

An “unleveraged” return is hypothetical and it is not appropriate to include such a return in a composite regardless of whether the leverage arising from derivatives is discretionary (decided by the firm) or non-discretionary (required by the client). Unleveraged performance is only permitted to be presented as supplemental information in accordance with the Guidance Statement on Supplemental Information. A firm may calculate the performance of derivatives on an “unleveraged” basis by using their delta-adjusted exposure. For example, the exposure of an option can be calculated by multiplying the market value of the underlying instrument by the option delta. Using the exposures instead of the effective portfolio capital in the denominator would “deleverage” the performance. The following example illustrates this for a portfolio containing three call options:

Instrument	Beginning-of-day Value	End-of-day Value	Beginning-of-day Underlying Value	Delta	Exposure	Performance	
						Leveraged	Unleveraged
Call Option A	100	110	1,000	0.9	$1,000 \times 0.9 = 900$	$(110 - 100) / 100 = 10\%$	$(110 - 100) / 900 = 1.11\%$
Call Option B	200	210	5,000	0.8	$5,000 \times 0.8 = 4,000$	$(210 - 200) / 200 = 5\%$	$(210 - 200) / 4000 = 0.25\%$
Call Option C	300	360	10,000	0.7	$10,000 \times 0.7 = 7,000$	$(360 - 300) / 300 = 20\%$	$(360 - 300) / 7000 = 0.86\%$
Total	600	680			11,900	13.33%	0.67%

If the use of derivatives is non-discretionary (required by the client) and, as a result, the leverage arising in the portfolio can be considered non-discretionary, the non-discretionary derivatives positions can be removed from the portfolio in accordance with the allowed treatment to exclude a non-discretionary investment from the composite as stated in the Guidance Statement on Composite Definition: “In the case of client-restricted securities, the firm may choose to classify the restricted portion of the portfolio as non-discretionary”.

The following table summarizes the possible options of the treatment of leverage:

	Option 1. Leveraged return	Option 2. Unleveraged return	Option 3 Removing derivatives
Meaning:	Derivatives are included in the portfolio and their return contribution is based on their market value (13.33% in the above example).	Derivatives are included in the portfolio and their return contribution is based on their effective underlying exposure (0.67% in the above example).	Derivatives are entirely removed from the portfolio as if they had never existed, i.e their return contribution is nil.
Treatment:	Must be presented for the GIPS purposes, regardless if the use of derivatives is discretionary or non-discretionary.	Must not be presented for the GIPS purposes. Allowed to be presented as supplemental information only.	Only allowed for non-discretionary derivatives.