Module 29 & 30

soft dollar : commission payment to brokers in part to pay for other service (e.g. comissions)

Code of Ethics.

Std. of Pro. Cond.

30.7.
Can't make recommend upon an anamoly.

Module 31

Under ERISA, fiduciary has the duty to diversify the plan investment to protect from potential substantial loss. The firm must follow pension plan instructions & restrictions unless they conflict w/ ERISA (or other law / regulations).

7a. Conduct as a participant
b. Reference to CFA Institute

Module 32 AMC of Professional Conduct

6 General principles of conduct:

- always act ethnically & professionally
- act in the best interest
- act in an objective & independent manner
- Perform actions using skill, competence & diligence
- Communicate accurately with clients
- Comply with legal & regulatory requirements.

1. Loyalty to client

a. Place client interest ahead of the firm's.

b. Maintain client confidenticlity.

- Include an anti-money laundering policy (if needed)

c. Refuse business relationships & gifts that compromise independence objectivity & loyalty.

2. Investment process & actions

3. Trading

- Info Barrier

4. Risk management, compliance & support

a. Develop P&P

b. Hire compliance officer

c. Use an independent 3rd party to verify info

d. Maintain records.
Recommendation: Retain >7 years

e. Employ enough staff to meet AMC standards.

f. Establish business continuity plan to deal with disasters or market disruption

g. Establish firm-wide risk management plan to measure and manage the risk taken
Recommendation: perform stress testing. & scenario analysis

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5. Performance & valuation.

a. present performance data that is fair, accurate, relevant, timely & complete.
Recommendation : adopt GIPS.

b. Use fair market prices when available & fair valuations in other cases.

6. Disclosure.

need to disclose both gross-of-fees & net-of-fees.
allocation procedure
valuation method.
proxy policies

Module 33: Overview of GIPS.

Module 33.1: GIPS Overview

GIPS Objective:
- Advance client interest, increase client confidence
- Provide accurate data
- Create globally accepted std.
- Faciliate fair competition
- Encourage self regulation

Scope.
Only investment manager firms & asset owners who manage discretionary assets & compete for business may claim GIPS. for firms.
- can only be claimed on firmwide basis
- can't be claimed only on specific product/composite/port.
- must comply all GIPS requirements.
- GIPS recommendations are best practices.
- GIPS. standards evolve over time.

(asset owners who don't compete for business may claim GIPS for asset owner).

GIPS Terminology:
Composite: collection of portfolios. w/ similar strategy/mandate/objective.

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Seggregated account: a port. owned by a single. investor (aka. SMAs).

Pooled Fund: a port. owned by > 1. investors.

Broad distribution: available to public (i.e. mutual fund).

Limit. distribution: not. available to public (i.e. hedge fund).

Prospective client ⇔ investing in Seg. A/C.
Prospective investor ⇔ investing in Seg. pooled fund

Fundamentals of Compliance:

Characteristics of distinct business entity:

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Fair value of total firm assets:

Includes:

- discretionary & nondiscretionary assets.
  (nondiscretionary assets. not included in composite).
- Fee paying & non-feepay assets
- Actual, non-simulated assets, net of leverage

Excludes:

- Advisory-only assets.
- Uncalled committed capital.

Claiming GIPS. Compliance

Indicates:

- data inputs, processes & return calc are compliant.

- Seggregated account have been assigned to. >1 composites.

- Limit. dist. Pooled Fund have been assigned to an composite.

- Broad dist Pooled Fund are excluded unless used in seperate a/cs.

Other Compliance Fundamentals.

Module 33.3: Return Calculations.

GIPS mandates the use of Time-weighted returns (TWR):

- TWR negates the effect of ECF.
- TWR must be calculated at least monthly or or at the time of a large CF during the month
- Private market portfolios (e.g. PE, RE, infrastructure) must be valued quarterly.
- Pooled Funds must be valued annually

GIPS allows money-weighted returns (MWR)

- if firm has control over ECF
- portfolio is closed-end, fixed-life, fixed commitment OR have a significant amt of illiquid assets.

MWRs must be calculated at least annually.
Daily external CFs are used.
(must not annualize <1-yr return).

$$\left[R_{TWRR} = (1+R_1) \times (1+R_2) \times \dots \times (1+R_t) \right]$$

TWRR benefits:
- eliminate the distortion of ECF.
- id the manager performance
- subperiod returns must be geometrically linked.

Approximate Returns
- if portfolio aren't valued everyday
- ECF may be relatively small.
- use MD or MIRR.

$$\left[\quad R_{MD} = \frac{EV - BV - ECF}{BV + \text{adjusted } ECF} \quad \right]$$

Def. of large external cash flow is determined by each firm for each composite.

MIRR = IRR adjusts for timing of ECF.

(not required for exam).

Cash Treatment.

even if cash is managed by third party, cash & equivalent. must be included

GIPS, presented gross-of-fees. return must be calculated after deduction of transaction fee (i.e. commissions, spreads, fees). (includes advisory but not custody fee).

Bundled / All-in fees may include trading costs, custody & Investment Management. fee.

When trading fees can't be seperated from bundled fees:
- Presenting gross-of-fees. ⇒ reduce return for entire. bundled fee or portion of bundled fee known to. include trading fees
- Presenting net-of-fees. ⇒ reduce return for entire. bundled fee or portion of bundled fee known to. include trading fees

Module 33.4: Composite.

Composite Returns must be calculated in 1 of 3 ways:

- Asset-weighting portfolio returns by beginning-of-period values.
- Asset-weighting portfolio returns by both beginning-of-period values. & ECFs.
- The aggregate method.

EXAMPLE: A U.S. manager's equity composite contains three portfolios. The following values for the month of October show the external cash flows and the beginning and ending portfolio values. The values are in $ millions.

Portfolio	30-Sep	3-Oct	13-Oct	19-Oct	31-Oct
A	$110.00			–$10.10	$109.20
B	$167.80		–$11.10		$166.90
C	$344.20	$22.00			$345.10
Total	$622.00	$22.00	–$11.10	–$10.10	$621.20

Questions:

a) **Calculate** the Modified Dietz return for each portfolio.

b) **Calculate** the composite return using beginning of period portfolio values.

c) **Calculate** the composite return using beginning of period portfolio values with external cash flows.

d) **Calculate** the composite return using the aggregate return method.

a).

Port					Adjusted ECF
A	$(31-19)/31$	$\times$	-10.1	$=$	-3.91
B	$(31-13)/31$	$\times$	-11.1	$=$	-6.45
C	$(31-3)/31$	$\times$	22	$=$	19.87.

$$r_{MD_A} = [(109.20 - 110) - (-10.10)] \div (110 - 3.91)$$
$$= 8.77\%$$
$$r_{MD_B} = [(167.80 - 166.90) - (-11.10)] \div (167.80 - 6.45)$$
$$= 6.32\%$$
$$r_{MD_C} = [(344.20 - 345.10) - (22.00)] \div (344.20 + 19.87).$$
$$= -5.80\%$$

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b). $W_A = 110/622 = 17.68\%$

$W_B = 167.8 / 622 = 26.98\%$

$W_C = 344.2 / 622 = 55.34\%$

$R = 0.1768 \cdot 8.77\% + 0.2698 \cdot 6.32\%$
$+ 0.5534 \cdot -5.80\%$
$= 0.05\%$

c) $Value_a = (110 - 3.91) = 106.09$

$Value_b = (167.80 - 6.45) = 161.35$

$Value_c = (344.20 + 19.87) = 364.07$

$Sum = 631.51$

$W_a = 106.09 / 631.51 = 16.80\%$

$W_b = 161.35 / 631.51 = 25.55\%$

$W_c = 364.07 / 631.51 = 57.65\%$

$R = 16.80\% \cdot 8.77\% + 25.55\% \cdot 6.32\%$
$+ 57.65\% \cdot -5.80\%$
$= -0.25\%$

d). $R = \dfrac{621.20 - 22 - (-11.10) - (-10.10) - 622.}{631.50} = -0.25\%$

2nd & 3rd method (in many cases) will produce the same result.

Discretion & Comp. Construction

Discretionary portfolios must be included in ≥ 1 composite:

- All actual, fee-paying, discretionary seggregated accounts.
- Pooled funds that are offered as seggregated accounts.
- Non-fee-pay, discretionary a/cs. can be included as long as disclosed

IPS will specify risk references & constraints.

Clinet risk preferences. do not automatically make portfolio non-discretionary:

- Is manager's ability to use professional judgement materially constrained
- ECF can indicate that the portfolio is nondiscretionary (e.g. a client makes significant withdrawals that necessitates a large cash balance).
- low basis stock may be considered nondiscretionary if manager is unable to reallocate.

Model Portfolios

- aka. Simulated / hypo / theoretical portfolio.
- can be provided in supplemental information
- must be clearly labeled

Composite must:
- be determined by investment strategy / mandate / objective.
- contain all portfolios that match portfolio definition
- based upon documented criteria within firm policy.
- be representative of firm products & marketing
- Enable clients to compare performance of the firm.

Composites construction may include:
- equity style
- BM
- Equity / Bond sector
- Risk / Return profile.
- Active / Passive or Core.
- Investment Strategy.

Portfolio Inclusion

New portfolios should be included in a composite @ the beginning of the next measurement period

Portfolio Exclusion

Terminated Portfolios should be included in a composite through the last full measurement period in which the firm has discretion.

Switching Portfolios B/W Composites.

- may be due to change in mandate/objective/strategy
- firm might redefine.
- after switching, the portfolio performance must remain in the old composite.

Significant CFs.

- large enough to impede the firm from implementing the strategy on a timely basis:
- may temporarily exclude portfolio from composite
- or create/report on a temporary new a/c. that can contain cash/securities until it can be invested/divested

Minimum Asset Levels.

- MAL is defined by firms. to determine the minimize size of portfolios to be included in composites.
- a portfolio may be excluded from a composite. if its size is below the firm's minimum asset level.
- As portfolio change in size, they may be added or removed
- Historical performance must remain

Module 33.5: GIPS Presentation & Reporting

Performance History, Returns & Size.

Upon GIPS adoption:

- Firms are required to present annual performance for at least 5 yrs. (unless firm is <5 yr).
- extend each yr until firm builds a 10-yr GIPS compliant history

Required Elements of a GIPS Composite Report.

- Composite & BM returns for all year
- Asset value of the composite.
- No. of portfolios in the composite. (if 6 or more).
- Total amt. of firm assets.
- A measure of internal dispersion (if 6 or more port). & a 3-yr ex-post S.D.

Risk Measures.

- GIPS report must include annual measure of:
  - internal composite dispersion
    (variability of portfolio returns within the comp).
  - BM. dispersion
  - composite dispersion

/ /

Acceptable methods of calculating internal dispersion:
- High & Low returns
- Range
- Equal-weighted S.D.
- Asset-weighted S.D.
- Or other measure chosen by firm that. represents. the

BM & Composite Dispersion
- calculated using ex post. S.D.

S.D. must be presented

EXAMPLE: Internal dispersion

The following figure illustrates the structure of a composite during 2020. An *X* indicates that the portfolio was included in the composite for the quarter. If a cell is blank, the portfolio was not included in the composite for the entire quarter. **Determine** which portfolios should be contained in the internal dispersion measure for 2020.

Figure 33.1: Composite Structure, 2020

Portfolio	Quarter 1	Quarter 2	Quarter 3	Quarter 4
A	X	X	X	X
B	X	X	X	
C	X	X	X	X
D		X	X	X
E	X	X	X	X
F			X	X

Portability

When one firm acqures / joins with another, the new firm can link their performance to the previous firm if:

- all the decison makers are retained
- the decision making process remains intact & independent within the new firm.
- no breaks in performance b/w new firm & old firm historical performance
- old firm was GIPS compliant, 1yr to attain compliance

Module 33.6 : The Valuation Heirarchy

Portofolio valuation must be based on fair value. (not cost basis or book value)

Module 33.7: GIPS Verification

Assess :

- Policies & Procedures for composite & pooled fund
- Performance calculation & presentation
- Distribution of performance

Verifications can be only claimed for the entire firm

Ethics, AMC & GIPS.

1. Ethics : Code & Standard	REQUIRED	— charterholder — candidates
2. AMC. of coduct.	Voluntary	– Firms.
3. GIPS.	Voluntary	– Firms.
↓		
4. Verification (indep. audit).	Voluntary	– Firms.
↓		
5. Performance examination	Voluntary	– Firms.

GIPS. Level III

1. Overview
2. Definition of firm & Discretion
3. Return Methodologies. (TWRR & Modified Dietz).
4. Return Calculations
5. Presentation & Reporting
6. Valuation Heirarchy
7. Verification

Not simulated/model port.

discretionary only

All Actual, Fee Paying, Discretionary, segregated a/c.

portfolios meeting min. asset lv.

pooled funds. where they meet composite def.

can include non-fee paying (must disclose).

must be included in >1 composite.