

# DISCRETIONARY VS. NON-DISCRETIONARY ASSETS

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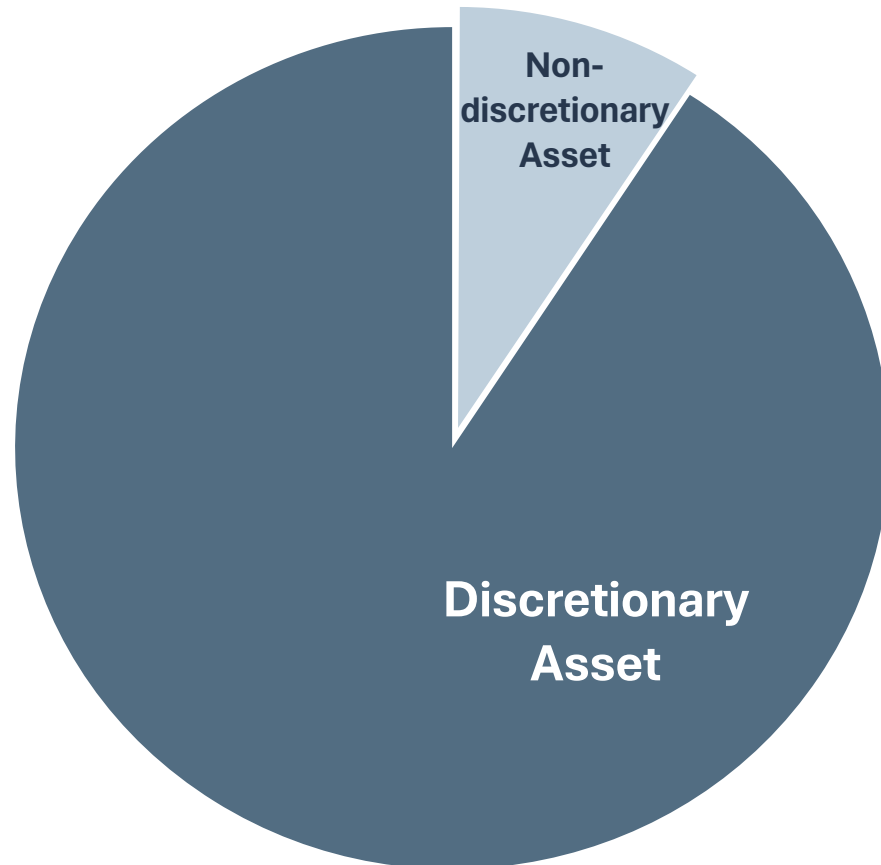


Twenty-second Meeting of the Asset Owner Roundtable

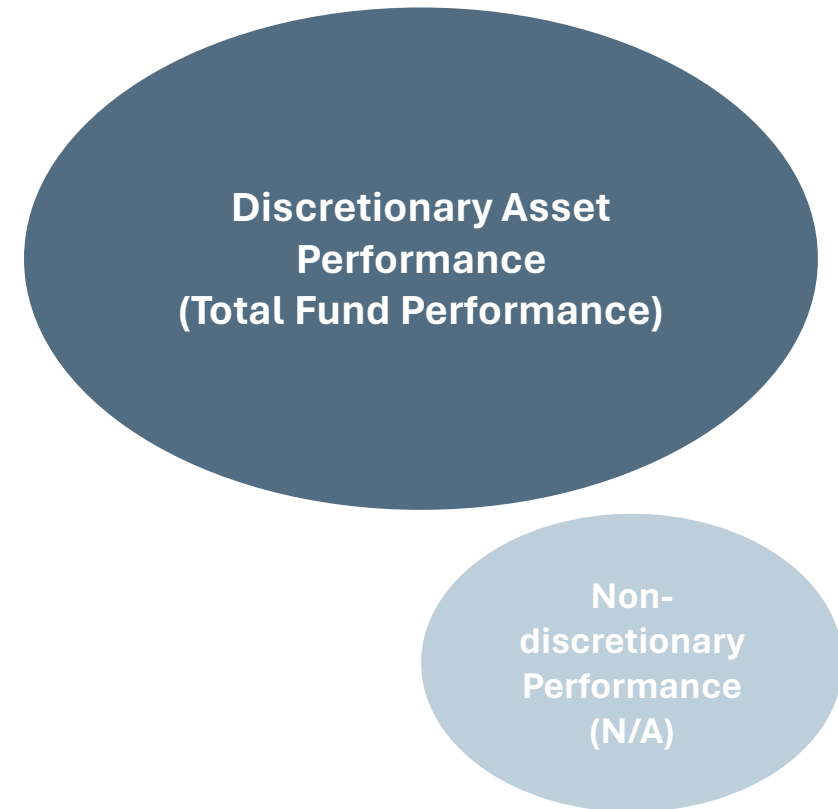
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# Asset Count vs. Performance Reporting

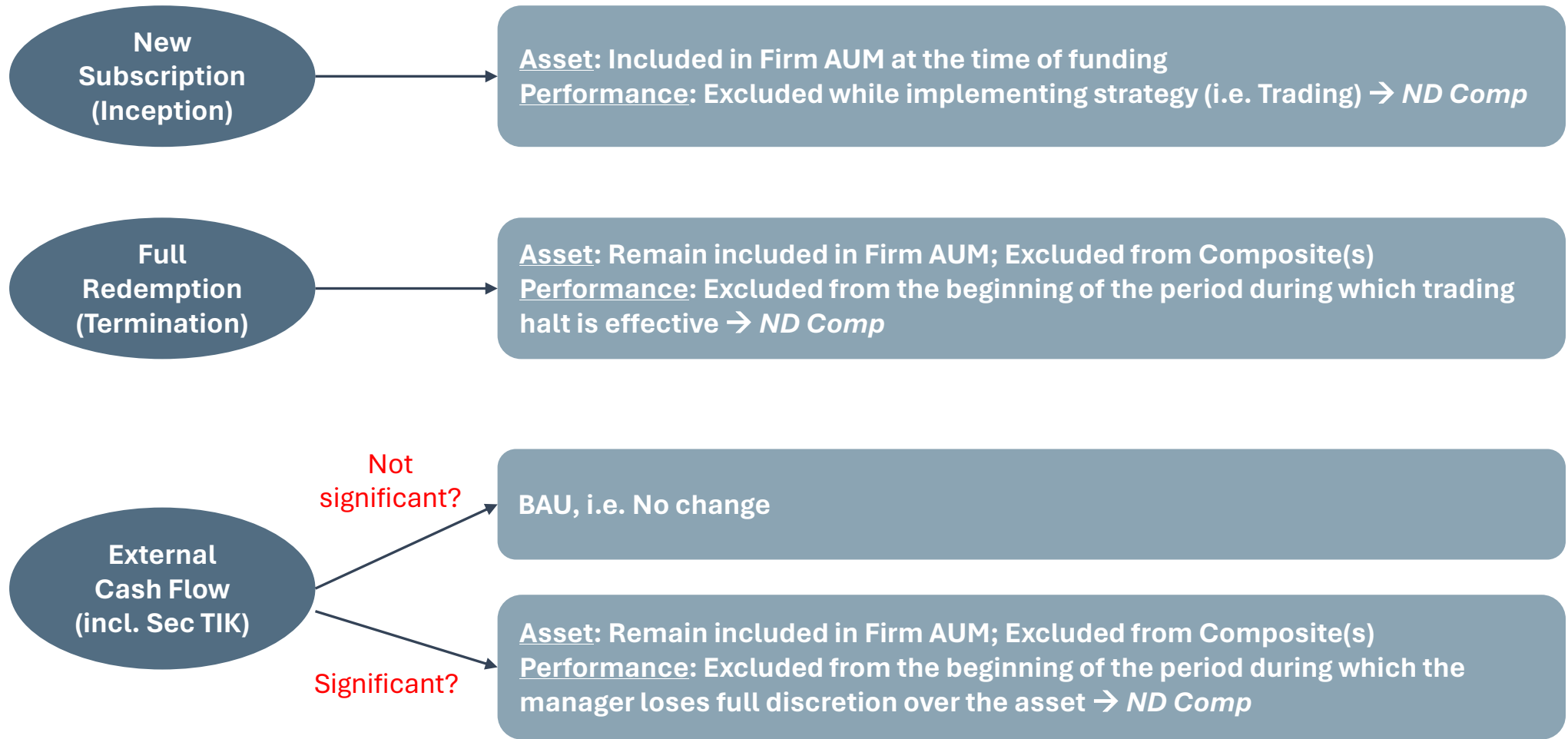
Total AUM or Total Fund Assets  
(USD)



Performance Calculations  
and Reporting (%)



# Sample Treatment of Non-discretionary Assets (AM)



# Sample Treatment of Non-discretionary Assets (AM)

## Measures to help determine discretion/non-discretion:

- ✓ At what point do we as an asset manager lose discretion over the client assets?
- ✓ Is the event significant enough to impede our ability to manage in line with our investment strategy?
- ✓ External CF Policy implementation
  - Potential advantages: Systematic tracking of composite entry/exit, Consistency
  - Potential disadvantages: Analyst's oversight may trigger the firm's error correction policy

# Examples of Non-discretionary Assets

## For Firms

- ✓ Model portfolios (permanent)
- ✓ Client-directed activities (ST/temporary)
  - External CFs → *ECF Policy?*
  - Subscriptions/Redemptions
  - Account Inceptions/Terminations

## For Asset Owners

- ✓ Legacy assets
- ✓ Set-aside liquid assets (i.e. cash and cash equivalents) for liability/benefits payment purposes → *Violation of Provision 22.A.8?*
- ✓ Any other scenario?

*It is imperative that both firms and asset owners document the rules and procedures clearly and always adhere to them consistently.*

# How MUST non-discretionary assets be treated?

## 22.A. Input Data and Calculation Methodology—Requirements

### Assets

#### Provision 22.A.1

TOTAL ASSET OWNER ASSETS MUST be the aggregate FAIR VALUE of all discretionary and non-discretionary assets managed by the ASSET OWNER. This includes both fee-paying and non-fee-paying PORTFOLIOS.<sup>1</sup>

#### Provision 22.A.2

TOTAL ASSET OWNER ASSETS, TOTAL FUND assets, and COMPOSITE assets MUST:

- a. Include only actual assets managed by the ASSET OWNER.
- b. Be calculated net of leverage and not grossed up as if the leverage did not exist.

#### Provision 22.A.3

The ASSET OWNER MUST NOT double count assets when calculating TOTAL ASSET OWNER ASSETS, TOTAL FUND assets, and COMPOSITE assets.

# How MUST non-discretionary assets be treated?

## Provision 22.A.8

Cash and cash equivalents that are considered discretionary and part of the investable assets of the TOTAL FUND MUST be included in TOTAL FUND assets and performance calculations.

### Reasoning:

1. Cash/cash eq may be available for investment along with other total fund assets.
2. If considered discretionary and part of investable assets, cash/cash eq must be included in TF asset count *and* performance calculations, because AO's asset allocation decisions (including allocation to cash) are a component of the investment strategy implementation.
3. Even if AO does not control actual investment of cash (e.g. always invested in a custodial MMF) but does control the amount that is allocated to cash → Cash assets must be included in TF assets *and* performance of cash must also be included in TF performance.

# How MUST non-discretionary assets be treated?

## Provision 22.A.8

Cash and cash equivalents that are considered discretionary and part of the investable assets of the TOTAL FUND MUST be included in TOTAL FUND assets and performance calculations.

### Reasoning (cont):

4. Operating cash accounts (Not available for investment, e.g. checking account for ops purposes)  
→ **Should not** be included in TF assets or performance calculations  
(Provisions 22.B.9 and 10 – Recommendations)
  
5. Multiple purpose cash account (i.e. available for investment as well as used as operating cash, and unable to differentiate % of cash available for investment)  
→ Entire cash a/c **should** be considered available for investment and thus included in TF assets and performance calculations (This conservative approach is recommended).

*Asset Owners must create policies and procedures for the treatment of cash accounts and apply them consistently.*



# How **SHOULD** non-discretionary assets be treated?

## 22.B. Input Data and Calculation Methodology—Recommendations

### Provision 22.B.9

Operating cash accounts that are not available for investment **SHOULD NOT** be included in **TOTAL ASSET OWNER ASSETS, TOTAL FUND assets, or COMPOSITE assets.**<sup>F</sup>

Asset  
Count

Performance  
Reporting

### Provision 22.B.10

Operating cash accounts that are not available for investment **SHOULD NOT** be included in **TOTAL FUND returns or COMPOSITE returns.**<sup>G</sup>

# Questions?

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