IIPC Illmer Investment Performance Consulting AG

Best practice investment reporting

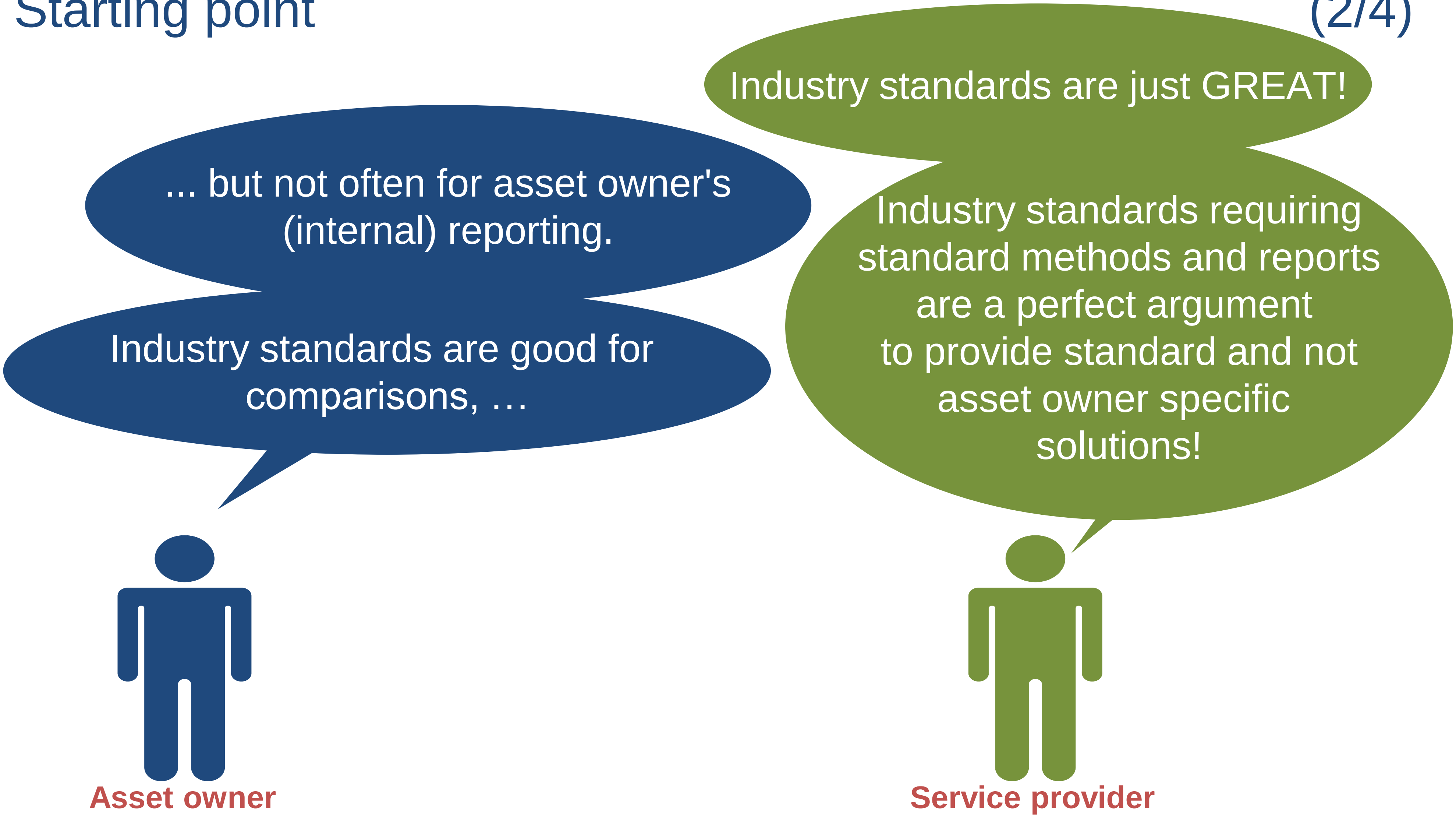
- from an asset owner perspective

Date: 06.12.2017

Produced by: Dr. Stefan J. Illmer

Starting point (1/4)

Starting point (2/4)



Starting point (3/4)

Asset owner driven **investment reporting**

Service provider driven **investment reporting**

This type of investment reporting is designed by the asset owner – considering the asset owner's specific circumstances. The objective is to provide relevant management information for internal decision makers.

This type of investment reporting is mainly designed by the service provider – maybe considering a kind of standard asset owner. The objective is to make the service provider look better or to provide a reasonable report with low costs and with no risk.

Asset owner have a big problem getting the relevant management information and tailor-made reports that **reflect best practice**.

Service provider have little incentive to reflect asset owner's needs regarding tailor-made information and reports, and therefore **provide best (standard) practice**.

Starting point (4/4)

Examples for opposites – standard versus tailor-made (1a/3)

Return measurement – the use of the time weighted rate of return:

- TWR is useful if evaluating performance of an asset manager who has no discretion over cash flows => specific case.
- TWR is in focus because of its characteristic to neutralize the effect of external cash flows and therefore to allow comparisons.
- Industry standards require mainly TWR for marketing performance track records to asset owners => specific case.
- Industry standards provide indirectly reasoning to not offer MWR calculations and analytics => standard.
- Propaganda around TWR led to less and lesser use of MWR.

Result: Asset owner often use a TWR for purposes which TWR is not designed for.

Software and service provider often do not provide a proper MWR calculation and analytics.

Examples for opposites – standard versus tailor-made (1b/3)

Return measurement – the use of the time weighted rate of return:

Absolute profit:	EUR -100
TWR:	10%
MWR:	-10%

=> The question is not what measure to use – the question is: what is the **appropriate** measure for the specific purpose in mind.

Examples for opposites – standard versus tailor-made (2a/3)

Return measurement – the use of the gross return:

- Gross return is useful if evaluating performance of an asset manager who has no discretion over the management fees => specific case.
- Gross return is in focus because of its characteristic to neutralize the company specific management fees and therefore to allow comparisons.
- Industry standards require mainly gross return for marketing performance track records to asset owners => specific case.
- Industry standards provide indirectly reasoning to offer by default gross return calculations => standard.
- This led to less and lesser use of net returns - except where it is required by laws and regulations.

Result: Asset owner often use a gross return for purposes which a gross return is not designed for.

Software and service provider often do not provide a proper and flexible net of fee calculation and analytics.

Examples for opposites – standard versus tailor-made (2b/3)

Return measurement – the use of the gross return :

Gross TWR:	10%
Net TWR:	9%

=> The question is not what measure to use, the question is: what is the **appropriate** measure for the specific purpose in mind.

Examples for opposites – standard versus tailor-made (3a/3)

Return measurement – the use of a return net of transaction costs:

- Return net of transaction costs is useful if evaluating net performance of an asset manager without asset owner driven transactions => specific case.
- Return net of transaction costs is in focus because of its characteristic to account for management activity and therefore to allow comparisons.
- Industry standards require mainly a return net of transaction costs for marketing performance track records to asset owners => specific case.
- Industry standards provide indirectly reasoning to offer by default return calculations net of all transaction costs => standard.
- This led to less and lesser correction for return impacts caused by asset owners – for example if investing in illiquid asset classes.

Result: Asset owner often interpret returns in a way they were not designed for.

Software and service provider often do not provide a proper and flexible net of relevant transaction costs return calculation and analytics.

Examples for opposites – standard versus tailor-made (3b/3)

Return measurement – the use of a return net of transaction costs:

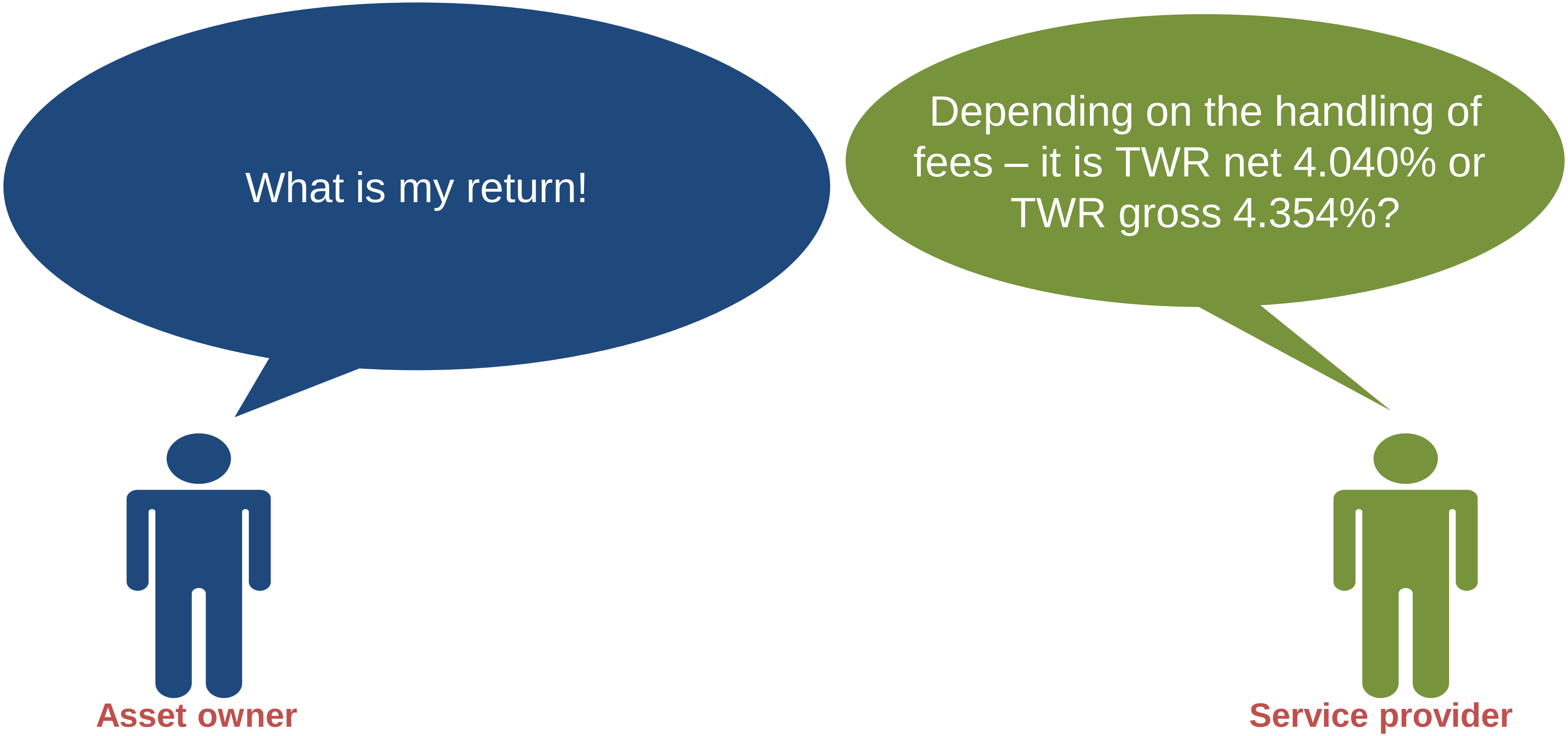
Gross TWR:	10%
Gross TWR gross of asset owner driven transaction costs:	11%

=> The question is not what measure to use, the question is: what is the **appropriate** measure for the specific purpose in mind.

Comprehensive return measurement (1/8)

Type of profit and costs / taxes	Profit / costs
Net AO profit according to accounting (before accounting related corrections like e.g. IT write-downs)	**4'000**
Non-asset management costs and all non-asset management taxes	40
Net AM profit	**4'040**
External asset management costs and taxes	**314**
Management fees	200
Estimated TER-costs	100
Custody fees	10
Non-reclaimable withholding taxes and other taxes	4
Internal asset management costs and taxes	**32**
Internal asset management costs	30
Other internal asset management costs (e.g. reporting, risk analysis)	2
Transaction costs caused by the board of directors	**10**
Gross AO and AM profit	**4'396**

Comprehensive return measurement (2/8)



Comprehensive return measurement (3/8)

We not just need one or two types of return.
Different questions need different measures - for a proper answer !

But people always say:
TWR is the solution?

In some cases but not in all.
... and there is not just one type of TWR.

Asset owner

Service provider

Let's have a closer look

Comprehensive return measurement (4/8)

Type of return	Underlying profit and return (with total assets of 100'000 and no external cash flows)	
Net AO return	**=> 4'000**	**=> 4.000%**
Net AM return	**=> 4'000 + 40 = 4'040**	**=> 4.040%**
Gross AM return 3	**=> 4'040 + 314 = 4'354**	**=> 4.354%**
Gross AM return 2	**=> 4'354 + 32 = 4'386**	**=> 4.386%**
Gross AO / AM return 1	**=> 4'386 + 10 = 4'396**	**=> 4.396%**

Comprehensive return measurement (5/8)

That is great if we want to evaluate the performance of the whole organization.

But what if looking at the individual portfolio manager?

Asset owner

Let's have a closer look

Comprehensive return measurement (6/8)

Type of profit and costs / taxes	Profit / costs
Net AM profit	**4'040**
Net AM profit (internal account 1)	**1'040**
Account specific internal and external asset management costs and taxes	20
AO / AM driven transaction costs (due to rebalancing and changes in the strategy)	10
Gross AM profit (internal account 1)	**1'070**
Net AM profit (external account 2)	**3'000**
Account specific internal and external asset management costs and taxes	326
AO / AM driven transaction costs (due to rebalancing and changes in the strategy)	40
Gross AM profit (external account 2)	**3'366**

Comprehensive return measurement (7/8)

Let's have a closer look

Comprehensive return measurement (8/8)

=> a bit more concrete if evaluating the asset management.

Returns / return contributions	YTD return	YTD return contribution to total assets
Gross TWR for total assets	**+ 4.396%**	**+ 4.396%**
Net TWR for total assets	**+ 4.040%**	**+ 4.040%**
Net TWR for bonds (50%)	**+ 2.080%**	**+ 1.040%**
Gross TWR for account bonds	+ 2.140%	
...	...	
Net TWR for equities (50%)	**+ 6.000%**	**+ 3.000%**
Gross TWR for account equities	+ 6.732%	
...	...	

Additional information:

Gross MWR for total assets	**+ 4.896%**	
Net MWR for total assets	**+ 4.540%**	

Other examples for opposites – standard versus tailor-made

- Risk measures.
- Risk models.
- Asset classifications.
- Pricing logics.
- Asset characteristics.
- Definition of benchmarks.
- Calculation of benchmark returns.
- Input data for calculating measures and running analytics.
- ...

Conclusions (1/2)

- Best practice investment reporting is not identical to current industry standards for presenting information to prospective clients or marketing performance track records to asset owners.
- Best practice investment reporting is not about best (standard) practices for measuring performance figures or presenting information.
- Best practice investment reporting is not about ONE FITS ALL.

But ...

- Best practice investment reporting **is about** appropriate information for the specific purpose in mind.
- Best practice investment reporting **is about** communication between the preparer and the user about the necessary and appropriate information.

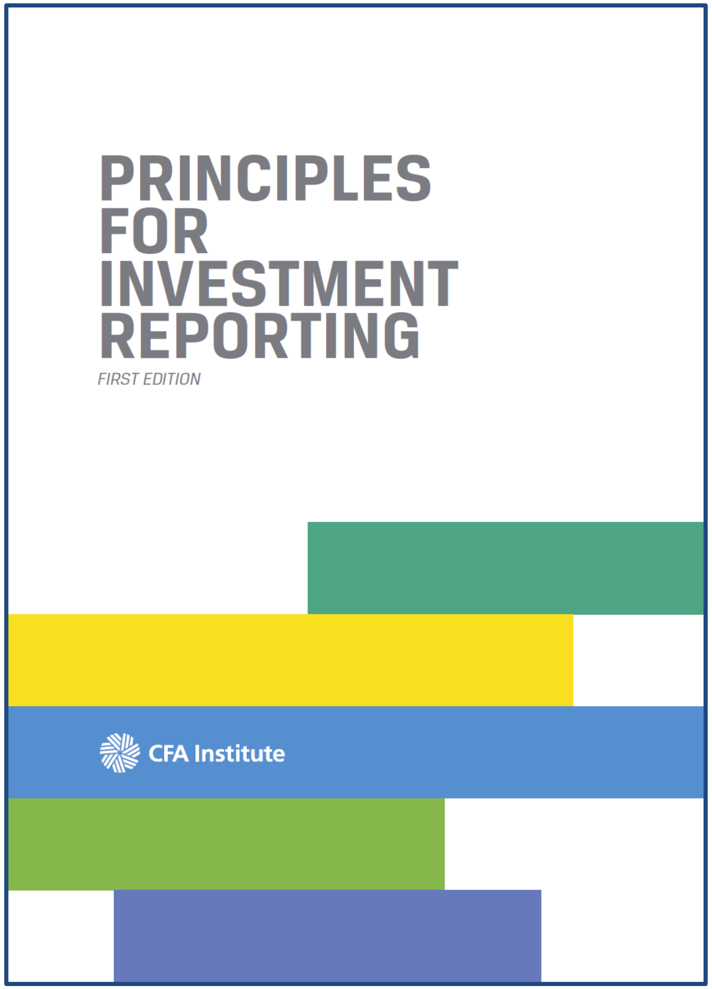
Conclusions (2/2)

- The GIPS Standards are not the solution for this kind of issue, because they are designed:
  - for a specific kind of investment reporting (to market performance track records),
  - for a specific need (to compare performance track records) and
  - for a specific purpose or use (to evaluate and select asset managers).

- One way to better address the needs of asset owners regarding investment reporting is considering and implementing the "**P**rinciples for **I**nvestment **R**eporting" and the "Guidance to **E**ffective **I**nvestment **R**eporting" – both available on the CFA Institute's webpage.

Let's have a closer look

Steps towards best practice investment reporting (1/4)



Principles for investment reporting:

1. Communication occurs between the preparer and the user as to the purpose of and need for investment reporting.
2. Control processes, policies, and procedures are documented and followed.
3. Client preferences are reflected in the investment report.
4. Clear and transparent presentation of investment risks and results.
5. Comprehensive fee disclosure.

=> leads to effective investment reporting.

Steps towards best practice investment reporting (2/4)

The five principles for investment reporting:

1. Communication occurs between the preparer and the user as to the purpose of and need for investment reporting.
2. Control processes, policies, and procedures are documented and followed.
3. Client preferences are reflected in the investment report.
4. Clear and transparent presentation of investment risks and results.
5. Comprehensive fee disclosure.

=> leads to effective investment reporting.

Effective investment reporting reflects certain qualities (like the communication process), which are discussed in the Principles for Investment Reporting.

Recommendations that support the qualities which, if implemented, lead to Effective Investment Reporting.

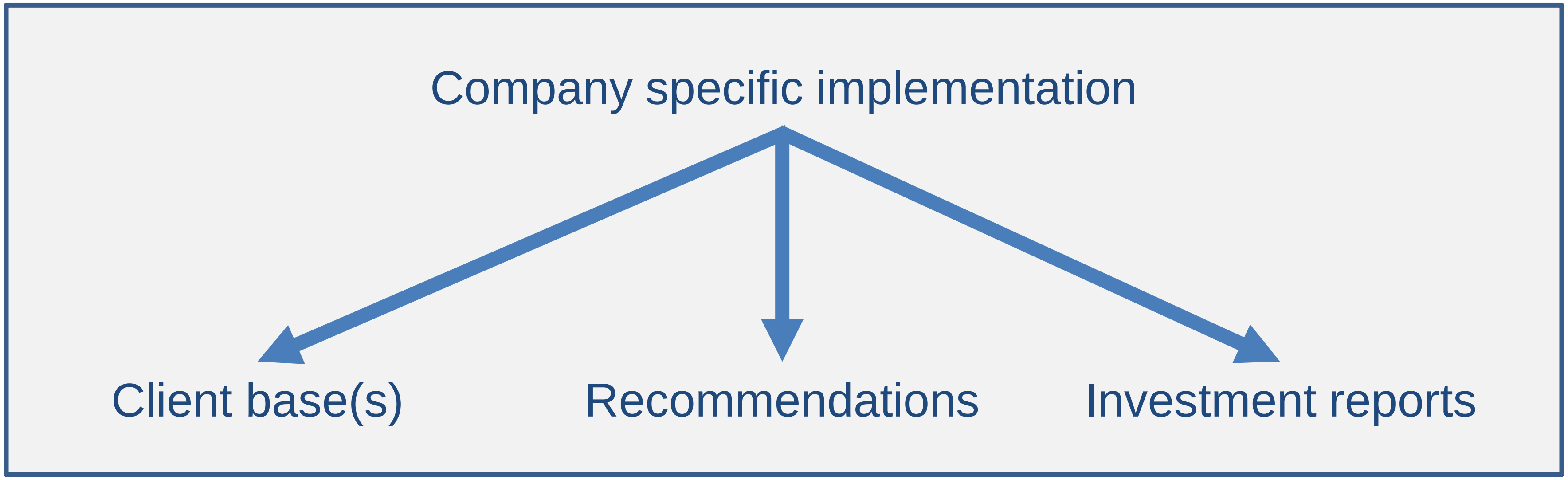
Steps towards best practice investment reporting (3/4)

EIR addresses the need for flexible guidance that allows for the production of investment reports that incorporate:

a. the needs and requirements of the user,

b. the capability of the preparer,

c. the availability of sufficient information to understand the investments made, the results achieved, the risks taken, and the associated costs.



Steps towards best practice investment reporting (4/4)

Results of implementing **EIR**

EIR statements

Effective **I**nvestment **R**eporting Ability Statement:

"[Preparer's company name] is able to prepare and deliver investment reporting in accordance with the recommendations of the Guidance to Effective Investment Reporting (EIR) to XYZ client base."

Effective **I**nvestment **R**eporting Report Statement:

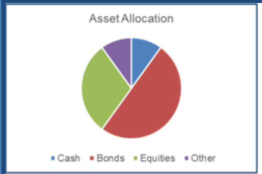
"This Report has been prepared in accordance with the Guidance to Effective Investment Reporting (EIR)."

EIR document

EIR recommends that preparers maintain an **EIR** document, which can be divided into two sections:

a. a section that contains the documentation that is generic to all members of the defined client base and
b. a section that contains the user-specific requirements that have been determined and documented following the discussion between the preparer and the user.

EIR report



Key figures	
Total assets	1'000 EUR
Profit and loss YTD	60 EUR
Return YTD	6.0%
Benchmark return YTD	5.6%
Risk	3.3%
Benchmark risk	3.1%
Duration	2.5

List of holdings	
Cash Nr. 123	90 EUR
Margin account Nr. 456	10 EUR
ABC share	200 EUR
DEF Structured	100 EUR
GHI bond	500 EUR
JKL portfolio fund	100 EUR
Total assets	1'000 EUR

EIR assurance

EIR recommends that preparers engage an independent third party to provide assurance concerning their ability.

The exact scope and content of the assurance can be determined by the preparer and the assurance provider, but it should result in an assurance that the processes followed by the preparer are sufficient to support the use of the statements and the production of reports in accordance with **EIR**.

Discussion

Discussion


thank you!

Contact details and disclaimer

Contact details

Illmer Investment Performance Consulting AG
Weinbergstrasse 28
CH - 8200 Schaffhausen
Switzerland
www.iipc-ag.com

Dr. Stefan Joachim Illmer
Tel. +41 / 79 / 962 20 37
Email: stefan.illmer@iipc-ag.com

Disclaimer

This document was produced by Illmer Investment Performance Consulting AG (hereafter "IIPC-AG") with the greatest of care and to the best of its knowledge and belief. However, IIPC-AG provides no guarantee with regard to its content and completeness and does not accept any liability for losses which might arise from making use of this information. This document is provided for information purposes only and is for the exclusive use of the recipient. It does not constitute an offer or a recommendation to buy or sell financial instruments or banking services.

It is expressly not intended for persons who, due to their nationality or place of residence, are not permitted access to such information under local law.