Northern Trust Response to Guidance Statement for OCIO Strategies

Question for public comment:

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

Given the unique nature of investment committees, there are many instances when decisions are made to exclude certain asset classes (High Yield, Private Equity, Hedge Funds, etc) that would normally be a part of recommended portfolios under our OCIO strategy. As a result, many clients will be excluded from the Guidance Statement and composite. Additionally, most clients have an existing IPS with Strategic Allocations when added as new clients. Many of these new clients will not change their long-term plans to completely align with OCIO recommendations.

It is unclear when a client funding a new PE allocation should be required to be included in the composite. Depending on the program, we fund that a mature program can take up to 7 years to fund and for performance measurement to reflect the economic reality of the investment.

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

Yes, this will assist investors in better understanding a firm's historical performance of similar accounts and strategies and begin to develop a baseline of performance across firms.

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

Yes, due to the unique and differentiated approach in constructing these portfolios, we agree that segmenting them for performance purposes is appropriate.

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?

We think a presentation based on risk profiles makes sense but there is a risk that the ranges drive behavior. The caveat of, "portfolios must be assigned based upon the portfolio's target asset allocation, not the actual asset allocation weights" presents some challenges. Since OCIOs generally set the strategic targets and the ranges used by their clients, they could use the CFA designated ranges to improve their performance rankings. By using the strategic allocation targets, a firm may enhance performance by consistently and materially overweighting risk assets relative to the target but still within the permitted bands. This could mislead investors to conclude that performance is based on skill and not just the overweight of risk assets. Additionally, the language, "firms will have discretion to determine how these assets are categorized" and "emerging market debt might be considered risk-mitigating at one time but considered growth at other times", there seems to be an opportunity to materially increase a portfolio's risk profile to enhance returns by changing how assets are categorized. We suggest the mandatory inclusion of risk metrics in the reporting (Sharpe ratio) to assist investors in understanding the risk assumed to generate the returns provided.

Additionally, the current framework neglects to draw a distinction between investors who are Qualified Purchasers ($25mm and above) who can access illiquid investments and those who cannot. We believe creating a distinction between these two groups (and portfolio approaches) would help smaller clients better understand potential performance of portfolios aligned to their current constraints.

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

7. Do you agree with requiring both gross-of-fees and net-of-fees returns for Required OCIO Composites?
   The use of Gross of Fee returns will be complicated with Alternative investments in comingled funds.

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?
   With the performance of PE greatly outperforming other asset classes, using a 5 year date will amplify the ranking of firms over allocated to PE. A shorter time frame will allow any potential correction in that market to be better reflected by the time these rules are mandated.

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

Given the work required to track and report on these new standards, we believe 24 months is necessary to fully comply and begin reporting.