CFA Institute

67 Lombard Street
7th Floor
London EC3V 9LJ
United Kingdom

+44 (0) 20 7330 9500 tel
+44 (0) 20 7330 9501 fax
info@cfainstitute.org
www.cfainstitute.org

17 August 2018

Project Manager
Investment Consultancy Market Investigation
Competition and Markets Authority
Victoria House
Southampton Row
London
WC1B 4AD

Dear Members of the CMA's Investment Consultants Market Investigation group,

CFA Institute thanks you for the opportunity to submit this response to your provisional decision report, specifically regarding Remedy 8:

Establish basic standards for how investment consultants and fiduciary managers report performance of recommended asset management 'products' and 'funds'.

CFA Institute submit this response to address the questions contained in Box 8 and paragraphs 12.129 to 12.138 and the relevant common questions in chapter 13.

CFA Institute would like to consider two issues that could be addressed by Remedy 8:

a) those raised in paragraphs 5.64 to 5.67 and analysed in appendix A2 which concern how a fiduciary manager represents, in aggregate, the performance of the products they have recommended or 'buy rated' over x years, which is used as a proxy to compare or assess the quality of advice provided across fiduciary managers and,

b) the quality of the supporting information provided by the fiduciary manager to the client for each recommended asset management product.

Addressing issue b) the quality of the supporting information provided by the fiduciary manager to the client for each recommended asset management product, to the points raised in box 8

'Should basic standards apply to the reporting of recommended asset management 'products' and 'funds'?

Answer: Yes.

CFA Institute is a strong supporter and advocate for the provision, at the individual product, strategy, and fund level, of full, fair, and comparable past-performance and related information to prospective and current clients.

CFA Institute and its predecessors has been creating and funding performance presentation standards for over thirty years, initially with the Financial Analysts Federation publishing Performance Presentation Standards in 1987, followed by Association of Investment Management and Research (AIMR) publishing the US Performance Presentation Standards (AIMR-PPS) in 1992, and with the first edition of the Global Investment Performance Standards (GIPS®) being published in 1999 with subsequent editions in 2006, the current edition: [2010 edition of the GIPS standards], and an edition scheduled for 2020. 15 countries, including the UK through NAPF, combined their individual performance standards into the global standard with an additional 10 countries contributing to and adopting GIPS in 1999. As of 2018 there are over 40 countries that accept GIPS as the global investment performance standard within their local asset management industry. Please refer to the following link for further information: https://www.gipsstandards.org/Pages/index.aspx

The GIPS Standards provide an ethical and standardized framework based on the principles of full disclosure and fair representation, and outline internal controls that are necessary to ensure that the calculation and presentation of the investment performance history of an investment management firm is directly comparable across the information supplied for a single product, across products managed within a firm, and between firms that claim compliance with the GIPS Standards.

The fiduciary manager could ensure comparability of the information being presented to their clients for products that they are recommending by including the compliant presentation or GIPS related report that is generated by the investment manager and presented to the fiduciary manager for each product that the fiduciary manager recommends.

For that to occur, the fiduciary manager would need to be recommending products of asset managers who claim compliance with the GIPS standards. Fiduciary managers could actively improve the quality of performance and performance related information being provided by encouraging asset managers to implement and support the GIPS standards. Further, the asset owners having received full, fair and comparable information from the fiduciary managers, will start to request identical information which in turn will encourage the asset managers to claim compliance with the GIPS standards. While acknowledging that the fiduciary managers will be undertaking due diligence when assessing products that they are considering for recommendation, having an initial set of information available to them from each asset manager that is full, fair and comparable because it is generated by following the same standard, would be advantageous to them. The promotion of the GIPS standards by the fiduciary managers is beneficial to the fiduciary manager and their clients.

While the claim of compliance is made by the asset management firm without requiring input from a third party, the GIPS standards recommends that a firm claiming compliance engage an independent third party to Verify the claim of compliance. In excess of 85% of firms that claim compliance with the GIPS standards undergo Verification[1]. A fiduciary manager could indicate that they prefer to work with asset management firms that are claiming GIPS compliance and are verified.

Mindful that any additional requirements that an asset manager or a fiduciary manager must follow when presenting a recommended product or fund could reduce the size of the pool being considered for each recommendation, the approach of ‘comply or disclose’ could be applied so that the product from a firm that does not (currently) claim GIPS compliance could still be considered by the fiduciary manager as long as the asset manager can justify why they are not claiming compliance. The acceptance of ‘comply or disclose’ could be limited to before a certain date to provide a grace period to those asset management firms that wish to be considered by fiduciary managers to bring themselves into compliance with GIPS, but ultimately raising the quality of the supplied information from the end of the grace period.

Information on the number and domicile of firms that are claiming compliance with the GIPS standards as of July 31st 2018 from the notifications received by CFA Institute are included in this response.

[1] eVestment ACA Compliance The Value of GIPS Compliance: 2018 Manager and Consultant Survey

CFA Institute believes that, while there is an initial cost associated with collating the information required to support claiming compliance with the GIPS standards, maintaining the claim does not impose additional costs on the firm. Briefly, the GIPS standards require policies and procedures to be maintained and applied consistently regarding some core principles including providing the required information to all prospective clients, adhering to all applicable laws and regulations, ensuring that information presented is not false or misleading, that the claim of compliance is applied across the whole firm that is claiming compliance. Provisions also apply to the input data including valuations, accounting practices, use of trade date. The calculation methodology is controlled as comparability among investment management firms' performance presentation requires uniformity in methods used to calculate returns. The generation of a composite, where the composite is the aggregation of all portfolios that are managed according to a similar investment mandate, objective, or strategy ensures a full and complete representation of the manager's ability to manage the strategy being promoted. Only actual portfolios are included in the composite, the components are assigned on a monthly basis and historical track record is retained should a portfolio move out of the composite or is terminated therefore eliminating survivor bias and incorporation of theoretical or back tested information. There are also requirements concerning qualitative information with disclosures accompanying the quantitative information in the compliant presentation. The disclosures are designed to provide context in which to understand the performance. Returns must be shown alongside the associated risk and the cost (fees) that accompany accessing that performance; all of these are required disclosures in a compliant presentation. The GIPS standards include requirements relating to the reporting of net and gross performance, treatment of performance fees and disclosure of fee related information. Finally, the information that must be reported; time periods, benchmarks, risk measure, values, currency, are detailed in the presentation and reporting section of the standards.

CFA Institute believes that for any firm that is marketing its products to prospective clients, the requirements in the GIPS standards represent the minimum that the firm should be undertaking to present full and fair information and therefore is not imposing an additional cost on the firm. It is likely that the firm will need to reorganise their existing resources and approach to the calculation and presentation of ex-post performance to implement and maintain the GIPS standards.

In addition to producing the necessary information regarding past performance, a firm that follows the GIPS standards will benefit from improved internal controls and can leverage the policies and procedures in several ways including in the firm's risk management, business continuity, internal training and internal audit functions as well as feedback to their investment management process.

Question: Are there any other areas that we should include in the reporting standards?

Answer: All areas listed in paragraph 12.131 are addressed by the GIPS Standards and are included in the required performance and performance related information that constitutes the compliant presentation that must be presented by a firm to all prospective clients.

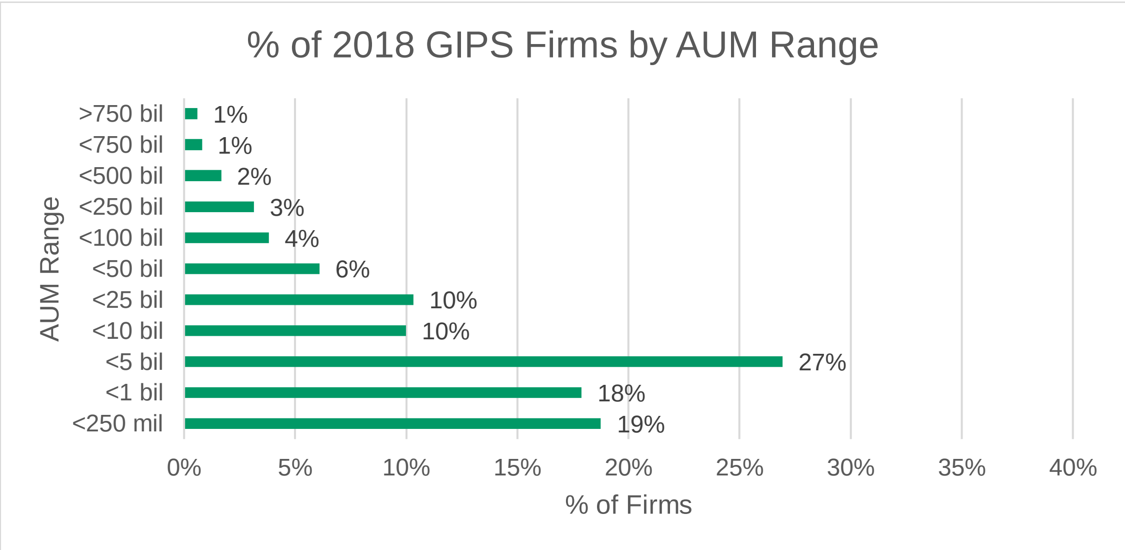
There is additional performance and performance related information included in the compliant presentation with the precise disclosures determined by the style of the strategy and the environment within which the strategy was generated. Some information is not required to be included in the presentation but must be disclosed as being available upon request.

A sample compliant presentation is included as Appendix A

Question: Should standards be developed and agreed by an implementation committee similar to Remedy 6?

Answer: In line with our response to Remedy 6, CFA Institute believes that the GIPS Standards would be a solution to issue b) for Remedy 8, and do not require the formation of an implementation committee or additional development beyond that which is already in progress for the GIPS standards.

As an indication of the acceptance of the GIPS standard as the global standard for the calculation and presentation of ex-post investment performance, as of 31 July 2018 over 1660 firms have notified CFA Institute of their claim of compliance for periods ending 31/12/2017, of which 86 indicate their address as the UK. Many of the asset management firms that operate globally supply the address of their headquarters, with a significant proportion of those being in the US. Regionally 80% of firms claiming compliance indicate their address as in the Americas, 14% in EMEA and 6% in Asia Pacific, with firms claiming compliance domiciled in 44 countries/regions. CFA Institute is unaware of another globally accepted ex-post performance presentation standard. The optionally submitted assets under management for firms claiming compliance ranges from less than $250 million to over $750 billion both globally and for the UK domiciled firms, with the breakdown of all firms sorted by Assets Under Management indicated below.



While over 60% of the firms that provided AUM data manage less than $5 billion, over 80 of the largest asset management firms ranked by assets under management globally (managing in excess of 60% of global asset under management) claim compliance with GIPS for a portion of their assets under management, indicating acceptance of the GIPS standards across all sizes of asset management firm. The GIPS standards have been designed to set a meaningful hurdle in terms of the quality of the information provided but at the same time not favour or preclude any size or style of asset manager.

The GIPS standards are a dynamic standard and are developed to respond to industry changes. The draft document of a major development in the standards, GIPS 2020, will be released for public comment on August 31st 2018 for a four month period. The final version will be released on June 30th 2019 with an effective date of January 1st 2020.

With GIPS 2020, the standard is broadening its relevance to asset managers that manage pooled funds, distinguishing between composite reporting and fund reporting, and further increasing the applicability of GIPS to alternative funds and strategies by providing more opportunity to report money-weighted rates of return where appropriate.

Asset Owners are being provided with further clarity and specificity that will ensure the requirements of GIPS are relevant to an Asset Owner who is reporting to an oversight board or trustees rather than presenting to prospective clients.

The GIPS standards accommodate change and development through the publishing of Questions and Answers for specific points, Guidance statements that address a topic such as fees, benchmarks, risk, calculation methodology, and periodically new editions such as GIPS 2020 which has been previously mentioned. The GIPS standards can respond effectively to market developments, for example the work being presented by the Institutional Disclosure Working Group (IDWG) regarding cost and fees, where appropriate.

Addressing issue a) for Remedy 8, concerning how a fiduciary manager represents, in aggregate, the performance of the products they have recommended, the requirements for GIPS standards composite construction could be applied to this issue. The problems that you have explained in appendix A2: the individual records being presented with survivor bias, linking of actual with theoretical performance, inclusion and exclusion of individual components occurring in an inconsistent pattern among others, are all addressed in the GIPS standards discussion on composite construction. Ensuring that the information regarding the track record produced by each fiduciary manager is comparable, particularly in terms of inclusion or exclusion of fees, has also been addressed broadly in the GIPS standards, though a specific treatment would need to be defined to address the fiduciary manager recommendations track record.

CFA institute and IC Select have submitted a response to Remedy 6. If fiduciary managers were to be mandated to comply with a fiduciary management performance standard and it were mandated that verification was required of that compliance, the testing of the validity of the fiduciary management recommendations track record produced by the fiduciary manager could be incorporated into the verification of the fiduciary manager's claim of compliance and the fiduciary management performance standard could include the requirements that would ensure a full and fair track record of their recommendations is produced and presented.

An alternative approach would be for the fiduciary management standard of Remedy 6 to be tasked with including requirements for how fiduciary managers generate performance of recommended asset management 'products' and 'funds' to report the fiduciary manager's ability to add value.

CFA Institute thanks you for the opportunity to comment on your provisional decision report and would welcome further discussion of any details contained in our response should that be useful to you.

Sincerely,

Iain McAra, Director, Global Investment Performance Standards, CFA Institute

cc: Leilani Hall, CFA, CIPM, CAIA
Paul Smith, CFA

APPENDIX A Sample Compliant Presentation

Sample 1 Investment Firm
Balanced Growth Composite
1 January 2002 through 31 December 2011

Year	Composite Gross Return (%)	Composite Net Return (%)	Custom Benchmark Return (%)	Composite 3-Yr St Dev (%)	Benchmark 3-Yr St Dev (%)	Number of Portfolios	Internal Dispersion (%)	Composite Assets ($ M)	Firm Assets ($ M)
2002	–10.5	–11.4	–11.8			31	4.5	165	236
2003	16.3	15.1	13.2			34	2.0	235	346
2004	7.5	6.4	8.9			38	5.7	344	529
2005	1.8	0.8	0.3			45	2.8	445	695
2006	11.2	10.1	12.2			48	3.1	520	839
2007	6.1	5.0	7.1			49	2.8	505	1,014
2008	–21.3	–22.1	–24.9			44	2.9	475	964
2009	16.5	15.3	14.7			47	3.1	493	983
2010	10.6	9.5	13.0			51	3.5	549	1,114
2011	2.7	1.7	0.4	7.1	7.4	54	2.5	575	1,236

Sample 1 Investment Firm claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Sample 1 Investment Firm has been independently verified for the periods 1 January 2000 through 31 December 2010. The verification report is available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

Notes:

Sample 1 Investment Firm is a balanced portfolio investment manager that invests solely in U.S.-based securities.

Sample 1 Investment Firm is defined as an independent investment management firm that is not affiliated with any parent organization. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The Balanced Growth Composite includes all institutional balanced portfolios that invest in large-cap U.S. equities and investment-grade bonds with the goal of providing long-term capital growth and steady income from a well-diversified strategy. Although the strategy allows for equity exposure ranging between 50–70%, the typical allocation is between 55–65%. The account minimum for the composite is $5 million.

The custom benchmark is 60% YYY U.S. Equity Index and 40% ZZZ U.S. Aggregate Bond Index. The benchmark is rebalanced monthly.

Valuations are computed and performance is reported in U.S. dollars.

Gross-of-fees returns are presented before management and custodial fees but after all trading expenses. Composite and benchmark returns are presented net of non-reclaimable withholding taxes. Net-of-fees returns are calculated by deducting the highest fee of 0.83% from the monthly gross composite return. The management fee schedule is as follows: 1.00% on the first $25 million; 0.60% thereafter.

This composite was created in February 2000. A complete list of composite descriptions is available upon request.

Internal dispersion is calculated using the equal-weighted standard deviation of annual gross returns of those portfolios that were included in the composite for the entire year.

The three-year annualized standard deviation measures the variability of the composite and the benchmark returns over the preceding 36-month period. The standard deviation is not presented for 2002 through 2010 because monthly composite and benchmark returns were not available and is not required for periods prior to 2011.