

The Security Analysts Association of Japan

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Professional Standards and Advocacy
Association for Investment Management and Research
P.O. Box 3668
Charlottesville, Virginia 22903

Re: GIPS Guidance Statement on Composite Definition

Dear Sir/Madam,

The Security Analysts Association of Japan (SAAJ), sponsor of the SAAJ Investment Performance Standards (SAAJ-IPS®), would like to make the following comments on the proposed Guidance Statement on Composite Definition based on discussions of the SAAJ-IPS Committee:

1. Discretion

- It is indicated that, in the case of client restricted securities, a firm may choose to classify the restricted portion of a portfolio as non-discretionary (also referred to as “un-managed” or “un-supervised”) and keep the remaining discretionary portion of the portfolio in the composite provided the remaining portion is representative of the composite’s strategy.

This is in effect a “carve-out” of the discretionary portion from a whole portfolio and thus involves the question of cash allocation (carve-out requirements including relevant disclosures must be met). Also, it may be burdensome from a practical viewpoint (i.e. regarding technical systems). Accordingly, it may not be such an easy method and should be treated under the Guidance Statement on Carve-outs if indicating such a method is appropriate.

Instead, as mentioned in the first part of “Discretion”, a more appropriate approach would be for a portfolio with client restricted securities to be included in a composite with some restrictions or be treated as non-discretionary assets as a whole (it depends on how significantly client restricted securities impede the implementation of the intended strategy).

2. Minimum Asset Level

- “If the portfolio falls below the minimum due to market movements, the firm must leave the portfolio in the original composite until there is a documented change in client guidelines or acknowledgement from the client that the firm considers ...” should read “If the portfolio falls below the minimum due to market movements, the firm should leave the portfolio ...” since “must” is too strong and implies mandatory authority.
- The last paragraph of “Minimum Asset Level” (“Firms should bear in mind that if all the portfolios in a composite fall below the minimum and are removed from the composite, the performance record would stop. If portfolios later but not linked to the on-going composite performance.”) is not an issue concerning composite definition nor minimum asset level but one regarding disclosure/presentation for a composite performance which discontinues because of a lack of portfolios for certain periods. Accordingly, the issue should be generally covered under another appropriate Guidance Statement.

3. Composite Definition

(1) Guiding Principles

- “Firms must disclose the definition of each composite” is indicated as a guiding principle. On the other hand, the GIPS standards provide that a firm must disclose the availability of a composite list and description of all of the firm’s composites (4.A.3).

Is the meaning of “the definition of each composite” the same as “description of all of the firm’s composites”? As the relationship between the proposed guiding principle and the provision is not clear, more explanation about how the definition of each composite must be disclosed as well as what content should be given.

- The last part of “Guiding Principles” indicates that the old composite would continue to be listed on the firm’s list of composites and should be maintained as long as the firm manages portfolios that meet the definition. This part seems to conflict with GIPS provision 3.A.4: Terminated portfolios must be included in the historical record of appropriate composites up to the last measurement period that the portfolios were under management. Accordingly, the sentence should read “as long as the firm manages portfolios that meet the definition or there are terminated portfolios that met the definition existing as historical performance records”.

(2) Constraints/Guidelines

- In addition to the issue of “Measurement Periods”, we recognize there are similar problems arising from differences in valuation methods and return calculations among portfolios (including trade-date vs. settlement-date valuation, time-weighted rate-of-return calculation methods, etc.). Accordingly, we recommend that the Guidance Statement should also discuss if including portfolios whose performance records have been calculated based on different valuation methods and TWR calculation methods in the same composite is appropriate.

(3) Additional Considerations – Investment Guidelines: Multi-Asset Portfolios

- This issue is very important as balanced accounts still account for a large portion of pension assets managed by management firms in Japan. We have a question with respect to the proposed treatment of multi-asset portfolios: only multi-asset portfolios for which the firm has discretion over the asset mix are to be included in multi-asset composites (i.e. other multi-asset portfolios can be treated as non-discretionary assets). In this regard, there is only an example given with respect to “restricting asset allocation” under “Discretion”: i.e. a firm cannot alter asset allocation established by a client.

We believe balanced accounts should be treated as discretionary assets as a whole even though firms do not have full discretion over the asset mix targeting effect of strategic asset mixes (but have discretion over selecting stocks, bonds, etc) and be included in any of the multi-asset composites. However, as such balanced accounts’ strategies are different from those of accounts focused on the strategic targeting of asset mixes, they are grouped in composites different from those of the latter accounts.

- “Multi-asset portfolios with different strategic asset mixes should be grouped in separate composites defined by the percentages of investments in the different asset classes or according to the investment guidelines with respect to the different asset classes”.

Can we understand “multi-asset portfolios with different strategic asset mixes should be grouped in separate composites” means that, if strategic asset mixes provided in the investment guidelines are substantially different, they should be grouped in separate composites? Then, “defined by the percentages of investments in the different asset classes” should be deleted since this may mislead firms to interpret that they can group such accounts on an ex post facto basis as the result of the percentages of investments in the different asset classes.

- We understand that multi-asset portfolios can be grouped in accordance with a

combination of asset classes regardless of the percentage allocated to each asset class and that active returns can be presented against a composite benchmark which is a combination of multi-benchmarks of individual portfolios (asset-weighted benchmark). This should also be referred to in the Guidance Statement.

4. Implementation Date

- As also mentioned in our comments on the proposed Guidance Statement on the Definition of the Firm, we understand that after making necessary modifications the proposed Guidance Statement on Composite Definition will officially be put to the IPC meeting to be held in March 2002 in Singapore for adoption, and thus we think that the proposed implementation date, April 1, 2002, is too early considering there is not enough time for firms to have a full knowledge of the fixed Guidance Statement after adoption by the IPC. Accordingly, we recommend that the implementation date should be January 1, 2003.
- It seems difficult to correctly understand the explanation about the implementation date for composites created on or after the implementation date and those already existing because:

The first line indicates that this guidance statement will apply to all composites from the Adoption Date forward and that it will also apply to any composite that is created after the Adoption Date, regardless of the time periods presented. From this, we understand that, while as for already existing composites the guidance statement will apply to the periods beginning from the implementation date, as for new composites created after the Adoption Date it will apply for all periods presented.

However, the last line indicates that on this date this Guidance Statement will replace all previous guidance and firms must comply with this guidance for all composites created on or after the implementation date.

The explanation is confusing and should thus be made clearer so as to avoid any misunderstanding on the part of firms. Also, more explanation should be given about how the guideline will be applied to already existing composites created before the implementation date.

- The meaning of “Adoption Date” and “Implementation Date” is not clear. Are there any differences between the two?

Sincerely yours,

Kiyoto Hagiwara
Executive Managing Director