Practical Topics in Managing Managers: Selection, Monitoring, and Termination

Session 13: Engaging External Fund Managers

Speaker: H.S. Choo

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Agenda

- **Why Work with External Fund Managers?**
- **Common Misconceptions about EFMs**
- **Hiring**
  - Active vs. Passive Approaches
  - Manager selection
  - Fees – Only a Tie-Breaker
- **Monitoring – The Best Teacher**
- **Terminating: Timing & Discipline**

Why work with External Fund Managers (EFMs)

- **Return Enhancement**
  - Access to asset classes not available in-house
  - Capture Alpha opportunities
  - Create synergy with internal portfolio

- **Learning & Capacity Building**
  - Transfer knowledge & upskill Staff
  - Build Institutional capacity for future in-house management

Common Misconceptions about EFMs

- Good Managers always beat the Benchmark
- Lower Fees = Better value
- 2 – 3 bad years → Must punish
- Outsourcing → Fewer staff
- Monitoring = Junior responsibility

Hiring - Active vs. Passive Approach

- **Active: Beat the benchmark**
  - Requires strict due diligence to select the best
  - Needs a bigger allocation to hire 3-4 managers
  - Heavy monitoring burden & resource-intensive
- **Passive: Replicate the benchmark**
  - Lower fee, lower stress, simpler oversight = Piece of mind
  - Best for first-time EFMs
- **Natural Path: Passive → Enhanced indexing → Active**

Hiring - Manager selection

- Past performance ≠ Repeatable skill
- Evaluate investment process, not just returns
  - Return sources: Skill vs. Market environment vs. Luck
- Knowledge transfer adds value
  - Strategy sharing, market intelligence, staff training
  - But it only works with sufficient internal staff
- Big names are safe…but courage brings value

Hiring – Fees as a tie-breaker

- Differ by asset classes, mandate types, and fund size
- Flat vs. Performance fees: Similar cost over time
  - Beware Traps: Negative return + extra fees
- Lowest fee is rarely the best choice
- Consider all factors reflecting the objectives

Monitoring : The best teacher

- Key decisions: Scale up, reduce, or terminate
  - Look beyond numbers → Strategy, Risk, Performance attribution
  - Peer comparison: distinguish manager skill from market effects
- Ongoing process, not a quarterly exercise
- Best channel for institutional learning and capacity building
- Requires senior-level involvement, not juniors

Termination: Timing and Discipline

- Murphy’s Law in managing EFMs
  - Hire after strong track record → disappoint
  - Fire after weak performance→ rebound
- Solution: Close monitoring + peer comparison
- Tenure rule: Keep ≥ 3 years (ideally 5), unless:
  - SAA changes → the mandate no longer needed
  - EFM’s Strategy drift or key staff departure
  - Major operational risk issues

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Thank you