November 20, 2023

CFA Institute CFA Global Industry Standards
Cc: Ken Robinson (via email)

Re: North Pier Search Consulting Comment on The CFA Institute's GIPS Exposure Draft Guidance Statement for OCIO Strategies (the "Exposure Draft"

To Whom It May Concern,

Please consider the following comments from North Pier Search Consulting and its professionals in response to the OCIO Exposure Draft.

Summary and Background of North Pier

Since 2012, North Pier Search Consulting (North Pier or NPSC) has been providing search and evaluation services on behalf of asset owners covering the outsourced chief investment officer (OCIO) and non-discretionary consultant industry. Prior to that, the principals and senior consultants of North Pier have been serving institutional fiduciaries for over 25 years each. North Pier principals Jim Scheinberg and Gregory Metzger organized the industry's first-ever working group, the Discretionary Investment Management Working Group on Data Standards (DIMWG), in 2018 to establish data standards for the OCIO industry, similar to the objective of the CFA Institute working group (CFAI WG).

Purpose and Positioning Statement

North Pier is responding to the CFA Institute's Exposure Draft with two primary objectives. First, North Pier and its professionals are passionate about equipping asset owners with the information they need to prudently and effectively steward their pools of capital in the best interest of their missions and beneficiaries. As such, our objective of providing guidance to the CFA Institute, as well as the purpose of DIMWG, is to create a level playing field in which asset owners and their advocates can make effective evaluations, whether for the oversight of an incumbent or for the search for a potential new OCIO partner.

The second objective of North Pier's response is from the perspective of an industry search consultant who utilizes this data to assist asset owners in their oversight and evaluation responsibilities and objectives.

North Pier has accumulated a substantial amount of experience in over a decade of evaluation work about what data is required to make said effective evaluations, as well as having observed the various types of asset owners. Further, five years of stewarding objectives similar to the CFAI WG's for the creation of OCIO industry reporting standards has given us a broad perspective on the thoughts and practices of the majority of the U.S. OCIO industry. Additionally, we have spent considerable time

considering and deliberating on the very same issues that the CFAI WG has taken up over the last year. We share these observations to further both of the above-mentioned objectives.

Please note that the comments expressed within this response are those of North Pier and its principals and, although potentially informed by the majority views of DIMWG and its participants, do not represent any other person or entity outside of North Pier.

North Pier commends the work of the CFAI WG, many of whom we have collaborated or worked with in the past. Although we point out areas of disagreement or questioning in the pages that follow, we have faith in the work of both the working group and the CFA Institute and are hopeful that they will contemplate our comments and the comments of the members of the OCIO community to forge a new set of OCIO data standards that will afford asset owners, OCIOs, and their evaluators the opportunity to access accurate, meaningful, and useful data for decades to come.

General Comment About the Stated CFAI Approach to Attempting a Standard

The Exploration Draft states, “The purpose of this Guidance Statement is to provide guidance on how to apply the GIPS standards to OCIO strategies.” North Pier cautions against sole reliance on this mindset. Although it is paramount to arrive at standards that are effective and administrable, it is equally important to arrive at standards that are ultimately usable and valuable to the industry over which they preside. If the general framework of the GIPS standards, when being applied to OCIOs, leads to unusable or misleading results, then the portions of the standards themselves that lead to such “static” need to be addressed, adapted, or perhaps overlooked for OCIO applications. At the end of the day, standards must lead to data that is effective to the end user(s) when applied.

Q1. 1. Is it clear when a firm must apply the Guidance Statement for OCIO Strategies?

NPSC Answer: Generally, North Pier believes it is clear when a firm must apply the Guidance Statement for OCIO Strategies. However, we envision cases where, as defined, the standard may exclude what we believe would qualify as a fully discretionary OCIO. The issue revolves around the insistence that the OCIO “recommend a strategic asset allocation or work with the client to develop the investment policy statement.” There are very well-established institutions (many quite large and many with internal investment office staff) that have well-formed investment policies and strategic asset allocations expressed within them. They seek an OCIO for manager selection, implementation, and dynamic shifts of asset allocation within pre-established boundaries. We believe that if the OCIO feels aligned with the directive, this type of client should not be excluded. We suggest softening the language presented to include this type of client.

Q2: Do you agree with the use of a Required OCIO Composite structure?

NPSC Answer: Yes. North Pier believes in a required composite structure, at least for applicable return-seeking portfolios, as long as those structures are highly valuable for evaluation. A required OCIO composite that led to overly broad and watered-down composites or to those that outright misinformed the end user should be avoided.

Q3. Do you agree with differentiating liability-focused composites from total return objective composites in the Required OCIO Composite structure?

NPSC Answer: Yes. North Pier believes liability-focused composites should be differentiated from total return objective composites, as the latter are not managed solely for return but in conjunction with the relationship between the portfolio's performance and the capital markets' impact on the asset owner's liabilities. As an example, an LDI-managed portfolio for a corporate defined benefit plan would be managed to create a net impact on the plan that is related to the gap between the present value of future liabilities and the plan's assets. If assets of the LDI portion of the portfolio were to decline by 20% in a given year due to a spike in interest rates, but liabilities declined by 30%, that may be considered a big success for the plan and potentially the OCIO. Total Return portfolios must be segregated from liability-focused composites.

However, the creation of liability-focused composites may prove to be challenging. There are many contributing factors, and it would take time to properly evaluate them before reaching a consensus and before creating *usable and reliable* composites for these asset pools.

Q4. 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?

NPSC Answer 4: (a) North Pier does not agree with the Exposure Draft's depiction of its liability-focused corridors. (b) North Pier agrees with some of the Exposure Draft's proposed corridors for Total Return composites and disagrees with other portions. (c) We also challenge that the 60/40 portfolio is the "most common." (d) Lastly, the resulting proposal leads to what North Pier believes are overly broad inclusions in the key 50%–70% corridor. We also challenge the use of a "widely used set of OCIO indices" as the basis for the CFAI WG's proposed composites in both the liability-focused and Total Return categories. North Pier implores the CFA Institute to ensure that all endorsed composite definitions are detailed enough to allow for value in making effective comparisons amongst OCIOs. From North Pier's perspective, this is the most important aspect of a set of standards for them to be valued and respected in the industry. The reasons for our above-mentioned answers are as follows**.**

Q4 Qualification of Observations

North Pier has directly observed hundreds of actual and OCIO proposed client portfolios in our 11 years of conducting OCIO search and evaluations and still many more in our collective institutional consulting histories. This experience spans significant work with endowments, foundations, pensions, health systems, and institutional family structures. Further, as stated previously, this experience is augmented with five years of interaction and deliberation with the OCIOs that have been participants in DIMWG.

NPSC Answer 4(a) - Liability-Focused Composites

North Pier disagrees with the liability-focused composite definitions expressed in the Exposure Draft, primarily because the CFIA WG's approach does not factor the duration of hedge assets. The most meaningful impact on the performance of the hedging assets used in a liability-focused portfolio is the duration of those assets, which is purposely set to match a desired interest rate hedge. When interest rates move meaningfully, the more hedged a portfolio is, and the longer duration that hedge is targeted to, the more impactful interest rate moves will be on the performance of that portion of the portfolio and of the portfolio as a whole. This has very little to do with an OCIO's performance.

Further, North Pier disagrees with the approach expressed in the Exposure Draft in terms of assuming liability hedging is directly in proportion to the "Allocation to Liability Hedging Assets" and further assuming that the rest of the portfolio is allocated to "Growth Assets." This is an improper approach, as bond duration can vary regardless of the amount of assets utilized. Performance attributes for these sleeves is driven by the duration of bonds or derivatives purchased with the allocation. Additionally, an OCIO can replicate substantial amounts of duration with far smaller amounts of assets if they utilize derivatives to implement the hedge.

Though it appears that the CFAI WG contemplated some of these complexities (e.g., "return calculation challenges"), they chose not to incorporate them to "make the composite structure understandable for clients." Unfortunately, in so doing, the "asset allocation percentage" approach to composite structure is so overly broad and disconnected from the fundamental performance mechanics of liability-focused portfolios that it is unusable at best or leads to improper conclusions at worst.

As mentioned earlier, OCIOs managing liability-focused portfolios don't just manage plan assets for growth, but they also manage the gap between the present value of future liabilities and plan assets. In the example of a defined benefit plan, a younger demographic for a plan that is still accumulating benefits may have a much longer duration of liabilities than a plan that is frozen to new benefits and participants and has an older demographic. The difference between the views on hedging interest rate risk may vary between the two sponsors as well, as might the ratio of funding of the plans as well as the expected corporate contributions. None of these things have anything to do with the OCIO's approach to investing, but they do have a material impact on the duration of plan liabilities and each sponsor's target for hedging them. As a result, one of the biggest impacts, if not the biggest, on these plans' performance can be the individual circumstances of each plan and the resulting duration of its hedged portfolio, not the investment results of the OCIO's strategy.

One needs to look no further than the recent two years to understand this phenomenon. With generationally unprecedented spikes in interest rates in 2022 and 2023, the impact on asset values and, thus, performance has not necessarily been due only to the amount of assets used for the hedge but to the duration (or interest rate sensitivity) of the hedge itself. Long government bonds, which are frequently used to hedge interest rate exposure in defined benefit plans, have lost over a third of their value in the last 24 months while taking on nearly three times as much volatility as traditional aggregate bonds. The difference in performance for two portfolios with identical return-seeking components,

when one is 25% hedged to a 10-year duration of liabilities (for an older demographic) versus the other portfolio that is 90% hedged to a 15-year duration of liabilities (for a younger demographic) could have seen a difference in asset performance of over ten full percentage points.

North Pier cautions the CFA Institute on taking such a simple approach to liability-focused portfolio composites. It would be better to exclude this type of account from any composite altogether until such time as consensus can be reached on how to create reasonably symmetrical composite groups that would allow for effective evaluation and "fair representation" of what they intend to depict. This is where applying the full existing GIPS standards to OCIO strategies may run into an obstacle. If the CFAI insists on applying Provision 3.A.2 of the 2020 GIPS standard, that "All actual, fee-paying, discretionary segregated accounts must be included in at least one composite," then we would suggest it provide full disclosure about the shortcomings of the composite and recommend that they not be relied upon for comparison purposes. Ultimately, this is where the traditional GIPS framework may conflict with the unique needs and characteristics of the OCIO marketplace.

Benchmark Comment in sample report

Also, note the Exploration Draft's definition of "Hedging Assets" may be confusing without further definition. Simple aggregate bonds can be a hedging asset but not used for the purpose of implementing a hedging strategy.

NPSC Answer 4(b) - Total Return Composites

North Pier implores the CFA Institute to ensure that all endorsed composite definitions are detailed enough to allow for value in making effective comparisons amongst OCIOs. From North Pier's perspective, this is the most important aspect of a set of standards for them to be valued and respected in the industry.

Although North Pier can appreciate the CFA WG's intention to make the composite corridors wide enough to allow "smaller" OCIOs to populate enough client data in a given category to be compared, we do not believe that that this interest outweighs the interest of the asset owner and their right to be able to rely on meaningful composite data for comparison purposes. As with all emerging businesses, these smaller OCIOs will need to grow organically to increase the sample sizes of their composites. If their track records and services are compelling, then they will succeed.

North Pier supports (and voted for) the return-seeking asset composite corridors for total return asset owners that were overwhelmingly agreed upon by the voting membership of DIMWG in 2022.

- **0 to <30%
- 30% up to <45%
- 45% up to <60%
- 60% up to <70%
- 70% up to <80%
- 80% or more

As such, North Pier agrees with the CFAI WG's findings for growth-seeking mandates at 70% or higher. However, based on our direct experience and through conversations with many leading OCIOs, North Pier believes that the most commonly used total-return mandates (60%–80% growth-seeking) should be separated into 10% segments to facilitate effective OCIO-to-OCIO comparison. Our suggestion differs most materially in the corridors between 45% and 70% (as seen below).

Below is a comparison of the approved DIMWG consensus findings & the suggested corridors from North Pier and the initial suggestion of the Exposure Draft:

North Pier & DIMWG	0%	CFAI WG
Up to <30%	20%	0–24%
	25%	
	30%	25%–49%
30% up to <45%	45%	
45% up to <60%	50%	50%–69%
	60%	
60% up to <70%	70%	
70% up to <80%	80%	70%–79%
80%–100%	100%	80%–100%

(Source: DIMWG. DIMWG: Discretionary Investment Management Working Group on Data Standards; CFAI WG: GIPS Standards for Outsourced Chief Investment Officers Working Group. For DIMWG data above, "<70%" means up to but not including 70%)

North Pier restates the example that DIMWG provided in its comment letter to the CFA Institute:

"DIMWG highlights this difference for CFAI's consideration and provides an illustration for the CFA Institute's consideration:

> Contemplate the 41 basis point dispersion of expected return that a simple passive portfolio comprised of Growth-seeking (AC World Equity*) and Preservation (U.S. Aggregate Bonds*) experiences between the 50% growth-seeking and the 65% growth-seeking portfolios.

	% Growth		
	50%	**60%**	**65%**
Total Blended Return	6.45%	6.72%	6.86%
Difference from 50% Growth		0.27%	0.41%

* Expected return computed from the most recent JP Morgan capital markets assumptions for 2024 of U.S. Aggregate Bonds of 5.1% and AC World Equity of 7.8%."

North Pier agrees with the consensus formed by DIMWG participants that no more than a 10% spread should be used for the often-used 60% and 65% return-seeking portfolios. North Pier believes that anything wider provides less meaningful comparisons and skews results to be based on the dispersion of *client objectives* and not the *variability of OCIOs' returns*. Along those lines, the Exposure Draft's suggested spread of 20% for those with a return-seeking portion from 50% to 70% is too wide. The illustration above shows the expected variability of just 15%**.** *We request that the CFA Institute consider an additional division at the ~60% mark.* As there are very few return-seeking portfolios in the sub-50% return-seeking range, we do not have major concerns about the difference in the lowest two corridors.

NPSC Answer 4(c) – The 60/40 Portfolio

North Pier challenges the assertion in the question itself that the 60/40 portfolio is the "most common" portfolio. In over a decade of conducting OCIO search and evaluations, North Pier has found far more asset owners (except for those that are liability-focused) with 65% to 75% allocations to growth-seeking instruments. If this assumption is to be relied upon, we suggest further research into the true facts in today's OCIO marketplace.

NPSC Answer 4(d) – Use of Existing OCIO Indices as Basis – No Established Precedence

The CFAI WG stated that OCIO indices that were "widely used" formed the foundation of the composites. North Pier asks if this was a broad and general statement that was not supported by market share evaluation. Although our observation as a search and evaluation firm is a collection of anecdotal observations (although quite a few of them), we do not find that the referenced indices are in any way widely used in comparison to the tens of thousands of asset owners and thousands that use OCIO services. Regardless of their use, they do not represent a "standard" akin to the Dow Jones Industrial Average (DJIA). They are only the *first* commercial indices of what will likely be many more applied to the OCIO industry over the coming decades. Similar to the DJIA, more indexes were later created by other providers to better reflect both the usability of the indexes (take the 500 stocks of the S&P 500 vs. just 30 of the Dow as an example) and different views of the ways of assembling membership (e.g., the Russell 1000 vs. the S&P 500). The CFA Institute GIPS standards should not favor the first of these OCIO indices due to their time of creation. Composites should be concocted based on the actual groupings of similar asset owner mandates in the real world, as well as the way data is used and useful. Otherwise, one could argue that the North Pier corridors, created in 2014, which have been in wide commercial use in search and evaluation for far longer than the referenced commercial indices, should be used for the

CFAI standard. On their face, they should not. The CFA Institute should look at this topic objectively and without prejudice.

Legacy Assets

Q5: Do you agree with the proposed three options for the treatment of legacy assets?

NPSC Answer: No. North Pier does not agree with the third option: "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." It is our opinion, and the opinion of most North Pier has consulted in the industry, that OCIO composite performance should be all or none. If an OCIO finds that any legacy asset or a group of legacy assets creates too much distortion to make the whole portfolio reflective enough of the OCIO's broader body of works, the OCIO should label the account as not fully discretionary until such time as the investment(s) no longer represent such a meaningful impact. Until then, the account should not be included in performance for the composite. The OCIO can make said determination on a case-by-case basis and memorialize the not full discretionary nature of the relationship, or the OCIO could set a maximum exposure to said undesirable legacy assets to render their impact di minimums to the account's attribution**.**

The CFAI WG did not outline the treatment of the non-legacy-impacted portion of the portfolio. Would just the surviving portion be operated under its own mandate and subsequent allocation policy? Or would the policy of the whole portfolio, inclusive of the undesirable portion, be used for composite selection? The simple variability of different circumstances leaves far too many variables that would need to be disclosed and ultimately fully investigated and understood by the asset owner or third-party evaluation firm. This is especially true for organizations that have significant legacy holdings. Their exclusion from performance composition could potentially significantly distort the meaning of the performance of the remainder of the portfolio. It can only be assumed that the OCIO would be building a portfolio that complements the undesirable legacy holding, regardless of whether they approve it or not. As such, the individual circumstances of each portfolio would have far more bearing on the performance of the remaining portion of the portfolio than the OCIO's prowess. It is North Pier's position that, ultimately, composites should provide a true reflection of the OCIO's collection of performance data from buckets of clients that have meaningful symmetry amongst them. If the proportion of undesirable legacy holdings is only slight, then the OCIO should have the right to accept them due to the fact they feel that the impact would not meaningfully change the overall portfolio's performance characteristics. If the impact would be great, this itself proves the point that the OCIO would likely be offsetting that position's impact on the portfolio with an atypical allocation on the remaining portion. Either way, a partial performance would not be truly reflective of the OCIO's impact on the portfolio in a symmetrical way compared to other non-impacted portfolios and, as such, would only distort data from the OCIO going into the composite.

North Pier supports both the contractually defined approach (determining full portfolio discretion and thus inclusion in composites in the client's Investment Management Agreement) or a maximum legacy assets threshold approach (setting a firmwide policy on the maximum amount of legacy assets allowed

to be included in the firm's composites). These approaches were both vetted and overwhelmingly approved by DIMWG's voting participants. North Pier cautions that letting OCIOs pick and choose account-by-account (as we believe option 1 allows) could leave the door open for gaming the system due to the reporting lag prevalent in the private markets.

Required OCIO Composite Returns and Fee Schedule Disclosure

North Pier has made a great effort to fight for disclosure of all fees and costs associated with OCIO-led portfolios, as well as disclosure of indirect benefits and conflicts that may arise from an OCIO relationship. Although clear and understandable disclosure is necessary and should be expected from fiduciary relationships, simple disclosure is not enough due to how many OCIO engagements and proposals are situated. North Pier found situations in the past where disclosures were made, but in a manner that could be only characterized as *non-forthright*. As such, North Pier believes that a standard fee reporting template, or an exhaustive set of categories, is the only way to ensure that asset owners and third-party evaluators <u>of all capabilities</u> have detailed enough information to make a proper assessment of the fees and costs in a given OCIO relationship. We believe that the template agreed to at the November 2022 meeting of DIMWG ("Final Fee and Cost Framework") should be compared to that of the proposed CFAI disclosures for completeness.

Q6. Do you agree with requiring firms to disclose information about their policy for the treatment of legacy assets?

NPSC Answer: Yes. North Pier believes that substantial and proactive disclosure of an OCIO's policies for the treatment of legacy assets is paramount as it pertains to composite composition.

Q7. Do you agree with requiring both gross-of-fees and net-of-fees returns for Required OCIO Composites?

NPSC Answer: Yes. North Pier believes that the proposed gross-of-fees and net-of-fees return reporting detailed in the Exposure Draft is a sound course of action.

<u>**Additional Areas for Comment**</u>

Suggest Including Liquidity Corridors in Composite Definitions

North Pier strongly suggests that the CFA Institute add composite segmentation based on a portfolio's allocation to and/or budget for illiquid assets. The one thing that truly differentiates return-seeking portfolio's characteristics besides their target allocation to return-seeking assets is the asset owner's proportion of investments intended for illiquid assets (e.g., maximum illiquid asset exposure).

Over the last several years, North Pier has listened to most leading OCIOs lobby for more meaningful inclusion of illiquid assets in appropriate client portfolios in order to increase expected returns. In client and prospective client presentations, OCIOs routinely suggest that there is an illiquidity premium that would be expected on returns of 300 to 500 basis points, not including manager Alpha. North Pier has

directly observed in its client portfolios, as well as in the projections of proposing OCIO candidates, variation of over 100 basis points of expected return just based on illiquidity budgets.

Though some types of asset owners may routinely have the ability to absorb more illiquidity in their portfolios (e.g., endowments, foundations, healthcare systems, and public pensions funds), North Pier believes that it is ultimately the final determinant of illiquidity budgeting that is the important factor that leads to variability of expected returns (assuming return-seeking targets are generally equal), not the client type.

If industry assumptions of illiquidity premium hold true, OCIOs with a concentration of clients with higher illiquidity budgets would likely have resultant higher composite returns. Again, this is problematic because this would lead to a false perception of the OCIO's capabilities when, in actuality, it may be the OCIO's client mix that is determining the performance. Even more concerning is the possibility that, knowing that this phenomenon exists, certain OCIOs may pressure clients into higher allocations of illiquid investments to positively impact returns for market-competition purposes and not necessarily for reasons that are aligned with the client's objectives and liquidity needs.

Again, it is North Pier's experience gained over more than a decade of both examining OCIO returns and observing the marketing practices of certain OCIOs that leads us to believe that for composites to be "fair representations" of an OCIO's prowess, the CFA Institute must include illiquidity as a factor in segmenting different clients and their respective portfolio data.

Note: Simple disclosure suggested in the Exposure Draft's Material Disclosure Section (which is not specifically required) is not enough, nor does it provide the evaluator with sufficient information to contemplate the extenuating circumstance(s) or comparable peer groups among which to conduct the evaluation.

Conclusion

We understand that the "purpose of this Guidance Statement is to provide guidance on how to apply the GIPS standards to OCIO strategies." While this initial approach has led to substantial progress, we request that the CFA Institute and the working group refine their initial findings in light of what is most helpful to the asset owner and what builds the most credibility for the OCIO industry as it enters its next chapter. North Pier hopes our observations are of value as the Institute embarks on the next phase of crafting a performance and data standard.

Respectfully submitted,

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