

# Global Investment Performance Standards (GIPS®) for Fiduciary Management Providers to UK Pension Schemes

Explanation of the  
Provisions in Section 33

June 2020



**CFA Institute®**  
Global Investment  
Performance Standards



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# INTRODUCTION

The Explanation of the Provisions in Section 33 provides interpretation of each provision included in Section 33: Composite Maintenance. Fiduciary Management Providers that choose to comply with the Global Investment Performance Standards (GIPS®) for Fiduciary Management Providers to UK Pension Schemes (GIPS standards for FMPs) must comply with all applicable requirements of the GIPS standards for FMPs, including any interpretive guidance published by CFA Institute and the GIPS standards for FMPs governing bodies.

A composite is an aggregation of one or more schemes managed according to a similar investment mandate, objective, or strategy. The composite return is the equal-weighted average of the performance of all scheme relative returns in the composite. Creating meaningful composites is essential to the fair presentation, consistency, and comparability of performance over time and among Fiduciary Management Providers.

Each provision is included in a grey text box. Within the provisions are words appearing in small capital letters. This indicates defined terms that can be found in the GIPS Standards Glossary. Following each provision is a discussion that provides interpretive guidance to help readers understand the provision.

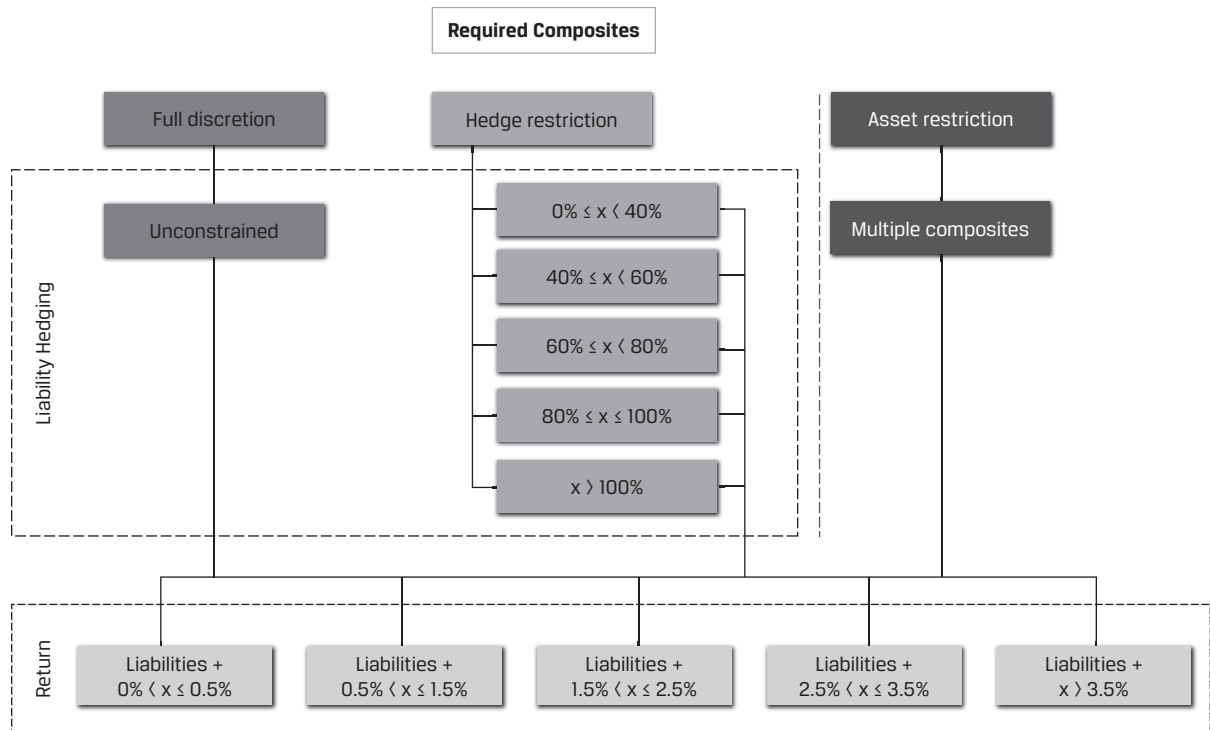


# 33. COMPOSITE MAINTENANCE

## 33.A. Composite Maintenance—Requirements

### Provision 33.A.1

The FIDUCIARY MANAGEMENT PROVIDER MUST create COMPOSITES consistent with the following REQUIRED COMPOSITE STRUCTURE. (See Appendix A for a list of REQUIRED COMPOSITES.)



### Discussion

A composite is an aggregation of one or more schemes managed according to a similar investment mandate, objective, or strategy. To provide comparability of performance results from Fiduciary Management Providers, the GIPS standards for FMPs are prescriptive in how required composites

may be defined. See Appendix A for a list of required composites. A Fiduciary Management Provider must create a composite if it manages at least one scheme in the respective strategy. See Provision 33.A.2 for a discussion of schemes that must be included in composites.

It is important to remember that the GIPS standards for FMPs do not differentiate between “marketed” and “non-marketed” composites. The requirement to create composites applies to all strategies that are managed for at least one scheme, whether or not the strategy is marketed by the Fiduciary Management Provider. A composite will contain only one scheme if the Fiduciary Management Provider has only one scheme that is managed for a particular strategy.

### ***Restricted Composites***

The Fiduciary Management Provider may acquire a client that imposes an investment restriction that prevents a scheme from being managed consistent with other schemes in the composite strategy. While such a scheme is discretionary, if it is included in a required composite, it could distort the composite performance and provide a prospective client with an inaccurate picture of the strategy’s historical performance. To avoid this situation, schemes with client-imposed investment restrictions may be included in a “restricted” version of the required composite.

### ***Multiple Composites***

Fiduciary Management Providers are required to include discretionary schemes in at least one of the required composites. In addition to creating required composites, a Fiduciary Management Provider may wish to create sub-composites or umbrella composites. For example, the Fiduciary Management Provider may wish to create an umbrella composite that includes all schemes with a return objective of liabilities plus greater than 3.5%, regardless of the hedge restriction. All schemes that meet that criterion would be included in the umbrella composite. Fiduciary Management Providers are welcome to create composites beyond those that are consistent with the required composite structure.

#### **Provision 33.A.2**

All actual discretionary SCHEMES included in TOTAL FIDUCIARY MANAGEMENT PROVIDER ASSETS MUST be included in at least one COMPOSITE that is consistent with the REQUIRED COMPOSITE STRUCTURE.

### **Discussion**

Because the intent of the GIPS standards for FMPs is to accurately and fairly represent Fiduciary Management Provider performance, all actual discretionary schemes must be included in at least



one of the Fiduciary Management Provider's composites. This requirement helps ensure that a Fiduciary Management Provider presents a complete performance record. In the absence of this requirement, Fiduciary Management Providers could potentially exclude poorly performing schemes from composites.

An actual scheme is a scheme invested in real (tangible) assets, and it is differentiated from a hypothetical, simulated, or backtested track record for a scheme or a model scheme.

A discretionary scheme is one for which the Fiduciary Management Provider has the ability to implement its intended strategy. If documented client-imposed restrictions significantly hinder the Fiduciary Management Provider from fully implementing the strategy, the Fiduciary Management Provider may include the composite in a "restricted" version of the required composite (see the discussion for Provision 33.A.1). Including the scheme in a restricted version of the required composite allows the Fiduciary Management Provider to meet the requirement of this provision. There are degrees of discretion, and not all client-imposed restrictions will necessarily cause a scheme to be placed in a restricted version of a required composite. The Fiduciary Management Provider must determine if the restrictions will materially affect implementation of the intended strategy to the extent that the scheme is no longer representative of the strategy. Discretion may be defined at the composite or Fiduciary Management Provider level. Once the definition of discretion has been determined, it must be documented in the Fiduciary Management Provider's policies and procedures and applied consistently. Fiduciary Management Providers must document the reasons for classifying each restricted scheme as restricted.

When considering the hedge restriction, it is important to understand that this is specific to an interest rate hedge. The hedge is a percentage of liabilities, which is then applied to the assets. Because the hedge ratio is based on assets, it is possible to have an investment mandate in which more than 100% of assets are hedged. For example, if liabilities are £1 billion, assets are £700 million, and the mandate is to hedge 80% of the liabilities, the Fiduciary Management Provider will hedge £800 million (80% of £1 billion), resulting in a hedge ratio of 114% (£800 million/£700 million). This ratio will change as the value of the assets fluctuates. The scheme must not change composites when the tactical hedge ratio as a percentage of assets changes. When contributions to the scheme significantly affect the hedge ratio, the Fiduciary Management Provider should discuss with the client to determine whether there is a change in the hedge ratio that would require moving the scheme from one composite to another.

In the case of client-restricted securities (e.g., 5% of scheme assets are invested in a property trust that may not be sold), the Fiduciary Management Provider may choose to classify the restricted portion of the scheme as "unmanaged" or "unsupervised" and consider those assets to be non-discretionary. The Fiduciary Management Provider may include the remaining discretionary portion of the scheme in the composite, provided the discretionary portion is representative of the composite's strategy. All calculation and composite construction requirements would apply to the remaining discretionary portion of the scheme. The unmanaged portion of the scheme assets would be excluded from composite assets but would be included in total Fiduciary Management

Provider assets. The Fiduciary Management Provider may instead choose to consider the scheme discretionary despite the restriction and include the scheme in a required composite.

The Fiduciary Management Provider may choose to create umbrella or sub-composites, which are additional composites beyond those that the Fiduciary Management Provider is required to create. If the Fiduciary Management Provider has chosen to create additional composites, it must include a scheme in any additional composite for which it meets the composite definition. As is always the case, the Fiduciary Management Provider must be careful not to double count total Fiduciary Management Provider assets. A scheme must be counted only once, even if it is included in more than one composite. (See Provision 32.A.3.)

It is the Fiduciary Management Provider's responsibility to ensure that all of its actual discretionary schemes are included in any composite for which they meet the composite definition. Accordingly, Fiduciary Management Providers must have policies and procedures to identify changes to a scheme that would require a scheme to be reclassified for composite assignment purposes. If a scheme changes investment strategy in response to a new client-imposed restriction, or if a client-directed change in the scheme's strategy requires a change in the scheme's composite assignment, the scheme must be removed from the composite on a prospective basis only.

### **Provision 33.A.3**

COMPOSITES MUST be defined according to investment mandate, objective, or strategy.  
COMPOSITES MUST include all SCHEMES that meet the COMPOSITE DEFINITION.

## **Discussion**

A composite is an aggregation of one or more schemes managed according to a similar investment mandate, objective, or strategy. Creating meaningful composites is critical to fair presentation, consistency, and comparability of results over time and among Fiduciary Management Providers. Fiduciary Management Providers make the ultimate decision as to which schemes belong in each composite. Fiduciary Management Providers must document policies and procedures related to composite definition.

To create appropriate composites, Fiduciary Management Providers must understand what is meant by a composite description and a composite definition. The glossary of defined terms includes both composite description and composite definition. For many of the provisions of the GIPS standards for FMPs, it is important to understand the meaning of each term and the difference between a composite description and a composite definition.

A *composite description* is general information regarding the investment mandate, objective, or strategy of the composite. The composite description may be more abbreviated than the

composite definition but must include all key features of the composite and must include enough information to allow a prospective client to understand the key characteristics of the composite's investment mandate, objective, or strategy, including:

- If leverage, derivatives, and short positions are a material part of the strategy.
- If illiquid investments are a material part of the strategy.

A *composite definition* is the detailed criteria that determine the assignment of schemes to composites. Criteria may include, but are not limited to, the level of discretion, the nature of the benchmark, any hedge ratio restriction, the objective or risk, and the asset restrictions that would materially affect performance.

To differentiate between a composite definition and a composite description, think of a composite description as focused on a description of the strategy represented by the composite. In contrast, a composite definition includes not only the composite strategy, as represented by the composite description, but also the criteria that determine whether and when a scheme is included in a composite. These additional criteria would include factors such as the composite-specific new scheme inclusion policy, client-imposed restriction considerations, and which composite a scheme is assigned to when there is a band (e.g., target hedge is 95%  $\pm$  5%), and if this is considered an unconstrained or constrained mandate. Fiduciary Management Providers must use their judgment in determining what information is appropriate to include in a composite description and composite definition for a specific strategy.

The following are examples of composite descriptions and composite definitions.

### **Liability plus between 1.5% $< x \leq$ 2.5%, Unconstrained Composite**

#### ***Composite Description***

The composite includes all pension schemes with the objective to earn the return target of the liability plus between 1.5%  $< x \leq$  2.5%, where the amount of liabilities that may be hedged is at our discretion. Some schemes in the composite use total return swaps on the MSCI World ex UK Index to gain exposure to global equity markets. Interest rate swaps and inflation swaps are used to hedge scheme liability interest and inflation risks. The composite was created in November 2019, which represents the first time all the schemes were grouped together in the composite. The composite inception date is 1 February 2017, which represents the date the first scheme was included in the composite. As of 31 December 2019, there are 10 schemes in the composite.

#### ***Composite Definition***

The composite includes all pension schemes with the objective to earn the return target of the liability plus between 1.5%  $< x \leq$  2.5%, where the amount of liabilities that may be hedged is at our discretion. Schemes are invested primarily in five asset classes: Global Equity, Inflation-Linked Securities, Corporate Bonds and Gilts, Cash, and Alts. Schemes with higher funding ratios will

have more assets allocated to Gilts than those with lower funding levels. Some schemes in the composite use total return swaps on the MSCI World ex UK Index to gain exposure to global equity markets. Interest rate swaps and inflation swaps are used to hedge scheme liability interest and inflation risks. Schemes included in the composite are measured against the present value of the full scheme liabilities. Schemes that have a restriction against investing in private equity are excluded from the composite. Schemes are included in the composite beginning the first full month under management if funded before the 15th of the month and after the first full month under management if funded on or after the 15th of the month. Schemes remain in the composite through the last full month they are managed to the strategy.

Composite descriptions are disclosed in GIPS Composite Reports and are included on the list of composite descriptions. Composite definitions must be documented in the Fiduciary Management Provider's policies and procedures.

The Fiduciary Management Provider must create composites that are consistent with the required composite structure (see Provision 33.A.1). The Fiduciary Management Provider may also create additional composites that are broader or narrower in scope than the required composites. These additional composites are often defined as umbrella composites (broader definition than the required composites) or sub-composites (narrower definition than the required composites).

#### **Provision 33.A.4**

Any change to a COMPOSITE DEFINITION MUST NOT be applied retroactively.

### **Discussion**

A composite definition is the detailed criteria that determine the assignment of schemes to composites. Although investment strategies can change over time, in most cases Fiduciary Management Providers should not change the definition of a composite. Because of the required composite structures as specified in Provision 33.A.1, a change to a composite definition would most likely be applicable only to additional sub-composites or umbrella composites that the Fiduciary Management Provider chose to create. Umbrella composites have broader definitions than the required composites, and sub-composites have narrower definitions.

Generally, changes in strategy result in the creation of a new composite. In some cases, however, it may be appropriate to redefine a composite. If a Fiduciary Management Provider determines that it is appropriate to redefine a composite, it must disclose the date and description of the redefinition. Changes to composites must not be applied retroactively. This requirement is not intended to prevent Fiduciary Management Providers that created composites under the old IC-Select guidelines from creating composites as required by Provision 33.A.1 and applying

the information retroactively. The Fiduciary Management Provider may choose to keep any composites created under the IC-Select guidelines or may terminate them.

When there are changes related to the implementation of the strategy, the Fiduciary Management Provider must determine if the changes to the composite's resources, process, or personnel result in a change in the investment strategy of the schemes in the composite. If the Fiduciary Management Provider determines that the changes result in a new investment strategy offered by the Fiduciary Management Provider, a new composite must be started with a current composite creation date and no composite history. The Fiduciary Management Provider must clearly document its decision and rationale. If the changes in resources, process, and personnel do not result in a change in investment strategy, the Fiduciary Management Provider must not create a new composite but must instead revise the composite description and composite definition where appropriate. The redefinition must take place on a prospective basis. This approach eliminates the opportunity to "cherry-pick" schemes that qualify for inclusion once performance results are known.

Note that if a Fiduciary Management Provider chooses to create a new composite to reflect a new investment strategy, the Fiduciary Management Provider may move schemes that meet the new composite definition into the new composite. The history of existing schemes must remain with the original composite.

The following is an example of a change in investment strategy resulting from the evolution of a strategy:

"A Fiduciary Management Provider creates a sub-composite that includes only schemes that invest at least 60% of assets in gilts and corporate bonds rated BBB and above. The composite does not include schemes that invest in below-investment-grade bonds. It is decided that the composite will now allow for up to 10% of scheme assets to be invested in below-investment-grade corporate bonds. Most client guidelines do not permit the use of below-investment-grade bonds, but some do."

The Fiduciary Management Provider is permitted to view this change as an evolution of its existing strategy rather than as the creation of a new strategy. It must change its composite description and composite definition to indicate the use of below-investment-grade bonds and the date on which the use of below-investment-grade bonds was first permitted. The schemes that do not allow the use of below-investment-grade bonds remain in the composite.

### **Provision 33.A.5**

COMPOSITES MUST include new SCHEMES on a timely and consistent COMPOSITE-specific basis after the FIDUCIARY MANAGEMENT PROVIDER becomes responsible for the SCHEME'S performance.

## Discussion

The Fiduciary Management Provider is responsible for setting reasonable guidelines for each composite regarding the inclusion of new schemes. Fiduciary Management Providers are encouraged to establish a policy that includes new schemes in composites as soon as possible, preferably at the start of the next full performance measurement period. The measurement period is the period for which the composite performance is calculated and must be for a full month.

Fiduciary Management Providers may need time to invest the assets of a new scheme to reflect the Fiduciary Management Provider's investment strategy, and the GIPS standards for FMPs allow Fiduciary Management Providers flexibility in determining when to add the new scheme to the composite. Different strategies may result in different time frames for inclusion based on the liquidity of the assets involved. Although in most situations it is fairly easy to purchase and sell securities, some securities may be more illiquid and, therefore, a longer period may initially be required to implement the Fiduciary Management Provider's strategy. Fiduciary Management Providers must establish a policy on a composite-specific basis and apply it on a timely and consistent basis.

In the case of specific instructions from the client, Fiduciary Management Providers may delay including a new scheme in a composite. For example, a client may indicate to the Fiduciary Management Provider that assets will be deposited over an extended period, which may delay the full implementation of the Fiduciary Management Provider's strategy until all assets are received. This scenario can result in an exception to the composite's new scheme inclusion policy. If a Fiduciary Management Provider determines that the incremental investing does not affect the implementation of the style or strategy, the Fiduciary Management Provider must follow its composite-specific policy for including new schemes in the composite.

### Provision 33.A.6

COMPOSITES MUST include only those SCHEMES that are managed for the full performance measurement period for which the COMPOSITE return is calculated. SCHEMES that are not managed for the full performance measurement period MUST NOT be included in the COMPOSITE.

## Discussion

Fiduciary Management Providers must include in the composite only those schemes that are managed for the full performance measurement period (i.e., for the full month). Including schemes that were not managed for the full month would result in returns that are not truly

representative of the strategy for the performance period being calculated. For example, when calculating the composite return for the month of March, only schemes that have a full month of performance are included. A scheme with an inception date of 5 March would not be included, nor would a scheme that terminated on 23 March. A Fiduciary Management Provider must create policies and procedures regarding the inclusion of new schemes in a composite and must apply the policies and procedures consistently.

### **Provision 33.A.7**

Terminated SCHEMES MUST be included in the historical performance of the COMPOSITE up to the last full measurement period that each SCHEME was under management.

### **Discussion**

The requirement to include terminated schemes in the composite's historical performance up to the last full measurement period (i.e., the last full month) that each scheme was under management prevents survivorship bias by retaining the performance history of the scheme while it was managed to the composite's strategy. Once a client notifies the Fiduciary Management Provider of the termination, the Fiduciary Management Provider generally loses its discretion over the scheme because the Fiduciary Management Provider is restricted in its management of the scheme. In such a case, the Fiduciary Management Provider must include the scheme in the composite through the last full measurement period that each scheme was under management and exclude it from the composite for subsequent periods. As an example, suppose that a Fiduciary Management Provider was notified on 25 May of the termination of a scheme, and the Fiduciary Management Provider was instructed to immediately commence liquidating the scheme. Assuming monthly composite calculations, because the Fiduciary Management Provider lost discretion to manage the scheme effective 25 May, the scheme must be included in the composite performance calculation for April and must be excluded from the composite calculation for May. A Fiduciary Management Provider must create policies and procedures regarding the handling of termination of schemes in a composite and must apply the policies and procedures consistently.

If all of the schemes are removed from a composite, for any reason, the composite's performance record comes to an end. If, after a period of time, schemes are again included in the composite, the composite's prior performance history must be presented. The composite's prior performance history must not be linked to the ongoing composite performance results. If the break in performance occurred more than 10 years ago, the performance prior to the break does not need to be presented.

### **Provision 33.A.8**

SCHEMES MUST NOT be moved from one COMPOSITE to another unless documented client-directed changes to a SCHEME'S investment mandate, objective, or strategy make it appropriate. The historical performance of the SCHEME MUST remain with the original COMPOSITE. SCHEMES MUST NOT be moved into or out of COMPOSITES as a result of the FIDUCIARY MANAGEMENT PROVIDER'S tactical changes.

### **Discussion**

Fiduciary Management Providers are permitted to move schemes into and out of composites only when there is a documented change to a scheme's investment mandate, objective, or strategy or in the case where the redefinition of a composite makes it appropriate. Documentation of the client-directed change can include, but is not limited to, letters, e-mails, and internal memorandums documenting conversations with clients.

Over time, a client's investment objective may change. In those instances, moving a scheme from one composite to another may be necessary. For example, the client may determine that it wishes to change the target range of a hedge restriction for a scheme. This change in strategy must be documented.

Some clients contractually give the Fiduciary Management Provider a predetermined de-risking plan. Following the de-risking will cause the scheme to gradually target lower returns as the funding progresses and may therefore require a change in composite assignment. In such cases, the contract that documents the de-risking plan should be considered "client directed" documentation for the strategy change when the change in composite assignment becomes appropriate. For example, the Fiduciary Management Provider and the client may agree that if interest rates hit a certain trigger percentage (e.g., 3.00%) the Fiduciary Management Provider will increase the hedge by 10%. This agreed-upon trigger would potentially result in the scheme moving from one hedge restriction composite to another. Documentation of this change should include a reference to the original contract directing this change in strategy, when the change was made, and who directed the change. A memo to the client file or client management system noting this information would suffice.

The transfer of a scheme from one composite to another is treated as a scheme termination when it is removed from the former composite and as a new scheme when moved to the new composite. The scheme's prior history must remain in the former composite through the last full measurement period (i.e., the last full month) the scheme was managed in the former style.



## 33.B. Composite Maintenance—Recommendations

### Provision 33.B.1

Actual SCHEMES may be included in COMPOSITES other than those that are consistent with the REQUIRED COMPOSITE STRUCTURE (e.g., sub-COMPOSITES or umbrella COMPOSITES), but FIDUCIARY MANAGEMENT PROVIDERS are NOT REQUIRED to create such COMPOSITES.

Provision 33.A.1 requires a Fiduciary Management Provider to create composites that are consistent with the required composite structure. The Fiduciary Management Provider has the option of creating umbrella composites or sub-composites, which are not required.

An umbrella composite is more broadly defined than composites required by the required composite structure. For example, assume a firm has the following required composites: Unconstrained Liabilities plus  $0.5% < x \leq 1.5%$  Composite, and Unconstrained Liabilities plus  $1.5% < x \leq 2.5%$  Composite. If the Fiduciary Management Provider wishes to market the performance of all schemes that have a return range of liabilities plus 0.5% to 2.5%, it may create the Unconstrained Liabilities plus  $0.5% < x \leq 2.5%$  Composite, which will include all schemes that are included in the Unconstrained Liabilities plus  $0.5% < x \leq 1.5%$  Composite and the Unconstrained Liabilities plus  $1.5% < x \leq 2.5%$  Composite.

A Fiduciary Management Provider may also want to market a strategy that has a narrower definition than the required composite structure specifies. The Fiduciary Management Provider could create a composite with a tighter hedge range, such as an Unconstrained Liabilities plus  $0.5% < x \leq 1.0%$  Composite. This sub-composite would include a subset of schemes that are included in the required Unconstrained Liabilities plus  $0.5% < x \leq 1.5%$  Composite.

If the Fiduciary Management Provider wishes to create umbrella composites or sub-composites, it must treat them as if they were required composites. For example, an umbrella composite or sub-composite must include all schemes that meet the composite definition (see Provision 33.A.3). The Fiduciary Management Provider may not selectively include schemes in an umbrella composite or sub-composite, because doing so would be considered cherry-picking.





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