

Investment Basics: XXXV. AIMR's performance presentation standards: Gaining global acceptance

1. INTRODUCTION

The demand for uniformity of performance results provided by investment managers sparked the need for a universal set of reporting guidelines. The Association for Investment Management and Research (AIMR), an international organisation of investment professionals based in the U.S., has taken the lead in developing industry standards concerning the ethical presentation of performance results. After widespread North American acceptance, AIMR is now focusing on a separate set of global standards which can also be universally applied. AIMR's Performance Presentation Standards are gaining increased recognition and acceptance throughout the world.

2. WHY STANDARDS ARE NEEDED?

"Do your performance results adhere to AIMR Performance Presentation Standards?" That's the question clients and potential clients are asking asset money managers. Consultants are also increasingly adding that question to their list of screening criteria used in recommending clients to prospective investment managers.

Investors are becoming more conscious of how their money is being invested. They are constantly scrutinising the performance results of their portfolios in a constant search for adequate investment returns. Disparity in performance results presented by investment managers is what prompted the development of the AIMR Performance Presentation Standards (AIMR-PPS™).

The dynamics of issues arising in the industry create a need for flexible ethical guidelines that can be universally applied. The AIMR-PPS standards fulfil that need.

3. BACKGROUND OF THE AIMR-PPS STANDARDS

The AIMR Performance Presentation Standards were first introduced by the Financial Analyst Federation in the 1987 issue of the *Financial Analysts Journal*. The *Financial Analyst Journal* is one of the premier journals, dealing with current and leading issues on financial analysis. Since that time under the guidance of the AIMR Performance presentation Standards Implementation Committee, The AIMR-PPS standards have been reviewed extensively by leading investment professionals throughout the world and revised in response to their many comments and recommendations. However, the underlying principles of

fair representation and full disclosure of performance results have remained the same.

The AIMR-PPS standards are the manifestation of a set of guiding ethical principles and should be interpreted as *minimum* standards for presenting investment performance. The AIMR-PPS standards have been designed to meet the following four goals:

- Achieve greater uniformity and comparability among such presentations.
- Improve the service offered to investment management clients.
- Enhance the professionalism of the industry
- Bolster the notion of self-regulation

Several of AIMR's PPS subcommittees have studied issues specific to the application of the AIMR-PPS standards that have arisen in the industry since the original standards were adopted effective January 1, 1993. These subcommittees have addressed issues in areas concerning international investing, the treatment of portfolios using leverage and/or derivatives, real estate, bank trust departments, venture and private placement securities, wrap fee accounts, calculation of after-tax return, and performance verification.

4. HIGHLIGHTS OF THE AIMR-PPS STANDARDS

The following list is an overview of the AIMR-PPS standards. The standards consist of several required and recommended guidelines for North American, as well as, non-North American portfolios.

1.1 Creation of composites

All of the manager's fee-paying discretionary portfolios must be included in at least one composite defined according to similar strategies or investment objectives. Composites must include new portfolios at the start of the next performance measurement period. They must also exclude terminated portfolios after the last full performance measurement period the portfolios were under management. Portfolios can not be switched from one composite to another unless documented changes in client guidelines make it appropriate.

1.2 Calculation of returns

Total return, including realised and unrealised gains plus income, must be used. Time-weighted rates of return must be used, as must accrual accounting for fixed income and all other securities which accrue income. Composites must be asset weighted using beginning-of-period weightings. Portfolios must be valued at least

quarterly and periodic returns must be geometrically linked. Performance must be calculated after the deduction of fees.

1.3 Presentation of results

A ten-year performance record (or period since firm inception, if shorter) must be presented. Annual returns for all years must be presented. Composite results may not be restated following changes in a firm's organisation. Composites must include only assets under management and may not link simulated portfolios with actual performance. Performance results of a post firm or affiliation must not be used to represent the historical record of a new affiliation or new firm entity.

1.4 Disclosures

For all composites a performance presentation must disclose the availability of a complete list and description of the firm's composites. The number, size, and percent of total firm's assets each composite represents must be included and it must be disclosed whether performance results are calculated gross or net of fees. The existence should be stated of a minimum asset size below which portfolios are excluded from a composite. The use should be stated of a settlement date rather than trade date, as should be the use and extent of leverage including a description, frequency and characteristics of any derivatives used.

AIMR's PPS standards place an emphasis on the verification of performance results in order to substantiate claims of compliance by managers. The verification process is required to be performed by an independent third party. The process which consists of two levels of compliance focuses on verifying composites and an attestation, by the verifier, that the return calculations are appropriately represented. While specific composites from a company can achieve the second level of verification, compliance with AIMR-PPS standards must be firmwide.

The standards provide insight in how to solve some common problems that arise when performance results are reported. Three common issues are *representative accounts*, *survivorship basis*, and *portability of investment results*.

4.4.1 Representative accounts

When managers choose only their best performing portfolio to portray investment results, they are inaccurately representing their overall performance. The standards require all actual, fee-paying discretionary portfolios to be included in at least one composite. Composites are comprised of portfolios or asset classes which have a similar strategy or investment objective. Disclose the existence of a minimum asset size below which portfolios are excluded from a composite.

4.4.2 Survivorship basis

This issue deals with a manager's tendency to delete poor performing portfolios from composite results. According to the standards, terminated portfolios must be excluded from a composite for all periods after the last full reporting period they were in place, but included for all periods prior to termination. New portfolios added to a composite must be included after the start of the next performance measurement period or according to reasonable and consistently applied manager guidelines.

4.4.3 Portability of investment results

Changes in a firm's organisation must not lead to an altering of composite results. The standards state performance results are those of the firm, not the individual. Performance results can not be linked and used as historical performance results of a portfolio manager. Managers can only use performance results of a past affiliation as supplemental information.

The standards are not without controversy. A common complaint of the standards is that they are too difficult to interpret. Managers are offered too much discretion is another complaint.

The standards were not developed to be a rigid set of guidelines for a money manager to follow. Given the expansion of the standards into new areas of financial analysis (e.g., wrap fee portfolios, international portfolios, leverage, etc.), it would be impossible to address every issue in one complete publication since the industry is so dynamic. The AIMR-PPS standards recognise this limitation. Because the standards attempt to cover a broad range of issues concerning the investment industry, they are constructed to be a **general** set of ethical guidelines which promote full and fair disclosure of investment performance results.

4.5 Global efforts and impact

The adoption and implementation of the AIMR-PPS standards continues to expand on a global basis. Currently, the AIMR-PPS Implementation Committee and its subcommittees are examining the need for a separate global standards handbook. The global Performance Presentation Standards Subcommittee was formed in 1995 with the mission to encourage, through consensus building and education, worldwide adoption of a set of guiding ethical principles to present investment performance in a fair, comparable uniform format with full disclosure. Given the widespread acceptance of the AIMR-PPS standards as *the* industry standard in North America, the committee is now addressing the need to further establish uniform, ethical standards to present comparable results on a global basis. Countries which have already accepted standards almost identical to the AIMR-PPS standards are Switzerland and Canada.

The Global PPS Subcommittee is comprised of leading professionals from thirteen countries representing investment management firms, consultants, banks, plan sponsors, European Federation of Financial Analysts Societies (EFFAS), Investment Analysts' Society of South Africa (IASSA), Brazilian Association of Capital Markets Analysts (ABAMEC), Asian Society of Financial analysts Federation, and Investment Management Regulatory Organisation Limited (IMRO). Countries and regions represented include: South Africa, United Kingdom, Germany, Switzerland, Netherlands, France, Japan, Hong Kong, Australia, New Zealand, South America, and North America.

In developing these principles, AIMR has recognised that global money managers face different challenges than domestic managers. Global money managers are faced with concerns of how to deal with exchange rates and base currencies, country weights, hedging, and varying local laws and regulations. The standards specifically address international concerns separately. They outlined as additional requirements and disclosures for international portfolios in an attempt to address potentially varying circumstances.

One particular concern of global managers is the AIMR-PPS standards do not require daily valuation of portfolios. Global managers would like to see this issue a requirement for compliance. Currently the standards offer three examples of calculating time-weighted returns, with daily valuation listed as a *preferred* method.

AIMR has attempted to identify these differences and construct guidelines which can be applied in a global arena. The expertise and insight of the global PPS Subcommittee has been the guiding force in tackling issues concerning this diverse marketplace.

According to an intersect database survey of 128 non-North American managers at year-end 1994, eighty-six percent of those surveyed claimed to be in compliance. Forty-three percent had been verified or planned to be verified.

5. IS YOUR FIRM IN COMPLIANCE?

Given the growing worldwide acceptance of the AIMR-PPS standards, investment managers are taking a closer look at implementing the AIMR guidelines for performance presentation results. Is your firm going to be ready when the question is asked about compliance with AIMR-PPS standards?

If you are, congratulations! Your firm is on the forefront of an important development in the global investment industry.

If not, maybe your firm should consider reviewing the standards to see what the steps are needed to claim compliance with the AIMR-PPS standards. By joining the firms who are in compliance, your company will be

among the group of proactive global investment managers who are on the brink of being a part of a worldwide approach to a universal set of uniform, ethical performance presentation guidelines.

WHERE TO RECEIVE INFORMATION

The following published materials are available as guidance for implementing the AIMR-PPS standards:

- *Performance presentation Standards Handbook* (AIMR, 1993)
- Questions and Answers clarifying the PPS, and
- Subcommittee Reports on the following PPS issues:

International Portfolios
Venture Capital and Private Placements
Taxable Portfolios
Leverage/Derivatives
Wrap Fee Portfolios
Verification

To obtain copies of any of these materials, you can contact:

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or visit AIMR's world wide web site:
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