

CFA Institute
CFA Centre for Financial Market Integrity

29 December 2004

JE/RAE/MXP/jc

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Dear Sirs

Comments on the Guidance Statement on the Use of Leverage and Derivatives

We would like to thank the CFA Institute for the opportunity to comment on the proposed GIPS Guidance Statement on the Use of Leverage and Derivatives.

Please find enclosed the response of Ernst & Young LLP, with comments and suggestions, on the proposed Guidance Statement.

If you wish to discuss any of our points further, please contact Matthew Price (tel. +44 20 7951 2223, e-mail mprice1@uk.ey.com).

Yours faithfully

Ernst & Young welcomes the opportunity to comment on the proposed Guidance Statement on the Use of Leverage and Derivatives. We view the Guidance as extremely important given the increasing use of leverage and derivatives by asset management firms, and additional guidance is needed to present such products to clients in a fair and consistent manner.

1. Do you agree with the principles established in the Guidance Statement?

We agree with the principles set out and the overall approach taken to presenting the Guidance. In particular, we welcome the application of the concept of materiality as a risk-based approach that will also manage the cost to compliant firms of implementing the Guidance.

The only concern we have in respect of the Guidance is that while the varied techniques of leveraging a portfolio and of the derivative instruments themselves restrict the extent to which a 'one size fits all' set of disclosures can be prescribed, the presentation of a detailed list of recommended disclosures could result in a lack of comparability (in terms of quality and quantity of information) between compliant firm composite reports presenting similar products using similar techniques of leverage and derivative instruments.

2. Are there other elements involved in the use of leverage and derivatives that are not included?

We would advocate that the firm also discloses the types of instruments that are employed in the individual strategies as well as maximum threshold levels for leverage and short positions. In this regard, we believe the exposure limits and risk measure targets set forth in a typical Investment Management Agreement for the strategy presented (assuming they are disclosed as 'representative') to be important information for potential investors as criteria to which they can reasonably expect the compliant firm to have adhered.

3. Do you agree with the guiding principles provided for firms employing leverage and / or derivatives?

As stated above, Ernst & Young is supportive of the form and content of the Guidance Statement. We would however like to see some more clarification of the Guiding Principles, in particular as to the definition by the firm of an ex ante leverage policy and the treatment of portfolios that allow for the use of leverage and / or derivatives. Specifically, the following questions arise which should be clarified:

- **Leverage Policy:** Assuming the Investment Management Agreement allows for hedging transactions to be entered into (covered call writing or the like) for the purposes of reducing absolute risk, can the firm use its leverage policy to exclude such portfolios from the additional disclosures as laid out in the Guidance Statement?
- **Composite Construction:** The GIPS have always advocated that portfolios permitted to use leverage and derivatives should be placed in separate composites. We support this principle and would recommend adding that the 'permitted extent of usage' of leverage and derivatives be used in composite construction. For example it may not be appropriate to combine portfolios employing the same strategy (global currency overlay) with different limits of leverage (100% and 150%) in the same composite.

- **Risk Measure Disclosure and Reporting:** In practice, materiality will typically be defined with reference to threshold measures, and portfolios may not always be deemed to have material exposure to leverage and derivatives throughout their existence according to such criteria. For consistency purposes, will firms always be required to present the additional disclosures as defined by the firm even if the materiality threshold level was not reached for some strategies due to decisions taken by the investment committee or portfolio manager?

4. Do you agree with the proposed effective date?

As a firm offering verification services we abstain from answering this question, as we believe it should be addressed by the industry participants. However, we believe that any Guidance Statement recommending a number of additional disclosures will impose a varying degree of manual design as well as systems development work in order for firms to maintain their compliance with the Standards and accordingly, an implementation time delay that is fair and balanced should be taken into account.