

CFA Institute  
CFA Centre for Financial Market Integrity  
Reference: Guidance Statement on the Use of Leverage and Derivatives  
PO Box 3668  
Charlottesville, Virginia 22903  
United States of America

December 31, 2004

Dear Sir/Madam:

**Proposed Guidance Statement on the Use of Leverage and Derivatives**

PricewaterhouseCoopers wishes to thank the CFA Institute for this opportunity to comment on the Proposed Guidance Statement on the Use of Leverage and Derivatives. We welcome the efforts of the CFA Institute to continuously develop the GIPS standards and its commitment to fair representation and full disclosure.

Our comments are provided in the appendix attached to this letter. If you wish to discuss these points further, please contact Kelvin Laing-Williams in London at +44 (20) 7804 1707 or Peter McNamara in New York at (646) 471 8743.

Yours faithfully,

PricewaterhouseCoopers LLP

## **Appendix: PwC Comments on the Proposed Guidance Statement on the Use of Leverage and Derivatives (the “Guidance Statement”) to the GIPS Standards**

### *General comments*

Generally, we welcome the revised version of the Guidance Statement as it now no longer attempts to present any prescriptive definitions, formulae and requirements, but rather provides a broad framework to be applied by investment managers in the context of materiality. We agree with the guiding principles established by the Guidance Statement as well as with the proposed effective date. However, we would like to present the following items for your consideration.

To enhance the clarity of this Guidance Statement and to be consistent with the provisions of other guidance statements, we recommend that it be broken out by “requirements” and “recommendations”. Currently, words such as “should” and “must” are used, which may be confusing and subject to interpretation.

We have the following additional comments to make with respect to the draft Guidance Statement.

### *Specific comments*

#### Private equity and real estate asset classes

The Guidance Statement excludes real estate and private equity asset classes that utilize leverage and derivatives from the provisions of the statement, and indicates that leverage and derivatives for these asset classes are addressed elsewhere in the GIPS guidance. We recommend that this provision be clarified to indicate whether the existing GIPS requirement to disclose the use and extent of leverage and derivatives would apply to these asset classes, as there presently does not appear to be any additional guidance on disclosing the extent of leverage and derivatives for these asset classes.

#### Creation of a leverage policy

One of the guiding principles of the Guidance Statement is the creation of a leverage policy, however, it is unclear as to whether this is a requirement or a recommendation. In addition, this is a fundamental guiding principle as the other guiding principles are largely dependent on the policy adopted. Accordingly, we recommend that this be clarified to require firms that utilize leverage and derivatives to have documented leverage and derivatives policies and procedures. We agree with the guidance on the aspects that need to be addressed by the policy, in particular, the inclusion of a definition of materiality.

## Appendix: PwC Comments on the Proposed Guidance Statement on the Use of Leverage and Derivatives (the “Guidance Statement”) to the GIPS Standards

### Composite construction for portfolios utilizing leverage strategies

The Guidance Statement indicates that firms should consider including portfolios that utilize leverage and derivatives in separate composites from those portfolios that are restricted from such instruments or strategies. This language is consistent with the guidance statement on composite definition. The risk/return characteristics of portfolios that materially, pursuant to a firm’s definition of materiality in its policies and procedures manual (see above), employ leverage and derivatives are likely to be significantly different from those of traditional strategies that do not. Accordingly, we believe that this Guidance Statement should include a recommendation or even a requirement for firms to include portfolios that **materially** employ leverage and derivatives in separate composites from those that do not.

### Disclosure of risk measures

The Guidance Statement indicates that disclosing proper risk measures is crucial for capturing the altered risk/return profile of strategies that employ leverage and derivatives. We agree that it is up to the firm to determine what the crucial risk measures are for composites that employ leverage and derivatives, however, it is unclear as to whether the disclosure of these risk measures is a recommendation or requirement in the proposed Guidance Statement. Accordingly, we believe that the Guidance Statement should include a recommendation or even a requirement for firms to disclose the crucial risk measures for strategies that **materially** employ leverage and derivatives.

### Disclosure of calculation methodologies

The Guidance Statement acknowledges that there are a variety of calculation methodologies for risk measures. Given that, we believe that a performance presentation would be enhanced if firms disclosed a brief description of methodologies and/or systems used to calculate risk measures in performance presentations to assist prospective clients in comparing risk statistics between various investment managers. It is unclear as to whether this is a recommendation or requirement in the current Guidance Statement. Accordingly, we believe that the Guidance Statement should include a requirement for firms to disclose the calculation methodology and/or system that is used to calculate the risk measure and information, to the extent that information is disclosed in the performance presentation.

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Exposure

The Guidance Statement indicates that “Firms are encouraged to present the exposure of each of the individual segments as supplemental information.” Since this is a more precise disclosure of exposure and to be consistent with the provisions of the Guidance Statement on Supplemental Information, we believe that firms should be encouraged to disclose the individual segments as additional information as opposed to supplemental information.

Appendix A – Calculating returns for portfolios that utilize leverage

The calculation language will need to be reviewed to ensure consistency with the final provisions of “Gold” GIPS, when released.

Appendix C – Calculation of composite value at risk

Include an “s” after “calculation” in the last sentence of the second paragraph so it reads: “If the strategy assumes frequent change of leveraged positions, these calculations should be performed based on daily data.”

Effective date

To the extent that the proposed Guidance Statement is amended to denote specific “requirements”, the January 1, 2006 effective date language may need to be clarified with respect to these specific requirements.