Track record matters, so does performance presentation

By CFA Society Singapore Advocacy Team

"Track record," remarked one participant when asked how they would choose a robo-advisory platform. The other participants of a CFA Society Singapore focus group discussion on trust levels concurred. For the other retail investors who were not comfortable with the use of artificial intelligence to select risk assets, they expressed similar sentiments when deciding on which traditional funds to invest in.

The focus group discussions on trust levels in the financial sector took place via Zoom in June. At the sessions, some retail investors in Singapore said they would also like to examine historical performance over a few economic cycles instead of being presented data for the last few years.

Although historical performance is no guarantee of future returns, retail investors do wish to compare performance records among competing funds and robo-advisory platforms. Hence, it is important for financial professionals to adopt established best practices to ensure consistency and transparency in reporting performance. This empowers investors to make fair and meaningful comparison between asset managers.

Presentation of track record

As a premier global association for investment management professionals, the CFA Institute, under its Performance Presentation Standard, requires members to provide credible performance information and to avoid misstating performance or misleading clients and prospective clients about the investment performance of members or their firms. This standard encourages full disclosure of investment performance data.

It covers any practice that would lead to misrepresentation of a performance record, whether in the area of performance presentation or measurement. The standard prohibits misrepresentations of past performance or reasonably expected performance. There must be a fair and complete presentation of performance information whenever communicating data with respect to individual accounts, composites or groups of accounts, or composites of an analyst's or firm's performance results.

Furthermore, there should not be statements or implications that clients would obtain or benefit from a rate of return that was generated in the past. The requirements of this standard are not limited to those managing separate accounts.

Whenever performance information is given for which a manager claims responsibility, such as for pooled funds, the history must be accurate. Research analysts promoting the success or accuracy of their recommendations must ensure that their claims are fair, accurate, and complete.

If the presentation is brief, detailed information supporting that communication must be made available on request. Best practice dictates that brief presentations include a reference to the limited nature of the information provided.

Procedures for compliance by applying the GIPS standards

For those who are showing the performance history of the assets they manage, compliance with the CFA Institute Global Investment Performance Standards (GIPS) is the best method to meet their obligations under this standard.

GIPS are globally accepted standards considered industry best practice for investment performance reporting and presentation. Adopted by hundreds of organisations around the world, the GIPS standards have been implemented by many top asset management firms.

Compliance without applying the GIPS standards

Alternatively, members can also meet their obligations under the Performance Presentation Standard by:

- Considering the knowledge and sophistication of the audience to whom a performance presentation is addressed, presenting the performance of the weighted composite of similar portfolios rather than using a single representative account;
- Including terminated accounts as part of performance history with a clear indication of when the accounts were terminated;
- Including disclosures that fully explain the performance results being reported (for example, stating, when appropriate, that results are simulated when model results are used, clearly indicating when the performance record is that of a prior entity, or disclosing whether the performance is gross of fees, net of fees, or after tax); and
- Maintaining the data and records used to calculate the performance being presented.

Ethics in action

Here is a case to illustrate how the standards work. The case is adapted from material developed by CFA Institute. As a guide, the desired ethical behaviour required is based on the CFA Institute Code of Ethics and Standards of Professional Conduct (Code and Standards).

Case: Prior fund and employer

Aaron, CFA, is the senior portfolio manager of Mastermind Financial Advisors, a new business formed in the midst of the global pandemic. Mastermind recruited Aaron because he had a proven six-year track record with Eastern Financial. In developing Mastermind's advertising and marketing campaign, Aaron prepares an advertisement that includes the equity investment performance he achieved at Eastern Financial.

The advertisement for Mastermind does not identify the equity performance as being earned while at Eastern Financial. The advertisement is distributed to existing and prospective clients of Mastermind in a company event held at Tanjong Pagar.

There are a number of possible responses to this situation. Aaron may believe he did not violate any standards of professional practice as he was mainly responsible for fund performance at his previous firm.

Another possibility is that as a new set-up, Mastermind Financial Advisors' code of ethics and company rules may be silent on performance presentation. Aaron's supervisor should probably have checked on the performance track record and disclosure before approving the advertisement. Or, Aaron could make full disclosure of the source of the historical performance to prospective clients.

From the CFA Institute standpoint, Aaron violated the Performance Presentation Standard by distributing an advertisement that contains material misrepresentations about the historical performance of Mastermind Financial Advisors. The standard requires members to make every reasonable effort to ensure that performance information is a fair, accurate, and complete representation of an individual's or firm's performance to existing and potential clients.

The performance standard does not prohibit showing past performance of funds managed at a prior firm as part of a track record. But that record must be accompanied by appropriate disclosures about where the performance took place and the person's specific role in achieving that performance.

If Aaron, a CFA Charterholder, chooses to use his past performance from Eastern Financial in Mastermind's advertising, he should make full disclosure of the source of the historical performance even though Mastermind is silent on this requirement for performance presentation.

This column has been adapted from content by CFA Institute and is printed here with permission from CFA Institute. The writers are CFA Charterholders who volunteer with the Singapore chapter on advocacy issues with a view towards promoting financial literacy among retail investors.