SIMCORP

TOTAL **PORTFOLIO** APPROACH

Gain agility and improved decision-making
in an uncertain world

AsianInvestor

SimCorp

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EXECUTIVE **SUMMARY**

COVID-19 has reinforced the urgency for asset owners to rethink how they effectively build portfolios and manage risks. The agility needed to react to sudden market changes while achieving optimal risk-adjusted returns is paramount today—and will be increasingly relevant amid the uncertainty of a post-pandemic world.

The economic fallout from the volatility and persistent low yields (including negative rates) has compounded challenges for asset owners. They were already grappling with increasingly complex portfolios and datasets, stemming from waves of new products and investment strategies, multiple siloed systems and incohesive risk management across all asset classes. In response, many are now considering what has become known as a "total portfolio approach."

The Total Portfolio Approach (TPA), implemented by a growing crop of leading asset owners globally, offers an increasingly viable option to address the unpredictability of markets—including the governance, benchmark and inertia drags inherent in more traditional Strategic Asset Allocation (SAA)-based methodologies, revealed a panel discussion hosted by SimCorp and AsianInvestor.

By basing asset allocation on risk exposure—rather than rigidly-defined asset-class benchmarks—and assessing it continuously in real time and across the entire investment team, TPA promises much more nimble and flexible decision making. In turn, it enables asset owners to quickly react to opportunities and, ultimately, produce a diversified portfolio that is more robust in uncertain times.

THE HALLMARK OF TPA COMPRISES THREE KEY ELEMENTS:

- A blueprint of clearly specified investment goals across the organization
- A collaborative process across the firm to create competition for capital amongst all investment opportunities—the best ideas make it into the portfolio
- Real-time governance with greater delegation

PART I
BUILDING THE CASE FOR **TPA ADOPTION**

While TPA as a concept and methodology isn't new, there's been increasing interest in recent years. Tim Unger of Willis Towers Watson gives a possible reason why it's gaining more traction in this uncertain and volatile market, "It's about building the best possible portfolio for an investor at any point in time."

In its narrowest definition, TPA is effectively a new approach to portfolio construction. However, portfolio construction is just one component of a much broader process that entails critical commitments on governance and the culture of an organization for an effective TPA implementation.

Unger also points out the need to adapt to a much more complex world today as a key reason to depart from more conventional practices of portfolio construction.

> *"Asset owners that take a traditional approach to portfolio construction largely reflect the governance and people models of the past."*
>
> **TIM UNGER**
> Senior Investment Consultant,
> **Willis Towers Watson**

For example, explains Unger, looking back 20 years or so, boards were the main decision-makers since investment issues were far less complex. At the time there were far fewer asset classes and strategies, and nowhere near as many options for how they were implemented.

By contrast, the complexity of today's portfolio considerations (i.e. number of strategies, products, implementation methods, etc.) coupled with ever-larger internal investment teams have exposed shortcomings in the approach to Strategic Asset Allocation (SAA).

"Certain asset owners started to see merit in splitting roles differently [and] TPA was born," explains Unger.

Initially, TPA evolved from the practices of a few leading asset owners as more of a "joined up" investment philosophy, more aligned with fund goals. They needed an approach that was more dynamic in nature, operating in real-time governance, rather than decisions made on a calendar-based meeting schedule.

Unger explains how TPA is thought to enhance decision framing, decision making and dynamism—benefits that seem to resonate with asset owners who have embraced the model.

TOTAL PORTFOLIO APPROACH VS. STRATEGIC ASSET ALLOCATION

	SAA	TPA
Performance assessed vs.	Benchmarks	Fundgoals
Success measured by:	Relative value added	Total fund return
Opportunities for investment defined by:	Asset classes	Contribution to total portfolio outcome
Diversification principally via:	Asset classes	Risk factors
Asset allocation determined by a:	Board-centric process	CIO-centric process
Frequency of change:	Infrequent, calendar meeting based	Continuously monitored, changes made in real time
Portfolio implemented by:	Multiple teams competing for capital	One team collaborating together

Better decision framing

Better decision making

Greater dynamism

Source: *Thinking Ahead Institute*

Getting aligned with TPA

Despite its advantages and the nature of the current market environment, TPA is yet to catch on as widely as some market participants might expect.

This is due to several inherent challenges. Among these, Unger highlights the impact of governance since some boards might be reluctant to delegate decision-making to internal teams. Even when they do, it is tricky to get the balance right between appropriate oversight of the team and overinvolvement.

The cultural aspect of TPA is another potential hurdle. The more "joined up" approach involves getting teams that have often operated in silos to act more as a single unit with a strong emphasis on collaboration. Realistically, this takes time and needs to be supported by strong leadership.

At the same time, Unger says that having the appropriate IT, technology, and data capabilities is particularly important for asset owners looking to adopt TPA because dynamism is critical to the model.

Those that have implemented TPA successfully have learned some important lessons in the process.

LESSONS LEARNED:

— TPA works better with governance structures that facilitate delegation, coupled with appropriate oversight and engagement—between the board and the management team

— Asset owners with a more advanced TPA set-up have a skilled internal capital markets team that can implement and monitor portfolio market (beta) exposures in a cost-effective and timely manner

— Adopting a fully-fledged TPA relies more on meeting governance and cultural challenges than mastering the technicalities of the investment model

— Focus on IT and technology—having a whole-of-portfolio view of all asset classes via a single source of data—is especially important for asset owners looking to implement a TPA

PART II
TPA IN PRACTICE—A DISCUSSION WITH LEADING ASSET OWNERS IN ASIA PACIFIC

The role, relevance and the rewards of implementing TPA were the basis of an insightful panel discussion, *Revisiting Total Portfolio Approach: Position Your Organisation For Uncertain Times*, recently held by SimCorp in partnership with *AsianInvestor*.

PANEL DISCUSSION HIGHLIGHTS:

— Asset owners globally now have a much sharper focus on how they achieve key investment goals such as optimal risk-adjusted returns, greater agility, shared decision-making and effective diversification.

— Shifting away from traditional SAA to TPA can enable asset allocation to reflect risk exposure rather than rigidly defined asset class benchmarks. In addition, sharing real-time, whole-of-portfolio data can help investors and fund managers act quickly on opportunities and drive better investment outcomes.

— Setting up TPA relies on a mindset shift in terms of the culture of institutions that have been groomed in SAA, often with teams in asset-class silos. It also requires asset owners to ensure a certain level of internal investment in technology and data capabilities to make TPA effective.

— Anecdotal evidence from asset owners that have implemented TPA and have therefore aligned their operations and investment support systems, shows the value of a more dynamic and collaborative process in making allocation decisions.

— There is evidence that a well-executed TPA can provide a return benefit of 50 to 100 basis points per annum, compared with a SAA-based approach[1] while also reducing risk.

— From a risk management standpoint, Cbus highlighted that having different views on the portfolio to make decisions is another important feature of TPA for asset owners. Traditional risk tools face limitations from being mostly backward-looking and focused on individual asset classes. Being able to assess multiple dimensions of risk including regulatory changes at the portfolio level is key.

— The ability to quickly react to market changes has been critical to navigate the crisis. Future Fund could do scenario-type markdowns across assets, helping its teams identify their impact on risk and currency hedging and, in turn, enable timely hedging and rebalancing decisions. To deal with early member withdrawals after the Australian government eased rules on superannuation redemptions, Cbus was able to extract liquidity from different sources as they were able to bring together individuals and teams with different roles into the decision-making process.

TO LISTEN TO THE FULL PANEL DISCUSSION, PLEASE CLICK HERE

[1]Total Portfolio Approach – A global asset owners study into current and future asset allocation practices. Thinking Ahead Institute

PART III
PROVIDING **THE RIGHT SUPPORT** FOR TPA

Organizations that have adopted TPA have taken steps to address the data and infrastructure requirements over time, but legacy systems with siloed roles and responsibilities inherited from the SAA-approach still abound.

This is reflected in our audience poll during the panel discussion—over half of the respondents said having access to clean, real-time data and a whole-of-portfolio view was the main challenge they face.

> *Given the need for much closer collaboration between and within teams, a single view on data across the entire organization is paramount."*
>
> **MARC SCHRÖTER**
> Senior Vice President/Global Product Management
> **SimCorp**

MARK SCHRÖTER OF SIMCORP EMPHASIZED HOW TECHNOLOGY CAN SUPPORT A TPA AND GIVES THREE RECOMMENDATIONS:

— Trust your data

— Empower your teams with a single view of all asset classes

— Control risks

Trust your data

Data is the basis for the whole investment process. Yet many firms spend significant time comparing and qualifying data from multiple vendors to obtain a golden copy.

To make better asset allocation and investment decisions, it is key to have access to a technology solution that can ensure consistent and high quality data throughout the investment value chain. This single trusted source of data will increase transparency and reduce risks.

More and more firms find it therefore crucial to work with a technology partner that can help them source accurate and real-time data to support their investment process and bring it to the next level.

Schröter further states that since most asset owners are aligned in their desire to have an integrated view of their portfolio, it can be more efficient for a technology vendor to deliver data as a service.

The goal is to reduce the complexity of managing multiple data sources and, in turn, reduce the time and cost spent on sourcing, validating, correcting, and reconciling this data.

Empower your teams with a single view of all asset classes

Schröter also emphasizes the importance of having a whole-of-portfolio view—shared across the teams—as part of realizing the benefits of TPA. To achieve this, it is key to have access to an Investment Book of Record that enables a holistic view across the business—recording every position across all asset classes in the portfolio, regardless of whether they are managed internally or externally.

Ultimately, since TPA is not constrained by asset classes, it is paramount to have access to an integrated front-office that offers seamless support for all instruments, in both public and private markets

BENEFITS OF AN INTEGRATED FRONT OFFICE

1 Gain valuable time to focus on markets

- Across all assets – including alternatives
- Complex derivatives and overlay strategies
- Support for Liability Driven Investments

2 Focus on driving investment performance and alpha

- Rebalancing and modelling strategies
- Multi-hierarchy investment and fund structure
- No need for portfolio managers to reconcile data

3 Make better informed investment decisions

- Simulations, what if scenarios and stress tests
- Multi-asset investment strategies (private & public markets)
- Support for ESG driven investments

4 Get a clear view on all the risks in the portfolio

- Multi-layer Look Through capability
- Full range of portfolio analytics: Integrated
- Valuation, Compliance, Risk & Performance analytics

Control risks

The ability to run ‘whole of fund’ liquidity and balance sheet forecasting—having a clear view on portfolio sensitivities—is critical to support a TPA. Teams have to take control of their liquidity needs and longterm risks, as well as ensure ongoing compliance at all times, explains Schröter.

This requires that risk calculations are based on the same data as the investment forecasting to get the holistic view.

WHY ARE RISK MANAGEMENT AND FORECASTING CAPABILITIES SO IMPORTANT FOR A TPA?

1 Stay on top of the risks in your portfolios

- Timely risk and performance analytics as an integrated part of the investment decision process
- Access to real-time updates on exposures and risks

2 Get a clear view on the sensitivities of your portfolios

- Standard and complex risk analytics – factor attribution
- Credit default stress tests
- Long-term horizon path of event simulations

3 Take control of your long-term risks and liquidity needs

- Whole of fund liquidity & balance sheet forecasting
- Integration of liability flows and external cash flows
- Run multiple simulations & risk scenarios simultaneously

4 Be regulatory compliant at all times

- Full pre-trade and post-trade compliance
- Proactive management to respect investment mandates
- Support Front-to-Back compliant workflows

Delivering on the promise - panellists' experience with Covid-19

Among those asset owners with varying degrees of practical experience of a TPA, the three senior investment executives speaking as part of the panel discussion said the volatile and challenging markets in early 2020 helped certain benefits of the model become more tangible.

Together with Kristian Fok at Cbus, Sue Brake at the Future Fund said the unprecedented market volatility has underscored the value of the time and effort spent implementing a more collaborative, dynamic investment model with a TPA.

"It's times like this that really vindicate us [and our focus on] the trust levels between the team members, [as shown by] some of the big decisions we were able to make very quickly."

SUE BRAKE
Deputy Chief Investment Officer
Future Fund

"It's been a good test of the model and or our commitment to it."

For Fok, the fast-changing and uncertain nature of the new environment has highlighted the benefits of getting individuals who represent the whole portfolio to solve problems. "This has created a greater focus among teams to move further in the TPA direction," he added.

"Having a common issue that we came together to manage really showed the benefits of [the TPA] approach."

KRISTIAN FOK
Chief Investment Officer
Cbus

At Cbus, the TPA journey in the first instance entailed building internal capabilities to focus on whole portfolio outcomes—bringing specialists and different roles together, allowing greater delegation (which is critical to deal with rapidly changing market conditions) and creating a common language for shared objectives.

For Future Fund, by contrast, the TPA journey began in 2006, shifting away from the more traditional asset allocation approach and instead building TPA into its thinking from conception.

From Brake's viewpoint, a key element for the institution in building TPA has been collaboration—which she described as "a group of smart people making decisions for the greater good." Brake said she is convinced that TPA enables Future Fund to make the best decision, and in a nimble way, fuelled by the quality of data available that makes it very clear what the basis of the decision is so they feel in control.

"Moving from a linear decision-making process towards one that is more outcome-focused and collaborative works better, especially during difficult market periods."

DAVID CHUA
Head of Investment Strategy
Prudential Assurance

David Chua, at Prudential in Singapore—which is in a nascent stage of adopting some of the TPA practices—mentioned the move towards this new approach requires a different skillset and has changed the way his institution creates teams. Instead of having different groups of investment specialists as part of the traditional SAA approach, TPA enables a good mix of expertise and capabilities, both from a top-down as well as a bottom-up perspective.

At the same time, Chua said he has seen the TPA approach create richer and more collaborative conversations with external fund managers. In the past, managers simply had a benchmark and mandate to follow. Today, they must focus more on risk and return drivers to align not only with the latest market developments, but also with the more demanding role Prudential expects them to play in portfolio construction.

CONCLUSION

As asset owners have started adopting TPA with the goal of better managing increasingly complex portfolios, TPA has also evolved as a way to overcome the limitations of the traditional, siloed SAA approach to have a more "joined up" and dynamic investment philosophy, better aligned with fund goals.

Now, in the wake of the pandemic, TPA has become even more relevant by enabling investors to respond swiftly to changing market conditions and to capitalize on new opportunities.

The reality is that most asset owners are relatively new to the methods of TPA. While a handful of institutions globally are benefiting from the attributes of TPA, most are still discovering its potential. In particular, they need to address issues that hinder the speed of adoption, such as legacy data and portfolio systems.

Yet based on the experiences and feedback of the growing number of asset owners embracing TPA, we believe it's no longer a question of 'if' but rather 'how quickly' they can implement the model. Given the promise of what TPA can deliver, it is likely to become a key consideration for many asset owners over the next decade. It certainly provides a viable solution to today's turbulent markets.

ABOUT SIMCORP

SimCorp provides integrated, best-in-class, multi-asset investment management solutions to the world's leading asset managers, fund managers, asset servicers, pension and insurance funds, wealth managers, central banks, sovereign wealth funds, and treasury. Deployed on premise or in the cloud, SimCorp's core solution, SimCorp Dimension®, alongside SimCorp Coric®, SimCorp Gain™, and SimCorp Sofia™ form a powerful and complete solution. Together with a range of managed services, they support the entire investment life cycle, based on a market-leading IBOR. SimCorp invests around 20% of its annual revenue in R&D, helping clients develop their business and stay ahead of ever-changing industry demands. Listed on Nasdaq Copenhagen, SimCorp is a global company, with regional offices across Europe, North America, and Asia Pacific.

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