

Managing Performance Data

ABSTRACT

While scrutiny on performance reporting has increased based on the current regulatory environment and specific industry standards, like demonstrating GIPS compliance, the systems that calculate performance data by and large have not kept up with industry demands for more accurate and timely performance data management on an automated basis.

The following white paper seeks to assist money management firms with assessing their performance systems and managing their data. It offers recommendations on best practices that can be used to manage performance data more efficiently.

CURRENT INDUSTRY TRENDS

Aite Group, an independent research firm focused on technology in financial services including the buy side, identified the top business priorities for asset managers as being an emphasis on new business development, attention to supporting and enhancing the investment process, and risk mitigation through system and process improvement.

“Regulators and clients expect more process controls throughout the firm’s activities, enhanced reporting and greater transparency. Asset managers need technology to help meet these goals with ease and speed,” said Denise Valentine, Senior Research Analyst with the Aite Group.

Nothing can be more critical to a buy side firm’s business development efforts than its performance data. ROR (Rate of Return) data is at the heart of every presentation and investment professionals spend massive amounts of time compiling, reviewing and explaining performance data, both internally to the firm’s portfolio managers and senior executives and externally to clients, consultants and prospects.

The demand for greater transparency has created an additional emphasis on accurate and timely data.

Reporting inaccurate data risks the loss of clients or even worse, the loss of the firm’s reputation in an extremely competitive industry. The push for transparency is only expected to increase in the coming years.

INDUSTRY STANDARDS THAT RELATE TO PERFORMANCE DATA

GIPS®

The GIPS, or Global Investment Performance Standards®, are voluntary, ethical principles for the reporting of investment performance results. While GIPS compliance is voluntary in theory, it is, in reality, a main business requirement for most money management firms.

The GIPS are designed to:

- Facilitate apples-to-apples comparisons
- Provide fair representation & full disclosure
- Ensure accurate & consistent data
- Foster industry-wide best practices and self-regulation
- Provide enhanced internal controls as well as marketing benefits

The latest version became effective January 1, 2006. A revised version was issued in early 2010. The effective date of the next version will be January 1, 2011.

Among the more salient aspects of the GIPS that relates to a higher industry standard for transparency is the Error Correction

Guidance Statement which was adopted in June 2008 and made effective on January 1, 2010.

Errors are defined as any component of a compliant presentation that is missing or inaccurate. Previously, errors were only focused on performance.

According to the corrected Guidance Statement:

- Firms must have a written procedure in place to correct and address errors
- Firms must set materiality thresholds to determine which course of action to take

A Q&A on Error Correction was released in October 2009 that reconsidered the requirement to disclose a material error for 12 months (as found in the Error Correction Guidance Statement).

The newly released Q&A states that disclosure is not required in compliant presentations provided to prospects who never received the error. If unsure, firms must present a corrected presentation with error disclosure which may result in two versions of the presentation.

According to ACA Beacon Verification Services, a leading provider of GIPS verification and compliance services, a new requirement on the horizon with the 2010

GIPS going into effect next year is the move from market value to fair value. "This will not impact highly liquid securities, but it may require intervention with pricing for other less liquid securities that are contained in the system," said Alicia Hyde, Managing Director, ACA Beacon Verification Services. "Firms will also need a report from their software system to report the composite and benchmark 3-year annualized ex-post standard deviation," she added.

While the GIPS standards apply to composite construction and composite performance, the same set of standards can be logically applied to individual portfolios and all performance data by extension.

Questions for firms to ask internally are:

1. What procedures are in place to prevent or eliminate errors from occurring in the first place?
2. If errors are encountered, what are the standard operating procedures in place to address them?
3. Are these processes documented at all? If so, are they based on paper or spreadsheet-driven checklists or are they part of the performance software systems themselves?

BEST PRACTICES FOR PREVENTING PERFORMANCE DATA ERRORS

A key best practice to help prevent errors is to calculate performance on a daily basis. "The majority of firms that we see are still doing a monthly valuation with large cash flow revaluation," commented ACA Beacon's Alicia Hyde. "However, we're beginning to see more and more switch to daily, as it is considered a true time weighted return and the most accurate method, as opposed to an approximated method such as the Modified Dietz," she continued.

Another best practice is to scrutinize return data by setting up a range of tolerances for expected performance at a given level. Ideally, the performance software system itself should alert performance administrators directly if a tolerance level is exceeded but if it does not, internal screens should be created to verify performance data results.

THIRD PARTY PLATFORMS USED TO CALCULATE PERFORMANCE DATA

Many third party software packages that are used by investment firms to calculate performance data started from a portfolio management/portfolio accounting standpoint and only added performance measurement later.

These systems were designed primarily for bookkeeping and, unlike other systems for

trading, which have changed to become real-time systems, still treat bookkeeping as the primary function and performance as a secondary function. Many operate in batch mode and only calculate performance monthly.

Another issue that impacts performance data is the use of multiple systems. In this instance an investment manager might be using one system for portfolio accounting, another for trading and perhaps even a third for performance data and reporting.

Often there is lack of integration between systems. What happens when a new security is set up or a classification change occurs? Does it need to be batched from one system to another, or worse, does it need to be manually entered more than once, increasing the possibility of human error and creating an unnecessary business risk?

From the standpoint of having accurate performance data, it follows that industry best practice would be to have an integrated system in place so that all data relevant to performance is updated and maintained in a single system.

In the absence of an integrated system, data management procedures need to be put in place to validate the accuracy of data being transferred between systems that make up the final performance numbers.

DATA MANAGEMENT CHALLENGES RELATED TO PERFORMANCE

According to the Aite Group, data management is one of the most pressing issues facing the financial industry and firms are expected to spend \$1.18 billion dollars on data management technology and operations in 2010.

According to Fritz McCormick of the Aite Group, effective data management is at the heart of being able to demonstrate greater transparency into the business, a key industry trend, following the credit crisis and ensuing downturn. "Asset managers who invest in technology solutions to enhance transparency, such as data management, are better able to demonstrate their capabilities to regulators and clients," he commented.

For buy side firms, effective data management is integral to accurate and timely performance data.

The following are a number of areas that money managers should evaluate:

Position and Transaction data

Two different models exist for updating position and transaction data. Either firms operate with an integrated trading and accounting system or they will deploy different systems for front and back office.

If an integrated system is not in place, firms need to monitor the batch update processes that exists when transactions are posted from their trading system to their portfolio accounting system, where performance data is typically calculated.

Another issue exists with updating non trading related transactions from custodian sources. Custodial data reconciliation has a direct impact on the ability for investment managers to verify performance and send out client statements in a timely fashion. Rather than reconciling custodian by custodian, data aggregation services can provide value by aggregating and normalizing the data in a shorter amount of time.

Security Master Data

If an integrated system is not in place firms need to be especially proactive in monitoring the set up of new securities. Often times when security setups are transferred via batch from one system to another there may be incomplete information due to limitations of what data can be exported or imported into one system or another.

Security classification changes are also key. Special attention should be paid to securities that come in as "not classified" as they need to be reviewed to determine the correct classification for performance reporting purposes.

Pricing/Corporate Actions Sources

Another area of focus for the effective management of performance data is the underlying pricing and corporate actions data that is coming into the system. Particular attention should be paid to static data.

Price checks on widely held securities should also be performed so that prices can be verified as accurate prior to calculating performance rate of return data.

Software systems that proactively alert users as to data changes or incomplete data and also track any data corrections in an audit trail for full accountability should be preferred. In the absence of technology, build manual checks and balances around all processes that go into maintaining data.

PERFORMANCE DATA EXTRACTION FOR GIPS AND OTHER AUDITS

Another issue with the current systems environment, by and large, is the data model of many providers. Now that the best practice is for daily return calculations, many systems still operate in batch mode and do not fully store daily values for all of the components that go into calculating a rate of return.

If they do, many systems still have a “black box” model where data is stored in a non-relational format. Extracting data is either onerous or impossible, both of which are not acceptable in today’s environment.

Lack of relational databases means that data may need to be manually extracted or entered which is also prone to errors.

“Extracting information for verification can be challenging and time consuming. Many reports that are out of the box do not include all required statistics a verifier needs to conduct their testing procedures,” said ACA Beacon’s Alicia Hyde. “Even if the default or custom built reports contain all of the proper information in the proper formatting, running the reports individually for each composite for each annual period can be onerous. Ideally, systems should have the ability to batch reports and export to spreadsheets but this functionality is still somewhat rare,” she added.

Industry best practice is to export data with as little human intervention as possible. If technology platforms in place don’t allow for this, investment firms should look to systems that do or build in extra time for exporting and reviewing data.

For additional information on GIPS, visit: <http://www.gipsstandards.org>

SUMMARY OF INDUSTRY BEST PRACTICES RELATED TO MANAGING PERFORMANCE DATA

Error Prevention/Documentation

- Calculate performance on a daily basis
- Scrutinize return data by setting up tolerances of what is a range of expected performance at a given level
- Establish written procedures to correct and address errors
- Maintain an audit trail of all corrections

Performance Software Systems

- Utilize an integrated system if possible so that all data relevant to performance is updated and maintained in a single system
- If an integrated system is not in place, build data management checks and balances related to performance data

Data Management Practices

- Software systems that proactively alert users as to any data changes or incomplete data and that track any data corrections in an audit trail for full accountability should be preferred
- In the absence of technology, build manual checks and balances around all processes that go into maintaining data

Data Extraction for GIPS Audits

- Export data with as little human intervention as possible
- If technology platforms in place do not provide, look for systems that do or build in extra time for exporting and reviewing data

Resources

INDATA®

INDATA® is a leading industry provider of SaaS (Software as a Service) for buy-side firms, including trade order management (OMS), compliance, portfolio accounting and front-to-back office. INDATA's iPM – Intelligent Portfolio Management® technology platform allows end users to collaborate in real-time across the enterprise. The company's mission is to provide clients with cutting edge technology products and services to increase operational efficiency while reducing risk and administrative overhead.

INDATA provides software and services to a variety of buy-side clients including asset managers, registered investment advisors, banks and wealth management firms, pension funds and hedge funds. Assets under management range from approximately \$25 million to over \$80 billion across a variety of asset classes (i.e. equity, fixed income, etc.) both domestic and international.

For more information, visit www.indataipm.com.

ACA Beacon Verification Services

Since its founding in August 2001, ACA Beacon has pursued the ideal that an investment manager and its chosen verification firm work together, in partnership, to improve not only transparency for the manager's prospective client, but also the investment firm itself. Today, we provide verification services to more than 200 firms that manage a broad spectrum of investment products.

ACA's Verification Division specializes in providing investment advisers with GIPS® compliance and verification services. ACA Beacon provides a consultative verification that promotes interactive communication during all phases of the verification process. With extensive practical knowledge and experience rooted in investment management and performance measurement and less so from an accounting angle, our review process is based on objectivity, independence, and adherence to compliance with the Global Investment Performance Standards published by the CFA Institute.

For more information, visit www.acacompliancegroup.com/gips/