CFA Institute®
Global Investment
Performance Standards

GUIDANCE STATEMENT ON WRAP FEE PORTFOLIOS

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GUIDANCE STATEMENT ON WRAP FEE PORTFOLIOS

Introduction

The purpose of the Global Investment Performance Standards (GIPS®) is to create performance presentations that allow for greater comparability of returns and increase the transparency of information provided to prospective clients and prospective investors. Although it is impossible to develop standards that cover every situation, the GIPS standards provide a general framework that can be applied to many different circumstances. It is important to remember the underlying principles of the GIPS standards: fair representation and full disclosure.

To provide prospective clients with a variety of investment options, firms offer different types of investment products/services as well as fee structures. One of these structures offers clients the ability to "bundle" multiple fees incurred during the management of a portfolio (i.e., bundled fees).

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

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

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

Wrap fee portfolios are unique and significantly different from traditional brokerage or investment management relationships. As a result, additional guidance is necessary for firms managing wrap fee portfolios on how to apply the GIPS standards.

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Scope

This Guidance Statement is applicable to those GIPS-compliant firms that have discretionary portfolio management responsibility for wrap fee portfolios. The wrap fee provisions and related guidance apply to the calculation and presentation of performance when presenting a GIPS Composite Report to a wrap fee prospective client, which includes prospective wrap fee sponsors, prospective wrap fee clients, and current wrap fee sponsors.

Although there are different types of wrap fee structures, the wrap fee provisions and related guidance apply to all wrap fee portfolios in which there are bundled fees and the wrap fee sponsor serves as an intermediary between the firm and the end user of the investment services. The wrap fee provisions and related guidance are not applicable to portfolios defined as other types of bundled fee portfolios. These provisions and related guidance are also not applicable to model portfolios provided by a firm to a wrap fee sponsor if the firm does not have discretionary portfolio management responsibility for the individual wrap fee portfolios. Similarly, a firm or overlay manager in a multiple-strategy portfolio (MSP) or similar program is also excluded from applying the wrap fee provisions and this guidance to such portfolios if it does not have discretion. For additional guidance on this topic, see the section titled "Determining Discretion for Wrap Fee Portfolios, Including Unified Management Accounts (UMAs)."

All wrap fee GIPS Composite Reports that include performance results for periods beginning on or after 1 January 2006 must meet all the applicable requirements and guidance.

This guidance does not impose any specific additional requirements for a firm to monitor the use of its performance information once it has provided that information to a third party; however, as in all situations where a firm's performance information is distributed by a third party, the firm should take appropriate measures to ensure that its performance is not misrepresented or used in a misleading fashion.

Application of the GIPS Standards to Wrap Fee Portfolios

A number of complex issues relating to achieving fair representation and full disclosure exist for a wrap fee investment manager to calculate, maintain, and present performance results in compliance with the GIPS standards. These issues result in several challenges, including the following:

- A single fee is charged by a brokerage firm (often referred to as a wrap fee sponsor) for several combined services (e.g., advisory, trading, custody, and other services).
    - The firm typically has no involvement in or knowledge of the total fee charged by the wrap fee sponsor to individual wrap fee clients. The firm typically has knowledge of only the fees it receives for its investment management services.

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    - The GIPS standards require firms to deduct transaction costs from all returns. Because the total fee charged to wrap fee portfolios typically is determined by the sponsor, a wrap fee is difficult, if not impossible, for the firm to separate into parts in order to identify which portion is attributable to a specific service (e.g., 20% of the wrap fee is attributable to custody fees, 70% to investment management fees, 5% to transaction costs, and 5% to client reporting).
- The firm typically does not have a direct relationship with the end user of its wrap fee investment management services, even though these portfolios are often considered discretionary assets of the firm. Instead, this business model involves multiple parties (typically an investment management firm, a wrap fee sponsor, and an end user), with the wrap fee sponsor serving as the intermediary between the firm and the end user of the investment services.
    - Firms must have records to support performance presented to satisfy laws and regulations as well as the requirements of the GIPS standards; however, wrap fee sponsors typically maintain underlying portfolio records, and firms may not have access to those records.
    - The firm provides wrap fee sponsors with GIPS Composite Reports and other information, which the wrap fee sponsors may or may not use for presenting to wrap fee prospective clients.
    - The firm provides prospective wrap fee sponsors with GIPS Composite Reports and other information, which the prospective sponsors use to evaluate the firm. The wrap fee sponsor typically requires specific information from the firm that may or may not comply with the GIPS standards.

Guiding Principles

It is important for firms to consider the following guiding principles when determining the manner in which to apply the GIPS standards to wrap fee portfolios:

- Firms are required to comply with all applicable laws and regulations regarding the calculation and presentation of performance. This requirement includes laws and regulations relating to recordkeeping (e.g., having records to substantiate the performance record), which can be difficult to satisfy for some firms that manage wrap fee portfolios.
- The GIPS standards require that all returns must reflect the deduction of transaction costs incurred during the period. Firms may deduct actual transaction costs or estimated transaction costs. A firm may use estimated transaction costs only for those portfolios for which actual transaction costs are not known. In most cases, firms that wish to deduct actual transaction costs to calculate gross-of-fees returns will not be able to segregate the bundled fee into its component parts. If this is the case, the firm must deduct the total wrap fee or the

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portion of the total wrap fee that includes transaction costs when calculating gross-of-fees returns.

- Firms may wish to calculate performance history for presentation to wrap fee prospective clients using the gross-of-fees performance results for non–wrap fee portfolios managed to the same investment mandate, objective, or strategy, reduced by the highest wrap fee applicable to that product. This performance history can be presented in compliance with the GIPS standards because the performance of the investment strategy presented is based on actual assets managed by the firm and satisfies the underlying principles of fair representation and full disclosure.
- The firm must not exclude the performance of actual wrap fee portfolios when presenting performance to wrap fee prospective clients.

Definition of the Firm

For purposes of claiming compliance, the firm must be defined as an investment firm, subsidiary, or division held out to the public as a distinct business entity. A distinct business entity is a unit, division, department, or office that is organizationally and functionally segregated from other units, divisions, departments, or offices, and that retains discretion over the assets it manages. The business entity should have autonomy over the investment decision-making process. Possible criteria that can be used to determine what constitutes a distinct business entity include, but are not limited to, the following:

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

Organizations that have both a non–wrap fee division (e.g., institutional, private client, or mutual fund) and a wrap fee division should examine the alternatives for defining the firm according to the above definition. These alternatives apply both to organizations that are just entering into the investment management industry as well as to those that are simply expanding their operations to incorporate wrap fee products.

Benefits and drawbacks must be considered for each alternative definition. Possible scenarios include the following:

1. Define the entire organization as the firm, and the firm claims compliance with the GIPS standards.
2. Define the divisions separately, and either:
    a. the non–wrap fee division and the wrap fee division are defined as separate firms, and both claim compliance with the GIPS standards, or

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b. the non–wrap fee division and the wrap fee division are defined as separate firms, and only one division claims compliance with the GIPS standards.

1. *Define the entire organization as the firm, and the firm claims compliance with the GIPS standards.*

The GIPS standards recommend that firms adopt the broadest, most meaningful definition of the firm. If both the wrap fee and non–wrap fee divisions are held out to the public as one entity, in order to meet the objectives of fair representation and full disclosure, the GIPS standards require that the entire organization, including both the non–wrap fee and wrap fee divisions, be defined as the firm. The organization will likely benefit from this broad definition for the following reasons:

- Both the non–wrap fee and wrap fee portfolios are included in and increase total firm assets.
- The firm has the option to combine wrap fee and non–wrap fee portfolios managed according to a similar investment mandate, objective, or strategy in the same composite, provided that it makes additional required calculations and disclosures.
- Prior to the firm acquiring actual wrap fee portfolios, the firm can use the historical, non–wrap fee gross-of-fees performance history, adjusted to deduct the highest total wrap fee charged to the end user by the wrap fee sponsor, in order to calculate a wrap fee performance history.

However, the firm should also consider the following potential disadvantage of defining the entire organization as the firm: If the firm includes wrap fee portfolios in a composite that is presented to prospective clients other than wrap fee prospective clients, the firm must deduct the entire wrap fee from the performance of the wrap fee portfolios—unless the firm is able to identify and deduct either actual transaction costs charged to wrap fee portfolios or estimated transaction costs.

2. *Define the divisions separately.*

Organizations that choose to hold the divisions out to the public as separate and distinct entities must define those divisions as separate firms for purposes of compliance. The claim of compliance with the GIPS standards may be made solely by either division, or both divisions may claim compliance independently.

It is possible that the divisions of an organization may not be organizationally and functionally separate or independent of each other, but if:

- their operations and functions are distinct within the organization, and
- the divisions are held out to the public as distinct business entities,

the organization would be permitted to define one or both of the divisions as separate firms for purposes of compliance with the GIPS standards.

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For example: A legal entity has a division serving institutional clients and a division serving wrap fee clients. Each division is managed autonomously, and each has a distinct client type. The legal entity's marketing department decides that these two divisions will begin to use the same brand, regardless of client type, because of the significant cost savings in promoting a single brand.

Each division serves a distinctly different client type. The legal entity may define the institutional division and the wrap fee division as separate firms for the purposes of GIPS compliance if it wishes to do so, even if both divisions are operating under the same brand. The wrap fee and non–wrap fee divisions would have different firm names, even if operating under the same brand name (e.g., XYZ Wrap Fee Division and XYZ Institutional Division). However, the two firms must be consistently held out to the public as distinct business entities and be clearly defined to avoid potential confusion, particularly if one of the firms claims compliance with the GIPS standards but the other does not. A non-compliant firm must not receive any inappropriate benefit from a related firm's claim of compliance. When a firm jointly markets with other firms, the firm claiming compliance with the GIPS standards must ensure that the firm is clearly defined and separate relative to other firms being marketed and also that it is clear which firm is claiming compliance.

The potential disadvantage to defining the wrap fee and non–wrap fee divisions as separate firms is that neither division may use the other division's performance or assets.

Determining Discretion for Wrap Fee Portfolios, Including Unified Management Accounts (UMAs)

Wrap fee programs are offered by brokerage firms (often referred to as wrap fee sponsors). These programs give investors access to numerous investment managers through one platform. Wrap fee sponsors charge a single "wrap" or "bundled" fee for several combined services (e.g., investment management, trading, custodial, and other administrative services). An investor selects the investment manager (i.e., the firm) whose strategy appears to best suit his or her needs, and the firm assumes responsibility for managing the investor's wrap fee portfolio. The firm typically has full discretion to manage the wrap fee portfolio, and the wrap fee sponsor handles trade execution, custodial, and administrative services. For this type of wrap fee portfolio, wrap fee assets are discretionary and would be included in the firm's total firm assets.

Model delivery programs are a type of wrap fee program in which the firm does not direct trades and provides only a model portfolio to the wrap fee sponsor. From the firm's perspective, the service provided is characterized as investment advice because the firm has no control over whether the trades are executed as intended. Wrap fee assets included in model delivery programs would be considered advisory-only assets, because the firm is offering advice only and is not

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managing the account or directing trades. These assets would, therefore, not be included in total firm assets.

There is a type of wrap fee account called a Unified Managed Account (UMA) for which the determination of discretion, and whether or not the wrap fee portfolio should be included in total firm assets, are particularly challenging. A UMA program is similar to standard wrap fee programs in many ways. Investors have access to multiple managers through a single platform, and a single bundled fee is charged for a combination of services. The distinguishing feature of a UMA portfolio is the ability to combine multiple investment strategies into a single portfolio. A UMA portfolio may hold securities associated with multiple investment strategies and firms in one custodial or brokerage account.

Although firms generally dictate the investment strategy to be used for their designated portion of the assets in a UMA portfolio, their trading responsibilities can range from those of a standard wrap fee relationship to those of a model delivery program and often lie somewhere in between.

In a typical UMA program, the firm provides a model portfolio to the UMA platform and leaves the responsibility for executing trades to the wrap fee sponsor. In some UMA programs, the firm has discretionary authority to enter trades directly on the wrap fee sponsor's platform, although such an arrangement is not typical. It should also be noted that most UMA programs include an overlay component, whereby another firm (often the wrap fee sponsor) oversees the overall composition of, and coordinates all activity in, the wrap fee portfolio. This arrangement includes cash management (how cash will be distributed among the various firms) and asset allocation decisions (rebalancing or changing the asset allocation to each firm).

The discretion that a firm has regarding a UMA portfolio depends on the characteristics of the particular UMA program. Some UMA programs may be fully discretionary, others may have shared discretion between the wrap fee sponsor and the firm, and some may be model delivery only. Discretion may also be influenced by the presence and responsibilities of an overlay manager who may have the authority to override the firm's trading directives. Determining the level of discretion is important because it dictates whether the firm must include the UMA program assets in total firm assets. Because of the varying characteristics of different UMA programs, firms must evaluate each UMA program individually to determine whether its assets must be included in total firm assets.

The following are some factors to consider when determining whether to include UMA portfolios in total firm assets:

- The contract between the sponsor and the firm:
  - A contract that indicates that the firm has discretionary authority may suggest that the portfolios governed by the contract should be included in total firm assets. If so, the level of control the firm actually has should be assessed.

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- In the case of "dual contracts," in which the firm has contracts with both the sponsor and the client, a contract with the client that specifies that the firm has discretionary authority would support including the UMA portfolios in total firm assets.
- Trading authority:
  - The firm must have trading authority for the UMA portfolios to be included in total firm assets. Some possible scenarios include the following:
    - The firm submits trades to the wrap fee sponsor's platform, but the wrap fee sponsor has final approval before execution. The firm may determine that it retains sufficient trading discretion for the wrap fee portfolios to be included in total firm assets.
    - The firm does not execute trades but has contractual assurance that the trades submitted will be executed in a timely manner and receives confirmation of execution. A firm could determine that these UMA portfolios should be included in total firm assets.
    - The wrap fee sponsor is responsible for all trading and can freely decide to deviate from the firm's trading instructions. This is an advisory-only relationship, and the UMA assets must not be included in total firm assets.
- Authority at the portfolio level:
  - If the firm is making trading decisions on a portfolio-specific basis, this scenario indicates the firm has discretion. Inclusion of UMA assets in total firm assets is likely permitted.
  - If the firm does not have access to the data necessary to make decisions at the portfolio-specific level, the firm is likely to have limited authority over the portfolio and assets would not likely qualify for inclusion in total firm assets.

Because of the complexities that often exist in determining the level of discretion for a firm's UMA assets, it is common for firms to exclude UMA assets from total firm assets and treat these assets as advisory-only assets. Firms must review all UMA programs to determine if the assets should be included in total firm assets and, if included, whether the portfolios should be included in a composite.

Underlying Records

Firms have options for satisfying the GIPS standards requirement that all data and information necessary to support all items included in a GIPS Composite Report must be captured and maintained.

Some firms that manage wrap fee portfolios do not maintain or have access to the data necessary to substantiate portfolio-level performance. To satisfy this requirement of the GIPS standards, firms may choose to do the following:

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- Place reliance on the performance calculated and reported by the wrap fee sponsor. This can be done either on the aggregate level, effectively viewing the wrap fee sponsor as a single portfolio, or on the underlying wrap fee portfolio level. When relying on information provided by a third party (in this instance, the wrap fee sponsor), the firm claiming compliance with the GIPS standards must take the necessary steps to be satisfied that the information provided by the wrap fee sponsor can be relied on to meet the requirements of the GIPS standards.
- Use "shadow accounting" to track the wrap fee portfolios on their in-house performance measurement systems. Shadow accounting is the process of maintaining investment performance records for each portfolio that enables an investment management firm to determine beginning- and end-of-reporting-period values and cash flows.
- Exclude the wrap fee division from the definition of the firm (see the section titled Definition of the Firm above).

A firm claiming compliance with the GIPS standards is responsible for its claim of compliance and is responsible, as well, for reporting information in compliance with the GIPS standards to prospective clients. The firm must determine that the performance provided by the wrap fee sponsor can be used by the firm to satisfy the requirements of the GIPS standards, or the firm must maintain separate/duplicate records (e.g., use shadow accounting) that meet the requirements of the GIPS standards. Further, if the firm undertakes the verification process, the wrap fee portfolios are subject to the same level of testing as all other portfolios within the firm.

For periods beginning on or after 1 January 2006, the firm must maintain or have access to supporting records for all portfolios included in a composite. A lack of records is not a reason to classify portfolios as non-discretionary.

Constructing and Maintaining Composites for Wrap Fee Portfolios

Although a firm can use the same investment strategy for both wrap fee and non–wrap fee portfolios, the delivery of information about the strategy to the end user is what distinguishes wrap fee portfolios and necessitates additional guidance for creating and maintaining composites that include wrap fee portfolios.

If a firm claiming compliance with the GIPS standards wishes to present performance for a specific strategy to wrap fee prospective clients that the firm historically managed for *only* non–wrap fee portfolios, the firm definition must include both the wrap fee and non–wrap fee assets.

Prior to Managing Wrap Fee Portfolios

A firm may wish to present performance to wrap fee prospective clients for a specific strategy for which the firm does not yet manage wrap fee portfolios. In such a case, the firm must not

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present the GIPS Composite Report created for non–wrap fee clients. Instead, the firm must calculate a wrap fee performance history for that specific strategy by using that strategy's gross-of-fees non–wrap fee composite history reduced by the highest total wrap fee charged to the client (end user) by the wrap fee sponsor for the strategy (product).

The result is net-of-fees wrap fee performance. Note that this approach is permissible only if the firm has no wrap fee portfolios under management for the strategy during the time periods for which the firm compiles the wrap fee performance using only non–wrap fee portfolios.

Once a Firm Acquires One or More Wrap Fee Portfolios

Once a firm acquires one or more wrap fee portfolios for management, the firm must include the performance of the actual wrap fee portfolio(s) in a composite that reflects the specific strategy of the wrap fee portfolios in accordance with the firm's established portfolio inclusion policies. The firm must determine if it will combine wrap fee portfolios in a composite with non–wrap fee portfolios with the same strategy or if it will have a separate composite for non–wrap fee portfolios.

The firm has three options to consider:

1. Retain the calculated history that had been shown to clients prior to the acquisition of a wrap fee portfolio (i.e., the strategy's gross-of-fees non–wrap fee composite history reduced by the total model wrap fee), redefine the composite to include only actual wrap fee portfolios going forward, and include relevant disclosures related to the redefinition;
2. Continue to include the ongoing performance of the non–wrap fee portfolios and combine it with performance of actual wrap fee portfolios; or
3. Create a new composite that includes only wrap fee portfolios. The new composite will have no history prior to the date that wrap fee portfolios are first managed.

When presenting wrap fee performance to wrap fee prospective clients, the firm must choose one of these three options.

Firms must not redefine a composite on a retroactive basis. If a firm has chosen Option 2 and combines the ongoing performance of non–wrap fee portfolios with the performance of wrap fee portfolios, it may not retroactively strip those portfolios out of the composite at a later date in order to create a "wrap fee" composite history. At any point in time, however, the firm may choose to create a new composite that includes only wrap fee portfolios on a prospective basis. This composite would have no history prior to the composite creation date. The firm could then terminate the composite that includes both non–wrap fee portfolios and wrap fee portfolios if it wishes to do so.

When a firm manages only wrap fee portfolios for a specific strategy and does not manage any non–wrap fee portfolios for that strategy, it may wish to use the wrap fee history when presenting

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performance to non–wrap fee prospective clients. The firm may do so as long as the returns that are calculated meet any applicable requirements for calculating gross-of-fees and net-of-fees returns. For example, both gross-of-fees and net-of-fees returns must reflect the deduction of transaction costs.

Sponsor-Specific Composites

The 2010 edition of the GIPS standards included the concept of a sponsor-specific wrap fee composite for the internal use of a wrap fee sponsor only. A sponsor-specific wrap fee composite included only the wrap fee portfolios that were managed for the particular wrap fee sponsor. The concept of sponsor-specific wrap fee composites is considered to be client reporting to a specific wrap fee sponsor and has been eliminated in the 2020 edition of the GIPS standards. A wrap fee composite must include all wrap fee portfolios managed in a specific investment strategy and must not be limited solely to the wrap fee portfolios managed for a specific wrap fee sponsor. Prospective clients for a specific wrap fee strategy must receive information about all portfolios managed in that strategy. Firms that previously maintained sponsor-specific composites would terminate any sponsor-specific wrap fee composites. Firms may remove these composites from the list of composite descriptions and are not required to include them on this list as terminated composites. Sponsor-specific performance may still be used when creating materials for the use of a specific wrap fee sponsor, but such materials are considered to be client reporting and not a GIPS-compliant composite.

Calculating Pure Gross-of-Fees, Gross-of-Fees, and Net-of-Fees Returns

When presenting performance to a wrap fee prospective client, performance must be shown net of the entire wrap fee. This requirement applies to all wrap fee portfolios in the composite as well as any non–wrap fee portfolios that are included in the composite.

When using a model wrap fee, it is up to the firm to determine the appropriate highest wrap fee to deduct. This highest wrap fee should be obtained from the prospective wrap fee sponsor and should be comparable to the investment mandate, objective, or strategy of the wrap fee composite. The firm should make its best efforts to determine the wrap fee that will be charged by prospective wrap fee sponsors and use that fee as the model wrap fee. If the firm cannot determine the appropriate wrap fee to use, it may use as the model fee the generally assumed highest model wrap fee (currently 3.00% for equities and 1.50% for fixed income).

It is recognized that, when starting with the gross-of-fees non–wrap fee composite history, the gross-of-fees performance already reflects the deduction of actual transaction costs incurred. By then reducing the composite performance by the highest total wrap fee, which includes a portion attributable to transaction costs, performance will reflect the deduction of transaction

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costs twice (actual transaction costs and a portion of the highest wrap fee). If the firm can identify the portion of the highest total wrap fee attributable to transaction costs, or if the firm can estimate appropriate transaction costs, the firm may first calculate performance reflecting the deduction of both transaction costs and the highest wrap fee. The firm may then increase this result by the identifiable portion of the wrap fee attributable to actual or estimated transaction costs in order to compute a net-of-fees return.

"Pure" gross-of-fees returns, which represent the return on investments that is not reduced by any transaction costs incurred during the period, are permitted only as supplemental information in a GIPS Composite Report and must be clearly labeled as such. Firms may present pure gross-of-fees returns as supplemental information in addition to the required net-of-fees returns.

The following table describes the various returns that can be calculated for wrap fee portfolios: (Note that if a firm wishes to use a wrap fee track record for non–wrap fee prospective clients, the calculations would be the same as described for "Presenting to Current Wrap Fee Sponsors and Clients When Unbundling Wrap Fees.")

Examples of Gross-of-Fees and Net-of-Fees Calculations

Non-wrap Composite	**Presenting to Current Wrap Fee Sponsors and Clients When Unbundling Wrap Fee**	**Presenting to Prospective Wrap Fee Sponsors and Clients**
Return on investments ("pure gross")[a]	Return on investments ("pure gross")[a]	Return on investments ("pure gross")[a]
– Transaction Costs	– Portion of wrap fee that includes transaction costs that can be segregated *Or* – Estimated transaction costs	
Gross-of-fees return	**Gross-of-fees return**	
– Investment management fee	– Portion of wrap fee that includes an investment management fee that can be segregated *Or* – Model investment management fee	– Model wrap fee *Or* – Actual wrap fee
Net-of-fees return	**Net-of-fees return**	
– Administrative Fee	– Remaining portion of wrap fee (administrative fees, if any)	
Client return[b]	**Client return**[b]	**Gross-of-fees return** **Net-of-fees return** **Client return**[c]

[a]Although the "pure gross" return is not required or recommended by the GIPS standards, it may be presented as supplemental information.

[b]The client return is not required by the GIPS standards and is presented here as additional information that may be helpful for existing clients.

[c]For wrap fee portfolios, the net-of-fees return is equal to the client return. If the firm does not have the ability to unbundle the wrap fee or estimate transaction costs, the net-of-fees return will also equal the gross-of-fees return.

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Wrap Fee GIPS Composite Reports

There are some wrap fee–specific requirements that firms must adhere to when preparing a wrap fee GIPS Composite Report

If a firm presents pure gross-of-fees returns for a wrap fee composite, the returns must be clearly labeled as pure gross-of-fees returns and must also be identified as supplemental information. Supplemental information is any performance-related information included as part of a GIPS Composite Report that supplements or enhances the requirements and/or recommendations of the GIPS standards. The required labeling of a pure gross-of-fees return and its designation as supplemental information helps prospective clients distinguish pure gross-of-fees returns, which do not reflect the deduction of transaction costs, and gross-of-fees returns, which do reflect the deduction of transaction costs.

Some prospective clients may not be aware of what a pure gross-of-fees return represents. Therefore, in addition to requiring that a pure gross-of-fees return be clearly labeled and identified as supplemental information, it is required that the firm disclose that pure gross-of-fees returns do not reflect the deduction of transaction costs.

Sample Disclosure:

"The pure gross-of-fees returns do not reflect the deduction of transaction costs and are supplemental information."

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

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

Sample Disclosure for a Wrap Fee Composite Fee Schedule:

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

To help prospective clients interpret the risk measures presented in a GIPS Composite Report, the firm must disclose which returns are used in the calculation of the presented risk measures.

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This requirement applies to both required risk measures (e.g., the three-year annualized ex post standard deviation and internal dispersion) and any additional risk measures. It is recommended that firms use gross-of-fees returns when calculating risk measures. For wrap fee composites, it is sometimes not possible for a firm to calculate gross-of-fees returns. Because of the bundled fee for wrap fee composites, the firm may be unable to identify the transaction costs that must be deducted from the return on investments to arrive at gross-of-fees returns. Firms may, therefore, use pure gross-of-fees returns (the return on investments that is not reduced by any transaction costs incurred during the period) or returns that are net of the entire wrap fee when calculating risk measures presented in a GIPS Composite Report for a wrap fee composite.

The Use of Aggregate Information

The use of aggregate information for performance and performance-related reporting purposes is permitted. A firm may choose to rely on and report aggregate information obtained from the wrap fee sponsor, effectively viewing the sponsor as a single portfolio. For example, at year-end, if a firm is managing 1,000 underlying wrap fee portfolios for one sponsor and the firm effectively views the sponsor as a single portfolio, the firm may choose to report "1" or "≤5" for the number of portfolios in the composite. Firms are not required to disclose the number of portfolios if the wrap fee composite contains five or fewer portfolios.

Alternatively, the firm may choose to rely on the underlying portfolios of each sponsor, and the performance and performance-related information presented will reflect the individual wrap fee portfolios (end users). In the example above, the firm will report "1,000" for the number of portfolios in the composite.

Calculating Internal Dispersion for a Wrap Fee Composite

The GIPS standards require that all GIPS Reports include a measure of dispersion of portfolio annual returns, considering only those portfolios that have been included in the composite for the full year. Firms are encouraged to maintain the individual (end user) portfolio-level returns, which will facilitate computation of the required measure of dispersion (and number of portfolios within the composite).

A firm may choose to view the aggregate performance information reported by a wrap fee sponsor as a single portfolio. This measure of internal dispersion considers the sponsor-level returns, not the portfolio-level returns that are consolidated in the sponsor-level returns. If the composite contains five or fewer portfolios for the full year, a measure of internal dispersion is not required.

Effective Date

The effective date for this Guidance Statement is 1 October 2021. When bringing past performance into compliance, firms may comply with this version of the Guidance Statement

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or with prior versions in effect at the time. Prior versions of this Guidance Statement are available on the GIPS standards website (www.gipsstandards.org).

Exhibit A

ABC Investments
Small Cap Value Wrap Composite
January 1, 2011 through December 31, 2020

Year	Pure Gross Return[a] (%)	Gross Return (%)	Net Return (%)	Benchmark Return (%)	Internal Dispersion (%)	Number of Portfolios	Composite Assets ($ M)	Firm Assets ($ M)
2020	28.84	28.72	25.10	23.75	0.7	2,368	1,015	18,222
2019	12.30	12.20	9.01	9.79	1.1	1,730	687	17,635
2018	17.57	17.47	14.14	14.56	1.0	1,462	432	19,246
2017	10.55	10.45	7.30	7.84	1.2	928	321	14,819
2016	39.05	38.93	35.04	31.74	0.9	649	163	12,362
2015	−6.75	−6.75	−9.53	−7.47	0.8	68	1,115	7,051
2014	6.64	6.64	3.50	4.22	1.0	52	1,110	6,419
2013	45.86	45.86	41.68	34.50	1.1	46	990	5,612
2012	24.41	24.41	20.79	18.05	0.9	38	975	4,422
2011	−4.90	−4.90	−7.73	−5.50	0.8	41	870	3,632

Year	Composite Pure Gross 3-Yr Annualized Ex Post Std Dev (%)	Benchmark 3-Yr Annualized Ex Post Std Dev (%)	Percentage of Wrap Fee Portfolios (%)	Strategy Advisory-Only Assets ($ M)	Firm Advisory-Only Assets ($ M)
2020	13.44	12.58	100	349	1,822
2019	11.52	10.98	100	232	1,764
2018	13.99	12.62	100	102	1,925
2017	15.75	13.97	100	68	1,482
2016	17.49	15.50	100	32	1,236
2015	15.52	13.46	0	0	0
2014	14.91	12.79	0	0	0
2013	18.82	15.82	0	0	0
2012	22.65	19.89	0	0	0
2011	29.31	26.05	0	0	0

[a]Effective January 1, 2016, pure gross returns do not reflect the deduction of any expenses, including transaction costs, and are supplemental information. See Note 6.

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1. ABC Investments is an independent investment adviser registered under the Investment Advisers Act of 1940 and was founded in March 1996. The firm was redefined in January 2016 to include institutional and wrap accounts. Prior to January 2016, the firm included only institutional accounts.
2. ABC Investments claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. ABC Investments has been independently verified for the period from April 1, 1996 through December 31, 2020. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all of the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The Small Cap Value Wrap Composite has had a performance examination for the period from 1 January 2016 through 31 December 2020. The verification and performance examination reports are available upon request.
3. The Small Cap Value Wrap Composite is composed of portfolios invested in US equities that have a market capitalization of between $500 million and $2 billion at purchase. Historically, small-cap stocks have been more volatile than large-cap stocks. Effective January 1, 2016, the composite was redefined to include only wrap fee accounts. Prior to the redefinition, the composite included only institutional accounts. Performance results prior to 2016 are those of the Small Cap Value Institutional Composite. Wrap accounts are charged a wrap fee that is based not on transactions in a client's account but is based on a percentage of account assets. The composite inception date is February 1, 2006. The composite was created in March 2016.
4. All returns are calculated and presented in US dollars. Policies for valuing investments, calculating performance, and preparing GIPS reports are available upon request. A list of composite descriptions is available upon request.
5. The benchmark is the XYZ Small Cap Value Index and is provided to represent the investment environment existing during the periods shown. The XYZ Small Cap Value Index is a float-adjusted, market-cap-weighted index that measures the performance of the smallest 800 companies traded on US exchanges with low price-to-book ratios that are included in the XYZ 3000 Value Index. The XYZ 3000 Value Index is a float-adjusted, market-cap-weighted index that includes 3,000 of the largest companies traded on US exchanges with low price-to-book ratios. The index is fully invested and includes the reinvestment of income. The returns for the index do not include any trading costs, management fees, or other costs. Index returns have been taken from published sources.
6. Pure gross returns, presented as supplemental information from 2016 through 2020, do not reflect the deduction of any trading costs, fees, or expenses. Pure gross returns prior to 2016 reflect the deduction of transaction costs because performance is from the Small Cap Value Institutional Composite. Effective January 1, 2016, the gross return is calculated by applying a model transaction cost of $0.05 per share to each trade. The firm determined the estimated

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transaction cost for this composite by calculating the actual average transaction costs for accounts in the firm's Small Cap Value Institutional Composite. Prior to January 2016, gross returns are net of actual trading costs.

7. Net returns are calculated by subtracting the highest applicable wrap fee (3.00% on an annual basis, or 0.25% monthly) on a monthly basis from the pure gross composite monthly return. The standard wrap fee schedule in effect is 3.00% of total assets. Wrap fees include all charges, transaction costs, portfolio management fees, custody fees, and other administrative fees.
8. The internal dispersion is measured by the equal-weighted standard deviation of annual pure gross returns of those portfolios included in the composite for the full year. The three-year annualized standard deviation measures the variability of the composite and the benchmark returns over the preceding 36-month period.
9. Strategy advisory-only assets are assets for which ABC Investments provides investment recommendations to another firm for portfolios managed to the composite strategy but has no control over the implementation of investment decisions or trading authority for the assets. Firm advisory-only assets are assets for all strategies within the firm for which ABC Investments provides investment recommendations but has no control over the implementation of investment decisions or trading authority for the assets.
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