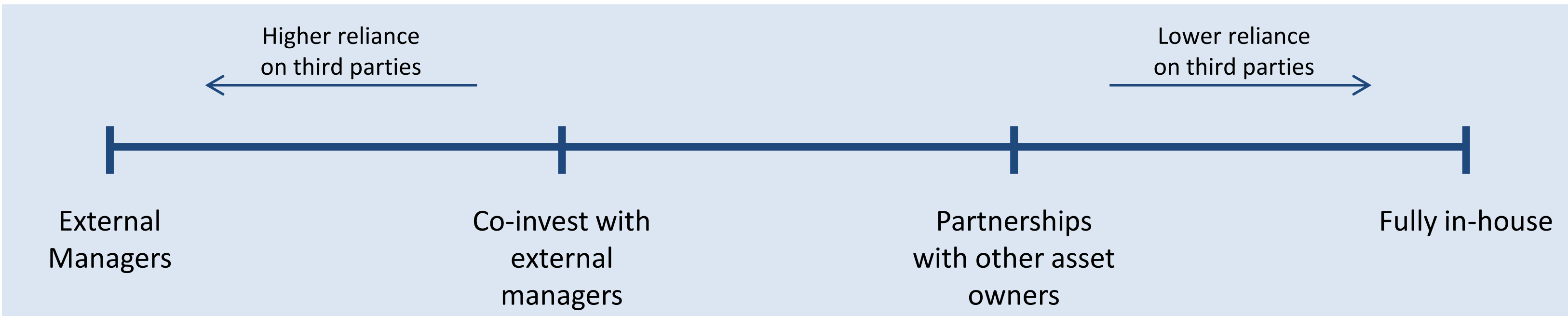
International Forum of Sovereign Wealth Funds

November 8, 2016

Building In-House Investment Capabilities

Why bring investment activities in house?

A spectrum of choice not always the best practice



Possible benefits as in-sourcing is increased

- Could yield higher net-of-fees returns on certain strategies
- Creates better alignment by reducing principal-agent conflicts
- Creates greater bargaining power with third parties, since you have credible internal alternatives
- May provide access to certain assets, markets or partnerships that would otherwise be unavailable
- May generate insights that then improve a broader set of investment decisions
- Offers the potential for a more responsive portfolio that is a better match with liabilities and market conditions

What challenges do you face beforehand?

A path to implementation

- Establish Board appointment procedures
- Appoint Board with appropriate expertise
- Assess institutional capability for change
- Attract high-quality talent with proper incentives and alignment
- Develop expertise in appropriate fields
- Build out financial and operational risk-management systems

Human Capital

- Appointing appropriate board members to ensure proper governance and resources needed to develop in-house capabilities
- Attracting front office talent with appropriate financial and extra-financial incentives, aligning their goals closely with those of the institution
- Investing in middle and back-office resources to support the front office and ensure a smooth operational transition

Processes

- Establishing appropriate systems for managing financial risks, potentially requiring a chief risk officer and a dedicated risk team
- Developing compliance and control processes, while also minimizing the amount of bureaucratic burden
- Encouraging a culture of responsibility, efficiency, accountability and high performance

Infrastructure

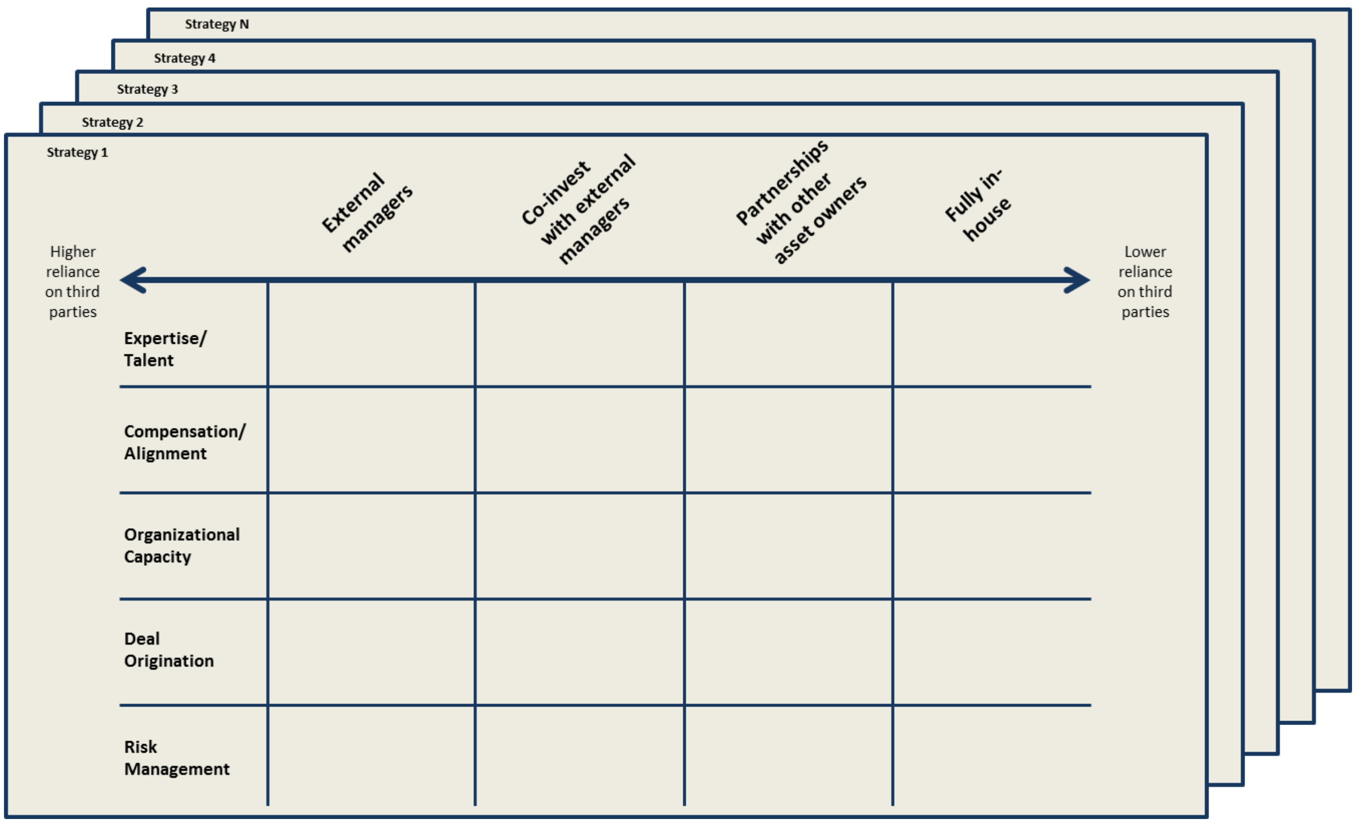
- Developing data systems that allow management to assess risk exposures
- Investing in adequate technologies to support investment activities (e.g. high-frequency trading requires specific, expensive technology)
- Partnerships, brand and deal-origination networks can be considered infrastructure for in-house investment capabilities

Note: Much of this page is based on the framework and insights contained in Clark, Gordon L. and Monk, Ashby H. B. “Principals and Policies for In-House Asset Management”, University of Oxford and Stanford University

What can you expect if you move forward?

- Each strategy you move in-house will have its own trajectory but face a similar set of challenges at each step along the way
- Generally, for each strategy we look at five sets of challenges – expertise, alignment, organizational capacity, deal origination and risk management. Each of these five challenges need to be address not only for each strategy, but then reassessed at each step along the path towards (or away from) in-house investment.

A scorecard for continuous evaluation



What questions are worth asking?

What are your organization's "competitive advantages"?

- Do you have a particular geographic or asset class expertise that could create easier entry into a specific investment style?
- If you already taken full advantage of this edge with respect to your own portfolio, should you syndicate these opportunities with other asset owners? How could peer-to-peer partnerships enable you to benefit from expertise in a given geography or asset class?

What is your organization's "governance budget"?[1]

- How suited is your current governance for the management of in-house investment teams versus work with third parties?
- Does senior leadership have the time to adequately supervise? Is this the best use of their time?
- Can you take the political or "headline" risk of short-term performance fluctuations due to in-house decisions?

What is your business plan for bringing investing in house?

- Do you have the runway and budget to spend years investing internally before the results prove out?
- Are your organization's goals within reach without taking the risks associated with changing your basic business model?
- Are there lower-cost partnerships between asset owners that could help you achieve the same allocation objectives?

1. Clark, Gordon L. and Monk, Ashby H. B. "Principals and Policies for In-House Asset Management", University of Oxford and Stanford University