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**Long-term investing: An institutional investor perspective – a seminar organised by the Centre for International Finance and Regulation**

**Speech by David Neal, Managing Director, Future Fund.**

***Check against delivery.***

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Thank you David.

Today's seminar marks the culmination of a significant amount of work that has produced three papers on long-term investing which are a valuable contribution to thinking and practice among investors.

The work combines academic research and practical experience with the aim of shedding light on:

- what determines investment horizon
- the benefits of being a long-term investor; and
- how investors can better organise themselves towards their long-term objective.

Along the way this work also identifies some of the challenges and pitfalls faced by long-term investors, and explores how these can be addressed.

I'd like to make a few comments about this research:

- to highlight its importance to us at the Future Fund;
- to reflect briefly on my own perspective on long-term investing; and then
- to put this work into the broader context of evolution in the financial system and the growing influence of asset owners in that system.

The Future Fund started this collaboration with the Centre for International Finance and Regulation for a number of reasons. It began from our own desire to be as good as we can be. We've aimed to create an environment and culture at the Future Fund that is deeply curious about finding the best way to run long term money.

In part then this work has allowed us to put some additional focus on to topics that we believe are vitally important to our success as a long-term investor.

We've been managing the Future Fund for a little over 7 years, over which time we're proud to have achieved our mandate with a return of 7.3%pa, adding $44bn to the initial contributions in the process.

While we have put in place structures and strategies that we believe will help us to pursue our long-term goals, we recognise that we of course have only been investing for 7 years, which is only a medium amount of time. We certainly don't think we have all the answers.

So we're keen to gather different views and perspectives to test our own thinking. We think that this work, and the discussions it stimulates, can help us become a better investor.

At the same time, we also recognised that many other investors are similarly focused on the long-term and that there was scope to contribute something to the wider investment industry.

We saw an opportunity to help shape a discussion that can create new ideas and perspectives and in the end contribute to better long-term outcomes for beneficiaries.

In that vein, I hope that these papers stimulate discussions and reflections today and beyond that help us all get better at running long term money, and as a result get better at meeting the needs of those for whom we invest.

Let me talk a little about the Future Fund and those for whom we invest.

As I'm sure most of you know, the Future Fund is Australia's Sovereign Wealth Fund. Our job is to invest for the benefit of future generations of Australians.

Our investment mandate is to seek to generate returns of at least CPI+4.5%-5.5% per annum over the long-term. And we are tasked with doing that whilst taking acceptable, but not excessive, levels of risk.

The extent to which we are successful will help offset the Commonwealth's unfunded public sector superannuation liabilities and thereby ease pressure on the Commonwealth's budget in years and indeed decades to come, and so our purpose is truly intergenerational.

Since we were set up in 2006, we have sought to develop a business model and investment strategy that reflects - and, in fact, drives - our long-term focus.

During today's seminar, we will hear about the ways in which long-term investors do this and the challenges and opportunities that exist. In the papers we reflect on a number of aspects of the Future Fund's structure and approach, and perhaps some of this will come up through the discussions. I'd like to take the opportunity to highlight what I believe is the single most important factor, which is culture.

I define culture as "the collective influence from the shared values, beliefs and behaviours of the <u>individuals</u> on the way the organisation <u>as a whole</u> behaves". Long term investing requires an organisation as a whole to behave in a certain way, and culture is critical to this.

The kind of culture you have does many things. It drives

- who you recruit
- how you recruit them
- how you incentivise them
- how the organisation learns and develops
- the kinds of relationships you have and how they are managed
- and so on.

But crucially, in the context of a long term investor, it defines <u>how people make decisions</u>, and in so doing it influences at quite a deep level the extent to which you have true alignment to the long term objective. It offers some hope of escaping the principal/agent issues that structurally plague the endeavour of long term investing. Incentive arrangements get you some of the way there, but its culture that matters most.

In many ways I see myself as Chief Culture Officer with a responsibility to shape, sustain and strengthen the culture, because culture has mean-reverting characteristics. Left unattended it will inevitably weaken and lose its power.

This is a never-ending challenge, and I'd be interested to explore this further in discussion later on.

I'd also like to put this work into a broader context.

Today, more than ever, long term investors - be they sovereign wealth funds, superannuation funds, insurance companies or family offices - have an opportunity to reshape the financial system.

In Australia and globally, asset owners are professionalising. Long term investment funds are now a much more competitive part of the landscape for talent. That isn't just a statement about remuneration; it's a statement about the more sophisticated, technical and challenging investment careers that can be had at funds like ours and others, and also the real sense of purpose that comes with the long term mission.

So top talent is being attracted to funds, and they are using these new skills and resources to study and understand the complete value chain of investing, from the decisions the CFO is making in an investee company, through the actions of all the other various agents in the chain, up to the management teams and Boards of the funds themselves.

And they are inspecting all these parts of the value chain and thinking about whether they are well placed to meet their needs as a long term investor. In many cases it feels like the financial system serves the interests the agents who have dominated the system for a number of decades, rather than those of the asset owners and their beneficiaries.

Corporate governance and engagement are getting increasing attention, which will help foster long term decision-making in investee companies. Improved mandate design and monitoring processes for managers, that emphasise longer term results, will also help take the pressure of quarterly earnings results.

Misalignments in the way investment banks and managers operate are another key source of concern. We've seen many large funds begin to deal with this by building internal teams, with the view that doing so provides better alignment and lower costs.

Other investors, such as the Future Fund, prefer to continue to work through external agents, but we've prioritised efforts to shape and manage those relationships to better reflect our interests.

There is no right or wrong way here; rather it's a function of the institution's own particular context. What is interesting though is that, either way, the business models of the investment banks and investment managers need to change if they are to be sustainable. This will take time to fully play out. It's a bit like water on a stone, but change is underway.

So understanding and responding to the challenges and opportunities of long term investing are important agenda items not only for funds themselves but also the broader system. The work on long-term investing that we explore today is important work indeed.

In closing, I'd like to thank CIFR, and David and obviously Geoff Warren in particular, for the opportunity to collaborate on this work. I congratulate Geoff on an impressive trio of high quality and thoughtful papers. I'd also like to acknowledge the input that many others across the industry have provided to the research. I must make a particular mention of the Future Fund's own Nigel Wilkin-Smith, who has been our primary contributor to this work.

Of course, I'd like to thank our panellists in advance for their contributions today, and to thank you all for attending this launch.

I look forward to the discussions during the seminar and afterwards as we focus on how to be the best long-term investors we can be.

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