Agility

7979 East Tufts Avenue, Suite 700
Denver, CO 80237

T 303.813.7913
F 303.379.7788
agilitycio.com

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CFA Institute
Global Investment Performance Standards
OCIO Working Group

Re: Comment on Exposure Draft Guidance Statement for OCIO Strategies

We would like to begin by thanking the CFA Institute and the OCIO Working Group for the thoughtful approach to tailoring the GIPS Standards for Outsourced Chief Investment Officers (OCIOs). As an OCIO that recently became GIPS-compliant, we spent significant time and effort grappling with how best to apply the standards to our business, while also considering the SEC regulatory requirements we are subject to. In many cases our outcome aligned with the draft guidance statement, but there are some cases where we feel the guidance statement could benefit from some additional flexibility or further clarification or guidance.

In an effort for completeness, we are organizing our comments here to address each question posed for public comment in the exposure draft. We do not have comments on other elements of the proposal not addressed below.

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

No. As drafted, the definition of OCIO Strategy appears to be limited to Total OCIO Portfolios of institutional clients. "Institutional client" is not explicitly defined, but repeatedly referenced as referring to client types such as pensions funds, endowments and foundations. The definition of an institutional investor varies across jurisdictions and regulators, and we would appreciate clarity that the proposal is not intended to exclude client types that otherwise meet the standard of being a Total OCIO Portfolio managed in a multi-asset class OCIO Strategy. For example, we believe other types of investors, such as family offices and certain high net worth investors, are increasingly adopting the OCIO model and could benefit from being in scope. Narrowly defining the client type appears in contrast with the spirit of the GIPS standards and SEC guidance to provide composite performance data on a more inclusive basis, regardless of account type. The GIPS Standards explicitly state that firms "must not exclude portfolios from composites based solely on legal structure differences". The SEC's marketing rule also states that presenting a composite aggregation of performance results must include all related portfolios falling within the stated criteria (with limited exclusions for immateriality). Without further clarity, we believe it would be challenging for firms to comply with the OCIO guidance while still complying with the GIPS standards and local regulatory requirements. We believe the determination of which clients to include in an OCIO composite should rest on the remaining elements of the definition and determination of discretion in accordance with each firm's GIPS policies and procedures.

2. Do you agree with the use of a Required OCIO Composite structure?

No. The GIPS standards require that composites be defined according to investment mandate, objective or strategy, and the definition of discretion is based on the firm's ability to implement its intended strategy. While we agree with the overall principles of defining composites based upon their target allocations to liability-hedging vs. growth assets (for liability-focused composites) or risk-mitigating vs. growth assets (for total return objective composites), we believe the requirement to use prescribed allocation bands does not align with GIPS requirements for firms to define their composites according to the strategy they manage or offer. We would propose these either change to “Recommended” instead of “Required” composites, or that firms are given flexibility to define their composites according to broader target ranges applicable to the strategies they manage or offer.

It is also unclear whether firms would be required to implement the exact naming convention used within the guidance statement. We believe firms should retain the flexibility to name their composites in accordance with the GIPS principles of fair representation and full disclosure.

3. *Do you agree with differentiating liability-focused composites from total return objective composites in the Required OCIO Composite structure?*

Yes. We agree that liability-focused and total return strategies are managed according to different objectives and should be differentiated in composite construction.

4. *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?*

No. As noted for Item 2 above, we believe that firms should retain flexibility to define their composites according to the strategy managed or offered pursuant to GIPS standards. Not every OCIO firm will define their strategies according to these precise bands, and to the extent their ranges cross over some of the thresholds this would require them to present multiple composites to prospects, causing inconsistency and confusion. For instance, we have defined our “core” composite to include a 70-80% allocation to growth assets. The 79% cutoff in the proposed Moderately Aggressive strategy would require us to present two separate composites to prospects where we do not yet know which band would be most applicable to them. Additionally, we would either need to redefine our existing composite, or present that as a third composite in order to continue to comply with the overarching GIPS standards. We understand the premise behind these proposed composites, but believe there could be a lot of unintended consequences when defining composites with such narrow bands.

If these are changed to “Recommended” composites, this would alleviate the inconsistency with the GIPS standards, while still creating a common standard that may be requested by certain recipients, such as institutional search consultants, that may want to compare results across these specified bands.

Whether or not these are to remain “Required” composites, we would suggest that firms be permitted some leeway on either side of each band, perhaps up to 5%, or the ability to collapse some of the bands together if applicable to their strategy. For the moderately aggressive strategy in particular, we would view that as one that targets 70-85% allocation to growth assets, which is a common target range for institutional investors with a total return mandate.

5. *Do you agree with the proposed three options for the treatment of legacy assets?*

Yes. We agree that the implications of legacy assets to the overall portfolio management can vary by portfolio, and the options presented provide appropriate flexibility for a firm to determine composite inclusion in alignment with GIPS principles.

6. *Do you agree with requiring firms to disclose information about their policy for the treatment of legacy assets?*

Yes. We agree that disclosing information about the treatment of legacy assets will allow recipients to better evaluate the information presented. We believe firms should retain flexibility on the specific language used, but appreciate the inclusion of sample disclosure in the guidance statement.

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

No. In alignment with the GIPS standards for firms, we believe firms should retain the option to present returns gross-of-fees, net-of-fees, or both, provided the methodology is applied consistently and with appropriate disclosure. As an alternative, we would propose that net-of-fees returns be required, and gross-of-fees returns be optional. Net-of-fees returns are the preferred standard of the SEC, which regulates U.S.-based investment advisers. Additionally, we believe net-of-fees returns are most meaningful to prospective investors. For firms such as ours that calculate investor performance on a net-of-fees basis, backing into a gross-of-fees return would be a manually intensive process, as well as likely to involve use of assumptions, resulting in less useful performance data.

As long as firms are providing net-of-fees performance, we believe that requiring more detailed disclosure of fee ranges of underlying funds and strategies presents a number of challenges, and does not provide value to the recipient. An OCIO strategy may have hundreds of underlying investments, inclusive of legacy investments to the extent those may be included according to composite inclusion criteria. Underlying private funds or separately managed account (SMA) allocations do not report expense ratios in the same manner as broadly distributed pooled funds, leading to inconsistency in fee metrics. Additionally, a fee range does not account for fee impact – for example, smaller funds may have higher fees than larger funds, but also comprise a smaller part of a portfolio. Underlying portfolio holdings are also constantly changing – it would be impractical to provide all historical fee ranges, but a snapshot in time doesn't give complete perspective of historical performance. Given all of these factors, we believe the disclosure of underlying fee ranges in the proposed format does not provide meaningful data as to the ultimate impact of the fees on performance for the recipient's evaluation.

To the extent that a firm may charge a low or zero OCIO fee that is offset by fees charged on proprietary funds, however, we do agree that this should be disclosed as part of the overall fee schedule disclosure.

8. *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?*

Yes. We agree that requiring at least five years of initial performance for OCIOs is appropriate and consistent with the GIPS standards for firms.

9. *Do you agree that the effective date should be 12 months after the issue date?*

Yes. While we generally agree that a 12 month period for implementation appears appropriate, given that GIPS Reports are generally issued on a calendar year basis, we believe it would be most helpful to specify an effective date on a calendar year basis, as was done with the GIPS 2020 Standards. In determining such date, firms should be provided at least 12 months to implement the requirements, and not be required to re-issue previously finalized GIPS Reports.

We thank you for your consideration and welcome you to contact us if it would be helpful to further discuss any of the above points.

Best regards,

Kyle Adams, CFA®
Executive Director
Member of GIPS OCIO Advisory Group