January 29, 2018

GIPS Executive and Technical Committees
CFA Institute
915 East High Street
Charlottesville, VA 22902

RE: USIPC Comments on the Exposure Draft of GIPS® Guidance Statement on Benchmarks

Dear Executive and Technical Committee Members,

The United States Investment Performance Committee ("USIPC" or the "Committee") has reviewed the exposure draft of the GIPS® Guidance Statement on Benchmarks currently out for public comment. The Committee was truly impressed by its content and believes that the industry will greatly benefit from it. Specific comments addressing the language and questions within the guidance statement have been inserted in red font within the body of the guidance statement below.

Sincerely,
USIPC

Global
Investment
Performance
Standards

EXPOSURE DRAFT OF GIPS® GUIDANCE STATEMENT ON BENCHMARKS

Effective Date (expected): 1/1/2019

Public Comment Period: 10/30/2017 – 1/29/2018

CFA Institute

www.gipsstandards.org

GUIDANCE STATEMENT ON BENCHMARKS

Executive Summary

The purpose of this Guidance Statement is to provide new interpretation on benchmarks as it pertains to the application of the Global Investment Performance Standards (GIPS®). Such topics as selecting an appropriate benchmark, the role of benchmarks, and practical considerations provide a strong background for firms when considering benchmarks within compliant presentations. Such concepts as price-only benchmarks, multiple benchmarks, and benchmark changes attempt to answer questions long held by the industry.

In addition, there is existing benchmark guidance that is currently dispersed throughout the body of the GIPS standards and may be difficult to find. This exposure draft consolidates and organizes the benchmark-related information, providing one reliable source for everything to do with benchmarks within the GIPS standards.

The expected effective date of the Guidance Statement on Benchmarks is 1 January 2019.

Invitation to Comment

Exposure Draft of the Guidance Statement on Benchmarks

CFA Institute established the GIPS Executive Committee as the governing body for the Global Investment Performance Standards (GIPS). The GIPS Technical Committee is responsible for technical oversight of the GIPS standards. The GIPS Technical Committee seeks comment on the proposal set forth below regarding the Guidance Statement on Benchmarks.

There are questions positioned throughout the document to elicit feedback on specific issues, and these questions highlight new proposed requirements. In addition to responding to the specific questions, please provide feedback on the entire document, including items you support. All comment letters will be considered carefully and are greatly appreciated.

Comments must be submitted and received no later than 29 January 2018. Responses will be accepted via email, hardcopy and fax. Please submit your comments as early as possible to facilitate the review process. Unless otherwise requested, all comments and replies will be made public on the GIPS standards website (www.gipsstandards.org). Comments may be submitted as follows:

Email: standards@cfainstitute.org
Fax: +434-951-5687
Post:

CFA Institute
Global Investment Performance Standards
Re: Guidance Statement on Benchmarks
915 East High Street
Charlottesville, VA 22902
USA

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Introduction

The GIPS standards are ethical standards for the calculation and presentation of investment performance to ensure fair representation and full disclosure of investment performance.

Benchmarks are a fundamental component of the principle of fair representation and are the focus of many provisions of the GIPS standards. Firms are required to select a composite benchmark if one is appropriate and present benchmark performance in compliant presentations.

The GIPS standards define a benchmark as a point of reference against which the composite's performance and/or risk is compared.

Properly used, a benchmark should be a focal point in the relationship between the firm and the fiduciary body overseeing the prudent management of the assets. The thoughtful choice of a benchmark will make the relationship between these parties more effective and enhance the value of the investment strategy by clearly defining expectations and success.

"Relationship between the firm and the fiduciary body overseeing the prudent management of the assets" is unusual terminology for GIPS and does not seem to apply to retail mutual fund clients. Consider replacing with:

Properly used, a benchmark should be a focal point in the evaluation of the strategy. The thoughtful choice of a benchmark will enhance the performance evaluation of the investment strategy by clearly defining expectations and success.

Benchmark guidance is imbedded within the GIPS standards' provisions, guidance statements, and Q&As, as well as the GIPS Handbook. The purpose of this Guidance Statement is to serve as a reference for the already existing guidance and to provide new interpretation on the treatment and presentation of benchmarks within the GIPS standards.

The primary goal of this Guidance Statement is to provide guidance on benchmarks for composites. However, there are comments that refer to portfolio benchmarks, and to avoid misunderstanding, those comments are clearly identified.

The Role of Benchmarks

As firms manage different kinds of strategies, the benchmarks they are measured against can also be utilized differently. Investment strategies generally fall into one of three categories:

1. Benchmark Relative: In this category, investment decisions are made relative to benchmark weights, exposures, and risks. The portfolio may be very similar to the benchmark in this instance (e.g., passive and active index strategies).
2. Benchmark Aware: In this category, benchmark relativity is observed or the benchmark serves as an investable universe. Generally, there will be distinct differences between the portfolio and the benchmark (e.g., concentrated strategies).
3. Benchmark Neutral: In this category, benchmarks are treated more as target returns or hurdles to beat or there is no appropriate benchmark. This is common with absolute return and alternative strategies and for strategies not covered by index providers. In these instances, a predefined target return that is not based on a market index may be used.

The Committee believes it would be helpful to clarify that the same "strategy" can fall into two different buckets. In other words, it's really a different in investment processes rather than strategies. For example, two managers can present their Large Cap Growth strategy against the Russell 1000 Growth benchmark. One manager's investment process could start with the benchmark, and make deviations from there. The other could choose stocks regardless of whether they are in the benchmark, but will be aware of their bets since it will be driving excess performance. The former case falls into the benchmark relative strategy and the latter falls into the benchmark aware strategy. Although the benchmark aware strategy will likely have a higher active share, it could still be considered the same strategy as benchmark relative.

Laws and Regulations

In some jurisdictions, there has been increased regulation surrounding benchmark calculations (e.g., blending indexes, currency conversion). Firms must ensure that they are aware of any benchmark-related regulations. If the firm is required under local laws and/or regulation to present performance within the compliant presentation in a manner that differs from the requirements of the GIPS standards, then the firm must disclose this fact and disclose the manner in which the laws and/or regulations conflict with the GIPS standards.

Presentation and Reporting of Benchmarks

When an appropriate benchmark exists, firms must present the benchmark total return for each annual period in compliant presentations. In addition to the required annual benchmark returns, firms must also present benchmark returns for any additional periods for which composite returns are presented. For example, if the compliant presentation includes partial periods or quarterly composite returns, matching benchmark returns must also be included.

Example showing a partial period in 2017 and a break in the return history when there were no portfolios in the composite from September 2012 through February 2014.

Year	Global Bond Composite Net Returns	ABC Global Bond Index

2017 (to 30 June)	1.00%	0.43%
2016	2.48%	2.04%
2015	1.49%	–1.61%
2014 (From 1 March)	–3.29%	1.50%
2012 (to 31 August)	–2.79%	1.81%
2011	4.99%	4.38%
2010	4.92%	–2.43%
2009	1.35%	2.04%

Since this is a guidance statement, consider reformatting this example so it is more “formal” and consistent with the compliant presentations in the handbook. Or alternatively remove the example.

Example showing quarterly returns.

Year	Global Equity Composite Net Returns					XYZ Global Equity Index				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
2016	1.03%	–1.15%	–1.71%	–1.10%	-2.92%	–2.37%	–0.24%	1.22%	–3.69%	–5.05%
2015	3.00%	1.05%	2.45%	–0.26%	6.35%	–3.77%	2.48%	2.37%	–3.05%	–2.13%
2014	3.55%	1.92%	3.88%	0.02%	9.65%	–4.26%	–1.53%	3.89%	2.48%	0.37%
2013	4.43%	–0.78%	1.12%	–1.45%	3.26%	2.39%	3.46%	–3.00%	0.83%	3.61%
2012	4.53%	–0.93%	–3.90%	–0.71%	–1.19%	–2.46%	3.47%	3.76%	2.67%	7.52%
2011	3.55%	1.52%	1.53%	2.33%	9.22%	1.52%	4.04%	3.63%	–4.78%	4.22%
2010	1.40%	–1.79%	–4.31%	3.72%	–1.16%	4.49%	–0.28%	–1.62%	–1.99%	0.47%
2009	0.02%	2.66%	-0.94%	3.45%	5.22%	–1.59%	–0.44%	–0.71%	–0.05%	–2.77%

Selecting an Appropriate Benchmark

The benchmark is usually the first place to start when measuring the success or failure of an investment strategy. Each portfolio will likely have a benchmark that it is compared to that is often selected by the client or prospective client. In some cases, however, the portfolio benchmark is chosen by the firm; whereas in all cases, the composite benchmark is chosen by the firm.

A benchmark is appropriate if it reflects the composite’s investment mandate, objective, or strategy, but multiple benchmarks may meet this single criterion. Firms should also consider the qualities of good benchmarks. A good composite benchmark has many of the following properties. It is

- *specified in advance*. Although this may not always be the case, firms should select a composite benchmark prior to the evaluation period.
- *relevant*. The benchmark reflects the investment mandate, objective, or strategy of the composite.
- *measurable*. The benchmark is quantifiable.
- *unambiguous*. The constituents of the investable universe can be clearly identified and priced.
- *representative of current investment opinions*. The firm has current knowledge of the investable universe.
- *accountable*. The firm selects the benchmark and is accountable for any deviations from the

benchmark.

- *investable*. The benchmark offers a passive alternative that is a realizable and alternative opportunity genuinely open to the investor.
- *complete*. The benchmark provides a broad representation of the sector of the market to which it pertains.

It is important that when choosing a benchmark, the firm considers how an index has balanced the trade-off between completeness and investability. A more complete index can provide broader, more diversified performance. However, investability is an important concern for managers facing frequent and uncertain withdrawals. Another consideration is that strategies tracking more popular indexes tend to have lower trading costs because of their greater liquidity.

There are many considerations which would make an index investable. Some considerations are from the index point of view (liquidity of securities, number of securities) and others are from the manager's point of view (frequent withdrawals from clients cause higher trading). The definition of investable above is speaking to "a passive alternative that is a realizable and alternative opportunity genuinely open to the investor" which is different than the explanation about withdrawals. Also, trading caused by frequent cash flows (contributions and withdrawals) is just one reason from the manager's perspective. Suggest re-wording as below.

It is important that when choosing a benchmark, the firm considers how an index has balanced the trade- off between completeness and investability. A more complete index can provide broader, more diversified performance, but will be less investable. An index that has fewer and/or more liquid securities will be more investable.

Also, the terms "benchmark" and "index" are used interchangeably. Consider either defining that they are the same and will be used interchangeably, or use one term throughout.

The process for determining the benchmark for a composite should be maintained in the firm's policies and procedures. This documentation should include any review and approval processes.

The GIPS standards require that all actual, fee-paying, discretionary portfolios must be included in at least one composite. Composites must be defined according to investment mandate, objective, or strategy, and include all portfolios that meet the composite definition. Just because portfolios are included in the same composite because they meet the same composite definition, it does not mean that the underlying portfolios have the same benchmark.

One example is a Large-Cap US Equity Composite that is composed of portfolios in which some are benchmarked to the Russell 1000 Index and others to the S&P 500 Index. These portfolios are managed similarly even though they may have different portfolio benchmarks chosen by the owners of the assets. The composite benchmark could be either the Russell 1000 or S&P 500 as long as the composite benchmark best represents the investment mandate, objective, or strategy of the Large-Cap US Equity Composite.

Another example is a composite containing similar balanced mandates (e.g., 60% Equity/40% Bond and 57% Equity/43% Bond). In this scenario, firms may use portfolio-weighted benchmarks as a composite benchmark. Please see the next section for more information about portfolio-weighted benchmarks.

It should be noted that an industry benchmark is more understandable to the prospective client and easy to measure. Its formulation has a high degree of transparency. If all portfolios in the composite are managed against a widely recognized benchmark or a blend of well-known indexes, firms should assign that benchmark to the composite. This could be a broad index (e.g., MSCI World) or a style (e.g., Russell 1000 Growth) or a blend (e.g., 50% MSCI World, 50% US Treasury).

The composite benchmark is used to evaluate how the firm manages a specific strategy. The benchmark must reflect the investment mandate, objective, or strategy of the composite. Firms should disclose material differences between the benchmark and the composite's investment mandate, objective, or strategy.

Sample Disclosure: *The XXX composite contains all equity portfolios whose objective is to beat the median of the YYY peer group universe. Because peer groups can be subject to survivorship bias, the benchmark shown is the ABC Global Equity Index.*

Types of Benchmark

There are a number of benchmarks commonly used. The following are some of the options:

a. *Market Indexes:* Market indexes are commonly used and widely recognized. Often published publicly, market indexes represent a segment of investing that can be comprehensive in nature (e.g., global developed market equities, European bonds) or a narrowly defined financial product, such as country, sector, or style-bias. For example, the investment objective may be to outperform the Barclays Global Aggregate index (broad) or S&P Financials (narrow) over a five-year period.

b. *Blended Benchmarks*: Blended benchmarks are created by combining multiple market indexes. This type of benchmark may be used as a comparison for balanced strategies, asset allocation strategies, and liability matched investments, among others. The components of a blend can range from simple (e.g., 60% MSCI World, 40% Barclays Aggregate Fixed Income, rebalanced on a monthly basis) to complex blends of multiple indexes rebalanced at irregular intervals. Asset owners often use a custom blended benchmark that reflects asset class strategic weights. The Guidance Statement on the Application of the GIPS Standards to Asset Owners includes in the Appendix examples of these custom blended benchmarks and the related disclosures.

c. *Custom*: Custom benchmarks are universes of securities created by either the firm or investor that specify a benchmark more reflective of the investment strategy. There are many types of custom benchmarks, such as those created by narrowing the opportunity set of investments (e.g., excluding specific stocks) or establishing rules for inclusion in the benchmark (e.g., excluding specific sectors). The GIPS standards require that if a custom benchmark, blended benchmark, or combination of multiple benchmarks is used, the firm must disclose the benchmark components, weights, and rebalancing process. Please see the portfolio-weighted benchmark section (i) for more information.

d. *Absolute Value/Target Return*: Examples of absolute value/target return strategies are to earn a 5%to 10% average annual return, or CPI+5% over a five-year period. Absolute value or target return benchmarks are popular with certain types of hedge funds and other market neutral approaches in which the investment strategy has no relevance to a market index. It may also be used to compare the success of a strategy to a fixed level of spending.

   Target Income Returns are not addressed here. In the private wealth space, retirees are more focused on the income a portfolio generates and thus strategies target high dividend paying stocks. Success is then measured by comparing the income return to a target withdrawal rate (e.g., 4%). We know that GIPS is focused on total return, which included income and principal. But in the case of a strategy where the goal is to earn a 4% income return (for withdrawals), could the firm present the total return, no total return benchmark, and show income return versus a 4% benchmark as additional information?

e. *Peer Groups and Universes*: Peer groups and universes are often used for comparing like-managed funds within a certain industry, country, or sector. For example, the investment objective may be "to perform in the top quartile of UK managers over a three-year period." Peer groups have several drawbacks when used as a benchmark; they often display survivorship bias, returns cannot be chain-linked to calculate performance over longer periods, and they do not fulfill all of the criteria specified previously for defining a good benchmark (e.g., they are not investable). Also, because a peer group is typically a median fund return over a specific time period, risk statistics, such as standard deviation, which must be shown in a compliant presentation, are not necessarily meaningful because the median fund could be different for each time period used in the calculation. Although the use of peer groups as benchmarks is not considered best practice, there are certain asset classes (e.g., private equity, real estate, alternatives) in which these are widely used and generally considered the best options available.

f. *Factor Based Models*: This comparison involves calculating a return based on a pre-defined set of risk exposures. The simplest of these is the CAPM (capital asset pricing model), which relates the beta of a portfolio to an expected rate of return. For example, the investment objective may be to outperform a beta-adjusted benchmark return over a three-year period.

Is factor based returns simply a type of custom benchmark?

g. *Returns Based*: Benchmarking in this manner involves estimating historical exposures to various style indexes by performing a regression analysis on the historic returns of the portfolios to the returns on the related style indexes. A common example has been to use returns based–benchmarks to determine style biases in the portfolio's track record. Blended market indexes are developed from this approach, for which the investment objective may be to outperform a blend of J% Growth Index and K% Value Index, rebalanced monthly, over an X-year period, where J and K represent the long-term style exposures of the portfolio.

Returns-Based doesn't seem like a separate type of index. Rather, it seems like a way to arrive at a blended index. The firm is using returns based analysis to arrive at the weights of a blended index. Consider removing this section and add a sentence to the blended benchmarks about how this may be one way to arrive at it.

h. *Exchange Traded Fund (ETF):* An ETF is a market instrument that tracks a basket of underlying securities, such as an index. An ETF could, in some instances, be considered as a viable benchmark for a strategy. It should be noted, however, that unlike an index, an ETF will incur trading and other charges and so, in general, will underperform an index. Firms must not select a benchmark primarily to make performance look better by lowering the benchmark return. If an ETF is chosen as the benchmark for a strategy, and the ETF is based on a market index, the firm must disclose the reason for selecting the ETF rather than using the market index and must present the returns of the ETF that are comparable to the presented composite returns. For example, if composite gross returns are presented, the ETF returns must also be gross.

Question 1: Do you agree that firms should be required to disclose why they have chosen an ETF rather than a market index as the composite benchmark?

Yes. As noted above, an ETF will incur trading and other charges which could be a good thing, but could also cause significant divergence from the benchmarks they track. Some of the trading could be due to external influences such as derivatives on the ETF or arbitragers, which can materially impact performance. Additionally, we have seen material divergence due to treatment of withholding taxes. The prospective investor should be aware of these facts and nuances.

Question 2: Do you agree that the ETF chosen must be one in which the returns are comparable to those of the composite?

Yes, assuming comparable = appropriate to the strategy. The Committee suggests replacing comparable to appropriate.

i. *Portfolio-Weighted Composite Benchmark:* Some investment strategies may naturally lend themselves to customization for client investment solutions. Although the investment objective, mandate, or strategy is similar, there are differences in the actual application. Examples of this include liability-driven investing (LDI) and balanced mandates. Even though asset allocations or liability streams may be slightly different, firms may choose to group accounts with similar mandates into a single composite in order to present meaningful alpha and a track record that demonstrates the firm's ability to manage such mandates. Although some level of dispersion would be expected in this instance, firms may use a portfolio-weighted benchmark for comparative purposes. While these are considered to be custom benchmarks and require additional disclosure, they can help reduce the proliferation of single member composites where the investment mandate is similar, but other factors in the client guidelines vary. Firms can also better demonstrate their ability to manage to customized benchmarks, which are increasingly demanded by clients. However, this style of benchmark has limitations with respect to its comprehension by a prospective client.

The GIPS standards require that if a custom benchmark or combination of multiple benchmarks is used, the firm must disclose the benchmark components, weights, and rebalancing process. For a portfolio-weighted custom benchmark, the benchmark may change every month as part of the normal procedure. It is required in this instance to disclose that the benchmark is rebalanced monthly using the weighted-average returns of the benchmarks of all of the portfolios included in the composite. A firm is not required to disclose how the underlying portfolio benchmarks and weights have changed each month. If the benchmark for the composite were to change from a portfolio-weighted custom benchmark created monthly using the benchmarks of the individual portfolios in the composite to a market index, this would be a benchmark change that must be disclosed.

In the spirit of full disclosure and fair representation, firms must disclose the components that comprise the portfolio-weighted custom benchmark, including the weights that each component represents, as of the most recent annual period end. Firms should also offer to provide this information for prior periods upon request.

Example: *The Long US Government/Credit Custom Benchmark is calculated using the benchmarks of portfolios in the Composite. The benchmark is rebalanced monthly based on the beginning values of portfolios included in the composite. As of 31 December 2016, the breakdown of the benchmark is 88.2% Bloomberg Barclays US Long Government/Credit Index and 11.8% Bloomberg Barclays US Long Government/Credit A+ Index. The breakdown of the custom benchmark for different time periods is available upon request.*

No Appropriate Benchmark

Benchmarks are important tools that aid in the planning, implementation, and review 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 compliant presentations. The benchmark must reflect the investment mandate, objective, or strategy of the composite. If the firm determines that no appropriate benchmark for the composite exists, the firm must disclose why no benchmark is presented.

Sample Disclosure: *"Because the composite's strategy is absolute return and investments are permitted in all asset classes, no benchmark is presented because we believe that there is no benchmark that reflects this strategy."*

Practical Considerations

The following are several practical considerations to take into account when choosing an appropriate benchmark.

a. *Currency:* Returns can be significantly different depending on the currency in which they are expressed. If a firm chooses to present composite performance in a different currency, all required information and additional information must be converted into the new currency (e.g., composite and benchmark returns). While returns from the index provider may be in a different currency from that of the composite, firms are required to convert benchmark returns into the same currency as the composite. A firm should use the same method of currency conversion for the benchmark as it does for the composite. If a firm chooses to convert a compliant presentation from one currency to another, this conversion should be calculated using the same exchange rates for composite data and benchmark data. Firms must disclose if the exchange rates used to convert composite data and benchmark data are materially different. Even if the firm and benchmark provider are using the same exchange rates in the conversion, they may be using a different calculation method for performing the currency conversion. Thus, the resulting benchmark returns in the compliant presentation may differ from any benchmark returns published by the benchmark provider. As such, it is recommended to disclose this fact when performing any currency conversion of benchmark data.

Sample Disclosure: *Sources of foreign exchange rates may be different between the composite and the benchmark; however, there have been no material differences to date.*

b. *Currency Hedging:* Indexes can be hedged, unhedged, or partially hedged against movements in spot currencies. If a hedged or partially hedged benchmark is used, the hedging criteria for the benchmark must be disclosed. (It is expected that the hedging criteria for the composite is disclosed in the composite description.) Hedging can be used for a number of purposes (e.g., eliminate currency effects, add alpha). Any difference in hedging between the composite and the benchmark that the firm deems material must be disclosed. The firm should create a policy for materiality and apply it consistently.

Sample Disclosure: *The XYZ European Equity Index is 50% hedged to the US dollar. The ABC European Equity Composite maintains a 45%-55% hedge to the US dollar.*

Question 3: Do you agree that the hedging criteria for the benchmark must be disclosed? Do you agree that it should be required that any material difference in hedging between the composite and the benchmark be disclosed?

Yes, the hedging criterion for the benchmark is critical information for the investor as differences in hedges will materially impact the performance. Since the firm determines materiality as well as the composite definitions and criteria for membership there should be minimal deviations between a composite hedge % and the benchmark; however any material differences should be noted.

c. *Geographical Exposure:* Although investment markets are becoming more global in nature, many regions and countries have biases toward economic trends or certain industry sectors. For example, the Pacific region and the emerging markets region traditionally tend to have different risk profiles from those of developed markets, and the Australian market is concentrated around natural resource sectors.

d. *Breadth or Concentration of the Index:* A greater number of constituents in an index will make the benchmark less concentrated, although even with a broader market index there can be significant weightings in some companies and industries if constructed via market capitalization.

e. *Asset Mix:* The asset mix often reflects the neutral, long-term asset allocation of the composite's investment strategy. Investors can improve long-term risk–return characteristics by diversifying their portfolios across asset classes that are negatively correlated. If the asset mix of the investment strategy does not reflect that of the benchmark, there are likely to be large differences in returns over time.

f. *Style:* This should match the composite's strategy. For example, a growth composite is most likely better suited to a growth index, whereas a composite in which the investment style moves between growth and value companies would warrant a broader index that captures both investment styles.

g. *Sector:* It is advisable to choose a benchmark with a similar sector concentration to the long-term investment strategy the firm is using because the dispersion between sector returns can be significant (e.g., information technology in the technology boom/bust or financials in the 2008 crisis). Benchmarks can be defined at various levels of sector granularity based on the industry classifications of index providers.

h. *Net/Gross Withholding Tax Returns*: 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 impact of withholding taxes when calculating performance. The GIPS standards 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. If withholding taxes are material, firms must disclose how withholding taxes are treated when calculating performance.

   Composite total returns include the recognition of income, which may be gross or net of withholding taxes. As a result, the benchmark should reflect income on similar terms. For international indexes for which withholding taxes may be incurred, index vendors often offer both gross of withholding tax and net of withholding tax options. If both options are available, firms must select the benchmark that is most consistent with the withholding tax status of the portfolios in the composite. Firms must disclose if benchmark returns are net of withholding taxes if this information is available.

Sample Disclosure: *Portfolio returns are net of all foreign non-reclaimable withholding taxes. Reclaimed taxes are recognized when and if received. Benchmark returns are net of withholding taxes from a Luxembourg tax perspective.*

Question 4: Do you agree that firms should be required to select the benchmark that is most consistent with the withholding tax status of the portfolios in the composite?

This can be difficult to achieve in practice. Within a single composite there can be multiple portfolios with different taxes due to the client's domicile or entity type, as well as different custodian banks and reclaim processes.

If both options are available, and it is clear which benchmark is more consistent, then the firm must use that version of the benchmark (e.g., if a firm does not net down for withholdings taxes in their composite, using a net benchmark would be misleading). However, if a firm calculates composite returns net of non-reclaimable withholding taxes, then it should be up to the firm which benchmark to use and firms must disclose if benchmark returns are net of withholding taxes if this information is available.

i. *After-Tax Benchmarks:* Firms may choose to present performance that takes into consideration the effect of all taxes on the portfolios in the composite. When showing after-tax performance, firms are encouraged to present benchmark returns that are consistent with the timing of investments and tax rates applied to the portfolios in the composite.[1]

j. *Custom Net-of-Fees Benchmarks:* To provide a comparison of composite net-of-fees returns to the benchmark, some managers elect to present a custom net-of-fees benchmark. Some firms use the annual management charge (AMC), others use the total expense ratio (TER), and some use the bundled fee. Additionally, fees can vary by client type. Some index providers offer customized net-of-fees benchmarks. Alternatively, some firms calculate their own custom net-of-fees benchmark returns. Firms may also choose to present custom benchmarks that reflect the deduction of trading costs. If a net-of-fees and/or trading costs benchmark is presented, the firm must disclose the fee schedule and/or trading costs used to derive the benchmark returns and must disclose that it is a custom benchmark. Such benchmark returns may only be presented when the net-of-fees and/or trading costs composite returns are presented.

Question 5: Do you agree with the creation of custom benchmarks using fees and/or trading costs to provide returns comparable with the net-of fees and/or trading costs composite returns?

Yes, but the following must be done:

- **Present net of fee composite returns**
- **Fees applied to the composite must not be lower than fees applied to the benchmark**
- **If excess returns are presented, they must be based on the same return type (net or gross)**
- **Benchmark returns must be clearly labelled as net of fees**

Additionally, if gross of fee composite returns are shown, then we recommend presenting the unadjusted benchmark.

Question 6: Do you agree that if a net-of-fees and/or trading costs benchmark is presented, the firm should be required to disclose the fee schedule and/or the trading costs used to derive the benchmark returns?

Yes

k. *Frequency of Rebalancing:* When a benchmark is a blend of two or more indexes, it is important to consider the frequency of rebalancing and its potential impact. The frequency of portfolio rebalancing may be defined by the client or the firm and can be triggered by different factors, such as timing or a shift in the asset mix caused by market movement. However, frequent rebalancing can result in increased turnover and trading costs in the portfolio, which are not a consideration of benchmarks. Less frequent rebalancing can lead to an unintended shift in asset mix during steadily rising or falling markets.

For custom blended benchmarks, if a client mandates that a firm rebalance on a certain interval, then the benchmark *should* align with that. If a firm has discretion over when to rebalance (and can add alpha through its rebalancing techniques, e.g., asset allocation strategy) then the firm *should* come up with a consistent rebalancing methodology that enables them to measure that alpha.

Market indexes are rebalanced on a regular basis and a firm has no control over this frequency. It is important to understand the benchmark's rebalancing policies to appropriately manage the results of the portfolio in comparison. A blended benchmark's rebalancing policy must be disclosed and any difference in rebalancing policy between the investment strategy and the benchmark should also be disclosed.

It's a little confusing to switch back and forth between custom blended benchmarks and market indices. We suggest separating these topics clearly within letter k.

l. *Other Considerations:* Additional considerations when selecting a benchmark include the following:

- The liquidity of the constituents of the benchmark. It may prove easier to manage a strategy against a benchmark with more liquid securities.
- When and how valuations are established for the benchmark and the portfolios in the composite. There may be differences in the timing used for prices and exchange rates of the constituents of the index between index providers. There may also be differences in the pricing process used, especially for less liquid securities.
- The way the benchmark is constructed (e.g., GDP-weighted, market-cap-weighted, price-weighted). Firms should consider the weighting structure of constituents within the benchmark. Different weighting methodologies are now increasingly available in the market and firms will need to consider the relevance of the weighting structure of the benchmark selected to the management of the composite strategy.

It should be noted that there are fundamental differences between a portfolio and its benchmark. A portfolio incurs transaction costs and the benchmark performance does not take these into consideration. A portfolio may be permitted to engage in alpha-generation functions, such as stock lending, to improve its performance whereas a benchmark does not. One exception might be an ETF that is used as a benchmark. Many ETFs do engage in stock lending and also incur transaction costs.

Private Equity and Real Estate

The committee suggests organizing this section by including 2 sub sections:

- **Private equity and closed-end real estate**
- **Open-end real estate**

Right now, the Guidance Statement discusses the first two, but then later on creates a separate section for all real estate which is confusing.

Firms may encounter certain challenges when selecting and presenting private equity, real estate, and alternative strategies benchmarks.

Private Equity and Closed-End Real Estate

Private equity and closed-end real estate composites are made up of closed-end, fixed-life, fixed-commitment portfolios that have no client-driven external cash flows. Firms must present a since inception internal rate of return (SI-IRR) for these composites and their benchmarks.

The last sentence above omits the fact that real estate closed-end strategies must present TWRR. Suggest removing that sentence and replacing it with the below. Also, please note that the committee moved the real estate language from the sub section titled "Real Estate" below to here.

~~Firms must present a since inception internal rate of return (SI-IRR) for these composites and their benchmarks.~~ Firms must present a since inception internal rate of return (SI-IRR) for private equity composites and their benchmarks. For closed-end real estate fund composites, the following performance metrics are required: SI-IRR, total time-weighted rate of return (TWRR), and capital and income TWRRs. When an appropriate benchmark for the composite does exist, it is possible that not all of these metrics are available. Firms are recommended to present the component returns of the benchmark, if available. In addition, the GIPS standards

require that the SI-IRR benchmark has the same vintage year as the composite vintage year.

Additionally, the committee believes an additional requirement should be added to ensure the benchmark is using the same methodology to determine the vintage year (first cash flow or the first close of capital commitments)

Standard public market indexes may be appropriate benchmarks for private equity and closed-end real estate composites. However, public market indexes are typically calculated using a time-weighted return. If a firm chooses to present a public market index, it should do so using the public market equivalent (PME) method as described below. Firms may also choose to present a non-PME benchmark as supplemental information.

The following sentence seems to recommend firms use the specific PME method described below. Suggest re-wording it as below.

If a firm chooses to present a public market index, it should do so using a public market equivalent (PME).

Benchmarks for private equity and **closed-end** real estate strategies are not widely available and are typically vintage year peer universes available only through commercial vendors. Firms may use public market indexes as benchmarks, but the public market indexes by themselves are not directly comparable to the SI-IRR of a private equity or closed-end real estate composite because of the different return methodology.

The PME method is when a public market index is used to create a comparable SI-IRR from a series of cash flows that replicate those of the composite and that can be compared to the SI-IRR of the composite. Firms that choose to present a composite's PME as a benchmark must disclose the index used to calculate the PME. There are several ways to calculate a PME, but a common method is to invest the composite's external cash flows in a public market index to create a hypothetical investment that earns the returns of a public market index. By combining the composite's cash flows with the hypothetical investment, firms can calculate the IRR of a benchmark to which the composite's SI-IRR is comparable. Firms may choose the PME benchmark calculation method they consider appropriate provided that the method is applied consistently. Given the bespoke nature of PME benchmarks, they will be unique to the composite.

Some PME benchmark calculation methods are known to fail to produce a result under certain patterns of external cash flows. Firms have the option not to present any benchmark if the firm determines no appropriate benchmark for the composite exists. Firms must disclose why no benchmark is presented.

Sample Disclosure for Non-PME Benchmark: *The benchmark is the SI-IRR for the ACME Advisory US Venture Capital Funds Universe – 2008 Vintage Year. The vintage year is determined by the date of first capital call for each fund in the universe.*

Sample Disclosure for Private Equity 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 for which a public market index is used to create an SI-IRR that is comparable to a composite's SI-IRR 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.*

Sample Disclosure for Closed-End Real Estate PME Benchmark: *The benchmark is the public market equivalent (PME) of the Real Estate Publicly Traded ABC Index, which tracks the performance of* *moderate to highly leveraged diversified real estate investments in the United States. The PME is an index comparison method for which a public or private market index that is calculated using time-weighted rates of return is used to create an SI-IRR that is comparable to a composite's SI-IRR 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 or private market index using the dates and amounts of actual composite cash flows.*

Real Estate: ~~**For closed-end real estate fund composites, the following performance metrics are required: SI-IRR, total time-weighted rate of return (TWRR), and capital and income TWRRs. When an appropriate benchmark for the composite does exist, it is possible that not all of these metrics are available. Firms are recommended to present the component returns of the benchmark, if available. In addition, the GIPS standards require that the SI-IRR benchmark has the same vintage year as the composite vintage year.**~~

Sample Disclosure for Open-End Real Estate Composite: *The ABC Benchmark returns have been taken from published sources. The ABC Benchmark is leveraged, includes various real estate property types, and excludes cash, cash equivalents, and other non-property-related assets, liabilities, income, and expenses. The extent of leverage used by the Benchmark may be different from that of the portfolios in the composite. As of 31 December 2011, the Benchmark leverage was 52%.*

As discussed, the sample disclosure above should be moved under a sub section called open-end real estate. Also, real estate indices such as the NCREIF Fund Indices do <u>include</u> cash as part of the fund's holdings. Therefore, the sentence which says "and excludes cash, cash equivalents, and other non-property-related assets, liabilities, income, and expenses" is not appropriate. The NCREIF property indices do exclude cash, payables, receivables, etc., but we don't believe that is an appropriate example to use in the sample disclosure.

Sample Disclosure for Closed-End Real Estate Composite: *The ABC Benchmark is a time-weighted return index and returns have been taken from published sources. The Benchmark is leveraged and includes various real estate investment and property types, cash and other non-property-related assets, liabilities, income, and expenses. The extent of leverage used by the Benchmark may be different from that of the fund in the composite. As of 31 December 2011, the Benchmark leverage was 60%. There is no SI-IRR benchmark available for the 2006 vintage year.*

Move the sample disclosure above to the closed-end real estate section. Also suggest providing the reason why a SI-IRR is not presented at the beginning of the sample disclosure instead of at the end.

Alternative Strategies

Smart Beta: This defines a set of investment strategies that emphasize the use of alternative index construction rules applied to traditional market capitalization–based indexes. Smart beta emphasizes capturing investment factors or market inefficiencies in a rules-based and transparent way.

Sample Disclosure: *The Smart Beta Composite is managed against the Nasdaq Nordea Smart Beta Dividend Momentum TR Index. This index is a transparent, rules-based equity strategy index aimed at providing exposure to high dividend yield and low volatility. The index follows a systematic selection approach in which the first step is a liquidity screening. The securities that meet the liquidity screening test are then ranked according to highest dividend yield measured over the last 12-month period. The* *securities that rank among the top 50 are subsequently ranked according to highest momentum measured over the last 12-month period. Finally, the securities that rank among the top 30 are selected.*

This seems to imply that smart beta strategies should be measured versus the index that reflects the smart beta strategy in it. Shouldn't it be compared to the unaltered market cap index? Smart beta strategies are essentially like quantitative active strategies. Typically quantitative active strategies are measured versus a market index.

Liability-Driven Investing (LDI): LDI strategies are highly customized investment strategies for which the main objective is to gain sufficient assets to meet current and future liabilities. Standard public market indexes are generally not appropriate benchmarks for LDI strategies. Benchmarks for LDI strategies are typically constructed of a bespoke set of securities designed to match a client's defined liability stream. The liability stream may be based on actuarially estimated characteristics, such as duration and convexity, without reference to specific securities. For example, a benchmark for a UK-based pension portfolio is a ladder of UK government bonds for which the cash flow stream matches the liability stream of the portfolio. The ladder of UK government bonds is a better match of the portfolio's liabilities than a broad all government bond benchmark published by an index provider. For a composite that includes multiple LDI portfolios, a portfolio-weighted composite benchmark is often used.

Sample Disclosure for Single Portfolio LDI Composite: *The XYZ Composite is measured against a custom benchmark calculated by overlaying the client's liabilities on a US Treasury zero curve. The benchmark represents this client's specific liability stream matching and may not be indicative of custom benchmarks derived for other clients.*

Sample Disclosure for Multi-Portfolio LDI Composite: *The XYZ composite is measured against a blended benchmark, rebalanced monthly, combining the individual account benchmarks at the same weights as the account weights in the composite. As of December 2016, the benchmark consisted of 61.3% ABC US Long Credit Index, 23.5% ABC Long Corporate Index, 7.1% ABC Long Corporate Index with 2% Issuer Cap, 2.1% ABC Long Corporate A or better, and 5% ABC Long Baa US Corporate, and the remainder is in various other long-duration benchmarks, each representing less than 2% of the total blend. The breakdown of the custom benchmark for different time periods is available upon request.*

Unconstrained: An unconstrained strategy allows a firm to invest across many classes and sectors, and can be opportunistic, go-anywhere strategies. As a result, these types of strategies may be measured against a risk-free rate or target benchmark (e.g., Libor+2%) rather than a public market index. When using a risk-free rate or target as a benchmark, the requirement to present the three-year composite and benchmark standard deviations would highlight the difference in risk between the strategy and the benchmark. Alternatively, the firm can determine that there is no appropriate benchmark and, as such, disclose the reason why no benchmark is presented.

Sample Disclosure: *No benchmark is presented for the XYZ composite because it is managed with an absolute return objective and, as a result, is not managed against a specific benchmark and is not expected to be correlated with any particular market index.*

Sample Disclosure: *The Absolute Return composite invests in stocks both long and short regardless of country of domicile or market capitalization. The composite benchmark is the T-bill rate, which is the hurdle rate, and is composed of materially different investments.*

Long/Short strategies: A long–short strategy involves buying investments that are expected to increase in value and selling short those that are expected to decrease in value. As such, the overall portfolio profits from both market increases and declines and may have a net market exposure of less than 100%. Benchmarks for this type of portfolio should reflect the strategic market exposure of the portfolio.

Sample Disclosure: *The XYZ Composite has a strategic benchmark of 80% FTSE World and 20% Libor although the actual exposure to the FTSE World will vary between 50% and 100%.*

Overlays: Please refer to the (Draft) Guidance Statement on Overlay Strategies.

Total Return vs. Price-Only Return Benchmarks

The GIPS standards require that all composite and benchmark returns are presented as total return in a compliant presentation. This is required because it can be misleading to compare a composite return that includes income (i.e., a total return) against a benchmark return that does not also take in income (i.e., a price-only return). In this instance, the price-only benchmark return will be lower than a total-return benchmark and thus will artificially inflate the relative composite return.

There are some asset classes that do not create income (e.g., commodities), and so the total return and price-only return for such asset classes will be identical. An index composed solely of these assets will also have an identical total return and price-only return. These indexes are considered to be total return indexes under the GIPS standards.

Question 7: Do you agree with the proposed treatment of price-only benchmark returns?

Yes

Income Sweeping

Some clients require income distributions to be paid to them directly and they are not included in the portfolio's transactions. In this scenario, firms should generate the income transactions in the portfolio and then balance these transactions using cash withdrawals. This workaround may show a very small difference in performance compared with portfolios that retain the income for reinvestment. Total return benchmarks assume the reinvestment of income. Although this solution may address the recognition of income in the portfolio return, it does not address the incremental return arising in the future from the reinvestment of income. In this instance, however, a total return benchmark must be presented.

This sentence is not true:

Although this solution may address the recognition of income in the portfolio return, it does not address the incremental return arising in the future from the reinvestment of income.

Because time weighted returns are compounded, even if the income is taken out (like a cash flow) the return should be the same as if the income was reinvested pro-rata in the portfolio. The Committee has provided an example in Excel to illustrate this.

Benchmark Changes

Firms must disclose any changes to the composite benchmark over time. A composite benchmark change can take two forms:

- The composite benchmark is changed from one benchmark to another at a given point in time, perhaps as a minor strategy change (i.e., prospectively)
- The composite benchmark is changed for all periods (i.e., retroactively).

In most cases, the firm should only change the composite benchmark prospectively and not change it retroactively. However, 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 representation of an investment strategy, the firm may consider changing the benchmark retroactively. The firm must disclose the date the benchmark is changed, the description of the change, and the reason for the change. The firm must disclose that the benchmark has been changed retroactively. In addition, firms are encouraged to continue to present the old benchmark. If the firm changed a benchmark retroactively, it is important that the disclosure of the change remain in the compliant presentation for as long as it is meaningful. If appropriate, the firm must create a policy for determining the length of time that retroactive benchmark changes are disclosed, and apply that policy consistently.

If a benchmark has changed prospectively, firms must disclose the date of, description of, and reason for the benchmark change for as long as returns for the old benchmark are included in the compliant presentation.

For GIPS 2020, a distinction should be made here between a typical separate account manager (where the client chooses their own benchmark and the firm is responsible for choosing the composite benchmark), and a mutual fund or ETF (where a client may want to sell out of the fund when a benchmark is changed). In the latter case, advance notification should be given before a benchmark change is made.

Question 8: Do you agree that if a firm changes a benchmark retroactively, the disclosure of the change should be required to be included in the compliant presentation only for as long as it is meaningful as per the firm's policy and the disclosure can be removed once it is no longer meaningful?

Yes, ideally the firm is changing the benchmark for a valid reason and the new one is more appropriate. We recommend including a 12 month sun-setting provision (similar to error guidance and composite name change).

If a firm uses a custom benchmark that is a blend of two or more benchmarks, a change in the weights of the constituent benchmarks is not considered a benchmark change within the scope of this requirement. For example, the benchmark may change every quarter as part of the normal procedure. In this instance, it is appropriate to disclose that the benchmark is rebalanced quarterly using the weights of the asset classes in the model portfolio. A firm is not required to disclose how the asset class weights have changed each quarter but may do so. If a firm uses a custom benchmark or combination of multiple benchmarks, the firm must disclose the benchmark components and weights that each component represents as of the most recent annual period end. The firm should also offer to provide this information for prior periods on request.

Firms must not make changes to the benchmark primarily intended to make performance look better by lowering the benchmark return.

Example:
A firm may consider changing a benchmark if the strategy of the composite transitions and is better suited to an alternative index.

Sample Disclosure: *Benchmark results presented are a combination of two indexes. ABC Index was used prior to 30 September 2010; ABC Value Index is used subsequently. This change was made to better align the benchmark with the composite's increasing value tilt.*

Multiple Benchmarks

It is permissible to include more than one benchmark within a compliant presentation. For example, a firm has a single investment process for its UK equity strategy and implements this strategy for clients with similar benchmarks (e.g., FTSE Allshare and Freedom All Stock). The composite is based on the investment process, so the firm discloses the returns of both benchmarks in the compliant presentation with equal prominence. Any and all benchmarks provided within a compliant presentation (including supplemental information) must adhere to the requirements and recommendations of the GIPS standards. The firm may distinguish composite benchmarks as primary or secondary, and so on, but the GIPS standards do not differentiate between primary and secondary or other benchmarks. For example, firms must disclose

- a description for all composite benchmarks.
- reasons for a change to (or deletion of) any composite benchmark.
- the three-year standard deviation of all composite benchmarks.

If the firm distinguishes between primary and secondary benchmarks, it must disclose when these designations change (e.g., if a primary benchmark becomes a secondary benchmark). For example, a firm designates the primary benchmark of its composites to be the market index and the secondary benchmark to be the relevant peer group. In all instances, if there are multiple composite benchmarks and one or more of the benchmarks is removed from the compliant presentation, the firm must disclose this fact.

Please see the section on Supplemental Information for the treatment of benchmarks when they are labeled as such.

Question 9: Do you agree that firms must disclose changes to benchmark ordinal (primary, secondary)?

Yes, we agree that a change in the order should be disclosed because firms sometimes use only the primary index in other parts of their marketing materials (e.g., include primary and secondary in compliant presentation but only primary in the body of the presentation).

Also, it should be clearly stated that the outcome of question 8 should apply to the removal of a secondary or tertiary benchmark as well. Currently, the below sentence is included, but more clarity could be given that the principles from a single benchmark apply to secondary or tertiary benchmarks as well.

> ***"In all instances, if there are multiple composite benchmarks and one or more of the benchmarks is removed from the compliant presentation, the firm must disclose this fact."***

Also, if a firm decides to later add a secondary benchmark, either prospectively or retroactively are they required to disclose the date and reason for the addition? For example, let's say a firm has a fixed income composite with 6 portfolios that use Bloomberg Barclays indices and 2 portfolios that use Merrill. The composite uses the Bloomberg Barclays over time, the Bloomberg Barclays portfolios close and the portfolios that use Merrill index remain open. The Portfolio Managers feel that since the majority of the composite is using a different index than the composite, that the Merrill index should be added to the composite presentation. If a firm adds Merrill as the secondary benchmark, do they disclose that they do that it was added as of a certain date?

Data Sources

For periods beginning on or after 1 January 2011, firms must disclose and describe any known material differences in exchange rates or valuation sources used among the portfolios within a composite, and between the composite and the benchmark. Firms should also disclose any known material difference in pricing sources used among the portfolios within a composite and between the composite and the benchmark.

Sample Disclosures:

Exchange rates used for the benchmark are WM/Reuters Closing Spot Rates at 1600 hours London time;

the composite uses WM/Reuters Closing Spot Rates at 1600 hours New York time.

All portfolios within the composite are valued using WM/Reuters 4:00 p.m. (London) exchange rates and XX valuation sources. Mutual funds within the composite are also fair valued as of 4:00 p.m. (New York) if markets have materially changed after the London close. The XYZ Benchmark is valued as of 4:00 p.m. (London).

In an effort to reduce the size of disclosures, perhaps only disclose when material.

Off-Benchmark Assets

A good way of understanding the role of the benchmark in an investment strategy is to know how much the firm can invest in assets not held within the composite benchmark (off-benchmark assets). Depending on the role of the benchmark (benchmark relative, benchmark aware, or benchmark neutral), the percentage of off-benchmark assets can provide important information about the appropriateness of the benchmark to the strategy. As such, firms may consider disclosing the percentage range that the strategy is allowed to deviate from the composite benchmark. Firms should disclose material differences between the benchmark and the composite's investment mandate, objective, or strategy.

Sample Disclosure: *Portfolios in the composite are allowed to hold up to 20% of securities not found in the XYZ benchmark.*

Benchmark Description

The GIPS standards require that firms must disclose the benchmark description in each compliant presentation. The benchmark description is defined as general information regarding the investments, structure, and/or characteristics of the benchmark. The description must include the key features of the benchmark or the name of the benchmark for a readily recognized index or other point of reference. Each firm must decide for itself whether a benchmark is widely recognized. If the firm is not certain about whether the benchmark is widely known, the firm must include the benchmark description. An index that is readily recognized in some markets (e.g., ISEQ in Ireland) may not be readily recognized outside of the local market. It is the firm's responsibility to ensure that any potential prospective clients receiving a compliant presentation will be familiar with the benchmark if only the benchmark name is provided. If the firm is uncertain about whether the benchmark is readily recognized by any potential prospective client, the firm must include the benchmark description. For example, compliant presentations on company websites must have the benchmark description. The reason is because the firm may have little or no control over who might access the compliant presentations and therefore the firm will be unable to determine whether the benchmark is readily recognizable to the prospective client accessing the website. While it is acceptable to produce compliant presentations with different benchmark descriptions dependent on the prospective client, it is operationally simpler to provide a consistent benchmark description in all compliant presentations for a composite.

Question 10: Do you agree that firms should be allowed to present the name of the benchmark for a readily recognized index or other point of reference instead of presenting the full benchmark description?

Yes, but as pointed out this becomes onerous operationally, and the costs to the firm would likely outweigh the benefits.

Question 11: Do you agree that if the firm is uncertain about whether the benchmark is readily recognized by any potential prospective client, the firm should be required to include the benchmark description?

Yes

Standard Deviation and Other Risk Measures

Evaluating past performance requires an understanding of the risks taken to achieve the results and so the GIPS standards require the presentation of "external standard deviation," which is a measure that quantifies the variability of the composite and benchmark returns over time.

For periods ending on or after 1 January 2011, firms must present the three-year annualized ex-post standard deviation (using monthly returns) of both the composite and the benchmark. If 36 monthly returns are not available for the composite, firms are not required to present the ex-post standard deviation for either the benchmark or the composite.

The title includes "Other Risk Measures" but there is no discussion of other risk measures. Standard 5.A.2.b should be referenced here:

> ***Provision 5.A.2 For periods ending on or after 1 January 2011, firms must present, as of each annual period end:***
> ***a. The three-year annualized ex-post standard deviation (using monthly returns) of both the composite and the benchmark; and***
> ***b. An additional three-year ex-post risk measure for the benchmark (if available and appropriate) and the composite, if the firm determines that the three-year annualized ex-post standard deviation is not relevant or appropriate. The periodicity of the composite and the benchmark must be identical when calculating the ex-post risk measure.***

Error Correction

Please refer to the Guidance Statement on Error Correction. It should be noted that an error is defined as any component of a compliant presentation that is missing or inaccurate and, as such, this includes all benchmark information.

Advertisement Prepared in Accordance with the GIPS Advertising Guidelines

Firms must consider the benchmark-related requirements in the GIPS Advertising Guidelines.

The benchmark presented in the advertisement must be consistent with the benchmark presented in the compliant presentation. If more than one benchmark is included in the compliant presentation, firms should consider whether multiple benchmarks should be presented in the advertisement. Only benchmarks presented in the compliant presentation may be presented in an advertisement.

In addition to presenting benchmark total returns, firms must also disclose the benchmark description. This disclosure must be consistent with the disclosure of the benchmark description included in the corresponding compliant presentation unless the disclosure included in the advertisement is a more current benchmark description that has not yet been reflected in the corresponding compliant presentation. It is not expected that this disclosure would differ from the disclosure required in the corresponding compliant presentation.

The GIPS standards require firms to present total returns for a benchmark that reflects the investment mandate, objective, or strategy of the composite. In instances where no benchmark is provided because an appropriate benchmark does not exist, the firm must explain why no benchmark is presented. This disclosure must be consistent with the disclosure required in the corresponding compliant presentation unless the disclosure included in the advertisement is more current and has not yet been reflected in the corresponding compliant presentation. It is not expected that this disclosure would differ from the disclosure required in the corresponding compliant presentation.

Supplemental Information

Supplemental information is defined as any performance-related information included as part of a compliant presentation that supplements or enhances the required and/or recommended provisions of the GIPS standards. For example, a smart beta composite would be benchmarked against a smart beta index and, as such, the compliant presentation would contain information on that index. The firm may want to explain how the choice of the smart beta strategy has been beneficial by providing details on the opportunity cost associated with the choice of a smart beta index versus a market-capitalization index with similar constituents. As such, the firm may decide to enhance the compliant presentation by providing a comparison of the strategy and the smart beta index versus the market index as supplemental information.

Including other index data as supplemental information can show the opportunity costs of investing in another strategy. For example, a fixed-income composite compliant presentation may include real estate, cash, or equity benchmarks as supplemental information. If other benchmarks are presented and labelled as supplemental information, all of the required benchmark disclosure and presentation items are required to be presented for all benchmarks included in the compliant presentation (please see the section on Multiple Benchmarks).

Question 12: Do you agree that if other benchmarks are presented and labelled as supplemental information, that all of the required benchmark disclosure and presentation items should be required to be presented for all benchmarks included in the compliant presentation?

Agree that if other benchmarks are presented within a compliant presentation, all of the required benchmark disclosures and presentation items should be required.

Other Marketing Materials

Composite benchmark returns should be included whenever composite returns are being presented. Firms must not present performance and/or performance-related information that is false or misleading.

Broadly Distributed Pooled Funds

Because there are some unique issues surrounding benchmarks for pooled funds, please refer to the Guidance Statement on Broadly Distributed Pooled Funds for the treatment of pooled funds' benchmarks.

Policies and Procedures

Firms must document policies and procedures used in establishing and maintaining compliance with the GIPS standards. This includes policies and procedures for complying with all benchmark-related requirements and any recommendations with which the firm chooses to comply. The following statements are found within the body of this document under their relevant sections, but are also included in this section for completeness:

The process for determining the benchmark for a composite should be maintained in the firm's policies and procedures.

Any difference in hedging between the composite and the benchmark that the firm deems material must be disclosed. The firm must create a policy for materiality and apply it consistently. If appropriate, the firm must create a policy for determining the length of time that retroactive benchmark changes are disclosed, and apply that policy consistently.

Effective Date

Firms are required to apply this guidance beginning on or after 1 January 2019. Firms are encouraged, but not required, to apply this guidance prior to the effective date.

This guidance statement does not address multi-asset strategies for private wealth and robo-advisors.

In the institutional world, the client typically defines the strategic asset allocation. Benchmarking is easy – it's simply the strategic asset allocation – and the manager's skill is measured based on their tactical asset allocation and any other active management. However, in the private wealth / robo-advising space, the manager comes up with the strategic asset allocation based on the client's time horizon, risk, and tax consequences. How do you measure if the manager did a good job?

In practice, many managers use an asset weighted blend of the asset classes in the portfolio, but then the excess return doesn't capture the asset allocation decision. Should it be a return target? See the mention of GIPS in the below blog.

https://www.kitces.com/blog/the-problems-with-trying-to-benchmark-unconstrained-portfolios-guest-post/