

**GIPS COUNCIL
REGIONAL INVESTMENT PERFORMANCE SUBCOMMITTEE
FOR EUROPE, MIDDLE EAST AND AFRICA (RIPS EMEA)**

**Guidance for
Recipients of Investment Reporting**

Chapter 1 – Introduction

Reporting for investment management clients is not only a part of a routine service delivery, but also an instrument of the dialogue between investment managers and their clients.

Like any other information source, client reporting provides meaningful information to the user only to the extent the user understands the assumptions and concepts underlying this presentation. That's why it is crucially important that the presentation of investment reporting is provided in a way that does not mislead the users and contains all necessary details to explain the underlying assumptions and concepts.

In view of the above, the Regional Investment Performance Subcommittee for Europe, Middle East and Africa (RIPS EMEA) of the GIPS Council (formerly the European Investment Performance Committee, EIPC) has decided to take the initiative to address the needs of investment management clients for transparent and comprehensive information and to issue a specific guidance with respect to presentation of investment reporting. The Guidance for Recipients of Investment Reporting pursues the following objectives:

- To expand the philosophy of ethics and transparency into the area of reporting for investment management clients.
- To create a *questionnaire* for investors and investment management clients to draw their attention to important aspects of investment reporting and to provide a list of possible questions to ask their investment managers regarding the reporting.
- To contribute to improvement of quality of investment reporting in general by increasing investors awareness.

Therefore, this Guidance is primarily regarded as an *educational paper for investors* and does not attempt to present any prescriptive provisions for investment managers. On the other hand, investment managers may find this Guidance a useful source for structuring their investment reporting.

The Guidance applies to investment reporting for *existing* investment management clients only. Reporting for prospective clients is addressed within the scope of the Global Investment Performance Standards (GIPS).

For the purposes of this Guidance, the term “client investment reporting” has a broader meaning and includes reporting in a durable medium but also oral and other forms of communication to clients.

RIPS EMEA regards it a responsibility of recipients of investment management reporting to duly inform themselves about basic investment management concepts and to ask relevant questions to properly understand the reporting. Not doing this may lead to misinterpretations and misjudgment of the substance and contents of the reporting. It is also recommended that investors study the RIPS EMEA guidance papers previously issued on various performance and reporting matters (refer to Chapter “Related documents” for a list of the recommended materials).

The Guidance was approved by RIPS EMEA on June 22, 2006. RIPS EMEA proposes that this Guidance be adopted by the GIPS Council and GIPS Executive Committee as an educational paper for investment management clients.

Chapter 2 – Components of client reporting

The purpose of the following definitions is to provide users with an overview and elaborations on typical components of the investment management reporting clients may expect to receive. This overview is just an indication and is not deemed to be exhaustive. It should be also taken into account that some of those components may not always be included in the standard reporting package but rather may have to be requested additionally.

- Portfolio information:* This part of the reporting includes the general portfolio standing data, such as client name and portfolio identification, mandate type, reference currency, investment strategy and the portfolio benchmark, etc.
- Portfolio structure:* This report may include the following information:
- Portfolio asset allocation, which is a breakdown/overview of the portfolio assets by various criteria, e.g. by asset class, country, currency, industry sector, maturity, derivative type, manager, sub-advisor, etc. This may be provided as of the reporting date as well as a dynamic analysis for a particular period.
 - The largest portfolio positions and their share in the total portfolio.
 - Asset-liability analysis, etc.
- Performance report:* This report provides a summary of the portfolio and the benchmark performance achieved over the reporting period, and may include single period, cumulated and average returns, etc.
- Return and risk analysis:* This report may include the following components:
- Return analysis for the portfolio and benchmark by various factors, e.g. by asset class, country, industry sector, maturity profile, manager, sub-advisor, etc.
 - Return contribution and attribution analysis
 - Ex-post and ex-ante analysis of portfolio risk measures, e.g. volatility, tracking error, risk-adjusted performance measures, value-at-risk, etc.
- Portfolio valuation statement:* This report provides a total portfolio valuation as of a specific date with a breakdown of the assets by individual securities and investment instruments.
- Profit and loss statement:* This report provides an analysis of gains and losses generated during the reporting period. This report may also show an analysis of costs of asset management, e.g. total expense ratio, breakdown of transaction costs and fees, etc. The degree of detail may vary.
- Transactions report:* This report shows all transactions (purchases and sales of securities) carried out during the reporting period on a trade date basis.
- Cash and capital flow report:* This report shows cash flows into/out of the portfolio during the reporting period. Cash flows typically include capital contributions and withdrawals by client (both as cash and securities), dividend and interest income payments, fee charges, etc.

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Investment compliance report: This report may include the following information:

- Analysis of compliance with the statutory legal requirements applicable for a particular client, such as legal investment exposure limits.
- Analysis of compliance with the client's investment guidelines, such as investment restrictions, asset allocation ranges, asset-liability parameters, tracking error targets, etc.

Composite report: GIPS compliant composite report the portfolio belongs to.

Descriptive information: This report may include the following information:

- Qualitative information on the investment process
- Information on the market developments, such as interest rate and currency exchange movements, general macro-economic situation, etc.
- Qualitative information about the portfolio risk-return profile.
- Various disclosures and disclaimers.

Chapter 3 – Guiding principles

Clients should expect their investment managers to adhere to the industry ethical principles and standards, such as the Asset Manager Code of Conduct of CFA Institute, Global Investment Performance Standards (GIPS), EFAMA Code of Good Conduct on the Presentation of Performance, etc.

Investment reporting for individual clients is subject to the following guiding principles:

- Reporting philosophy should be identifiable and transparent. For example, presentation of performance as a part of the client reporting should clearly state if a client return perspective or a portfolio manager return perspective is applied.
- Reporting should take into account the type of client. Institutional clients may have other reporting needs than private retail clients.
- Reporting should present a true and fair picture of the client assets and performance and contain all necessary details relevant to the client.
- Reporting should be timely and accurate.
- Reporting should take into consideration the applicable legal requirements.

Chapter 4 – Questionnaire

Clients may consider it useful to ask their investment managers the following questions to understand their investment management reporting. This list is not considered to be exhaustive. On the other hand, some questions may not always be applicable depending on the situation.

1. Investment process and portfolio strategy

1.1. Describe the main elements of the investment management process, including the key investment decision factors employed. Disclose any significant recent changes to the investment management process.

Investment management clients usually do not prescribe all details of their portfolios' management but rather define the strategic objectives. The tactical implementation of the investment strategy is the task of the manager and the clients should be informed on the active management decisions being taken by their manager.

1.2. Disclose the composition of the benchmark and the benchmark rebalancing rules.

Investment management clients may not always define by themselves the benchmark their portfolio will be measured against. If the investment manager defines the portfolio benchmark, the clients should be informed on the main benchmark features which will help them to assess if the selected benchmark is appropriate for the portfolio. Typical benchmarks are represented by market indices or compositions thereof and model portfolios.

1.3. Disclose investments outside of the scope of the benchmark.

For actively managed portfolios, managers are expected to take active decisions and as a part of that may invest in instruments beyond the benchmark universe. Knowing this information will help clients to understand the ways their portfolios are being managed.

1.4. Disclose if there have been any changes in the benchmarks.

The portfolio benchmarks should be defined ex ante and not ex post. However, changes in the market environment or external circumstances may force the manager to change the benchmark (e.g. if the index provider discontinues to calculate a particular index and a replacement is necessary). Clients should be informed on such situations, especially if benchmarks are changed retroactively.

1.5. If the portfolio allows discretionary leverage, describe how the leverage is employed.

Clients should be aware that use of leverage may significantly influence the risk-return profile of the portfolio. Clients should demand information on to what extent and using what investment instruments the portfolio is being leveraged.

1.6. Describe the process of investing/disinvesting the portfolio capital contributions and withdrawals.

Contributions and withdrawals of cash and/or securities into/from the portfolio by the client, require appropriate portfolio adjustments in terms of investing/disinvesting, which can be at discretion of the portfolio manager with respect to timing and stock selection priority. Clients should understand how this is handled.

1.7. Describe the principles of allocating trades among portfolios.

Clients can expect fair dealing from their managers and demand information on how the principle of fair allocation of trades is implemented.

1.8. Disclose the composite building philosophy of the investment manager and the composite the portfolio is included in. Disclose the investment strategy characteristics of the composite the portfolio belongs to.

Knowing the composite universe of the manager and the particular composite the portfolio belongs to will help the clients understand how their portfolios generally fit into the investment process and focus of the investment manager.

1.9. Disclose any discretionary use of third-party managers and sub-advisors.

Clients should be duly informed if their investment manager employs sub-advisors or delegates the portfolio management to other third-parties.

2. Underlying portfolio input data

2.1. Disclose the sources for securities prices and exchange rates used for the portfolio valuation and if they are consistent across all investment instruments in the portfolio.

Reliable price sources are crucial for the quality of reporting. In addition, clients should be aware that use of different sources for securities kept in the same portfolio may create distortions in the valuation.

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2.2. Disclose if market prices are used for all instruments and assets in the portfolio. If not, what is the valuation process for securities and assets where market prices are not used / not available?

Portfolio valuation should be based on the fair value principle which implies use of the “tradable” market prices. Market prices are not always available for all instruments. For example, some less liquid bonds may be valued using interest rate curves, some OTC derivatives may not have a market price, and private equity investments may have to be valued using specialised valuation methods. Clients should understand the process of valuation of such instruments.

2.3. Disclose if the valuation of any instruments in the portfolio is based on preliminary or estimated prices.

The timely market or fair value prices may not always be available for all instruments in the portfolio. For example, some alternative investment vehicles may only deliver their final valuation as of the reporting date with a delay of several months.

2.4. Disclose if the portfolio valuations include accrued interest and dividend income from securities.

Timely accruals of the interest income from fixed income securities and dividend income from stocks (accounting for dividends as of ex-dividend date) improve the quality of the investment result calculation in the reporting period.

2.5. Disclose if portfolio transactions are accounted for using the trade date or settlement date principle.

Choice of accounting conventions with respect to the investment transactions may impact the presentation of the investment results, especially if the transaction trade and settlement dates lie in different reporting periods.

2.6. Disclose if the current reporting is subject to any retroactive corrections expected in the next time, e.g. reversing entries, missing transaction bookings, etc. What is the probable impact of these corrections?

If reporting is required to be provided immediately after the reporting date, it may happen that not all corrections have been captured by the internal controls system by that time. Clients should be aware of the impact of ex-post corrections if such corrections are expected.

2.7. Disclose if there are any differences with respect to sources and timing of prices of underlying securities between the portfolio and the benchmark and describe the impact of these discrepancies.

The underlying pricing data for portfolios and their benchmarks often do not come from the same source. As a result, inherent valuation distortions emerge which make portfolios and benchmarks less comparable. Clients should be informed if such discrepancies exist.

2.8. Disclose if the responsibility for the portfolio valuation, performance measurement and investment reporting is delegated to internal units not fully independent from the portfolio management unit.

To prevent conflicts of interest, investment managers should not be involved in the process of portfolio valuation or accounting.

3. Performance reporting

3.1. Describe the philosophy of the portfolio performance presentation. Is a client return perspective or a portfolio manager return perspective applied?

Portfolio performance can be calculated and presented either from the perspective of the client or from the perspective of the investment manager. From the client perspective, a money-weighted rate of return (MWR), net of fees, is often considered most appropriate to reflect the size and timing of client-driven cash flows and represents the actual net performance result. From the manager perspective, the time-weighted rate of return (TWR), gross of fees, is the best measure of the manager's performance as it neutralises the effects of client-driven cash flows and return components beyond the manager's control (such as fees) and as such provides a comparable performance result. The MWR method is often used for performance reporting to existing clients, while the TWR method is used for performance reporting to prospective clients. Many managers also report TWR returns to existing clients. If managers report both MWR and TWR performance, it is advisable that the difference in the calculation methodologies and in the performance results are explained.

3.2. Describe the methodology and frequency of calculation of portfolio and portfolio segment returns (if applicable).

Clients should obtain information on specific portfolio return calculation methods being employed, e.g. Daily Valuation method, Modified Dietz, Modified IRR, etc. Various calculation methods may have significant impact on performance results.

3.3. Disclose if performance is presented gross or net of fees (management, custodian, administrative fees, bundled fees, etc).

Various fees incurred in the investment management process may be treated differently for performance calculation purposes. Clients should be able to assess the impact of fees on performance.

3.4. Disclose if the realised income from dividends and coupons is accounted for after or before deduction of applicable withholding taxes both for the portfolio and the benchmark. Is there a differentiation in treatment between reclaimable and non-reclaimable withholding taxes?

Assumptions with respect to withholding taxes applied for the performance calculation purposes may have a significant impact on the performance results especially in strategies where income component plays an important role.

3.5. Disclose if performance is presented gross or net of transaction costs and trading expenses.

Performance is usually presented net of transaction costs and trading expenses because they represent direct costs of investment management. Not accounting for such costs would result in a meaningless artificial performance.

3.6. Disclose if performance presented in the client reporting is calculated by the manager or by the custodian. Can a reconciliation of returns calculated by the manager with those calculated by custodian be provided and discrepancies (if any) be explained?

In case of external custody portfolios, performance figures may be provided both by the investment manager and by the custodian and may deviate for various reasons (e.g. different calculation methodology or assumptions regarding treatment of fees). Clients should be able to understand the reasons for deviations and assess the meaningfulness of performance figures.

3.7. Provide a performance presentation of the particular composite the portfolio belongs to (if available). Is this presentation GIPS compliant?

Composite comparisons may provide useful information on how consistently the portfolio has been managed as compared with other peer portfolios managed under a similar investment strategy.

3.8. Disclose the methodology of calculation of the benchmark performance and the assumptions with respect to the benchmark rebalancing.

Frequency of calculation of the benchmark returns may have a significant impact on the benchmark results. For example, for a balanced benchmark with fixed weights of the constituent indices, monthly return calculation implies a monthly rebalancing of the portfolio. Understanding this is important for a proper comparison analysis.

3.9. If the underlying portfolio includes leverage, disclose how the calculation of portfolio returns takes into account the leverage effect.

The method of return calculation for leveraged portfolios depends on whether the leverage is mandated by client or is at discretion of the investment manager, and also whether the manager performance perspective or the client return perspective is applied. For example, leverage mandated by the client can be treated as a source of capital from the manager perspective but will reduce the capital basis from the client perspective for the return calculation purposes. Clients should be aware of these implications.

3.10. Disclose the methods of calculation of the risk measures presented in the reporting.

Risk measures are important instruments within the performance analysis. Clients should understand the way risk measures are calculated and the underlying assumptions. For example, the return variability heavily depends on the frequency of calculation and the number of the data points in the observation period. Ex-ante risk statistics may involve a return forecasting mechanism, which reliability should be periodically tested by reconciliation with the actual results. Clients should be informed on the assumptions and models underlying the calculation of expected return and risk figures.

3.11. If performance (return and risk) attribution analysis is presented as a part of the client reporting, investors are referred to a separate questionnaire in the *EIPC Guidance for Users of Attribution Analysis* for a list of relevant questions.

4. Costs of investment management

4.1. Disclose the individual components of the costs associated with the investment management services.

Clients are entitled to a full and fair disclosure of costs of investment management and should be provided with a transparent breakdown of costs and expenses incurred within the reporting period, such as management and performance fees, custodian fees, portfolio administration charges, brokerage and commissions, indirect trading costs (e.g. bid-ask spreads), etc.

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4.2. Disclose the methodology of calculation of fees, e.g. performance fees. Has an independent audit been performed with respect to compliance of this methodology with the investment management agreement?

Performance fees are often based on complicated models which may also be ambiguously worded. Clients should have assurance that the performance fees charged to their portfolios effectively comply with the investment management agreements.

5. Compliance with investment guidelines, regulatory requirements and industry standards

5.1. Describe how compliance with the client's investment guidelines, such as investment restrictions, tactical asset allocation limits, rating restrictions, tracking error targets, etc., is ensured and disclosed in the reporting.

Client should have assurance that their investment guidelines are complied with and subject to an appropriate internal control process.

5.2. Describe how compliance with the statutory legal requirements applicable for a particular client, such as legal investment exposure limits, is ensured.

Client should have assurance that the applicable regulatory requirements are complied with and subject to an appropriate internal control process.

5.3. Disclose whether the client reporting has been provided by the investment manager to regulatory bodies.

This question may be relevant in case the manager is required by law to provide the reporting or parts thereof to the regulators.

5.4. Disclose if the investment manager is in compliance with the Global Investment Performance Standards (GIPS) and with any other industry investment reporting standards, e.g. EVCA Reporting Guidelines for private equity investments.

The GIPS compliance provides to clients additional assurance that investment management and performance calculation processes are subject to a standardised and uniform process and provide a greater degree of confidence in the reliability of the performance reporting.

Compliance with industry standards on investment reporting demonstrates the manager's commitment to the best practice and transparency.

6. Risk management process

6.1. Describe if there is an appropriate risk management process with respect to investment and operational risks.

Managers should ensure that the client assets are appropriately invested, administered and protected with support of an appropriate internal risk management process.

6.2. Disclose if there is a business and systems continuity plan in place to ensure that the execution of the investment management business is guaranteed in case of disaster events or disruptions.

Clients can expect their managers to have appropriate procedures for safeguarding the client assets in case of emergency or market disruption situation.

7. Third-party examination

7.1. Disclose if any third-party examination or audit of the portfolio reporting and/or performance results has been performed.

Clients should have assurance that the accuracy of their reporting has been examined by an independent party.

7.2. Describe if the manager's internal control process around the investment management business has been examined by a third-party.

Clients should have assurance that the internal control process their managers have in place is subject to regular examination by an independent party.

7.3. Describe if the GIPS compliance of the investment manager has been subject to an independent verification.

Verification of the GIPS compliance, although not directly relating to the individual reporting for existing clients, provides additional assurance in the reliability of the processes underlying investment management and performance calculation.

Chapter 5 – Relation to the Global Investment Performance Standards (GIPS®)

RIPS EMEA does not currently view this Guidance as a part of the Global Investment Performance Standards (GIPS) compliance framework for the following reasons:

- The GIPS standards regulate presentation of investment performance, while the client reporting may also include other additional information.
- The GIPS standards deal with performance presentation for prospective clients rather than for existing clients.
- The GIPS compliance deals with performance reporting on the composite level rather than with reporting for individual portfolios.
- Some GIPS provisions may inherently not be applicable for individual client reporting, e.g. return calculation methods.

However, the Guidance admits that information produced within the GIPS compliant reporting may be one of the sources for client investment reporting. Clients are advised to duly inform themselves on the contents and the main provisions of the GIPS standards.

Related documents

- CFA Institute Asset Manager Code of Conduct
- Committee of European Securities Regulators (CESR): Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments (Art. 19.2, 19.3, 19.8).
- EFAMA Code of Good Conduct on the Presentation of Performance
- EIPC Guidance for Users of Attribution Analysis
- EIPC Guidance on Performance Attribution Presentation
- EIPC Questionnaire for Investors
- EVCA Reporting Guidelines
- Global Investment Performance Standards (GIPS)
- NAPF Guidance for Assessing Manager's Performance Presentations
- PEIGG Private Equity Reporting and Performance Measurement Guidelines