



# **Common Practices of GIPS®-Compliant Firms**

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# Introduction

## What do other firms do?

A firm that claims compliance with the Global Investment Performance Standards (GIPS®) has many decisions to make regarding the policies it uses to attain and maintain compliance with the GIPS standards. Each firm has unique circumstances that must be factored into decisions about policy creation. The types of strategies a firm manages, its composite and performance calculation systems, and internal resources are just a few of the factors that should be considered for each policy decision. Many of our clients contact us when they are considering implementing a new policy or changing an existing policy. The most common question we receive from clients is, “What do other firms do?”

As a result of being asked this question many times, we gathered information about the firms we work with to provide answers to commonly asked questions that are based on real data versus anecdotal information.

Much of the information that follows was presented originally in August 2016 and subsequently in a September 2018 white paper. We work with a large client base who have adopted the 2020 GIPS standards, providing us the opportunity to update the information to provide data on a very broad client base. In 2020, the SEC released new guidance on how firms are able to present performance in an advertisement. This will have an impact on how a firm addresses certain questions in the future.

The information that follows was gathered from over 800 firms across 24 different countries that have had at least one verification completed by ACA as of August 1, 2021. The firms manage diverse assets ranging from less than \$1 billion to over \$1 trillion, and include investment strategies from traditional equity and fixed income to alternative assets.

All references to “firms” are to firms that claim compliance with the GIPS standards.

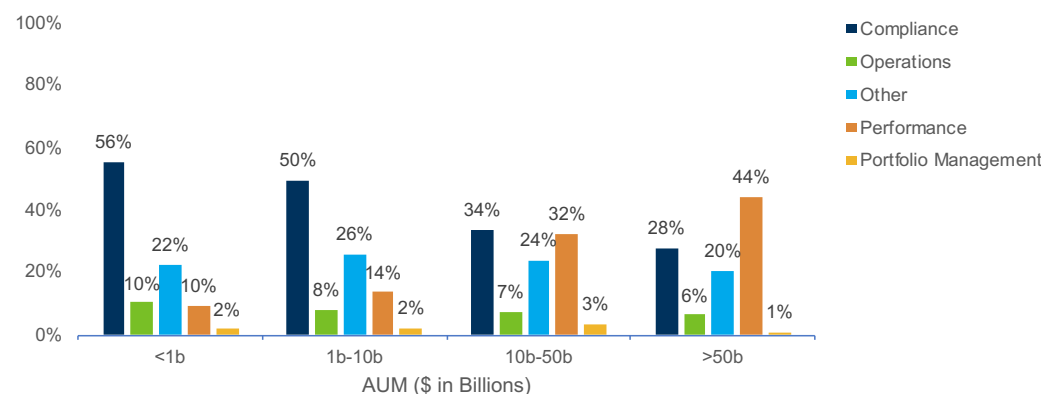
## Firm Structure

GIPS compliance is impacted by many different business units within the same firm.

- » Operations is often responsible for ensuring portfolio returns are properly calculated.
- » Marketing and Investor Relations are responsible for ensuring performance is presented in compliance with the GIPS standards.
- » Compliance is responsible for overall firm-wide compliance including SEC, FCA, NFA, FINRA, GIPS, and any other regulatory bodies.
- » Portfolio Management has a vested interest in GIPS compliance, as that is often how capital is raised.

This cross-pollination can make it difficult to determine who owns GIPS and is ultimately responsible for ensuring the firm complies with the GIPS standards on a firm-wide basis, and where this functionality sits within the firm. Our research found that most often ownership of GIPS compliance falls within one of three departments: compliance, operations, or performance. Since 2018, we have seen an uptick in joint responsibilities through a GIPS Committee which is typically made up of representatives from all three of these departments. This collaborative approach allows GIPS compliance to be a functioning part of the firm's business practices and ensure all stakeholders are providing input. The majority of the respondents labeled as "Other" in Chart 1 are firms that rely on a GIPS Committee, as well as other departments such as client service and marketing.

**What Internal Business Unit Is Responsible For GIPS Compliance?**



Larger firms are more likely to have a dedicated performance team that is responsible for GIPS compliance since they often have larger, more complicated corporate structures. At smaller firms, employees often wear multiple hats and perform many different functions. Assigning responsibility for GIPS compliance to either operations or compliance makes more sense than having a dedicated performance department.

# Composite Construction

A composite includes portfolios that are managed according to a specific investment mandate, objective, or strategy. With the 2020 GIPS standards the definition of a portfolio is clarified to include both segregated accounts and pooled funds. Firms must establish detailed criteria for determining how portfolios are assigned to composites. A composite must include all portfolios that meet the respective composite's criteria. Although firms are not required to create a composite only for pooled funds, they would have to consider composites if that fund strategy is also offered to segregated accounts. Firms must determine whether portfolio size, cash flow activity, or portfolio type impact the assignment of portfolios to each composite.

## Composite Minimums

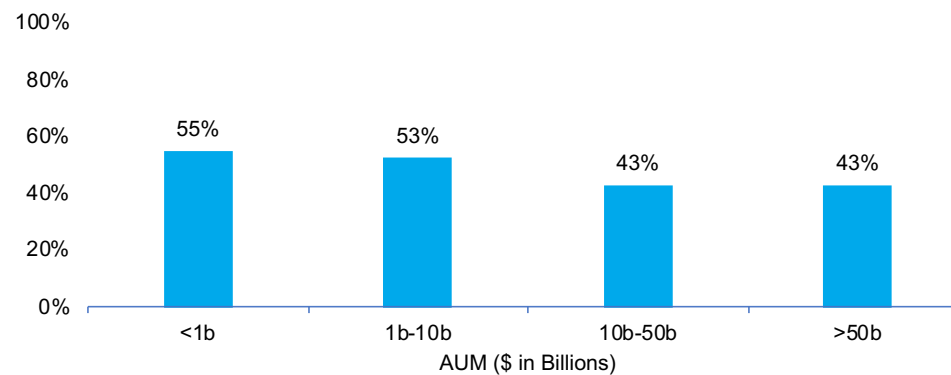
A firm may set a minimum asset level for portfolios to be included in a composite. The composite minimum is set by the firm on a composite-specific basis and must represent the minimum amount of money needed to implement the intended strategy.

### How firms use composite minimums

By establishing a composite minimum, the firm has determined that portfolios that do not meet the composite minimum are not discretionary. Composite minimums considerations:

- » apply consistently across all portfolios for that composite,
- » portfolio must be removed from composite when below minimum according to the firm's documented policy,
- » even if this may cause a track record to end. Periods both before and after the break must be presented and must not be linked.

### What Percentage of Firms Use Composite Minimums?



Composite minimums can help decrease noise in a composite by eliminating smaller portfolios that may not be managed the same as larger portfolios. However, composite minimums can be difficult to apply consistently and, depending on a firm's systems, can be a very manual process. 51% of our clients have a composite minimum for at least one composite.

Larger firms are less likely to use composite minimums. For firms over \$10 billion, 57% do not have a composite minimum for any composite; a increase of 2% relative to the 2018 research. Larger firms tend to manage larger portfolios and may not accept portfolios below a certain size. In addition, if composites include some very large portfolios, smaller portfolios typically do not have a material impact on the composite-level return. Firms may decide that implementing and maintaining a composite minimum provides no value for the effort required to do so.

## Significant Cash Flows

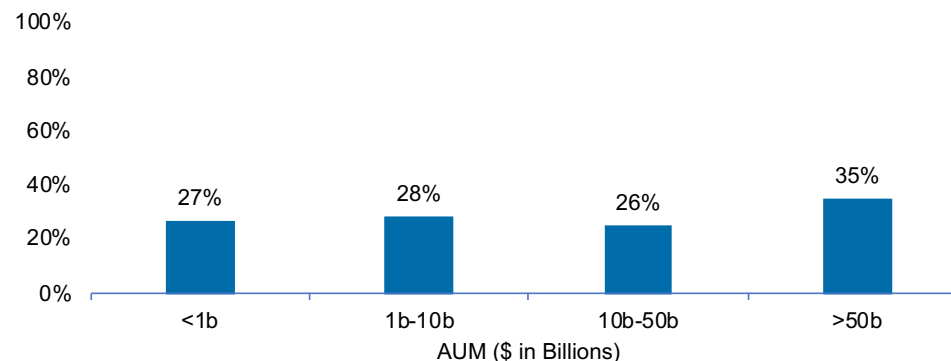
Firms may choose to implement a significant cash flow policy for all composites, or for selected composites. A significant cash flow is the level at which a firm determines that a client-directed cash flow causes a portfolio to become temporarily non-discretionary.

Firms that choose to adopt a significant cash flow policy for certain composites must define the significant cash flow level on a composite-specific basis. When a client-directed cash flow meets or exceeds the composite's significant cash flow level, the portfolio is removed from the composite for the affected period. Like a composite minimum, firms must remove the portfolio even if a significant cash flow causes the composite track record to end and resume at the time of re-inclusion. Often significant cash flow policies can be difficult to implement consistently and, depending on a firm's systems, can be a highly manual process.

### Our observations

Over the last decade, we have noticed a trend of firms moving away from implementing significant cash flow policies. However, compared to the 2018 research we have seen a modest increase of five percent of firms implementing significant cash flow policies. We attribute this to the increase of firms managing illiquid investments that are more likely to be impacted by significant cash flows. Although firms are not required to establish a significant cash flow policy to eliminate the impact of cash flows on portfolio returns, this factor often motivates firms to establish a significant cash flow policy, nonetheless. However, with more firms moving to daily performance calculations, the impact of cash flows in general is reduced such that significant cash flow policies are not as critical as they are for firms that use a Modified Dietz calculation. Firms over \$50 billion are more likely to have established a significant cash flow policy for at least one composite. 35% of these firms have chosen to do so, versus 28% of all firms.

### What Percentage Of Firms Use A Significant Cash Flow Policy?



The significant cash flow level must be determined as either a specific monetary amount or as a percentage of portfolio assets, based on the most recent valuation. Most of our clients that have adopted a significant cash flow policy use a percentage of portfolio assets to determine the significant cash flow level. Significant cash flow levels range from 5% to 100%, with 20% or greater being the most common level.

# Calculation Policies

A GIPS-compliant firm has many choices to make when calculating portfolio-level and composite-level returns and other composite-level data. A firm's performance system and resources often drive calculation policy selections.

## Model Versus Actual Investment Management Fees

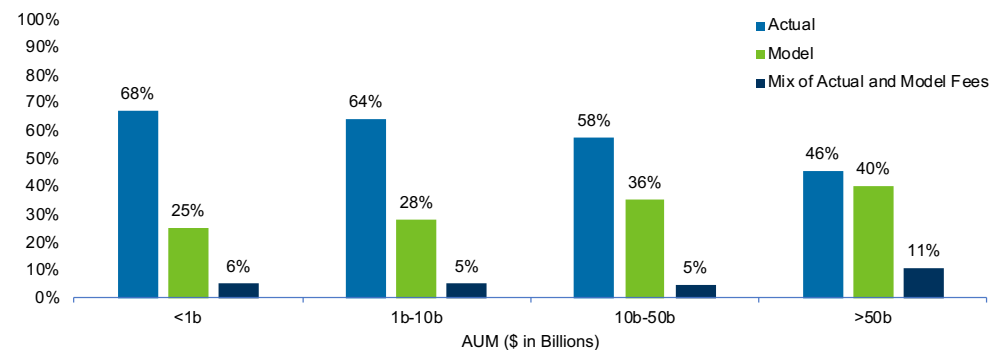
A firm may use actual or model investment management fees to calculate net composite returns. A firm's performance system's limitations often will drive this decision. For example, a firm may not have the ability to obtain actual fees incurred by all portfolios on a timely basis. The net return calculation methodology is composite-specific, so a firm may choose to use model fees for some composites and actual fees for others.

### Our observations

We have observed that more firms are beginning to move towards the use of actual fees. Just over 60% of our clients use actual fees to calculate net composite returns; an increase of approximately 10% relative to 2018.

Larger firms are less likely to calculate net returns using actual fees, but we have observed a shift to actual net returns over the last few years. For those firms that manage over \$10 billion, 53% use actual fees to calculate net composite returns as compared to 38% during the 2018 research. We also noted 44% use only model fees or a combination of actual and model fees compared to 49% from the 2018. The remaining 2% present gross-only returns. Under current regulatory requirements, presentations that do not include net composite returns may be used only in one-on-one presentations.

## Which Methodology Is Used To Calculate Net Composite Returns?



### SEC's New Marketing Rule Impact

It is important to note that the U.S. Securities and Exchange Commission's (SEC) new marketing rule which goes into effect November 4, 2022, expressly notes that showing gross-of-fee returns without also showing net-of-fee returns in an advertisement is prohibited. While this isn't new, the clarification that standardized materials, although used in a one-on-one setting, would be considered an advertisement and subject to the rule. In addition, the new rule clarifies that composites including non-fee-paying accounts that present actual net-of-fee returns should reduce the non-fee-paying accounts by a model fee. Disclosure alone, as required by the GIPS standards, may not be enough for a prospect to understand the net returns shown and may be considered misleading. This will require firms to review those composites with non-fee-paying accounts to ensure the treatment is appropriate to satisfy both GIPS and regulatory requirements.



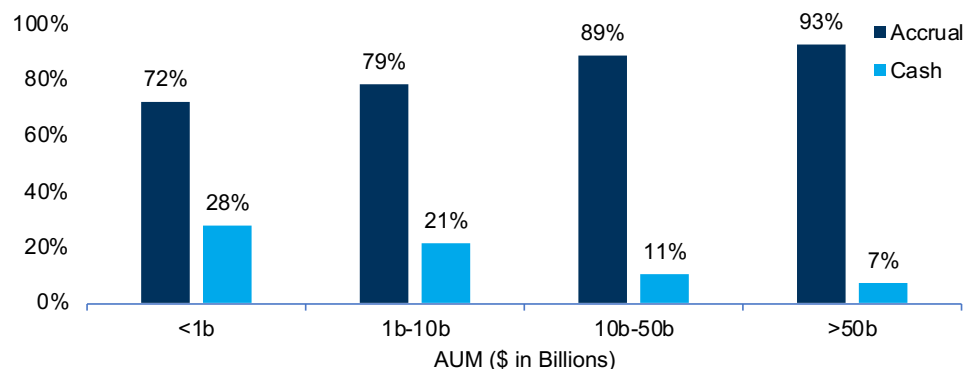
Keep in mind that if model fees are used, a firm must ensure that the net composite returns calculated using model fees are equal to or lower than those that would have been calculated if actual fees were used. 41% of firms using model fees net down gross returns by the highest tier of the composite fee schedule. An additional 34% of firms net down by the highest fee paid by any of the accounts in the composite. Firms find themselves weighing the pros and cons that a model fee provides. The main pro of using model fees is that it is very easy to calculate net composite returns versus the main con that net returns may be understated because the model fee may be significantly higher than the actual fees of portfolios, due to negotiated fees and breakpoints.

## Accounting Method for Dividends

Firms are required to accrue income for fixed income securities and must include accrued income in portfolio values when calculating performance. Firms have a choice for how they recognize dividends on stocks. A firm may choose to accrue dividends, as recommended by the GIPS standards, or recognize the dividends as they are paid (cash basis).

While most firms from our population accrue for dividends, larger firms are much more likely to accrue dividends. Often a firm's performance system and pricing resources impact the firm's decision on which method is used.

**Which Accounting Method Is Used For Dividends?**

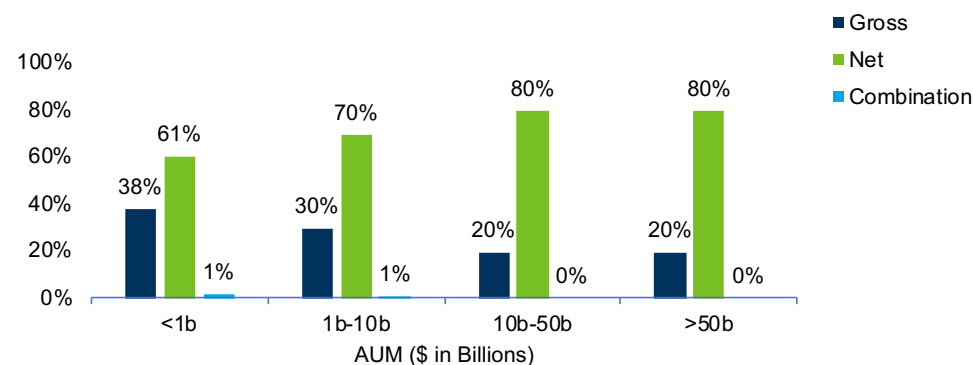


## Foreign Withholding Taxes

A firm that manages foreign equity securities must determine how to treat foreign withholding taxes. The firm may choose to calculate returns net of foreign withholding taxes or gross of foreign withholding taxes. If the firm chooses net, dividends are reduced by the taxes withheld. If a firm chooses gross, the whole dividend is credited to the account and the tax withholding is posted as a cash flow.

A firm's decision is often driven by a firm's performance system capabilities and how information is received from custodians. We found that 70% of our clients that manage at least one international strategy choose to calculate performance net of foreign withholding taxes.

**Do Firms Calculate Returns Gross Or Net Of Foreign Withholding Taxes?**

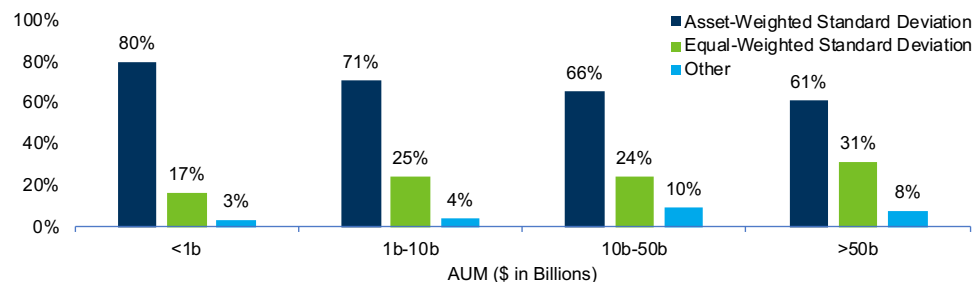




## Internal Dispersion

A firm must calculate and present a measure of internal dispersion if the composite contained more than five portfolios for the entire year. A firm may choose to present internal dispersion for annual periods that contain five portfolios or less for the entire year but is not required to do so. The GIPS standards do not dictate which measure of internal dispersion must be used, nor do they require a specific calculation method. Many of our clients use asset-weighted standard deviation as the internal dispersion measure.

**Which Internal Dispersion Measure Is Used?**



The prevalence of asset-weighted standard deviation is driven by the standard calculations included in many performance systems. When the internal dispersion measure was initially required under the predecessor AIMR Performance Presentation Standards (AIMR-PPS™) in 1997, many performance systems assumed that asset-weighted standard deviation was the appropriate internal dispersion measure given the requirement to calculate composite performance using asset-weighted portfolio returns.

However, we believe that the best measure of internal dispersion is an equal-weighted standard deviation. This provides much better information about whether portfolios within the composite are managed similarly. An asset-weighted standard deviation can be greatly impacted by large portfolios within the composite, and a composite that includes accounts with a wide range of returns may have a very small asset-weighted standard deviation due to the impact of a single large portfolio.

Under the 2020 GIPS Standards, firms are required to disclose whether gross or net returns are used when calculating risk metrics (internal dispersion, 3-year ex-post standard deviation, any additional risk metrics presented).

# 74%

of firms are calculating risk metrics using gross-of-fee performance.

This is in line with what is recommended by the GIPS Standards, as gross-of-fee returns eliminate the noise created by varying management fees at the account level.

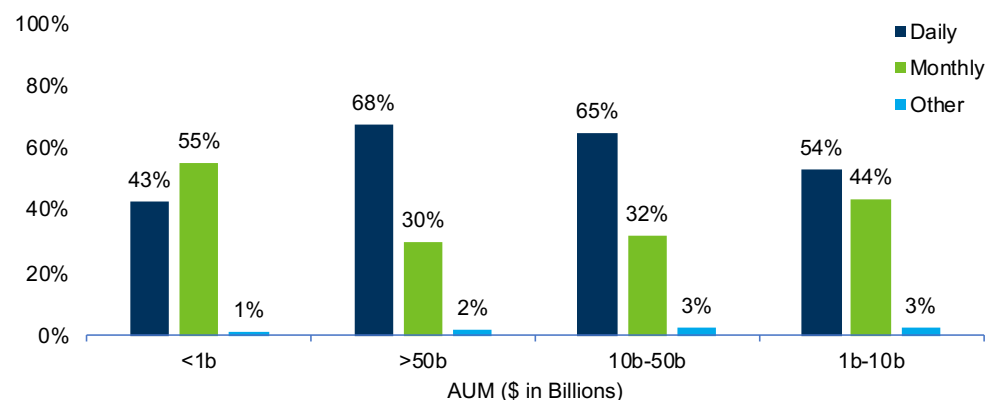
## Valuation and Performance Calculation Frequency

GIPS-compliant firms must establish a policy to determine when portfolios in a composite are to be valued for performance calculations. Firms were required to value portfolios at least monthly beginning January 1, 2001. Beginning January 1, 2010, portfolios are required to be valued on the date of all large cash flows. A large cash flow is the level at which the firm determines that an external cash flow may distort performance if the portfolio is not revalued at the time of the external cash flow. Firms must define large cash flow for each composite to determine when portfolios must be valued. While this is a composite-specific requirement, we often see cash flow policies defined in a firm's performance system and therefore the same level is applied to all composites.

It is important to note that a large cash flow policy is different from a significant cash flow policy. A significant cash flow policy establishes the level at which the firm determines an external cash flow causes a portfolio to become temporarily non-discretionary and is therefore removed from the composite. This policy is optional and is applied on a composite-specific basis.

Valuing portfolios and calculating performance more frequently results in a more accurate time-weighted rate of return. Some firms will revalue portfolios daily. A firm's revaluation and performance calculation frequency is often driven by the firm's performance system. Just over one-half of firms value portfolios and calculate performance daily. Larger firms are more likely to revalue portfolios daily because they have the operational resources to support the additional time and expense associated with daily valuation. For smaller firms, valuing portfolios more frequently than monthly can be cost prohibitive. The Other category in Chart 8 represents firms with alternative assets that have different valuation requirements under the GIPS standards or firms that use a combination of daily and monthly revaluations.

**How Frequently Are Portfolios Revalued For Performance Measurement Purposes?**



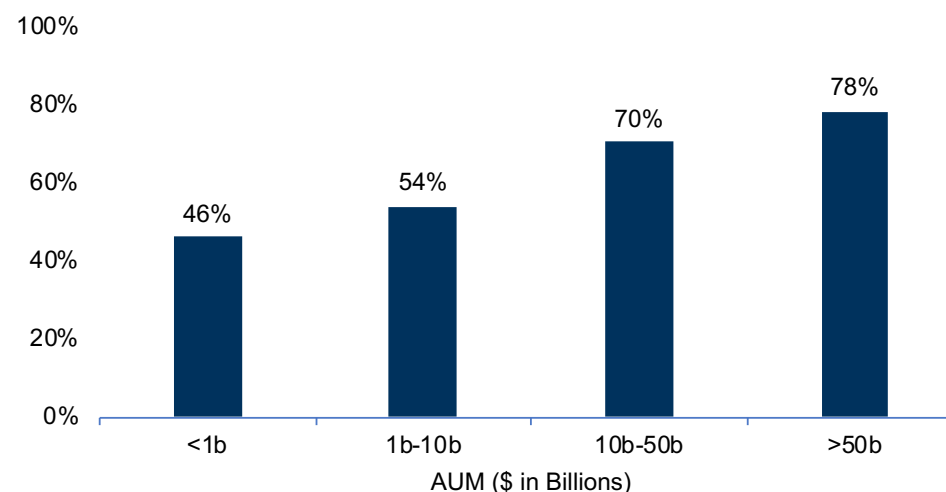
## Calculating Performance for Mutual Funds

Under the 2010 GIPS standards, firms were required to include all mutual funds in a composite. The 2020 GIPS standards now only require mutual funds to be included in the composite when managed to a strategy that is offered as a segregated account. When mutual funds are included in composites, firms typically want to calculate a gross return for the fund that is comparable to other portfolios in the composite, i.e., it is only net of trading expenses. Returns calculated for mutual funds using fund net asset values (NAVs) reflect the deduction of all expenses incurred by the fund.

Firms often gross up a fund's NAV return by the fund's total expense ratio and calculate a gross return that reflects only the deduction of trading expenses. The fund's net return can then be calculated by reducing the grossed-up return by only the management fee. This is particularly important when a firm includes mutual funds in composites with segregated accounts. This calculation ensures the gross returns are net of only trading expenses and the net returns are net of only trading expenses and management fees.

The other option for calculating mutual fund returns is to treat the fund like any other separately managed portfolio and run the fund's performance on the firm's system. Almost 60% of our clients that manage mutual funds start with fund NAVs to calculate fund returns versus placing the fund on their performance system.

**What Percentage Of Firms Use NAV-Based Fund Returns?**



## Estimated Transaction Costs

There are instances where the firm does not know the transaction costs for its portfolios. Under the 2020 GIPS Standards, firms now have the option to reduce portfolio returns by estimated transaction costs. Currently, 2% of our clients have chosen to reduce performance by estimated transaction costs. Wrap managers are more inclined to use estimated costs, as they often do not know the portion of the wrap fee attributable to transaction costs and would like to market gross returns to non-wrap prospects. We have found that the low implementation rate is largely due to system limitations and/or low demand given downward pressure on costs of trading.

## Carve-Outs

The 2020 GIPS standards now allow for the use of carve-outs with allocated cash. For a firm to include an account's assets as part of a carve-out composite, the carve-out account must be representative of a stand-alone portfolio. Since the release of the new guidance, we have not seen a significant number of firms create carve-outs in a GIPS framework. Less than 1% of our clients have chosen to create at least one carve-out composite. The biggest operational hurdle for firms creating carve-outs is the lack of system capabilities for allocating cash.

The GIPS handbook introduces four of the acceptable methodologies for allocating cash:

- » beginning-of-period cash allocation,
- » beginning-of-period plus weighted cash flow cash allocation,
- » strategic cash allocation (true up actual), and
- » strategic cash allocation (target weights).

We have observed that our clients that implemented carve-outs have a near equal split of using the strategic cash allocation (target weights) and beginning-of-period cash allocation methodologies.

### SEC's New Marketing Rule Impact

It is important to note that the SEC's new marketing rule speaks to the use of extracted performance and carve-outs in advertisements. The SEC defines extracted performance as the presentation of a subset of investments from a single portfolio. The marketing rule considers a carve-out to hold a greater risk for being misleading because it provides an opportunity for a firm to cherry-pick holdings from across the composite and to hold those out as part of a strategy which may not be reflective of any single actual investor. Because of this concern, the SEC views carve-out performance from multiple portfolios as hypothetical and subject to additional disclosure. This additional scrutiny from regulators may continue to keep advisors cautious about implementing the new carve-out provisions.

Keep in mind that under the new rule firms that claim compliance with the GIPS standards are still able to present a non-cash carve-out or extracted performance outside of the composite framework but will need to determine if that performance falls under the extracted classification or hypothetical performance classification.

### Overlay Strategies

The 2020 GIPS standards include guidance on how to apply the GIPS standards to overlay strategies and portfolios. The GIPS standards define an overlay strategy as a strategy in which the management of a certain aspect of an investment strategy is carried out separately from the underlying portfolio. These strategies are typically designed either to limit or maintain a specified risk exposure that is present in the underlying portfolio or to profit from a tactical view on the market by changing a portfolio's specified risk exposure. Examples of overlay strategies include a currency overlay to hedge against adverse movements in foreign currencies, an option overlay to seek gains through premium income or enhance returns, or an interest rate overlay to hedge a set of cash flows or manage to a specific target duration.

An important item for overlay managers to consider is how to calculate overlay exposure, which is the economic value for which a firm has investment management responsibility. Overlay exposure can be calculated as:

- » the notional value of the overlay strategy being managed,
- » the value of the underlying portfolios being overlaid, or
- » a specific target exposure.

#### Our observations

Of the overlay managers we work with, we have seen each of the three calculation methodologies implemented. For overlay strategy composites, firms are not required to present total firm assets (in some cases there may be few, if any, underlying assets being managed) and may instead choose to present total firm overlay exposure as of each annual period end. Most of the overlay managers we work with have continued to present total firm assets in lieu of total firm overlay exposure.

# GIPS Reports

GIPS-compliant firms are required to make every reasonable effort to provide GIPS Reports to all prospective clients and prospective investors when initially becoming a prospect and at least once a year if still a prospect. There are two main reports to consider.

- 1. GIPS Composite Report:** This report is a presentation for a composite that contains all the information required by the GIPS standards and may also include recommended information or supplemental information.
- 2. GIPS Pooled Fund Report:** This report is a presentation for a pooled fund that contains all the information required by the GIPS standards and may also include recommended information or supplemental information.

## GIPS Report Updates

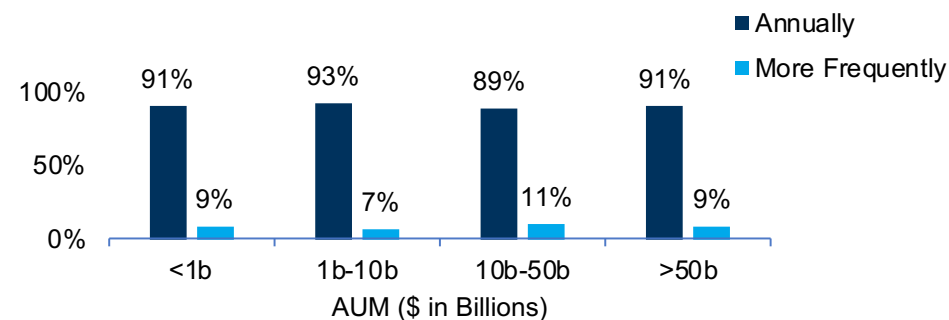
Frequency and methodology for updating the GIPS Report is dependent on the agreed upon policies at the firm. When updating firms will need to include:

1. Information for the most recent year-end, at a minimum;
2. The firm must update the GIPS Report for the most recent annual period end within one year of that annual period end.
3. A firm may choose to update GIPS Reports more frequently than annually, to include current-year information, such as quarterly or year-to-date performance. While updating GIPS Reports more frequently than annually is recommended, we encourage our clients to carefully consider this option to limit the firm's risk of error.

After a GIPS Report is distributed, any changes to the presentation must be considered under the firm's error correction policy. This is true even if the firm labels the presentation as preliminary. If there is a material error in the GIPS Report, the firm must correct the presentation, disclose the error, and distribute corrected presentations to prospective clients or investors that received the erroneous GIPS Report and to the firm's verifier, if applicable. Non-material errors must be handled in accordance with the firm's previously established error correction policies. Reducing the frequency of updates reduces the risk of triggering error correction procedures.

We encourage clients to update GIPS Reports annually and to present current-year information, such as quarterly or year-to-date performance, in marketing materials outside of the GIPS Report. Less than 10% of firms update GIPS Reports more frequently than annually.

How Often Do Firms Update GIPS Reports?

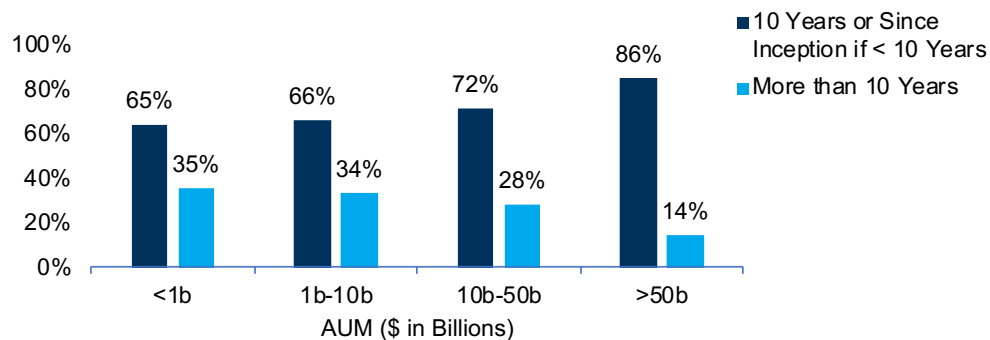


## Periods Presented in GIPS Reports

A firm must be able to prepare a GIPS Composite Report for every composite on the firm's list of composite descriptions; this includes marketed composites as well as non-marketed composites. When initially claiming compliance with the GIPS standards, a firm must present a track record of at least five years (or since inception, if the composite has been in existence for less than five years) in GIPS Reports. For firms that are SEC registered, they will need to consider the new marketing rule provision which requires a 10-year return to the extent a strategy has been in existence for that time.

After the firm initially claims compliance, GIPS requires a firm add an additional year of information until it has a 10-year track record. Subsequently, a firm may choose to present more than the required 10 years of data, or may choose to present data for only the most recent 10-year period. Some reasons to only include the minimum required period are to limit the risk of errors that may trigger error correction, decrease the size of the GIPS Reports, and reduce the time it takes to create and maintain the GIPS Reports.

**Which Periods Do Firms Present In GIPS Reports?**



## Annualized Returns

To fully explain the performance included in a GIPS Report, firms are encouraged to present all relevant additional information and supplemental information in addition to the required disclosure and presentation items. Additional information is information that is required or recommended under the GIPS standards and is not considered supplemental information. Additional information does not require labeling or additional disclosure. Annualized composite and benchmark returns for periods longer than 12 months are considered additional information and recommended by the GIPS standards to be included on the GIPS Report. 22% of firms present annualized composite and benchmark returns in the GIPS Report. Many firms choose to present annualized returns in marketing materials outside the GIPS Report that captures performance for periods prior to the required minimum 10-year period.

### SEC's New Marketing Rule Impact

It is important to note that once the SEC's new marketing rule goes into effect, advertisements that include performance must present one, five, and ten year or since inception net performance. To meet this requirement, we encourage all impacted firms to add annualized performance to the GIPS Report.

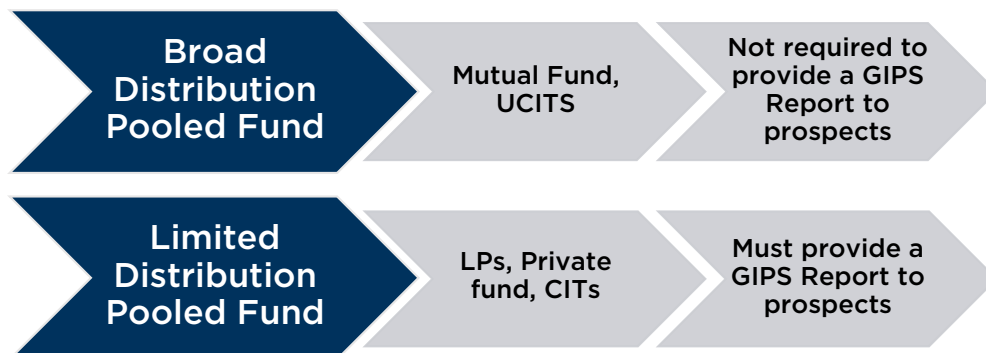


## Pooled Fund Reports

Following the release of the 2020 GIPS Standards, firms must classify pooled funds into one of two categories: broad distribution pooled fund (“BDPF”) and limited distribution pooled fund (“LDPF”). Firms are not required to provide prospective investors in BDPFs with a GIPS Report. However, prospective investors in a LDPF must receive a GIPS Report. If a pooled fund’s strategy is offered as a segregated account, then it must be included in a composite with other segregated accounts managed to the same strategy. If a LDPF is included in a composite, firms can choose to provide either a GIPS Composite Report or a GIPS Pooled Fund Report to prospective investors. Otherwise, firms must offer the prospective investor a GIPS Pooled Fund Report for the fund.

# 75%

of firms provide LDPF prospects a GIPS Composite Report



Of ACA’s clients that manage LDPFs, 75% are providing prospective investors with a GIPS composite report. From the feedback we have received, firms have favored GIPS Composite Reports due to the novelty of the new provision and that firms are often marketing a strategy as opposed to a specific vehicle.

When presenting a GIPS composite report to a prospective investor in a LDPF, the prospective investor must receive the fee schedule and current expense ratio of the fund for which one is a prospect. There are several ways in which this requirement can be met. Of ACA’s clients providing GIPS composite reports to LDPF prospective investors, 51% are including the pooled fund fee schedule and expense ratio in the same GIPS composite report as the segregated account prospective fee schedule. Firms under \$10 billion of AUM are most likely to implement this approach, largely due to the operational ease of maintaining one version of the GIPS composite report. The second most popular solution is to include the fee schedule and expense ratio of the fund as an addendum to the GIPS report. 31% of our clients chose to implement this approach. Examples of addendums we have seen implemented in practice are private placement memorandums (PPM), fund offering documents, and pitchbooks and/or other marketing materials.

## GIPS Report Distribution

Under the 2010 version of the GIPS standards, there was a de facto requirement to track the distribution of GIPS reports. Today the 2020 GIPS standards explicitly requires that firms be able to demonstrate how it made every reasonable effort to provide a GIPS Report to prospects when they initially become a prospect. This not only helps ensure that firms are providing prospects with GIPS Reports, but also enables effective re-distribution of reports in the event of a material error.

Two common ways firms are tracking distribution is through a CRM system or through spreadsheets. The use of a CRM system is more common for firms with over \$10 billion of AUM, as many smaller firms do not have access to systems that offer the capability to track specific pieces of marketing. Another common solution we have seen is the copying of an email group to save GIPS Report correspondence.

# Wrap Fee Accounts

Wrap fee/separately managed account (SMA) portfolios, which we refer to as wrap accounts, present some unique challenges for calculating and reporting performance. The GIPS standards define wrap fees as a type of bundled fee that is specific to a particular investment product. The wrap fee is an asset-based fee charged by a wrap fee sponsor that may include a combination of investment management fees, trading expenses, custody fees, and/or administrative fees.

Wrap accounts are generally offered by a broker-dealer (the “sponsor”), whereby clients of the sponsor have access to institutional investment managers that they typically would not otherwise be able to hire. The sponsor acts as the intermediary between the individual wrap client and the investment manager. Essentially the sponsor sub-contracts with investment managers to provide investment advisory services on behalf of the sponsor’s clients. 36% of our clients manage wrap accounts. Many firms we work with have seen a gradual shift from traditional wrap account arrangements to UMA model delivery platforms. Model delivery assets are commonly considered advisory-only assets for GIPS purposes and therefore not included in a firm’s GIPS firm AUM calculation. Under the 2020 GIPS Standards, firms now have the option to show advisory-only assets if it is presented next to total firm assets plus firm-wide advisory-only assets. As of this publication, less than ten percent of firms have chosen to present advisory-only assets in GIPS Reports.

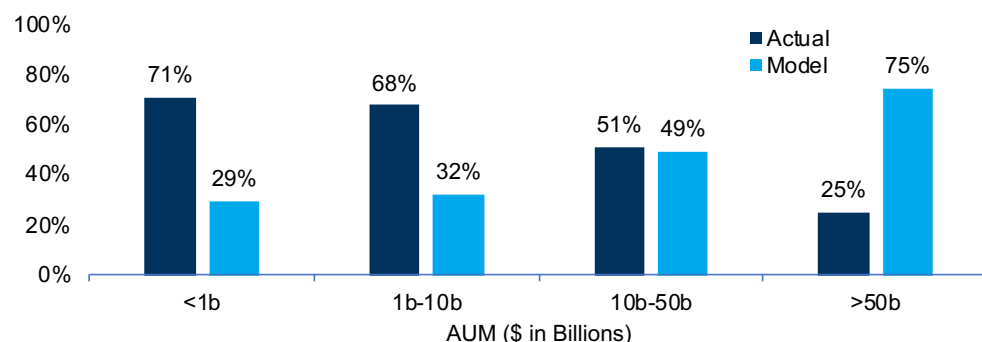
## Calculating Performance for Wrap Accounts

The primary issue with wrap accounts is the inability to calculate a GIPS-compliant return that reflects the deduction of trading expenses because they typically do not pay explicit trading expenses, such as commissions. Since trading expenses are part of the total wrap fee paid to the sponsor and generally cannot be segregated, there is no easy way for a firm to calculate returns net of trading expenses.

Most firms we work with calculate and present a “pure” gross return for wrap composites. A “pure” gross return is a return that does not reflect the deduction of trading expenses and is considered supplemental information under the GIPS standards.

When presenting performance to a prospective wrap client, composite returns must be presented net of the total wrap fee. Just like non-wrap composites, wrap composite net returns may be calculated using actual fees or model fees. Determining the sponsor’s actual total wrap fee can be difficult, if not impossible. Wrap sponsors generally are not willing to share this information with managers, and, as a result, many firms choose to calculate wrap composite net returns using an industry standard 3% model wrap fee for equity portfolios and 1.5% model wrap fee for fixed income products. A firm may use a model fee that is different from industry standard, but the firm must be able to prove that the fee that is used is the highest wrap fee for a particular composite. 38% of our clients that manage wrap accounts use a model fee to calculate wrap composite net returns.

## Which Methodology Is Used To Calculate Wrap Composite Net Returns?



58% of firms over \$10 billion use model fees to calculate wrap composite net returns. This is likely because larger firms tend to have multiple sponsors for each strategy, and identifying actual fees paid for thousands of wrap accounts on multiple platforms is difficult, if not impossible.

## Books and Records for Wrap Accounts

Another challenge with wrap accounts is maintaining books and records to support performance. Because the sponsor acts as an intermediary between the investment manager and the individual wrap client, the firm must determine how it will obtain appropriate records to support performance. Under the GIPS wrap provisions of the GIPS standards, firms have options for satisfying the requirement to capture and maintain all data and information to support all items included in a GIPS Report.

One option is for the firm to use shadow accounting. Shadow accounting involves calculating performance on the firm's in-house performance system. With shadow accounting, the firm is essentially replicating the account returns of the sponsor and is in control of composite assignment. While shadow accounting can require additional resources, it is the most transparent way to calculate performance for wrap accounts and allows firms to ensure they have the records necessary to support performance. Just over half of ACA's clients perform shadow accounting for its wrap accounts.

Instead of shadow accounting, a firm may choose to place reliance on the sponsor's records. Placing reliance on the sponsor can be beneficial for smaller firms that have staffing or system constraints that would not allow the firm to effectively process a large volume of accounts. However, placing reliance on the sponsor does not alleviate the firm's responsibility to ensure accounts are properly included in composites and performance is calculated correctly. A firm should perform periodic testing to ensure that it can continue to place reliance on data from the sponsor.

# Verification and Performance Examinations

To add credibility to its claim of compliance with the GIPS standards, a firm may choose to have a firm-wide verification performed by an independent third party. Verification tests the construction of the firm's composites as well as the firm's policies and procedures as they relate to the GIPS standards. A firm-wide verification report attests, for a specified period, that the firm has established policies and procedures for complying with the GIPS standards related to composite and pooled fund maintenance, and the calculation, presentation, and distribution of performance that are designed in compliance with the GIPS standards, as well as whether these policies and procedures have been implemented on a firm-wide basis.

## Verification

According to recent data reported by CFA Institute, 85% of firms claiming GIPS compliance are verified. Most of the firms we work with choose to have their firm-wide verification conducted on an annual basis. Often, the verification process starts shortly after the firm has finalized all year-end composite data. We have observed a trend to move away from frequent verifications to one annual verification. Because a verification can add a fair number of hours to a firm's workload, reducing the firm's verification frequency can have a positive impact on the firm. If the firm has good controls in place to calculate and present performance, we believe that annual verification is sufficient.

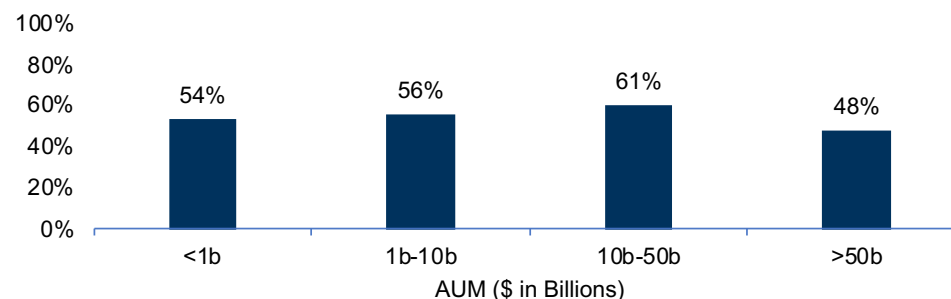
## Performance Examinations

A firm-wide verification does not provide assurance on the accuracy of any specific composite. If a firm wants to have the results of a specific composite tested, this can only be done by having a performance examination of that composite.

A Performance Examination Report attests, for a specified period, that the specific composite has been constructed and its performance has been calculated in compliance with the GIPS standards, and that the firm has prepared and presented the composite's GIPS Report in compliance with the GIPS standards. A performance examination takes a deeper dive into the specific composite to ensure that the composite is constructed and consistently calculated with the firm's policies and the GIPS standards. It also includes a detailed review of the composite's GIPS Report, to ensure all the information presented in the GIPS Report is proper and that all required disclosures are included.

Note that a performance examination may not be performed in the absence of a firm-wide verification. Firms that choose to get performance examinations generally get them for their key marketed composites. 55% of our clients have at least one composite examined.

### How Many Firms Receive At Least One Performance Examination?



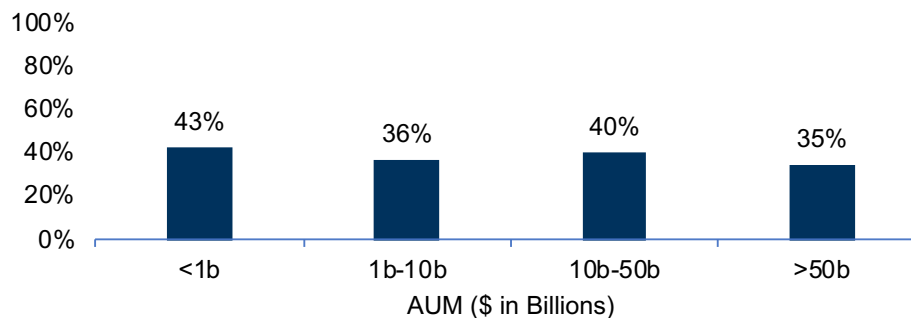
# Marketing Performance and GIPS Compliance

Marketing is an important function within any organization as it attracts new business which leads to firm growth of their assets. A GIPS-compliant firm is required to provide a GIPS Report to all prospective clients when initially becoming a prospect and at least every 12 months thereafter if still a prospect. Many firms also choose to present performance and advertise their GIPS claim of compliance outside of the GIPS Report. However, it is important to keep in mind that a GIPS-compliant firm must adhere to the required provisions of the GIPS standards, in addition to any applicable regulatory requirements.

## GIPS Advertising Guidelines

The GIPS compliance statement is a required disclosure on a GIPS Report. However, that compliance statement may only be used in a GIPS Report that includes all the required statistics and disclosures. Alternatively, firms have the option to follow the GIPS Advertising Guidelines to advertise their claim of compliance without having to provide a full GIPS Report. The GIPS Advertising Guidelines are effectively an abbreviated version of the GIPS Report, though firms following them are not absolved of the obligation to provide a fully GIPS Report to prospective clients at least once a year.

**How Many Firms Choose To Follow The GIPS Advertising Guidelines?**



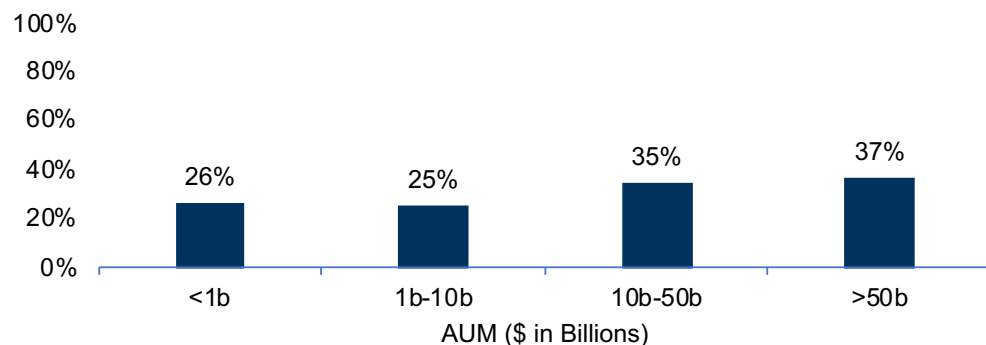
61% of firms choose not to follow the GIPS Advertising Guidelines. The reason is likely that following the GIPS Advertising Guidelines can add additional risk to the firm if they are not followed correctly with proper oversight in place.

## Website Performance Presentation

Firms may choose to advertise their performance in many ways, including on the firm's website. Firms that choose to advertise performance on their website will often include more recent returns than what is presented in the GIPS Report, in addition to other information such as representative account data. A firm's website is considered an advertisement and is therefore subject to applicable regulatory requirements. For this reason, many firms opt not to present performance on their website. Instead, they will include descriptive information about the strategies they manage and an invitation to contact the firm to receive more detailed performance information. Approximately 28% of firms present performance on their website.

A person who views a firm's website is not considered a prospective investor, as defined by the GIPS standards, and therefore the firm does not have to provide a GIPS Report to those that view the firm's website. However, some firms choose to include either a GIPS Report, or a link to the GIPS Report, for the strategies they are marketing on their website. It is important to note that directing prospective clients to the firm's website does not satisfy the requirement to provide a GIPS Report. Firms can, however, provide prospects the direct link to a GIPS report to meet delivery requirements.

### How Many Firms Choose To Follow The GIPS Advertising Guidelines?



## Conclusion

The practices and observations we noted in this paper are a result of our close work with over 800 firms across 24 countries. The findings we shared are what we use to help guide and educate our clients. Although each firm is unique, the information in this paper provides a framework for considering new policies or evaluating existing policies.

In the future, we plan to update this paper to evaluate trends and provide information on how firms are implementing policies as a result of new guidance, the SEC Marketing Rule, or other interesting data points we can gather from our clients. Please subscribe to our list to stay up-to-date or contact us if you would like more information about any of the facts presented or if we can help you evaluate other policies or practices.

## About ACA Group

ACA Group (“ACA”) offers Global Investment Performance Standards (GIPS®) verification and consulting services to investment managers around the world. ACA is the largest team of professionals solely dedicated to GIPS standards verification and related services globally. For more information, please visit [www.acaglobal.com/gips](http://www.acaglobal.com/gips).

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