

CFA GIPS EXPOSURE DRAFT
GUIDANCE STATEMENT FOR OCIO STRATEGIES
DEADLINE NOV. 20, 2023
(Draft 231023)

Required OCIO Composite Structure

I very much appreciate the guidance required to establish composites. As you already know, it is a major source of current confusion in comparing performance between OCIOs. I particularly like the idea of having liability-focused and total return defined strategies.

I do wonder whether the specifics of the asset allocation end ranges are too restrictive. Maybe allowing for the ranges to overlap by a couple of points and giving OCIOs some discretion and guidance might be an alternative. But, given the opportunity to game performance, which is one of my themes, does concern me.

Optional Non-Required OCIO Composites

I like this reference in the draft. As an OCIO consultant, I work largely with Endowments and Foundations with an asset allocation range of 70% to 30% or 75% to 25% equity to fixed income. For RFP purposes, I could see myself asking for a composite of Endowments and Foundations with a total return objective of moderately aggressive.

Legacy Assets

There is no definition of legacy assets in this section. The definition will be helpful in OCIOs understanding the issues that can arise in this section. Legacy assets could be a number of investment strategies, but typically include private, illiquid, higher returning asset classes, that include buyouts, venture capital, credit and real assets. The expected return can be as much as 3% to 5% higher than public market equities over the long term. And among some harder to access GPs, there can be a level of persistence in their performance.

Option 1

Given these legacy asset characteristics, my concern is the gaming of Legacy Asset Options to drive investment performance. For example, Option 1 requires that an OCIO exclude legacy assets from portfolio under specified circumstances. The OCIO is given discretion in the amount of and type of legacy assets to be consistent with its investment strategy.

This might be the clearest case where an OCIO has the opportunity to cherry-pick GP investments with a likelihood of persistence and delete those that might have unattractive performance characteristics going forward. Not certain why disclosure is limited to assets or portfolios excluded from the composite. Included legacy assets are what will drive future performance.

Option 2

Option 2 permits an OCIO to retain all legacy assets within a portfolio. If in aggregate the OCIO has less private investment assets than peers, would the OCIO be incentivized to hold as many legacy assets as possible? And because the assets are included, are they not subject to disclosure in the GIPS Report.

Option 3

Option 3 requires an OCIO to exclude legacy assets where the Total OCIO portfolio would be inconsistent with it. I'm not certain how often this option would be applied as a major benefit of an OCIO relationship is the OCIO's ability to build alternative portfolios. I suppose there could be one-off liquid portfolios composites, but wouldn't there also be composite portfolios with alternatives that could match up with the new portfolio. Maybe I don't fully understand this option.

Selection of Benchmarks

I would like to suggest adding a benchmark to this section might possibly offset gaming in the Legacy Assets section of the Exposure Draft. The new benchmark would have the effect of neutralizing any alpha potential from cherry picking GPs. I am suggesting a benchmark that replicates the performance of the strategy itself. In this approach, the return of the legacy portfolio will be the same as the investment strategy itself.

Distribution of GIPS Report

I like this section of the draft.

Effective Date

OCIOs are required initially to state at least five years of performance for the Guidance Statement. OCIOs are required to present an additional year of performance each up to a minimum of 10 years of performance. From an OCIO consultant's perspective, this is unrealistic. Consultants will require at least 10 years of performance information for its due diligence process. Those unwilling to invest the resources are likely to regret the likely result.

Thanks you for the encouragement and opportunity to comment on the Exposure Draft. As a user, I am thrilled with the solution offered in a very difficult strategy to tame. Thank you.

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