

# Sleeve Accounting With SS&C Advent

THOUGHT LEADERSHIP

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The GIPS 2020 standards are a set of standardized, industry-wide ethical principles that guide investment managers and asset owners on how to fairly calculate and present their investment results, with the goal of promoting performance transparency and comparability.

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The Global Investment Performance Standards (GIPS®) standards of 2010, and now 2020, came about to define a set of common accounting practices implemented by professional asset managers to ensure that their returns could be fairly compared by professional investment performance analysts and consultants advising institutional clients. Only via such standards can the associations between strategy, skill, and results be fairly compared across different money managers competing for institutional assets.

While the contractual obligations, detailed in the investment policy statements of institutional clients, made these practices a necessity for asset managers, investment consultants, and trustees alike, these same practices can benefit Registered Investment Advisors and their private clients as well.

The performance standards guide the construction and reporting of time and money weighted returns for pooled funds and composites. In doing so they seek:

1. Firm-wide compliance as compared to limited composite, pooled-fund, or portfolios basis.
2. Five years of history if the firm has existed long enough.
3. Benchmarks based on investment mandate, objective, or strategy for the total composite—not just price.

GIPS prescribes many practices that should be reviewed in detail. This whitepaper will focus only on GIPS guidance on carve-outs as it relates to sleeve accounting.

## Sleeve Accounting in Principle

At the core of sleeve accounting is the desire to account for the management of a collection of assets as if it were in a separate account. There are many reasons for carving out portfolios into sleeve accounts, including:

- Ability to manage a client's portfolio of assets with different strategies and portfolio managers, even if the assets are in a single custody account.
- Ability to standardize the management of investment strategies and products independent of individual client cash flow needs.
- Ability to independently manage allocation—the value allocated to the sleeves—and selection—the holdings in the sleeves—when making investment decisions.
- Ability to identify and advertise investment management performance in a GIPS-compliant manner to attract institutional assets.
- When the firm has or obtains standalone portfolios managed in the same strategy as the carve-outs with allocated cash, the firm must create a separate composite for the standalone portfolios. (GIPS 2020 3.A.18)
- It is not GIPS-compliant to advertise a composite that includes carve-outs, separate accounts, and pooled funds that would attempt to simulated a total strategy return. (GIPS 2020 3.A.19)

These rules derive from two principles, oriented to cash management efficiency:

1. Carve-outs are simulated separate accounts and therefore must have fixed accounting practices that would enable them to be accurate simulations.
2. Because carve-outs are simulated, they should not be included with real separate accounts in aggregate analysis even if a common strategy is used to manage them.

When addressing real separate accounts, a firm has no choice to invest or divest when a client gives or takes money, while a simulated carve-out account allows for rules around managing cash flows. This can then buffer buy/sell decisions, which can be good when it comes to preserving long-term gains and managing funds in a tax advantageous way.

With GIPS 2020, new considerations arise:

- Cash returns must be included in performance. (GIPS 2020 3.A.15)
- All carve-out accounts must have an allocation to cash that is managed with a standard policy that makes that account representative of a standalone account. (GIPS 2020 3.A.16)
- If a firm creates a composite consisting of carve-outs for a particular strategy they must carve out and include all accounts that have that strategy in the composite. (GIPS 2020 3.A.17)

Another way of looking at this is that a manager that carves out accounts is isolating market selection via the sleeve account allocation and asset selection via the investments held in the sleeve accounts, which is not something a separate account can do as readily.

## Benefits for Investment Advisors

Because GIPS is so strongly associated to the management of institutional assets, the investment advisors of private clients have not classically concerned themselves with GIPS practices. However, applying GIPS sleeve rules provides benefits both to the advisor and their private clients.

The main benefit is what might otherwise be seen as GIPS 2020's relatively stringent

cash flow rules. The asset managers of GIPS compliant accounts do not typically worry that one day they will need to raise a bunch of cash because the asset owner wants to make a large purchase. Instead, they are managing institutional money so cash flows are much more planned and predictable. For investment advisors this is not the case. And depending on how they structure those advised assets, that type of client initiated activity can be very damaging to the advisor's plans for how those assets would be put to work and what return they would yield.

Taking a page from GIPS and carving assets into term and associated risk based sleeve accounts with their own time horizons, the advisor can better ensure that their plan is protected so that their advice sees its full potential realized by those investments.

Grouping accounts of similar policy and strategy can also improve the quality and efficiency of all the managerial, administrative, and reporting work that those capital assets require. Doing so can also provide a foundation for statistical analysis across accounts thereby providing performance feedback and insights which might guide the advisory practice as a whole.

## Sleeve Account Construction and Processing

For a carve-out process to work properly, the business rules used to construct a simulated separate account or sleeve account must be pre-defined. To help clarify the choices that go into a sleeve account workflow, the below table provides a list of pros and cons for each choice involved.

### Trading

Decision	Pro	Con
Trading in the sleeve account vs the total portfolio	Trades should always match between trading and accounting systems	Trades will flow from the trading system into a total portfolio in the accounting system
	Different portfolio managers can manage the sleeves Sleeves in the trading system will have a real cash allocation such that a surprise negative account position is unlikely	Transactions will need to have rules applied to them to copy and/or split them from the parent account to the sleeve accounts Sleeves in the trading system will have a simulated cash allocation
Trading in the total portfolio vs the sleeve account	If already doing so, then no workflow changes in operations nor portfolio/group structures for reporting need to be made	Attributing sleeve level cash impacts from different trading activity becomes very complex Cash flow allocation must also be applied at runtime, which can also be slow and complex The odds of generating a negative cash position in the sleeve account are high

### Handling Cash Flows

Decision	Pro	Con
Allocate cash flows to/from the sleeves	More accurately models the client-initiated actions of a true separate account	Adds processing complexity and more workflow steps
Allocate cash flows to/from a single cash account	Simple to implement Allows the manager to control how assets flow into their sleeves	This is not a GIPS-compliant method for handling cash flows

## Rebalancing

Decision	Pro	Con
Do not rebalance value across sleeves	More accurately models a true separate account	Does not allow the manager to allocate value in a total portfolio, asset allocation-based way
Implement a fixed rebalancing strategy via an investment policy	A fixed policy simulates separate account management more accurately while still allowing the manager to have an impact on their client's total portfolio return with their asset allocation policy decisions	Depending on implementation detail, it may or may not be GIPS 2020 compliant
Use an ad-hoc rebalancing strategy to reallocate value across sleeve accounts	Can quickly react to market allocation opportunities and their resulting asset selection opportunities	Does not accurately simulate a true separate account and therefore is not GIPS-compliant

## Reconciling

Decision	Pro	Con
Reconcile positions to the custodial consolidated group	A very straightforward and high-level way to reconcile. No added processing or technology costs	Does not assist with determining where the problem with a given holding resides causing problems at scale.
Reconcile transactions to the custodial consolidated group	Provides a deeper reconciliation, which can be very helpful in dealing with more complex reconciliations such as accruals and dividend reinvestments	Single-sided transactions such as cash flows must either be processed (routed or split) by an outside process to avoid breaks or breaks Must be dealt with manually and can break-down at scale
Reconcile positions in the sleeve account	Can point directly to problem portfolios where misses occur	Difficult to implement at a strategic level for securities Can only be implemented at a policy level for sleeve cash
Reconcile transactions to the sleeve account	Provides the most granular level of reconciliation available	Produces more points to reconcile. Requires nearly full automation to whittle down expectations to those that truly require manual intervention

## Reconciling at the Sleeve Level

	Total Portfolio	Sleeve Account
Cash movements	Ensures that taken together the transaction has a matching value at the cost of not knowing if a particular investment management policy or accounting rule is truly applied to the sleeve portfolio	Sleeve security/cash positions are only known by the manager. As such, one can only reconcile, and enforce transactions and allocations, to an investment management policy or accounting rule
Accrued income		
Dividends		
DRIPS		
Management Fees		
Expenses		
Reorganizations		
REPOs		

The theme from the table above is that the creation of sleeve accounts by carving out positions and routing or splitting transactions requires the application of many business rules. If transaction volume is low and the complexity of the business rules is low, then doing the work manually is possible even if cumbersome. At scale, the risk of manual process breakdown is real, and automation is needed to accurately and efficiently apply business rules to the data that creates and maintains sleeve accounts for sound data management and execution.

## Interoperability

The interoperability of a sleeve accounting workflow boils down to shared account identifiers and common business rules for sleeve construction. Such rules specify either how securities are routed to sleeve accounts or how cash is split amongst them. The common rules across portfolio accounting and trading systems ensure that sleeve accounts are consistent.

Further, the rules of sleeve portfolio construction can be ran programmatically and can yield Advent Custodial Data (ACD) files. These files can then be imported into varying solutions such as APX, Moxy, and Genesis, making ACD a natural data integration point.

SS&C Advent's Genesis portfolio rebalancing application ingests business rules for sleeve account construction and allows for the visibility of assets segmented into sleeve accounts for trading. Considerations revolve around allocation, exposure, model drift, and rebalancing. In addition to those capabilities, Genesis allows for grouping sleeve accounts into larger strategy based aggregates so that different portfolio managers with different expertise can manage the assets independently.

Moxy, a trade order management application, will allow trading in blocks to minimize trading costs and efficient communication with brokers on order status. After trades are filled, they can then be allocated back to the trading accounts.

Trading activity then flows into the portfolio accounting system of APX or Axyx. With APX, portfolios can be placed into portfolio groups that can be marked as a custodial consolidated group, which allows APX to treat the group as a single account that can have custodial positions posted and reconciled to it using the standard position reconciliation report. If the REX capability is enabled, the same can be done with transactions by posting them to the custodial consolidated group and reconciling to the transactions in the sleeve accounts via a roll-up methodology. When a single-sided transaction like cash flow is received from the custodian, REX will equally weight it. For a more complex cash flow or fee allocation policy, implementing a custom solution offered by SS&C Advent's Custom Engineering Services group may be required.

When it comes to sleeve accounts, the main issue is in dealing with cash flows that originate only from the bank. When managing bank data delivered through Advent Custodial Data (ACD) account identifiers will typically be equivalent to the custodial consolidated groups set up in APX. The bank will not know about a firm's sleeves. Therefore, trades will arrive from the trading system via a trade blotter while the reconciling trade will arrive from the bank via a statement blotter (if using REX), otherwise reconciliation will only be applicable to the positions rather the transactions. SS&C Advent offers a custom add-on solution allowing the ability to manage carve-out accounts to establish standardized cash allocation rules and policies.

GIPS outlines that such allocation rules are consistently executed across all accounts that share the same strategies. Classic blotter files can also be created and imported into APX, which can then feed downstream systems, but the all-or-none importing of blotter data must also be taken into account in deciding to use that data integration point.

## Automation

The process of automating the sleeve accounting practice comes down to two components:

1. Define accounting rules that can be used to construct the files that form and move the data into the sleeve accounts.
2. Ensure those rules are executed consistently across the source data.

Sleeve accounting workflow can be 100% hands-off if the business rules for account construction and management are defined in such a way that the results are accepted.

For example, a classic scenario is when sleeve cash is not known/respected and an implicit transfer is required to move cash between sleeves to reduce a negative cash position generated by the purchase of a security in that sleeve. Another example is when a bond is sold in a bond sleeve such that the proceeds can be used to purchase equity in an equity sleeve. Normal sleeve construction rules simulate two separate accounts so the cash generated in the bond sale would not move over to the equity sleeve to cover the equity purchase. This results with cash in the bond sleeve and negative cash in the equity sleeve. When such a scenario occurs, it is apparent that trading is not in line with the sleeve's true cash position because the sleeve accounts are not actually managed as separate accounts. As such, manual intervention needs to be taken. If sleeve accounting practices are adopted to ensure that unintentional negative cash positions are not created, only then can a sleeve accounting practice truly be automated.

A sleeve accounting workflow attempts to simulate separate accounts by using business rules for data processing and it is the choices regarding the business rules used to manage those separate accounts that make the experience with sleeve accounting a positive one.

## Conclusion

Simulating separate accounts with sleeve accounting practices can enable asset managers and advisors to segment client capital into term and risk budgets that can be used to better structure guidance around asset allocation and selection decisions. In doing so, firms can put those assets to work and protect their plan for those assets. In observing that the total portfolio return is built with time, risk, and reward, and that the individual assets are the building blocks in that construction, sleeve accounting can help structure those blocks into foundations, walls, supports, and spires needed to make the return a virtuous one.

SS&C Advent works with firms on defining a successful sleeve accounting strategy while leveraging the expertise and technologies to execute on those initiatives.

For more information about SS&C Advent and Professional Services, please contact 1-800-727-0605, email [info@advent.com](mailto:info@advent.com), or visit us at [advent.com](http://advent.com).

## ABOUT SS&C ADVENT

SS&C Advent, a business unit of SS&C, is helping over 4,300 investment firms in more than 50 countries—from established global institutions to small start-up practices—to grow their business and thrive. Delivering unparalleled precision and ahead-of-the-curve solutions for more than 30 years, we help our clients minimize risk, work together seamlessly, and shape the future of investment management.

For more information, visit [www.advent.com](http://www.advent.com) or contact us at (800) 727-0605 or [info@advent.com](mailto:info@advent.com).

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