Demystifying Sleeve-Level Reporting: Creating Operational Efficiencies While Satisfying Demand for Accuracy and Transparency

SUMMARY

Today, many wealth management firms seek to find the right balance between meeting client needs and achieving scalability. Using model portfolios and technology to efficiently implement trade decisions across an entire book of business optimizes the operating model. However, this approach may cause significant hurdles when it comes to client reporting and Global Investment Performance Standards (GIPS®) composite reporting. This article dives into the concept of sleeves – what they are, why they exist, common performance reporting problems and how one technology provider aims to address these challenges.

WHAT IS A SLEEVE?

A single custodial account can be broken down into multiple sub-accounts, or sleeves. Each sleeve can be managed independently according to a different investment strategy. This account configuration is then used to efficiently implement trades based on strategy changes across a large book of business. Sleeves create **operational efficiency and reduce maintenance costs** when compared to opening separate custodial accounts for each strategy. Thus, the use of sleeves is the preferred implementation approach for **multi-strategy portfolios**.

WHAT ARE THE TOP OPERATIONAL CHALLENGES ASSOCIATED WITH SLEEVES?

<u>Client reporting problem: Aligning performance across two platforms</u>

Established firms venturing into sleeves likely use two separate technology stacks – one for their primary platform and a secondary one for sleeve-level accounting and calculations. This leads to a few common problems:

1) Concerns over accuracy: Performance returns calculated from the primary system using custodial-level data don't match returns sourced from the sleeve-level platform due to unreconciled accounting differences. As a result, advisors face questions from clients who receive performance from both sources.
2) Insufficient details: The firm's primary performance system offers class-level returns and advanced analytics, but this same information is not available from the secondary sleeve-level platform. The more sophisticated clients expect to receive the same level of detail regardless of the implementation approach.

<u>GIPS composite reporting problem: Accuracy of cash positions by strategy</u>

Platforms that enable trading of multiple sleeves may not be tracking cash balances and cash activity by sleeve. This becomes a problem if the firm plans to include the sleeve-level returns in the corresponding GIPS composites. The 2020 GIPS standards once again enabled firms to include carve-outs, and one can consider a sleeve as an example of a type of carve-out; however, there is a difference. A carve-out may use an allocation of cash, rather than the actual cash balance for that sleeve. A subtle difference, but it has significant reporting implications as a firm cannot mix stand-alone portfolios with carve-outs where cash is allocated.

HOW CAN TECHNOLOGY HELP?

Can wealth managers achieve scalability in a managed account platform without sacrificing data consistency and deep analytics? The key is access to quality sleeve-level accounting data. Any performance calculation engine that receives incomplete sleeve-level accounting data cannot provide the same level of detail and accuracy as a stand-alone portfolio with one strategy. One efficient solution is a multi-faceted platform that starts with trading by sleeve and incorporating non-trade activity following standard accounting practices – and reconciling back to the official accounting source.

We spoke with Archer, a technology-enabled service provider aimed at simplifying investment management operations, to gather their perspective on sleeve-level reporting challenges.

Tina: *How are your clients using sleeves to implement their investment programs? Why are sleeves necessary?*

Archer: Our clients are using sleeves to offer investors custom products that allow multiple strategies to be housed under one custody account. This approach reduces operational headaches by minimizing the amount of paperwork required at custody. In addition, our technology enables our clients to separate cash at the sleeve level so that the sleeves are eligible to be in the pure strategy composite as well. This structure meets CFA Institute requirements for each sleeve to maintain its distinct cash and enables a more effective, efficient way to bring those strategies to the market for holistic distribution.

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Tina: *What are the expectations for reporting at the sleeve level, especially with respect to rates of return? Is this expectation different than other types of accounts?*

Archer: When managers use sleeves, they are often segregating the securities by distinct investment strategies.

There is an expectation for reporting at the individual sleeve level as well as at the investment entity level or the aggregate of individual sleeves. This may show overall asset allocation, portfolio characteristics and performance to the investor while viewing a single portfolio. Returns can be provided at both the asset class and security level, with bond analytics calculated per sleeve.

Managers may also expect to use individual sleeve performance in composites for underlying strategies, in addition to the aggregate performance for use in a composite representing an asset allocation strategy.

An account is often viewed on a one-to-one basis where a single IBOR account is matched to a single custodian account. Sleeves allow multiple IBOR accounts to be managed individually, all related to the same custodian account or investment entity. Using a multi-tiered account structure provides more flexibility in how investment strategies are managed and reported, with each level providing its own view into the segregated portfolio.

Tina: *What are some operational challenges related to sleeve-level reporting and how have you helped your clients address these challenges?*

Archer: Because different teams often manage separate sleeves, it can be difficult to attribute transactions and performance to the appropriate sleeve while reconciling all activity in one custody account. Archer uses a proprietary tool to maintain positions in the appropriate sleeve and accurately account for gains and losses, transactions, valuations and performance. Ideally, a firm's performance system will calculate daily, time-weighted returns that are geometrically linked to offer a month-to-date return. Time-weighted returns provide a more accurate calculation than other returns such as modified Dietz since it accounts for the timing of any flows more accurately.

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CONCLUSION

Performance and reporting teams within wealth firms often find it challenging to comingle outsourced managed account reporting with their in-house solutions for high-net-worth and ultra-high net worth client reporting. Likewise, asset managers with multiple distribution paths want to find efficient ways to include the managed account sleeves in their GIPS composites. Several investment management technology providers are working to solve sleeve-level reporting challenges today. There are experts who can help your firm identify the best-fit solution and implement necessary changes to the target state operating model.

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