



# Engaging External Fund Managers

OCTOBER 2023

RESERVE MANAGEMENT DEPARTMENT

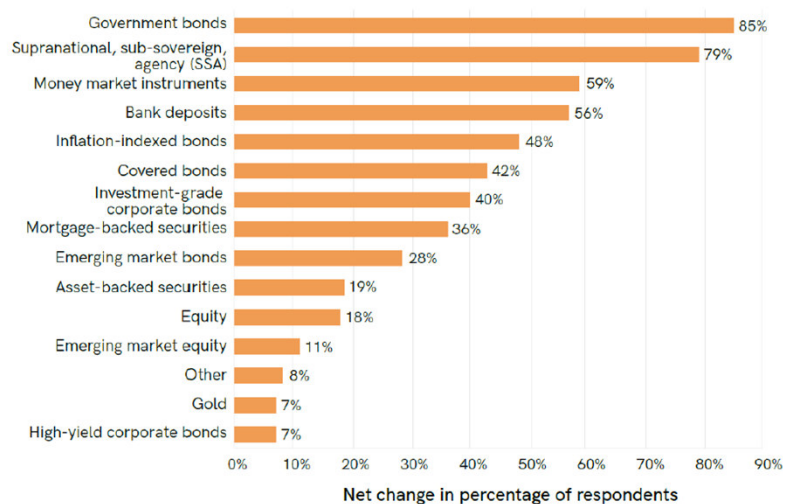


# External Portfolio Managers in Central Bank

## Background

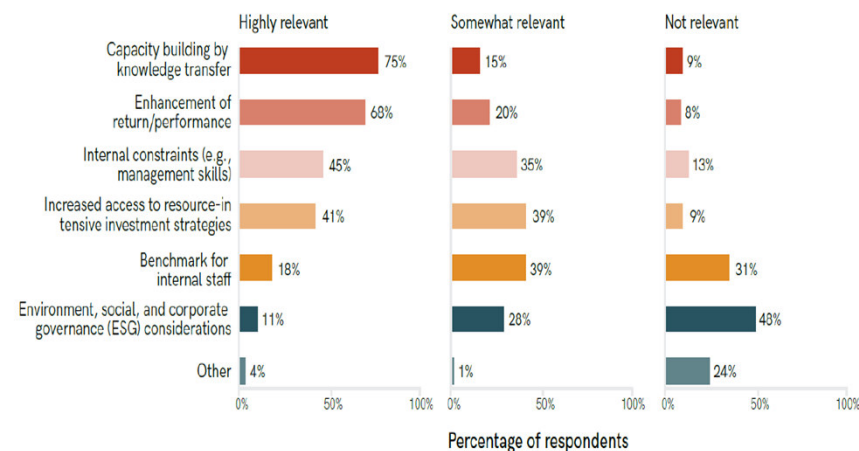
Central banks commonly explore more diverse investment options for various reasons, with knowledge transfer and return enhancement being among the top motivations.

### Asset classes approved by central banks for external managers



N=85.

### Central banks' motivation to have external managers

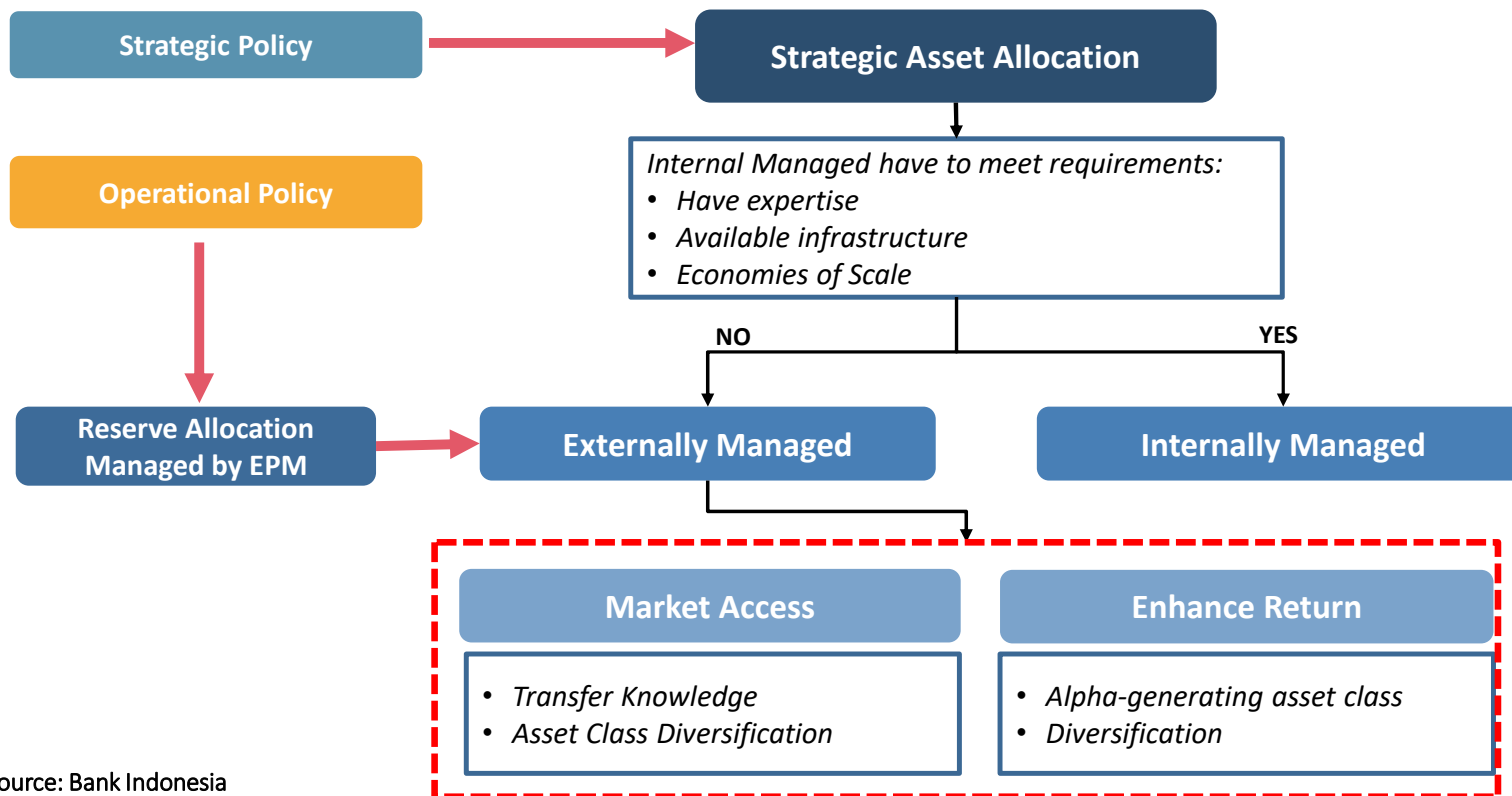


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Source: Third RAMP survey on the Reserve Management Practices of Central Banks

# External Managed Framework

- Strategic Partnership with External Fund Manager is part of FX Reserve Management Strategy to implement strategic asset allocation (SAA)
- Main reason for using EFM are : i) Gaining market Access and ii) Enhance Return



Source: Bank Indonesia

# Evolution of External Fund Manager Partnership

*Bank Indonesia has been collaborating with a variety of external fund managers, with their current emphasis being on mandates related to spread products.*

EFM Mandates	2002	2011	2012	2013	2019
Government Bond	✓				
EMLC		✓	✓	✓	
EMUSD		✓	✓	✓	✓
Corp			✓	✓	✓
MBS				✓	✓
MSFI					✓

International Financial Cooperation	2005	2019	2020
BIS – ABF 2	✓	✓	✓
WB RAMP – US MBS		✓	✓
BIS – BISIP G3			✓

## Factors to be considered:

### 1. Level of Reserve

The larger the reserve, the more diverse the asset classes

### 2. Strategic Asset Allocation

Outlook, Risk Appetite, LT Strategic Business Plan

# The Need for Effective Management

*Establishing an external management program requires a comprehensive process for selecting, evaluating, and replacing asset managers, which also incurs costs.*

## EPM Management Cycle

- 4. FOLLOW-UP**
  - DIMA Adjustment;
  - Mandate Addition or Reduction,
  - Termination
- 3. EVALUATION**
  - Monthly
  - Quarterly
  - Yearly



### 1. SELECTION

- Planning ( Type of Mandate, Allocation, management Style, benchmark and investment guideline)
- Selection ( Interview, Due diligence)
- Appointment (Fee negotiation, legal document)

### 2. MONITORING

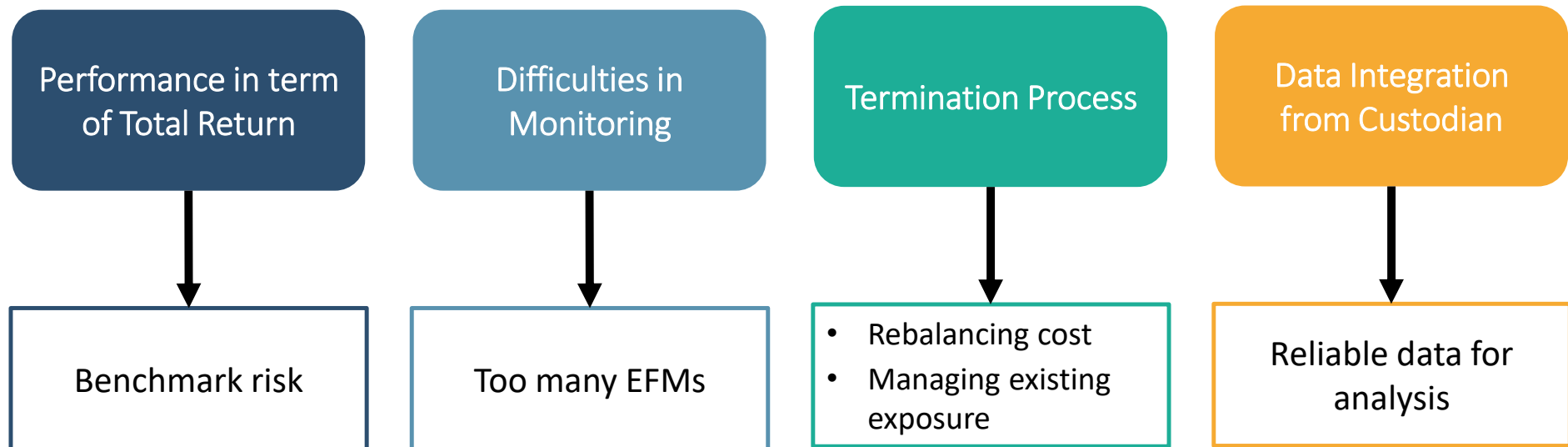
- Compliance ( Limit TE, Derivatif, eligible asset)
- Performance ( 3yrs Excess Return, IR, consistency)

Source: Bank Indonesia

*Note: In every stage, close coordination with Risk Management Department is being maintained.*

# Lesson Learned

*Overseeing diverse external fund managers, each with their own unique mandates, offers valuable insights that contribute to improved management of the current EFMs.*



# Next Step

*To improve the management of EFMs, the next step involves aligning EFM management with reserve management purposes, strengthening the assessment and guidelines for each EFM, and effectively communicating these changes to the EFMs to support BI's mandate.*

## Aligning

*Benchmark Modification*



*Asset Allocation, Portfolio Duration, Issuer Category*

*Reviewing Number of EFM*



*Selection on existing EFM, reduce EFM around 3 for each mandate*

## Strengthening

*Assessment on Fees Structure*

*Investment Guideline Review*

## Communicating

*Communicate BI mandate to preserve capital.*

*Explore potential mandate which inline with BI's mandate to preserving capital*

# Conclusion

- 01.** Strategic Partnership with External Fund Manager is part of FX Reserve Management Strategy to implement strategic asset allocation (SAA), with main reason for using EFM are : i) Gaining market Access and ii) Enhance Return
- 02.** Bank Indonesia has been collaborating with a variety of external fund managers, which offers valuable insights that contribute to improved management of the current EFMs.
- 03.** The current financial market turmoil poses lesson learned in the management of foreign exchange reserves through EFM, such as: i) Alignment of investment strategy with central bank mandate, ii) monitoring of many EFM, iii) termination process and iv) data management.
- 04.** The next step involves aligning EFM management with reserve management purposes, strengthening the assessment and guidelines for each EFM, and effectively communicating these changes to the EFMs to support BI's mandate.



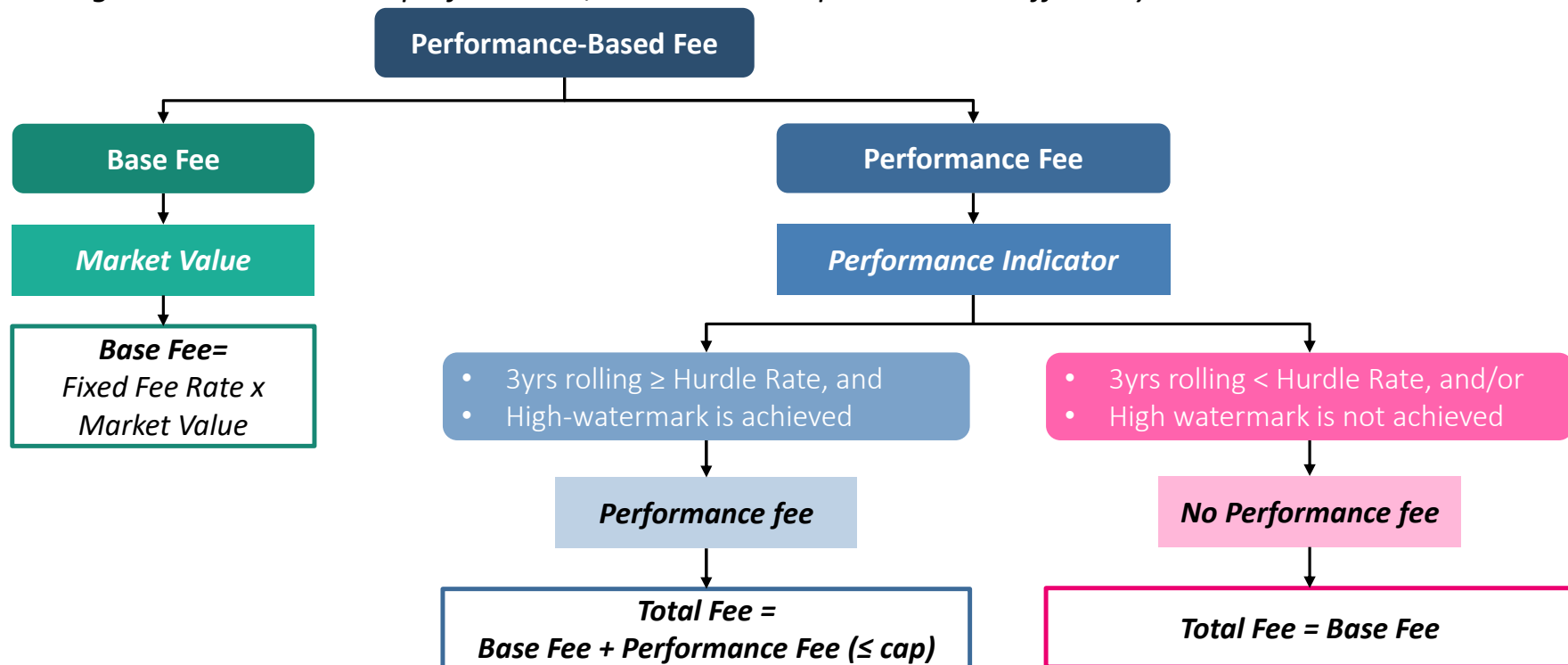
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**THANK YOU**

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# Management Fee

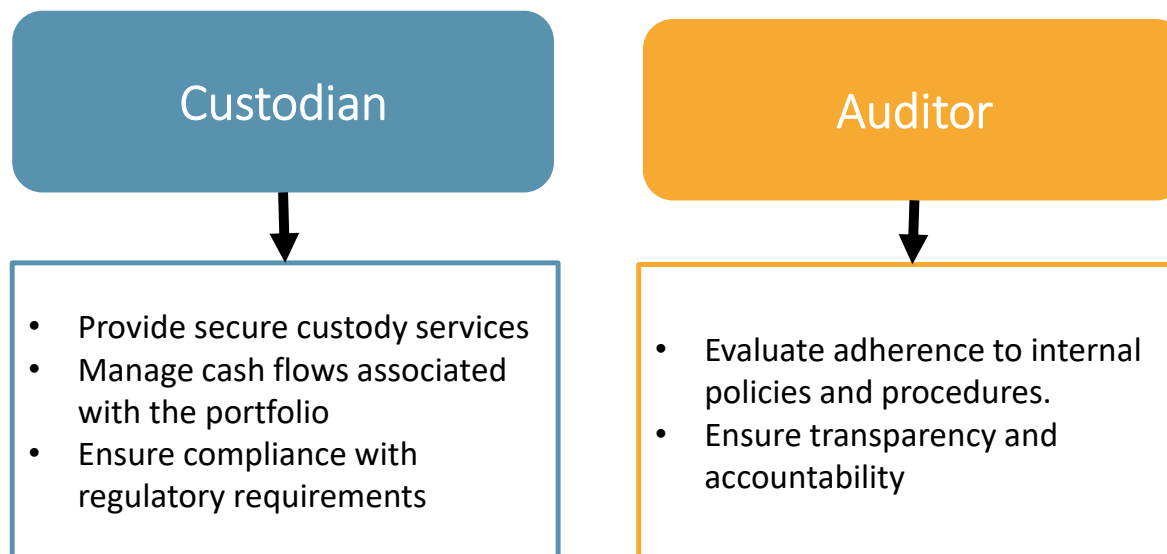
- Management Fees consist of **Base Fee** and **Performance Fee**
- The implementation of a Performance-Based Fee (PBF) structure is expected to provide incentives for fund managers to enhance their performance, which will also promote cost efficiency based on historical simulation.



Source: Bank Indonesia

# External Service Providers

*Central banks not only have to manage relationships with external portfolio managers but also with external parties related with the external management program.*



# Defining the Appropriate Mandate

*The appropriate mandate for an EFM should align with the central bank's objectives, risk tolerance, and preferences, taking into consideration the associated costs.*

## Objectives

- Knowledge sharing?
- Enhance return?
- Seeking for EPM expertise?
- Increase access?
- Other objectives?

## Preference

- Active vs Passive Management
- Target: Absolute vs Excess Return
- Active Risk: Conservative vs Aggressive
- Other risk such as credit risk, liquidity risk, etc.

## Things to Consider

- Management Fees
- Procurement and Legal Process
- Oversight and Monitoring Cost

# Leveraging External Portfolio Managers

*Enhancing the effective use of an EPM could be done by giving attention to qualitative aspects such as communication and intangible benefits.*

## Maintaining continuous communication

### Regular Monitoring and Meeting

- Daily, weekly, monthly, and annual reporting and monitoring
- Performance review presentation
- Review and outlook for specific asset classes for a certain period

### Inquiry

- Performance/Portfolio-related topic
- Survey of EPM's opinion regarding specific topic

## Utilization of Intangible Benefit

### Training Program

- On-site or Online training for specific topic, related to mandate or not
- Attachment Program
- Customized research paper

### Speaker for Events

- By inviting EPM representation as speaker in events held by central banks