November 27, 2017

CFA Institute
Global Investment Performance Standards
Re: Guidance Statement on Overlay Strategies
915 East High Street, Charlottesville, VA 22902
USA

Re: Exposure Draft of GIPS Guidance Statement on Overlay Strategies

Dear Sirs or Madams,

On behalf of the Canadian Investment Performance Council ("CIPC"), we are pleased to provide our comments on the Exposure Draft of GIPS Guidance Statement on Overlay Strategies.

The following pages include responses to the questions posed. Thank you for providing the opportunity to submit our feedback.

Kind regards,
Canadian Investment Performance Council

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 above examples are appropriate. If underlay is to be included, restrictions on the amount and investable assets could be an attribute that may make a portfolio non-discretionary.

Question 2: *Are the three "allowable methods" for calculating overlay exposure appropriate?*
The 3 allowable methods are:

- *Notional exposure of the overlay strategies being managed;*
- *The value of the underlying portfolios being overlaid;*
- *A specified target exposure*

The notional exposure makes the most sense because it is the most intuitive and precise metric to measure the overlay performance.

We agree that, at a total firm level, firms could sum the overlay exposure of composites using different allowable methods, with proper disclosure. The use of the value of an underlying portfolio is only appropriate in certain circumstances, when the entire portfolio is relevant. Can the specified target be anything as long as specified in advance and falls within fair representation? How can this target be changed over time; does a drastic change in the target mean that it can no longer be a part of the composite?

Question 3: *Are there other methods for calculating overlay exposure that are also appropriate: If so, please explain.*
The notional exposure makes the most sense; the guidance should clarify the requirement to use the absolute amount of long/short overlay portfolios.

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.*

Notional exposure should be used for all strategies. Other methods could be permitted for specific circumstances if the firm determines that the notional exposure is not appropriate. If a method other than notional exposure is used, disclosure of the other method, and why it is appropriate, should be required.

Question 5: *Are the methods used to calculate the denominator in an overlay portfolio return calculation appropriate?*
The 3 allowable methods are:

- *Notional exposure of the overlay strategies as of the beginning of the period;*

- *The value of the underlying portfolio being overlaid as of the beginning of the period;*
- *The specified target exposure as of the beginning of the period, which can be defined as either a target exposure or determined by a formula used to calculate the target exposure for each period.*

Notional exposure <u>should</u> be used for all strategies. Other methods may be permitted for specific circumstances if the notional exposure is not appropriate. If a method other than notional exposure is used, disclosure of the other method, and why the notional is not appropriate, should be required.

Note: It is implied that the method used to calculate overlay exposure is the same as the method used in the denominator.

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**?***

If the collateral is actively managed by the overlay manager as part of the strategy, it should be included, with proper disclosure. The guidance does not mention underlay, but if underlay is managed as part of the overlay strategy, it should be included as well, with proper disclosure.

The inclusion of collateral (underlay) should be a recommendation, not a requirement. If underlay is included, the return becomes some kind of weighted blend of the base exposure and collateral (underlay) management. This could reduce comparability as different levels of collateral (underlay) can greatly affect returns calculated, along with the potential of being slightly misleading to blend returns from drastically different sources.

If the income of the collateral (underlay) is included in the numerator, should the collateral also be included in the denominator?

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, with proper disclosure. Maybe there should be a requirement to disclose the market value of the overlay portfolio (disclosing only notional value could be misleading).

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 <u>overlay returns must not be geometrically linked</u> 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.*

This is not consistent with the underlying portfolio return. Returns should be calculated using the MTM of the overlay position, and linked. If returns are only calculated when there is an “external cash flow”, and then linked, each return would be on an equal footing regardless of the amount of exposure that generated the returns.

The proposed method makes sense only if the profits and losses are NOT reinvested in the overlay strategy and the notional remains stable. In this case, there is no compounding effect, so the returns should not be geometrically linked.

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 believe the disclosure of the use of derivatives requirement is sufficient.

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

We agree with the disclosure requirements with the exception of the requirement to disclose total firm overlay exposure. Total firm overlay exposure (which may have been calculated using different methods) is not a number that would explain composite performance. The total firm notional exposure might be misleading in terms of true economic exposure and risk. Moreover, the end of year exposure may not be representative of the exposure throughout the year.

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

Yes.