VOLUME 19 – ISSUE 8 AUGUST 2023

Since 1990, TSG, an employee-owned business, has had an increasing presence in the money management industry.

TSG is the fastest-growing verification firm, serving clients around the globe, with assets ranging from less than $100 million to more than $1 trillion. We provide an array of other performance measurement services and products, including consulting, publishing (*The Journal of Performance Measurement*®), research, and training. We also host the Performance Measurement Forum, the Asset Owners' Round Table, and the Annual PMAR™ Conferences.

We are actively involved as members of the CFA Institute and other industry groups. TSG has also led the charge for the industry in the handling of error correction, attribution guidelines/ standards, and Investment Performance Measurement Analyst Certification (since handed over to the CFA Institute and now called the CIPM program).

Several of our senior staff regularly speak at and/or chairs industry conferences. Our founder and CEO, David Spaulding, is a frequent author and source of information to various industry publications. Our firm continues to make huge contributions to our industry, in terms of valuable content, innovative ideas, and volunteer activities.

Our clients appreciate our industry focus and understanding of their business, their needs, and the opportunities to make them more efficient and competitive.

TSGperformance.com

Perhaps not as obvious as it should be

The "standards," speaking broadly for a moment, have had a habit of redefining terms that many folks in the investment industry were familiar with: altering terms can be confusing.

Discretion, discretionary, non-discretionary

One example, which continues to haunt us, is "discretion."

Investopedia explains that "A discretionary account is an investment account that allows an authorized broker to buy and sell securities without the client's consent for each trade. The client must sign a discretionary disclosure with the broker as documentation of the client's consent."

One of their "Key Takeaways" is "A discretionary account is one in which clients hand over control of their trading account to brokers or advisors, who select and execute trades for them."

But this isn't what the AIMR-PPS® meant, nor is it what the GIPS® standards mean.

Let's begin with this rule: "Firms must include all actual, fee-paying, discretionary segregated accounts in at least one composite."

Interestingly, such important terms as "discretionary" and "non-discretionary" are not worthy of being in the glossary. And nowhere in the Standards[1] do we find what would qualify as a definition.

However, we can glean what the terms mean in the "firm" handbook,[2] where we find:

- "In the case of a non-discretionary segregated account that is included in total firm assets, the account has documented client-imposed restrictions that significantly hinder a firm from fully implementing its intended strategy."
- "Although the account is considered non-discretionary because the intended strategy cannot be fully implemented, the firm is responsible for managing the account, including the trading of its assets."

The Journal of Performance Measurement®

PLEASE SEE OUR CURRENT ISSUE:
https://tsgperformance.com/free-journal-of-performance-measurement/

Oddly, firms are required to define discretion, when arguably they should define what non-discretion is.

Rather than the alteration of a well established term, a new term should have been introduced, such as "representative." That is, is the account *representative* of the strategy? If it isn't, it is excluded from the composite. Instead, this old term has been used for over 30 years. And while those of us who have worked with the Standards for some time understand it, individuals new to the Standards must undergo an education as to what the term means in "GIPS speak," so to speak.

Discretionary accounts are ones that are representative of the strategy, while non-discretionary are not representative. And the firm is obligated to explain, in detail, what conditions would cause an account to be non-discretionary.

A legally non-discretionary account (i.e., one where the client has withheld the authority for the manager to trade without their approval) would be considered "advisory." For GIPS purposes, non-discretionary accounts are discretionary. Get it?[3]

<u>Since inception</u>

The 2020 version introduced a new term, which, again, has a long history: since inception.

The overseers of the Standards initially proposed to drop the requirement for "creation date," since so many were confused by the term. I always found this odd, that someone would not understand what the words meant, since this term at least is what it means: the date you created the composite. Why did so many, including a former senior GIPS official, not get it? Too many thought it meant "inception date." But if we meant inception date, we would have said inception date. Instead, the term "creation date" was introduced. Nice, simple, clear; never-the-less, confusion erupted.

To me, creation date is a meaningful and important disclosure, as it lets the prospect understand how long the composite they're looking at has actually been around. And so, I was pleased that it is still a required disclosure.

Now, inception date is a different matter. I would say that most folks in our industry understand it to mean when a strategy began or incepted. And so, if you began your U.S. Large Cap Growth strategy in July 2003, that would be its inception date (congratulations on being around for 20+ years!).

But, that's not what the GIPS standards mean.

Before we get to what the Standards mean, consider that the Standards have spoken about inception in the past. For example, a new firm must bring at least five years of performance into compliance, or for the period since the composite's inception, if it's less than five years old. I've always felt this was pretty clear.

The standards define "composite inception date" as "The initial date of the composite's track record."

So, to be clear, "inception date" isn't the *strategy's* inception date, but the composite's.

Consider this: your 20 year old US LCG composite's inception date would be the first date your track record appeared in a GIPS report. If you became compliant this year, and only went back five years, with the initial period starting January 2018, then January 2018 is your composite's inception date, despite the strategy being much older.

Plus, if 10 years from now, you've rolled off the first five years of history, so that the report no longer shows January 2018, that date remains the composite's inception date.

Can you report the strategy's inception date? Absolutely, though I suggest you label it as "supplemental information," just to be safe.

Many investors want to know how experienced you are. And if you choose to begin compliance with just five years' history for a 20-year old strategy, you probably want to let folks know you've got a longer than five year history.

I get it ... (I think)

Making a rather complicated standard clear is, well, complicated. Despite the GIPS Executive Committee's aim to make the 2020 version simpler, in some (many?) respects, it's more confusing.

TSG's verifiers occasionally get confused by some of this, despite the team being entirely comprised of senior level professionals. That's why we frequently "bounce" things around among ourselves.

Is there something you find particularly confusing? If so, let us know, and we'll try to help.

And hopefully this issue has provided you with some clarity.

---

1. Going forward in this issue, any reference to the Standards is to the GIPS standards.
2. Page 71, 2020 version of the [firm] handbook.
3. Sorry; just having a bit of fun. Here, in this sentence, we use the term "non-discretionary" in the way GIPS means it, while we use the term "discretionary" from a "legal" perspective: that is, where the client has granted authority to the manager to trade.

TSG'S 2023
INVESTMENT PERFORMANCE MEASUREMENT CALENDAR OF EVENTS

DATE	EVENT	LOCATION
September 13, 2023	Webinar - Asset Owner Insights with TSG and Rimes	On-line 11:00 AM EDT
November 9-10, 2023	Performance Measurement Forum	Porto, Portugal
November 29, 2023	Asset Owner Roundtable	Orlando, FL
November 30 - December 1, 2023	Performance Measurement Forum	Orlando, FL
October 23-24, 2023	Fundamentals of Performance Measurement	Los Angeles, CA
October 25-26, 2023	Performance Measurement Attribution	Los Angeles, CA

For additional information on any of our 2023 events, please contact Patrick Fowler at 732-873-5700.