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NORSKE FINANSANALYTIKERES FORENING
THE NORWEGIAN SOCIETY OF FINANCIAL ANALYSTS

CFA Institute
CFA Centre for Financial Market Integrity
Reference: Guidance Statement on the Use of Leverage and Derivatives
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Oslo, 17.12.2004

INVITATION TO COMMENT:
Guidance Statement on the Use of Leverage and Derivatives

Dear Sir or Madame,

We would like to thank you for the opportunity to comment on the Guidance Statement on the Use of Leverage and Derivatives to the GIPS ® Standards.

The Norwegian Society of Financial Analysts (Norske Finansanalytikeres Forening, hereafter-named NFF), is the sponsor for GIPS® in Norway.

Norsk GIPS as a Translation of GIPS® was endorsed by IPC at the September meeting 2001.

Our comments to IPC are as follows:

- **IPC: Do you agree with the principles established in the Guidance Statement?**

  NFF: Yes we do.

  - We believe it is important that minor use of derivatives and leverage not automatically requires the firm to calculate and disclose risk measures.

    We welcome that the firm has to create its own leverage policy, and to calculate and disclose risk measures in compliance with this policy when the use of derivatives is regarded as materially.

  - We refer to current GIPS 4.A.9: "If applicable, the firm must disclose the presence, use, and extent of leverage or derivatives including a description of the use, frequency, and characteristics of the instruments sufficient to identify risks."
    We recommend that this proposed Guidance Statement clarifies whether the definition of materiality in accordance to the proposed leverage policy also should be applied to GIPS 4.A.9.
    Is the firm required to disclose the presence, use and extent, frequency and characteristics of the use of derivatives if the use of derivatives not materially alters the risk / return characteristics of the strategy?

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- **IPC: Are there other elements involved in the use of leverage and derivatives that are not included?**

  NFF:

  - Appendix A: Overlay Strategies page 5, 9 and 9:

    We would welcome a discussion in connection to example 8 (Appendix A), covering the distinction between calculation and presentation of returns arrived from overlay strategies and the calculation and presentation of returns for "pure" tactical asset allocation portfolios / funds. Some asset managers do not provide overlay strategies, only tactical asset allocation portfolios / funds. These tactical asset allocation portfolios are provided without knowledge and consideration of the clients' remaining assets, and are regarded as an individual product and portfolio from the asset manager's view.
    Since the asset manager of "pure" tactical asset allocation portfolios has no knowledge of the client's remaining assets, there are no "asset base" to which the achieved gain / loss can relate to, except the value of the tactical asset allocation portfolio.
    Even with the same strategy implemented, either as an overlay strategy or as a tactical asset allocation portfolio, the achieved return can be significant different (due to different value basis).
    The significant difference in calculated return, within the same implemented strategy, is likely to create problems in conjunction to composite construction. As mentioned we would welcome a discussion on this matter in relation to example 8.

- **IPC: Do you agree with the guiding principles provided to firms employing leverage and / or derivatives?**

  NFF:

  Yes we do.

  We appreciate that the descriptions of the risk measures in this proposed Guidance Statement are only recommendations, since no risk measure is able to capture all situations where derivatives are applied.

- **IPC: Do you agree with the proposed Effective Date:**

  NFF:

  Yes, we do.

- **Other proposals:**

NFF:

- Verification: As with all Guidance Statements we recommend that part III of GIPS, covering Verification, is updated simultaneously. We recommend, as a minimum, that the verifier as a pre-verification procedure receives the firm's leverage policy, with referende to pre-verification procedures D. xiii (Knowledge of Firm Policies).

- General comments to appendixes A, B and C: We are aware that the calculations and formulas in the appendixes are only recommendations. Despite this fact, it is our opinion that the precision in the examples in the appendixes can be improved (see below).

- Appendix A: We welcome a reconciliation of the TWRR formula in Appendix A in this proposed Guidance Statement with the TWRR formula in the GIPS Handbook (Guidance Statement on Calculation Methodology). Different wording and letters should be avoided. Otherwise confusion might be the result.

- Appendix A: Our opinion is that the denominator in example 8 should include the basis of the overlay strategy and the value of the overlay strategy itself (10 MUSD + 100 MUSD), and not only the value of basis for the strategy (please refer to page 5 "Overlay Strategy Discussion" in the proposed Guidance Statement where the same example is present).

- Appendix B: Exposure of Stock – page 11:
  We regard the discussion in connection to different "Beta" as redundant. If the "Beta" is significantly different between portfolios, different composites should be created in order to be in compliance with the GIPS Standards.
  We would also welcome a discussion in relation to the frequency of "Beta" calculation. This is regarded as imperative since the value and the risk characteristics of non – linear derivatives are sensitive to the time to expiration.

- Appendix B: Multi – Asset Composites (example 5) – page 14 - 15:
  We regard the calculation of an average exposure across different derivatives and asset classes as not relevant. The calculation of exposure should be done in connection to the individual segment within the multi asset strategy that applies derivatives and leverage.

- Appendix C: Calculation of Composite Value at Risk:
  The use of VaR requires a covariance matrix. It is important that Firms state how they handle products in a VaR perspective that do not naturally fall into the matrix (options, several OTC's, unlisted or very small companies etc.)

Best regards,
The Norwegian Society of Financial Analysts (NFF)

Gunnar Winther
Secretary General

All inquiries or comments related to GIPS should be sent to the chairman of the "NFF Committee on Performance Measurement" Mr. Jorn Kleven, AFA, CEFA, jorn.kleven@c2i.net