

# Response on Exposure draft guidance statement on benchmarks for asset owners

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From: CFA Society VBA Netherlands - Investment Performance Measurement committee

Please find below a number of comments and responses to the questions as raised for public comment in the Exposure draft guidance statement on benchmarks for asset owners.

## Page 6, Types of benchmarks, 4<sup>th</sup> paragraph:

*“A target return benchmark may also be used to compare the success of a strategy with a fixed level of spending or liability matching. Target return benchmarks, however, do not have certain characteristics of a valid benchmark. For example, they do not reflect an investment mandate, objective, or strategy; and they are not investable.”*

Comment: A target return benchmark does represent a clear investment objective in our opinion, namely to generate a return similar to this target return. One not yet named limitation of the use of target return benchmarks is also that it does not provide any expectation regarding the risk that the investment mandate is expected to take to generate the return. The standard deviation of the target return benchmark is typically zero indicating no risk at all.

The calculation methodology of a hurdle benchmark should at least be available upon request, if not included in the disclosure. The time period that a hurdle is added, whether the calculation is arithmetically or geometrically and how often (part of the hurdle) is added (every month, twice a year or once a year) leads to different results.

## Page 7, section d:

With regard to disclosing benchmark components we think it is important to state to what extent the disclosure should be performed. The level of disclosure as stated in the example, looks OK. It might be that in case asset owners with complex customized benchmarks have to disclose its components, that this disclosure might also run into problems (e.g. confidentiality / intellectual property of the benchmark provider).

## Page 10, section d.iv: Custom Net Benchmark:

Comment: Asset Owners often pay different Tax regimes than the public available benchmarks and typically they are lower. In this section there are comments on fees and transaction costs which are

at least of the same size as taxes if not lower. Including a comment on how to apply gross and net of taxes would be very beneficial for the industry.

Question for public comment:

*“Do you believe that asset owners commonly use custom benchmarks that reflect the deduction of fees or expenses? Which disclosures are necessary to accompany this type of benchmark?”*

Response:

In general no: typically the portfolio returns are presented gross and net of fees. The fees are not applied to the benchmark. Taxes are a different story that might need more attention. However, a number of pension funds as asset owners do use custom benchmark after deduction of fees or expenses. Required disclosures are in that case the kind of customization, the reason for customizing and documentation of both.

Page 12, Question for public comment:

*“Do you believe that benchmarks adjusted for leverage should be allowed to be presented in GIPS Asset Owner Reports? Which disclosures are necessary to accompany this type of benchmark?”*

Response:

Yes, a leveraged benchmark can give be a good representation of the expected risk and return profile of an asset class or investment mandate. Arguably even better than a target return due to the leveraged risk profile that might be more representable for the asset class. Disclosures should contain a description of the calculation methodology as well as a description of any benchmarks used.

Page 13, Question for public comment:

*“Do you agree with the types of benchmarks used by asset owners? Should we modify any explanations of the benchmark types? Are any benchmark types missing?”*

Response:

- Duration adjusted market benchmarks might need a notice since this is regularly used (although this is discussed on page 14) .
- Currency-hedged benchmarks can also be seen as customized (partly hedged, or with bespoke methodology). The hedge percentage, which currencies and the methodology should be disclosed. This is mentioned on page 13 section b, but might be moved upwards.

Page 16, Question for public comment:

*“When an asset owner is transitioning from one asset allocation to another, it may wish to present the policy benchmark using weightings that change incrementally during the transition period, adhering to a predefined schedule. Do you agree that asset owners should be allowed to change asset class weightings incrementally to include interim weightings in order to match the total fund*

*weights in GIPS Asset Owner Reports, rather than using a policy weight benchmark? Which disclosures are necessary to accompany this type of benchmark?"*

Response:

Yes, we think that asset owners should be allowed to change asset weightings incrementally; a policy benchmark should have the possibility of transition periods to be reflected somehow. A policy can be changed from one day to the other, but it usually takes more time to adjust the portfolio, and the relative performance should not have to many impact from these changes.

Using transition weights is in our opinion a valid investment approach (although not very common), and as long as it is well documented (as with other policy benchmark weight changes) should be allowed.

Page 16, Question for public comment (2):

*"Do you agree that asset owners should be able to present an actual-weight benchmark in GIPS Asset Owner Reports instead of a policy weight benchmark? Which disclosures are necessary to accompany actual-weight benchmarks?"*

Response:

In the case that a policy benchmark is available we would not suggest to present an actual-weight benchmark since this might lead to misleading information. However, the use of actual weightings in the policy benchmarks (to reflect the problem allocation problem to illiquid asset classes) should be allowed. Especially if the asset owner does not take active allocation decisions, otherwise fixed weights should be used. Asset allocation can vary over time; asset owners usually have target weights but not always rebalance their portfolio. Disclosures should be clear on the way rebalancing is executed, if asset weights are used.

Page 17, Question for public comment:

*"Do you agree that asset owners should be allowed to present a lagged benchmark to match the date of lagged valuations in the asset class of a total fund or additional composite? Which disclosures are necessary to accompany a lagged or partially lagged benchmark?"*

Yes, we agree that in that case lagged benchmarks to match the date of lagged valuations can be used. The benchmarks used for specific asset classes should match the return expectation of those asset classes. Therefore if the return incurred by the asset classes only take the lagged valuation into account from the day they receive this information than this process should also be reflected in the benchmark.

Page 18, last paragraph:

We think the restriction not to combine TWR and MWR might be too hard and suggest to make it a recommendation. If the most suitable benchmark is a MWR benchmark, GIPS would forbid you to aggregate these into a policy return, forcing asset owners to use less suitable benchmarks. Disclosure of these combinations should be required in that situation.