

# Decision-oriented risk and return monitoring

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# Agenda

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- Performance framework
- Decision-oriented risk and return monitoring
- Conclusion and summary
- Comments and questions
- Contact details and disclaimer

# Introduction

# Current investment conditions

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Investment management organization in a very broad way.

## Commonalities

- Client or employer.
- Investment mandate.
- Investment regulations.
- Investment guidelines.
- Investment process.
- Investment instruments.
- Investment target.
- Investment risk profile.
- Investment risk budget.
- ...

... with a lot of variations.

# Current investment conditions

(2/4)



Investment management organization in a very broad way.

## Commonalities

- Increasing regulations.
- Increasing needs of the client or the investment organization.
- Increasing complexity of the investment products.
- Increasing uncertainty.
- Increasing instability of the circumstances.
- Increasing difficulty to meet the investment target.
- ...

... with a lot of variations.

# Current investment conditions

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Investment management organization in a very broad way.

## Commonalities

- Increasing investment risk, i.e. market, credit or liquidity risk.
- Increasing difficulty to find risk-free investments
- Increasing operational risk.
- Increasing process risk.
- Increasing legal and regulatory risk.
- Increasing reputational risk.
- Increasing risk to not meet the investment target.
- ...  
... with a lot of variations.

# Current investment conditions

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Investment management organization in a very broad way.

## Trends commonly faced

- towards constantly changing environment.
- towards constantly challenging financial markets.
- towards a more process-oriented investment management.
- ...

... means manifold increasing and long-lasting challenges to be addressed now and in future!

# Is there a common way to master these challenges?



Investment management organization in a very broad way.

**No!**

Answer depends on the specific situation of the individual investment management organization.

**But**

the answers include some common aspects.

=> transparency, accountability, integrity, and ethical behavior.



# Best practice to address transparency



Investment management organization in a very broad way.

## Performance framework means

- performance measurement, reporting and monitoring are embedded in the overall performance governance and framework.
- respective principles, objectives, structure, setup, processes, tools, guidelines, addressees, responsibilities, policies, procedures and regulations are defined as well as documented.

# Best practice to address accountability



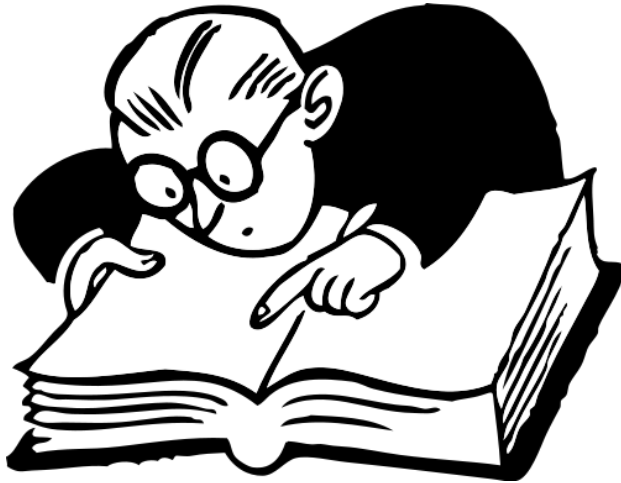
Investment management organization in a very broad way.

## Decision-oriented risk and return monitoring means

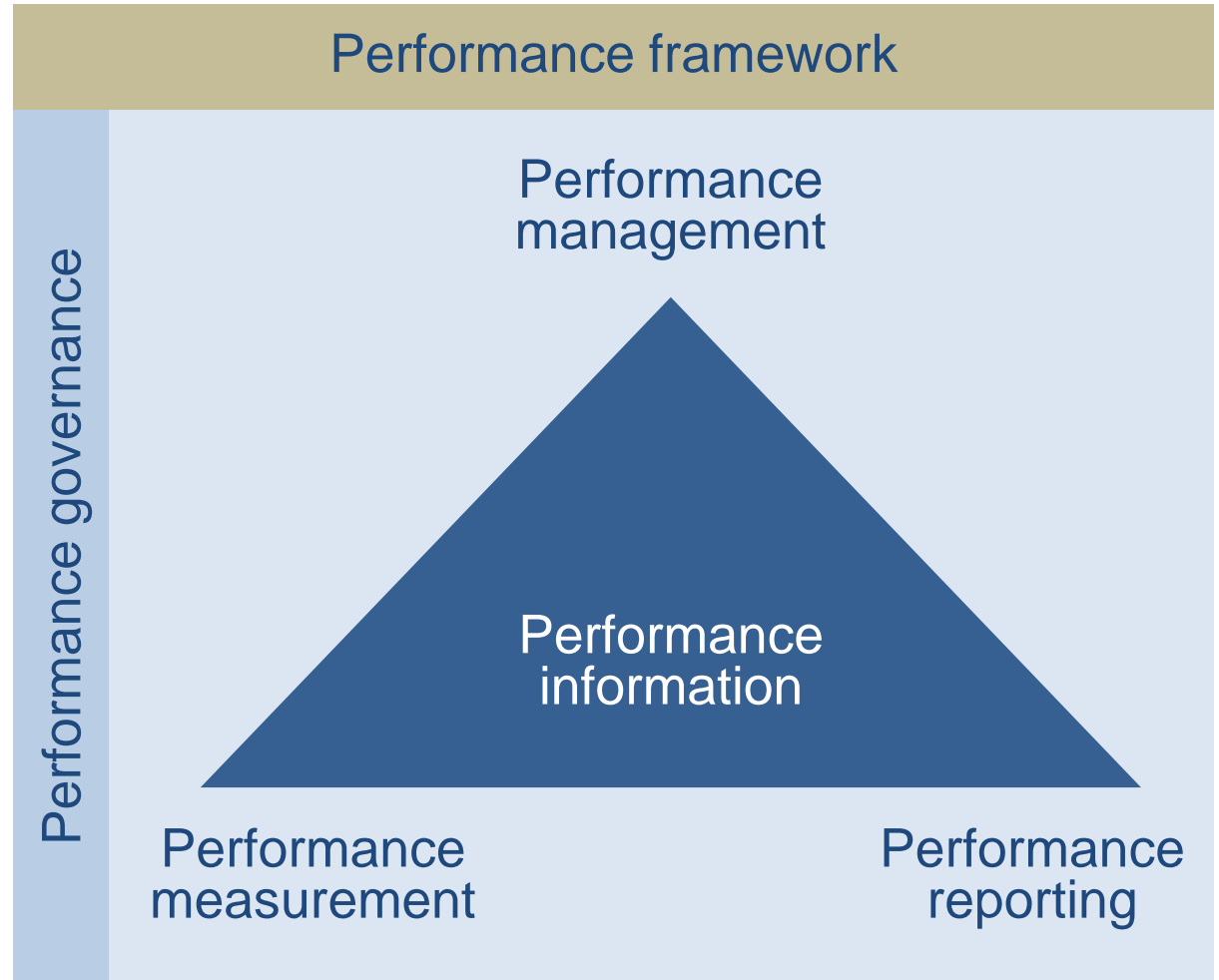
- clearly defined responsibilities within the investment process.
- responsibility-oriented information preparation and illustration.
- decomposed performance (return and risk) according to the whole value chain by using specific figures which measure the impacts of the different decisions made.

# Performance framework

# Conceptual setup of a performance framework



Performance measurement and reporting standard



# Definitions

(1/2)

- **Performance is the result of activities** of an organization over a given period of time.
- Embedded in the overall performance governance, **the performance framework defines and describes** performance measurement, reporting and management of an organization, where:
  - **performance measurement** is the process of quantifying the efficiency and effectiveness of past action or  
more concrete the process of measuring how well organizations are managed against their targets and the value they generate for their stakeholders.
  - **performance reporting** is a recurring and rolling process to identify, generate, collect, calculate, enhance, analyze, and present relevant and reliable performance information such as case specific indicators, measures or analytics as well as the respective disclosures.

# Definitions

(2/2)

- **performance management** is the process of ensuring that predefined targets are met or exceeded in an efficient and effective manner including activities such as performance monitoring, performance appraisal or performance review.
- Performance framework therefore defines and comprises the respective principles, objectives, structure, setup, processes, tools, guidelines, addressees, responsibilities, policies, procedures and regulations.

## A lot of questions are addressed such as:

- What are the overall objectives of the organization and how are the overall objectives transferred into performance targets?
- What are the relevant decision makers / committees and the relevant activities and decisions leading to the performance?
- Are respective duties, responsibilities and competencies defined, documented and clearly assigned to the different decision makers?
- Are valuation principles, policies and procedures defined and consistently applied?
- Are performance (risk and return) measurement principles, policies and procedures defined, documented and consistently applied?
- Is an error handling and correction process as well as record keeping process defined and implemented?
- Are performance figures relevant for the individual analytics and appropriate for the intended use? ...

# Outline of a performance framework

- Definition and description of the investment management process along the whole value chain of the investment management organization including duties, responsibilities and competencies.
- Definition and description of the performance management process covering the main sub-processes: a) performance measurement, b) performance analysis, c) performance reporting, d) performance monitoring and review, and e) performance escalation.
- Investment performance manual or standard defining the policies and procedures relevant for the measurement and reporting of performance.
- Definition and description of the respective internal control process - ideally reviewed or verified by an independent third party.

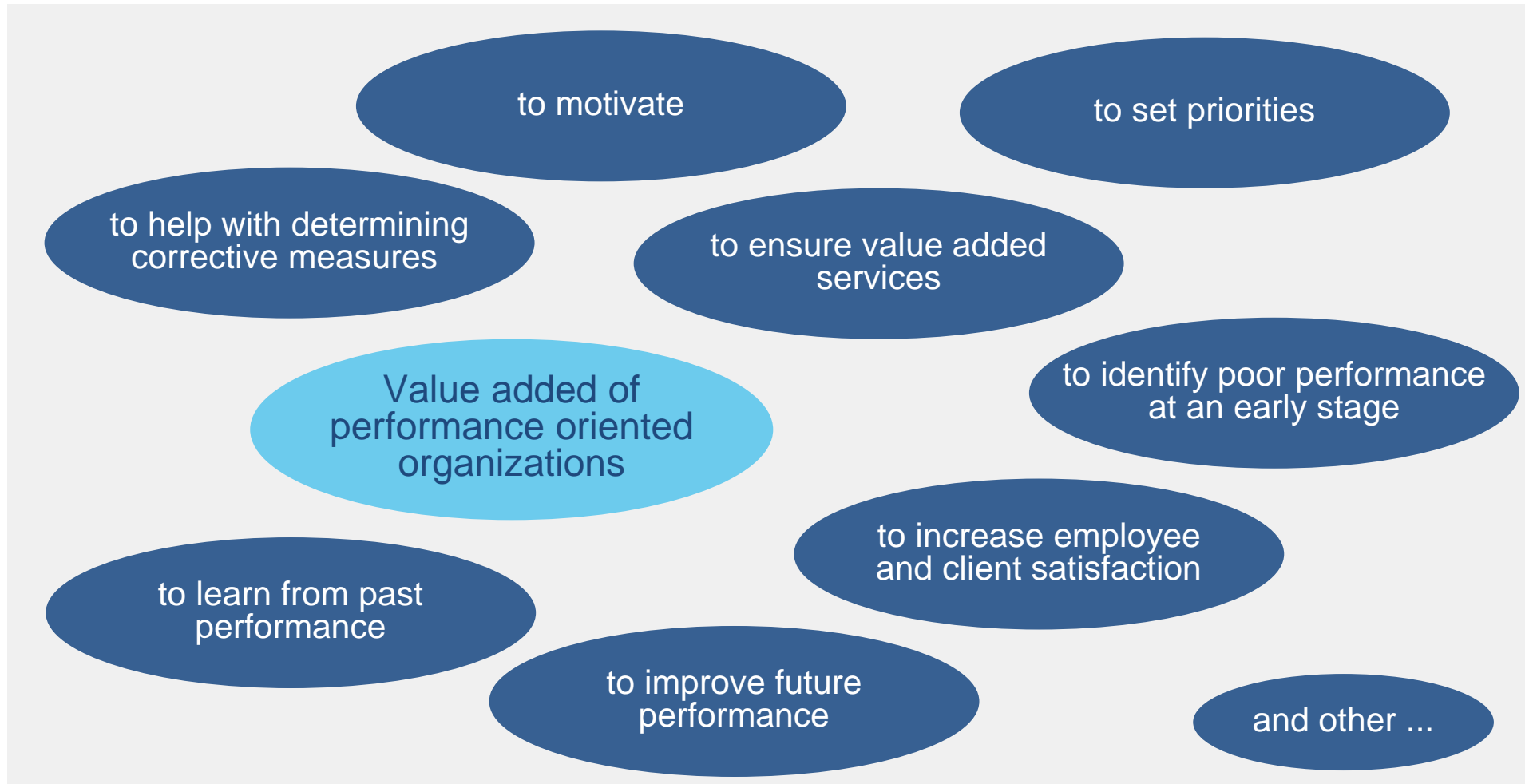




# Characteristics of sustainable performance management



# But ... why is a performance framework important?

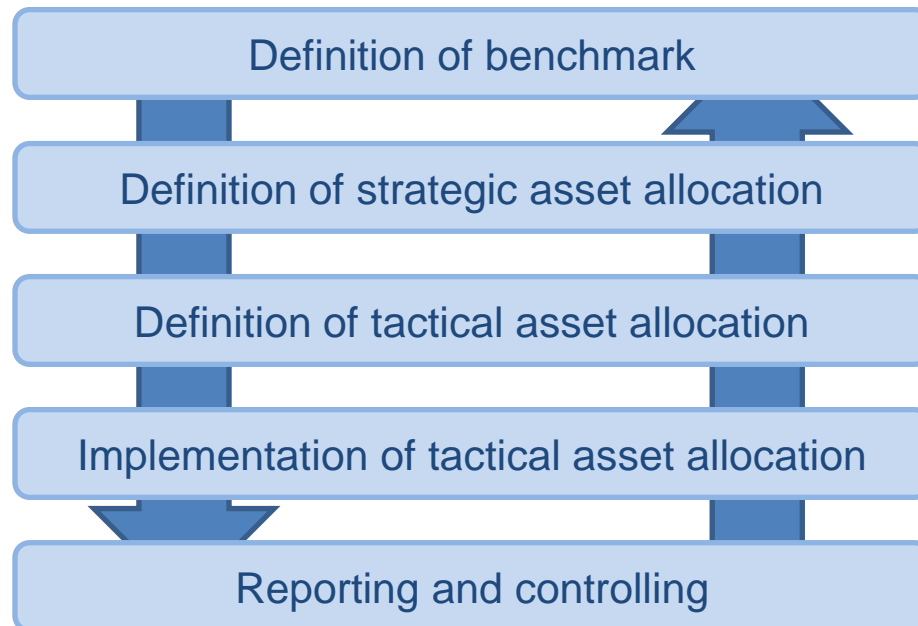


# Decision-oriented risk and return monitoring

# Decision-oriented risk and return monitoring

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## Investment process



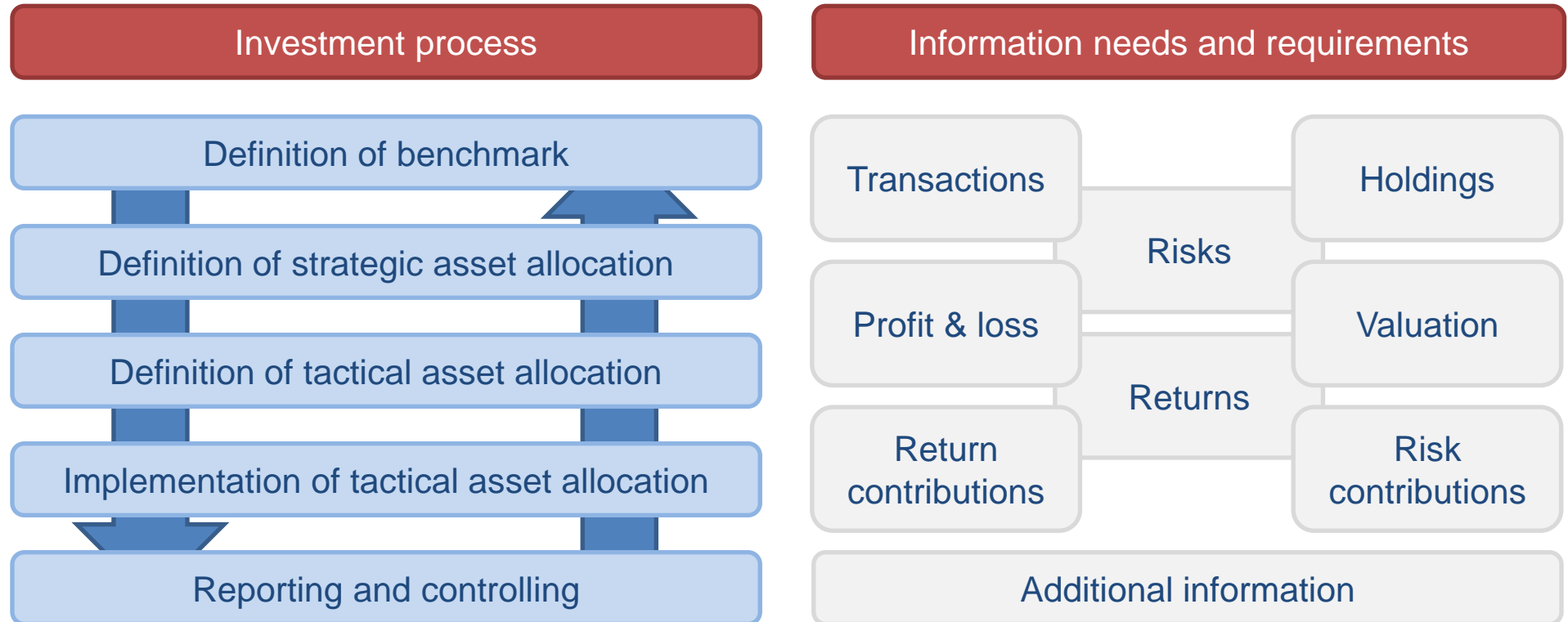
## Tasks and duties of decision makers

- Monitor target achievement.
- Monitor compliance with policies and guidelines.
- Systematic process evaluation and constant process improvement.
- Review circumstances and forecasts relevant as input for decision-making process.
- Determine contributions to and drivers for risk and return.

Decision-oriented risk and return monitoring covers the whole investment process.

# Decision-oriented risk and return monitoring

(1b/7)



Information needs and requirements follow the investment process.

# Decision-oriented risk and return monitoring

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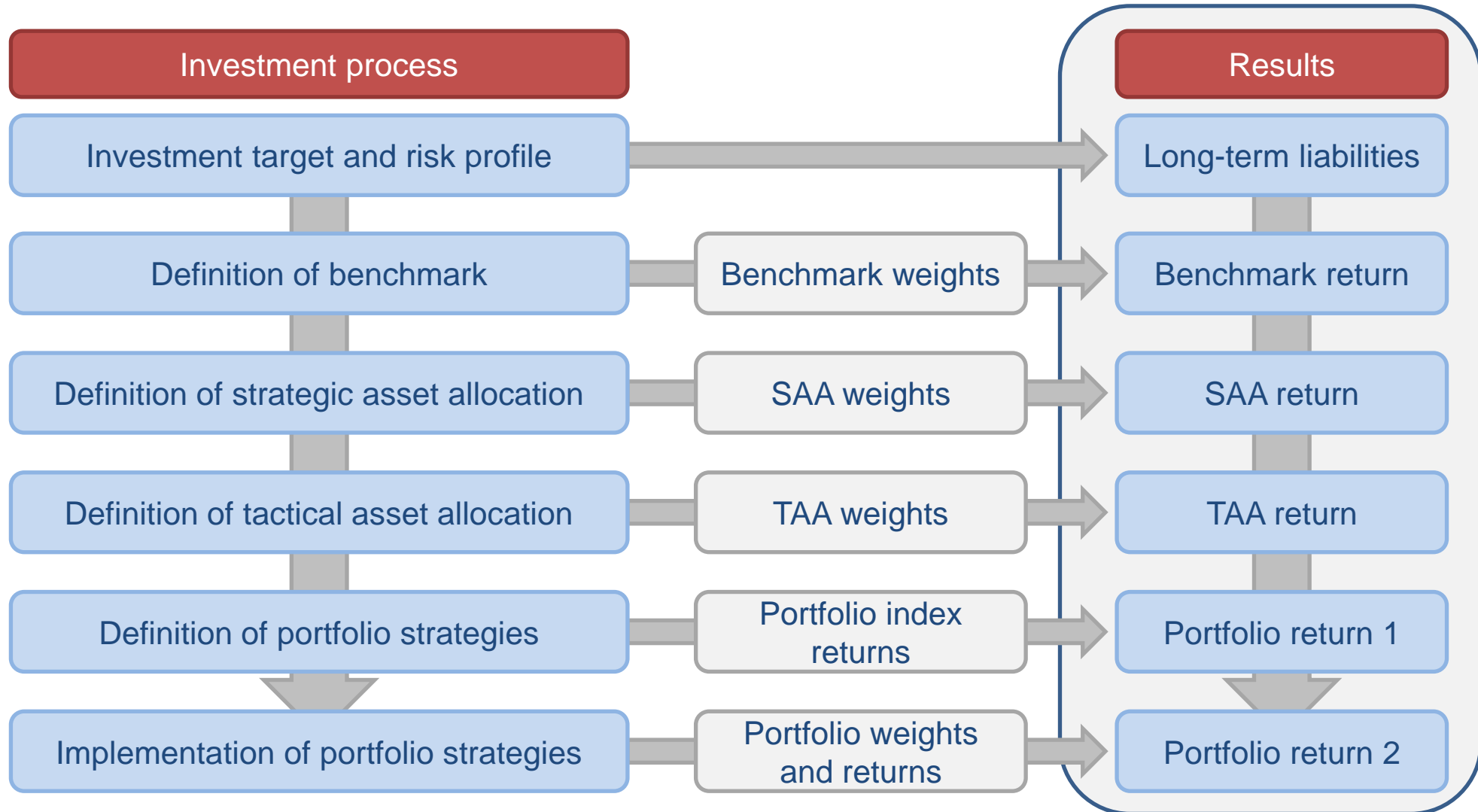


Decision oriented decomposition of the risk (return) allows to quantify the added risks (value added) of the individual decision makers and is based on the following steps:

- **Step 1:** Identify the circumstances, the investment management setup and derive relevant assumptions for calculation.
- **Step 2:** Mirror the specific investment decisions into (absolute) asset allocations.
- **Step 3:** Calculate the corresponding returns.
- **Step 4:** Assign the returns as well as the return differences to the investment decisions and to the relevant decision makers.

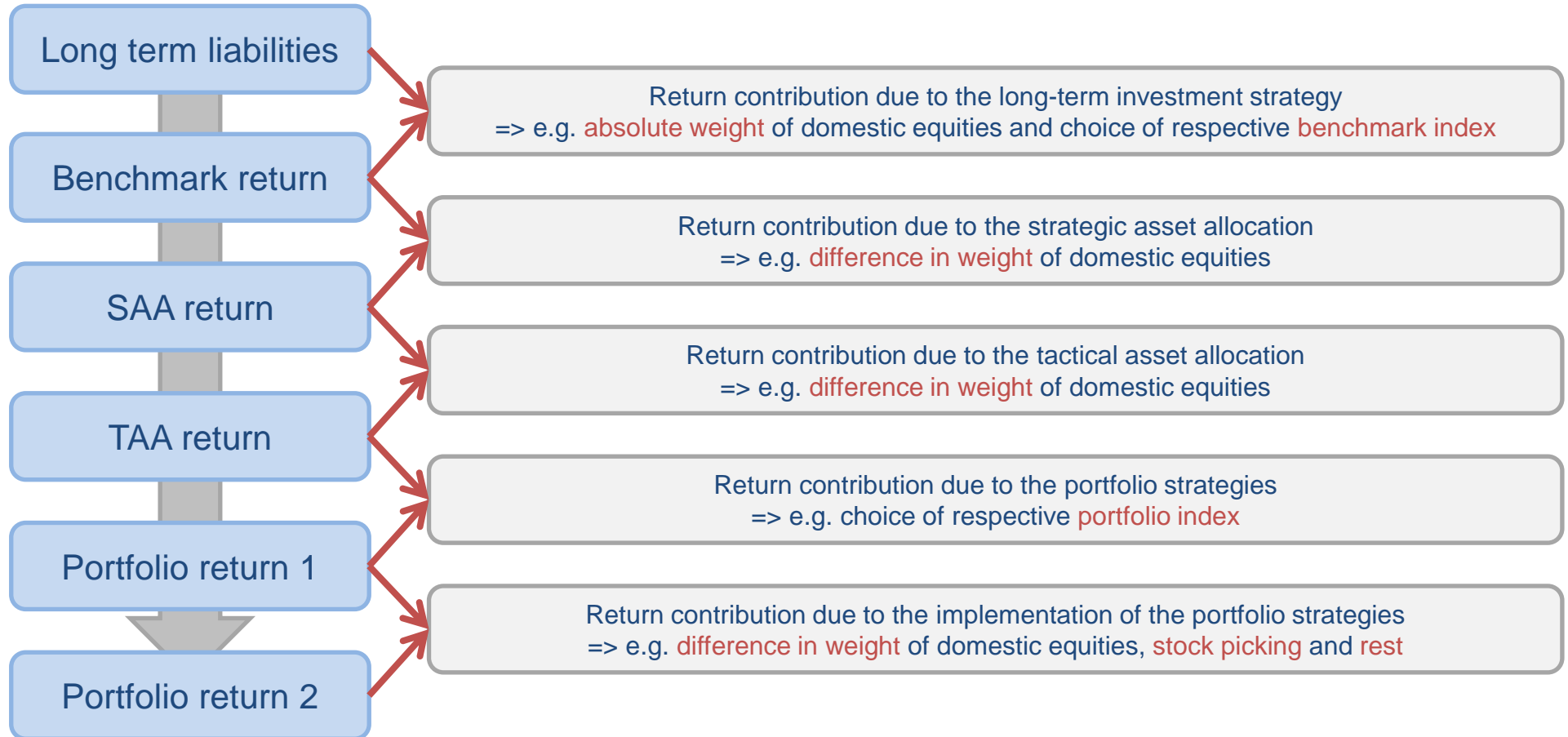
# Decision-oriented risk and return monitoring

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# Decision-oriented risk and return monitoring

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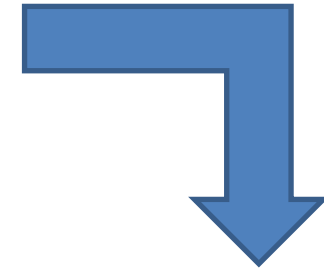




# Decision-oriented risk and return monitoring

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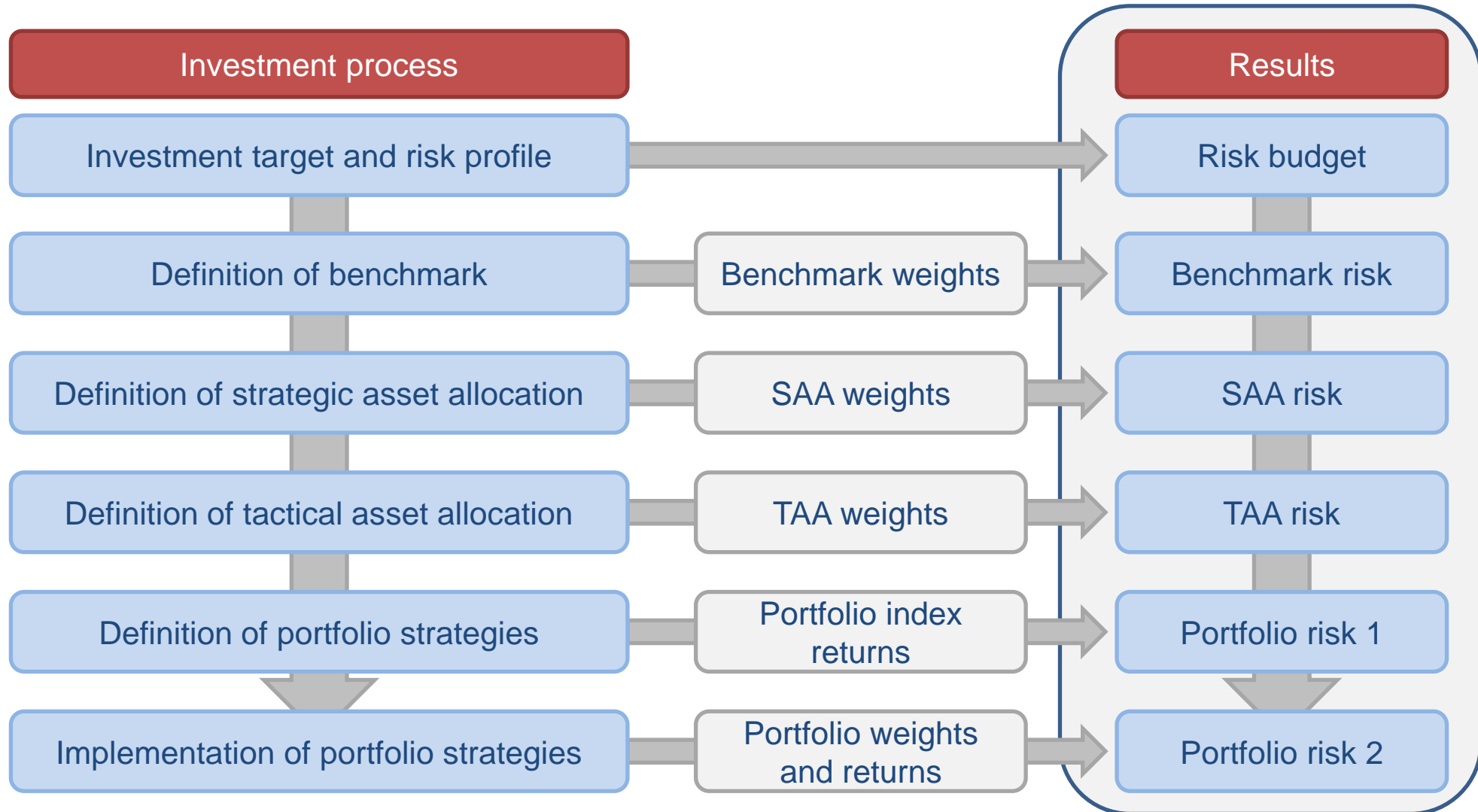
	Asset allocation effect	Stock picking effect	Interaction effect	Total management effects
Domestic bonds	0.18%	0.06%	0.09%	0.33%
Foreign bonds	0.03%	-0.33%	-0.06%	-0.36%
Domestic equities	-0.06%	0.48%	-0.33%	0.09%
Foreign equities	-0.33%	-0.33%	-0.06%	-0.73%
Total assets	-0.18%	-0.12%	-0.36%	-0.67%



	Board of directors	Investment committee	Portfolio Manager	Total effects
Domestic bonds	0.12%	0.18%	0.03%	0.33%
Foreign bonds	0.36%	-0.27%	-0.45%	-0.36%
Domestic equities	-0.06%	-0.06%	0.21%	0.09%
Foreign equities	-0.20%	-0.03%	-0.50%	-0.73%
Total assets	0.22%	-0.18%	-0.71%	-0.67%

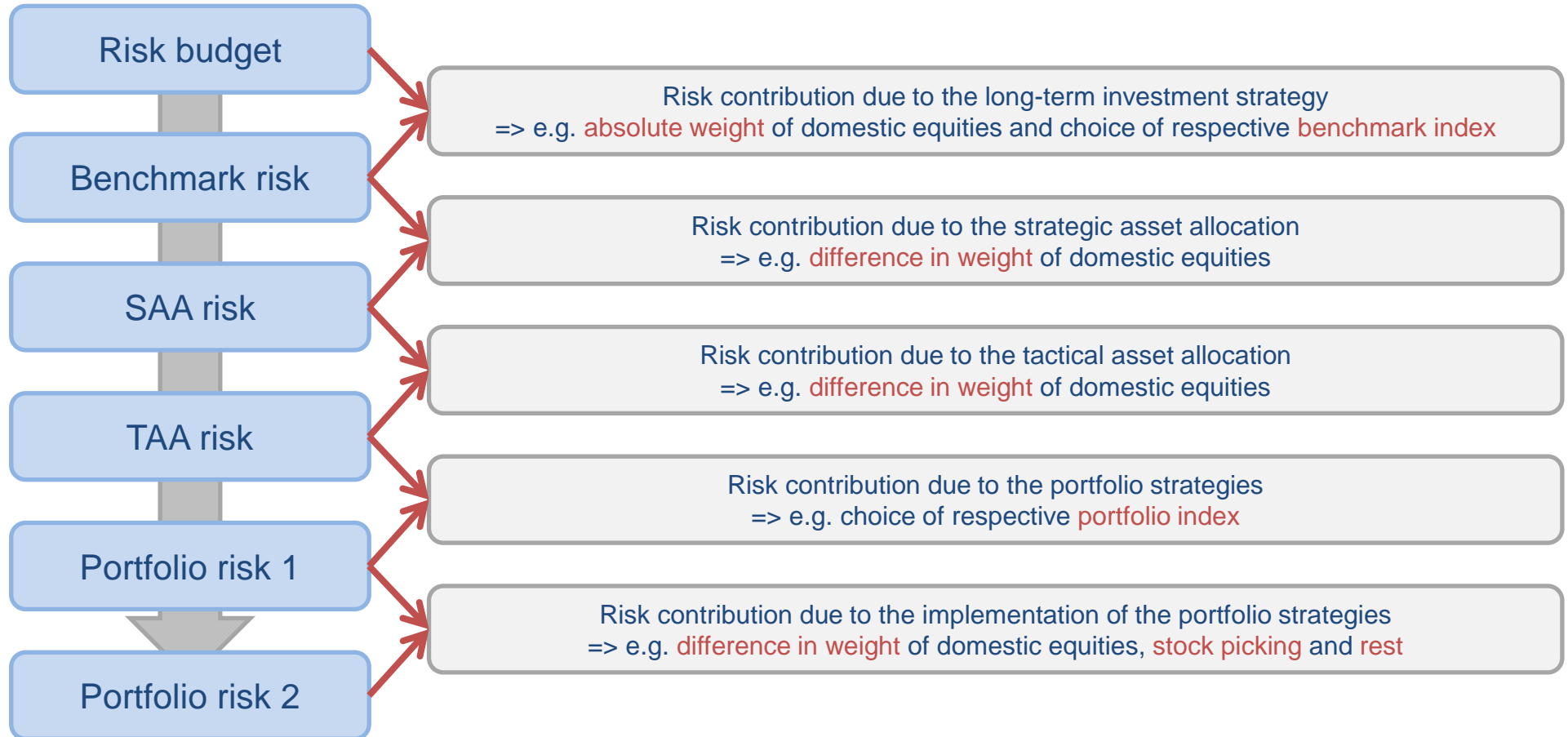
# Decision-oriented risk and return monitoring

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# Decision-oriented risk and return monitoring

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# Conclusion and summary

# Conclusion and summary

- The increasing complexity of the financial markets, the increasing regulations and the increasing uncertainty forces investment management organizations even more to **reduce the unintended and the reducible risks**.
- There is no common response to the changing environment of the investment management industry and organizational specific solutions needs to be developed and implemented - but all solutions have to address common aspects of monitoring: **transparency, accountability, integrity and ethical behavior**.
- Implementing a **performance framework and a decision-oriented risk and return monitoring** is not an easy undertaking but needs to be addressed to be known as an up-to-date and an exemplary investment management organization.
- A **decision-oriented performance framework** is of course no guarantee but for sure is becoming more and more a **precondition** for long-term performance.

# Comments and questions

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# Contact details and disclaimer



# Contact details

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