

CFA Institute GIPS Exposure Draft Guidance Statement for OCIO Strategies

From: LCG Associates

Upon reviewing the guidance statement there are several key components that we believe require further discussion and/or clarification:

- 1) **Definition of an OCIO.** As written, an OCIO is defined as providing investment advice and investment management services for total portfolios. A total portfolio is defined as a pool of assets that crosses multiple asset classes, is not a subset of a larger multi-asset pool and is managed in a discretionary manner. A point that requires clarification is when an asset owner splits marketable securities and private markets. Both mandates likely cover multiple asset classes and can be run in distinct and separate fashion. We encourage the CFA Institute to clarify this point and strongly consider such an example (i.e. an OCIO that manages only liquid assets) to fall within the definition of an OCIO.
- 2) **Asset Classifications Used for Asset Allocation.** As written, each OCIO is responsible for defining how different assets and strategies are classified within a composite. In our opinion, this creates a significant opportunity for an OCIO to influence how their composites show. It also has the potential to render comparisons across composites, even within a particular asset allocation band, to be meaningless. It also then leaves asset owners at the mercy of disclosures to determine how and why one composite's performance differs from another. We encourage the CFA Institute to define, in advance, how particular assets will be classified and not leave it up to each OCIO.
- 3) **Legacy Assets.** As written, the treatment of legacy assets is up to the OCIO provider. As with asset classifications, this will likely lead to managers defining their treatment based on whether legacy assets improve the composite results. We encourage the CFA Institute to define, in advance, how legacy assets will be classified.
- 4) **Benchmarks.** As written, allowing custom benchmarks will perpetuate one of the most problematic practices of the OCIO industry – manager created benchmarks that mask true underlying risk exposures and sources of out or under performance. The result of benchmarks unique to each composite and manager mean that asset owners will again need to make heavy use of potentially complicated disclosures to understand if they are evaluating an apples-to-apples comparison. Because the Standards already propose asset allocation ranges for the composites, our recommendation is for standardized benchmarks to be adopted that correspond to those ranges. The baseline for any asset owner is to build a diversified market-cap weighted passive portfolio that corresponds to their unique risk and return profile. Any decision then to deviate from that baseline portfolio reflects a decision/recommendation by the OCIO to which they should be held accountable. This would ensure that both risks and returns are appropriately measured, and composites can be evaluated across firms and asset owners.
- 5) **Effective Date.** As written the initial composite is required to have five years of performance unless the composite inception date is less than five years. The concern here is that firms will initially create composites with the most attractive return profile. Requiring a longer track record disadvantages OCIOs who are newer to the market. Our recommendation is to create a standard view that can be used across all firms. Initially 12 months of official track record with the

composite gaining time going forward. OCIOs that want to show additional performance can, but it would be unaudited and disclosed.

- 6) Governance. A realistic concern by both OCIOs and asset owners is with respect to validation and independent verification of GIPS compliance. Because of the potential to influence composites based on asset definitions and treatments, our recommendation is to encourage independent 3rd party validation of GIPS composites that are used with clients or prospects. This is of relevance to the extent GIPS compliance becomes a pre-requisite for OCIOs to be included in RFP searches.