CFA Institute®
Global Investment
Performance Standards

GUIDE FOR CREATING A GIPS® STANDARDS POLICIES AND PROCEDURES MANUAL FOR FIRMS

CFA Institute

www.gipsstandards.org

Guide for Creating a

GIPS® Standards Policies and Procedures Manual for Firms

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Introduction

There is no “one size fits all” GIPS Standards Policies and Procedures Manual (P&P Manual) for firms. Each firm’s P&P Manual must be created for the specific conditions and circumstances of the firm. This guide for creating a P&P Manual does not cover every GIPS standards requirement and recommendation. Firms should, therefore, take care to make sure they have reviewed and addressed all of the GIPS standards requirements that are applicable to the firm, as well as any recommendations the firm has chosen to adopt.

When determining which requirements of the GIPS standards are applicable to the firm, the firm must consider not only the GIPS standards, but any requirements that are included in Guidance Statements, interpretations (see the GIPS Standards Handbook), and Questions and Answers published by CFA Institute and the GIPS standards governing bodies. A list of requirements outside the provisions is included on the GIPS standards website, on the Tools webpage.

This guide is not authoritative guidance and is simply a starting point to help firms think about what should be included in a P&P Manual.

Each firm will need to tailor its policies and procedures to fit its situation. For example, this guide assumes that the firm has a GIPS Standards Oversight Committee, but all firms may not have a GIPS Standards Oversight Committee. As another example, some firms will have a significant cash flow policy or composite minimums while other firms will not.

We included as appendices policies for topics that are more likely to not apply to all firms, such as wrap fee portfolios and carve-outs with allocated cash. If these topics apply to a firm, it must include these topics within its P&P Manual.

Important Points to Keep in Mind

The GIPS standards require a firm to document its policies and procedures used in establishing and maintaining compliance with the GIPS standards. Because the GIPS standards are not static, and may change over time, firms must establish policies and procedures to identify any changes in the GIPS standards that affect them.

Firms must also comply with any laws and regulations regarding the calculation and presentation of performance. Laws and regulations can also change over time, so the GIPS standards require the creation of policies and procedures to monitor and identify changes in and additions to laws and regulations regarding the calculation and presentation of performance.

The P&P Manual serves a number of important functions. The P&P Manual:

- indicates choices where there are approved alternatives;
- specifies policies/rules for situations that the GIPS standards do not explicitly cover; and
- documents procedures for consistent application of GIPS standards policies.

Before a firm creates a P&P Manual, there are a few things that would be helpful to know. First, it is important to understand the difference between a “policy” and a “procedure.”

Policy: A basic principle used to guide decisions and actions

Procedure: An action required to implement a policy

Because procedures are so firm specific, this sample P&P Manual focuses primarily on policies, but also includes some procedures. Detailed operational procedures will often reside outside of the firm's P&P Manual but may, in some cases, be incorporated or referenced within the P&P Manual. For example, a firm may include key concepts of its valuation procedures within the P&P Manual but refer to detailed valuation procedures that are maintained by the Operations Department.

Here are some important points for firms to keep in mind as they develop their own P&P Manual:

- Firms should identify personnel, or those who hold certain job titles or positions at the firm, who will be responsible for developing and maintaining the policies and procedures and for ensuring that all applicable requirements are being followed. It is likely that several areas within the firm (accounting, legal and compliance, investment operations, risk management, marketing, etc.) will need to be involved.
- Policies and procedures are unique to a firm – there is no "one size fits all" template. While getting help from others outside of the firm is fine, the P&P Manual must be designed for the specific firm.
- If a firm relies on third-party data, there must be policies and procedures for ensuring this data meets any calculation requirements of the GIPS standards.
- A P&P Manual should not simply repeat the GIPS standards provisions. Here is an example based on Provision 1.A.5.b, which states that the firm must create policies and procedures to monitor and identify changes and additions to all of the Guidance Statements, interpretations, and Q&As published by CFA Institute and the GIPS standards governing bodies.
    - <u>Incorrect</u>: "Policies and procedures have been created to monitor and identify changes in and additions to the GIPS standards, as well as all of the Guidance Statements, interpretations, and Q&As published by CFA Institute." This would not be an appropriate policy because it simply repeats the provision and does not include the actions the firm will take to comply with the requirement.
    - <u>Correct</u>: "In order to stay informed of any new guidance, interpretations, or changes to the GIPS standards relevant to the firm, staff members responsible for compliance with the GIPS standards:
        - regularly attend industry conferences, including the GIPS Standards Annual Conference sponsored by CFA Institute;
        - participate in webinars and other online training programs offered by industry leaders;
        - subscribe to the CFA Institute GIPS Standards Newsletter; and
        - review the information provided by the firm's verifier and other performance industry service providers, regarding interpretation of and news about the GIPS standards.
- Firms must have policies and procedures in place for:
    - reviewing and ensuring that all required information is included in a GIPS Report and that the information is accurate; and
    - ensuring that all materials adhere to applicable laws and regulations regarding the calculation and presentation of performance results.
- Any changes in the firm's GIPS standards policies and procedures should be applied prospectively and not retrospectively.
- Both current and previous versions of the firm's P&P Manual must be maintained so there is an accurate history of policies and procedures for the entire period for which the firm claims compliance. Some firms will create a new version of the P&P Manual when a change is made, while others will update the same document noting any changes and the effective date of the changes. What is important is that firms are able to identify when changes to policies are effective so that anyone who is reviewing the policies and procedures, including verifiers, will know which policy was in place for which time period.

Questions to ask as policies and procedures are being formulated:

- For each requirement, and each recommendation that the firm chooses to adopt, do the policies and procedures clearly explain:
    - what is being done to meet the requirement or recommendation;
    - how it is done; and
    - who is responsible for doing it?
- Does the policy or procedure conform to:
    - the GIPS standards;
    - regulatory requirements;
    - the principles of fair representation and full disclosure?
- Is the policy or procedure easy to understand and apply consistently given the work processes and systems in place?
- Are appropriate internal controls included or referenced in the firm's policies and procedures?

Requirements and Recommendations

Requirements are provisions, tasks, or actions that must be followed or performed.

Recommendations are provisions, tasks, or actions that are not required to be followed but that should be followed. It is a recommendation of the GIPS standards that firms comply with the recommendations of the GIPS standards.

Requirements and recommendations can be found in the provisions or in interpretive guidance, including the GIPS Standards Handbook, Guidance Statements, and Q&As. A list of requirements outside the provisions can be found on the GIPS Standards website (www.gipsstandards.org) on the Tools webpage under Resources.

The contents for each topic in this guide are as follows:

- Background on key points that firms should consider and document in the firm's P&P Manual.
- Sample policy.

Sample Policies

Please keep in mind that the following sample policies do not address every requirement and recommendation that may apply to a firm. This guide is intended to help a firm get started with documenting its policies and procedures. A firm needs to tailor its policies and procedures to its specific circumstances and must also ensure the policies and procedures are complete.

Fundamentals of Compliance

Firm Definition

Background:
This section should contain the definition of the firm used for GIPS compliance purposes. Any changes to the firm definition should also be captured here as well.

Sample Policy:
XYZ Investments is an independent investment adviser registered under the Investment Advisers Act of 1940 and was founded in March 1996. It is a subsidiary of ABC Investments. Prior to January 2016, the firm was defined to include institutional accounts and pooled funds. The firm was redefined in January 2016 to include institutional accounts, pooled funds, and wrap accounts.

Period of Compliance

Background:

The firm should document the dates for which it claims compliance with the GIPS standards. It should also include the dates for any performance presented for periods ended prior to the minimum effective compliance date that does not comply with the GIPS standards, if any. Firms may not present non-compliant performance in GIPS Reports for periods prior to the minimum effective compliance date.

Sample Policy:

XYZ Investments initially claimed compliance with the GIPS standards for the five-year period from 1 January 2012 through 31 December 2016. XYZ Investments does not include any performance in GIPS Reports for periods ended prior to 1 January 2012. XYZ Investments continues to claim compliance with the GIPS standards on an ongoing basis.

Documenting Policies and Procedures

Background:

Firms must document their policies and procedures used in establishing and maintaining compliance with the GIPS standards. A firm must document all of the policies and procedures it follows for meeting the applicable requirements of the GIPS standards, as well as any recommendations the firm has chosen to adopt. There is no requirement to create and document policies and procedures to comply with requirements of the GIPS standards that do not apply to the firm. However, firms must actively make a determination about the applicability of all of the provisions or other requirements of the GIPS standards and document their policies and procedures accordingly. It is recommended that firms review all requirements of the GIPS standards on an annual basis to determine if changes in the requirements or changes in the firm's investment strategies warrant changes to existing policies and procedures.

Sample Policy:

The Performance Department is responsible for maintaining the firm's GIPS Standards Policies and Procedures Manual (P&P Manual). The Performance Department maintains all prior versions of the P&P Manual, to document the effective date of any changes. The Performance Department is responsible for monitoring for any changes to the requirements of the GIPS standards, including any guidance published by CFA Institute and the GIPS standards governing bodies. If changes to the firm's policies and procedures are required, the Performance Department will submit a draft of the proposed changes to the GIPS Standards Oversight Committee for review and approval. Once changes are approved, the Performance Department will update the P&P Manual. The updated P&P Manual will be posted on the company's intranet and a memo describing the changes will be distributed to relevant staff.

If a prospective client or investor requests policies for valuing investments, calculating performance, or preparing GIPS Reports, the Performance Department will prepare a draft of the policies from within the P&P Manual that are responsive to the request and will submit a draft to the GIPS Standards Oversight Committee for review and approval.

Identifying Changes to the GIPS Standards

Background:

Firms must ensure they are aware of any changes to the GIPS standards. Changes to the GIPS standards are communicated through the GIPS Standards Newsletter. Changes may be in the form of Q&As, Guidance Statements, and Interpretations published by CFA Institute and the GIPS standards governing bodies.

Sample Policy:
To stay up to date with the GIPS standards, the firm budgets for two people to attend the CFA Institute GIPS Standards Annual Conference each year. All members of the GIPS Standards Oversight Committee and all members of the Performance Department subscribe to the GIPS Standards Newsletter produced by CFA Institute. Also, our verification firm provides the GIPS Standards Oversight Committee with an update on any new guidance the firm needs to be aware of during the closing meeting at the end of the verification.

In addition, all employees involved with the GIPS standards are encouraged to obtain the Certificate in Performance Measurement (CIPM), which includes important concepts embodied in the GIPS standards.

Complying with Laws and Regulations:

Background:
Firms must create policies and procedures to ensure that they adhere to all applicable laws and regulations regarding the calculation and presentation of performance. Firms must also have policies and procedures to identify and monitor changes and additions to laws and regulations regarding the calculation and presentation of performance. Where laws and regulations are stricter than the GIPS standards, firms should document where that occurs and how they will comply with the stricter laws and regulations.

Sample Policy:
XYZ Investments complies with all applicable laws and regulations regarding the calculation and presentation of performance. The Compliance Department is responsible for identifying any changes to regulatory requirements that require a change to the GIPS standards policies and procedures. XYZ Investments accomplishes this using a variety of methods, including the use of retained outside counsel.

The Compliance Department will notify the GIPS Standards Oversight Committee of any changes to laws and regulations that impact the firm’s policies for complying with the GIPS standards. The Performance Department will update the firm’s GIPS standards policies and procedures as appropriate.

Responsibility for GIPS Compliance

Background:
The firm should document those personnel or the positions of those personnel who have overall responsibility for the firm’s compliance with the GIPS standards. Many firms establish a GIPS Standards Oversight Committee that includes members from all areas of the firm that play a role in maintaining the firm’s compliance with the GIPS standards.

Sample Policy:
XYZ Investments is committed to maintaining compliance with the GIPS standards. XYZ Investments acknowledges that compliance with the GIPS standards must be met on a firm-wide basis, and not on a composite or pooled fund basis. The Performance Manager coordinates the efforts to comply with the GIPS standards with the assistance of the GIPS Standards Oversight Committee. The GIPS Standards Oversight Committee meets quarterly and includes representatives from performance, portfolio management, operations, compliance, marketing, risk, and client service. At these meetings, the Performance Department updates the committee on any recent events or changes to the GIPS standards that have an impact on the firm’s compliance with the GIPS standards.

The GIPS Standards Oversight Committee is responsible for:

- reviewing new composite and pooled fund descriptions;
- reviewing the classification of new pooled funds as limited or broad distribution;

- determining that changes in the firm's policies and procedures resulting from changes in the GIPS standards or regulatory requirements have been made and have been properly documented in the firm's P&P Manual;
- overseeing the GIPS standards verification process, including selecting which composites and pooled funds will be examined.

The GIPS Standards Oversight Charter, with roles and functions, can be found in the Internal Policies and Procedures folder in the Performance Department's Intranet site.

Classifying Pooled Funds

Background:
For purposes of complying with the GIPS standards, the firm must classify each pooled fund it manages as either a broad distribution pooled funds (BDPF) or a limited distribution pooled funds (LDPF). Certain requirements apply only to LDPFs and not to BDPFs; firms that manage pooled funds, therefore, must classify their pooled funds as either LDPF or BDPF to determine whether certain requirements apply. The classification of pooled funds is made at the fund level, not the share class level.

Sample Policy:
The Performance Manager is responsible for reviewing each new pooled fund to determine whether it should be classified as a broad distribution pooled fund or limited distribution pooled fund. For each new pooled fund, the Performance Manager will prepare a memo for the GIPS Standards Oversight Committee explaining why the Performance Manager proposes classifying the pooled fund as either limited or broad distribution, and will include documents supporting the decision, including fund offering documents.

Maintaining Lists of Composites and Pooled Funds

Background:
A firm is required to maintain a list of composite descriptions, a list of pooled fund descriptions for limited distribution pooled funds, and a list of broad distribution pooled funds. A firm can instead prepare a list of all the strategies that it offers, with a description of the strategy, and indicate in which vehicles the strategy is available (segregated account, LDPF, or BDPF). These lists can be included within the P&P Manual, or they can be a separate document.

Firms should document policies and procedures for who maintains these lists and how they are updated as strategies and funds are launched or terminated. The list of composite descriptions must include composites that terminated within the past five years. The LDPF and BDPF lists are not required to include terminated pooled funds.

A firm must provide these lists to any prospect that makes a request. A firm must also provide a description of any BDPF to any BDPF prospective investor upon request.

Sample Policy:
The Performance Department is responsible for maintaining the firm's list of composite descriptions, list of LDPF descriptions, and list of BDPFs. These lists have been created and are available on the firm's Performance Department Intranet site. On an annual basis, the Performance Department updates these lists to remove any composites that terminated more than 5 years ago and also delete any LDPF or BDPF that has terminated. To facilitate the removal of terminated composites after 5 years, terminated composites are maintained in a separate section of the list of composite descriptions, and the termination date is noted.

Annually, the Performance Department reconciles the list of composite descriptions to the current list of composites from the composite management system. The Performance Department also reconciles the list of

LDPF descriptions and the list of BDPFs to the list of pooled funds maintained by the Fund Accounting Department. The Performance Department adds any new funds or composites, and any corresponding descriptions.

The Marketing and Sales Departments may access these lists on the Performance Department Intranet site in order to respond to any prospective client or prospective investor request to obtain these lists. The Marketing and Sales Departments will report all such requests to the GIPS Standards Oversight Committee.

Recordkeeping

Background:
Records that support the performance information presented in GIPS Reports must be captured, maintained, and made available within a reasonable time frame. This recordkeeping requirement applies to all of the periods that are presented in GIPS Reports. This section should include the types of records that are maintained, and the systems that store those records. Firms also need to consider regulatory recordkeeping requirements. Regulatory requirements may be stricter than the GIPS standards requirement, and the firm must follow the stricter requirement. If a firm uses a third party as part of its process for complying with the GIPS standards, and it places reliance on records from the third party, the firm must establish policies and procedures to ensure that the third-party performance records and information that it uses meet the requirements of the GIPS standards.

Sample Policy:
It is XYZ Investments' policy to keep all documentation supporting performance since the firm's inception. Records to support performance information for all portfolios and benchmarks are stored in the firm's portfolio accounting and performance systems. These records include reports to support holdings, valuations, cash flows, transactions, and return calculations. Custody reports and reconciliations are maintained by the Operations and Fund Accounting Departments on the shared drive of the Intranet site.

Multiple departments within the firm are responsible for documentation that supports performance reported in a GIPS Report. Fee information is maintained by the Finance Department, client agreements are maintained by the Legal Department, and any supporting Excel calculations are stored on the Performance Department Intranet site. Most documentation is stored electronically on-site with a back-up maintained at an off-site location per the company's disaster recovery policy. Some hard copy documentation prior to January 2005 is stored at an off-site location.

XYZ Investments relies on valuation data from sub-advisors for some of its multi-strategy portfolios. XYZ Investments acknowledges that it is responsible for ensuring the information provided by the sub-advisors meets the requirements of the GIPS standards. XYZ Investments also ensures it has access to the data supporting the valuations.

The Legal Department will obtain input from the Performance Department to ensure all required records are addressed in the service-level agreements. The Legal Department ensures that service-level agreements with any third party provide XYZ Investments with adequate access to documentation supporting any records upon which XYZ Investments relies. They also ensure these agreements contractually support XYZ Investment's ability to obtain this critical information in the event the companies end their business relationship. The Legal Department reports on the status of these contracts to the GIPS Standards Oversight Committee.

GIPS Compliance Notification Form

Background:

A firm is required to notify CFA Institute of its claim of compliance when the firm initially claims compliance with the GIPS standards by submitting a GIPS Compliance Notification Form. Subsequently, the firm must file an updated GIPS Compliance Notification Form annually, by 30 June. Information within the GIPS Compliance Notification Form must be as of the most recent 31 December. The firm should document in its policies and procedures who is responsible for filing its annual GIPS Compliance Notification Form and the date the form is due.

Sample Policy:

The Performance Manager is responsible for submitting the GIPS Compliance Notification Form annually. The filing is in our Compliance Calendar for filing by 31 March. The Performance Manager is listed as the primary contact and the Chief Compliance Officer is listed as the secondary contact. XYZ Investments allows its name to be listed on the CFA Institute website as a GIPS compliant firm. The Performance Manager will save a copy of the submitted GIPS Compliance Notification Form and the receipt confirmation from CFA Institute to the Performance Department Intranet site.

Input Data and Calculations

Calculating Total Firm Assets

Background:

This section should discuss how the firm calculates total firm assets for GIPS compliance purposes. This calculation may be different from the firm's calculation of assets under management for regulatory reporting purposes, especially if the legal entity is defined differently than the GIPS compliant firm. The firm should document how different types of assets are treated for total firm assets calculation purposes. (See the table in the GIPS Standards Handbook discussion of Provision 2.A.1, which explains how different types of investment management and trading authority affect which portfolios are included in total firm assets.) Also, the firm needs to establish policies to ensure that assets are not double counted, if applicable. Double counting of assets can occur when portfolios are included in multiple composites, or a portfolio is invested in a pooled fund that is also included in total firm assets.

Sample Policy:

Total firm assets are calculated by the Finance Department monthly. XYZ Investments has an advisory business, and the Finance Department calculates both "Assets Under Management" and "Assets Under Advisement." The "Assets Under Management" calculation is used for total firm assets. This represents the total amount of actual discretionary and non-discretionary portfolios managed by XYZ Investments. It also includes all assets assigned to a sub-advisor for which XYZ Investments has discretion over the selection of the sub-advisor.

The calculation is reviewed by representatives from the Operations Department and the Performance Department prior to being finalized.

On a quarterly basis, the Performance Department will reconcile total firm assets to accounts included in composites and the list of pooled funds and segregated accounts that are not included in composites. Any differences will be researched and either resolved or explained. Some accounts are included in more than one composite, including when master accounts are included in a composite and sub-accounts of a master account are included in a different composite. Assets that are included in multiple composites are identified and the account's value is included only once when calculating total firm assets. The Performance Department ensures that an adjustment has been made for all portfolios that are invested in a pooled fund that is also included in total firm assets. The Performance Department also makes any adjustments to not double count assets in composites when portfolios are invested in pooled funds that are in the same composite.

Any theoretical performance, such as model accounts in the performance system, are flagged as model portfolios and excluded from total firm assets.

Use of Fair Value

Background:
Firms are required to fair value all portfolios. Fair value is defined as the amount at which an investment could be sold in an arm's length transaction between willing parties in an orderly transaction. The valuation must be determined using the objective, observable, unadjusted quoted market price for an identical investment in an active market on the measurement date, if available. In the absence of an objective, observable, unadjusted quoted market price for an identical investment in an active market on the measurement date, the valuation must represent the firm's best estimate of the fair value. Fair value must include any accrued income.

Sample Policy:
The firm's objective is to ensure the accuracy of all asset prices maintained in the firm's investment systems.

Pursuant to FAS 157, the firm has established a three-level pricing hierarchy. The pricing team maintains the following guidelines to classify each asset in accordance with FAS 157 leveling classifications:

> Level 1: Quoted prices in active markets for identical investments.
>
> Level 2: Other significant observable inputs (e.g., quoted prices for similar investments, interest rates, prepayment speeds, and credit risk).
>
> Level 3: Significant unobservable inputs (including the analyst's assumptions in determining the fair value of investments).

For Level 1 assets, the pricing team works with third-party pricing vendors to collect prices on a daily basis. The current third-party pricing vendors are as follows:

Asset Class	Vendor
Equities	Main Market Pricing Services
Bank Loans	Bank Loan Pricing Direct
Bonds	Main Market Pricing Services
CLOs	Securitized Pricing Direct
Fx Rates	Currency Exchange Worldwide

For thinly traded securities, the firm may utilize broker pricing to the extent the prices provided by the third-party pricing vendors are determined to not be accurate.

On a monthly basis, the pricing team provides a summary report of all asset prices, including documentation to support Level 3 prices, to the Valuation Committee for review and approval.

Calculating Portfolio-Level Returns

Background:

Sections 2 and 3 of the GIPS standards include numerous requirements applicable to the data and the methodology that is used to calculate portfolio-level returns. This section should include information on the data inputs and portfolio-level return calculations.

Sample Policy:

Input data – The following conventions apply to all portfolio-level returns:

- Total returns – Returns that reflect capital appreciation/depreciation and income earned are calculated for all portfolios.
- Transaction costs – All returns reflect the deduction of transaction costs. Transaction costs include brokerage commissions, exchange fees and/or taxes, and bid–offer spreads.
- Trade date accounting – All purchases and sales are recorded on trade date.
- Income – Interest and dividend income are recognized on an accrual basis, except income on short-term cash accounts is recognized on a cash basis. Accrued income is included in market values.
- Withholding taxes – Dividends are reflected net of all withholding taxes. Reclaimable withholding taxes are recognized on a cash basis if and when received.
- Securities lending income – For proprietary funds, securities lending income is recognized as income. For segregated accounts, securities lending income is not recognized as income and is treated as an external cash flow.
- Fair value – Investments are valued according to our fair value policies, which can be found in the Operations Department fair value folder on the Intranet site.
- Estimated values – XYZ Investment does not use preliminary or estimated values as fair value.
- Leverage – All portfolio values are net of discretionary leverage.

Reconciliation to the custodian – The Operations Department reconciles cash transactions and ending cash and security positions to the custodian on a daily basis for each portfolio. At month end, security positions and valuations as well as income accruals are reconciled to the custodian. All differences are researched and resolved. Reconciled month-end data is the source for total firm assets, which ensures only actual assets are included in total firm assets, composite assets, and pooled fund assets.

Valuation – The Operations Department is responsible for loading the pricing files from the pricing sources at the end of each day. Exception reports are run to identify large changes in price (+/–4%) or missing prices. The Operations Department researches the exceptions. If a price change is required, the information is submitted to the Valuation Committee for review, approval, and correction. Only select members of the Valuation Committee can input changes into the trading system. Other staff do not have system access to make a price change.

All segregated accounts and BDPFs are valued daily. Hedge funds are valued monthly, which aligns with the openings for subscriptions and redemptions. Private equity and real estate funds are valued quarterly, as of calendar quarter end.

For the firm’s real estate funds, an external valuation is done once every 12 months by a certified commercial property appraiser. The appraiser’s fee is not contingent upon the investment’s appraised value.

Private equity funds are valued using the latest available valuation from the General Partner, with positions adjusted for any capital activity.

Portfolio-level return calculations – Our calculations differ by vehicle type, which are explained below.

Segregated accounts

The firm's performance system is used to calculate portfolio-level returns.

Returns are calculated daily. The following return formula is used to calculate a daily gross return. Gross returns are net of transaction costs only.

$$Daily\,Gross\,Return = \frac{\text{Ending Market Value} - \text{Beginning Market Value} - \text{External Cash Flows}}{\text{Beginning Market Value}}$$

Market values include accrued income.

Daily returns are geometrically linked to calculate monthly gross returns, using the following formula.

$$r_t^{TWR} = \left[(1 + r_1) \times (1 + r_2) \times \ldots \times (1 + r_I)\right] - 1,$$

where r_t^{TWR} is the time-weighted return for day *t* and period *t* consists of *I* days.

Portfolio net returns are calculated using actual fees. Investment management fees are accrued monthly. To calculate net returns, at month end the monthly investment fee accrual is deducted from the numerator, using the same gross return formula. The monthly fee amount comes from the billing system. Although net returns are calculated for all portfolios, some composites use model fees.

For portfolios that have performance fees, the actual fee used is the monthly accrued management fee plus any accrued performance-based fee. If subsequent performance is negative and this reduces a previously accrued performance-based fee, a fee rebate is accrued. In these cases, the net return can be higher than the gross return. After a performance-based fee is paid, if there are any clawbacks, the clawback will be reflected in the period in which it was repaid.

Mutual Funds

We use the institutional share class for return calculations. On a monthly basis we calculate the NAV based (net/net) pooled fund return, which includes reinvestment of any capital gains and dividend distributions and is net of all pooled fund fees and expenses. To calculate a monthly gross return, we add back 1/12th of the annual total expense ratio (TER) to the NAV based (net/net) pooled fund return. We use the TER from the most recent annual report or semi-annual report. For funds that have short positions, we adjust the TER to deduct the expenses for dividends on short positions. For pooled funds that have an expense cap, we use the TER that is the lower of the uncapped TER or the expense cap.

> Example: Monthly NAV return = 0.85%, TER = 1%, Monthly Gross Return = 0.85% + (1%/12) = 0.9333%

Hedge Funds

The Performance Department obtains market value and share information from the fund administrator on a monthly basis and calculates fund performance as of calendar month end in Excel. All hedge funds allow for subscriptions and redemptions on a monthly basis as of month end. We track performance of a "since inception investor" in the highest fee share class for use in GIPS Pooled Fund Reports. For funds with discretionary side pockets, two returns are calculated for the fund — with and without side pockets. The return without the side pocket is used for internal purposes only. The inception date for a hedge fund is the date when the fund strikes the first NAV.

When a hedge fund has a performance fee, the net return is calculated using actual investment management fees and accrued performance fees according to the respective fund's investment management agreement. The Performance Department is responsible for reviewing investment management agreements to determine that net return calculations are proper.

Real Estate Funds

For open-end real estate funds, net returns are calculated quarterly.

The NAV-based returns reflect the deduction of all transaction costs, custody fees, administrative fees, investment management fees, and any other fees and expenses incurred by the fund. For real estate funds, transaction costs include acquisition, disposition, and financing services that are on a particular transaction. Gross returns are calculated by adding back 1/4th of the annual management fee to the quarterly net return. Gross returns reflect the deduction of administrative fees.

Closed-End Private Equity Funds

XYZ Investments controls the cash flows for our closed-end funds and the firm has decided that the money-weighted return is the most appropriate return for these funds. The money-weighted return is calculated in Excel using the Internal Rate of Return (XIRR) calculation on a quarterly basis as of calendar quarter-end. The IRR solves for the *R* that makes this equation true. W_i is the weight of external cash flow *i*, assumed to happen at the end of day.

$$Terminal\,Value = \sum_{i=0}^{n} CF_i (1 + R)^{W_i}$$

Effective 1 January 2020, cash flows are reflected on the date that they occur. Prior to 1 January 2020, cash flows were reflected quarterly. Stock distributions are included as external cash flows and valued at the time of distribution. Returns are calculated using cash flows for the limited partners only. When calculating gross returns, capital calls for fees are eliminated.

If reporting an IRR for a period less than a year, the XIRR is unannualized as follows:

$$R_{SI-IRR} = \left[(1 + r_{SI-IRR})^{\frac{TD}{365}} \right] - 1,$$

where

$R_{SI\text{-}IRR}$ = non-annualized SI-IRR

$r_{SI\text{-}IRR}$ = annualized SI-IRR

TD = total number of calendar days in the measurement period (less than one year)

If a fund has a subscription line of credit that was not repaid within 120 days with a capital call, or that was used to fund distributions, XYZ Investments calculates gross and net IRRs both with and without the subscription lines of credit. The return with the subscription line of credit uses the actual limited partner capital calls and distributions and does not include the cash flows from the subscription line of credit. The return without the subscription line of credit includes the cash flows from the subscription line of credit and excludes the interest expense.

Composite-Level Calculations

Composite Returns

Background:
This section should provide the methodology and formulas used to calculate composite returns, as well as the frequency of these calculations. If model fees are used, a firm should have policies and procedures to test whether the net returns calculated using the model fees are equal to or lower than net returns that would have been calculated if actual fees had been used.

Sample Policy:
All composites use time-weighted returns. Monthly composite returns are calculated by asset-weighting the monthly portfolio returns by the beginning market values, using the following formula:

$$Composite\,Monthly\,Return = \sum_{i=0}^{n} Beginning\,Weight_{Portfolio_i} * Monthly\,Return_{Portfolio_i}$$

All composites except real estate composites are calculated monthly. Real estate composites are calculated quarterly using quarterly portfolio-level returns.

Composite gross returns are calculated by asset weighting the monthly portfolio gross returns by the beginning market values. For composites that use actual fees, composite net returns are calculated by asset weighting the monthly portfolio net returns by the beginning market values.

For any composites that use actual net returns and include non-fee-paying accounts, we apply a model monthly fee to the non-fee-paying portfolio using the highest tier of the fee schedule in effect for the respective period.

For composites that use model fees, composite net returns are calculated by subtracting 1/12th of the annual model fee from the monthly composite gross return. The annual model fee is the highest tier of the standard fee schedule in effect for the respective period.

Monthly composite returns are geometrically linked to arrive at the annual composite return, where the annual return (R_{ANN}) is:

$R_{ANN} = [(1+ R_1)\times(1+ R_2)\times\ldots\times(1+ R_n)]-1$,

where R_1 is the composite return for Period 1 and R_n is the composite return for the most recent period.

For our real estate composites, we calculate a composite gross and net return on a quarterly basis, as of calendar quarter ends.

Tests to Ensure Model Net Returns are Not Higher Than Actual Net Returns

Background:
If a firm uses model investment management fees to calculate composite returns, it should have policies and procedures to test whether the net returns calculated using the model fees are equal to or lower than net returns that would have been calculated if actual investment management fees had been used.

Sample Policy:
On a quarterly basis, the Performance Department is responsible for confirming that the composite net returns using model investment management fees are equal to or lower than net returns using actual investment management fees. For each composite, the model investment management fee is compared to the investment management fees paid by each portfolio in the composite. If the model investment management fee is equal to or greater than the highest investment management fee of any portfolio in the composite, then no additional testing is required. If the model investment management fee is lower than the highest investment management fee of any portfolio in the composite, the Performance Department will compare the composite net returns using actual investment management fees to the composite net returns using model investment management fees. If the model net returns are not equal to or lower than the actual net returns, a higher model investment management fee will be applied.

Internal Dispersion

Background:
This section should detail which internal dispersion measure the firm includes in its GIPS Composite Reports and how this measure is calculated. Firms must present a measure of internal dispersion of individual portfolio annual returns for each annual period. If the composite contains five or fewer portfolios for the full year, a measure of internal dispersion is not required. Firms must identify the portfolios in the composite that have been included for the full annual period and calculate the annual return for each of those portfolios. Firms must use those annual returns to calculate the composite's internal dispersion. The GIPS standards do not require or recommend a specific measure of a composite's internal dispersion. Common measures of internal dispersion include:

- Equal-weighted standard deviation
- Asset-weighted standard deviation
- High-Low
- Range; and
- Interquartile Range

Firms are required to disclose which internal dispersion measure is presented.

Sample Policy:
Internal dispersion for a composite is calculated using the equal-weighted standard deviation of the portfolio annual gross returns. Portfolios are included in the calculation only if they are included in the composite for the entire year. If there are fewer than 6 portfolios included in the composite for the full year, no internal dispersion measure is shown. XYZ Investments uses the STDEVP function in Excel to calculate internal dispersion.

Three-Year Annualized Standard Deviation

Background:
This section should detail the policies and procedures for calculating the three-year annualized ex post standard deviations that are included in GIPS Reports. Firms are required to present the three-year annualized ex post standard deviation using monthly returns of the composite or pooled fund and the

benchmark as of each annual period end. The same formula must be used to calculate the standard deviation for the composite or pooled fund and the benchmark.

Firms may also include other risk measures, known as “additional risk measures.” When a firm calculates additional risk measures, the periodicity of the composite or pooled fund returns and the benchmark returns must be the same, and the risk measure calculation methodology of the composite or pooled fund and the benchmark must be the same.

Sample Policy:
XYZ investments uses the STDEVP function in Excel to calculate the three-year annualized ex post standard deviation. The result is multiplied by the square root of 12.

We use monthly gross composite returns for GIPS Composite Reports and monthly gross pooled fund returns for GIPS Pooled Fund Reports.

We use the same calculation methodology to calculate the benchmark three-year annualized ex post standard deviation.

Composite and Pooled Fund Maintenance

Actual Portfolios

Background:
Only actual portfolios may be included in a composite. Firms are required to include all actual, fee-paying, discretionary segregated accounts in at least one composite. All actual fee-paying, discretionary pooled funds must be included in any composite for which they meet a composite definition.

Sample Policy:
XYZ Investments manages segregated accounts, broad distribution pooled funds (BDPFs), and limited distribution pooled funds (LDPFs). Pooled funds for which XYZ Investments acts as a sub-advisor are treated as segregated accounts. We include all LDPFs and BDPFs in any composite for which the LDPF or BDPF meets the composite definition.

Treatment of Non-Fee-Paying Portfolios

Background:
A firm is not required to include non-fee-paying portfolios in a composite but may choose to do so. If a firm chooses to include non-fee-paying portfolios in a specific composite, then all non-fee-paying portfolios meeting the definition of that composite must be included.

Sample Policy:
XYZ Investments has several seed portfolios that do not pay a fee. We include all non-fee-paying portfolios in composites, but apply a model fee to these portfolios.

Defining Discretion

Background:
A discretionary portfolio is one for which the firm has the ability to implement its intended strategy.
Once the definition of discretion has been determined, it must be documented in the firm’s policies and procedures and applied consistently. A firm’s policies and procedures should state how discretion is determined and how discretion is monitored over time. Firms are not permitted to include non-discretionary portfolios in a composite.

Sample Policy:
XYZ Investments defines discretion at the firm level as having the authority to trade a portfolio. Portfolios for which we have no legal authority to trade the portfolio are considered advisory only and are not included in total firm assets. For composite assignment purposes, we define discretion at the portfolio level. We consider the materiality of each restriction based on its effect on the portfolio's strategy. Such restrictions include, but are not limited to, pre-trade approval, restrictions on purchasing or selling certain stocks or industries, and material allocation restrictions. The Performance Department reviews client guidelines for all new segregated accounts and for segregated accounts with new or changed guidelines, to identify any restrictions. If any restrictions have the potential to materially affect the management of the account, those restrictions are discussed with the Portfolio Manager. The decision to include or exclude a portfolio from a composite is done on an ex ante basis, at the portfolio's inception or at the time the restriction is placed on the portfolio. Based on the Portfolio Manager's knowledge of the implementation of the strategy, a decision is made as to whether the restriction can have a material effect on their ability to implement the portfolio according to the intended strategy. The decisions about the impact of the restrictions are documented so that the decisions are applied consistently. If a portfolio is deemed to be non-discretionary, the Performance Department prepares a memo, including the relevant guidelines and the rationale for why the portfolio is considered to be non-discretionary, and this memo is provided to the GIPS Standards Oversight Committee. On an annual basis, portfolios that are deemed non-discretionary are reviewed to determine if the portfolio's designation as non-discretionary is still appropriate. If we determine that a portfolio should no longer be classified as non-discretionary, we will assign the portfolio to a composite on a prospective basis.

All proprietary pooled funds are deemed discretionary because we have the ability to create the guidelines and implement the intended investment strategy.

Defining Composites

Background:
Firms are required to create composites for strategies that are managed for a segregated account or offered as a segregate account. The GIPS standards require firms to develop objective criteria for defining composites. Firms must establish objective criteria for defining composites that will allow prospective clients and prospective investors to compare performance of one firm with another. When considering how to define composites, firms may define composites by Investment Mandate, Objective, or Strategy; Asset Class; Style or Sector; Benchmark; or Risk/Return Characteristics. Firms should create policies for determining who is responsible for creating the composite definition and ensuring all information required is captured (e.g., composite minimum, benchmark, etc.).

Sample Policy:
Composites are defined based on the investment mandate. When a new composite is created, performance staff will work with portfolio management on the composite definition and composite description. All composite descriptions will include the material risks of the strategy; how leverage, derivatives, and short positions are used, if material; and if illiquid investments are a material part of the strategy. The composite definition will provide the criteria for assigning portfolios to the composite. Once a new composite description and definition are drafted, they will be presented to the GIPS Standards Oversight Committee for final approval prior to being included in the list of composite descriptions and the GIPS Composite Report. Annually, the composite description is reviewed with the portfolio manager to ensure the strategy and risk description remain relevant and complete.

The creation date of the composite is the date that the composite was first formed. For a new composite that is created because the first portfolio has launched as part of a new strategy, the creation date will typically be the first of the month that the portfolio entered the composite. When a new composite is created due to a restructuring (e.g., creating more narrowly defined composites after seeing too much dispersion in a broad composite), the creation date will be the first of the month that the new composite has been approved by the GIPS Standards Oversight Committee.

The firm's policy is to create a new composite to house any limited distribution pooled funds where a composite does not exist. All limited distribution pooled funds are included in a composite. Any broad distribution pooled fund that meets a composite definition will be included in that composite. We do not create a composite for a BDPF if the BDPF is the only portfolio managed in that strategy and the strategy is not offered as a segregated account.

Composite Redefinition

Background:
Composite definitions, once established, should rarely change. If a composite definition is changed, the redefinition must not be applied retroactively.

Sample Policy:
If a change in composite definition is requested, the GIPS Standards Oversight Committee will determine if it is appropriate. Any approved change will be applied on a prospective basis. The historical performance of the composite prior to the redefinition will not change. The Performance Department will review all portfolios, including investment guidelines, to determine that the correct portfolios are included in the composite and that the investment guidelines are consistent with the composite definition on a prospective basis. The Performance Department will contact the Client Service Department if any changes to client guidelines are needed.

Benchmark Selection

Background:
Firms should document how and when a benchmark is selected for the firm's composites and pooled funds. The benchmark selected for a composite or pooled fund, which will be presented in a GIPS Report, has to reflect the investment mandate, objective, or strategy of the composite or pooled fund. The benchmark for a composite can differ from the benchmarks of the portfolios included in the composite. If a firm manages pooled funds and creates GIPS Pooled Fund Reports, the benchmark selected for a pooled fund's GIPS Pooled Fund Report can differ from the official pooled fund's benchmark. Benchmark selection should be done on an ex ante basis, and a firm must not select a benchmark based on how the composite or pooled fund performed relative to the benchmark. Also, benchmarks must be total return benchmarks. A price-only benchmark cannot be used in a GIPS Report. Finally, there are cases where it may be appropriate to change the benchmark for a composite or pooled fund. For example, a more appropriate benchmark may be created that did not exist before. A firm's P&P Manual should describe how changes to benchmarks are handled.

Sample Policy:
Benchmarks are selected for a composite when the composite is defined. Typically, the benchmark will align with the investment mandate of the first portfolio, but in some cases a portfolio benchmark may differ and the rationale for the benchmark selection for the composite is included in the new composite summary provided to the GIPS Standards Oversight Committee. For global strategies, the benchmark that is net of withholding taxes is used, if one is available, to match the treatment of withholding taxes by the portfolios. If a strategy does not have an appropriate benchmark, either no benchmark is shown and it is disclosed that there is no appropriate benchmark or an opportunity cost benchmark such as the risk-free rate is shown. If a benchmark change is requested for a GIPS Report, that change is brought to the GIPS Standards Oversight Committee for review. If the change is approved, it is determined, on a case-by-case basis, how the change

will occur (e.g., link the old benchmark to the new benchmark, show both the old and new benchmark, or show just the new benchmark for all periods).

<u>Benchmark Returns</u>

Benchmark returns for market and peer group indices are calculated in the firm’s performance system. The underlying index values used in the calculations are sourced directly from the index vendors. Returns are calculated on a daily or monthly basis depending on the frequency of the index data. Returns for longer time periods are calculated by geometrically linking daily or monthly returns.

Balanced composites use asset class weighted benchmarks, based on the strategic allocation percentages. These custom blended benchmarks are calculated monthly, and assume monthly rebalancing, and are calculated using the following formula:

$$Weighted\ Custom\ Blended\ Benchmark\ Monthly\ Return = \sum_{i=0}^{n} Weight_{Benchmark_i} * Monthly\ Benchmark\ Return_{Benchmark_i}$$

Some fixed income composites use portfolio-weighted custom benchmarks, using the benchmarks of the individual portfolios in the composite. These benchmarks are rebalanced on a monthly basis, and each monthly return is calculated using the following formula:

$$Portfolio - Weighted\ Custom\ Benchmark\ Monthly\ Return = \sum_{i=0}^{n} Beginning\ Weight_{Portfolio_i} * Monthly\ Return_{Benchmark_i}$$

We use Public Market Equivalents (PME+ methodology) as benchmarks for our private equity pooled funds. These PMEs are calculated by applying the pooled fund’s cash flows to a hypothetical investment in a public market index growing at the rate of the return of the public market index, to calculate the SI-MWR of a benchmark that is comparable to the pooled fund’s SI-MWR.

New Portfolio Inclusion Policy

Background:
Firms must establish a policy for the timing of adding portfolios to composites. The new portfolio inclusion policy should be objective, and it is typically based on a certain time period after the portfolio is funded. Firms are encouraged to establish a policy that includes new portfolios in composites as soon as possible, preferably at the start of the next full performance measurement period. When establishing an inclusion policy, firms should also consider how long it takes for a portfolio to be fully invested in a strategy. For example, the new portfolio inclusion policy for a public equity strategy could be very different from the policy for an emerging market debt strategy.

Sample Policy:
XYZ Investments includes all portfolios in the composite after the first full month under management. For example, a portfolio that funds at any time in January would be included in the composite for the month of March. There may be circumstances when a deviation from this policy is appropriate, such as when funding will be done through a series of staggered contributions, or when a contribution is made in kind. Any deviations from the new portfolio inclusion policy will be reviewed and approved by the GIPS Standards Oversight Committee.

Terminated Portfolio Exclusion Policy

Background:
Terminated portfolios must be included in composites through the last full measurement period that the portfolios were managed and for which the firm has discretion. Firms must establish policies for determining when the firm no longer has discretion for terminated portfolios and when terminated portfolios are removed from composites.

Sample Policy:
Terminated portfolios will be included in a composite through the last full month that they were managed to the strategy. The Performance Department will review the termination notice or other client communication to determine when the firm's ability to manage the portfolio to the intended strategy has terminated. If it is not clear when discretion has ended, the portfolio manager will be consulted to understand how the termination notice has affected the management of the portfolio.

Moving Portfolios between Composites

Background:
Policies should address when and how portfolios are removed or added to composites when a portfolio's strategy changes. Portfolios may move from one composite to another based only on client-directed changes or the redefinition of the composite and may not be moved based on tactical changes.

Sample Policy:
Portfolios that have a client-directed change in strategy are removed from the old composite following the terminated portfolio exclusion policy and are included in the new composite following the new portfolio inclusion policy. On rare occasions, there may be a need to deviate from this policy. Any deviations and the reason for the deviation will be reviewed and approved by the GIPS Standards Oversight Committee.

Composite Minimums

Background:
Firms may establish a policy, on a composite-specific basis, to exclude portfolios from a composite if they are below a minimum asset level. This is appropriate when a portfolio must be a certain size in order to implement the intended strategy. Firms should bear in mind that if all the portfolios in a composite fall below the minimum asset level and, according to the firm's policies, are removed from the composite, the composite's performance record would come to an end. If, after some period of time, portfolios move above the minimum asset level or new portfolios are added to the composite, the composite's prior performance history must be shown but not linked to the ongoing composite performance results.

Sample Policy:
The XYZ Core Fixed Income Composite has a composite minimum of $500,000. Portfolios below the composite minimum at the beginning of the month are excluded from the composite. A portfolio that begins the month above the composite minimum will be included in performance for that month even if the portfolio goes below the minimum before the end of the month. Portfolios excluded from a composite because they do not meet the composite minimum are excluded from all composites because they are considered non-discretionary.

Significant Cash Flow Policy

Background:
A significant cash flow is a cash flow that is above the level at which the firm determines that a client-directed external cash flow may temporarily prevent the firm from implementing the composite strategy. A significant cash flow level may be determined as either a specific monetary amount or a percentage of

portfolio assets. A portfolio that experiences a significant cash flow is considered temporarily non-discretionary and it is removed from the composite. A firm may adopt a significant cash flow policy on a composite-specific, ex ante basis. Firms must establish policies for defining significant cash flows (e.g., if a significant cash flow is based on a single cash flow or a combination of cash flows within a certain period) and for determining when a portfolio is removed and re-included in a composite. These policies must be defined in advance and applied consistently. If a firm has a single portfolio in a composite and that portfolio is temporarily removed from the composite because of the firm's significant cash flow policy, the composite's track record stops, and its continuous performance history ends. Once the portfolio is added back to the composite and the composite performance is restarted, the performance history must be presented for periods both before and after the break and cannot be linked across the break.

Sample Policy:
The XYZ Emerging Market Debt Composite has a significant cash flow policy. A significant cash flow is defined as a single cash flow that is 25% or more of a portfolio's last calculated market value. When a portfolio experiences a significant cash flow, the portfolio will be removed from the composite for the month in which the significant cash flow occurred. The portfolio will be re-included in the composite after the first full month under management after the date of the significant cash flow.

Excluded Accounts

Background:
Portfolios may be excluded from all composites on a permanent or temporary basis. Portfolios that are permanently excluded are typically deemed to be non-discretionary, such as when the client requires all trades to be cleared by them before execution. Portfolios may be temporarily excluded from all composites for a variety of reasons. For example, towards year end a client may instruct the firm to sell securities with unrealized losses for tax loss harvesting, or a client may instruct the firm to temporarily cease trading to enable the assets to be transferred to a new custodian. Firms must establish policies for how excluded portfolios are treated.

Sample Policy:
Excluded Portfolios: XYZ Investments excludes from composites all portfolios where the client has directed us to pre-clear all trades with them. We also exclude portfolios where the client has imposed restrictions that would prohibit us from implementing the strategy. Examples of these restrictions include a prohibition or constraint for investing in certain sectors or industries, or limiting realizing gains to a certain dollar amount. For each portfolio that is deemed to be non-discretionary, the Performance Department will document why the portfolio is deemed non-discretionary. All non-discretionary portfolios will be reviewed annually to determine if there has been any change that would allow a portfolio to be considered for composite inclusion.

Temporarily Excluded Portfolios: XYZ Investments temporarily excludes portfolios that fall below composite minimums or that have significant cash flow (SCF) policies that are triggered (see composite minimum and SCF policies for further information). We also temporarily exclude portfolios where the client has directed us to harvest losses for tax purposes. Portfolios where the client has directed us to harvest losses will be removed from composites in the month that tax loss harvesting begins and will be re-included in the composite the first full month after we have finished harvesting losses in the amount directed by the client. All temporarily excluded portfolios will be reviewed on a monthly basis to determine if the portfolio should be re-included in its composite.

Performance Review Process

Background:
Firms should establish policies to review performance on a monthly basis to determine if there are obvious performance anomalies that should be researched.

Sample Policy:
XYZ Investments reviews all portfolio returns on a monthly basis. All portfolio returns are compared to other portfolios in the composite to determine if there are outliers that should be researched. For equity strategies, any portfolio gross return that deviates from the monthly average portfolio gross return by more than 50 bps is flagged as an outlier for further review. For fixed income composites, any portfolio gross return that deviates from the monthly average portfolio gross return by more than 25 bps is flagged as an outlier for further review.

Outlier portfolio returns are reviewed to determine that portfolios are included in the proper composite, and that return calculations are correct. If a portfolio is an outlier due to a difference in guidelines or restrictions, the Performance Department will discuss the portfolio with the Portfolio Manager. If it is determined that the difference in guidelines or restriction is deemed to have a material effect on the Portfolio Manager's ability to manage the portfolio to the strategy, the portfolio will be reviewed by the GIPS Standards Oversight Committee to determine if the portfolio should be removed from the composite on a prospective basis, or if the portfolio should be removed from the composite for all periods and an error has occurred.

To be proactive in discovering errors, the Performance Department reviews the following reports to ensure they are aware of any changes in portfolios:

- Backdated transactions
- Changes to portfolio performance start dates or end dates
- Changes to portfolio strategy or Portfolio Manager
- Changes to fee information
- Trading halts

GIPS Reports

Selecting TWRs or MWRs

Background:
Firms should establish policies for when a composite or pooled fund will include time-weighted returns (TWRs) or money-weighted returns (MWRs). Firms are required to include TWRs in a GIPS Report unless certain criteria are met that allow MWRs to be presented instead of TWRs. A firm may choose to present MWRs instead of TWRs for a specific composite or pooled fund only if the firm controls the external cash flows into the portfolios in the composite or into the pooled fund, and the portfolios in the composite have or the pooled fund has at least one of the following characteristics: closed-end; fixed life; fixed commitment; or illiquid investments as a significant part of the investing strategy. If this is the case the firm may elect to report MWRs instead of TWRs.

Sample Policy:
XYZ Investments includes time-weighted returns in all GIPS Reports with the exception of our closed-end funds, which qualify to use money-weighted returns.

Preparing GIPS Reports

Background:

A firm's policies and procedures do not need to address every metric and disclosure that is included in a GIPS Report, but policies and procedures should address:

- When a firm has a choice in which metric to present, what the firm has selected.
- How the firm ensures that all required numerical information and disclosures are included in GIPS Reports.
- The periods that are included in a GIPS Report (e.g., the 10 most recent annual periods).
- How often GIPS Reports are updated.
- Who reviews GIPS Reports for completeness and accuracy.
- Any laws or regulations that conflict with the GIPS standards, and the manner in which the laws or regulations conflict with the GIPS standards.

GIPS Reports must be updated through the most recent annual period end within 12 months of that annual period end.

Sample Policy:

The Performance Department is responsible for preparing all GIPS Reports. The Performance Manager reviews all GIPS Reports before final review by the Compliance Department. GIPS Reports are updated annually, once December returns and total firm assets are finalized. This is typically done by the end of February. Once the Compliance Department has completed their review, the Marketing Department is provided with all updated GIPS Reports.

XYZ Investments presents the information required by the GIPS standards in each GIPS Report for the most recent 10-year period, or since inception of the composite or pooled fund for those composites and pooled funds that have less than 10 years of history.

It is our firm's policy to include in GIPS Reports only the information that is required by the GIPS standards. If there is a break in track record, performance is shown before and after the break, and performance is not linked across the break. When a composite or pooled fund starts or ends mid-year, the stub period for the partial year is shown. Returns are shown both gross and net to illustrate the effect of fees.

The number of portfolios is presented at the end of each annual period end, except when there are five or fewer portfolios, in which case "≤5" is shown.

For real estate funds, income and capital returns are also presented.

For pooled funds that use MWRs, we present a gross and net since-inception IRR. If the fund uses a subscription line of credit, we present gross and net returns both with and without the subscription line of credit. We calculate a PME based on fund cash flows both with and without a subscription line of credit. For assets and committed capital, we present:

- Pooled Fund Assets
- Combined Pooled Fund Uncalled Committed Capital and Pooled Fund Assets
- Total Firm Assets
- Combined Firm-wide Uncalled Committed Capital and Total Firm Assets

The Performance Department and Compliance Departments are responsible for ensuring all of the required information and disclosures are included in GIPS Reports. The Performance Department completes the CFA

Institute Disclosure Checklist for each GIPS Report, and provides the checklist and the draft GIPS Reports to the Compliance Department. All GIPS Reports are reviewed by the Compliance Department.

Any potential significant events (e.g., a portfolio manager leaving) will be reviewed by the GIPS Standards Oversight Committee to determine if it is a significant event that needs to be disclosed. There will be no change to the historical track record as a result of a significant event.

Distributing GIPS Reports

Background:
This section should address the distribution of GIPS Reports. It should include who at the firm is responsible for ensuring that all prospective clients and limited distribution pooled fund prospective investors ("prospects") receive a GIPS Report when they initially become prospects, and how the firm determines who is considered a prospect. If a firm chooses to provide broad distribution pooled fund prospective investors with a GIPS Report, the firm must also establish policies and procedures for doing so. In addition to providing prospects with a GIPS Report when they initially become a prospect, a firm needs to ensure that prospects receive an updated GIPS Report at least once every 12 months if the prospect is still considered a prospect. A firm should, therefore, have policies regarding how it determines who is still a prospect. To do so, a firm might consider if a certain time period has passed since the firm last had contact with the prospect, or a salesperson could be responsible for determining the status of each of their prospects. Firms should establish policies for how this information is tracked.

Firms also need to be able to demonstrate that they made every reasonable effort to provide prospects with a GIPS Report when they were required to do so. Firms should, therefore, establish policies and procedures for tracking which GIPS Reports were provided to which prospects, and when. Doing so will also allow a firm to determine when ongoing prospects must receive an updated GIPS Report, as well as which prospects must receive a corrected GIPS Report when a material error occurs. (See error correction policies.)

Firms must also provide a GIPS Report for any composite listed on the firm's list of composite descriptions or for any limited distribution pooled fund listed on the firm's list of pooled fund descriptions when a prospect requests it.

Sample Policy:
The appropriate GIPS Report is included as Exhibit A in all pitch books for composite strategies. The GIPS Report for each LDPF is included as the second page in each fund's fact sheet. The fund fact sheet is included as an exhibit in each fund's offering memorandum. The firm does not provide a GIPS Report to BDPF prospective investors.

The Marketing Department is responsible for ensuring that all prospective clients and limited distribution pooled fund prospective investors receive a GIPS Report once the prospective client or prospective investor has shown interest in a specific strategy or pooled fund and it is determined that the prospective client or prospective investor is qualified to invest in the strategy (e.g., meets the minimum amount needed to invest in the strategy) or the pooled fund. The Compliance Department keeps a log of all pitch books and offering documents that are provided to prospective clients and prospective investors. The log contains the name of the marketing material, the date of the report (e.g., Large Cap Growth Composite as of 31 December 2020), the person/firm that received the report, and the date the report was provided.

GIPS Reports are updated annually, to add information as of the most recent annual period end. Once the updated GIPS Reports have been finalized, which is usually by the end of February, the updated GIPS Reports are provided to all prospects who received a GIPS Report within the past 12 months and are still considered a prospect. The determination of whether a prospect is still considered a prospect is made by the Sales

Department on an individual prospect basis, and the status is maintained in the Client Relationship Management system.

Updated GIPS Reports are also provided to databases and consultants.

If a prospect requests a GIPS Report for any strategy or pooled fund, we will provide the GIPS Report. These requests are tracked in the Client Relationship Management system.

Error Correction Policy

Background:
Firms that claim compliance with the GIPS standards are required to correct material errors in GIPS Reports and provide corrected GIPS Reports to clients and certain other parties that received the GIPS Report that had the material error. In addition, there may be regulatory requirements that must be considered. Regulations may also require firms to treat errors in a GIPS Composite Report differently from errors in a GIPS Pooled Fund Report. For example, a GIPS Composite Report typically will have a multi-level error correction policy while a GIPS Pooled Fund Report may have only two levels (material and not material).

Sample Policy:
To address errors that occur in GIPS Reports, we have adopted the following policies and procedures.

1. **Definition of error**
   An error is defined as any component of a GIPS Composite Report or GIPS Pooled Fund Report (together, GIPS Reports) that is missing or inaccurate. Errors can be quantitative or qualitative. All errors in GIPS Reports are subject to this Error Correction Policy.

2. **Definition of material error**
   A material error is defined as any error in a GIPS Report that must be corrected and disclosed in a corrected GIPS Report.

3. **Definition of materiality**
   An error (or item) is material if the magnitude of the omission or misstatement of performance information, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed by the omission or misstatement. When considering materiality, and more than one error has occurred, errors will be considered in the aggregate for each reporting period. Errors that may be considered immaterial individually may be material when considered in the aggregate.

4. **Determining level of error**
   The table below establishes thresholds for determining the level of quantitative errors.

   A Level 1 error is any error that is below the threshold for a Level 2 error.

   Level 1, 2, and 3 errors are considered non-material errors.

   Level 4 errors are considered material errors.

		Level 4 Error		Level 3 Error		Level 2 Error	
Error	Asset Class	Absolute Change	Relative Change	Absolute Change	Relative Change	Absolute Change	Relative Change
Annual composite/pooled fund return	Equity	≥ 20 bps and	≥ 5%	≥ 15 bps and < 20 bps and	≥ 5%	≥ 10 bps and < 15 bps and	≥ 5%
	Fixed Income	≥ 10 bps and	≥ 5%	≥ 7 bps and < 10 bps and	≥ 5%	≥ 3 bps and < 7 bps and	≥ 5%
Annual benchmark return	Equity	≥ 20 bps	n/a	≥ 15 bps and < 20 bps	n/a	≥ 10 bps and < 15 bps	n/a
	Fixed Income	≥ 10 bps	n/a	≥ 7 bps and < 10 bps	n/a	≥ 3 bps and < 7 bps	n/a
Total Firm Assets	All	n/a	≥ 10%	n/a	≥ 7% and < 10%	n/a	≥ 3% and < 7%
Composite/Pooled Fund Assets	All	n/a	≥ 10%	n/a	≥ 7% and < 10%	n/a	≥ 3% and < 7%
Number of portfolios	All	≥ 5 and	≥ 10%	n/a	≥ 7% and < 10%	n/a	≥ 3% and < 7%
3-Year external standard deviation	All	n/a	≥ 10%	n/a	≥ 7% and < 10%	n/a	≥ 3% and < 7%
Internal dispersion	All	n/a	≥ 10%	n/a	≥ 7% and < 10%	n/a	≥ 3% and < 7%

Any error in composite or pooled fund returns that causes the corrected return to change from outperforming the benchmark to underperforming the benchmark is considered a Level 4 error.

5. **Quantitative errors not covered by the table above**
Not every possible type of quantitative error is covered by the table above. Quantitative errors not covered by the table above, such as an error in the percentage of non-fee-paying portfolios, will be reviewed by the GIPS Standards Oversight Committee, which will decide how the error should be handled and which level of corrective action will be taken.

6. **Qualitative errors**
Qualitative errors, which can be missing, incomplete, or incorrect disclosures, will be corrected immediately. Qualitative errors will be reviewed by the GIPS Standards Oversight Committee, which will decide how the error should be handled and which level of corrective action will be taken. Any error in disclosures that is deemed to have potentially impacted a prospective client's decision to invest will be treated as a Level 4 error.

7. **Time periods**
It is our policy to not differentiate errors based on the period in which they occur. All errors are treated the same, regardless of the period in which they occurred.

8. **Corrective actions by level**
We have developed the following categories for actions to be taken once an error has been identified and the error correction level has been determined:

Level 1
- Take no action.

Level 2
- Correct the data error in the system, if appropriate;
- Correct the GIPS Report;
- Do not disclose the change.

Level 3
- Correct the data error in the system, if appropriate;
- Correct the GIPS Report;
- Disclose the change;
- Do not distribute the corrected GIPS Report.

Level 4
- Correct the data error in the system, if appropriate;
- Correct the GIPS Report;
- Disclose the change;
- For GIPS Composite Reports:
  - Provide the corrected GIPS Composite Report to the current verifier.
  - Provide the corrected GIPS Composite Report to current clients, current investors, and any former verifiers that received the GIPS Composite Report that had the material error.
  - Make every reasonable effort to provide the corrected GIPS Composite Report to all current prospective clients and prospective investors that received the GIPS Composite Report that had the material error.

- For GIPS Pooled Fund Reports:
  - Provide the corrected GIPS Pooled Fund Report to the current verifier.
  - Provide the corrected GIPS Pooled Fund Report to current investors and any former verifiers that received the GIPS Pooled Fund Report that had the material error.
  - Make every reasonable effort to provide the corrected GIPS Pooled Fund Report to all current prospective investors that received the GIPS Pooled Fund Report that had the material error.

Any required disclosure will be included in the GIPS Report for a minimum of one year.

9. **GIPS Standards Oversight Committee**
The GIPS Standards Oversight Committee is responsible for reviewing all errors. The GIPS Standards Oversight Committee will discuss the nature of the error and if any additional procedures need to be implemented to minimize the likelihood that the same type of error reoccurs.

10. Error incident report

The responsible Performance Department team member will complete an Error Incident Report and submit this Report to the GIPS Standards Oversight Committee, along with the incorrect GIPS Report and the corrected GIPS Report, if applicable. The Error Incident Report will include the following information, as applicable:

- The composite or pooled fund affected by the error
- For composites, the affected portfolios
- The affected periods
- How the error was identified
- Materiality calculation
- Action level taken
- Steps taken or to be taken to prevent the same type of error from happening again
- Changes needed to the error correction policy

11. Distribution of corrected GIPS Reports

When a material error occurs, the distribution of the corrected GIPS Report that includes disclosure of the change resulting from the correction of the material error will be overseen by a member of the Compliance Department. The Compliance Department team member will coordinate efforts with the Performance, Sales, and Client Service Departments and is responsible for ensuring that the corrected GIPS Report is provided to all appropriate parties, including tracking the parties that received the corrected GIPS Report in the CRM system. Corrected GIPS Reports sent by email will cc the Compliance Department mailbox.

If the firm is not certain if a specific party received the GIPS Report that included the material error, the firm will assume that the specific party received the GIPS Report that included the material error and will provide that corrected GIPS Report that includes disclosure of the change resulting from the material error.

It is the Firm's policy to not provide a corrected GIPS Report with disclosure of the change resulting from the material error to former clients, former investors, former prospective clients, and former prospective investors.

12. Corrected GIPS Reports with disclosure of the change resulting from a material error

It is our policy to not provide GIPS Reports with disclosure of the change resulting from a material error to new prospective clients and prospective investors. When a material error occurs that requires disclosure of the change in the GIPS Report, the Performance Department will create a second version of the GIPS Report that does not include disclosure of the change resulting from the material error, and this is the only version of the GIPS Report that will be available to the Sales Department.

13. Changes to the error correction policy

Changes to the Error Correction Policy must be approved by the GIPS Standards Oversight Committee.

Verification

Background:

If a firm is verified, this section should include who the verifier is and the frequency of verification. It should also indicate if the firm chooses to have any performance examinations conducted. If the firm has chosen to engage a verifier, it must gain an understanding of how the verifier maintains independence from the firm and it must determine that the verifier is independent. A firm's policies and procedures should indicate what steps a firm takes to determine if the verifier is independent. The determination of independence is an ongoing process and must be performed in connection with each verification engagement.

Sample Policy:
XYZ Investments is verified annually after year-end. XYZ Investments uses Able Verification Services as its verifier. Prior to renewing the contract, we obtain a copy of Able Verification Services' policies for maintaining independence. The Performance Manager will discuss with the verifier any questions that were raised from reviewing the policies for maintaining independence. In addition, the Performance Manager will inquire internally to determine whether there are other services performed by the verifier for the firm that could cause an independence issue. The Performance Manager will report any concerns to the GIPS Standards Oversight Committee. Additionally, the GIPS Standards Oversight Committee will review any new or changed relationships that the firm has with the verifier to see if any potential conflicts of interest have been raised.

XYZ Investments obtains performance examinations for its flagship composite products. The claim of compliance included in the GIPS Reports is tailored to reflect when a composite has had a performance exam.

GIPS Advertisements

Background:
Firms are not required to use the GIPS Advertising Guidelines but may do so if they wish. The GIPS Advertising Guidelines provide a firm with options for advertising its claim of compliance with the GIPS standards. If the firm chooses to follow the GIPS Advertising Guidelines, the firm should ensure that it has policies and procedures for determining that all required information and disclosures are included in the advertisement.

Sample Policy:
On occasion, the firm may refer to its claim of compliance with the GIPS standards in advertisements following the GIPS Advertising Guidelines. In these instances, the advertisement will be prepared in accordance with the GIPS Advertising Guidelines and the Performance Department and Compliance Department will review all advertisements to determine that all required information and disclosures are included.

Marketing Materials

Background:
Most of the GIPS standards requirements focus on the performance information that is presented in GIPS Reports. However, there are requirements that affect areas outside of the GIPS Reports. One broad requirement that covers all materials that a firm produces, including pitchbooks, the website, and client reports, is that a firm cannot present any performance information that is false or misleading. A firm should address in its policies and procedures how it ensures that no false or misleading information is produced or distributed. There are also restrictions on how a firm can state that it complies with the GIPS standards and where this claim can be included. Personnel from other departments, such as sales or marketing, should be aware of how to answer prospective and current client or investor questions about GIPS compliance. The team responsible for reviewing marketing materials should be aware of the GIPS standards and regulatory requirements related to the calculation and presentation of performance information. Some examples of information that this team should be aware of are the types of performance information that have a high-risk of being considered misleading (e.g., actual performance linked to theoretical performance), what to do if

jointly marketing with another firm, and how to indicate the inclusion of the GIPS Reports in marketing materials.

Sample Policy:
The Performance Department and Compliance Department are jointly responsible for reviewing all marketing materials to ensure they have the information required by laws and regulations, as well as the GIPS standards, and to ensure that they do not include information that is false or misleading. Please refer to the Compliance Department's "Marketing Review Policy."

It is our policy to include any GIPS Composite Report that must be provided to a prospective client or prospective investor as Appendix A in all pitch books. The table of contents includes an entry for Appendix A, and the table of contents entry is named "GIPS Composite Report" or "GIPS Pooled Fund Report". On any page in the pitch book that includes composite performance, a footnote is added that states: "See Appendix A for GIPS Reports that XYZ Investments is required to provide to you." When new marketing materials are created that include a GIPS Report, the document must be reviewed and approved by the Marketing, Compliance, and Performance Departments, to ensure appropriate references to the GIPS Report are included.

Only actual performance information is included within a GIPS Report, but hypothetical performance is allowed outside of a GIPS Report subject to the Compliance Department's review and approval. Actual performance linked to hypothetical performance is not included in GIPS Reports, but may be presented outside of a GIPS Report, subject to the Compliance Department's approval.

If a concern is raised regarding a performance-related presentation that is not covered by the policy, it is reviewed by the Compliance and Performance Departments, and if it needs further review it is reviewed by the GIPS Standards Oversight Committee.

The Marketing Department is responsible for answering Requests for Proposal (RFPs) and populating databases. For questions relating to GIPS compliance, answers are used that have been pre-approved by the Compliance and Performance Departments. For any questions that cannot be answered with the preapproved responses, the Marketing Department confirms the correct answer with the Compliance and Performance Departments.

Client reporting materials do not include references to the GIPS standards, but if a client asks about GIPS compliance, the Client Service Department will confirm the correct response with the Performance Department.

Appendices

Appendices on the following pages address requirements that apply to some firms, but not all.

Carve-Outs Appendix

Background:

There are two types of carve-outs for GIPS compliance purposes — carve-outs managed with their own cash (e.g., a sub-portfolio with its own cash) and carve-outs where cash is allocated synthetically (e.g., equity securities are carved out of a balanced account and cash is allocated after the fact). There are additional GIPS standards requirements that apply to carve-outs with allocated cash, and additional policies and procedures need to be documented.

All carve-outs must be representative of a standalone portfolio managed to the composite strategy. Carve-out returns must include any cash and any related income. When a firm allocates cash to carve-outs, its policies must include how cash and related income is included in carve-out returns and assets. If a firm uses actual investment management fees to calculate composite net-of-fee returns, the firm needs to ensure that it is using appropriate fees to calculate net returns.

If a firm chooses to create a carve-out of a particular strategy, allocates cash to the carve-out, and includes the carve-out in a composite, then it must create carve-outs with allocated cash from all portfolios and portfolio segments within the firm managed to that strategy and must include those carve-outs with allocated cash in the composite.

If a firm is hired to manage a standalone portfolio for the same strategy as the carve-outs with allocated cash, then the firm must create a composite that includes only standalone portfolios. Once the firm has a composite of standalone portfolios, the firm has options with respect to the carve-out composite. It can

- continue to include only carve-outs with allocated cash in the carve-out composite;
- include both carve-outs with allocated cash and standalone portfolios in the carve-out composite;
- redefine the carve-out composite to exclude carve-outs with allocated cash and include only standalone portfolios going forward; or
- terminate the carve-out composite.

Sample Policy:

XYZ Investments has carve-outs managed with their own cash and carve-outs with cash that is allocated synthetically. Carve-outs managed with their own cash are referred to as “sub-portfolios” and treated like any other portfolio. A sub-portfolio is included in a composite only when it is representative of a standalone strategy, meaning the portfolio manager does not consider positions from the other sub-portfolios when constructing his/her own sub-portfolio. When a sub-portfolio is created for a strategy, all future sub-portfolios managed to the same strategy will be included in the appropriate composite.

For the Growth Equity Composite, we created carve-outs with allocated cash from all Broad Equity portfolios. Returns for carve-outs with allocated cash have been calculated in Excel, by taking the returns of the carved-out securities and cash from the accounting system. Cash has been allocated monthly using the beginning-of-period cash allocation method, which allocates cash based on the beginning value of the carve-out as a percentage of the beginning value of the total portfolio excluding cash.

Model fees are used for all composites that include carve-outs. If standalone portfolios do not exist in the carve-out strategy, model fees are determined by pricing the strategy of the carve-out in anticipation of it being managed as a standalone strategy. The fee schedule is determined by the Finance Department in conjunction with the Portfolio Manager. If standalone portfolios exist, then the standard fee schedule used for the standalone portfolios are applied to the carve-outs.

For a composite of carve-outs with allocated cash, once we obtain standalone portfolios in that strategy, we will include the standalone portfolios in the carve-out composite as well as a composite of standalone portfolios. We will show the returns for the composite of standalone portfolios in the carve-out composite's GIPS Composite Report.

Wrap Fee Appendix

Wrap fee portfolios have unique requirements that apply only to these portfolios. This appendix includes policies and procedures that apply only to wrap fee portfolios.

Defining Discretion

Background:

Discretion is the ability of a firm to manage a portfolio to the intended strategy, and discretion needs to be defined by the firm. A firm's policies and procedures must state how discretion is determined and will generally also outline how discretion is monitored over time. Given the unique nature of wrap portfolios, a firm may determine that it is appropriate to define discretion for wrap portfolios differently.

Sample Policy:

From a legal standpoint, our firm defines discretion at the firm level as having the authority to trade a portfolio. Portfolios for which we have no legal authority to trade the portfolio are considered advisory-only and are not included in GIPS standards total firm assets. For wrap accounts, any account with a restriction beyond a restriction to not buy shares of the wrap sponsor is automatically deemed non-discretionary. Similarly, a wrap account is deemed temporarily non-discretionary when the account goes through tax loss harvesting.

Creating Wrap Composites

Background:

When a firm does not have wrap accounts managed in a specific strategy, and it wishes to create a track record using a non-wrap composite history, it may do so if the non-wrap composite history is appropriate for wrap accounts.

Sample Policy:

If a strategy is launched as a wrap strategy, and a non-wrap composite is used as the initial track record, once a wrap portfolio launches, a wrap composite will be created with the non-wrap track record used as the history and the wrap-only track record will be used prospectively.

Distributing GIPS Reports

Background:

Unlike institutional clients, the firm does not typically provide a GIPS Report directly to the wrap fee participants. Instead, it distributes the GIPS Report to the plan sponsor who then provides it to wrap fee clients. 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.

If a firm has wrap fee prospective clients, and the firm manages wrap fee portfolios, the firm needs to ensure that performance of the composite containing wrap fee portfolios is provided to wrap fee prospective clients.

Sample Policy:

Prospective wrap sponsors and clients are provided with the appropriate wrap composite, if a wrap composite exists. If a strategy exists, but no wrap fee portfolios are managed in that strategy, the non-wrap composite is used but we apply a model wrap fee of 3.00%, which is the highest assumed wrap fee. Wrap sponsors are asked to acknowledge on an annual basis that they provided the GIPS Report to all prospective wrap fee clients.

Recordkeeping

Background:
Firms may contract with a third party to provide wrap fee performance. When a firm uses a third party for performance measurement, the firm is still responsible for the records to support any performance calculations. Firms should establish policies and procedures for making sure that third parties are maintaining records to support performance and that these records are available to the firm upon request, and at the time of termination of the third-party agreement.

Sample Policy:
XYZ Investments contracts with certain wrap sponsors to provide performance information for wrap accounts. The third-party agreement states that all records to support wrap fee performance must be maintained and all supporting documents must be provided upon request and at the time of termination of the third-party agreement. For these wrap accounts, performance results are monitored by the Performance Department on a monthly basis and control reports are reviewed to ensure the performance is in line with expectations.

Calculating Portfolio-Level Returns

Background:
It is not uncommon for wrap fee performance to be calculated using a different methodology or convention than institutional portfolios. As such, firms must establish policies and procedures that document how performance for wrap fee portfolios are calculated.

Sample Policy:
Performance for wrap accounts is calculated monthly and at the time of large cash flows, using the Modified Dietz method. Large cash flows are defined as a cash flow greater than 10% of an account's beginning market value.

Wrap fee portfolio returns are calculated using the wrap system. Wrap fee portfolio values include accrued dividends and interest. Returns are net of withholding taxes. Cash and cash equivalents are included in all market values. Portfolio values do not reflect any trading costs. Cash flows are assumed to happen at the end of the day. Trades are recognized on trade date.

The wrap system calculates a "pure gross" return, which does not reflect the deduction of any transaction costs. Transaction costs are not estimated and therefore a gross return that is net of transaction costs is not calculated.

Calculating Composite-Level Returns

Background:
Net-of-fees composite returns are required for wrap composites. Net returns must be net of the entire wrap fee and not just the portion of the wrap fee earned by the firm.

Sample Policy:
XYZ Investments reduces wrap monthly composite pure gross returns by a model fee of 1/12th of 3.00% to calculate wrap composite net returns.

Overlay Strategies Appendix

An overlay strategy is one in which the management of a certain aspect of an investment strategy is carried out separately from the underlying portfolio, and it is offered as a separate strategy. Overlay strategies include currency overlay, asset allocation overlay, and interest rate overlay. If a firm manages portfolios with overlay strategies, the firm is required to create one or more overlay strategy composites. Firms are not required to create an overlay strategy composite when the overlay strategy is implemented as part of a broader strategy, but they may do so.

Calculating Portfolio-Level Returns

Background:

Overlay portfolios have different portfolio-level calculation requirements than traditional portfolios because overlay portfolios use notional exposure rather than physical assets. For example, for periods beginning 1 January 2020, when calculating overlay strategy portfolio returns the firm must use as the denominator the notional exposure of the overlay strategy portfolios, the value of the underlying portfolio being overlaid, or a specified target exposure. The firm must use the same denominator for all portfolios within a composite. Firms that manage portfolios with overlay strategies should create policies and procedures for how portfolio-level returns are calculated.

Sample Policy:

For overlay strategies, income from collateral is treated like a cash flow and is not reflected in the return of the overlay portfolios.

For overlay portfolios, the performance system tracks the actual market value of the cash and derivatives, which can be negligible or negative, and it also tracks the exposure value. The exposure values are either a target set by the client or the value of an underlying portfolio. The target values are entered into the performance system and the amount is updated based on information from the client. When we manage both the underlying portfolio and the overlay portfolio, the performance system enables the Performance Department to link the underlying portfolio to the overlay portfolio. Two sets of returns are calculated for the overlay portfolio — one based on the actual market value of the cash and derivatives, and one based on the overlay exposure. The returns based on the actual market value are used for internal reporting purposes only. The return based on the overlay exposure is used for composite reporting.

Returns for overlay accounts are calculated using the exposure value in the denominator.

$$Daily\,Gross\,Return = \frac{\text{Ending Market Value} - \text{Beginning Market Value} - \text{Cash Flows}}{\text{Exposure Value}}$$

The daily returns are then arithmetically linked to calculate monthly gross returns.

Portability Appendix

Background:

If a firm acquires another firm, or acquires a team from another firm, it may be able to use the track record from the prior firm if it meets the portability requirements specified in Provisions 1.A.32 and 1.A.33. If the portability tests are met, the firm may choose to use the ported historical track record but is not required to do so. Firms should establish policies for determining that the portability requirements have been met prior to using the track record from a past firm or affiliation in a GIPS Report.

Sample Policy:

XYZ Investments may acquire a firm or team from time to time. Prior to using the historical track record of the acquired firm or team, the Performance Department and Compliance Department will conduct due diligence to determine whether the historical track record meets the portability requirements of the GIPS standards. The results of any findings will be reported to and approved by the GIPS Standards Oversight Committee prior to including the ported track record in a GIPS Report.

Joint Marketing Appendix

Background:

A firm that claims compliance with the GIPS standards may jointly market with another firm that may or may not comply with the GIPS standards. To avoid confusion when jointly marketing with another firm, a GIPS-compliant firm must be sure that it is clearly defined relative to the other firm with which it is jointly marketing, and it must be clear as to which firm is, or which firms are, claiming compliance with the GIPS standards. The clarity regarding which firm is, or which firms are, claiming compliance with the GIPS standards is necessary for the firm's joint marketing activities to meet the criterion of fair representation, a fundamental principle of the GIPS standards.

Sample Policy:

XYZ Investments jointly markets with its parent company ABC Investments. The marketing materials make clear that it is XYZ Investments that claims compliance with the GIPS standards, and that XYZ Investment is a subsidiary of the parent company ABC Investments.