CFA Institute®
Global Investment
Performance Standards

SURVEY REPORT OF US FIRMS ON THE CALCULATION AND PRESENTATION OF NET RETURNS

CFA Institute

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Executive Summary

During the second quarter of 2021, the United States Investment Performance Committee (USIPC), in conjunction with CFA Institute, conducted a survey of US firms claiming compliance with the Global Investment Performance Standards (GIPS®) to learn about the methodologies and practices that firms are using to calculate and present net returns. Key takeaways include the following:

- Larger firms favor the use of model investment management fees (or "fees"), whereas smaller firms prefer actual fees.
- Three-quarters of US firms using model fees use the highest tier of the standard fee schedule as the model fee when calculating net returns.
- When using a model fee, most firms (60%) periodically review portfolio fee schedules and compare them with the model fee to ensure that net returns calculated using model fees are equal to or lower than returns calculated using actual fees.
- When including a non-fee-paying portfolio in a composite, two-thirds of the respondents use the actual fee (e.g., $0) for that portfolio when calculating net returns.
- Almost half of the survey respondents that include pooled funds in composites and calculate net returns using actual fees deduct only the pooled fund's investment management fee.
- Almost half of the survey respondents report that performance-based fees are reflected in net returns only when those fees crystallize.
- Almost three-quarters of firms managing wrap fee equity composites use a 3.0% model wrap fee, whereas approximately 40% of firms managing wrap fee fixed-income composites use a model wrap fee of 1.5%.
- More than one-third of the respondents find that the most challenging activity associated with net returns and their related disclosures is ensuring that the model fee used results in net returns that are equal to or lower than returns calculated using actual fees.

About the Survey

Survey respondents were US-based firms that claim compliance with the GIPS standards. The survey aimed to determine how firms are addressing the requirements related to the calculation and presentation of net returns.

Demographics

To gain insight into the firms that responded to our survey, we asked about their assets under management (AUM). The respondents represent firms of all sizes. Large firms (with AUM of USD250 billion or more) made up the largest group of survey participants. Exhibit 1 shows the full breakdown.

Please indicate your approximate assets under management:	
Less than USD250 million	9.0%
USD250 million to less than USD1 billion	7.5%
USD1 billion to less than USD5 billion	13.5%
USD5 billion to less than USD20 billion	17.0%
USD20 billion to less than USD50 billion	13.0%
USD50 billion to less than USD250 billion	15.0%
USD250 billion or more	25.0%

Exhibit 1: Assets under management

Use of Actual vs. Model Fees

The GIPS standards allow the use of actual or model fees when calculating composite net returns. Thirty-seven percent of survey respondents use actual fees for all composites, and an almost equal number (36%) use model fees for all composites. Twenty-two percent of survey respondents use actual fees or model fees, depending on the composite. A small number of respondents (4%) indicated that they do not calculate composite net returns. (The new US SEC Marketing Rule, which has a compliance date of 4 November 2022, requires all advertisements to include net returns. Firms subject to this rule that do not calculate net returns should reevaluate their current policies.)

Which option best describes the type of investment management fees your firm uses when calculating composite net returns?	
Actual investment management fees for all composites	37.0%
Model investment management fees for all composites	36.4%
Actual investment management fees for some composites and model investment management fees for some composites	22.3%
We do not calculate composite net-of-fees returns	4.3%

Exhibit 2a: Use of actual vs. model fees for composite net return calculations

The survey showed no overall preference for actual or model fees. By looking at the data on the type of fee used in conjunction with firm AUM data, we can draw conclusions about the type of firms more likely to use one method than the other. The smaller the firm, the more likely it will use actual fees; conversely, the larger the firm, the more likely it will use model fees. This finding is not surprising because using actual fees is more operationally challenging, so using model fees becomes more practical when the firm is large. Details on the type of fees used in relation to firm AUM are shown in Exhibit 2b.

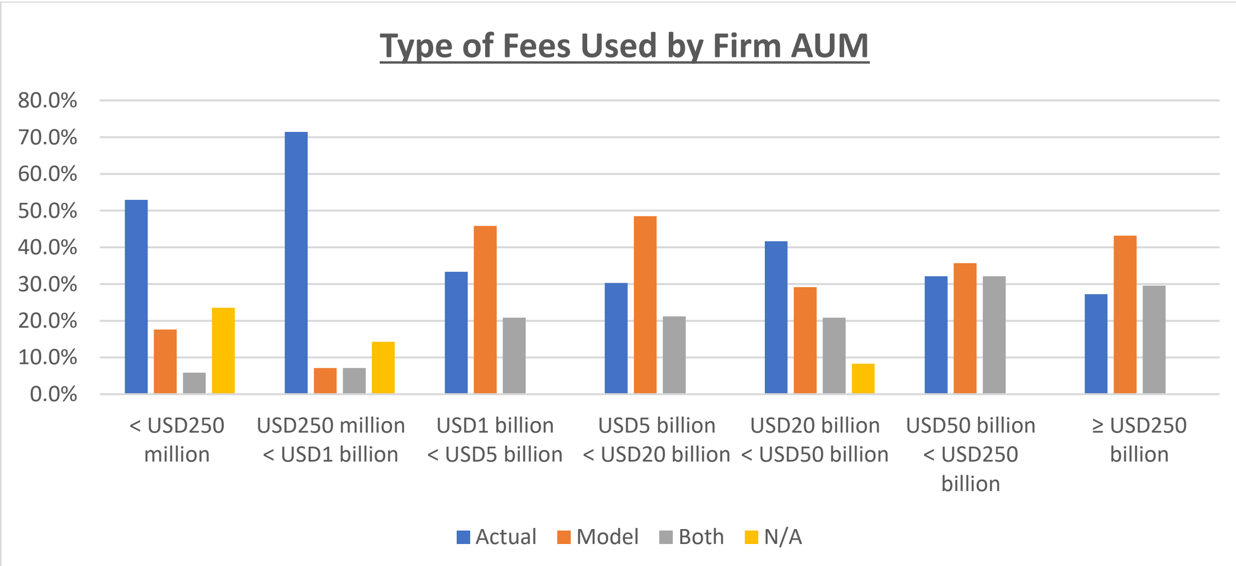

Exhibit 2b: Type of fees used, by firm AUM

Type of Model Fee Used

When calculating composite net returns, almost three-quarters of the respondents using a model fee apply the highest tier of the standard fee schedule, at either the composite level or the portfolio level. Fourteen percent of firms use as the model fee the highest fee charged to any portfolio included in the composite, whereas almost 8% apply the entire tiered fee schedule at the portfolio level.

When your firm uses model investment management fees to calculate composite net-of-fees returns, which option best describes the model fee used?	
Highest tier of the standard fee schedule, applied at either the composite level or portfolio level	73.6%
Highest actual investment management fee charged to any portfolio included in the composite	14.2%
Tiered fee schedule applied to each portfolio in the composite	7.5%
Other (please specify):	4.7%

Exhibit 3a: Type of model fee used

The most common practice for firms of all sizes is to use the highest tier of the standard fee schedule as the model fee. Details are shown in Exhibit 3b.

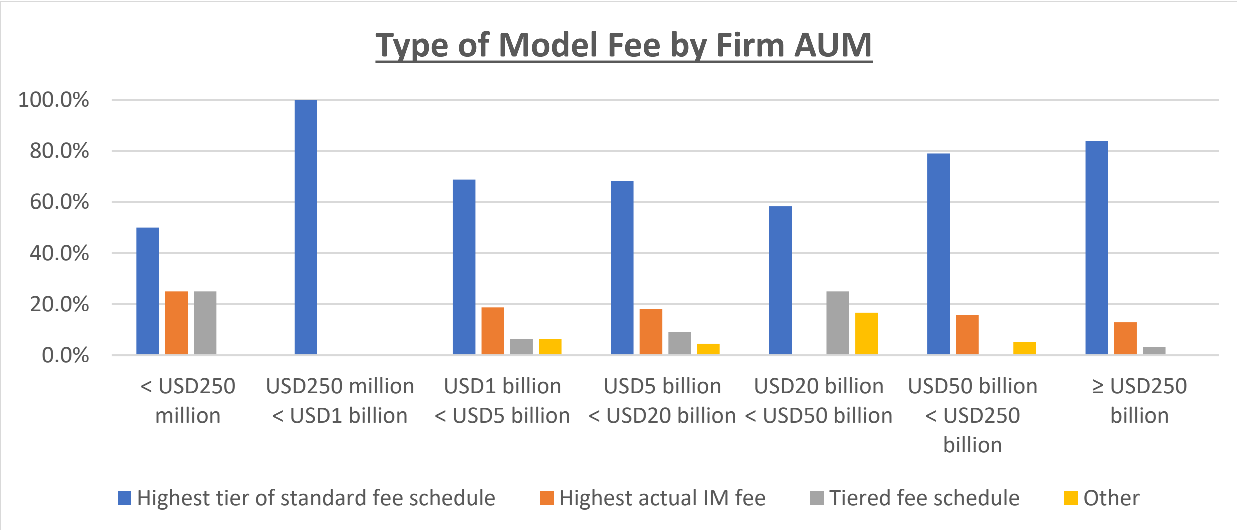

Exhibit 3b: Type of model fee, by firm AUM

Calculation and Presentation of Multiple Net Returns

The GIPS standards allow the calculation of net returns using a model investment management fee that is appropriate to prospective clients, as long as the calculated returns are equal to or lower than those that would have been calculated using actual investment management fees. Multiple net returns may be calculated and presented for a composite. A firm may have multiple versions of a GIPS Composite that have different net return streams. A firm may also include a second net return stream in a GIPS Report that has been calculated using a model fee specific to a prospective client. If this second net return stream does not meet the requirement of being equal to or lower than the return that would have been calculated using actual investment management fees, this second net return stream must be labeled as supplemental information.

We asked the survey participants what their practice is when calculating more than one net return for the same composite. More than half of the respondents (60%) maintain only one GIPS Report for each composite, and if they need to present net returns using a different investment management fee, they do so outside of the GIPS Composite Report. Approximately 17% of firms maintain multiple versions of a GIPS Composite Report that have different net return streams, and 12.5% of firms present multiple net return streams in a single GIPS Composite Report. Another 10% of respondents have adopted less common practices, such as presenting two net return series, with one series reflecting the deduction of actual fees and the other reflecting the deduction of model fees.

If your firm calculates multiple net returns for a composite using different model fees, which option best describes how these different net return streams are presented in GIPS Composite Reports?	
We maintain a single GIPS Composite Report with a single net return stream and use the other net return streams on an ad-hoc basis outside of the GIPS Composite Report	60.4%
We maintain multiple versions of a GIPS Composite Report that have different net return streams	16.7%
We present multiple net return streams in a single GIPS Composite Report	12.5%
Other (please specify):	10.4%

Exhibit 4a: Calculation and presentation of multiple net returns

Larger firms are more likely than smaller firms to calculate a single series of net returns. Details are shown in Exhibit 4b.

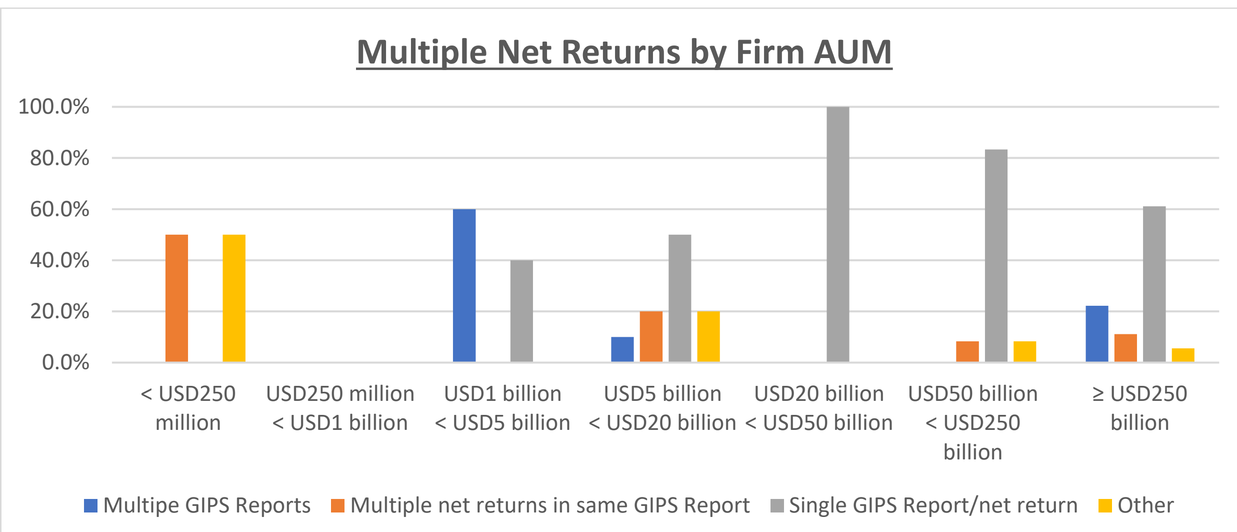

Exhibit 4b: Multiple net returns practices, by firm AUM

More Conservative Model Net Returns Check

Although the GIPS standards allow the use of model fees, they also require that the returns calculated using model fees are equal to or lower than those that would have been calculated using actual investment management fees. We asked firms what policies they have implemented to comply with this requirement. Almost two-thirds (62%) of the survey participants review fee schedules of portfolios in the composite and compare them with the model fee.

Which option best describes how your firm ensures that the composite net returns calculated using model investment management fees are equal to or lower than net returns that would have been calculated using actual investment management fees?	
We review portfolio fee schedules and compare them to the model fee	61.9%
We calculate composite net returns using both actual and model investment management fees and compare the results	14.4%
Other	23.7%

Exhibit 5a: Check to ensure model net returns are no higher than actual net returns

We analyzed the responses by firm size and concluded that the type of check performed to ensure compliance with the requirement to show model net returns that are no higher than actual net returns is not correlated with firm AUM.

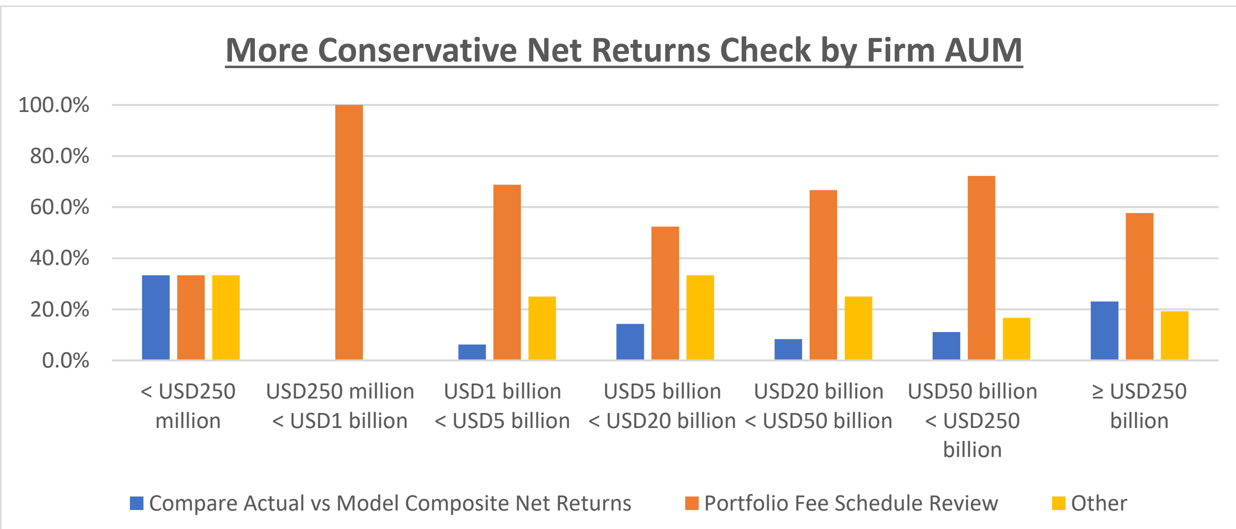

Exhibit 5b: Relationship between firm AUM and the type of check performed to ensure more-conservative model net returns

Reflecting Fees on a Cash vs. Accrual Basis

If a firm uses actual investment management fees to calculate net returns, it may choose to account for fees on a cash basis (i.e., as they are paid) or on an accrual basis (i.e., as they are billed). Although both methods are allowed, the GIPS standards recommend the accrual method because it ensures more accurate net returns, especially when portfolio values fluctuate. Additionally, if clients pay fees outside of the portfolio, accounting for them on a cash basis may be operationally challenging. Of firms responding that use actual investment management fees, 46% reflect fees on an accrual basis, whereas 35% reflect them on a cash basis. The remaining respondents reported that the treatment depends on the portfolio.

If your firm calculates net returns using actual investment management fees, which option best describes how net returns are calculated for portfolios that do not have performance-based fees?	
Fees are reflected in net returns on a cash basis	35.3%
Fees are reflected in net returns on an accrual basis	46.1%
How fees are reflected in net returns varies by portfolio	18.6%

Exhibit 6a: Reflecting fees on a cash vs. accrual basis

As we analyzed the responses by firm size, we found that the smaller the firm, the more likely it is to reflect fees on a cash basis; and conversely, the larger the firm, the more likely it is to accrue those fees. Exhibit 6b shows the full breakdown.

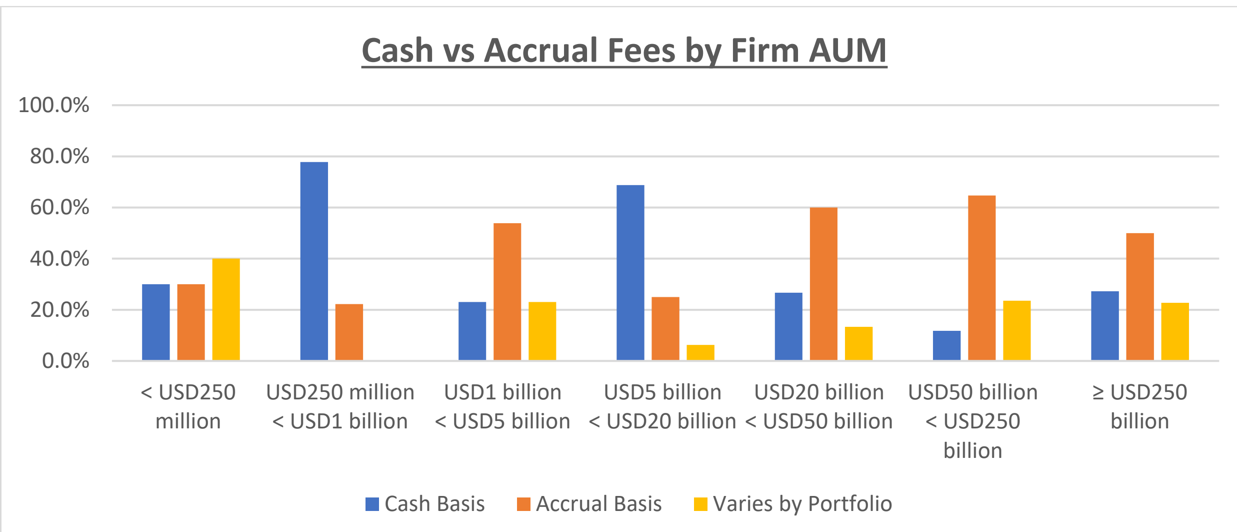

Exhibit 6b: Reflecting fees on a cash vs. accrual basis, by firm AUM

Non-Fee-Paying Portfolios

A firm is not required to include non-fee-paying portfolios in a composite but may choose to do so. If a firm chooses to include non-fee-paying portfolios in composites, then it faces another choice when calculating net returns: whether to use the actual investment management fees (e.g., $0) or use a model investment management fee. If it chooses the former option, the firm must disclose the percentage of composite assets that is represented by non–fee-paying portfolios as of each annual period end. Two-thirds of the respondents who include non-fee-paying portfolios in composites use actual management fees, whereas one-third use a model investment management fee.

If your firm includes non-fee-paying portfolios in composites and calculates composite net returns using actual investment management fees, which option best describes how non-fee-paying portfolios are treated?	
We use actual investment management fees (e.g., $0) for non-fee-paying portfolios	66.7%
We apply a model investment management fee to the non-fee-paying portfolios	33.3%

Exhibit 7a: Actual fees vs. model fees for non-fee-paying portfolios

According to the survey responses, smaller firms (<USD1 billion) are more likely to use actual investment management fees for non-fee-paying portfolios. As firm size increases from USD1 billion to USD50 billion, the proportion of firms using a model fee for those portfolios increases from 25% to more than 40%. Firms with AUM exceeding USD50 billion are equally likely to use actual or model fee for non-fee-paying portfolios. Exhibit 7b shows the full details.

This survey was conducted prior to the SEC Marketing Rule's compliance date of 4 November 2022. The Marketing Rule states that an adviser generally should apply a model fee to non-fee-paying portfolios, as well as to portfolios with reduced rates that are unavailable to unaffiliated clients. If a composite includes such portfolios, and net returns are calculated using actual fees, firms will need to determine if a model fee should be applied.

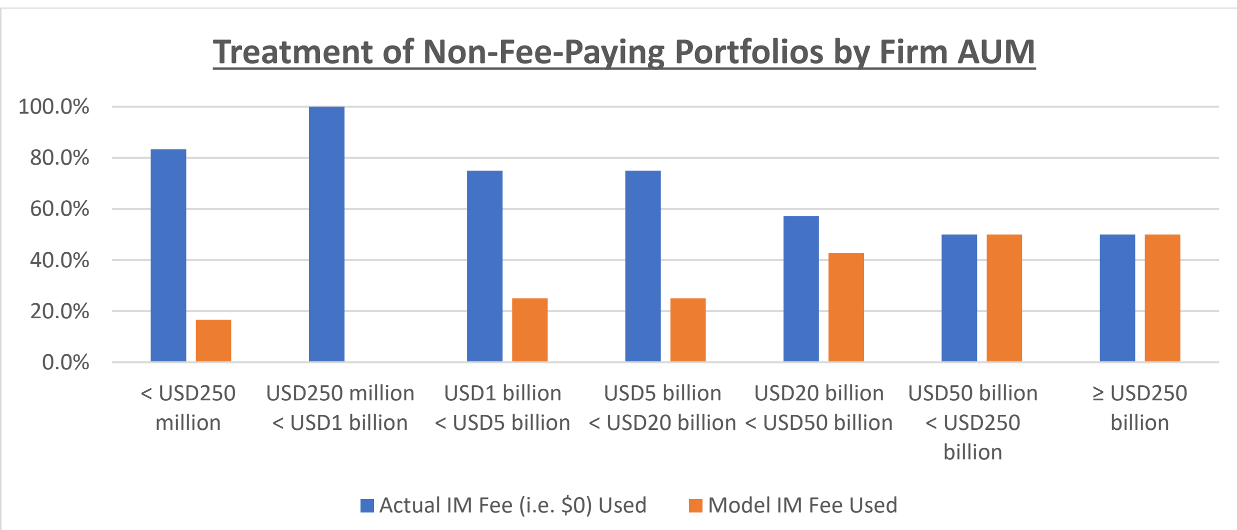

Exhibit 7b: Actual fees vs. model fees for non-fee-paying portfolios, by firm AUM

Pooled Funds Included in Composites

The 2020 edition of the GIPS standards requires a firm to include a pooled fund in a composite if the pooled fund is managed in a strategy that is managed for or offered as a segregated account, or if the pooled fund meets a composite definition. We asked survey participants which type of pooled fund net returns they use when calculating composite net returns using actual fees. Almost half of the respondents use pooled fund net returns that reflect the deduction of the pooled fund's actual investment management fee, and approximately 35% use the pooled fund's net returns that reflect the deduction of all pooled fund fees and expenses, including investment management fees, administrative fees, and other expenses.

If you include pooled funds in composites and calculate composite net returns using actual investment management fees, which option best describes the pooled fund net returns that are used?	
We calculate pooled fund net returns that reflect the deduction of the pooled fund's actual investment management fee	47.8%
We use the pooled fund's net returns that reflect the deduction of all pooled fund fees and expenses	34.8%
We calculate pooled fund net returns that reflect the deduction of a model investment management fee	14.5%
Other	2.9%

Exhibit 8a: Pooled fund net returns for pooled funds included in composites

If we look at the distribution of the responses across the firm AUM spectrum, we see that firms with AUM of USD250 billion or more are the only firms that are most likely to use pooled fund net returns that reflect the deduction of all pooled fund fees and expenses.

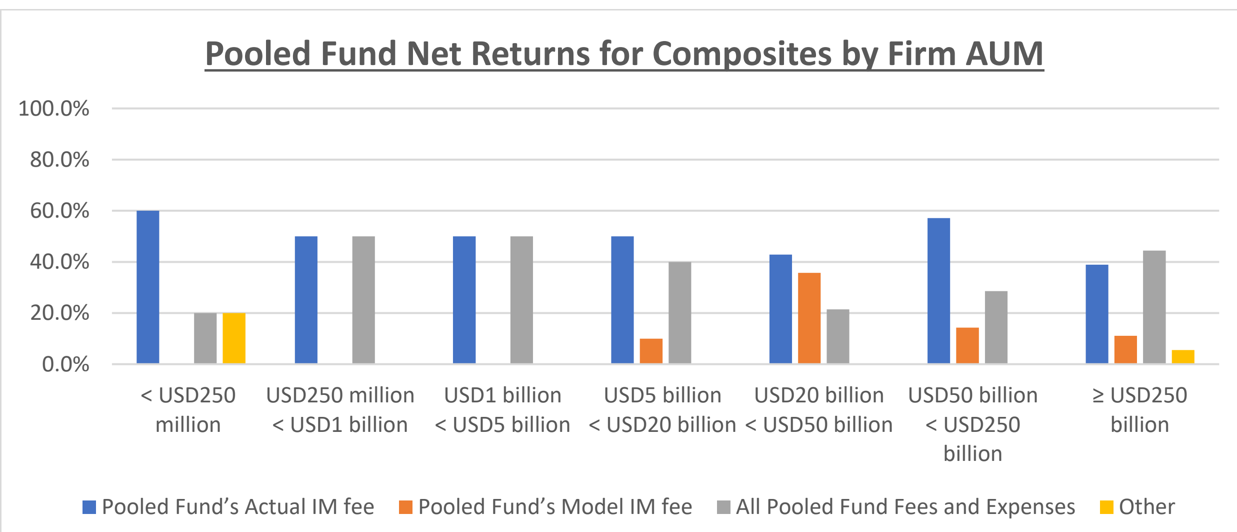

Exhibit 8b: Pooled fund net returns for composites, by firm AUM

Performance-Based Fees

When calculating net returns, firms must reflect the deduction of investment management fees, which include asset-based fees, performance-based fees, and carried interest. Accruing for performance-based fees can be challenging because the fees can materially change as performance fluctuates.

We asked the survey participants how they handle performance-based fees. Almost half of the respondents do not accrue these fees and reflect them in net returns only when those fees crystallize. Another 38% report that they accrue performance-based fees using both positive and negative accruals. Using this method can cause net return to be higher than the gross return for a specific period. In addition, 11% of the respondents accrue performance-based fees and restate prior periods returns as performance-based fees change.

If your firm calculates net returns with performance-based fees, which option best describes how performance-based fees are treated?	
We do not accrue the performance-based fee and only recognize it when it crystallizes	46.9%
Performance-based fees are accrued using both positive and negative accruals (i.e., the net return can be higher than the gross return for a specific period)	38.3%
Performance-based fees are accrued and prior periods are restated to reflect the YTD performance-based fee	11.1%
Other (please specify):	3.7%

Exhibit 9a: Treatment of performance-based fees

Smaller firms (AUM <USD5 billion) are more likely to accrue performance-based fees and reflect both positive and negative accruals, whereas mid-sized to large firms (AUM from USD5 billion up to USD250 billion) are more likely to recognize these fees on a cash basis. Larger firms are also more likely to restate prior period returns, with almost 20% of firms with AUM of USD50 billion or more reporting that they use this method.

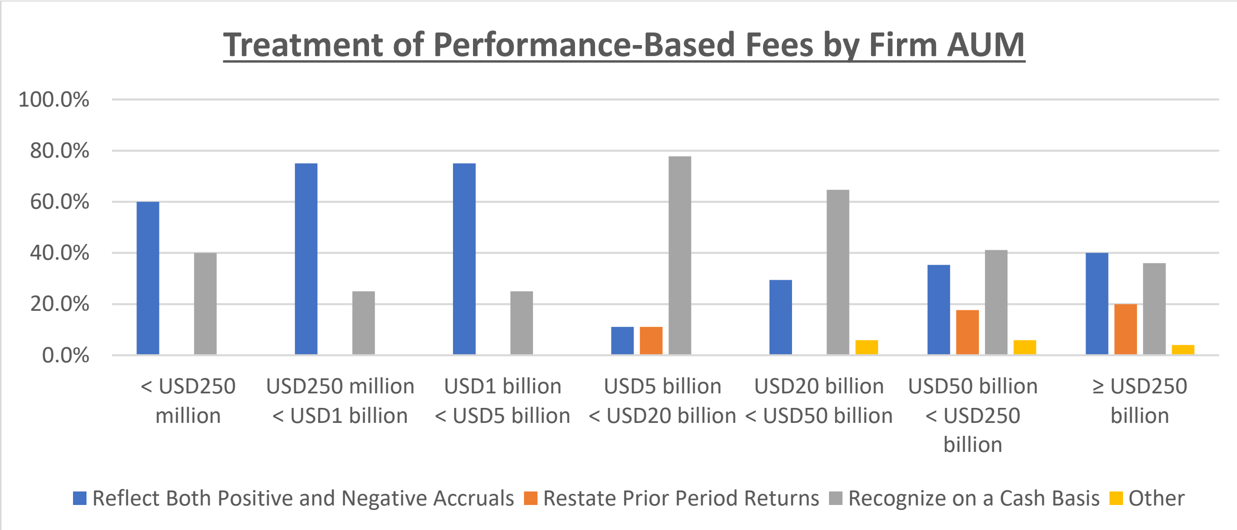

Exhibit 9b: Treatment of performance-based fees, by firm AUM

Wrap Fees

The Guidance Statement on Wrap Fee Portfolios addresses using model fees for wrap fee portfolios. When using a model wrap fee, the firm must determine the appropriate highest wrap fee to deduct. This highest wrap fee should be obtained from the prospective wrap fee sponsor and should be comparable to the investment mandate, objective, or strategy of the wrap fee composite. The firm should make its best efforts to determine the wrap fee that will be charged by prospective wrap fee sponsors and use that fee as the model wrap fee. If the firm cannot determine the appropriate wrap fee to use, it may use as the model fee the generally assumed highest model wrap fee (currently 3.00% for equities and 1.50% for fixed income).[1]

We surveyed participants to ask which model fee they use for equity and fixed-income composites, respectively.

[1] This survey was conducted prior to the issuance of the Guidance Statement on Wrap Fee Portfolios (effective 1 October 2021).

Equity Composites

The majority of firms use a model fee of 3.0% for wrap fee equity composites.

If your firm calculates net returns for wrap fee composites using model total wrap fees, which option best describes the model fee used for wrap fee equity composites?	
3.0%	71.8%
2.5%	7.7%
2.0%	5.1%
Other	15.4%

Exhibit 10a: Model fees used for wrap fee equity composites

The model fee of 3.0% is primarily used by all firms except those that manage less than USD250 million.

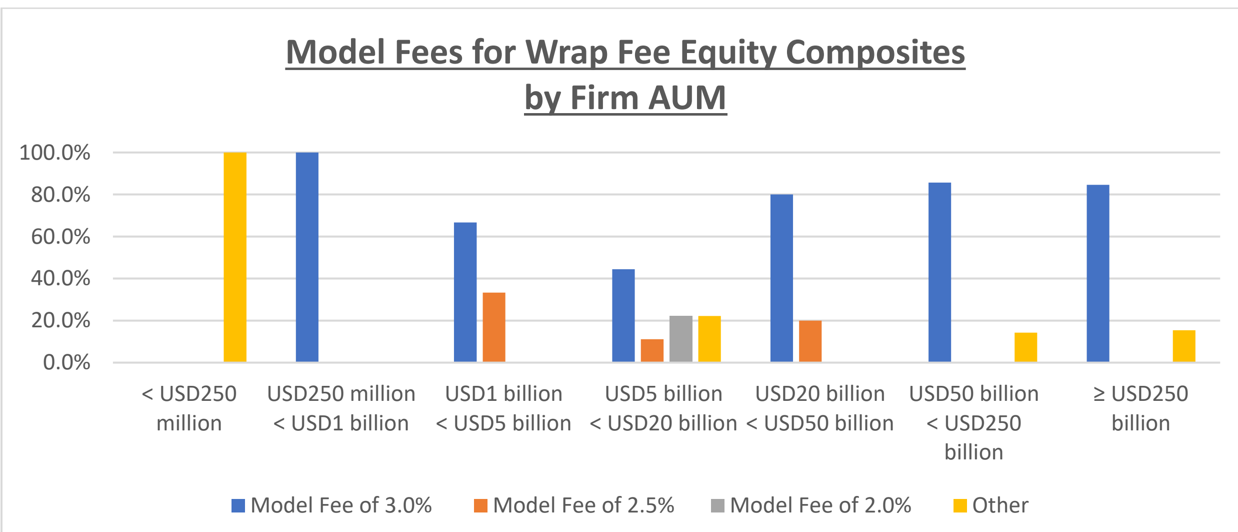

Exhibit 10b: Model fees used for wrap fee equity composites, by firm AUM

Fixed-Income Composites

Unlike equity composites, for fixed-income wrap fee composites, there is no single model fee rate used by most firms.

If your firm calculates net returns for wrap fee composites using model total wrap fees, which option best describes the model fee used for wrap fee fixed-income composites?	
2.0%	22.6%
1.5%	41.9%
1.0%	12.9%
Other	22.6%

Exhibit 11a: Model fees used for wrap fee fixed-income composites

Survey results showed no clear relationship between the model fee rate used in wrap fee fixed-income composites and firm size.

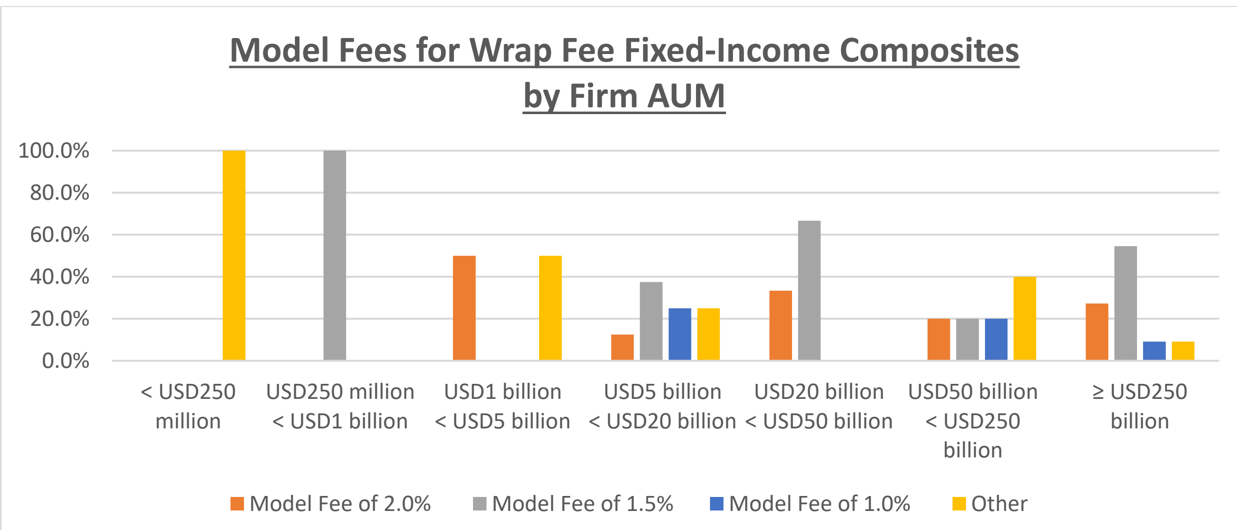

Exhibit 11b: Model fees used for wrap fee fixed-income composites, by firm AUM

2020 GIPS Standards Challenges

Participants were asked what they considered to be the biggest challenges with respect to the provisions related to net return calculations and the related disclosures in the 2020 edition of the GIPS standards. More than one-third of respondents reported that their biggest challenge is ensuring that composite net returns calculated using model investment management are equal to or lower than net returns that would be calculated using actual investment management fees. The next largest challenge, at approximately 28%, is determining which fee schedules to include in GIPS Reports. Calculating net returns for portfolios with performance-based fees is the biggest challenge for 22% of respondents.

Which activity associated with calculating net returns and their related disclosures do you find most challenging when complying with the 2020 edition of the GIPS standards?	
Ensuring that composite model investment management fees generate net returns that are equal to or lower than net returns that would be calculated using actual investment management fees	35.6%
Determining which fee schedules to include in the GIPS Report	27.9%
Calculating net returns for portfolios with performance-based fees	22.1%
Determining which net returns to use for pooled funds	10.6%
Other	3.8%

Exhibit 12: Challenges with net return calculations and the related disclosures in the 2020 edition of the GIPS standards

Conclusion

The calculation and presentation of composite and pooled fund net returns are important concepts in the 2020 edition of the GIPS standards. Although the GIPS standards provide industry best practices for calculating and presenting net returns, they allow firms some flexibility in terms of the types of fees that can be used and how to reflect fees in net return calculations. When determining which policies and procedures to use for calculating and presenting net returns, firms often look to their peers, and these survey results will help firms understand common practices in the industry.