



August 18, 2022

GIPS Standards Technical Committee
CFA Institute
915 E High St.
Charlottesville, VA 22902

Re: Exposure Draft Guidance Statement on Benchmarks For Asset Owners

Dear Members of the GIPS Standards Technical Committee:

First, I want to thank you for the opportunity to comment. And second, to applaud you for creating this document. The subject of benchmarks is both an interesting and challenging one, especially for asset owners.

Preliminary comments

I believe that for most asset owners, there should be at least two benchmarks:

- one to assess how the organization did in terms of meeting its overall objective; such an objective is, at times, derived by actuaries and may be referred to as the “targeted actuarial rate of return” or simply the “target return.” Since the time-weighted return would not be an appropriate one to use, the institution should calculate the internal rate of return for comparison to its target.
- the second to see how well the investments did, based on the selection of managers and allocation across asset classes, sectors, subsectors, etc. Here, it is typical to use time-weighted returns.

On page 1 we find the following:

“Total funds often use a policy benchmark. Asset owners may do an asset–liability¹ study or another type of analysis to arrive at the asset classes and appropriate weightings [*sic*] (e.g., strategic asset allocation) to achieve an expected return and risk profile for a total fund.”

I believe asset-liability studies are typically done to determine the institution’s funding requirements. E.g., a pension fund that can determine the benefits they will make in the coming year,

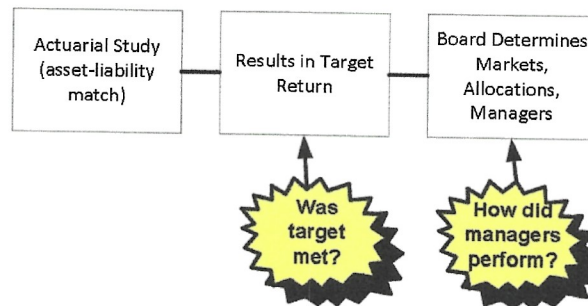
¹ It appears you are using a dash (–) between “asset” and “liability,” where I believe a hyphen (-) should be used.

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relative to the anticipated funding that it will receive. The asset class selection, along with the allocations to them are, I believe, separate exercises. The study is often performed by actuaries, from which the target return will be provided. The board would likely be the ones to determine what their selections/allocations should be to hopefully meet the associated return.

The following schematically explains my beliefs in terms of benchmarks:



On page 1 you mention the target benchmark: “Some asset owners instead use a target return benchmark, whereby a target return is established that indicates the return needed to maintain a minimum or desired level of assets for a total fund.”

What is important to mention is that the target return needs to be calculated using a money-weighted return (ideally, the IRR). The reason is that cash flows can cause a time-weighted return to fail to properly assess how well the institution did relative to its target. Most performance measurement professionals are aware that there are times when a time-weighted return can be positive, even though the fund lost money (or vice-versa); this is not the case with money-weighted returns. The Standards recommend that asset owners report a money-weighted return, and this dialogue can empathize its value.

Total Return Benchmark

On page 5 you state that a total return benchmark is required, which makes sense. This is an opportunity to explain what that benchmark does. It serves to allow the institution’s board (and other stakeholders) to assess how well the board’s investment decisions (in terms of market, selection, and managers) did, in aggregate. It does not, in most cases, serve to indicate how well the plan did relative to its target, because of the shortcomings of time-weighted returns.

Rebalancing frequency

You touch on this, and I believe it is important to state that the benchmark’s rebalancing should be in line with the rebalancing of the overall portfolio: otherwise, how can we properly assess performance?

An example: we rebalance the portfolio quarterly and the benchmark daily; our allocation is 60% stocks, 40% bonds. The stock market is hot, and over the quarter, its percentage of the overall portfolio grows to 85%. Because the benchmark wasn't allowed to drift, in response to the stock market, it keeps resetting to 60/40, and so will not have the same level of performance as the portfolio. Synching the rebalancing provides for a better comparison.

Questions 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?

No, but they should, as they provide a more meaningful representation of the institution's success. A simple disclosure would be sufficient. Deduction of fees and expenses should not be part of the target benchmark.

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?

Yes, if the institution feels it will be of value. A simple disclosure stating the use of leverage should suffice.

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?

Yes; no need to; not that I am aware of.

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?

Definitely. Only that this is being done, with perhaps details in terms of the changes and timings.

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?

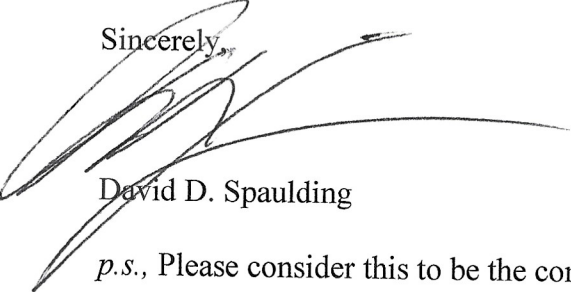
An *actual-weight benchmark* reflects the tactical decision; in general, this should not be allowed.² That is, the benchmark should be based on the strategy. That said, if asset owners feel this approach has value, then it probably should be permitted. That said, I would discourage their use. As for disclosures, explaining that this is being done and perhaps the downside, as it fails to compare relative to the strategy.

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. Simply state this is what is being done.

Again, thank you for the opportunity to comment. I hope what I've shared has some value.

Sincerely,



David D. Spaulding

p.s., Please consider this to be the comments of The Spaulding Group. Thank you.

² If the benchmark is aligned with the tactical decisions, it becomes difficult to evaluate whether those decisions (to veer from the strategy) were wise or not. E.g., simple example: our strategy is 60% stocks, 35% bonds, and 5% cash. We make the decision to increase exposure to stocks, so that our actual allocation is 70/25/5. If the benchmark is the same, do we know whether the over-weighting was good or bad? I do not believe so.