.

Discussion

Firms may use a portfolio-weighted custom benchmark, which is created using the benchmarks of the individual portfolios in the composite. If such a benchmark is used, firms must disclose that the benchmark is calculated using the weighted average returns of the benchmarks of all of the portfolios included in the composite, along with the frequency of the rebalancing. Firms are not required to disclose how the underlying portfolio benchmarks and weights have changed each period.

Additionally, in the spirit of full disclosure and fair representation, firms must disclose the components that constitute the portfolio-weighted custom benchmark, including the weight that each component represents, as of the most recent annual period end. It is also required that firms disclose that the information regarding the components of the portfolio-weighted custom benchmark, as well as the component weights, is available for prior periods upon request.

Sample Disclosure:

“The Long US Government/Credit Custom Benchmark is calculated using the benchmarks of the portfolios in the composite. The benchmark is rebalanced monthly based on the beginning values of portfolios included in the composite. As of 31 December 2018, the breakdown of the benchmark is 88.2% XYZ US Long Government/Credit Index and 11.8% XYZ US Long Government/Credit A+ Index. The breakdown of the custom benchmark for different time periods is available upon request.”

Provision 4.C.35

If the FIRM has adopted a SIGNIFICANT CASH FLOW policy for the COMPOSITE, the FIRM MUST disclose how the FIRM defines a SIGNIFICANT CASH FLOW for the COMPOSITE and for which periods.

Discussion

A significant cash flow is defined as the level at which the firm determines that one or more client-directed external cash flows may temporarily prevent the firm from implementing the composite strategy. The cash flow may be defined by the firm as a single flow or an aggregate of a number of flows within a stated period. The measure of significance must be determined as either a specific monetary amount (e.g., €50,000,000) or a percentage of portfolio assets (based on the most recent valuation). If a firm has adopted a significant cash flow policy for a specific composite, the firm must disclose how the firm defines a significant cash flow for that composite and for which periods.

Sample Disclosures:

“Firm ABC defines a significant cash flow for the European Developed Markets Equity Composite as an external cash flow within a portfolio equal to or greater than €50,000,000. If a portfolio experiences a cash inflow of €50,000,000 or more during a calendar month, it is removed from the composite for that month. Following the policy for inclusion of new portfolios in the composite, if the cash level is 5% or less of the portfolio’s assets at month end, the portfolio will be returned to the composite in the following month. A cash outflow of €50,000,000 or more during a calendar month will trigger removal of a portfolio from the composite for that month. The portfolio will be returned to the composite in the month following the outflow if it continues to meet other composite criteria, such as size. A portfolio may be removed from a composite prior to the month of the actual cash outflow if there is a significant buildup of cash to prepare for the outflow. The significant cash flow policy for the European Developed Markets Equity Composite was adopted in May 2017.”

“A Significant Cash Flow (SCF) policy was adopted for the Large-Cap Growth composite starting 1 February 2015. The SCF policy is triggered by a net cash inflow or outflow of 15% or more during a calendar month. If a portfolio in the composite experiences a 15% or greater cash inflow during a calendar month, it is removed from the composite for that month. If the cash level is 10% or less of portfolio assets at month-end, the portfolio will be returned to the composite in the following month. A cash outflow of 15% or more will trigger removal of a portfolio from the composite. The portfolio will be returned to the composite in the month following the outflow if it continues to meet other composite criteria, such as size.”

Provision 4.C.36

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.

Discussion

For periods ending on or after 1 January 2011, firms must present the three-year annualized ex post standard deviation of the composite and benchmark, which must be calculated using 36 monthly returns, as of each annual period end.

The 2010 edition of the GIPS standards required that a firm disclose, in all cases, 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. The 2020 edition of the GIPS standards modifies this requirement. This disclosure is required only if the three-year annualized ex post standard deviation is not presented for composites that have at least three annual periods of performance. This change applies to all periods presented in a GIPS Composite Report.

If a composite has at least three annual periods of performance but 36 monthly returns are not available for the composite, firms are not required to present the three-year annualized ex post standard deviation for either the benchmark or the composite. This scenario often applies to private market investment composites because they are not required to have monthly returns. Firms must disclose that 36 monthly returns are not available for the composite. (If private market investment composites do have monthly valuations and 36 monthly returns are available, the three-year annualized ex post standard deviation must be presented.) If 36 monthly returns are not available for the composite but are available for the benchmark, a firm is not required to present the three-year annualized ex post standard deviation for the benchmark but may do so.

If 36 monthly returns are not available for the benchmark but are available for the composite, firms are required to present only the three-year annualized ex post standard deviation for the composite. In this instance, because 36 monthly returns are not available for the benchmark, firms must not present a three-year annualized ex post standard deviation for the benchmark using data points other than monthly. Firms must disclose that 36 monthly returns are not available for the benchmark.

Sample Disclosure If 36 Monthly Returns Are Available for the Composite but Not for the Benchmark:

“The three-year annualized ex post standard deviation of the benchmark is not presented because the benchmark returns are calculated quarterly.”

Sample Disclosure If 36 Monthly Returns Are Not Available for the Composite:

“The three-year annualized ex post standard deviation of the composite and benchmark are not presented because the composite returns are calculated quarterly.”

Provision 4.C.37

The FIRM MUST disclose if performance from a past firm or affiliation is presented, and for which periods.

Discussion

Provision 1.A.32 includes the portability tests that must be met to determine if performance from a past firm or affiliation may be used to represent the historical performance of a new or acquiring firm and if that performance can be linked to the ongoing performance of the new or acquiring firm. Provision 1.A.33 includes the portability tests that must be met for the new or acquiring firm to use performance from a past firm or affiliation to represent its historical performance when there is a break in the track record between the past firm or affiliation and the new or acquiring firm. In this instance, the track record from the past firm or affiliation may be used if the tests are met, but it must not be linked to the performance of the new or acquiring firm.

If the firm meets the required portability tests and presents performance from a past firm or affiliation in the GIPS Composite Report, the firm must disclose this fact, as well as the periods for which performance from the past firm or affiliation is presented.

Sample Disclosure:

“Performance shown prior to 2017 represents results achieved by the Small-Cap Team while it was a part of ABC Investments. The Small-Cap Team joined the firm on 2 January 2017.”

Provision 4.C.38

The FIRM MUST disclose any change to the GIPS COMPOSITE REPORT resulting from the correction of a MATERIAL ERROR. Following the correction of the GIPS COMPOSITE REPORT, this disclosure MUST be included for a minimum of one year and for as long as it is relevant to interpreting the track record. The disclosure is not REQUIRED to be included in a GIPS COMPOSITE REPORT that is provided to a PROSPECTIVE CLIENT OR PROSPECTIVE INVESTOR that did not receive the GIPS COMPOSITE REPORT containing the MATERIAL ERROR.

Discussion

Firms claiming compliance with the GIPS standards are likely to be faced with situations in which errors are discovered that must be specifically addressed. An error, which can be qualitative or quantitative, can be related to any component of a GIPS Composite Report that is missing or

inaccurate. Errors in GIPS Composite Reports can result from, but are not limited to, incorrect, incomplete, or missing:

- composite returns or assets,
- firm assets,
- benchmark returns,
- number of portfolios in a composite,
- three-year annualized ex post standard deviation, or
- disclosures.

Any material error in a GIPS Composite Report must be corrected and disclosed in a revised GIPS Composite Report. A firm must define materiality within its error correction policies and procedures.

To adhere to this requirement, a firm must determine the criteria it will use to determine materiality. The following is a definition of materiality that firms might find useful as a starting point for their determination of materiality. “An error is material if the magnitude of the omission or misstatement of performance information, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed by the omission or misstatement.” Firms should have a defined process for determining the objective criteria it will use in determining materiality.

Disclosure of the change in the corrected GIPS Composite Report resulting from a material error must be included in the GIPS Composite Report for a minimum of 12 months following the correction of the report and for as long as it is relevant to interpreting the track record. The firm must consider the underlying principles of the GIPS standards, which are fair representation and full disclosure, when determining how long the disclosure will be included in the GIPS Composite Report that contained the material error.

Disclosure of the change resulting from a material error is not required to be included in a GIPS Composite Report that is provided to new prospective clients or prospective investors.

The discussion for Provision 1.A.20 provides additional information on error correction, including the determination of materiality, the actions that must be taken when an error in a GIPS Composite Report is discovered, and an explanation of who must receive the revised GIPS Composite Report.

Sample Disclosure:

“This GIPS Composite Report includes a correction of the information provided for the XYZ Index. The annual return for the XYZ Index for 2017 was originally presented as 3.4%. The correct return is 4.3%, as shown in this revised GIPS Composite Report.”

Provision 4.C.39

If the FIRM chooses to not present the number of PORTFOLIOS in the COMPOSITE because there are five or fewer PORTFOLIOS in the COMPOSITE, the FIRM MUST disclose that the COMPOSITE contains five or fewer PORTFOLIOS or use similar language.

Discussion

Each GIPS Composite Report must include information about the number of portfolios included in the composite. These figures must be presented as of the end of each annual period that is included in the GIPS Composite Report. (See Provision 4.A.1.f.) This requirement provides information to prospective clients on whether the composite is composed of a small number of portfolios or many.

In cases where there are five portfolios or fewer in a composite at period end, the firm may choose to not present the actual number of portfolios in the composite. The firm might choose to do this to protect the identity and confidentiality of its clients. Because firms must include information about the number of portfolios in the composite, however, firms must either state or indicate that the composite contains “five or fewer portfolios”, “fewer than six portfolios”, (or use similar language) or present the actual number of portfolios in the composite.

Note that “five or fewer portfolios in the composite” refers to the number of portfolios in the composite at the annual period end, not the number of portfolios in the composite for the full year. If there were four portfolios in the composite for the full year but seven portfolios in the composite at the annual period end, the firm would be required to present the actual number of portfolios (in this example, seven) in the composite at the annual period end.

Sample Disclosure:

“ABC’s policy is to not present the number of portfolios in the composite when there are fewer than six portfolios included in the composite as of year end.”

Sample Disclosure as Part of a Table:

The column where the number of portfolios in the composite at the annual period end is presented would simply note “<6” or “≤5” for any annual period end for which there were five or fewer portfolios in the composite at the annual period end.

Provision 4.C.40

If the FIRM chooses to not present the INTERNAL DISPERSION of individual PORTFOLIO returns because there are five or fewer PORTFOLIOS in the COMPOSITE for the full year, the FIRM MUST disclose that the INTERNAL DISPERSION measure is not applicable or use similar language.

Discussion

The internal dispersion of the individual portfolio annual returns must be presented for each annual period that is included in a GIPS Composite Report. In cases where there are five or fewer portfolios in a composite for the full year, the measure of internal dispersion is not required to be presented. Because firms must include some information about the internal dispersion of individual portfolio returns, however, firms must indicate that the internal dispersion measure is not applicable or include similar language. The firm may instead choose to present an internal dispersion measure.

Note that “five or fewer portfolios in the composite” refers to the number of portfolios in the composite for the full year, not the number of portfolios in the composite at the annual period end. For example, if there were four portfolios in the composite for the full year but seven portfolios in the composite at year-end, the firm would not be required to present the measure of internal dispersion for the composite.

Sample Disclosure:

“ABC’s policy is to not present the internal dispersion when there are five or fewer portfolios included in the composite for the full year.”

Sample Disclosure as Part of a Table:

The column where the measure of internal dispersion is presented for each annual period would simply note N.A. for any annual period for which there were five or fewer portfolios included in the composite for the full year.

Provision 4.C.41

The FIRM MUST disclose if preliminary, estimated values are used to determine FAIR VALUE.

Discussion

The use of preliminary, estimated values as fair value is common for some alternative strategies, including those that invest in underlying funds for which the firm relies on valuations provided by the underlying fund managers. When using preliminary, estimated values as fair value, it is important to remember the underlying principles of the GIPS standards: fair representation and full disclosure. If using preliminary, estimated values, firms must disclose this fact in the relevant GIPS Composite Report.

Firms that use preliminary, estimated values to determine fair value and subsequently change valuations when final values are received must determine how the firm's error correction policies will be applied. (Please see Provision 1.A.20 for guidance on error correction policies.) Differences between the final and estimated values are not necessarily errors but are treated in a similar manner because the correction of previously presented information may be involved.

In addition to this required disclosure, it is recommended (see Provision 4.B.8) that firms present the percentage of assets in the composite that were valued using preliminary, estimated values as of each annual period end. This information will help prospective clients to interpret the performance record.

Sample Disclosure:

"Preliminary, estimated values were used in the determination of the fair value of the composite's assets."

Provision 4.C.42

If the FIRM changes the type of return(s) presented for the COMPOSITE (e.g., changes from MONEY-WEIGHTED RETURNS to TIME-WEIGHTED RETURNS), the FIRM MUST disclose the change and the date of the change. This disclosure MUST be included for a minimum of one year and for as long as it is relevant to interpreting the track record.

Discussion

A firm must present time-weighted returns (TWRs) in a GIPS Composite Report unless certain criteria are met that allow money-weighted returns (MWRs) to be presented instead of TWRs. Firms may choose to present MWRs instead of TWRs for a specific composite only if the firm controls the external cash flows into the portfolios in the composite and the portfolios in the composite have at least one of the following characteristics: They are closed-end, fixed life, fixed commitment, or illiquid investments are a significant part of the strategy. (See Provision 1.A.35.)

If the firm changes the type of return presented for a composite, the firm must disclose, in the respective GIPS Composite Report, the change in the type of return (from MWR to TWR or from TWR to MWR) and the date of the change. This disclosure must be included in the GIPS Composite Report for a minimum of one year and for as long as it is relevant and helpful to the firm's prospective clients in interpreting the composite's track record. The firm must consider the underlying principles of the GIPS standards, which are fair representation and full disclosure, when determining how long the disclosure will be included in the GIPS Composite Report.

When a firm changes the type of return presented for a composite, for example from MWRs to TWRs, the firm must change the returns for all periods. As an example, suppose that a firm is presenting performance for the period from the inception of a composite on 1 January 2013 through 31 December 2020. It decides that it will switch to present TWRs as of 1 January 2020. The firm cannot present MWRs through 31 December 2019 and TWRs from 1 January 2020 through 31 December 2020. The firm must present TWRs from 1 January 2013 (the inception date of the composite) through 31 December 2020 in the GIPS Composite Report for the period ended 31 December 2020.

Sample Disclosure:

“Beginning with the GIPS Composite Report for the period ended 31 December 2020, the returns presented for the XYZ Composite were changed from money-weighted returns to time-weighted returns.”

Provision 4.C.43

If the FIRM presents ADDITIONAL RISK MEASURES, the FIRM MUST:

- a. Describe any ADDITIONAL RISK MEASURE.
- b. Disclose the name of the risk-free rate if a risk-free rate is used in the calculation of the ADDITIONAL RISK MEASURE.

Discussion

Understanding and interpreting investment performance requires the consideration of both risk and return. It is therefore recommended that firms present additional risk measures (i.e., beyond those required to be presented) for the composite and the benchmark. (See Provision 4.B.5.) It is important to keep in mind that additional risk measures should be consistent with the composite's strategy. For example, if the strategy is to track the benchmark, then tracking error would be consistent with that objective.

The GIPS Composite Report must include a description of any additional risk measure presented. If a risk-free rate is used in the calculation of an additional risk measure, the name of the risk-free rate must be disclosed. The disclosure of the name of the risk-free rate used in the calculation of an additional risk measure is required because of the importance of the selection of an appropriate risk-free rate. With a disclosure regarding the risk-free rate, the firm's prospective clients can better understand and interpret the additional risk measure(s) presented.

Provision 4.C.44

The FIRM MUST disclose if GROSS-OF-FEES OR NET-OF-FEES returns are used to calculate presented risk measures.

Discussion

To help prospective clients interpret the risk measures presented in a GIPS Composite Report, the firm must disclose which returns are used in the calculation of the presented risk measures. This applies to both required risk measures (e.g., the three-year annualized ex post standard deviation and internal dispersion) and any additional risk measures. As discussed in Provision 2.B.7, it is recommended that firms use gross-of-fees returns when calculating risk measures.

For wrap fee composites, it is sometimes not possible for a firm to calculate gross-of-fees returns. Because of the bundled fee for wrap fee composites, the firm may be unable to identify the transactions costs that must be deducted from the return on investments to arrive at gross-of-fees returns. Firms may therefore use pure gross-of-fees returns (the return on investments that is not reduced by any transaction costs incurred during the period) or returns that are net of the entire wrap fee when calculating risk measures presented in a GIPS Composite Report for a wrap fee composite.

Sample Disclosures:

“Gross-of-fees returns were used to calculate the three-year annualized ex post standard deviation of the composite.”

“Gross returns were used to calculate all risk measures presented in this GIPS Composite Report.”

“Net-of-fees returns were used to calculate the three-year annualized ex post standard deviation and the internal dispersion of the composite.”

Sample Disclosure for a Wrap Fee Composite:

“Pure gross returns were used to calculate the three-year annualized ex post standard deviation and the internal dispersion of the composite. A pure gross return is the return on investments that is not reduced by any transactions costs incurred during the period.”

Provision 4.C.45

For OVERLAY STRATEGY COMPOSITES, the FIRM MUST disclose:

- a. The methodology used to calculate COMPOSITE OVERLAY EXPOSURE.
- b. If collateral and collateral income are reflected in the COMPOSITE returns.

Discussion

According to Provision 2.A.6, for periods beginning on or after 1 January 2020, overlay exposure must be calculated by using one of the following options: (1) the notional exposure of the overlay strategies being managed; (2) the value of the underlying portfolios being overlaid; or (3) a specified target exposure as of the beginning of the period, which can either be defined as a target exposure or determined by a formula used to calculate the target exposure for each period. Because there are different allowable calculation methods, firms must disclose the methodology used in calculating composite overlay exposure. This disclosure will help prospective clients interpret the information presented.

Overlay strategies typically require collateral (sometimes referred to as margin or a margin account). The collateral provided may be for the required minimum or for a larger amount. The required minimum amount may be determined by law or regulation. There are different ways the collateral can be managed, which can affect the overlay portfolio return calculation. Firms must establish a policy for the treatment of collateral in the portfolio return calculation on a composite-specific basis. To help prospective clients interpret the composite returns presented, the firm must disclose whether collateral and collateral income are included in composite returns.

Sample Disclosure:

“Composite overlay exposure represents the total value of all underlying portfolios being overlaid in this composite. Returns include collateral and the associated income.”

Provision 4.C.46

For REAL ESTATE investments that are not in a REAL ESTATE OPEN-END FUND, the FIRM MUST disclose that:³⁷

- a. EXTERNAL VALUATIONS are obtained, and the frequency with which they are obtained, or
- b. The FIRM relies on valuations from financial statement audits.

Discussion

According to Provision 2.A.44, for periods beginning on or after 1 January 2012, real estate investments included in any portfolio except a real estate open-end fund must either:

- have an external valuation at least once every 12 months unless client agreements stipulate otherwise, in which case real estate investments must have an external valuation at least once every 36 months or per the client agreement if the client agreement requires external valuations more frequently than every 36 months; or
- 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.

Because valuation is such an important issue for real estate investments, firms must inform prospective clients whether they externally value real estate investments and, if so, how frequently, or instead place reliance on valuations from audited financial statements. This disclosure is required for periods ending on or after 31 December 2020.

Sample Disclosures:

“ABC Company obtains external valuations for all real estate investments annually.”

“XYZ Company relies on valuations from audited financial statements. The audits are performed by an independent public accounting firm.”

³⁷ REQUIRED for periods ending on or after 31 December 2020.

Provision 4.C.47

For WRAP FEE COMPOSITES, when the FIRM presents PURE GROSS-OF-FEES returns, the FIRM MUST disclose that PURE GROSS-OF-FEES returns do not reflect the deduction of TRANSACTION COSTS.

Discussion

When presenting information for a wrap fee composite to a wrap fee prospective client, firms may present pure gross-of-fees returns as supplemental information. Unlike a gross-of-fees or net-of-fees return, a pure gross-of-fees return is one that does not reflect the deduction of any transaction costs incurred during the period. Some prospective clients may not be aware of what a pure gross-of-fees return represents. Therefore, in addition to requiring that a pure gross-of-fees return be clearly labeled and identified as supplemental information (Provision 4.A.17), it is required that the firm disclose that pure gross-of-fees returns do not reflect the deduction of transaction costs.

Sample Disclosure:

“The pure gross-of-fees returns do not reflect the deduction of transaction costs.”

Provision 4.C.48

When the GIPS COMPOSITE REPORT includes THEORETICAL PERFORMANCE as SUPPLEMENTAL INFORMATION, the FIRM MUST:

- a. Disclose that the results are theoretical, are not based on the performance of actual assets, and if the THEORETICAL PERFORMANCE was derived from the retroactive or prospective application of a model.
- b. Disclose a basic description of the methodology and assumptions used to calculate the THEORETICAL PERFORMANCE sufficient for the PROSPECTIVE CLIENT or PROSPECTIVE INVESTOR to interpret the THEORETICAL PERFORMANCE, including if it is based on model performance, backtested performance, or hypothetical performance.
- c. Disclose whether the THEORETICAL PERFORMANCE reflects the deduction of actual or estimated INVESTMENT MANAGEMENT FEES, TRANSACTION COSTS, or other fees and charges that an actual client PORTFOLIO would have paid or will pay.
- d. Clearly label the THEORETICAL PERFORMANCE as SUPPLEMENTAL INFORMATION.

Discussion

To be presented as supplemental information in a GIPS Composite Report, theoretical performance must relate to the respective composite. The following are examples of theoretical performance that may be included in a GIPS Composite Report as supplemental information:

- Results created by applying a composite investment strategy or methodology to historical data to indicate how a strategy constructed with the benefit of hindsight would have performed during a certain period in the past had the strategy been in existence during that period.
- Ex ante performance that is linked to actual composite performance, or that is calculated using actual composite performance.
- Results that include the effect of currency hedging that has been applied after-the-fact to the composite when the composite was not originally managed including the currency hedging strategy, and the hedging is not part of the actual composite returns.

When theoretical performance is included as supplemental information in a GIPS Composite Report, a firm is required to include a number of disclosures to ensure that the recipients of the report, including prospective clients, understand the nature of the information being presented. Among the required disclosures are the source of the theoretical performance, the methodology and assumptions used to calculate the theoretical performance, and the treatment of fees and costs.

Firms must also clearly label the theoretical performance as supplemental information.

Sample Disclosure:

“A return history has been constructed for the period from 1 January 2015 through 31 December 2018 that reflects the application of an investment model used by XYZ Investment Management. The results are theoretical and are not based on the performance of actual portfolios. The return history is derived from the retroactive application of a model. Taking the constituents of the large-cap index at each month end, those securities that have an above-average dividend yield and an above-average dividend payout ratio were identified and reweighted by market capitalization. The next-month’s performance was then applied to those stock weights to derive a model return for the month. These monthly model returns are then linked to provide annual returns. The theoretical performance presented does not reflect the deduction of investment management fees, transaction costs, or other fees and charges.”

4.D. Disclosure–Recommendations

Provision 4.D.1

The FIRM SHOULD disclose material changes to valuation policies and/or methodologies.

Discussion

Valuation is a critical component of the performance calculation. Therefore, if a change to a firm’s valuation policies and/or methodologies is material, firms should disclose the change in order to enable prospective clients to understand the potential effect of such a change.

Some examples of a material change include, but are not limited to, the following:

- new valuation principles adopted by a local accounting standards board,
- adoption of new international standards in lieu of local standards,
- change of economic criteria used to value investments, and
- change from a discounted cash flow basis to a comparables basis.

Sample Disclosure for a Policy Change:

“Prior to 1 March 2016, illiquid securities were valued internally. Subsequently, illiquid securities are valued using a third-party pricing service.”

Sample Disclosure for a Methodology Change:

“For periods prior to 1 August 2019, real estate investments were valued on a discounted cash flow basis. As of 1 August 2019, real estate investments are valued on a comparables basis.”

Provision 4.D.2

The FIRM SHOULD disclose material changes to calculation policies and/or methodologies.

Discussion

Firms have discretion to determine which policies and methodologies are used for calculating performance. Although these policies and methodologies must adhere to all applicable calculation requirements, firms may choose from a wide variety of policies and methodologies. Firms may

change calculation policies and/or methodologies; however, firms must not change a calculation policy or methodology for the sole purpose of increasing performance. If a change to the calculation policies and/or methodologies is material, firms should disclose the change in order to enable prospective clients to understand the potential effect of such a change.

Sample Disclosure:

“Effective 1 January 2010, portfolio returns are calculated daily, using a true time-weighted return methodology. Previously, portfolio returns were calculated monthly using the Modified Dietz method.”

Provision 4.D.3

The FIRM SHOULD disclose material differences between the BENCHMARK and the COMPOSITE’S investment mandate, objective, or strategy.

Discussion

Firms are required to disclose the composite description (see Provision 4.C.4) and the benchmark description (see Provision 4.C.5) in a GIPS Composite Report. It is recommended that firms also disclose any material differences between the benchmark and the composite’s investment mandate, objective, or strategy. Prospective clients will be better able to evaluate the performance of the strategy relative to the benchmark presented if they understand any material differences between the composite and the benchmark.

Sample Disclosure:

“The Concentrated Equity Composite invests in only the top 20 stocks (as determined by the firm’s Investment Committee) of the stocks that are included in its benchmark, the XYZ Index.”

Provision 4.D.4

The FIRM SHOULD disclose the key assumptions used to value investments.

Discussion

Firms are required to disclose that valuation policies are available upon request. (See Provision 4.C.16.) Because valuation is a critical component of the performance calculation, it is

recommended that firms also disclose the key assumptions used when valuing portfolio investments. This will help prospective clients better understand how the firm values investments and compare valuation assumptions for similar strategies used by different firms.

Sample Disclosure:

“Investments are valued using recent market quotations. If there is no publicly traded reference, equity investments are valued using a market multiples approach for similar investments in active markets, and fixed-income investments are valued using inputs such as interest rates, yield curve shape, volatility, prepayments, and credit risk.”

Provision 4.D.5

If a parent company contains multiple firms, each FIRM within the parent company SHOULD disclose a list of the other firms contained within the parent company.

Discussion

The term “firm” is used in two different ways in Provision 4.D.5. “FIRM” is used to indicate an entity that claims compliance with the GIPS standards, whereas “firm” is used to indicate an entity that may or may not claim compliance with the GIPS standards. The definition of a firm will be based on the specific circumstances of the firm but must reflect how the firm is held out to the public as a distinct business entity. In some cases, a parent company may have two or more units, divisions, departments, or offices that are defined as separate firms within the context of the GIPS standards. To avoid confusion, a firm claiming compliance with the GIPS standards must be sure that it is clearly defined relative to the other firms within the parent company and that it is apparent which firm is claiming compliance. In the interest of fair representation and full disclosure, firms should disclose a list of the other organizations within the parent company. Firms should also consider indicating which organizations within the parent company claim compliance with the GIPS standards.

Sample Disclosure:

“ABC Institutional Investment Management is the institutional division of ABC parent company. The private banking division of ABC parent company also claims compliance with the GIPS standards, whereas the retail division of ABC parent company does not claim compliance with the GIPS standards.”

Provision 4.D.6

If the COMPOSITE contains PORTFOLIOS with BUNDLED FEES, the FIRM SHOULD disclose the types of fees included in the BUNDLED FEE.

Discussion

A bundled fee is a fee that combines multiple fees into one total or “bundled” fee. Bundled fees can include any combination of investment management fees, transaction costs, custody fees, and/or administrative fees. Two examples of bundled fees are all-in fees and wrap fees.

All-In Fee: An all-in fee is a type of bundled fee that can include any combination of investment management fees, transaction costs, custody fees, and administrative fees. All-in fees are typically offered in certain jurisdictions where asset management, brokerage, and custody services are offered by the same company.

Wrap Fee: A wrap fee is a type of bundled fee that is specific to a particular investment product. The wrap fee is charged by a wrap fee sponsor for investment management services and typically includes associated transaction costs that cannot be separately identified. Wrap fees can be all-inclusive, asset-based fees and may include a combination of investment management fees, transaction costs, custody fees, and/or administrative fees.

To help prospective clients better understand the nature of the fees charged for a particular investment product, and to facilitate comparison of bundled fee products offered by different firms, it is recommended that firms disclose the types of fees included in the bundled fee.

Sample Disclosure:

“Portfolios within the composite pay a bundled fee, which includes all charges for transaction costs, portfolio management fees, and custody fees.”

Provision 4.D.7

If the FIRM adheres to any industry valuation guidelines in addition to the GIPS valuation REQUIREMENTS, the FIRM SHOULD disclose which guidelines have been applied.

Discussion

Some market segments, such as private equity, have developed their own valuation guidelines. For these markets, it is not uncommon for the GIPS standards valuation requirements to be

supplemented by other local or international standards because other standards may be more stringent in their requirements.

The disclosure of which industry's valuation guidelines have been used in addition to the GIPS standards valuation requirements will help prospective clients to determine the comparability of GIPS Composite Reports from different firms and/or jurisdictions.

Sample Disclosure:

“The Global Diversified Distressed Composite adheres to the XYZ Venture Capital Association's valuation guidelines as well as the GIPS standards valuation requirements. The XYZ valuation standards are based on fair value but provide more prescriptive advice in terms of how to value specific investments, such as secondary investments and distressed debt investments.”

Provision 4.D.8

When using BENCHMARKS that have limitations, such as peer group BENCHMARKS, the FIRM SHOULD disclose these limitations.

Discussion

Firms must determine which benchmark(s) are most appropriate for composite(s). When determining which benchmarks to present in a GIPS Composite Report, firms should be guided by the ethical spirit of the GIPS standards.

Some benchmarks with known limitations are often used for certain types of investments. For example, peer group benchmarks, such as hedge fund peer group universe indices, are often used for hedge funds and other alternative investment strategies. Although peer group benchmarks are frequently used to evaluate hedge funds, there are some common problems with hedge fund peer group benchmarks, including the following:

- self-reporting bias (only some hedge funds choose to report performance data),
- survivorship bias (historical returns of closed hedge funds are removed from the peer group benchmark),
- inability to obtain returns for the same periods as the composite, and
- lack of investability (some hedge funds within a peer group benchmark are closed to new investors).

When using benchmarks that exhibit limitations, firms should describe these limitations in the relevant GIPS Composite Report. This helps prospective clients understand the nature of

the benchmark and be aware of any known drawbacks in comparing the risk and return of the benchmark and composite.

Sample Disclosure:

“The benchmark is the Hedge Fund Aggregate Multi-Style Index, which includes more than 100 hedge funds of various styles and strategies. Because this index is based on the data self-reported by the constituent funds, it may have a self-reporting bias. In addition, some funds are closed to new investors and are no longer investable. We believe that no better index exists as a comparison for this composite.”

Provision 4.D.9

The FIRM SHOULD disclose how research costs are reflected in returns.

Discussion

The focus on research costs has grown in certain markets. Although research costs are often absorbed by the firm, some firms instead charge research costs directly to clients. To allow prospective clients to understand the firm’s policy for the treatment of research costs, firms should disclose if returns do or do not reflect the deduction of research costs.

Sample Disclosures:

“ABC Company bears the costs of investment research. Research costs are not separately charged to clients.”

“Certain investment research costs are charged directly to clients outside the managed portfolio. Therefore, composite returns do not reflect the research costs that are charged directly to clients.”

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