GIPS STANDARDS PROPOSED GUIDANCE FOR OCIO STRATEGIES

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CFA Institute

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AGENDA

- Introduction to CFA Institute and the GIPS standards
- Background - what is an OCIO?
- Why GIPS standards guidance specific to OCIOs is needed
- Highlights from the Exposure Draft of the Guidance Statement for OCIO Strategies

CFA INSTITUTE AND THE GIPS STANDARDS

CFA INSTITUTE IS A GLOBAL, NOT-FOR-PROFIT ORGANIZATION

- Our mission is to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society.
- We are the premier global association for investment management professionals.
- Founded in 1947, we now count more than 190,000 charterholders worldwide in 160 markets. CFA Institute has nine offices and 160 local societies.

CODES AND STANDARDS

We have also developed specialized codes and standards oriented around important topics within the investment industry

Global Investment Performance Standards (GIPS®)

Standards for the calculation and presentation of historical investment performance

Global ESG Disclosure Standards for Investment Products

Standards for the disclosure of how a fund or strategy considers ESG issues in its objectives, investment process, and/or stewardship activities

Diversity, Equity, and Inclusion Code (USA and Canada)

Principles to promote a diverse, equitable, and inclusive culture within the investment management industry

WHAT ARE THE GIPS STANDARDS?

The CFA Institute **Global Investment Performance Standards (GIPS®)** are an investment industry standard for calculating and presenting historical investment performance.

The GIPS standards are developed, maintained, and promoted through the collaboration of:

- Volunteers from the investment community
- GIPS Standards Sponsors, which include 60+ not-for-profit organizations
- CFA Institute®, a global association of investment management professionals

By establishing standardized requirements for calculating and presenting performance, the GIPS standards make it possible for:

- Investment managers to compete on an equal footing in all markets.
- Investors to compare the past performance of asset managers.
- Asset owners to fully disclose and fairly present performance to oversight bodies and stakeholders.

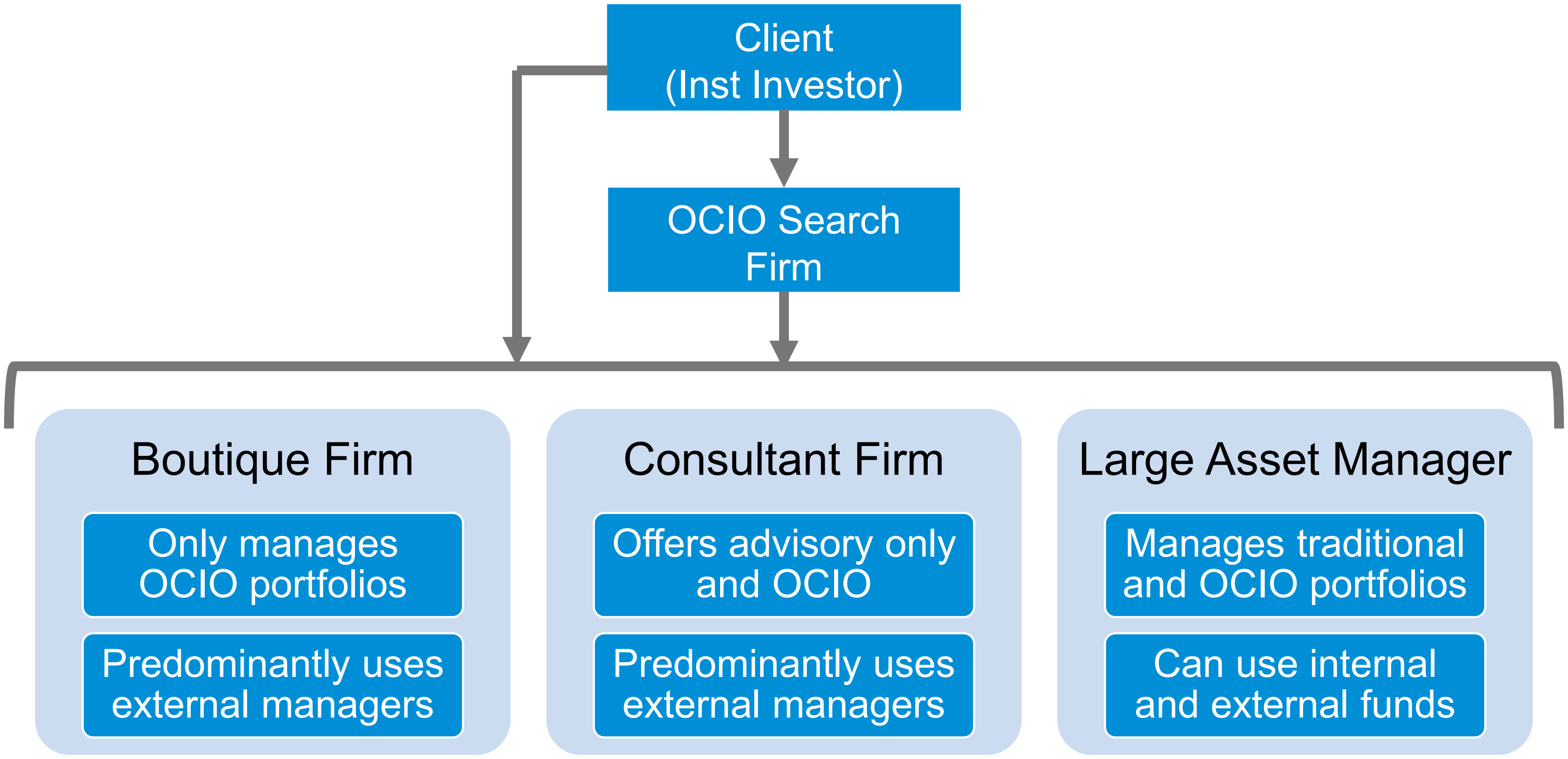
More than 1,700 organizations, across 48 markets, claim compliance with the GIPS standards.

WHAT IS AN OCIO?

WHAT IS AN OCIO?

- Outsourced Chief Investment Officer
- An OCIO provides investment advice and investment management services on an outsourced basis for Total OCIO Portfolios of institutional investors, such as pension funds, endowments, and foundations
- An OCIO's responsibilities typically include spending policy/liabilities analysis, investment policy development, portfolio construction, and ongoing portfolio management

OCIO MANAGERS CAN BE FOUND WITHIN DIFFERENT TYPES OF FIRMS



WHY HIRE AN OCIO?

- Appropriate for asset owners that wish to outsource the entire investment function rather than hiring dedicated investment personnel in-house, e.g., a small pension fund that is not large enough to justify having an entire internal investments team
- Allows for the ability to make asset allocation changes more quickly when market conditions change
- Obtain expertise for an increasingly complex investment environment
- Improved access to private markets
- Obtain back-office resources and support

WHY OCIO SEARCH FIRMS LOOK FOR GIPS COMPLIANCE

- Standardized GIPS Reports provide comparable and fully disclosed performance information, thereby improving the quality of due diligence and risk management
- Hiring a GIPS-compliant firm provides greater confidence that the manager will act in a trustworthy, ethical, and professional manner
- Compliance with the GIPS standards makes manager searches and RFPs more efficient because it allows only those firms that have designed and implemented policies and procedures to fairly present their past performance to pass the initial screen

WHY OCIO GUIDANCE IS NEEDED

OCIO PERFORMANCE CHALLENGES

- OCIO search firms have long complained about a lack of comparable, consistent, transparent, and reliable performance
- Firms were taking various approaches for presenting performance:
  - Representative accounts
  - Single account composites
  - Asset class performance
  - Strategy composites that varied by firm
  - All OCIO Portfolios grouped into one composite

WHY OCIO GUIDANCE IS NEEDED

- Many OCIO mandates are customized, which creates challenges for composite construction
- Many OCIO clients have legacy assets, and the GIPS standards don't have guidance specific to these assets
- OCIO mandates can have complicated fee structures, and prospective clients want more transparency into the fee schedule than is often included for a single strategy fee schedule

FORMATION OF VOLUNTEER GROUPS

- CFA Institute created a working group and an advisory group to address the performance challenges.
  - Included members from another OCIO industry group (DIMWG), started by North Pier
- These groups are diverse – consisting of small and large OCIO managers, OCIO search firms, asset owners, and service providers.

OCIO WORKING GROUP MEMBERS

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Kreischer Miller

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Alpha Capital Management, LLC

Scott Ayres
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ISSUANCE OF EXPOSURE DRAFT FOR PUBLIC COMMENT

- After twelve months of collaboration, the OCIO Working Group issued the Exposure Draft of the Guidance Statement for OCIO Strategies for public comment
- Firms that choose to comply with the GIPS standards must follow all the applicable requirements of the GIPS Standards for Firms as well as the guidance as outlined in the Guidance Statement for OCIO Strategies when presenting a GIPS Report for an OCIO strategy

KEY PRINCIPLES IN THE GIPS STANDARDS

1. Compliance must be met on a firmwide basis.
2. Performance must be based on actual assets managed by the firm.
3. Performance must be based on discretionary assets managed by the firm.
4. Performance must be calculated using specific methodologies and input data.
5. Composite performance must reflect performance of all portfolios managed in that strategy.
6. All prospects must receive specific performance information with accompanying disclosures (a GIPS Report) for the products for which they have expressed interest.
7. Benchmark returns must be provided along with the firm's performance.
8. A firm must maintain records to support all information included in GIPS Reports.
9. A firm must comply with all laws and regulations regarding the calculation and presentation of performance.
10. A firm must not present performance that is false or misleading.

GUIDANCE STATEMENT KEY TOPICS

- Applicability
- Required OCIO Composite Structure
- Legacy Assets
- Required OCIO Composite Returns
- OCIO Strategy-Specific Disclosures
- Sample GIPS Report
- Effective Date

APPLICABILITY

APPLICABILITY

- The guidance statement would only apply to firms managing an OCIO Strategy
- OCIO Strategy: a strategy in which a firm provides **investment advice and investment management services** on an outsourced basis for Total OCIO Portfolios of institutional investors, such as pensions, endowments, and foundations
  - Total OCIO Portfolio is defined as a pool of assets managed by a firm in an OCIO Strategy according to an institutional investor’s investment mandate, which is typically composed of multiple asset classes

DEFINITION OF OCIO STRATEGY

Both Investment Advice and Investment Management

	Service
Investment Advice	Strategic Asset Allocation
	Spending Policy / Liability Analysis, if applicable
	Investment Policy Development
Investment Management	Portfolio Construction
	Tactical Asset Allocation
	Ongoing Portfolio Management

OCIO STRATEGY EXAMPLE – LIMITED INVESTMENT MANAGEMENT

A firm is hired by a pension fund client to develop the Total OCIO Portfolio investment strategy and investment policy statement. For ongoing management of the portfolio, the firm's delegated responsibility is limited to the administrative or back-office tasks associated with the investments, such as raising cash monthly to pay beneficiaries or to meet operating expenses, rebalancing, and managing private investment cash flows. Any changes to the underlying investments must be approved by the pension fund client. Because the firm is providing only investment advice and is not providing ongoing investment management services for the pension fund client, the firm would not apply the Guidance Statement for OCIO Strategies to these portfolios.

OCIO STRATEGY EXAMPLE – BALANCED PORTFOLIO

A firm has institutional clients for which it manages multi-asset class portfolios, which includes implementing the client’s strategic asset allocation and selecting external managers. The firm does not recommend a strategic asset allocation or work with the client to develop the investment policy statement.

Because the firm is providing only investment management services and is not providing investment advice for these portfolios, the firm would not apply the Guidance Statement for OCIO Strategies to these portfolios.

OCIO STRATEGY EXAMPLE – USING TWO OCIO FIRMS

Two firms are hired to manage the client's Total OCIO Portfolio. Each firm manages half of the client's portfolio using six asset classes according to the Total OCIO Portfolio investment mandate. Each firm would apply the Guidance Statement for OCIO Strategies to these portfolios.

OCIO STRATEGY – QUESTION FOR PUBLIC COMMENT

Question 1: Is it clear when a firm must apply the Guidance Statement for OCIO Strategies?

REQUIRED OCIO COMPOSITE STRUCTURE

REQUIRED OCIO COMPOSITE STRUCTURE

- One of the major challenges the working group needed to address was whether comparable composites should be required
- There was general support for having a required composite structure to provide prospective clients with comparability of performance results across firms
- This is the minimum requirement - a firm may include Total OCIO Portfolios, or portions of Total OCIO Portfolios, in composites or groupings other than Required OCIO Composites

REQUIRED OCIO COMPOSITE STRUCTURE

- There were lengthy discussions about whether the Required OCIO Composite structure should be by client type (e.g., Foundation only, Endowment only, Pension Only, etc.) or asset allocation.
- While many prospective clients request composites by client type, it was determined that, in the spirit of the GIPS standards, it makes more sense to define the composites by strategy.

REQUIRED OCIO COMPOSITE STRUCTURE

- The Required OCIO Composite structure separates strategies into two buckets:
  - **Liability-focused** composites are managed with an objective to meet a liability stream for some or all of the client’s assets, e.g., pension funds
  - **Total return objective** composites are managed with a total return objective and no liability matching, e.g., endowments and foundations

REQUIRED OCIO COMPOSITE STRUCTURE

Within each category, there are 5 different asset class categories:

		Required OCIO Composites	Allocation to Liability Hedging Assets	Allocation to Growth Assets
Liability-Focused	1	Liability-Focused Aggressive	0-20%	80-100%
	2	Liability-Focused Moderately Aggressive	21-30%	70-79%
	3	Liability-Focused Moderate	31-50%	50-69%
	4	Liability-Focused Moderately Conservative	51-75%	25-49%
	5	Liability-Focused Conservative	76-100%	0-24%

		Required OCIO Composites	Allocation to Risk Mitigating Assets	Allocation to Growth Assets
Total Return Objective	6	Total Return Objective Aggressive	0-20%	80-100%
	7	Total Return Objective Moderately Aggressive	21-30%	70-79%
	8	Total Return Objective Moderate	31-50%	50-69%
	9	Total Return Objective Moderately Conservative	51-75%	25-49%
	10	Total Return Objective Conservative	76-100%	0-24%

REQUIRED OCIO COMPOSITE STRUCTURE

- Liability-focused portfolios are typically managed to a certain hedge ratio or duration.
- Defining composites by hedge ratio or duration could lead to many complexities, including return calculation challenges, and many prospective clients might not fully understand the composite definitions.
- Therefore, to make the composites understandable for clients, the Required OCIO Composite structure is based on a simple asset allocation percentage.

ASSET CLASSIFICATION

- A Total OCIO Portfolio must be assigned to a Required OCIO Composite based on the portfolio's strategic allocation to certain types of assets
- A firm must establish policies and procedures for determining how an asset is classified by strategy
- This determination must be made on an ex-ante basis, with one exception
  - When a firm initially creates Required OCIO Composites, it may classify assets on an ex-post basis
- Once a firm has classified asset types, any retroactive changes to an asset's classification would be subject to the firm's error correction policies

ASSET CLASSIFICATION

- For liability-focused OCIO composites:
  - Liability-hedging assets are used to hedge liabilities (these assets are intended to move in the same direction as the liability stream)
    - Examples are government bonds, stripped government bonds, high-quality corporates, or any derivative of these bonds
  - All other assets would be considered growth assets
    - For example, a low-volatility hedge fund used to lower risk of the overall portfolio would be a growth asset because it is not being used to hedge liabilities.

ASSET CLASSIFICATION

- For total return objective OCIO composites:
  - Growth assets are used to seek returns and also increase a portfolio’s risk (e.g., equities, high-yield bonds, and private equity).
  - All other assets would be considered risk-mitigating assets (e.g., cash, cash equivalents, and core bond funds). These assets could be used to mitigate portfolio risk or other types of risk, such as inflation risk.
  - Some assets are more challenging to categorize and may change categories (e.g., emerging market debt might be considered risk-mitigating at one time but considered growth at other times).

CURRENCIES

- Portfolios managed in different base currencies can be placed in difference composites if it affects the investment strategy
- If currency hedging is part of the investment strategy, different composites may be required (e.g., Total Return Objective Moderate (CAD Hedged) Composite and Total Return Objective Moderate (Euro Hedged) Composite)

REQUIRED OCIO COMPOSITES – QUESTIONS FOR PUBLIC COMMENT

- Do you agree with the use of a Required OCIO Composite structure?
- Do you agree with differentiating liability-focused composites from total return objective composites in the Required OCIO Composite structure?
- The proposed asset allocation ranges for the Required OCIO Composites have been created based on a widely used set of OCIO indices, which is built to include the most common 60/40 portfolio in the middle of the moderate bucket. Do you agree with these ranges, or do you think we should take a different approach?

LEGACY ASSETS

LEGACY ASSETS

- Firms that manage Total OCIO Portfolios often inherit legacy assets from the prior manager
- Firms might wish to sell these legacy assets, but they may not be able to do so on a timely basis, or even on a longer-term basis
- The high cost of disposing of legacy assets may also cause a firm to keep legacy assets it would otherwise wish to sell

LEGACY ASSETS

- We propose allowing firms to determine the materiality level that would impact the firm's ability to implement the intended strategy
- Depending on how firms define discretion and materiality, firms may either:
  - Exclude from composites portfolios with legacy assets when the legacy assets materially affect the ability of the firm to manage the portfolio
  - Include in composites portfolios with legacy assets, regardless of the amount or type of legacy assets
  - Include in composites the portion of the portfolio that excludes legacy assets when this portion of the portfolio is consistent with a Total OCIO Portfolio

LEGACY ASSETS

- The firm must disclose in the GIPS Report information about the portfolios or assets it excludes from the composite due to legacy asset positions
- This disclosure will allow the user of the GIPS Report to compare composites across firms and to inquire further about legacy asset positions

Sample disclosure

The Total Return Aggressive Composite excludes those portfolios whose private market investments acquired by a prior investment manager exceed 5% of the portfolio's initial total value. Such portfolios are re-assessed annually.

LEGACY ASSETS – QUESTIONS FOR PUBLIC COMMENT

- Do you agree with the proposed three options for the treatment of legacy assets?
- Do you agree with requiring firms to disclose information about their policy for the treatment of legacy assets?

PRESENTATION AND DISCLOSURES

GIPS REPORTS

- A firm must make every reasonable effort to provide a GIPS composite report to all prospective clients when they initially become prospective clients
- A GIPS Report is a presentation for a composite or pooled fund that contains all the information required by the GIPS standards and may also include recommended information or supplemental information

REQUIRED OCIO COMPOSITE RETURNS

Because of the complexity of the different fees that may be charged and reflected in a gross-of-fees return, a firm must present both gross-of-fees and net-of-fees returns for Required OCIO Composites.

Return Type	Return	Information Type
Pure gross-of-fees return	**11.00%**	**Supplemental information**
- Fees and expenses for underlying pooled funds and segregated accounts	–0.40%	
- Transaction costs	-0.04%	
Gross-of-fees return	**10.56%**	**Required**
- OCIO Investment management fee	–0.50%	
Net-of-fees return	**10.06%**	**Required**

REQUIRED RETURNS – QUESTION FOR PUBLIC COMMENT

- Do you agree with requiring both gross-of-fees and net-of-fees returns for Required OCIO Composites?

OCIO STRATEGY-SPECIFIC DISCLOSURES

- In addition to any required disclosures in the GIPS standards for Firms, firms must disclose the following items:
  - The types of assets included in composites (e.g., which asset classes are considered liability-hedging vs. growth)
  - Information about the portfolios or assets it excludes from the composite due to legacy positions
  - Material impacts that explain performance dispersion (e.g., some portfolios in the composite have an allocation to alternatives while others do not)
  - Fees and expenses of underlying investments

SAMPLE GIPS REPORT

Jaxx Investments
Total Return Moderate Composite
31 December 2022

				3-Year Std Deviation					
Calendar Year	**Gross Return (%)**	**Net Return (%)**	**Benchmark Return (%)**	**Composite Gross (%)**	**Benchmark (%)**	**# of Portfolios**	**Dispersion (%)**	**Composite Assets ($ M)**	**Firm Assets ($ M)**
2013[a]	18.91	18.39	17.51	n/a	n/a	11	n/a	2,165	3,068
2014	5.58	5.16	5.86	n/a	n/a	14	2.0	2,235	2,385
2015	–0.12	–0.52	–1.09	n/a	n/a	13	1.7	2,344	2,570
2016	7.10	6.59	7.33	5.30	4.52	12	2.8	2,445	2,789
2017	16.11	15.65	15.20	7.51	7.68	15	3.1	2,520	2,851
2018	–5.61	–5.99	–5.56	6.95	5.85	14	2.8	2,505	3,385
2019	21.60	21.14	21.17	8.29	7.53	16	2.9	2,975	5,206
2020	15.71	15.28	15.18	12.27	12.91	19	3.1	3,203	5,820
2021	11.96	11.50	11.70	9.84	8.72	21	1.5	3,231	5,863
2022	–17.51	–17.98	–17.09	11.82	10.63	20	2.5	3,275	6,379

[a]Returns are for the period 1 February 2013 (inception) to 31 December 2013.

SAMPLE OCIO-SPECIFIC DISCLOSURES

3. The Total Return Moderate Composite includes all fee-paying, discretionary portfolios that are invested in the Total Return Moderate asset allocation strategy. Portfolios in this composite have a target allocation to growth assets of between 51% and 70%, with the remainder of portfolio assets allocated to risk-mitigating assets. **Growth assets include equities and alternative investment strategies, such as real estate, commodities, private equity, and private debt. Risk-mitigating assets include fixed income, absolute return strategies, and hedge funds. Portfolios with legacy assets of 10% or more are excluded from the composite.**

4. **As of 31 December 2022, two portfolios in the composite representing 27% of composite assets had a 0% allocation to alternatives. The average tenure of the private equity pooled fund investments in the remaining portfolios is eight years. Approximately half of the private equity assets are benchmarked against a public market index plus a premium, and half are benchmarked against an industry peer group index.**

SAMPLE OCIO-SPECIFIC DISCLOSURES

8. The OCIO investment management fee is 0.40% on all assets, excluding legacy assets. Fees on underlying investments are expected to be as follows:

Asset Class	Underlying Fee	Description
International Equities (Active)	Total expense ratios range from 0.50% to 0.75% per annum	Internally managed mutual funds/commingled vehicles with a total expense ratio
Domestic Equities (Passive)	Total expense ratios range from 0.05% to 0.15% per annum	Externally managed ETFs with a total expense ratio
Fixed Income	Covered by stated fee	Internally managed fixed income vehicle with offset of management fee against OCIO fee
Private Debt	Investment management fees range from 1.50% to 2.0% per annum. Other fund expenses range from 0.25% to 0.75%. Carried interest for most vehicles is 10% over an 8% hurdle rate with catch up	Externally managed LP/LLC structures with an investment management fee, other fund expenses, and carried interest
Hedge Funds	Total expense ratios range from 0.70% to 1.25% per annum. Carried interest for most hedge funds is 20%	Internally managed multi-manager fund-of-funds, with a FoF investment management fee with offset against OCIO fee. Underlying funds pay a total expense ratio plus carried interest

EFFECTIVE DATE

EFFECTIVE DATE

- Firms will have 12 months to implement the new requirements.
- When initially preparing a GIPS Report for a Required OCIO Composite, a firm will be required to initially present at least five years of performance that meets the requirements of the GIPS standards and this Guidance Statement. Prospectively, the firm must present an additional year of performance each year, building up to a minimum of 10 years of performance.
- Firms are encouraged, but not required, to apply this guidance prior to the effective date and for more than the minimum five-year period.

EFFECTIVE DATE - QUESTIONS FOR PUBLIC COMMENT

- Do you agree with requiring firms to initially present at least five years of performance that meets the requirements of the GIPS standards and this Guidance Statement?
- Do you agree that the effective date should be 12 months after the issue date?

SUBMITTING COMMENTS

- Comments can be sent to standards@cfainstitute.org
- Comments must be received no later than 20 November 2023.
- Please submit your comments as early as possible to facilitate the review process.
- Unless otherwise requested, all comments and replies will be made public on the GIPS standards website (www.gipsstandards.org).

RESOURCES

- Exposure Draft of Guidance Statement for OCIO Strategies
- Subscribe to the GIPS Standards Newsletter
- CFA Institute Annual GIPS Standards Conference
- GIPS Standards Help Desk gips@cfainstitute.org
- CFA Institute SEC Marketing Rule resources

QUESTIONS?