Principles for Investment Reporting

Date: 25. March 2014
Produced by: Dr. Stefan J. Illmer
Agenda

- A message from a top chef
- Introductory thoughts about best practices for investment reporting
- Principles for investment reporting – how it started
- Principles for investment reporting – the current status
- Final remarks from a top chef and summary
- Comments and questions
- Contact details and disclaimer
A message from a top chef
A message from a top chef

"Preparing an investment report is similar to preparing a meal!

The result can be exquisite, stylish and good for you – but it can also be of little nutritional value and poorly presented.

The final decision – higher / lower end or quality – is up to the consumer!"
A message from a top chef

"High quality and high end cuisine is all about menu, recipes, ingredients, equipment and presentation ... and don’t forget the kitchen !"
"In comparison, high quality and high end investment reporting is about content, methodologies, data, tools and illustration ... and don't forget operations!

Common to both, generating a product that satisfies the consumer’s requirements.

Therefore a final advise: To reach the top you should start reviewing and afterwards implementing best practices because that leads you to high quality and if you like to high end products."
Introductory thoughts about best practices for investment reporting
Basic idea behind the need for best practices

GIPS Standards

... but what about investment reporting to existing clients?

Prospective clients gain from improved transparency.

Best practices for performance presentation to prospective clients

Investment reporting
Importance of investment reporting

... is the main or even the only monitoring and controlling tool I use ...

... therefore it should be useable for that purpose!

Investment reporting

Effective investment reporting!
A simple investment report

**Asset Allocation**

- Cash
- Bonds
- Equities
- Other

**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 derivative: 100 EUR
- GHI bond: 500 EUR
- JKL portfolio fund: 100 EUR
- Total assets: 1’000 EUR

**Cumulated return**

- Dez 2012: -2%
- Jan 2013: -1%
- Feb 2013: 0%
- Mrz 2013: 1%
- Apr 2013: 2%
- Mai 2013: 3%
- Jun 2013: 4%
- Jul 2013: 5%
- Aug 2013: 6%
- Sep 2013: 7%
Transparency – A simple investment 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 derivative: 100 EUR
- GHI bond: 500 EUR
- JKL portfolio fund: 100 EUR
- Total assets: 1'000 EUR

Internet definitions:

“Lack of hidden agendas and conditions, accompanied by the availability of full information required for collaboration, cooperation, and collective decision making.”

“Minimum degree of disclosure to which agreements, dealings, practices, and transactions are open to all for verification.”
Transparency – A simple investment report

Questions to ask to increase transparency:
- Is the valuation based on fair values?
- Is the profit and loss gross or net of fees?
- Is the return gross or net of fees?
- Is the return based on trade date accounting?
- How are accruals treated?
- What is the benchmark?
- What is the risk measure?
- Are the true exposures reflected in the asset allocation?
- What type of duration is shown?
- Does the duration include only the bonds?
- What is the inception date?
- What is the reference currency?
- What is the reporting period and date?
- and so forth …
Fairness – A simple investment report (1/2)

Internet definitions:

“The state, condition, or quality of being fair, or free from bias or injustice; evenhandedness”

“Fair means free from favoritism, self-interest, or preference in judgment.”
Questions to ask to check for fairness:

- Who designed the report and its content?
- Is the return calculated from a client or a portfolio manager perspective?
- Is the return gross or net of all fees?
- Is the return gross or net of taxes?
- Is the benchmark appropriate to the investment strategy?
- Were there any changes to the benchmark?
- Is the risk measure appropriate for the investment strategy?
- Are complex products reflected according to their economic exposure?
- What are the “total” fees earned by the parties involved, like asset manager or custodian?
- and so forth …
Principles for investment reporting – how it started
How it started

- 2001: Discussion started within the European Investment Performance Committee (EIPC) on transparency needs with respect to performance attribution.
- 2002: EIPC published "Guidance for Users of Attribution Analysis".
- 2004: EIPC published "Guidance on Performance Attribution Presentation".
- 2006: EMEA RIPS published the "Guidance for Recipients of Investment Reporting" => List of questions to ask asset managers with respect to client reporting.
- 2010: CFA Institute formed the Investment Reporting Working Group (IRWG).
- 2012: Initiative was integrated into the project “Future of Finance” of the CFA Institute.
Definition of investment reporting (1/2)

- The IRWG understands investment reporting as a subset of client reporting within the investment management industry.
- The IRWG defines investment reporting as the transparent and fair preparation and presentation of investment information including:
  - the investments made,
  - the results achieved,
  - the risks taken, and
  - the management and maintenance fees incurred.
- The IRWG considers investment reporting not only to include the output, but also the inputs, the creation of reports, the communication between the preparer and the user, and the respective policies and procedures.
Definition of investment reporting (2/2)

- The IRWG considers investment reporting to focus on current exposures of the investments and to include reports on asset allocation, performance, and risk, etc. Therefore, the IRWG does not address reports designed for accounting, tax, and regulatory purposes.

=> The key words are “transparency” and “fairness”!
Intermediate stop – Transparency & fairness

“Clear, trustworthy investment reporting continues to be the most valuable tool for communicating investment information. Whether you use this information as an investor or as a financial professional, it is what you don’t know that can be the most damaging. In today’s complex investment marketplace, there is a need for a tool set of guidelines to advance the next stage of evolution for investment reporting.

The Principles for Investment Reporting serve to facilitate a dialogue between report preparers and users. As trust is rebuilt through clear and transparent reporting, it will also encourage investors to refocus on securing their financial future in partnership with investment professionals.”

=> http://www.cfainstitute.org/learning/future/about/Pages/principles_for_investment_reporting.aspx
Principles for investment reporting – the current status
Contents – Principles for investment reporting

Contents
1. Preface
2. Why principles for investment reporting are needed
3. Background and definitions
4. Stakeholders
5. Objectives
6. The five principles for investment reporting
7. Implementing the principles
Relationship to GIPS standards (1/2)

=> Please note that the Principles for Investment Reporting are separate and distinct from the GIPS Standards!
Relationship to GIPS standards

Principles for Investment Reporting ≠ GIPS Standards

Other best practices

Principles for Investment Reporting

GIPS Standards

(2/2)
Important disclaimer

=> Purpose of the principles for investment reporting
– is not to restrict or define what elements should be in a report
– but to address that having created a report, it should include sufficient information or indicate where the information can be readily obtained so that the recipient understands the contents of the report and the reasons behind the selection presented.
Why principles for investment reporting are needed

1. Transparency and clarity
2. Client perspective
3. Fee transparency
4. Treatment of complex technical issues
5. Understanding between the prepares and the users
6. Anticipation of regulatory trends
Stakeholders

Stakeholders are manifold and include preparers as well as user of investment reporting, such as:

- asset management companies;
- mutual fund companies;
- administrators;
- prime broker;
- investment consultants; and
- asset owners.
Objectives

The objectives of the principles for investment reporting are:

– to highlight the importance of reporting as feedback into the investment management process;
– to ensure that the user’s preferences are reflected in the information contained in the report;
– to increase communication and education between the preparers and recipients of investment reporting;
– to document policies, procedures, controls, and preferences of the asset owner for report content and to make the documents available upon request;
– to provide guidance on the minimum content necessary for full, fair, transparent, and effective investment reporting;
– to promote consistency while accommodating and disclosing differences;
Objectives (2/2)

– to provide assurance to intended users of investment reporting that the preparers who follow the Principles adhere to high ethical standards;
– to provide guidance on methodologies for preparers and intended users;
– to promote strong and consistent internal processes for preparers of investment reporting; and
– to anticipate those aspects of investment reporting for which regulation may be considered necessary and complement existing regulations.
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.


5. Comprehensive fee disclosure.

=> leads to effective investment reporting.
The five principles for investment reporting (2/4)

Effective investment reporting reflects the following qualities:

– **active communication** occurs between the preparer and the user and all decisions about content of the report are documented as well as periodically reviewed;

– **intended user or audience** of the investment report and the expected use of the information are considered when designing the report;

– **purpose** of the investment report and **reasons** for its content and production are transparent and clearly stated;

– **investment report** is relevant and appropriate for the purpose stated and the assets and investment strategies being presented;

– **investment report** is a fair representation of the investments made, results achieved, risks taken, and costs as well as taxes incurred;

– **investment report** provides the user of the report with appropriate comparative data such as index data or even a GIPS composite;
The five principles for investment reporting (3/4)

- investment report provides information on changes in the investment strategy or investment style;
- data quality is defined and managed according to transparent criteria, and control processes are defined, documented, and made available on request;
- preparer follows an error-correction policy and discloses material errors affecting information included on prior investment reports;
- historical information presented in the investment report is not changed without disclosure;
- preparer has a policy for handling potential conflicts of interests and segregation of duties is sufficient that a fair and accurate representation of the assets to be reported occurs;
- preparer consistently adheres to the processes documented;
- production and control processes are periodically reviewed;
The five principles for investment reporting

- methodologies used for the production of the data in the report are disclosed or made available upon request;
- investment report is transparent regarding the fees and remuneration (e.g., commissions, referral fees) to be received by the preparer of the investment report and by third parties, such as custodians, investment management companies, or consultants, relating to the management or administration of the assets being reported.
Implementing the principles

The second edition of the principles for investment reporting will contain a series of specific recommendations for typical report types and the information that they should contain.

Report providers will then be able to use these recommendations to note their adherence to the principles for investment reporting.

The structure of the Principles is flexible so that preparers can support it fully for the client base that the preparer has defined, and expand the client base definition as the preparer’s ability and client demand develops.

If the preparer cannot follow the recommendations, the preparer may supply an alternative as long as the alternative is described during the communication process, the reason the preparer cannot follow the recommendation is disclosed, and the alternative, if selected by the client, is disclosed as such in the report.
“This first edition outlines the key Principles, and the second edition will contain a series of recommendations that are specific to typical report types and the information that they should contain.”

=> http://www.cfainstitute.org/learning/future/about/Pages/principles_for_investment_reporting.aspx
Final remarks from a top chef and summary
Final remarks from a top chef (1/2)

"Preparing exquisite and stylish cuisine is an art!

It demands an attitude and ambition that focuses on best quality and practice in every aspect of the preparation."
"Six letters stand for the drivers of high end quality – whether it is a meal or an investment reporting:

- **M** for *multiple*,
- **P** for *premium*,
- **F** for *flexible*,
- **R** for *relevant*,
- **C** for *compliant*, and
- **B** for *best practice*.

Addressing these drivers and especially the last one helps to experience an enjoyable meal ... and of course an effective investment reporting."
Summary – Achieving three starred investment reports?

Reaching the top in investment reporting is possible if implementing the principles for investment reporting by:

- Addressing and covering the reporting needs of the user.
- Willing and being able to adjust the investment reporting according to changing needs of the user.
- Illustrating complex matters in an easy and understandable way through clear as well as self-explaining content and structure.
- Creating transparency on the investments made, the results achieved and the risks taken.
Comments and questions
Comments and questions
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.