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Ethical & Professional Standards

Level III

Veronica

Introduction

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Introduction

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Introduction

复习建议

- 七大准则22条细则为基础，注意AMC和GIPS的联系和对比
- 考试依然很喜欢考code and standards，请大家引起重视！
- 多做练习题

Asset Manager Code

a. **explain** the purpose of the Asset Manager Code and the benefits that may accrue to a firm that adopts the Code;

b. **explain** the ethical and professional responsibilities required by the six General Principles of Conduct of the Asset Manager Code;

c. **determine** whether an asset manager’s practices and procedures are consistent with the Asset Manager Code;

d. **recommend** practices and procedures designed to prevent violations of the Asset Manager Code.

Basics

Differences between Asset Manager Code (AMC) and Professional Standards

- **Code and Standards**
  - ✓ For individual investment professionals who are members of CFA Institute or candidates
- **AMC**
  - ✓ For investment management firms

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Adopting the code and claiming compliance

- Once a Manager has met each of the required elements of the Code, the firm must make the following statement whenever the firm claims compliance with the Code:
- *"[Insert name of Firm] claims compliance with the CFA Institute Asset Manager Code of Professional Conduct. This claim has not been verified by CFA Institute."*
- Managers also must notify CFA Institute of their claim of compliance with the Asset Manager Code of Professional Conduct through the CFA Institute online notification process.

Six Components of AMC

A. Loyalty to clients

B. Investment process and actions

C. Trading

D. Risk management, compliance, and support

E. Performance and valuation

F. Disclosure

D. Risk Management, Compliance, and Support

- Managers must:

1. Develop and maintain policies and procedures to ensure that their activities comply with the provisions of this Code and all applicable legal and regulatory requirements.
2. Appoint a compliance officer responsible for administering the policies and procedures and for investigating complaints regarding the conduct of the Manager or its personnel.

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D. Risk Management, Compliance, and Support

- Managers must:

  2. (Cont.)

     - To appoint a compliance officer who is competent, knowledgeable, and credible and is empowered to carry out his or her duties.
     - May designate an existing employee to also serve as the compliance officer, may hire a separate individual for that role, or may establish an entire compliance department.

Six Components of AMC

D. Risk Management, Compliance, and Support

- Managers must:
  2. (Cont.)
     - Where possible, the compliance officer should be independent from the investment and operations personnel and should report directly to the CEO or board of directors.

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D. Risk Management, Compliance, and Support (Cont.)

- Managers must:

3. Ensure that portfolio information provided to clients by the Manager is accurate and complete and arrange for independent third-party confirmation or review of such information.
4. Maintain records for an appropriate period of time in an easily accessible format.

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D. Risk Management, Compliance, and Support (Cont.)

- Managers must:

5. Employ qualified staff and sufficient human and technological resources to thoroughly investigate, analyze, implement, and monitor investment decisions and actions.
6. Establish a business-continuity plan to address disaster recovery or periodic disruptions of the financial markets.
   - ✓ At a minimum, Managers should consider having the following:

Six Components of AMC

D. Risk Management, Compliance, and Support (Cont.)

- Managers must:

Business-continuity plan

- **Backup**: preferably off-site, for all account information
- **Alternative plan**: for monitoring, analyzing, and trading investments if primary systems become unavailable
- **Plans for communication**
  - Critical vendors and suppliers
  - Employee and coverage of critical business functions
  - Clients

Six Components of AMC

D. Risk Management, Compliance, and Support (Cont.)

- Managers must:

7. Establish a firmwide risk management process that identifies, measures, and manages the risk position of the Manager and its investments, including the sources, nature, and degree of risk exposure.

Six Components of AMC

E. Performance and Valuation

- Managers must:

1. Present performance information that is fair, accurate, relevant, timely, and complete. Managers must not misrepresent the performance of individual portfolios or of their firm.
2. Use fair-market prices to value client holdings and apply, in good faith, methods to determine the fair value of any securities for which no independent, third- party market quotation is readily available.

Six Components of AMC

F. Disclosure

- Managers must:

1. Communicate with clients on an ongoing and timely basis.
2. Ensure that disclosures are truthful, accurate, complete, and understandable and are presented in a format that communicates the information effectively.
3. Include any material facts when making disclosures or providing information to clients regarding themselves, their personnel, investments, or the investment process.

Six Components of AMC

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F. Disclosure (Cont.)

- Managers must:

4. Disclose the following:
   a. Conflicts of interests generated by any relationships with brokers or other entities, other client accounts, fee structures, or other matters.
   b. Regulatory or disciplinary action taken against the Manager or its personnel related to professional conduct.
   c. The investment process, including information regarding lock-up periods, strategies, risk factors, and use of derivatives and leverage.

F. Disclosure (Cont.)

- Managers must:

4. (Cont.)

   d. Management fees and other investment costs charged to investors, including what costs are included in the fees and the methodologies for determining fees and costs.

Six Components of AMC

F. Disclosure (Cont.)

- Managers must:

  4. (Cont.)

     d. (cont.)

     - ✓ At a minimum, Managers should provide clients with gross- and net-of-fees returns and disclose any unusual expenses.
     - ✓ Managers should also retrospectively disclose the actual fees and other costs charged, together with itemizations of such charges when requested by clients.

Six Components of AMC

F. Disclosure (Cont.)

- Managers must:
  4. (Cont.)
     d. (cont.)
     - ✓ This disclosure should include the specific management fee, any incentive fee, and the amount of commissions Managers paid on behalf of clients during the period.
     - ✓ Managers must disclose to prospective clients the average or expected expenses or fees clients are likely to incur.

F. Disclosure (Cont.)

- Managers must:

4. (Cont.)

   e. The amount of any soft or bundled commissions, the goods and/or services received in return, and how those goods and/or services benefit the client.

   f. The performance of clients' investments on a regular and timely basis. (at least quarterly or within 30 days after the end of the quarter)

F. Disclosure (Cont.)

- Managers must:

4. (Cont.)

   g. Valuation methods used to make investment decisions and value client holdings.

   h. Shareholder voting policies.

   i. Trade allocation policies.

   j. Results of the review or audit of the fund or account.

   k. Significant personnel or organizational changes that have occurred at the Manager.

   l. Risk management processes.

Six Components of AMC

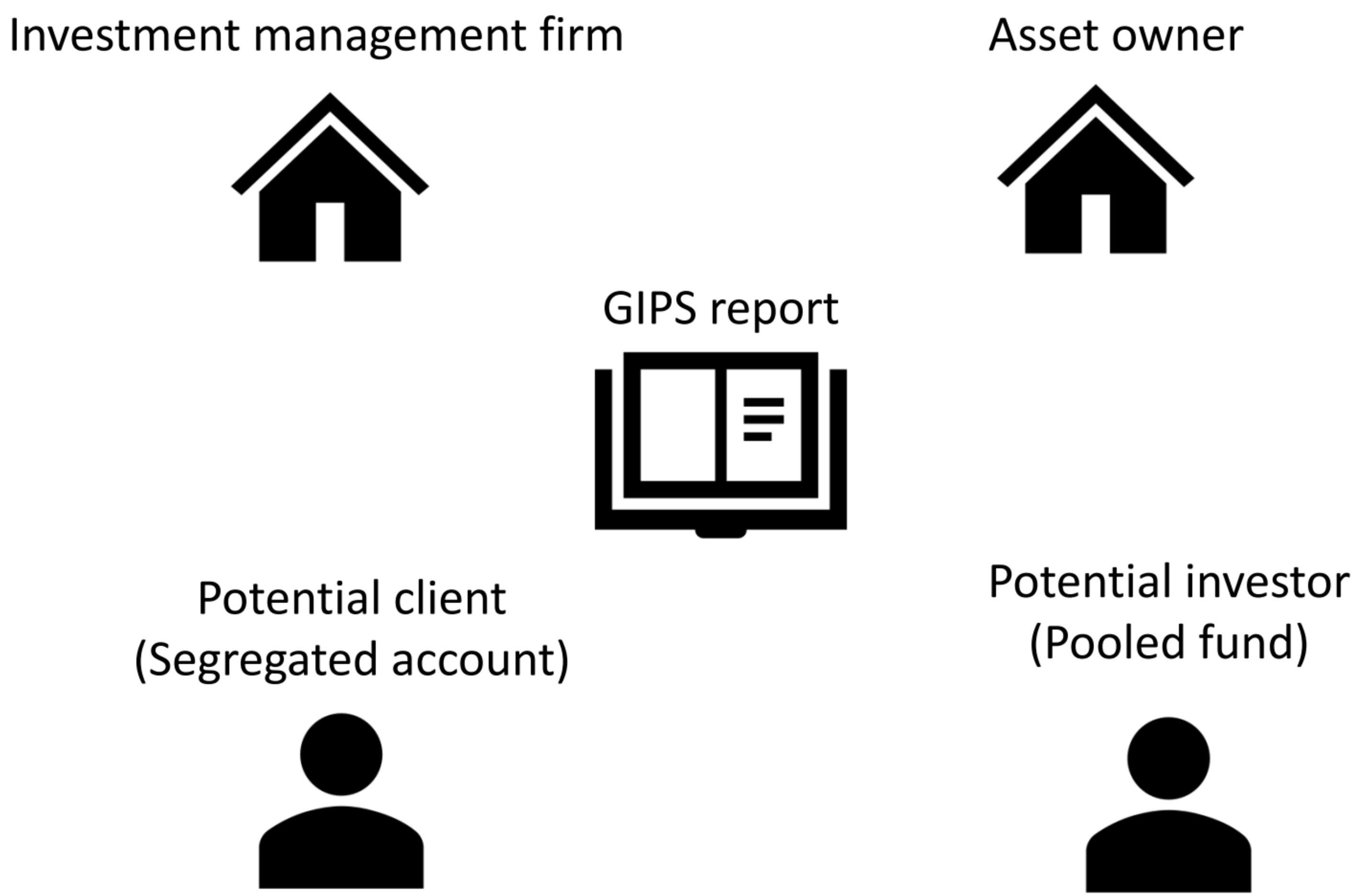
Summary

Compliance officer → Business continuity plan → Fees related disclosure

Overview of GIPS [1]: Objective, Scope, Firm and Discretion

Objective and Scope

Overview



Objective and Scope

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Understanding the key terms

- **Composite**: an aggregation of one or more portfolios that are managed according to a similar investment mandate, objective, or strategy.
- Segregated Account: a portfolio owned by a single client, sometimes referred to in practice as a separately managed account (SMA).
- Pooled Fund:
  - ✓ broad distribution pooled fund: mutual fund, UCITs
  - ✓ limited distribution pooled fund: hedge fund, private equity

Objective and Scope

Understanding the key terms

- Fair representation and full disclosure of investment performance is the key principle underlying the GIPS standards. As ethical standards, the GIPS standards are voluntary.
- The GIPS standards consist of requirements which must be followed in order for a firm to claim compliance. The GIPS standards also include recommendations, which are optional but should be followed because they represent best practice in performance presentation.

Objective and Scope

Understanding the key terms

- The GIPS standards rely on the integrity of input data, including the valuations of portfolio holdings and the use of certain calculation methodologies.
- When the GIPS standards conflict with laws and/or regulations regarding the calculation and presentation of performance, the GIPS standards obligate firms to comply with laws and regulations and to disclose the conflict in the GIPS Report.

Objective and Scope

Eight Sections of GIPS:

1. Fundamentals of Compliance
2. Input Data and Calculation Methodology
3. Composite and Pooled Fund Maintenance
4. Composite Time-Weighted Return Report
5. Composite Money-Weighted Return Report
6. Pooled Fund Time-Weighted Return Report
7. Pooled Fund Money-Weighted Return Report
8. GIPS Advertising Guidelines

Overview of GIPS

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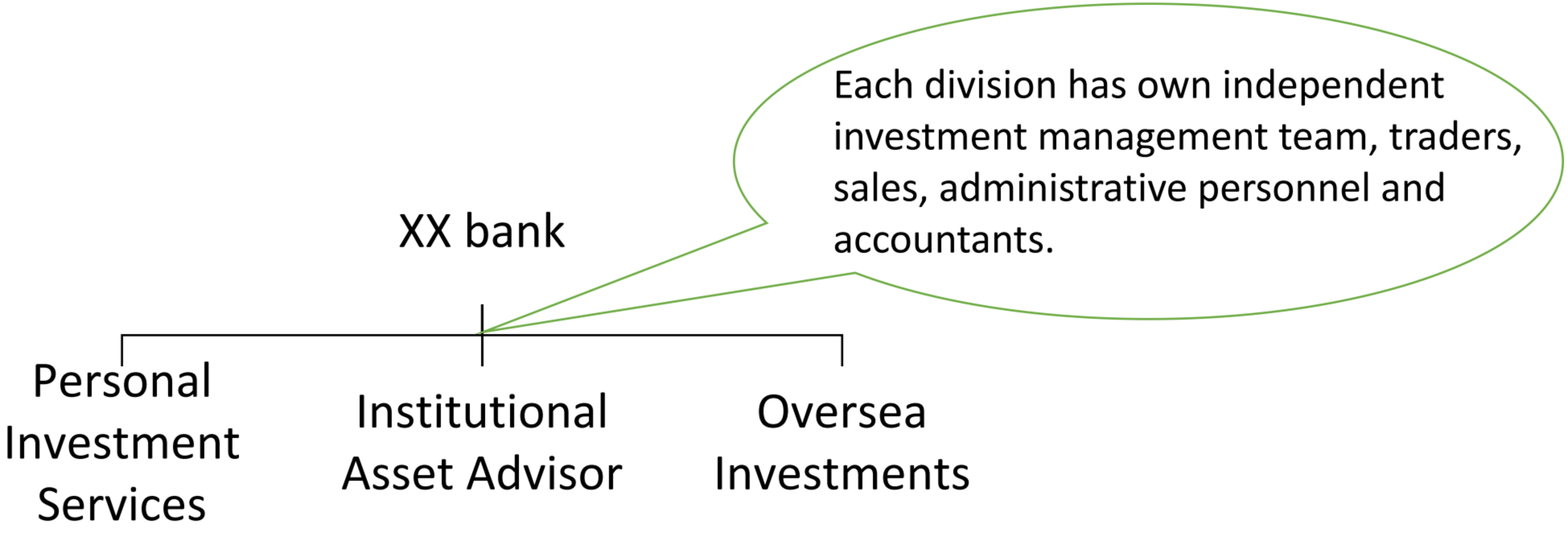
Definition of the firm and key terms

- The firm must be defined as an investment firm, subsidiary, or division held out to the public as a distinct business entity.



Overview of GIPS

Definition of the firm and key items

- The GIPS standards apply firm-wide.
- Total firm assets refers to the aggregate fair value of all assets, including assets managed by sub-advisors that the firm has authority to select but do not include advisory-only assets or uncalled committed capital.
- Changes in a firm's organization are not permitted to lead to alteration of historical performance.

Overview of GIPS

Definition of discretion and key items

- A portfolio is discretionary if the manager is able to implement the intended investment strategy.
- Restrictions that impede the investment process to such an extent that the strategy cannot be implemented as intended may be presumed to render the portfolio non-discretionary.
- Although both discretionary and non-discretionary portfolios are included in total firm assets, only discretionary portfolios are included in composites.

Other fundamentals of compliance

- To initially claim compliance with the GIPS standards, the firm must attain compliance for a minimum of five years or for the period since the firm inception if the firm has been in existence for less than five years.
- The firm must not present performance or performance-related information that is false or misleading.

Overview of GIPS

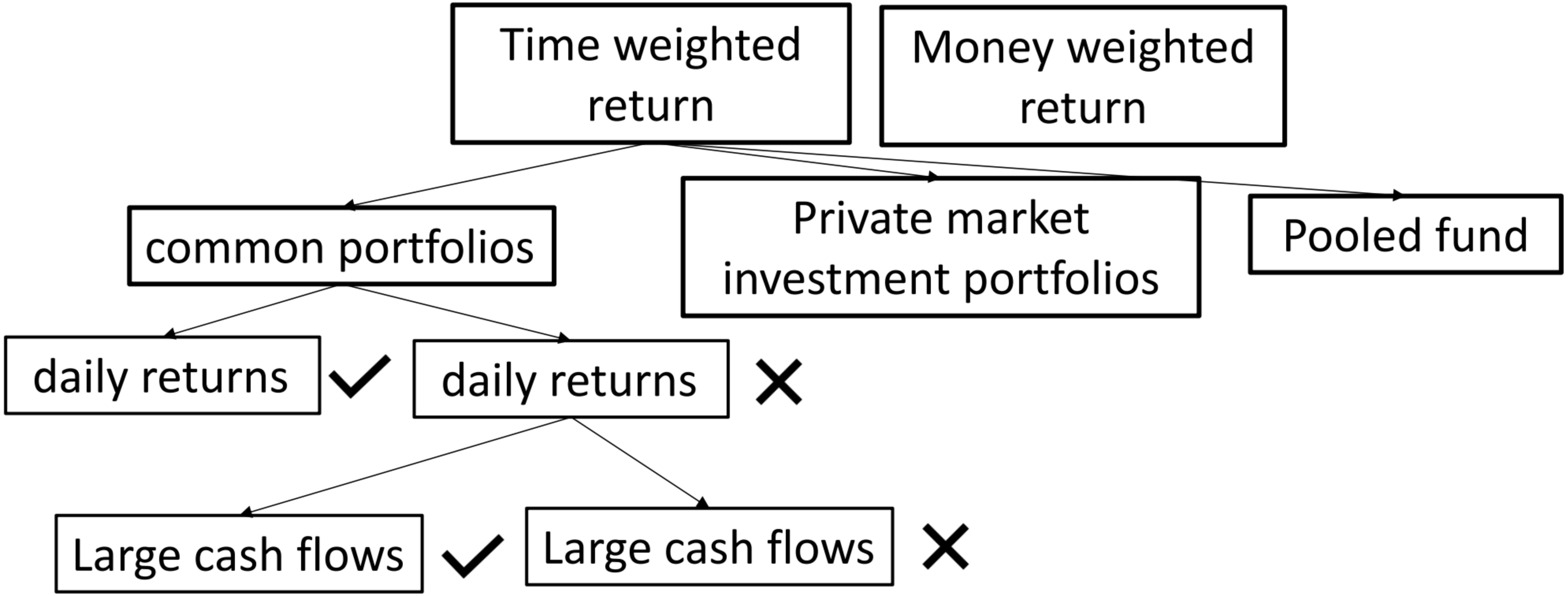
Other fundamentals of compliance

- The firm must make every reasonable effort to provide a GIPS composite report to all prospective clients when they initially become prospective clients. The firm must not choose to which prospective clients it presents a GIPS composite report.
- The firm must not link actual performance to historical theoretical performance.

Overview of GIPS [2]: Return Calculation Methodologies

Return Calculation Methodologies

Overview



Return Calculation Methodologies

Calculation details

- 什么时候用TWR？什么时候用MWR？
  - ✓ A firm may choose to present MWRs instead of TWRs if
    - the firm has control over the external cash flows and
    - the portfolios are closed-end, fixed life, or fixed commitment or illiquid investments are a significant part of the investment strategy.

Return Calculation Methodologies

Calculation details

- **Common portfolio 和 private market investment portfolio的区别是什么?**
  - ✓ Private market investment portfolio: real estate and infrastructure, private equity, and similar investments that are illiquid, not publicly traded, and not traded on an exchange.

Return Calculation Methodologies

Calculation details

- 计算的频率要求是什么?
  - ✓ Annualized, since-inception MWRs must be calculated at least annually.
  - ✓ All portfolios except private market investment portfolios included in composites: monthly
  - ✓ Private market investment portfolios must be valued quarterly.
  - ✓ If the portfolio is a pooled fund, and the pooled fund is not included in one of the firm's composites, the fund must be valued and returns must be calculated at least annually.

Return Calculation Methodologies

Calculation details

- 计算的时点要求是什么?
  - ✓ Portfolio: calculate monthly returns through the calendar month end or the last business day of the month.
  - ✓ Pooled fund: must be valued at the time of any subscriptions or redemptions and a sub-period return calculated as of that date.

Return Calculation Methodologies

Calculation details

- A true TWR calculation: requires valuation and return calculation with every external cash flow.
- 针对 large cash flows:
  - ✓ The returns calculated for each sub-period are geometrically linked according to the following formula:

$$r_{twr} = (1 + r_{t,1}) \times (1 + r_{t,2}) \times \cdots \times (1 + r_{t,n}) - 1$$

Where $r_{t,1}$ through $r_{t,n}$ are the sub-period returns.

Return Calculation Methodologies

Calculation details

- 针对 non-large cash flows:
  - ✓ Modified Dietz method and the Modified Internal Rate of Return (Modified IRR) method.
  - ✓ These methods are estimates of TWRs.

Return Calculation Methodologies

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Modified Dietz method

- If the portfolio experiences cash flows that are not large cash flows, and the firm does not calculate daily performance:

$$r_{ModDietz} = \frac{V_1 - V_0 - CF}{V_0 + \sum_{i=1}^{n} (CF_i \times w_i)}$$

$$w_i = (CD - D_i)/CD$$

Where CD is the total number of calendar days in the period, D_i is the number of calendar days from the beginning of the period to the time cash flow CF_i occurs.

Return Calculation Methodologies

Modified IRR method

- This method determines the internal rate of return for the period, adjusted to take into account the timing of cash flows:

$$Ending\ Value = V_1 = \sum_{i=1}^{n} [CF_i \times (1+r)^{w_i}] + V_0 \times (1+r)$$

- The Modified IRR method generates the same as the rate of return with the Modified Dietz method.

Return Calculation Methodologies

Example

Consider a portfolio with a beginning value of $100,000 as of 31 may, a value of 109,000 on 5 June (including a cash contribution of $10,000 received that day), and an ending value of $110,550 on 30 June. Calculate the total return for the period with:

a. True time-weighted method

b. Modified Dietz method

c. Modified IRR method

Return Calculation Methodologies

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Answer:

a. time weighted rate of return:

$$r_{t,1} = \frac{(109{,}000 - 10{,}000) - 100{,}000}{100{,}000} = -1\%$$

$$r_{t,2} = \frac{(110{,}550 - 109{,}000)}{109{,}000} = 1.42\%$$

$$r_{twr} = \left(1 + r_{t,1}\right) \times \left(1 + r_{t,2}\right) - 1$$

$$= (1 - 0.01) \times (1 + 0.0142) - 1 = 0.41\%$$

Return Calculation Methodologies

Answer:

b. Modified Dietz method:

$$r_{ModDietz} = \frac{110{,}550 - 100{,}000 - 10{,}000}{100{,}000 + 10{,}000 \times \frac{25}{30}} = 0.51\%$$

Return Calculation Methodologies

Answer:

c. Modified IRR method:

$$110{,}550 = 10{,}000 \times (1+r)^{\frac{25}{30}} + 100{,}000 \times (1+r)$$

$$r = 0.51\%$$

Return Calculation Methodologies

Other key terms

- Returns for periods of less than one year must not be annualized.
- Cash and cash equivalents
- Returns must be calculated after the deduction of transaction costs. (brokerage commissions, exchange fees and/or taxes, or spreads from either internal or external brokers, all legal, financial, advisory, and investment banking fees)
  - ✓ custody fees
  - ✓ bundled fee

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Overview of GIPS [3]: Composite Return Calculations

Composite Return Calculations

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Composite

- All actual, fee-paying, discretionary pooled funds must also be included in at least one composite if they meet a composite definition.
- Non-discretionary segregated accounts and pooled funds must not be included in composites.
- Non-fee-paying discretionary segregated accounts and pooled funds may be included in a composite, but additional disclosures may be required.

Composite Return Calculations

Composite Time-Weighted Return Calculations

Composite

- Asset weighting using beginning value
- Asset weighting using beginning value and external cash flow
- Aggregate return method

Composite Return Calculations

Asset weighting methods using beginning values

	Cash Flow Weighting Factor	Portfolio ($ Thousands)				
		A	B	C	D	Total
Beginning assets (31 Aug)		100	98.3	116.83	137.69	452.82
External cash flows						
6-Sept	0.80		16		-5.5	10.5
10-Sept	0.67	12				12
18-Sept	0.40				-18	-18
26-Sept	0.13		-7		-3.5	-10.5
29-Sept	0.03		-2.5			-2.5
Ending assets (30 Sept)		121.36	107.90	119.65	107.35	456.26
Percent of total beginning assets		22.08%	21.71%	25.80%	30.41%	100.00%

Composite Return Calculations

Asset weighting methods using beginning values

Composite Returns		
	Percent of Beginning Assets	**Return for Month of Sept**
Portfolio A	22.08%	8.67%
Portfolio B	21.71%	2.82%
Portfolio C	25.80%	2.41%
Portfolio D	30.41%	-2.66%
	100.00%	
Composite Return:		
Based on beginning assets		**2.34%**

Composite Return Calculations

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Asset weighting methods using beginning values and external cash flows

	Cash Flow Weighting Factor	Portfolio ($ Thousands)				
		A	B	C	D	Total
Beginning assets (31 Aug)		100	98.3	116.83	137.69	452.82
External cash flows						
6-Sept	0.80		16		-5.5	10.5
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18-Sept	0.40				-18	-18
26-Sept	0.13		-7		-3.5	-10.5
29-Sept	0.03		-2.5			-2.5
Ending assets (30 Sept)		121.36	107.90	119.65	107.35	456.26
Beginning assets + Weighted cash flows		108.00	110.08	116.83	125.62	460.54
Percent of total beginning assets + Weighted cash flows		23.45%	23.90%	25.37%	27.28%	100.00%

Composite Return Calculations

Asset weighting methods using beginning values and external cash flows

Composite Returns		
	Percent of Beginning Assets + Weighted Cash Flows	Return for Month of Sept
Portfolio A	23.45%	8.67%
Portfolio B	23.90%	2.82%
Portfolio C	25.37%	2.41%
Portfolio D	27.28%	-2.66%
	100.00%	
Composite Return:		
Based on beginning assets plus weighted cash flows		**2.59%**

Composite Return Calculations

Aggregate return method

	Cash Flow Weighting Factor	Portfolio ($ Thousands)				
		A	B	C	D	Total
Beginning assets (31 Aug)		100	98.3	116.83	137.69	452.82
External cash flows						
6-Sept	0.80		16		-5.5	10.5
10-Sept	0.67	12				12
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Ending assets (30 Sept)		121.36	107.90	119.65	107.35	456.26
Beginning assets + Weighted cash flows		108.00	110.08	116.83	125.62	460.54
Percent of total beginning assets + Weighted cash flows		23.45%	23.90%	25.37%	27.28%	100.00%

Composite Return Calculations

Aggregate Return method

$$r_{ModDietz} = \frac{V_1 - V_0 - CF}{V_0 + \sum_{i=1}^{n}(CF_i \times w_i)}$$

$$= \frac{456.26 - 452.82 - 10.5 - 12 - (-18) - (-10.5) - (-2.5)}{460.54}$$

$$= 2.59\%$$

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Overview of GIPS [4]: Discretion, Mandates, Composite Construction

Discretion, Mandates, Composite Construction

Defining discretion 业绩能否准确反映fund manager的投资能力?

- The portfolio manager must determine whether the client-imposed constraints are likely to materially affect her ability to execute the investment strategy.
  - ✓ If the constraint is not material, the manager could include the portfolio in a composite.
  - ✓ If the constraint is material, the manager may include the portfolio in a composite with other, similarly constrained portfolios or classify it as non-discretionary and exclude the portfolio from all composites.

Discretion, Mandates, Composite Construction

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Mandates

- No model or hypothetical portfolios may be included in any composite. Firms may not link the theoretical performance of simulated or model portfolios with actual performance.
  - ✓ Model, hypothetical, back-tested, or simulated returns are all considered theoretical performance. These returns can be shown as supplemental information but cannot be linked to actual composite or pooled fund returns.

Discretion, Mandates, Composite Construction

Including and excluding portfolios

- Firms are required to establish, document, and consistently apply a policy of including new portfolios in the appropriate composites on a timely basis.
- For many strategies, new portfolios should be included as of the beginning of the next full performance measurement period after the firm receives the funds.
  - ✓ If composite returns are calculated monthly and a portfolio is funded on 20 May, the composite should include the new portfolio as of the beginning of June.

Discretion, Mandates, Composite Construction

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Including and excluding portfolios

- A firm must include a terminated portfolio in the historical performance of the appropriate composite through the last full measurement period in which the firm had the discretion to manage the portfolio to the strategy.
  - ✓ If a firm that calculates performance monthly is informed on 20 May that its management contract is being terminated effective 31 May and is instructed to stop trading forthwith, then the firm should include the portfolio in its composite only through 30 April.

Discretion, Mandates, Composite Construction

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Including and excluding portfolios

- Portfolios cannot be switched from one composite to another unless:
  - ✓ the client revises the mandate, objective, or strategy governing the investment of portfolio assets and the guideline changes are documented; or
  - ✓ the original composite is redefined in such a way that the portfolio no longer fits it
- The historical performance of the portfolio must remain with the original composite.

Discretion, Mandates, Composite Construction

Including and excluding portfolios

- In the event of significant cash flows, a portfolio may be temporarily removed from the composite.
  - ✓ A significant cash flow is a client-directed cash flow sufficiently large that it may temporarily prevent the firm from implementing the strategy.
  - ✓ Firms must define "significant" on an ex-ante, composite-specific basis and must consistently follow the composite-specific significant cash flow policy.
- Alternatively, firms may use temporary new accounts to remove the effect of a significant cash flow.

Discretion, Mandates, Composite Construction

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Including and excluding portfolios

- If a firm establishes a minimum asset level for a composite, the firm must not include portfolios below the composite-specific minimum asset level in that composite.
- Portfolios below the minimum asset level would be considered non-discretionary with respect to that composite.
- If a firm establishes a minimum asset level for a composite, it must document policies addressing how portfolios will be treated if they fall below the minimum.

Discretion, Mandates, Composite Construction

Including and excluding portfolios

- The GIPS standards further state that any changes to a composite-specific minimum asset level must not be applied retroactively.
- If a portfolio is removed from a composite because it fell below the minimum, its prior performance must remain in the composite. The firm must determine if the portfolio that has been removed meets any other composite definition and include it in the appropriate composite in a timely and consistent manner.

Overview of GIPS [5]: Presentation and Reporting, Valuation and Verification

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GIPS report

- Firms claiming compliance with the GIPS standards must make every reasonable effort to provide a GIPS Report to all prospective clients and limited distribution pooled fund investors.
- There are two types of GIPS Reports: a GIPS Composite Report and a GIPS Pooled Fund Report.

Minimum years of performance

- Firms must show at least 5 years of annual performance and the GIPS-compliant performance record must then be extended each year until at least 10 years of performance have been presented.
- If the composite has been in existence for less than 5 years, the firm may present returns since inception and build over time to the 10 years of required returns.

Required elements of a GIPS composite report

- The core elements of a GIPS Composite Report that presents a time-weighted return includes:

1. composite and benchmark annual returns for all years;
2. the number of portfolios (if six or more) in the composite at each period end;
3. the amount of assets in the composite;
4. the amount of total firm assets at the end of each period;

Required elements of a GIPS composite report (Cont.)

- The core elements of a GIPS Composite Report includes:

5. a measure of internal dispersion of individual portfolio returns for each annual period if the composite contains six or more portfolios for the full year; (high/low, range, equal-weighted standard deviation, asset-weighted standard deviation)
6. if monthly composite returns are available, a three-year annualized ex post standard deviation of the composite and benchmark returns as of each annual period end.

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Portability

1.A.32 Performance from a past firm or affiliation may be used to represent the historical performance of the new or acquiring firm and linked to the performance of the new or acquiring firm if the firm meets the following requirements on a composite-specific or pooled fund-specific basis:

Portability

1.A.32 (Cont.):

a. Substantially all of the investment decision makers must be employed by the new or acquiring firm

b. The decision-making process must remain substantially intact and independent within the new or acquiring firm;

c. The new or acquiring firm must have records to support the performance;

d. There must be no break in the track record between the past firm or affiliation and the new or acquiring firm.

Portability

1.A.32 (Cont.):

If any of the above requirement are not met, the performance from a past firm or affiliation must not be linked to the ongoing performance record of the new or acquiring firm.

Portability

- If there is a break in the track record between the past firm and the new or acquiring firm, and if the first three portability tests are met, then the performance from the past firm or affiliation may be used to represent the historical performance of the new or acquiring firm—but the two performance records may not be linked.
- If a GIPS-compliant firm acquires another firm or affiliation, the firm is given a one-year to bring any non-compliant assets into compliance for future reporting periods.

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Valuation hierarchy

- Firms are required to apply a fair value methodology when valuing assets.
  - ✓ 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.

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Valuation hierarchy

- If unavailable, the GIPS standards recommend the following alternatives, in declining order of preference:
  - ✓ Quoted prices for similar investments in active markets;
  - ✓ Quoted prices for identical or similar investments in markets that are not active;
  - ✓ Market-based inputs, other than quoted prices, that are observable for the investment;
  - ✓ Subjective, unobservable inputs.

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Purpose of verification

- The GIPS standards recommend that firms undergo verification.
- Verification must be performed by a qualified and independent third party.
- A single verification report is issued only with respect to the whole firm; verification cannot be carried out on a single composite or pooled fund.

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Scope of verification

- If a firm does not meet all the requirements of the GIPS standards, it may not state or in any other way represent that it is in compliance with the GIPS standards—a firm cannot claim that a single composite is "in compliance," or that all the equity strategies are "in compliance".
- A firm that is verified may choose to have a detailed performance examination conducted on one or more specific composites or pooled funds