CFA Institute / GIPS: Guidance Statement on Alternative Investment Strategies and Structures

1. Introduction

The Hedge Fund Standards Board (HFSB) was set up to act as custodian of the Hedge Fund Standards published by the Hedge Fund Working Group (HFWG) in 2008 and promote conformity with them. It is also responsible for ensuring that they are updated and refined, as appropriate. Over 100 stakeholders, including hedge fund managers and investors have already committed to the HFSB process. The HFSB expects that its Standards will be widely adopted and an increasing number of investors will use them in their due diligence.

The Hedge Fund Standards Board (HFSB) is pleased to respond to the Global Investments Performance Standards (GIPS) Executive Committee proposal.[1] It should be noted that the GIPS initiative and the applicability of their principles to hedge funds was acknowledged in the HFWG's Consultation Paper (October 2007) and the final report (January 2008) [2]. it should also be mentioned that that the Hedge Fund Standards have a specific section on performance measurement (Standard 3). The Hedge Fund Standards provide high level information on a wide area of topics, including governance, disclosure, valuation, risk management and shareholder conduct. As for the GIPS exposure draft , it offers very detailed technical guidance, which often goes beyond the areas specified in the Hedge Fund Standards. Therefore, the HFSB is not in a position to comment on all technical aspects included in the exposure draft, however the HFSB would like to encourage the adoption of generally accepted approaches.

2. General observations

The HFSB welcomes efforts to bring alternative investments under the umbrella of the Global Investment Performance Standards (GIPS). Accurate and consistent reporting of investment performance enables investors to make well-informed decisions about their investments, to compare different managers and hold them accountable.

[1] http://www.gipsstandards.org/standards/guidance/pdf/alternative_investment_strategies_structures_gs.pdf
[2] See Hedge Fund Standards: Consultation Paper, Part 2: The best practice standards, p.13; Hedge Fund Standards: Final Report, p. 44 (http://www.hfsb.org/sites/10188/files/final_report.pdf)

3. Specific observations

1. Do you agree with the proposed requirements related to the frequency of portfolio valuations? Why or why not?

The HFSB broadly agrees with the proposed approach (i.e. monthly valuations, valuations on the date of all large cash flows). While most hedge funds will have monthly or even more frequent valuations, the key factors here are a) availability of valuation information, and b) redemption frequency. The HFSB also agrees with the duty segregation where valuations are performed in-house - a concept that is also reflected in the valuation section of the Hedge Fund Standard (Standard 5).

Separately, in relation to fair value, it might be advisable to review consistency with IASB IFRS 13 Fair value measurement.

2. Do you agree with the proposed treatment of estimated versus final values? Do you support different guidance for pooled funds and managed portfolios? Do you agree with requiring the disclosure of the use of estimated values? Why or why not?

The HFSB agrees that fair representation and full disclosure are important principles, but has not made a detailed assessment on how to treat estimated values, for example in the context of fund of funds, as this goes beyond the scope of the Hedge Fund Standards.

3. Do you agree with the proposed treatment of gross-of-fees returns and net-of-fees returns for master-feeder structures? Why or why not?

The HFSB agrees that there should be uniformity in firms' performance presentation when calculating returns . However, the HFSB cannot provide specific comments on the treatment of gross-of-fees and net-of-fees returns for master-feeder structures and fund of funds, as this goes beyond the scope of the Hedge Fund Standards.

4.a) Do you agree with the proposed treatment of side pockets? Why or why not? b) Should a firm be required to disclose the creation of a side pocket in all instances? Or, only when a side pocket is created to hold non-discretionary assets that are no longer reflected in composite performance? What should be required to be disclosed?

The HFSB agrees with the rationale for setting up side pockets, i.e. to separate illiquid assets, and avoid investment strategy distortions for the whole pooled fund when investors liquidate their positions. The HFSB also agrees that, in line with the approach in other areas of the GIPS Standards, assets managed at the express direction of a client (e.g. via a side pocket) may be considered non-discretionary and therefore excluded from the performance of the composite. Also, additional disclosures which help to understand the sources of performance better (such as a disaggregation of the pooled fund return and presentation of the performance of the side pocket as well as the pooled fund return, excluding the side pocket, as supplemental information) are useful.

5. Do you agree with the proposed treatment of illiquid investments? Why or why not?

The Hedge Fund Standards require ex ante disclosure of the investments /instruments/techniques used by the hedge fund manager, including the use of leverage in the offering documents (Standard 1). Also, in the context of performance measurement, the hedge fund standards require better transparency on exposure- to-hard to value assets (Standard 3).

The HFSB also agrees that in the interest of consistency and comparability, illiquid investment should not be excluded from a portfolio or composite for performance purposes.

6. Should firms be allowed to adjust portfolio and composite performance for the double counting of assets? Alternatively, do you agree that firms should be prohibited from recalculating portfolio and composite performance to eliminate double-counted assets? Why or why not?

This goes beyond the areas covered by the Hedge Fund Standards.

7. When presenting net-of-fees returns, firms are allowed to reduce gross-of-fees returns by the actual investment management fee incurred by each portfolio or a model fee. The model fee must be the highest investment management fee incurred by portfolios in the composite. Should firms also be allowed to present net-of-fees returns that are reduced by a model fee which is the maximum investment management fee applicable to the prospective client, even if it is not the highest investment management fee that is incurred by portfolios in the composite? Why or why not?

This goes beyond the areas covered by the Hedge Fund Standards.