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## Comments on proposed GIPS Guidance Statements

Dear Madam, Dear Sir,

On behalf of our Performance Standard experts, please accept our thanks for giving us the opportunity to comment on the some Guidance Statements.

### 1. Guidance Statement on the Use of Leverage and Derivatives

We welcome the revised version of the Guidance Statement. Other than the previous draft it does no longer prescript narrow definitions and formulae but provides a flexible and yet realistic framework. We have but one material comment:

- We are missing an explicit statement on derivatives with *symmetric* risk/return profile like futures/forwards. On page 4, first paragraph of the guidance document, it is stated "...identify at what point the risk/return profile for a composite becomes materially altered ...". If a composite does include all strategies with currency hedging the profile is NOT altered at all. Our request is to explicitly exclude futures/forwards used for currency hedging as well as for investments on covered basis (especially index futures) from the Guidance Statement. The mentioned instruments have a linear and symmetric risk/return profile. Unlike asymmetric derivative instruments a VaR calculation is not necessary for these derivatives.

For the rest we agree with the guiding principles established by the Guidance Statement. Nevertheless we think the Guidance could be further improved when two aspects were taken into account:

- Wherever the term "exposure" is used it should be specified whether we are looking at gross (long + short) exposure or net (long - short) exposure. Information of netting and aggregation procedures should be required as this can be a major source of errors with risk estimation. Basically, netting between two investment sectors with imperfect correlation results in risk underestimation. A minimal granularity for exposure reporting (e.g. by asset class and region) should be required.
- Ex-post tracking error measures the volatility of relative returns, but it is not an appropriate measure to quantify the impact of leverage or hedging. Tracking error

alone does not tell anything about leverage; you can have a large tracking error either by tilting a portfolio without adding leverage or by tracking the benchmark and taking leverage - or, most likely, by a combination of both techniques. We therefore strongly suggest not allowing the use of long-term ex-post tracking errors as a measure of leverage.

- The Guidance Statement specifies that firms should base the Value at Risk (VaR) on a 95% level at a one-month time horizon. However, it should be mentioned that parametrical VaR can be highly biased for non Gaussian return distribution strategies (especially non symmetric) and that in such cases historical or Monte Carlo approaches should be the preferred methods.

Furthermore we would like to draw your attention to some related matters, which in our opinion need further reflection:

#### Overlay strategies

The Guidance Statement properly addresses calculation and disclosure issues with respect to overlay strategies. However, there is not a clear guidance in the GIPS regarding composite construction with overlay portfolios. In particular, it remains unclear whether such portfolios must be included in the definition of the firm and whether they must be included in at least one discretionary composite.

#### Disclosure of calculation methodologies

The Guidance Statement acknowledges that there is a variety of calculation methodologies to measure risk. Given that, we believe that a brief description of the applied methodology by a specific firm must be disclosed alongside the composite presentation. This allows prospective clients to compare the risk statistics between investment managers (in the Guidance Statement this is recommended only).

## **2. Guidance Statement on Portfolio Recordkeeping Requirements**

We agree with the guiding principles established by the Guidance Statement as well as with the proposed effective date. We also believe that the Guidance Statement is comprehensive and covers most applicable areas. However, we like to draw your attention to the following additional matters which may need further elaboration.

#### Maintaining portfolio records

The Guidance Statement should elaborate on the purpose of recordkeeping in general. For instance, underlying portfolio records are usually maintained for the following purposes:

1. to satisfy the local regulatory requirements,
2. to allow reproduction of performance presentations if data get lost,
3. to provide sufficient basis for independent verification.

We consider that records should be kept as long as needed for one of the above purposes. For example, let's consider Application Example 2 of the Guidance Statement:

- a firm presents a compliant performance track record of 25 years
- assume a firm has been verified for the whole 25-year track record
- assume further the local regulations require to keep records during 10 years
- Finally suppose all reports are backed-up and secured in IT systems.

In this case it is unnecessary for a firm to retain all records for the full 25-year period.

#### Retention of evidence of internal controls

The Guidance Statement should not only deal with information requirements but also take into account that for verification evidence of control is required. Therefore, the Guidance Statement should explicitly require retention of evidence of performance of certain internal controls for the purposes of control work undertaken through verification. For example, retention of fund accounting and custody information is obvious but firms should also keep evidence that the custodian reconciliations were performed, signed off and reconciling differences resolved.

### **3. Guidance Statement on Separately Managed Account Performance (SMA)**

#### Requested comments

We support CFA Institute's effort to develop guidance for the calculation and presentation of wrap fee/SMA portfolios. We consider the proposed treatment for a "double hit" of transaction expenses (when creating a simulated wrap fee performance record) consistent with GIPS rules and the Fees guidance. We support 1 January 2006 as effective date. CFA Institute should consider merging the Fees Provisions and Guidance with the SMA Guidance Statement.

#### Other Comments

Although SMAs have some particularities they share the vast majority of the practices with classical institutional management. This Guidance Statement is correctly applying existing GIPS core principles to SMAs, as for example the necessity to document composite maintenance and performance figures (starting 1 January 2006).

The Guidance Statement states that "...[it] must be applied for all SMA portfolios where the calculation of gross-of-fees results does not reflect the deduction of actual trading expenses". We understand that this follows a pragmatic approach aligning SMA with GIPS. However, we should be careful not to create new and other exceptions for areas not yet covered by GIPS provisions.

GIPS rules should basically be restricted to prospective clients and should not be extended to existing clients. If, as in this case, exceptions are adopted, they should be applicable to all portfolios and/or all bundled fee portfolios.

If a firm relies on data obtained from an SMA sponsor how can the firm make sure that this data is compliant with GIPS? To what extent does the burden to verify compliance rest on the asset management firm? We suspect that the possibility of asset managers to "audit" compliance of data with their SMA sponsors is rather limited. In our opinion it would be more adequate to exclusively require shadow accounting as basis for data collection.

It is remarkable that reporting of "pure gross" figures is now allowed as long as these figures are labeled as supplementary data. In our opinion it would be more adequate to clearly separate GIPS-compliant data and supplementary data (e.g. showing supplementary data in an appendix only). The Guidance Statement on Supplemental Information should be applied.

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We are grateful for having had the opportunity to comment on the proposed provisions and hope that our comments will be taken into consideration.

Yours sincerely,

SWISS BANKERS ASSOCIATION

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