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Swiss Funds & Asset Management Association

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Exposure draft of GIPS® standards Guidance Statement on Overlay Strategies of the SFAMA Swiss GIPS Expert Group

Dear Sir/Madam,

Many thanks for the opportunity to provide feedback to the exposure draft of GIPS® standards Guidance Statement on Overlay Strategies on behalf of the Swiss Funds and Asset Management Association SFAMA as the GIPS country sponsor in Switzerland.

In general, we agree with the revised Guidance Statement. With respect to the public comment questions raised, our response is as follows:

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
Generally, we agree with the provided examples. However, we recommend to also mention the following additional examples of investment restrictions for currency overlays that may lead to classification as non-discretionary:
- Fixed or restricted hedge ratios or deviation limits from the benchmark that prevent varying the hedge ratio
- Restrictions on proxy-hedging and cross-hedging

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

Question 3: Are there other methods for calculating overlay exposure that are also appropriate? If so, please explain.
We see no further methods necessary to be mentioned.

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
We would leave this up to the firms to choose the appropriate method provided that it is meaningful and applied consistently.

We also recommend to combine bullet points 7 and 10 in the Overlay Exposure Principles to clearly state that: "Firms that manage overlay strategies must disclose both total firm overlay exposure and total composite overlay exposure as of each annual period end in all overlay strategy compliant presentations *in addition to the composite assets and total firm assets*. Firms that manage overlay strategies can choose not to present (a) composite assets and/or (b) either total firm assets or composite assets as a percentage of total firm assets when these numbers are not considered meaningful".

Question 5: Are the methods used to calculate the denominator in an overlay portfolio return calculation appropriate?
In general, yes. The provided example for an interest rate overlay that states: "The denominator for an interest rate overlay benchmarked to a set of cash flows must be the sum of the present value of the cash flows being hedged as of the beginning of the period" actually means that Method 2 (The value of the underlying portfolio being overlaid as of the beginning of the period) is applied - this should be clearly referenced in this example.
The statement "if the management of the collateral is part of the overlay strategy, then the value of the collateral as of the beginning of the period must be included in the denominator" should be expanded to also state that in this case the return from the collateral must also be included in the numerator.

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?
This should be a recommendation - this would also be in line with the current treatment of income from securities lending where firms are allowed to choose how they treat it for the GIPS purposes.
Additional comment - the existing sentence is not precise enough. The existing sentence is as follows “In this case the inclusion of the collateral income because of administrative limitations must be disclosed”. We would suggest changing the sentence to “In this case if the exclusion of the collateral income is not feasible, the inclusion of the collateral income must be specifically disclosed.”

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?
A requirement is appropriate.

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, we agree. However, the example provided on page 14 before Question 8 is not fully aproppriate because it is not worded in terms of the exposure change of an overlay portfolio. In fact, a much better reference in this respect would be the calculation example of a "Notional Exposure Change Attributable To a Large External Cash Flow" provided on page 12.

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.
We agree. We suggest to explicitly add in the calculation example provided in this respect that the assumption is that the monthly gains generated in the overlay portfolio are not reinvested (hence no change in the underlying capital/exposure).

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, a separate presentation of the overlay exposure and of the total assets is more transparent.

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

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

Further remarks:
1) Sections "Introduction" and "Common Types of Overlay Strategies" are not numbered - the numbering starts only with Section 3 "Definition of Investment Discretion".
2) The Guidance Statement includes several references to the so-called "Absolute Return Overlay" (e.g. in Sections "Determination of Total Overlay Exposure", "Composite construction" and "Selection of benchmarks"). However, Section "Common Types of Overlay Strategies" does not mention the Absolute

Return Overlay as a type of an overlay strategy at all. It would be helpful to include a brief description of the nature of the Absolute Return Overlay strategy in Section "Common Types of Overlay Strategies".
3) Presentation of composite dispersion: We believe that those firms that apply the Aggregate Return method for calculation of composite performance of an overlay composite should be allowed not to present the composite dispersion because in such cases the individual portfolio returns in the composite may not necessarily be calculated (as not necessary for the Aggregare Return method purposes).
4) Appendix B "Passive Currency Overlay Composite": We believe that the definition of the benchmark of this composite (a mix of various bond indices) is not appropriate for a currency overlay composite. An appropriate benchmark example would be the return arising from a passive hedge of the risk currency to the composite base currency (see also the discussion in Section "Example: Currency Overlay Benchmark Description" on page 10).

Thanks in advance for considering our comments.

Sincerely yours

Swiss Funds & Asset Management Association SFAMA

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President

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