

# Global Investment Performance Standards (GIPS®) for Firms

Explanation of the  
Provisions in Section 5

June 2020



**CFA Institute®**  
Global Investment  
Performance Standards



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# INTRODUCTION

The Explanation of the Provisions in Section 5 provides interpretation of each provision that is included in Section 5—Composite Money-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 5 includes the requirements and recommendations that apply to composites that include money-weighted returns in a GIPS Composite Report, when the firm meets the requirements specified in Provision 1.A.35 and chooses to present money-weighted returns.

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.



# 5. COMPOSITE MONEY-WEIGHTED RETURN REPORT

The following provisions apply to COMPOSITES that include MONEY-WEIGHTED RETURNS in a GIPS COMPOSITE REPORT when the FIRM meets the REQUIREMENTS specified in Provision 1.A.35 and chooses to present MONEY-WEIGHTED RETURNS.

## 5.A. Presentation and Reporting—Requirements

### Provision 5.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- a. The annualized COMPOSITE SINCE-INCEPTION MONEY-WEIGHTED RETURN through the most recent annual period end.

### 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. See Provision 1.A.3 for a discussion of the required periods for initially claiming compliance.

If a firm meets the requirements for presenting money-weighted returns in a GIPS Composite Report (see Provision 1.A.35) and chooses to do so, the firm must present the annualized composite since-inception money-weighted return (SI-MWR) through the most recent annual period end.

For example, assume a firm presents returns on a calendar year-end basis. If a composite has an inception date of 1 March 2015 and the most recent annual period end is 31 December 2019, the firm must present an annualized composite SI-MWR from 1 March 2015 through 31 December 2019. Although only the annualized composite SI-MWR through the most recent annual period end is required, it is recommended that firms present annualized composite SI-MWRs through each annual period end. (See Provision 5.B.1.) In this example, doing so would mean presenting SI-MWRs from 1 March 2015 through 31 December 2015, 1 March 2015 through 31 December 2016, 1 March 2015 through 31 December 2017, and 1 March 2015 through 31 December 2018. The SI-MWR from 1 March 2015 through 31 December 2015 must not be annualized because the return is for a period of less than one year.

Firms must clearly label the periods for which SI-MWRs are presented. Firms must select the annual period end for which SI-MWRs will be presented on a composite-specific basis and apply it consistently. For purposes of comparability, best practice would be for a firm to report composite SI-MWRs for periods ending on 31 December.

Firms may present either gross-of-fees or net-of-fees composite returns. Firms may also choose to present both gross-of-fees and net-of-fees composite returns in a GIPS Composite Report.

### Provision 5.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- b. When the COMPOSITE has a track record that is less than a full year, the non-annualized COMPOSITE SINCE-INCEPTION MONEY-WEIGHTED RETURN through the initial annual period end.

### Discussion

When a composite has a track record of less than a full year, the firm must present the non-annualized since-inception money-weighted return (SI-MWR) through the initial annual period end. Subsequently, the firm must extend the measurement period for the SI-MWR to include the next annual period and calculate an annualized SI-MWR through the most recent annual period end.

SI-MWRs for periods of less than a full year 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 5.A.1**

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- c. When the COMPOSITE terminates, the annualized COMPOSITE SINCE-INCEPTION MONEY-WEIGHTED RETURN through the COMPOSITE TERMINATION DATE.

**Discussion**

When a composite terminates, the firm must present the annualized composite since-inception money-weighted return (SI-MWR) through the composite termination date. For example, if a composite has an inception date of 1 July 2012 and terminates on 31 August 2019, the GIPS Composite Report for this composite must include a composite SI-MWR for the period from 1 July 2012 through 31 August 2019.

**Provision 5.A.1**

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- d. The SINCE-INCEPTION MONEY-WEIGHTED RETURN for the BENCHMARK for the same periods as presented for the COMPOSITE, unless the FIRM determines there is no appropriate BENCHMARK.

**Discussion**

Benchmarks are important tools that aid in the planning, implementation, and evaluation of a composite'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 the since-inception money-weighted return (SI-MWR) for the benchmark for the same periods as presented for the composite, unless the firm determines there is no appropriate benchmark.

The benchmark presented must be one that reflects the composite's investment mandate, objective, or strategy. A firm may choose to present more than one benchmark in a GIPS Composite Report but must include all required information for all benchmarks presented in the GIPS Composite Report.

Because the benchmark selected for a composite must be appropriate for comparison with the composite's performance, a firm must not compare a time-weighted return (TWR) benchmark with a composite's SI-MWR. Public market indexes by themselves are not directly comparable to

an MWR because the market indexes typically use TWRs. The public market equivalent (PME) is a method in which a public market index is used to create a comparable MWR from a series of cash flows that replicate those of the composite and that can be compared with the composite's MWR. When the firm uses a PME, the market index used must be a total return benchmark.

For composites that have a subscription line of credit (LOC), and the firm is required to present composite returns both with and without the subscription line of credit (see Provision 5.A.2), the firm must present benchmark returns for the same periods as both composite returns. If the benchmark is a PME, the firm must calculate a PME using the composite cash flows with the subscription LOC as well as using composite cash flows without the subscription LOC.

See Provision 1.A.19 for a discussion of total return benchmarks. See the discussion of Provision 5.C.33 for additional information regarding a PME.

### **Provision 5.A.1**

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- e. The number of PORTFOLIOS in the COMPOSITE as of the most recent 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. This figure must be presented as of the most recent annual period end 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 the most recent annual 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 5.C.38.)

Note that “five or fewer portfolios in the composite” refers to the number of portfolios in the composite at the most recent annual period end and not the number of portfolios in the composite for the full period for which the SI-MWR is presented. For example, if there were four portfolios in the composite for the full period 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 for periods ending on 31 December. A new portfolio that is funded during December and will be included in the composite beginning 1 January in accordance with the composite-specific policy must not be included in the number of portfolios in the composite as of 31 December.

### **Provision 5.A.1**

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- f. COMPOSITE assets as of the most recent annual period end.

### **Discussion**

Each GIPS Composite Report must include the amount of composite assets as of the most recent annual period end. 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 undertaken by the client. For example, if the firm is managing a composite that 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 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 for periods ending on 31 December. A new portfolio that is funded during December and will be included in the composite beginning 1 January in accordance with the composite-specific policy must not be included in composite assets as of 31 December.

### Provision 5.A.1

The FIRM MUST present in each GIPS COMPOSITE REPORT:

- g. TOTAL FIRM ASSETS as of the most recent annual period end.<sup>38</sup>

### Discussion

For periods ending on or after 31 December 2020, the firm must present total firm assets as of the most recent annual period end. For 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 undertaken by the client. For example, if the firm is managing a composite that has \$200 million in assets, including \$50 million of assets 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 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 5.A.2

If a SUBSCRIPTION LINE OF CREDIT is used, the FIRM MUST present the COMPOSITE SINCE-INCEPTION MONEY-WEIGHTED RETURN both with and without the SUBSCRIPTION LINE OF CREDIT through the most recent annual period end. The FIRM is NOT REQUIRED to present returns without the SUBSCRIPTION LINE OF CREDIT when the SUBSCRIPTION LINE OF CREDIT has all of the following characteristics:<sup>39</sup>

<sup>38</sup> REQUIRED for periods ending on or after 31 December 2020. For periods ending prior to 31 December 2020, FIRMS may present either TOTAL FIRM ASSETS or COMPOSITE assets as a percentage of TOTAL FIRM ASSETS.

<sup>39</sup> REQUIRED for periods ending on or after 31 December 2020.

- a. The principal was repaid within 120 days using COMMITTED CAPITAL drawn down through a capital call.
- b. No principal was used to fund DISTRIBUTIONS.

## Discussion

A subscription line of credit (LOC) is a loan facility that is usually put in place to facilitate administration when firms are calling for funds from investors. A subscription LOC can have a significant effect on returns. However, there has been a lack of consistency in return calculations when a subscription LOC is used. For comparability and transparency, firms that use a subscription LOC must calculate and present the since-inception money-weighted return (SI-MWR) that includes the subscription LOC. For periods ending on or after 31 December 2020, firms are required to also calculate and present an SI-MWR that does not include the subscription LOC, unless the subscription LOC has the following two characteristics:

- The principal was repaid within 120 days using committed capital drawn down through a capital call; and
- No principal was used to fund distributions.

If the subscription LOC has both of these characteristics, the firm is not required to calculate and present an SI-MWR that does not include the subscription LOC.

Presenting composite returns with and without the subscription LOC provides prospective clients with a more complete understanding of the composite's performance and the effect of the subscription LOC on the composite's returns.

If returns both with and without the subscription LOC are required to be presented in a GIPS Composite Report, these returns must be comparable. If the firm presents gross-of-fees returns only, gross-of-fees returns with and without the subscription LOC must be presented. If the firm presents net-of-fees returns only, net-of-fees returns with and without the subscription LOC must be presented. If the firm presents both gross-of-fees and net-of-fees returns, the firm must present gross-of-fees returns with and without the subscription LOC and net-of-fees returns with and without the subscription LOC.

The SI-MWRs with and without the subscription LOC are required for the SI-MWR that is presented through the most recent annual period end. If a firm chooses to also include SI-MWRs through each annual period end, the SI-MWRs with and without the subscription LOC must be presented in the GIPS Composite Report.

See Provision 2.A.50 for guidance for calculating returns with and without the subscription LOC.

### **Provision 5.A.3**

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 on 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 5.A.4**

If PORTFOLIOS in the COMPOSITE have COMMITTED CAPITAL, the FIRM MUST present the following items as of the most recent annual period end:

- a. COMPOSITE SINCE-INCEPTION PAID-IN CAPITAL.
- b. COMPOSITE SINCE-INCEPTION DISTRIBUTIONS.
- c. COMPOSITE cumulative COMMITTED CAPITAL.
- d. TOTAL VALUE to SINCE-INCEPTION PAID-IN CAPITAL (INVESTMENT MULTIPLE or TVPI).
- e. SINCE-INCEPTION DISTRIBUTIONS to SINCE-INCEPTION PAID-IN CAPITAL (REALIZATION MULTIPLE or DPI).
- f. SINCE-INCEPTION PAID-IN CAPITAL to cumulative COMMITTED CAPITAL (PIC MULTIPLE).
- g. RESIDUAL VALUE to SINCE-INCEPTION PAID-IN CAPITAL (UNREALIZED MULTIPLE or RVPI).

**Discussion**

Although the money-weighted return (MWR) is the basic metric used to report performance for composites in which the firm has control over the cash flows, has met the other requirements for presenting an MWR, and has chosen to present MWRs, it is not the only useful metric used to gauge performance. Other measures are also useful to provide additional insight. The MWR by its nature is sensitive to early cash flow events, and the MWR calculation assumes that the residual value, or fair value, of a composite is totally liquid—whereas, in reality, the residual value may be illiquid. Other metrics have been developed that allow a prospective client to examine aspects of performance other than simply a rate of return.

- a. COMPOSITE SINCE-INCEPTION PAID-IN CAPITAL.

The composite since-inception paid-in capital consists of all capital inflows to portfolios within a composite by clients or investors (e.g., limited partners). These inflows are also referred to as contributions to a composite by clients or investors. Paid-in capital also includes distributions that are subsequently recalled and reinvested into the composite.

- b. COMPOSITE SINCE-INCEPTION DISTRIBUTIONS.

The composite since-inception distributions includes all cash and stock distributed to composite clients or investors (e.g., limited partners).

**c. COMPOSITE cumulative COMMITTED CAPITAL.**

The composite cumulative committed capital represents the total pledges of capital to a composite by clients or investors (e.g., limited partners). Committed capital can be either drawn (paid-in) or undrawn (dry powder).

**d. TOTAL VALUE to SINCE-INCEPTION PAID-IN CAPITAL (INVESTMENT MULTIPLE or TVPI).**

The investment multiple, or TVPI, provides prospective clients or investors with a multiple that indicates how many times more the investment is worth compared with the original investment without taking into account the time value of money. Also known as the Multiple of Investment Capital (MOIC), it is equal to the sum of the composite since-inception distributions and its residual value (i.e., fair value) divided by the composite since-inception paid-in capital. The investment multiple is calculated as follows:

$$\text{TVPI} = \frac{\text{Since – Inception Distributions} + \text{Residual Value}}{\text{Since – Inception Paid – In Capital}}$$

TVPI can also be calculated as DPI + RVPI, where

DPI = realization multiple (see Provision 5.A.4.e)

RVPI = unrealized multiple (see Provision 5.A.4.g)

**e. SINCE-INCEPTION DISTRIBUTIONS to SINCE-INCEPTION PAID-IN CAPITAL (REALIZATION MULTIPLE or DPI).**

The DPI, or realization multiple, measures how much invested capital has actually been returned to clients or investors. It is the amount of invested capital that has been “realized” by clients or investors and is often viewed as the amount of the TVPI that is “realized.” TVPI, also known as the investment multiple, is calculated as total value divided by since-inception paid-in capital. (See Provision 5.A.4.d.) DPI is calculated as follows:

$$\text{DPI} = \frac{\text{Since – Inception Distributions}}{\text{Since – Inception Paid – In Capital}}$$

**f. SINCE-INCEPTION PAID-IN CAPITAL to cumulative COMMITTED CAPITAL (PIC MULTIPLE).**

The paid-in capital multiple, also known as the PIC multiple or PIC ratio, gives prospective clients or investors information regarding how much committed capital has actually been drawn down or called. It is also known as the “dry-powder ratio” because it measures how much capital has

already been invested and therefore indicates how much capital is left to invest. The PIC multiple is calculated as follows:

$$\text{PIC} = \frac{\text{Since – Inception Paid – In Capital}}{\text{Cumulative Committed Capital}}$$

Distributions can be either recallable or non-recallable. If a distribution is recallable, after the firm distributes proceeds to its clients or investors, it can draw down the same capital again, which makes it possible for the composite to have since-inception paid-in capital in excess of its total committed capital. A recallable distribution must be treated as an actual distribution and, if and when that distribution is recalled (drawn again), it must be treated as additional paid-in capital.

Recallable distributions affect the performance metric calculations. Firms may wish to consider additional disclosure when there is a material effect on the PIC or realization multiples. If a recallable distribution is re-contributed and reflected as paid-in capital a second time, the result will be that cumulative paid-in capital since inception is higher than total committed capital. It also means that the realization multiple (DPI), unrealized multiple (RVPI), and investment multiple (TVPI) will be lower. (For more information on DPI, RVPI, and TVPI, please see Provisions 5.A.4.e, 5.A.4.g, and 5.A.4.d, respectively.) All else being equal, for composites that have had recallable distributions, the denominator will be increased and the PIC multiple will be higher.

**g. RESIDUAL VALUE TO SINCE-INCEPTION PAID-IN-CAPITAL (UNREALIZED MULTIPLE OR RVPI).**

The unrealized multiple, or RVPI, is the converse of the realization multiple. It is equal to the composite's residual value (or fair value) at the end of the period divided by since-inception paid-in capital. It is calculated as follows:

$$\text{RVPI} = \frac{\text{Residual Value}}{\text{Since – Inception Paid – In Capital}}$$

### Provision 5.A.5

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.
- c. If COMPOSITE returns do or do not reflect the SUBSCRIPTION LINE OF CREDIT. This information is REQUIRED only if the FIRM presents returns both with and without the SUBSCRIPTION LINE OF CREDIT.

## Discussion

All periods presented in a GIPS Composite Report must be clearly labeled or identified.

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, the returns included in a GIPS Composite Report must be clearly labeled or identified as either gross-of-fees or net-of-fees.

If a firm uses a subscription line of credit (LOC), and it is required to present returns both with and without the subscription LOC, the firm must clearly indicate whether the composite returns do or do not reflect the subscription LOC. If no subscription LOC is used, or the firm is not required to present returns both with and without the subscription LOC, this disclosure is not required.

### Provision 5.A.6

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 the following:

- a description for all benchmarks, and
- a disclosure of changes to (or deletion of) any benchmark.

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. (See Provision 5.C.31.)

An appropriate benchmark for a composite reflects the investment mandate, objective, or strategy 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 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 5.A.7**

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 the most recent 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 the most recent 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 5.A.7 applies only to carve-outs with allocated cash. It does not apply to carve-outs with their own dedicated cash.

### **Provision 5.A.8**

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 the most recent 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 the most recent 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 2020.” Alternatively, the firm could add a column to its performance table titled “% composite assets composed of non-fee-paying portfolios” and list the percentage as of the most recent annual period end.

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 5.A.9

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, also known as dry powder, 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 5.A.10**

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, also known as dry powder, 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 firmwide 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 5.A.11**

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

Composite advisory-only assets are assets for which the firm provides investment recommendations in line with the composite's 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 5.A.12

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 5.A.13**

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 total firm assets). 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 cash flows and valuations 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.

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 5.A.14**

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 the COMPOSITE SINCE-INCEPTION MONEY WEIGHTED RETURN through the most recent annual period end and the COMPOSITE assets of the COMPOSITE of standalone PORTFOLIOS as of the most recent annual period end 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 firm must present information about this composite in the GIPS Composite Report for the composite that includes carve-outs with allocated cash. The firm must present the since-inception-money weighted return (SI-MWR) through the most recent annual period end and the composite assets as of the most recent annual period end. Even though the time periods for the two SI-MWRs will be different, this will allow a prospective client to compare the return and assets of the composite that includes carve-outs with allocated cash to the return 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 5.A.15**

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., composite 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 for a GIPS Composite Report that presents money-weighted returns (MWRs) include the following:

- segment MWRs that do not include cash,
- projected investment-level MWRs,
- projected multiples, and
- benchmark time-weighted returns.

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 an MWR that includes data from a past firm when the data does not meet the portability tests specified in Provision 1.A.32.

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 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.

## 5.B. Presentation and Reporting—Recommendations

### Provision 5.B.1

The FIRM SHOULD present annualized SINCE-INCEPTION MONEY-WEIGHTED RETURNS as of each annual period end.

### Discussion

Although a firm is required to present only the annualized composite since-inception money-weighted return (SI-MWR) through the most recent annual period end, it is recommended that the firm also present SI-MWRs as of each annual period end. Doing so will provide prospective clients with a more complete picture of the performance of the composite over time.

### Provision 5.B.2

If PORTFOLIOS in the COMPOSITE have COMMITTED CAPITAL, the FIRM SHOULD present the following items as of each annual period end:

- a. COMPOSITE SINCE-INCEPTION PAID-IN CAPITAL.
- b. COMPOSITE SINCE-INCEPTION DISTRIBUTIONS.

- c. COMPOSITE cumulative COMMITTED CAPITAL.
- d. TOTAL VALUE to SINCE-INCEPTION PAID-IN CAPITAL (INVESTMENT MULTIPLE or TVPI).
- e. SINCE-INCEPTION DISTRIBUTIONS to SINCE-INCEPTION PAID-IN CAPITAL (REALIZATION MULTIPLE or DPI).
- f. SINCE-INCEPTION PAID-IN CAPITAL to cumulative COMMITTED CAPITAL (PIC MULTIPLE).
- g. RESIDUAL VALUE to SINCE-INCEPTION PAID-IN CAPITAL (UNREALIZED MULTIPLE or RVPI).

## Discussion

Firms are required to present the composite since-inception money-weighted return (SI-MWR) through the most recent annual period end, as well as the since-inception paid-in capital, since-inception distributions, cumulative committed capital, investment multiple (TVPI), realization multiple (DPI), PIC multiple, and unrealized multiple (RVPI), as of the most recent annual period end. If firms choose to present additional SI-MWRs through prior annual period ends, firms are recommended to also present the same metrics as of each additional period end for which returns are presented. See Provision 5.A.4 for further discussion of these metrics.

### Provision 5.B.3

The FIRM SHOULD present both annualized GROSS-OF-FEES and NET-OF-FEES COMPOSITE SINCE-INCEPTION MONEY-WEIGHTED RETURNS.

## Discussion

A firm is required to present either an annualized gross-of-fees or net-of-fees composite since-inception money-weighted return (SI-MWR) in a GIPS Composite Report that presents money-weighted returns. Each type of return provides important information to prospective clients.

Because a gross-of-fees composite SI-MWR 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 SI-MWRs 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 SI-MWRs reflect the deduction of transaction costs and investment management fees. Net-of-fees composite 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 composite SI-MWRs provide important information to prospective clients, it is recommended that firms present both gross-of-fees and net-of-fees composite SI-MWRs in a GIPS Composite Report.

### **Provision 5.B.4**

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

### **Provision 5.B.5**

The FIRM SHOULD present an appropriate EX POST risk measure for the COMPOSITE and the BENCHMARK. The same EX POST risk measure SHOULD be presented for the COMPOSITE and the BENCHMARK.

### **Discussion**

Evaluating past performance requires an understanding of the risks taken to achieve the results. Although firms are required to include a qualitative narrative of material risks as part of the composite description, firms should also include an ex post risk measure for the composite and benchmark. Any risk measure presented must be calculated on an ex post basis and be based on actual historical data. Some examples of ex post risk measures that may be presented include drawdown measures, interest rate risk measures (e.g., duration), credit risk measures (e.g., credit spread), and

liquidity risk measures. Because no quantitative risk measure is required for composites that present money-weighted returns, all risk measures presented are considered additional risk measures.

If the firm chooses to present an ex post risk measure for the composite and benchmark, the same ex post risk measure should be presented for the composite and benchmark. The risk measure must be one that the firm determines is appropriate for the composite. When choosing an appropriate ex post risk measure to present, the firm should satisfy itself that there are sufficient data points for the selected risk measure to be statistically significant so as not to be misleading. Firms are required to describe any additional risk measure that is included in the GIPS Composite Report (see Provision 5.C.41).

### **Provision 5.B.6**

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 the most recent 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 (see Provision 5.C.39). It is recommended that the firm also present the percentage of assets in the composite that were valued using preliminary, estimated values as of the most recent annual period end. This provides important information that allows prospective clients to better assess the valuations and performance record presented.

### **Provision 5.B.7**

If the FIRM has COMMITTED CAPITAL, the FIRM SHOULD present FIRM-wide uncalled COMMITTED CAPITAL as of the most recent 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, also known as dry powder, 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 the most recent 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 firmwide uncalled committed capital. Provision 5.A.10 discusses the requirements relating to the presentation of firm-wide uncalled committed capital in a GIPS Composite Report.

## 5.C. Disclosure—Requirements

### Provision 5.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 5.C.1.a, 5.C.1.b, or 5.C.1.c.

It is acceptable to combine both paragraphs of the claim of compliance for a verified firm (Provision 5.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 5.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

compliance statement. For example, a firm might choose to use the verification compliance statement for all GIPS Reports, including GIPS Reports for composites and pooled funds that have had a performance examination, if it wishes to standardize the compliance statement 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 5.C.1.a and 5.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 compliance statement that is false or misleading.

### **Provision 5.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](http://www.cfainstitute.org)) for additional guidance on the proper use of “GIPS”.

### **Provision 5.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 the public 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 5.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 5.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 5.C.16 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 Disclosure:

“The Armor Distressed Debt Composite invests at least 85% of its assets in distressed euro-denominated bonds that have credit ratings of CCC or lower by at least one major credit rating agency. Key risks include widening corporate spreads and defaults, high levels of government debt, and elevated political tensions, which could lead to abrupt changes in monetary policy by the European Central Bank (ECB). A material amount of the composite's investments may be illiquid.”

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

### Provision 5.C.5

The FIRM MUST disclose 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.

### 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, the name of the benchmark will satisfy this requirement. There are few money-weighted return benchmarks that would be considered widely recognized. If the firm presents a public market equivalent (PME) as a benchmark, the benchmark description must include the name of the market index that is used to calculate the PME. Given the unique nature of a PME, if the market index used to calculate the PME is not readily recognized, the firm must also disclose the description of this benchmark. See the

discussion of Provision 5.C.33 for an explanation of a PME. 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.

### **Sample Disclosure:**

“The custom benchmark return is calculated by applying the investment cash flows of the Armor Distressed Debt Composite to the XYZ Eurozone Distressed Debt Bond Index. The index reflects a portfolio of euro-denominated distressed debt bonds issued in Eurozone countries that generally have credit ratings of CCC or lower from the main rating agencies and are listed on the XYZ platforms.”

### **Provision 5.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 5.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.<sup>40</sup>
- e. If model INVESTMENT MANAGEMENT FEES are used, the methodology used to calculate NET-OF-FEES returns.

**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.) Given the nature of a money-weighted return calculation, in most instances firms will use actual investment management fees. In some cases, however, it may be appropriate to use model fees, such as when a composite is seeded with firm capital and no investment management fees are charged. If model fees are used, and gross-of-fees returns are presented along with the net-of-fees returns, prospective clients can easily determine the model

<sup>40</sup> REQUIRED for periods ending on or after 31 December 2020.

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 also be disclosed if model investment management fees are used.

### **Sample Disclosure for Actual Fees:**

“Net-of-fees returns are net of actual investment management fees, including incentive fees, which are recorded on an accrual basis.”

### **Sample Disclosure for Model Fees:**

“Net-of-fees returns are calculated by applying a model fee of 0.4125% on a quarterly basis. This equates to a model annual fee of 1.65%, which is the highest tier of the standard fee schedule.”

### **Provision 5.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 5.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 5.A.13.)

**Sample Disclosures:**

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

“All numerical information is reported in Japanese yen.”

**Provision 5.C.10**

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 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.)

### 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. Including a range of fee schedules (e.g., management fees range from 0.50% to 0.95%) would not satisfy this requirement.

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. Presenting a range of expense ratios (e.g., the expense ratio for all share classes ranges between 1.40% and 1.85%) would not satisfy this requirement.

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. The exhibit may be the pooled fund’s offering documents, if the offering documents include the appropriate fee schedule and expense ratio.

### 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 Private Equity Composite and the Distressed Debt 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 Private Equity Composite and the Distressed Debt Fixed Income Composite are as follows:

Private Equity Composite	Distressed Debt Fixed Income Composite
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 above \$100 million”

**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 5.C.11**

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 Disclosure:**

“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 quarterly, and crystallizes annually. Further details of the performance fee calculation are available upon request."

### **Provision 5.C.12**

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. 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 Global Growth Composite has an inception date of 15 September 2019, the date on which the first portfolio in the composite experienced its first capital call from the limited partners."

"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."

### **Provision 5.C.13**

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 5.C.12.) 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 Disclosure:

“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.”

### Provision 5.C.14

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 BDPE. A BDPE 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 BDPE 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 BDPE 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 5.C.15**

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 readily 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 5.C.16**

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 5.C.4), Provision 5.C.16 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 5.C.16, 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 5.C.17**

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 5.C.18

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 February 2020, the portfolio manager responsible for managing the composite left the firm. The composite is now managed by a team of three of the firm's portfolio managers who are experienced in managing portfolios with similar strategies."

"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 5.C.19

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

In a GIPS Composite Report that includes money-weighted returns (MWRs), firms may present non-GIPS-compliant performance only for periods ending before the minimum effective compliance date, which is 1 January 2006 for private equity and real estate composites and 1 January 2000 for all other composites. (See Provision 1.A.30.) 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 performance prior to the minimum effective compliance date is not compliant and consider the effects of non-compliance on the historical performance.

The measurement period for a composite's since-inception money-weighted return (SI-MWR) is the period from the inception date of the composite through the end of the period being reported. The beginning date remains constant and the ending date is extended as the measurement period becomes longer. It is necessary to use the period-end date of an SI-MWR to determine the non-compliant period.

Determining the period of compliance for an MWR calculation requires consideration of cash flows and valuations. When calculating MWRs, quarterly or more frequent cash flows must be used prior to 1 January 2020, and daily cash flows must be used as of 1 January 2020. For periods ending on or after 1 January 2011, portfolios in the composite must be valued in accordance with the definition of fair value. See the discussion of Provision 2.A.19 for information on valuation requirements for periods ending prior to that date.

Given that the minimum effective compliance dates are so distant, and that firms are required to present only one SI-MWR (the SI-MWR through the most recent annual period end), it is not expected that the minimum effective compliance date will have an effect on many firms that present composite MWRs.

If non-compliant performance for periods ending on or after the minimum effective compliance date is included in a GIPS Composite Report, it must be labeled as supplemental information.

### Sample Disclosure:

"The returns for the XYZ Private Equity Composite for periods ending prior to 31 December 2005 are not in compliance with the GIPS standards."

### Provision 5.C.20

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 5.C.18.)

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 5.C.21

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 Disclosure:

“As of 1 July 2017, 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 5.C.22

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 performance 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 Small-Cap Composite was renamed the US Equity Opportunity Composite.”

**Provision 5.C.23**

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, there was no minimum.”

**Provision 5.C.24**

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 5.C.25

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 5.C.24 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 5.C.26

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:

“We present since-inception money-weighted returns through each annual period end. 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 5.C.27

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 Private Equity Carve-Out 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 at the time of the last valuation. A GIPS Composite Report for the Private Equity Composite that includes only standalone portfolios is available upon request.”

### Provision 5.C.28

The FIRM MUST disclose the use of a SUB-ADVISOR and the periods a SUB-ADVISOR was used.<sup>41</sup>

<sup>41</sup> REQUIRED for periods beginning on or after 1 January 2006.

## 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.

### 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 Global Private Equity Composite from its inception in 2001 through 31 December 2018.”

### Provision 5.C.29

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.)<sup>42</sup>

## 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.

<sup>42</sup>REQUIRED for periods beginning on or after 1 January 2011.

### 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 5.C.30

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

### 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 5.C.31

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. Given the nature of a money-weighted return (MWR), however, it is not expected that this situation would apply to a GIPS Composite Report that includes MWRs.

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.

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:

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

### **Provision 5.C.32**

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. Given the nature of money-weighted return (MWR) calculations, this disclosure will rarely apply to a GIPS Composite Report that presents MWRs.

Instead, it is expected that a firm would use a public market equivalent (PME) as a custom benchmark. See the discussion of Provision 5.C.33 for an explanation of a PME. A PME must be clearly labeled as such, and the methodology used to calculate the PME must be disclosed.

A firm may calculate a PME that is a gross-of-fees or net-of-fees return. A PME that is a net-of-fees return is calculated using the same cash flows that are used to calculate the composite's net-of-fees return. A firm may use a net-of-fees PME benchmark only when composite net-of-fees returns are presented. The use of a net benchmark when only composite gross-of-fees 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 a net-of-fees benchmark in a GIPS Composite Report, the firm must clearly label the benchmark as a custom benchmark and disclose the calculation methodology.

### **Sample Disclosure for a PME Benchmark:**

“The benchmark is the public market equivalent (PME) of the ABC Mid-Cap Equity Index, which tracks the performance of US mid-cap companies. The PME is a method by which a public market index is used to create a since-inception money-weighted return that is comparable to a composite's since-inception money-weighted return from a series of cash flows that are the same as those of the composite and uses a theoretical investment value. The theoretical investment value is derived by buying and selling the public market index using the dates and amounts of actual composite cash flows.”

**Provision 5.C.33**

The FIRM MUST disclose the calculation methodology used for the BENCHMARK. If the FIRM presents the PUBLIC MARKET EQUIVALENT of the COMPOSITE as a BENCHMARK, the FIRM MUST also disclose the index used to calculate the PUBLIC MARKET EQUIVALENT.

**Discussion**

The benchmark selected for a composite must be appropriate for comparison with the performance of the composite. Unlike benchmarks for publicly traded securities, however, industry benchmarks for private market investments are not as widely available or are available only through certain commercial vendors. Firms may use public market indices as a benchmark for private market investments, but the public market indices by themselves are not directly comparable to a money-weighted return (MWR) because the market indices typically use a time-weighted return. The public market equivalent (PME) is a method where a public market index is used to create a comparable MWR from a series of cash flows that replicate those of the composite and that can be compared with the MWR of the composite.

The GIPS standards require that the calculation methodology for the benchmark be disclosed. This information provides transparency as to the comparability of the performance of the composite and the benchmark. If a PME is used as a benchmark, the firm must disclose which public market index is used to create the PME.

**Sample Disclosure for a Non-PME Benchmark:**

“The benchmark is the since-inception money-weighted return for the ACME Advisory US Venture Capital Funds Universe—2018 Vintage Year. The vintage year is determined by the date of the first capital call for each fund in the universe.”

**Sample Disclosure for a PME Benchmark:**

“The benchmark is the public market equivalent (PME) of the ABC Mid-Cap Equity Index, which tracks the performance of US mid-cap companies. The PME is a method by which a public market index is used to create a since-inception money-weighted return that is comparable to a composite’s since-inception money-weighted return from a series of cash flows that are the same as those of the composite and uses a theoretical investment value. The theoretical investment value is derived by buying and selling the public market index using the dates and amounts of actual composite cash flows.”

### **Provision 5.C.34**

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

### **Discussion**

Although firms often think about time-weighted returns when considering portability issues, it is also possible for a money-weighted return to span two firms. Provision 1.A.32 includes the 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 the track record must not be linked to performance of the new or acquiring firm. A current since-inception money-weighted return (SI-MWR) must be calculated using only the performance after the break. A SI-MWR from the beginning of the track record up until the break may also be presented if the tests in Provision 1.A.33 are met. However, the current SI-MWR for the period after the break in performance and the SI-MWR representing performance prior to the break must not be linked and must be clearly labeled.

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:**

“The Opportunity Composite has an inception date of March 2016 and was managed by the Distressed Debt Team at a prior firm. On 15 December 2017, the prior firm sold the line of business that included the Distressed Debt Team to ABC Investments. Composite activity prior to 15 December 2017 is from the prior firm.”

### **Provision 5.C.35**

The FIRM MUST disclose the frequency of EXTERNAL CASH FLOWS used in the MONEY-WEIGHTED RETURN calculation if daily frequency was not used.

## Discussion

When calculating money-weighted returns (MWRs), quarterly or more frequent cash flows must be used prior to 1 January 2020, and daily cash flows must be used as of 1 January 2020. A historical cash flow stream may therefore include daily, monthly and/or quarterly cash flows. When constructing such a cash flow stream historically, and daily cash flows are not used, the firm must assume that all quarterly and monthly cash flows occurred on a particular date in the month or quarter regardless of the actual date of the cash flow. For example, all monthly or quarterly cash flows might be dated as if they occurred on the last day of the month, regardless of the actual date of the cash flow. See Provision 2.A.29 for an example of how quarterly and monthly cash flows can be reflected in an MWR calculation.

The MWR calculation is sensitive to the relative timing of cash flows and, especially early in the life of a composite, returns calculated using a quarterly cash flow dating convention can differ from returns calculated using a monthly or daily convention. Accordingly, firms are required to disclose the frequency of cash flows used in the MWR calculation if daily cash flows are not used for periods prior to 1 January 2020. It is recommended that firms use daily cash flows for all periods.

### Sample Disclosure:

“The money-weighted return calculation incorporates monthly cash flows for periods prior to 1 January 2020 and daily cash flows thereafter.”

#### Provision 5.C.36

If a SUBSCRIPTION LINE OF CREDIT is used, and the FIRM is REQUIRED to present returns both with and without the SUBSCRIPTION LINE OF CREDIT, the FIRM MUST disclose:

- a. The purpose for using the SUBSCRIPTION LINE OF CREDIT.
- b. The size of the SUBSCRIPTION LINE OF CREDIT as of the most recent annual period end.
- c. The SUBSCRIPTION LINE OF CREDIT amount outstanding as of the most recent annual period end.

## Discussion

Subscription lines of credit are being used by more firms and for longer periods, and they may have a significant effect on returns. It is therefore important that prospective clients have sufficient information about any subscription line of credit (LOC) that could influence composite performance.

In those situations in which a subscription LOC is used and the firm is required to present returns both with and without the subscription LOC (see Provision 5.A.2), the firm must disclose the purpose of the subscription LOC so that prospective clients can better understand why the subscription LOC exists. In some cases, the subscription LOC is short term in nature and is put in place simply to facilitate administration when capital is being called from investors. In other cases, the subscription LOC is longer term and is used to delay the capital calls from investors. To help prospective clients put the subscription LOC in perspective, the firm must also disclose both the size of the subscription LOC and the subscription LOC amount outstanding as of the most recent annual period end.

### Sample Disclosures:

“A \$100M subscription line of credit is in place as bridge financing to reduce the number of capital calls made to investors. As of 31 December 2020, \$40M is outstanding.”

“A \$250M subscription line of credit is in place and is used to finance investments. During the past two years, the subscription LOC was fully drawn but was repaid as of 31 December 2019.”

### Provision 5.C.37

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, 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 Peer Universe. The since-inception internal rate of return for the XYZ Peer Universe through 31 December 2020 was originally incorrectly presented as 3.4%. The correct return is 4.3%, as shown in this revised GIPS Composite Report.”

### **Provision 5.C.38**

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 as of the most recent annual period end. (See Provision 5.A.1.e.) 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 period for which the since-inception money-weighted return is presented. If there were four portfolios in the composite for the full period but eight portfolios in the composite at the annual period end, the firm would be required to present the actual number of portfolios (in this example, eight) 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 most recent annual period end is presented would simply note “<6” or “≤5” if there were five or fewer portfolios in the composite at the most recent annual period end.

### Provision 5.C.39

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 5.B.6) that firms present the percentage of assets in the composite that were valued using preliminary, estimated values as of the most recent 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 5.C.40

If the FIRM changes the type of return(s) presented for the COMPOSITE (e.g., changes from TIME-WEIGHTED RETURNS to MONEY-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.)

When a 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 (e.g., 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 TWRs to MWRs, the firm must change the returns for all periods. As an example, suppose that a firm is presenting TWRs for a composite from the inception of the composite on 1 January 2013 through 31 December 2019. It decides that it will switch to present MWRs as of 1 January 2020. The firm cannot present TWRs through 31 December 2019 and an MWR from 1 January 2020 through 31 December 2020. The firm must present the since-inception MWR for the period 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 time-weighted returns to money-weighted returns.

#### Provision 5.C.41

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

There is no required risk measure for a GIPS Composite Report that presents money-weighted returns. However, understanding and interpreting investment performance requires the consideration of both risk and return. It is therefore recommended that firms present additional risk measures for the composite and the benchmark. (Because no quantitative risk measure is required for composites that present money-weighted returns, all risk measures presented are considered additional risk measures. See Provision 5.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 includes managing foreign currency risk, the presentation of a hedge ratio 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 5.C.42**

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—gross-of-fees or net-of-fees returns—are used in the calculation of the presented risk measures.

### **Sample Disclosure:**

“Net-of-fees returns were used to calculate drawdown.”

### **Provision 5.C.43**

For REAL ESTATE investments that are not in a REAL ESTATE OPEN-END FUND, the FIRM MUST disclose that:<sup>43</sup>

- a. EXTERNAL VALUATIONS are obtained, and the frequency 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

<sup>43</sup>REQUIRED for periods ending on or after 31 December 2020.

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 real estate investments that are not in a real estate open-end fund, 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.”

#### Provision 5.C.44

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 calculated by combining actual composite cash flows with projected future cash flows.
- 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. The model assumes that an investment was made in the top 20 individual funds that have been identified as funds that meet the model’s ESG screening criteria currently, and it assumes an equal amount was invested in each fund on an assumed quarterly capital call. The first capital call was assumed to occur on 31 December 2014. The since-inception internal rate of return for the model does not reflect the deduction of investment management fees, transaction costs, or other fees and charges.”

## 5.D. Disclosure–Recommendations

### Provision 5.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 5.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:

“Prior to 2019, the internal rate of return method was used to calculate since-inception money-weighted returns. Subsequently, the Modified Dietz method is used for all periods.”

### Provision 5.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 5.C.4) and the benchmark description (see Provision 5.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 Small-Cap Opportunities Composite is a venture capital composite that invests in small-cap startups in all sectors, with a focus on the health care and financial services sectors. The benchmark for the composite is the public market equivalent (PME) of the ABC Small-Cap Index, which tracks the performance of US small-cap companies. The investment strategy of the composite differs from the small-cap investment strategies represented by the PME because the composite concentrates its investments. As of 31 December 2019, 62% of the composite was invested in the health care and financial services sectors, and 18% of the index was invested in these two sectors.”

### Provision 5.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 5.C.15.) 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 Disclosures:

“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.”

“The firm uses valuations reported by the general partners of the underlying pooled funds.”

### Provision 5.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 5.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 5.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. An example of a bundled fee is an all-in fee, which 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.

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 5.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 5.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 5.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.”

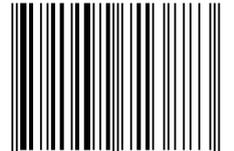
“Certain investment research costs are charged directly to clients outside the managed portfolio. Therefore, composite returns do not reflect the research costs that are charged directly to clients.”





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