

# Attribution standards

Pictet's position by Darren  
Crowley & Roger Buehler



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# Attribution standards

- 1. Introduction**

This review attempts to highlight the key issues relating to defining and practically implementing attribution standards. Recently this issue has become a hot topic through various industry publications (such as David Spaulding’s “ A case for Attribution Standards” and the SPPS “Guide for users of Attribution Analysis”). We expect this trend to continue and momentum to increase however we feel that a number of key points need to be discussed to gain a Pictet consensus which will be passed on to interested parties (i.e. the Investment Performance Council/ SPPS etc). We do not plan to comment on every proposal but to focus in on the main issues.
- 2. Management summary**

It is our opinion that to impose PPS attribution calculation standards would be incorrect because of the points we set out below. The attribution options available in the marketplace make setting a consistent, fair and measurable standard across all managers impossible.

However, we fully support a PPS attribution disclosure standard to provide transparent information that does not mislead the client or consultant. The disclosure standard should fully highlight how the attribution has been calculated and presented. Furthermore, we feel that the manager should also have the right not to present misleading attribution analysis as long as they provide a full disclosure of the reasons why the analysis is not appropriate.
- 3. Definition of standards**

Official dictionary definitions summarise standards to mean “an accepted or approved example of something against which others are judged or measured” and “a principle of propriety, honesty and integrity”.
- 4. Definition of attribution**

A process used to analyse either the absolute portfolio return (often called contribution) or the excess return (often referred to as relative return or alpha) between a portfolio and its benchmark into the investment management decisions.

Attribution attempts to measure whether the investment process is working, the strengths and weaknesses of the process, is there evidence of skill and highlight where we should focus management time and resource.
- 5. Are standards achievable?**

In recent surveys the question has been asked “Do you support standards for attribution?” the natural answer is yes because standards should meet the definition above and make life easier for all concerned. However, when the question was posed in a recent Spaulding survey the answer came back yes by 57.7% of Plan Sponsors, 54.6% of Investment Consultants and 44.2% of Money Managers. Cynics might point to the fact that Money Managers do not want the transparency of attribution analysis but it could be argued that the lower level of agreement is because Managers know the problems associated with calculating accurate attribution (frequency / data issues and software constraints) and therefore know the potential that attribution can lead to incorrect conclusions being drawn. We should also remember that in some cases sensible attribution is not achievable. For instance, a complicated multifactor investment approach is not best analysed using common attribution models. Furthermore, a client may set an absolute mandate (i.e. they do not want negative performance) and this policy can not be replicated using a standard relative attribution model.

6.  
Attribution  
options

The following summarises the main attribution differences / questions:-

1. Arithmetic vs. geometric.
2. Numerous calculation models - many published but several developed in-house.
3. Several linking methodologies.
4. Holding or transaction based.
5. Bottom up / top down.
6. Stock vs. Industry vs. geographical vs. customised.
7. Calculation frequency – daily, weekly, monthly.
8. Relative vs. Contribution.
9. Balanced portfolios, equity or bond based.
10. How do you attribute leverage / exotic instruments using traditional attribution models.
11. How do you attribute income – i.e. gross/ net dividends – Tax recoveries.
12. How do you deal with interaction effects.
13. How do you split out cash used in a TAA strategy from the residual cash from income and transactions.
14. Can the attribution module cope with benchmark re-balancing rules.
15. Transaction fees often impact stock selection but the decision to trade may be the effect of a changing asset allocation position
16. Ideally fees and cash should be applied at each geographical / sector / stock level to obtain an accurate analysis. Is this technically practical?

7. What is  
the correct  
option?

The answer is that all of the above options are correct in different circumstances. In fact you can have any possible combination of the above to measure different investment departments. Therefore, you have to conclude that there is no “standard” way of measuring attribution. We believe that the standards should not impose any attribution model, since attribution has to reflect the varying investment processes. Potential standards should focus on transparency and rules that avoid the possibility of hiding important information which could mislead the client.

8.  
Understanding  
of  
attribution?

Recently, we have heard many comments in the industry concluding that attribution is not well understood outside the teams who produce it. Therefore, we believe that all parties must understand the various options mentioned above before standards can help them make an informed decision. Furthermore, it is key that the client understands how the portfolio is being constructed and what key investment decisions are being made and who is taking them. It can also be argued that by setting standards you are increasing understanding through the necessary disclosures detailing the transparency of the methodology and investment process.

9. Composite  
vs.  
representative  
account

Generally how you view this point is a result of the attribution software you have available and the products you manage. If the software matches your investment style and is unitised it may be easy to produce composite attribution. However, if your composite is made up of many segregated accounts located on several accounting engines / attribution software platforms you require the individual data modules to be merged before you can attempt composite attribution. This situation becomes even more difficult after a merger of two different investment styles. For instance in the case of major global rivals you potentially have to link multiple accounting and attribution software modules based on differing investment styles. Therefore it can be less misleading to choose a representative account based on the surviving investment style. This has to be balanced with the fact that picking the most appropriate account is often subject to “cherry picking” criticism.

The standards have to take into account what is technically reasonable to expect from the asset manager. Our concern particularly relates to the complexity of the calculation, the number of transactions and holdings which have to be managed by the system. To create complicated aggregates obviously has a huge cost impact, in time, effort and money. We feel that it is likely that the cost is too great for the benefits to outweigh the expense. Furthermore, creating an attribution on a composite of several hundred accounts would be practically impossible. We should also bear in mind that single accounts often have history available but to create historical aggregates to match all the firm's PPS composites will be a very significant manual task.

10. Should attribution analysis exactly match PPS composites?

This question relates to realistic expectations of calculating attribution and how many basis points difference is considered acceptable. Most firms have complicated composite construction rules (i.e. min account sizes in and out etc) to build this constraints into attribution software in an automated basis would be extremely difficult. Furthermore software would have to attribute respecting strict new PPS rules for instance-

- 1.1.05 Accrued accounting (at the stock level?)
- 1.1.05 TWR that adjust for cash flows must be used (is this a cash flow between sectors/ countries?)
- 1.1.10 Actual valuations at the time of external cash flows will be required. (This suggests daily attribution and therefore Modified Dietz will not be acceptable).

Furthermore, we have issues such as daily MSCI indices do not match official monthly ones- so daily attribution indices might not match monthly composite benchmarks. Daily MSCI stock level indices do not include income so you have to estimate the dividend effect.

To completely mirror attribution to PPS composites would have a huge cost in time and effort and the devil is in the detail namely the data accuracy and system capabilities. We feel that it is acceptable to have differences as long as you disclose what they are. Furthermore, clients will have to be educated in the many differences. For ease of calculation we feel that managers must still be allowed to provide monthly Modified Dietz analysis (on asset class level) if they want as long as they disclose the basis of calculation.

It is also important to keep in mind that attribution does not always follow the same objective as performance measurement on total composite level. While performance monitors the portfolio, attribution monitors the manager. Therefore it can make sense to have different results. A typical example concerns elements the manager can not influence and which are usually not included in the benchmark (e.g. some fees, income of securities lending, tax recoveries, etc). If those transactions are excluded from the attribution analysis, it is logical that the results of attribution can not 100% explain the total fund composite performance. However standards should require adequate disclosures be made to explain why the difference exists.

11. Can the standards be verified?

Given the numerous calculation methodologies, linking methodologies, hold vs. transaction, arithmetic vs. geometric questions etc we are not sure that the verifiers could easily certify that asset managers comply with potential attribution standards. Therefore, if attribution can not be easily verified how will the standards be policed? If the manager creates an internal attribution model will the verifiers agree on the methodology.

If standards become imposed we are certain that consultants and verifiers will offer their services at a premium as they will see this as a revenue opportunity, however it will take time for verifiers to become experts in the field of calculating attribution.

12. Do they provide a level playing field for clients

We can not see that the various attribution options create a level playing field, for instance a client might want to review three asset managers with exactly the same return. One manager might show this return broken down by daily stock level, the second by monthly holding based geographical analysis and the third by monthly transaction based industrial analysis. Does this create a level playing field or might the client be tempted to appoint the manager by the sophistication of their attribution software rather than judge the manager on its Investment process? Of course the extra information on attribution helps judge the portfolio returns but the question remains “is the investment process correctly reflected in the analysis?”. Extra information is normally a good thing but it can also create more confusion if it is not relevant. However, we feel that the key aim of attribution must be to correctly attribute the investment process, if you do not do this you should not provide attribution analysis.

13. Is disclosure a better option?

If you can not set appropriate standards and / or verify them the best option left is to provide full disclosure to potential clients. By defining and disclosing the points covered in the attribution options section we feel that you are being transparent to the client and the extra information on the attribution process gives them a chance to understand how we achieve performance returns.

14. Should managers have the right not to show attribution?

If standards become imposed we think that the asset manager should have the right not to provide attribution they know is misleading. However, they must disclose why they have not provided attribution.

If you consider that attribution might only be one sector of one specific country, the only attribution that could be calculated is stock level attribution. This can not be expected from every company in every situation. Furthermore, in some circumstances attribution does not make sense at all. For instance an appropriate model might not exist (i.e. money market funds, hedge funds, forex etc).

15 Conclusion

When you consider the valid attribution options available in the marketplace the challenge of imposing a single standard is not fair, achievable or easily verifiable. Furthermore, we want to highlight that providing clients with multiple attribution options does not help them to compare managers on a like for like basis.

Therefore we feel that the scope of any future attribution standard should only be to add appropriate attribution disclosures to all marketing material.