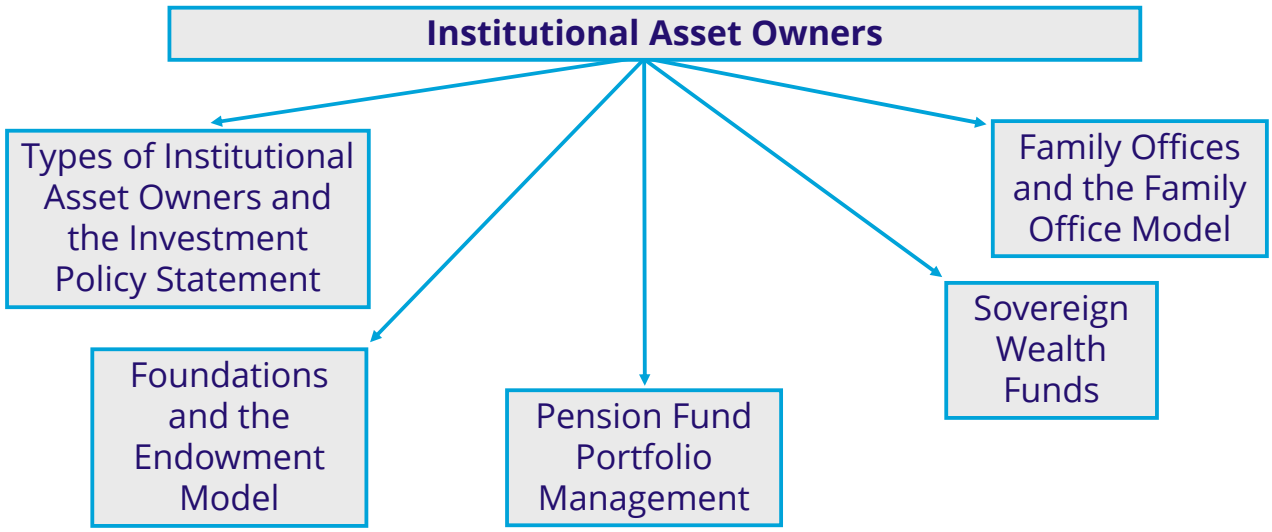
Institutional Asset Owners

Overview



© Kaplan, Inc.

Types of Institutional Asset Owners and the Investment Policy Statement



Need To Know Concepts

- Four types of **institutional investors**
- Three **challenges** to forecasting in alternatives
  - Use of naïve caps and floors
- Investor **constraints**: three internal, two external
- The Investment **Policy Statement (IPS)**
  - Six **benefits** of a thoughtfully developed IPS
  - 11 **sections** of the IPS

© Kaplan, Inc.

Institutional Asset Owners

- **Endowments and foundations:**
  - Used to fund institutions/make grants
- **Pension funds:**
  - National
  - Private defined benefit
  - Private defined contribution
  - Individually managed

© Kaplan, Inc.

Institutional Asset Owners

- **Sovereign wealth funds:**
  - Savings of nations running trade surpluses
- **Family offices:**
  - Advisors to ultra-high-net-worth individuals or families

© Kaplan, Inc.

Strategic Asset Allocation (SAA)

- The SAA is a set of portfolio weights in asset classes that:
  - provides *optimal* balance of risk and return;
  - acts as a *benchmark* for the actual portfolio; and
  - is a *reference* point for tactical asset allocation (TAA).

- Starting point for risk/return forecasts: historical data

asset class return = short-term real riskless rate + inflation + risk premium

© Kaplan, Inc.

Strategic Asset Allocation (SAA)

- Challenges in forecasting risk/return for **alternatives**:
  - Short history, alpha decay, and rapid pace of innovation
  - Naïve (nonscientific) allocation drives *cap and floors* for weights. Allocation needs to be:
    1. big enough to warrant an investment team, but not too big to find opportunity;
    2. big enough to impact portfolio without causing concentration; but
    3. not too big so that it causes liquidity issues.

© Kaplan, Inc.

Investor Objectives and Constraints

- **Objective:**
  - A preference that distinguishes an optimal solution
  - Expressed in consistent risk-adjusted performance values

- **Constraints:**
  - Conditions that any solution must meet
    - *3 × internal:* time horizon, liquidity, sector/country limits
    - *2 × external:* tax status, regulations

© Kaplan, Inc.

Investment Policy Statement (IPS)

A document that formally states the primary **goals** of an investment program and the **framework** used to achieve them

Six benefits of a thoughtfully developed IPS:

1. Articulates objectives and policies
2. Outlines risk tolerance and investment beliefs
3. Monitors outcomes vs. objectives
4. Helps train new investment staff
5. Takes holistic view on how investments relate to goals
6. Provides guidance to fiduciaries through market cycles

© Kaplan, Inc.

Sections of the IPS

- Introduction, scope, and purpose
- Roles and responsibilities
- Investment objectives
- Time horizon
- Risk tolerance
- Spending policy
- Asset allocation guidelines
- Selection/retention criteria for investment managers
- Strategic investment guidelines
- Performance measurement and evaluation
- Additional considerations

© Kaplan, Inc.

Sections of the IPS

Section	Typical Contents
Introduction, Scope, and Purpose	• Description of asset owner and mission • Purpose and scope of the IPS • Investment philosophy • Ongoing review
Roles and Responsibilities	Board of trustees, investment committee, internal staff, investment advisers and/or outsourced chief investment officer (OCIO), trustee/custodian
Investment Objectives	*Common investment objective for endowments:* return target X% above inflation, linked to long-term spending needs *Common investment objective for DB pension funds:* return target X% above the liability discount rate

© Kaplan, Inc.

Sections of the IPS

Section	Typical Contents
Time Horizon Constraint	Link time horizon to goals; a longer time horizon suggests higher capacity to absorb risk and illiquidity
Risk Tolerance	Must be consistent with objectives and constraints; may list specific risk factors and limits
Spending Policy	Often expressed as a spending rate, x%, of the portfolio's moving average market value over a trailing period
Asset Allocation	Targets and ranges by asset class, and rebalancing guidelines
Selection Criteria for Managers	Considerations when selecting and monitoring investment managers (not simply based on past performance)

© Kaplan, Inc.

Sections of the IPS

Section	Typical Contents
Strategic Investment Guidelines	Primary role of the investments in meeting the objectives (e.g., diversification, income, hedging liabilities, or inflation protection)
Performance Measurement and Evaluation	Identify benchmarks, and describe process used to appraise manager/investment selection
Additional Considerations	• ESG issues • Proxy voting policy • Review of expenses and fees • Liquidity policy

© Kaplan, Inc.

Discussion Questions

Match the following role descriptions (A, B, C, D) to the following entities in the governance structure of an institutional investor: board of trustees, investment committee, internal staff, custodian.

Role	Role Description
A	Overseeing investment activities of the portfolio to ensure investment management is consistent with policies and objectives
B	Ultimate fiduciary responsibility for the fund; approves IPS and ensures investment policies are implemented
C	Reporting of portfolio holdings and processing portfolio transactions
D	Managing the day-to-day investment activities of the fund and reporting information to the investment committee

© Kaplan, Inc.

Discussion Questions Answers

Role	Role Description
Investment committee	Overseeing investment activities of the portfolio to ensure investment management is consistent with policies and objectives
Board	Ultimate fiduciary responsibility for the fund; approves IPS and ensures investment policies are implemented
Custodian	Reporting of portfolio holdings and processing portfolio transactions
Internal staff	Managing the day-to-day investment activities of the fund and reporting information to the investment committee

© Kaplan, Inc.

Foundations and the Endowment Model



Need To Know Concepts

- **The endowment model:** key features
  - Risks: spending rate, inflation, liquidity
- Calculate change in endowment/foundation portfolio value
- Calculate real/nominal rates of return
- Six reasons larger endowments tend to outperform

© Kaplan, Inc.

Endowments and Foundations

- **Endowment:** large capital base maintained on an inflation-adjusted basis in perpetuity to generate annual income to help fund an organization (e.g., university)

- **Foundation:** nonprofit fund established for making charitable grants. Types of foundation:
  - Operating
  - Community
  - Corporate
  - Independent

© Kaplan, Inc.

Endowments vs. Foundations

	Endowments	Foundations
Nature	Funds established by institution that benefits from spending	Grant-making institutions
Lives	Perpetual	Often limited
Minimum spending requirements?	No	Usually, yes
Ongoing donations	Yes	Unlikely

© Kaplan, Inc.