Callan

Callan LLC
One Bush Street
Suite 700
San Francisco, CA 94104

Main 415.974.5060

www.callan.com

November 20, 2023

Via Email to: standards@cfainstitute.org

Krista Harvey
CFA Institute
915 East High Street
Charlottesville, VA 22902

RE: Guidance Statement for OCIO Strategies Exposure Draft

Thank you for the opportunity to comment on the Guidance Statement for OCIO Strategies. We appreciate the efforts of the CFA Institute to clarify and standardize GIPS requirements for the OCIO industry.

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

We would like confirmation that fully discretionary Target Date Funds ("TDFs"), including TDFs that are customized and managed on behalf of Defined Contribution Plan participants, are eligible members of Total OCIO Portfolio composites, subject to the level of risk assets at a given time. These types of portfolios represent the characteristics outlined in the definition of a Total OCIO Portfolio, including: being composed of multiple asset classes; implementation and discretion of strategic asset allocation based on analysis of future liabilities or cash needs; portfolio construction; tactical asset allocation; and ongoing portfolio management. Thus, in our view, they are a good representation of a firm's capability in managing Total OCIO Portfolios, particularly those with a Total Return objective. Similarly, Risk-Based Funds used in DC Plans should be viewed in the same way and appear aligned with the example given in Example 5.

Otherwise, we believe it is clear when a firm must apply the Guidance Statement for OCIO Strategies.

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

Yes, we agree with the use of a standardized Required OCIO Composite structure.

<u>Additional Comments:</u>
We would like the guidelines to explore the possibility of equal weighted composite calculations for Total OCIO Portfolios, with appropriate disclosure. Many firms will have a wide range of client sizes and we do not think that a single composite member or a small number of outsized composite members should potentially dominate composite performance results.

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

Yes, we believe it appropriate to distinguish liability-focused composites from total return objective composites.

Careful definition of liability-hedging assets will be important, particularly in fixed income.

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?

The ranges overall seem appropriate; however, we think that in both the Liability-Focused set and the Total Return Objective set, changing the threshold between Aggressive and Moderately Aggressive to 85% allocation to Growth Assets makes sense.

Careful definition of growth vs risk mitigating assets should be required in disclosures and be consistent firm wide.

<u>Additional Comments:</u>
With respect to Liability-Focused Composites, how much discretion will a firm be given to determine which asset classes belong in Liability-Hedging Assets vs. Growth Assets? For instance, private corporate debt or short duration/cash could be used in a portfolio as part of the overall duration management and align with a hedging strategy. In addition, some asset classes may have certain characteristics of hedging and some characteristics of growth – can a percentage split be assigned to a given asset class, for example 75% hedging, 25% growth?

With respect to Total Return Objective Composites, we have a similar question. Can an asset class that exhibits growth characteristics and risk-mitigating characteristics be assigned a percentage split as long as it is applied consistently across portfolios? Private Real Estate and Hedge Funds are examples of asset classes that might fall into this category.

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

Yes, the three options are reasonable, subject to proper disclosure of a methodology for determining inclusion/exclusion criteria in Option 3. We believe the criteria should be consistent firm wide, and that the criteria should be set at inception and remain consistent until the final liquidation of each legacy asset.

In addition, similar to the guidance offered around setting asset classifications on an ex-ante basis with the exception of the initial creation of the Required Composites, we think that determining the policies and procedures around the treatment of legacy assets should also be done on an ex-ante basis, and retroactive changes be subject to a firm's error correction policies. We believe similar language in the guidance statement along these lines would be worthwhile.

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

We feel that proper disclosure about policies and criteria for the treatment of legacy assets is imperative.

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

We feel that net-of-fee reporting presents the clearest and most comparable information to investors and that net-of-fee reporting should be required for OCIO composites.

Gross-of-fee reporting, as defined in the draft, appears to be net of all sub-advisory fees and pooled fund fees managed by subadvisors unrelated to the OCIO. We feel that this lens limits the ability of investors to compare open-architecture OCIO implementations (which must bear all third-party sub-advisory costs in gross-of-fee performance presentations) with those OCIO implementations utilizing internally managed or proprietary asset management components (and do not bear any sub-advisory costs in gross-of-fee performance presentation). This creates a potential apples-to-oranges comparison of gross-of-fee performance that may be confusing to prospective clients. Because of this, we think gross-of-fee reporting required as currently defined should be optional or supplemental information.

<u>Additional comments:</u>
For net-of-fees return calculations, we would like clarification on how carried interest and incentive performance fees are allocated. Given the time-weighted return nature of Total Portfolio composites, we expect carried interest and incentive performance fees would be accounted for in the period they are borne by the investor, even if those fees were "earned" by the manager over longer time periods.

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?

While the administrative burden will be high at the outset, we agree with a 5-year minimum. The most recent 3-year period at the time of adoption (2021-2023) may not be indicative of longer-term results.

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

Yes, we are comfortable with an effective date 12 months after the issue date.

Additional comments to overall Guidance Statement:
There is section that discussed the use of lagged benchmarks (page 11) – does this tacitly imply that it is acceptable to utilize lagged valuations for private market investments in the performance calculation of a Total OCIO Portfolio due to the timing of when such valuations are available, as long as the lagged period corresponds with lag of the benchmark? For instance, private equity portions of a portfolio might be lagged by one quarter, adjusted for any cash flows during the intervening period and the corresponding private equity benchmark is also lagged by one quarter?

Best regards,

Minho Hyun, CFA
Senior Vice President, Manager of Discretionary Operations
Callan LLC

Mark Andersen
Senior Vice President, Discretionary Practice Leader
Callan LLC