GERMAN ASSET MANAGEMENT STANDARD COMMITTEE

BVI CFA Society Germany DVFA

CFA Institute
Global Investment Performance Standards
915 High East Street
Charlottesville, VA 22902
USA

Frankfurt, 22 November 2017

Re: Exposure Draft of GIPS Guidance Statement on Overlay Strategies

Dear Ladies, dear Sirs,

On behalf of the German Country Sponsor GAMSC, thank you for providing us with the opportunity to comment on the Exposure Draft of GIPS Guidance Statement on Overlay Strategies. We appreciate the efforts to update and extend the GIPS and the opportunity to support this process with the following comments.

At first, there are missing numbers for paragraph 1 and 2. The first numbers start with number 3.

A harmonization of the described common types of overlay strategies and the examples given in the different sections of the guidance statement would be advantageous. On page 8 an absolute return overlay is discussed which isn't described under "Common Types of Overlay Strategies".

Question 1: Are these examples regarding the determination of discretion appropriate or are additional examples or other criteria needed? If additional examples or other criteria are needed, please explain your suggestions.

The examples are sufficient, we don't have other examples.

Question 2: Are the three "allowable methods" for calculating overlay exposure appropriate?

The three "allowable methods" are appropriate, we do not see other methods available.

Upon this, we think, the exposure draft should give some guidance on a 'hierarchization' concerning the appropriate usage of the allowed (denominator calculation related) methods.

Question 3: Are there other methods for calculating overlay exposure that are also appropriate? If so, please explain.

No, we do not see other methods.

Question 4: Should the allowable method(s) be required or recommended by strategy type? If so,please propose a required or recommended method by strategy type.

No, we think, a firm should decide which method to use.

Question 5: Are the methods used to calculate the denominator in an overlay portfolio return calculation appropriate?

Yes, we think this is adequate.

Question 6: Is the requirement to include collateral income in the overlay portfolio return when the collateral is actively managed appropriate? If not, should this be changed to a recommendation?

We think, if the firm has discretion on the collateral the strategy for the actively managed collateral has to be checked. If this strategy is in line with the overlay strategy from a risk return perspective, one should include it in the overlay portfolio. If the collateral investment strategy is inconsistent with the overlay strategy, then this would bias the performance results of the overlay strategy and, consequently, should not be allowed to be included. In either case, there should be a disclosure, how the collateral is handled.

Question 7: Is the requirement to establish a composite specific policy on the treatment of collateral appropriate? If not, should this be changed to a recommendation?

Yes, we think a firm should explain front-up, how collateral is used in the presentation.

Question 8: Do you agree that the returns for overlay portfolios must be geometrically linked when the overlay exposure changes over the time period? If not, please explain what method(s) you believe is appropriate.

Yes

Question 9: Do you agree that overlay returns must not be geometrically linked when the exposure remains constant, but rather the returns must be calculated as the cumulative profit/loss for the calculation period divided by the denominator? If not, please explain what method(s) you believe is appropriate.

A performance measurement concept with the purpose of consistency (and an as much as possible high operational standard of comparability) should be independent of (a) the investment strategy resp. the given benchmark definition and (b) the kind of exposure (physical vs. synthetic).

In theory, there are different areas of application of geometric or arithmetic (or other ways) of linking returns. The existing GIPS paradigm is a good compromise between an ex post view (performance reporting, technical description of a sample property) and an ex ante view (technical description for a forward-looking inference/suitability for expectations).

Keep in mind that Taylor series expansion provides only crude estimation formulas (quality depends on a lot of distributional parameters resp. time series properties) for estimating a geometric mean return based on an arithmetic mean return.

So, we don’t see a convincing argument which is leaving some room for introducing an alternative to geometrically linking of returns in the context of generating cumulative (multi period) returns based on a discrete rate of return definition.

The general method in GIPS is geometrical linking due to a well-founded theoretical background (including certain assumptions of reinvestment policy. time scaling properties etc.). Any change of resp. additional cumulative return calculation method will mean an inconsistency in the general methods with an unavoidable loss of comparability. Therefore, in our view the introduction of arithmetical linking is *very* critical.

The general formula for a return is:

Return = (profit&loss)/capital invested.

As we think in periods, this means

capital invested at beginning of period 2 =
capital invested at period 1 +/- (profit&loss) +/- (deposits&withdrawals).

In that sense, the formula requires geometric linking, as the denominator changes every period. As this is the case in general, the additional method has never to be used.

Furthermore, the calculation of a composite return with the aggregate return method will be hard to establish, as for any aggregated period of time using the additive method, the portfolios in the composites have to have the same denominator situation (unchanged denominator in each portfolio). No one will understand the result at the end or will be able to give a reasonable/convincing (economically clear-cut) interpretation of different calculation results in the case of a free methodical choice. The appropriate usage of calculating annualized cumulative returns by arithmetic linking is highly restrictive (and so far not relevant in most cases of investment practice) that means limited on one year periods and no reinvestment of returns.

Therefore, we think that a “must not geometrically linked” guidance is wrong. We have some sympathy for an exception to use an arithmetic formula the particular case mentioned, when the denominator doesn’t change. Nevertheless, for the sake of consistency and comparability, the principle of geometric linking should be clearly kept. So in general, we think the rule should be a geometrical linking and the use of another method in the exceptional case has to be clearly disclosed if applied at all.

Question 10: Should text be added to this Guidance Statement recommending disclosure of the sum of (a) total firm overlay exposure and (b) total firm assets, also known as total firm economic exposure?

No, we think the guidance describes in details, what this means.

Question 11: Are the required disclosures appropriate? If not, please explain.

Yes, they are appropriate.

Question 12: Is the proposed effective date appropriate or would additional time be needed to implement this Guidance Statement?

Assuming, that no additional return calculation method has to be implemented, we think the time period to implement this guidance is appropriate.

Yours sincerely

Signed Rudolf Siebel	Signed Harald Edele	Signed Ralf Frank
BVI	CFA Society Germany	DVFA