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31 December 2018

CFA Institute
Global Investment Performance Standards
Re: GIPS 2020 Exposure Draft
915 East High Street
Charlottesville, VA 22902

Dear Sir or Madam,

Thank you for the opportunity to comment on the proposed changes to the GIPS standards. The GIPS standards serve an important role in the investment management industry. It is important to remember that compliance with the GIPS standards not only facilitates fair competition between asset managers, but also allows investors to fairly assess asset managers. It is critical to consider the proposed changes through both of these lenses – i.e., how they affect asset managers and how they benefit investors.

Basis Point Solutions is a boutique consulting firm focusing on investment performance and the implementation of the GIPS standards. It was founded by Jonathan A. Boersma, CFA, who currently serves as the Chief Everything Officer. Mr. Boersma previously served as the Executive Director of the GIPS standards at CFA Institute from 2007-2017.

The proposed changes to the standards are extensive. Although primarily in form, there are several significant changes to the content as well. Below are comments on a few topics, followed by comments on specific provisions.

Conceptual Comments

1. Pooled Funds
   As you know, a great deal of work has been done on the issue of pooled funds and how they fit within the GIPS framework. Reaching back to when there was a dedicated seat on the Investment Performance Council (predecessor to the GIPS Executive Committee) representing mutual funds, to the alternative investment strategies working group, to the most recent pooled funds working group. These groups deliberated and contributed to authoritative guidance in the form of the Alternative Investment Strategies and Structures Guidance Statement and the finalized, adopted, but not in effect Guidance Statement on Broadly Distributed Pooled Funds. The latter Guidance Statement was approved by the GIPS Executive Committee and set to go into effect, but was subsequently canceled, without the benefit of a public comment period, contrary to standard setting best practices. While many of the concepts in the withdrawn Guidance Statement have flowed through to the GIPS 2020 exposure draft, one requirement in particular has been reversed.

   The Guidance Statement on Broadly Distributed Pooled Funds required that firms provide four basic items to a prospective pooled fund investor. These items, the fund description, a measure or description of risk, the fund return, and the currency used to express performance, are nowhere to

be found in the GIPS 2020 exposure draft and the requirement to provide them to a prospective pooled fund investor has been removed entirely. Although many broadly distributed pooled funds are regulated, not all of them are. In addition, in many jurisdictions the regulations may be very light. The net effect of the changes proposed in the GIPS 2020 exposure draft essentially result in no real requirements for firms that operate pooled funds. While there may be some minor administrative requirements, these are rather insignificant. The result is a best practice standard that allows firms to claim compliance while maintaining the status quo and does not, even incrementally, move the industry forward. I fully understand that firms do not wish to have additional requirements placed on them, but then what is the purpose of a voluntary ethical standard? This proposed change should be reversed and returned to what was included in the Guidance Statement on Broadly Distributed Pooled Funds, which allowed for significant flexibility in how and where the four required items are provided to prospective pooled fund investors.

2. Carve-Outs

   The GIPS 2020 exposure draft reintroduces the ability for firms to use carve-outs with allocated cash. I object to this change in the strongest manner possible. Allowing carve-outs with allocated cash is contrary to the core principles of the standards in two key ways.

   A carve-out with allocated cash is a model or hypothetical portfolio and is prohibited from being included in a composite. Cash is allocated in a hypothetical manner as if it were actually managed as part of a standalone portfolio. A carve-out with allocated cash is not an actual portfolio and must not be included in a composite

   A carve-out with allocated cash is not representative of a standalone portfolio and is contradictory to the foundational principle of the GIPS standards: fair representation. A carve-out with allocated cash does not represent an actual portfolio in a few ways. Consider a typical equity and fixed income balanced portfolio. The risk taken in the equity portion of the portfolio is often managed, mitigated, or off-set by assets in the fixed income portion of the portfolio, rendering neither representative of the strategy of a standalone portfolio. In addition, most fixed income managers use cash to help manage duration. By allocating some of that cash to the equity portion of the portfolio, the duration of the fixed income portion is skewed, making it not representative to a standalone portfolio. In the case of a balanced portfolio, if the firm decides to overweight one of the segments, this may result in a negative cash position. Again, this is not reflective of an actual portfolio.

   Finally, it is unhelpful to firms and investors if the requirements of the standards flip-flop from year to year. The decision to eliminate carve-outs with allocated cash was made years ago and has been consistently affirmed time and time again. It would be a significant mistake to allow them again.

3. Valuation Principles

   The GIPS 2020 exposure draft appears to have deleted the Valuation Principles that are a part of the 2010 edition of the GIPS standards. These principles for a critical part of the standards because without proper valuations, performance is meaningless. Although some of the elements of the Valuation Principles have been included in the provisions of the standards, it is essential to restore the Valuation Principles in their entirety.

4. Sunset Provisions

The GIPS 202 exposure draft proposes some disclosures that are only required for a year or for as long as the disclosure is determined to be relevant. The fundamental issue with this approach is that the determination of relevance should be in the hands of the prospective client rather than the firm. Of the proposed sunset disclosures, any of them could be relevant to a prospective client in certain circumstances. Considering this, it seems that a better approach would be to continue to require the disclosures to be made for as long as the affected time period related to the disclosure is presented. For example, if a composite name change occurred in 2017, it should be disclosed for as long as 2017 data is presented.

5. Compliance Statement
   The proposed changes to the compliance statement seem to be unnecessary. In particular, the first sentence of the second paragraph regarding policies and procedures seems very out of place and does not add any value to the reader. The statement also fails to note that verification also tests composite construction. It is strongly recommended that the compliance statement from the 2010 edition be carried forward without any changes.

6. Money-Weighted Returns
   The provisions related to money-weighted returns allow firms to calculate the return going back as far as the firm has records to support it. In many cases, this results in a return that is meaningless or misleading. This should not be allowed, or, at best, it should only be allowed to be presented as supplemental information with significant disclosures accompanying it.

7. Exposure Draft
   The exposure draft included many changes and I appreciate the notation of the current standard, Guidance Statement, or other source associated with each provision. It is not clear, however, if there have been any changes or edits to any of the existing provisions. Previously, all changes were made available to the public via a red-lined version. If any of the provisions from the 2010 edition have been carried forward to the 2020 edition, but have been edited or changed, it is critically important that these changes be highlighted and publicized so that the industry can consider and respond to any of these changes. Without this, the public is forced to do a word-for-word comparison with the 2010 edition, which is an unnecessary burden.

Comments on Specific Provisions

***Note: Comments made regarding provisions related to composites should also be carried forward to the corresponding provisions related to pooled funds and asset owners. Comments on provisions that are duplicated in subsequent sections will not be repeated, but the comment holds true for the same provision in the subsequent sections.***

1.A.4.b and 1.A.5.b: These provisions are unnecessary as they are inherent in each of the preceding provisions, respectively. In order to comply with the standards, firms must stay abreast of any changes to the standards, otherwise they risk violating the standards (1.A.3). Similarly, a firm must stay informed of any legal or regulatory changes, or they risk violating the law or regulation and 1.A.5.a. These “b” provisions are self-evident and belong in guidance.

Request for Comment #2: I fully support the timely preparation and distribution of reports and believe six months is sufficient time to update them.

1.A.14: This provision is rather awkward. Common sense and normal business practice would be to present a relevant track record if one does not exist yet for a new strategy. If the point of this provision is to say that a firm cannot only provide model or hypothetical performance, then it should simply state that. If the point is to require a fund or composite report of an existing strategy or fund to a prospective investor of the new fund that does not yet have a track record, then it should state this. The provision mentions “track records” but does not say anything about a fund report or composite report. The term “track record” is not defined. Is the “track record” supposed to be just the return series? Why would this be required rather than the appropriate fund or composite report? The provision as proposed makes little sense.

1.A.15 and 1.A.16: These provisions seem out of place in the document and would be better suited in the presentation and reporting section.

Request for Comment #3: Yes, firms should be required to include terminated funds just as they do for terminated composites.

1.A.24: Why is the word “historical” included in this provision? Is this meant to suggest that linking to ex-ante, or forward-looking theoretical performance is allowed? The word “historical” should be deleted.

1.A.29: The key issue with portability is how long sub-points a and b must be maintained. If the decision-making process is maintained for a day, is it enough? A week? A year? The same question remains for personnel.

1.A.30: Rather than referring to non-compliant assets, it may be better to refer to non-compliant portfolios, composites, or funds.

1.A.31: The second sentence of this provision refers to external cash flows <u>into</u> the portfolios or funds. This should state “into and out of” because cash flow control is needed for both inflows and outflows.

1.A.33: This provision is a little silly. I understand the intent, but I don’t think it is reasonable to require firms to do this. If the report is included in the table of contents, great. The biggest issue is simply getting the report into the prospective client’s hands. While well intentioned, this provision reaches too far and should be deleted or moved to a recommendation.

1.A.34: Item “c” should be incorporated into “b” – i.e., “Must be updated annually, by 30 June, with information…”

Request for Comment #7: I agree that firms must be prohibited form including advisory-only assets in total firm assets. While I agree with not including committed capital in total firm assets, the situation become murky if the firm is being paid fees on that committed capital. Perhaps this distinction should be considered when determining which assets to be included.

2.A.2.a: Depending on how committed capital is treated, this provision may need to change as those assets are not yet managed by the firm.

2.A.4: This provision is strange.  Is this meaning to impose a firm's policies and procedures on a sub-advisor?  If firm A uses sub-advisor B, must B adopt A's policies and procedures as their own? This is not reasonable.  If the intention is to require any sub-advised portfolios to be treated the same as any internally managed portfolios, then it would be clearer to simply state this.

2.A.5: This provision, immediately following the provision related to sub-advisors, seems to imply that sub-advised assets are to be excluded because they are managed by the sub-advisor and not the firm. This must be corrected.

2.A.7.b, 2.A.8.b, and 2.A.9: These three provisions convey the same concept and should be combined into one requirement.
Request for Comment #9: Yes, this allowance should be limited to third-party illiquid portfolios or funds. The concept of using preliminary or estimated values is noted throughout the proposed provisions and is missing the concept of error correction.  If a firm uses preliminary data, any subsequent updates to that data must be viewed through the lenses of the Error Correction Guidance Statement, just as any other update or correction.

General Comment: The valuation and calculation provisions are interspersed within chapter 2, making it very confusing.  It is strongly recommended that these concepts, while related, be more clearly delineated.

2.A.23: There should be some criteria that must be met for firms to be allowed to use preliminary or estimated values.

2.A.23.a: This provision should be revised because as it is written, it sounds as if the standards are dictating that if a firm uses estimated values that they are, by definition according to the standards, the best estimate of fair value.  This is backwards.  Estimated values may only be used if the firm determines that the estimated values are the best representation of fair value.  The firm still has the obligation to determine the fair value.  This is an enormously important differentiation.

2.A.24: This provision refers to both valuation and calculation dates.  The element related to calculation dates should be removed for clarity because it is stated again in 2.A.26.b.

2.A.26.e: It is unclear to what this is specifically referring.  If it is referring to the timing of inclusion or exclusion of external cash flows, then this should be stated.  Otherwise, there should be clarification as to exactly what "treatment" this is referring.

General Comment: The headings of the different sections are not consistent.  There is a section on "Portfolios – Time Weighted Returns" (starting with 2.A.25) and the next section is simply "Pooled Funds".  Should this be "Pooled Funds – Time Weighted Returns"? or should the prior section be "Time Weighted Returns – Portfolios"?

2.A.27 and 2.A.28: Annual valuation and calculation of returns is entirely insufficient.  As a best practice standard, the GIPS standards must call for more than the lowest common denominator.  I understand that there are some funds, e.g., real estate, where this frequency may be appropriate, but it is much better to make an exception for that than to use it as a baseline.  I cannot think of a single regulator in the world who would take seriously the notion of an annual valuation and calculation requirement.

Request for Comment #10: I disagree with the weakening of the requirement to use daily cash flows for private equity prior to 2020. This is a step backwards, even if only temporarily, and communicates the wrong message to the industry. Flip-flopping the requirements is neither good for the industry or the standards.

2.A.32.b: The use of the highest fee appropriate to a prospective client is a type of model fee and must be treated the same as any other model fee. Provision 2.A.33 may pose a problem because the model fee must be equal to or higher than the actual fees.

2.A.34.b: Same comment as above.

2.A.41: It should be noted that portfolios with different valuation frequencies should not be included in the same composite.

2.A.45: Valuers or appraisers must be independent. This point is reinforced in provision 2.A.46 and 2.A.47. The word "independent" should be included in 2.A.45.

2.B.2: As previously noted, independence should be a requirement.

Request for Comment #13: Risk measures are best calculated on gross-of-fee returns. However, whichever returns are used, gross or net, they should be clearly disclosed or labeled as gross or net.

3.A.3: The last sentence of this provision, while important, is better suited for a Q&A. It will have a relatively short lifespan and is not needed to be included in the provision.

3.A.4: What if a non-fee-paying portfolio is subject to different policies and procedures? Should it be excluded from the composite? What if it's policies and procedures are materially similar to those of the fee-paying portfolios? While I appreciate the intent here, it seems like this provision is perhaps a bit over proscriptive.

3.A.7: The provision notes that portfolios must be included on a "timely and consistent composite-specific basis". The word "composite" should be deleted. If a firm wants to have a firm-wide policy regarding the timing of portfolio inclusion, they should be allowed to do so. Again, it seems the standards are becoming unnecessarily proscriptive here.

Request for Comment #14: I agree with the proposed changes.

3.A.15.b: Absolutely not. This should be prohibited from inclusion in a composite as noted above.

3.A.16: The problem is that in most cases, a carve-out is, by definition, not representative of a stand-alone portfolio. I strongly believe this is the wrong approach to take regarding portfolio segments. A better approach would be to set strict criteria that, if met, would allow a segment to be included in a composite. Such cases would be where, for example, shares of an equity fund and shares of a fixed income fund are held to create a balanced portfolio and each fund is managed independently.

Request for Comment #15: I strongly oppose the proposed treatment of carve-outs as previously discussed.

4.A.1.b: This provision would be much clearer if it noted that it must be a TWRR, i.e., "Composite time-weighted returns for each annual period."

4.A.1.k.ii: This provision (and it's corresponding provision in the subsequent sections) is unnecessary because a qualitative disclosure of the composite strategy's key risks is already required in the composite description.

4.A.3: Shouldn't all items within a composite or fund report be clearly labeled or identified?

4.A.7: Non-fee-paying portfolios should not be allowed to be included in a net-of-fee composite return calculation unless they have been netted down by a model fee. This is misleading, even with disclosure, and most databases do not have a way to notate this in the return series.

4.A.15: There does not seem to be any requirement to clearly label supplemental information as such. This must be corrected.

Request for Comment #17: As previously noted, the determination of relevance of a disclosure can really only be made by the prospective client, not the firm. For this reason, I do not support the discontinuation of disclosures.

4.C.1: As previously noted, the compliance statement should revert to the statement that is required in the 2010 edition of the GIPS standards. Furthermore, I do not agree with the idea of allowing modifications, even if they are additive, to the compliance statement. The last sentence of item "c" should be deleted.

4.C.9: By allowing carve-outs with allocated cash, this becomes very messy.

4.C.16: I do not support the idea of limiting the disclosure of a significant event to one year. If the event is significant, it is by definition relevant for interpreting the track record. Again, the determination of relevance is one that can only be made by the prospective client.

4.C.25.a: While I appreciate the intent, particularly given my opposition to the allowance of carve-outs with allocated cash, I don't think the standards should be dictating this level of detail. The required disclosure should be sufficient.

4.C.32: The end of the provision should read, "…and for which periods the policy was in effect."

4.C.35: Once a firm has identified and corrected a material error, there is no need to continue to make a disclosure about the error. It should only be required to be disclosed on the corrected report when it is distributed to those that received the erroneous report. To require such disclosure beyond that is punitive and unnecessary.

4.C.39: As previously noted, I do not support the sunsetting of disclosures and, in particular one as significant as the changing of calculation methodologies.

4.C.46: There is no mention that this theoretical performance is labeled or identified as supplemental information. This must be corrected.

4.C.46.a: This provision introduces the notion of the “prospective application of a model”. Is this meant to address ex-ante performance? Or is this meant to address when a model is run in real-time, concurrent with other actual portfolios? This must be clarified. This seems very out of place in the standards. If ex-ante performance is going to be addressed, it must be done in a much more comprehensive manner.

4.C.46.c: This provision refers to fees that an actual client portfolio “would have paid or will pay.” Does the “or will pay” again refer to ex-ante performance? This seems very out of place in the standards. If ex-ante performance is going to be addressed, it must be done in a much more comprehensive manner.

General Comment: There does not appear to be any required disclosures related to the use and existence of side pockets. This should be required.

4.D.1, 4.D.2, and 4.D.3: All of these material changes should be required disclosures. In particular, it can be easily argued that 4.D.3 is, by definition, comparing apples and oranges and should not be permitted. If it is permitted, it most certainly should be a required disclosure.

4.D.6: This was previously a requirement and should remain so.

Request for Comment #19: I do not agree with only presenting one since-inception return. The annual since-inception returns are an important element of understanding the performance of the fund.

Request for Comment #20: While I agree with the approach to subscription lines of credit in general, I don’t understand the justification for the different treatment of them between money-weighted returns and time-weighted returns.

Request for Comment #21: These ratios should be presented annually as currently required in the 2010 edition of the GIPS standards. The movement of these ratios over time are important in understanding the performance of the fund.

5.A.5.b: This should be deleted as it is already included as part of the required composite description.

5.A.6: Everything in the report should be clearly labeled or identified.

5.A.14: This provision is missing the requirement that any supplemental information must be clearly labeled as such.

5.B.4: This provision should be a requirement.

5.D.8: All benchmarks have limitations. More guidance on this is needed.

6.B.7: The pooled fund expense ratio should be a required item in the pooled fund report.

6.B.11: Pooled Fund of Funds should be required to disclose any direct investments.

6.C.6: This provision is a bit unclear.  Is the intend to distinguish between model investment management fees and model total pooled fund fees, or between model investment management fees and actual total pooled fund fees?  Either way, this should be clarified.

6.C.10 and 7.C.10: These provisions require the firm to disclose what the inception date represents, but nowhere are they required to disclose the actual fund inception date.  The fund inception date should be a required disclosure.

6.C.29: There should be some conditions surrounding under what circumstances a firm can opt out of monthly valuations.

7.B.3, 7.B.5, and 7.B.6: These should all be required disclosures.

Request for Comment #32: I agree that this concept should continue.

9.A.21.c: This should be revised to say "…The asset owner must define large cash flow for the total fund and each composite…"

9.A.22.e: This provision should be clarified.  As stated, it appears that the firm can choose if it uses the total fund-specific policy or a composite-specific policy.  This should state that the total fund policy must be used for total fund external cash flows and the respective composite-specific policy for composite external cash flows.

9.A.24.a: As noted previously, allowing the calculation of the money-weighted return for as long as the firm has records can lead to a terribly misleading performance figure.

9.A.38: Can audits only be performed by "public" accounting firms? If not, then this word should be deleted.

10.A.2: This provision should be revised to indicate that total funds must be presented "…separately to those who have direct oversight responsibility for each respective total fund".  This clarifies that all the funds are not required to go to all of the oversight bodies.

11.C.3: This should be clarified that the total fund description or composite description are required to be disclosed in their respective reports, rather that seeming like asset owners can chose whichever description they would like to disclose.

11.C.6: I am a fan of the serial or Oxford comma and believe that it improves clarity. There is a comma missing in this provision.  Can you find it?

11.C.12: Money-weighted returns are allowed to be calculated going back as far as the asset owner has them.  This may lead to a different inception date for performance than for the fund itself.  This situation should be clarified.

12.A.8: It would be unusual for an asset owner to be acting as a general partner and have committed capital.

13.A.5 and 13.A.6: Both of these provisions include similar concepts – i.e., including information that is more current than what is included in the most recent composite report. In 13.A.5 the language "or that will be included" is used, while 13.A.6 uses a lengthier description (also included in 13.A.8) of "…unless the disclosure included in the GIPS advertisement is more current…" If the intent is to convey the same concept, then I strongly recommend that the same language be used.

13.D.1, 13.F.1, 13.G.10, and 13.J.1: The composite/pooled fund/total fund description must be included in the advertisement. How can a firm fairly represent the performance of a composite/pooled fund/total fund if the composite/pooled fund/total fund is not described? It is nonsensical to simply recommend this disclosure. Yet in 13.G.10 it is required for broad distribution pooled funds. The inconsistency is puzzling and must be corrected.

Request for Comment #46: I fully support the required inclusion of a benchmark in a GIPS advertisement.

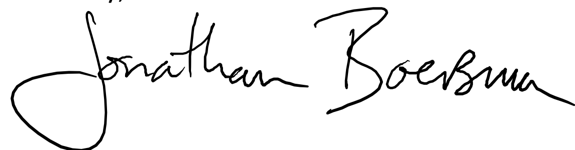
13.G.9: The word "otherwise" should be deleted to make it consistent with the similar provision in the rest of the standards.

13.G.12: This provision should be simplified and more simply stated as "…the firm must ~~choose~~ present and appropriate risk measure…likely to understand ~~and must present this information~~."

Glossary Term, External Manager/Sub-Advisor: The definitions of these terms should reference each other or be combined into one definition.

Thank you for the opportunity to provide feedback on the proposed changes. Should you seek any clarification or further explanation of any of the comments above, please do not hesitate to contact me.

Sincerely,



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