IPE INVESTMENT & PENSIONS EUROPE

IPE EUROPEAN INSTITUTIONAL ASSET MANAGEMENT SURVEY 2008

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CONTENTS

FOREW0RD

This is the eighth edition of the European Institutional Asset Management Survey.

One significant development this year is Invesco's partnership with Investment & Pensions Europe (IPE). At Invesco we are very excited to have the opportunity to partner with IPE, as their involvement has helped to further develop EIAMS as we set out to gain insights into the thinking of institutional investors in Europe.

In particular, under IPE's leadership and direction we have successfully extended the breadth of EIAMS's participating population to include organisations from Great Britain & Ireland, Central & Eastern Europe and the Nordic countries.

As mentioned, we have identified a broad cross-section of institutional investors across Europe, by both country and size. While considerable continuity has been maintained with the seven previous annual surveys, the opportunity has been taken not only to compare and contrast practices and intentions among more European countries, but also to set the scene for those countries with a relatively new, but rapidly expanding, pensions investment profile.

It should also be noted that, as a high proportion of respondents were pension funds, we have distinguished only by country and size. This year a total of 115 organisations participated in the survey with combined assets totalling nearly $550bn (€314bn) in assets under management.

Similarly to past surveys, our respondents vary in size from very large to very small. This survey is not intended to reveal the behaviour of just the super-large institutions as many other surveys are successfully doing that. We also want to show what the thinking is among what could be called the small and medium size institutions. For many in the investment community this world is under-researched, as we attempt to uncover some misconceptions.

We are very grateful to the respondents for providing their time and views for this survey. To thank them for their participation, we provided each with the opportunity to review and discuss the results at IPE's most recent 360° Event held near Paris, early in June.

We are also grateful to the think-tank members of this study: AFG (Association Française de la Gestion Financière), Euronext, and BVI.

Going forward, we hope that the wide range of respondents to this survey will wish to participate in future such annual surveys, and indeed that their numbers will grow, so that we will be able to examine the developing challenges, actions and intentions of participants in the European pensions investment marketplace.

I hope you find this survey both useful and of interest. I invite you to contact us with any questions or feedback.

Blake Turvey
Head of Corporate Development, Invesco

SUMMARY OF FINDINGS

1. Investment objectives

Absolute and relative performance are of most importance

Absolute and relative performance are the two most sought after objectives for internally managed assets. What has been striking is that investors have not seen any differences between absolute and relative returns when it comes to internally managed assets. For externally managed portfolios, relative performance was ranked as the most important objective.

2. Investment assets

Portfolio composition is changing

Institutions in our survey, on average, are allocating one third of their assets to equity and one half to bonds, a shift from the previous survey which indicated over twice as much investment in bonds than equity. Some size-related differences occur with the smaller institutions being much more heavily weighted to fixed income than the larger and medium investors.

There is three times as much investment in government bonds as in corporate bonds. Whilst equity investment is broadly unchanged in France, Benelux and Italy, it appears to have more than doubled in Germany and is highest in Great Britain and Ireland. Fixed income investing appears to have fallen in Benelux and Germany, and risen in France. Changes planned for the coming year indicate strong growth in all the alternative asset classes and with a shift away from investment in the US and towards Asia.

3. Sources of absolute and relative return

Whilst hedge funds are seen as the main source of absolute return, this now appears to be also much more sought after across the whole range of investment classes. However, equity and fixed income assets remain at the forefront when seeking relative return. The larger investors have signalled a change by moving from fixed income to all classes as their preferred route to absolute return. This is the path also being followed by the smaller investors whereas the medium-sized institutions are most focused on fixed income.

4. Alternative assets

Real estate is a mainstream asset for many

The institutions in our survey invest most heavily in real estate amongst the alternative asset classes, and with the trend being upwards since the last survey. It is most popular with the British & Irish and Swiss and, in a reversal of the previous survey's findings, it is now twice as popular with the large and medium investors than the smaller ones. The allocation to hedge funds is unchanged from the previous survey, which may indicate a stalling of interest for the time being at least. Commodities have shown some growth, but still with a modest overall allocation. Similarly, whilst private equity has shown growth, there is little evidence of a breakthrough, whether by country or size.

5. Structured products

Capital protection remains key

Overall, just over a quarter of institutions use structured products, down from one third in the previous survey. Size seems to drive demand, there being twice as much from the larger users than the medium ones. The main reason for their use was to increase capital protection, followed in equal measure by higher income and diversification.

6. Exchange traded funds

ETFs may have achieved 'lift-off'

Significant growth in ETFs is in evidence across all users, and appear to have been used by one half of the larger investors, representing about twice the usage by medium and smaller funds.

7. Duration

There appear to be wide variations between countries with regard to the optimum duration of their fixed income portfolios and actual liabilities. The average for fixed income is twice that of the British and Irish, but one half the levels reported in Switzerland, Italy and CEE. And the average for actual liabilities is double that in Britain & Ireland and the Nordics

8. Fundamental indexing strategies

For the first time, we asked institutions about their use of fundamental indexing strategies and found that almost three quarters did not use them, almost three times as many as did, with about one tenth saying that they were under consideration.

9. Interest and inflation rate swaps

In another first-time question, the main rationale for using interest or inflation rate swap approaches was predominately to manage liabilities, followed by guarantees.

10. Performance attribution

Investment managers are seeing more competition as suppliers of performance attribution

Performance attribution is gaining in popularity. While investment managers remain the single largest provider of this service, their market share has fallen by about one third since the previous survey, the slack being picked up, in almost equal measure by internal departments, custodians and external performance analysts.

11. Investment consultants
Consultants are more in demand
The use of consultants appears to have grown considerably from about one third in each of the previous four years to over one half in this survey. This may have been influenced by the inclusion in this survey of high users such as the British and Irish and more Swiss funds. Asset allocation remains the prime reason for their use and, in a reversal of the previous survey's findings, they are now much more actively sought for both manager selection and investment advice.

12. External managers: usage and change
The German institutions, now joined by CEE, have maintained the pattern of the previous two years by delegating least to external managers.

Conversely, high levels of delegation were reported by Benelux, France, Great Britain & Ireland and the Swiss. Compared with the previous survey, when twice as many smaller investors said that they delegated to external managers than the larger investors, institutions in this survey are indicating a closer pattern between all sizes. In the last two years, numbers using segregated mandates have fallen considerably whilst there has been a dramatic increase in the use of investment funds or pooled vehicles.

13. External managers: asset allocation
Institutions are indicating a sea-change by switching more fixed income assets to external managers. The highest proportions of fixed income delegated to external managers comes from Benelux, Germany, Nordics and Switzerland, with the British and Irish delegating the most equity.

14. External managers: selection
Performance still matters most
Performance remains the most important selection criterion, followed by risk control and clarity of investment process. Transparency of investment management fees, a new question, scored highly in fifth place. Level of fees continues to be relatively unimportant. The Germans appear to be most interested in the financial strength of their external managers whilst, for Benelux, it is the stability of the investment team.

15. External managers: fees
Performance fees are the ideal
Respondents to our survey continue to pay most of their fees to external managers as fixed fees, and have repeated previous messages that they want more performance-related fees. For example, 12% are currently paying performance fees for equity mandates, but 31% would like to do so. However, the differential between the current and preferred positions has narrowed markedly since the previous survey, which may be due in part to the sample but also to the possibility that increasing numbers of investors have met their aspirations of shifting investment manager compensation towards performance. It appears that it is the smaller investors who are still looking most to compensate their managers with performance fees, which may be because, by the very nature of their size, they are less able than the others to meet their aspirations. The most persistent demands for performance fees come from Germany, again, as well as from Great Britain and Ireland.

16. External managers: constraints
When investors give constraints to their external managers, almost all do so with benchmarks, followed by tracking error and following a specific allocation of assets. An average of three to four constraints continues to be imposed by respondents on each of their managers.

17. External managers: breaking relationships
Accusations of investor short-termism may be exaggerated
There was an average of just over one relationship terminated in 2007 by each respondent, and just under one in 2006. This compares with an average of one in 2005 and almost two in the previous two years. The British and Irish have broken the fewest relationships and the Nordics the most. Following the pattern of previous years, it is the larger investors that have broken the most relationships and it is the Italians, overall, who have been the most loyal. As in the previous survey, unsatisfactory performance remains the key reason to break a relationship, but failure to control risk is now also seen as much more critical.

18. Other findings
Socially responsible investing has increased dramatically
SRI and corporate governance strategies were in place among two fifths of our respondents, a dramatic increase on the previous survey's findings when only one in twenty said that they took an SRI position, and almost one third had a voting policy. This may be due in part to the higher participation in this survey of pension funds. The main reason given for SRI/ESG adherence, as previously, was that it reflected the beliefs of owners and boards. Written policies were most popular amongst the British and Irish and Nordic institutions.

Securities lending makes little distinction between equities and bonds
Whereas securities lending was mostly allowed against bonds in 2005, and against equities in 2006, we were told this year that the distribution between the two was much more even.

1. Sample

Pension funds dominant

This year's response to our 2008 survey questionnaire brought in 115 responses, which spanned a range of institutions based in 24 countries. This is a 28% increase in numbers of respondents to the previous EIAMS survey undertaken in 2006.

Probably the most significant change in the replies in the composition of the survey population was the increase in the number of pension funds, which are now the dominant type of institution represented. In the previous survey, though pension funds were the single biggest group of participants, they made up just 42%, when Caisse de Retraites were included.

However, we have been able to break down the pension sector into some of its component parts, which shows that it has a very good representation between the different categories, as shown in Figure 1.1.

Of the other types of institutional investors covered, insurance respondents were more prominent in the previous survey, comprising 17%, compared with 10% in the current. The other types of respondents were much the same as previously, being made up of banks, corporates, foundations and charities and mutual organisations.

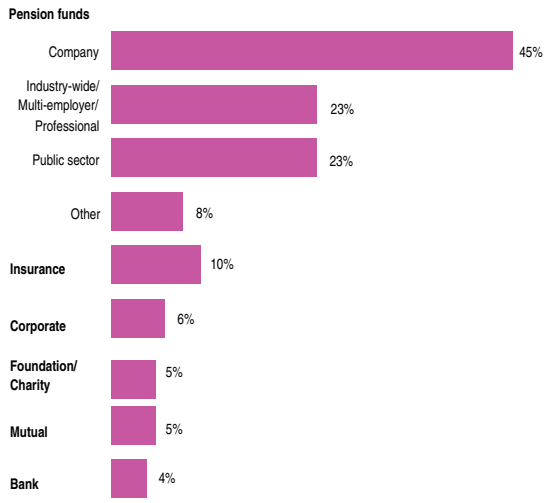
In total, the assets of those surveyed came to €314bn, which is not significantly different from the previous time, and is probably accounted for by the fact of the change in the population, as the average pension fund is likely to be considerably smaller than the typical insurance company (Figure 1.2).When it comes to the national origins of participants, the current survey has cast its net wider, though it may not have trawled as deeply as the previous one.

So this year, the British & Irish and Nordic markets feature strongly, where they did not appear at all in the previous survey. By the same token, numbers responding from France, Germany and Italy were down. But we do have a significant showing from the new Europe, with 15 respondents from CEE countries. We also had one respondent each from Austria, Cyprus and Spain who contributed to the findings in all respects except when analysed by country

One of the things we have done throughout the study is to break down the investing institutions by their size, using as our criteria the total assets under management. Those with less than €1bn (amounting to 67 of 115 in the sample), those with over €5bn are reckoned to be large with those in-between being ranked as medium (34).

1.1 Sample by type of institution

% of respondents (total 115). Two or more categories could be chosen



One of the consequences of the large pension fund presence in the sample is that to compare the other sectors is not going to provide meaningful data in any breakdowns. Even if these investors were grouped together as 'Others' it would not, we believe, contribute any additional insight to investor behaviour.

We will regard the pension fund investor as the proponent of all institutional investor types, but as we examine different issues in the survey findings, we point out where there were significant deviations in results for non-pension fund investors in the previous study to show that the results may need to be qualified to a degree.

As in previous studies' methodologies, where there are averages or totals shown, these are all simple averages. We have not weighted responses in any way.

Where we have shown results by size of respondent, we are aiming to ensure that the behaviour of large and small institutions can be properly compared. This is the eighth edition of EIAMS and the first one where the survey was entrusted to IPE. We are very conscious of the fact that the change in the composition of the respondents means that there has been a big change in the sample. This makes meaningful comparison with the last survey undertaken in 2006 difficult. But where we believe that such comparisons can be made fairly and without forcing the conclusions, and provide useful insights, we have made these observations.

1.2 Sample AuM and number of respondents

	All	*Benelux*	*France*	*Germany*	*Italy*	*Nordic*	*GB & Ireland*	*CEE*	*Switzerland*	*Large*	*Medium*	*Small*
Respondents	115	29	5	11	10	11	26	15	5	14	34	67
Total investment assets (€bn)	314	52	26	35	9	71	72	9	40	204	84	26
% of total investment assets	100%	17%	8%	11%	3%	23%	23%	3%	13%	65%	27%	8%
Average AuM (€bn)	2.8	1.8	1.6	3.9	0.8	6.5	2.5	0.6	8	15	2.5	0.4
Median AuM (€bn)	1	0.6	1	0.8	0.5	2.7	2	0.5	7	13.9	2.3	0.3

2. Investment objectives

Close match between performance and risk

Institutional investors are very clear this year about their investment objectives. As always, their concerns relate to the two poles they live between - those of performance and risk. This has been the case for the past few years of the EIAMS survey, even though the question has been phrased differently and the body of investors responding has changed significantly this year compared with the previous survey.

We have had more responses from more countries, though fewer from some individual countries. But here we pose the question "what are you investing for?" The answer is a very clear affirmation that it is to achieve returns, whether these are in terms of absolute or relative performance. Why otherwise be in business? And this is the case whether the assets are being externally or internally managed.

Care obviously has to be taken when comparing the previous EIAMS findings with this year's due to the sample change, but for high-level snapshots such as here, it is noteworthy that performance – both absolute and relative – has been ranked ahead of risk considerations, which is very much where investors were last year.

Many would agree that a climate where performance is ranked higher than risk considerations can be regarded as a more healthy investment environment.

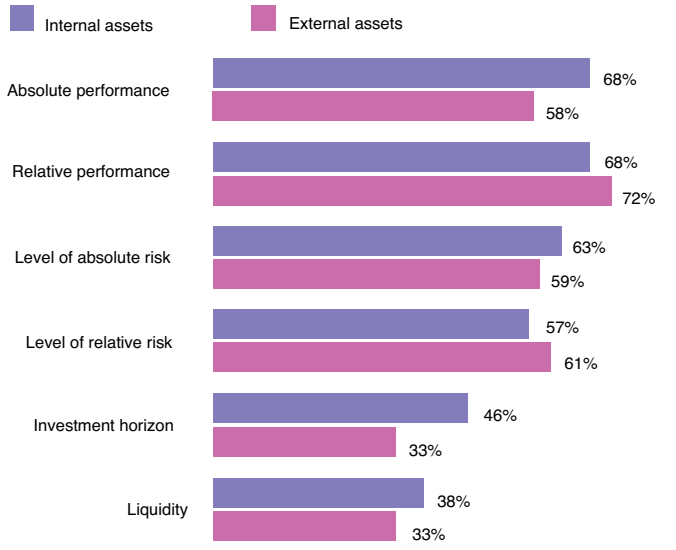
What is striking about the figures is that investors do not see any differences between absolute and relative returns when it comes to internally managed assets, whereas for externally managed relative return portfolios, performance is ranked as being the most important objective (see Figure 2.1). With absolute return mandates, there can of course be other objectives, such as portfolio diversification that investors are looking for (Figure 2.2).

Well below risk and performance come investment horizon and liquidity as priorities for investors for both internally and externally managed assets. Compared with the last survey, liquidity is now ranked below investment horizon, echoing perhaps a theme through our results that liquidity is being viewed differently by investors and is now more in line with the prior survey.

That less concern (33%) is expressed about having investment horizon as an objective for externally managed assets could be a reflection of the fact that most such mandates are put with managers for a fixed period of years, so horizon issues are not so pressing (Figure 2.1). On the other hand assets, being invested internally are likely to be invested with some very definite views regarding their ultimate horizon in the portfolio.

2.1 Most important investment objectives

% of 109 respondents answering question



2.2 Most important investment objectives 2006-2007

Ranking: 1 = highest

Objective	2007 (06) Internal assets	2007 (06) External assets
Absolute performance	1 (1)	2 (2)
Relative performance	2 (4=)	1 (3)
Level of absolute risk	3 (n/a)	4 (n/a)
Level of relative risk	4 (n/a)	3 (n/a)
Investment horizon	5 (4=)	5 (4=)
Liquidity	6 (3)	6 (4=)

When it comes to their internally managed portfolios, the inclusion of investor responses from Great Britain & Ireland and from the Nordic countries reflects the importance of equity investment exposure in these markets, using largely relative return approaches (100% and 80%), respectively. Another market with strong equity traditions is Switzerland and here relative returns as an objective is equally important as absolute returns (60%), where traditionally the market is also heavily invested in alternatives, with an absolute return focus (Figure 2.3).

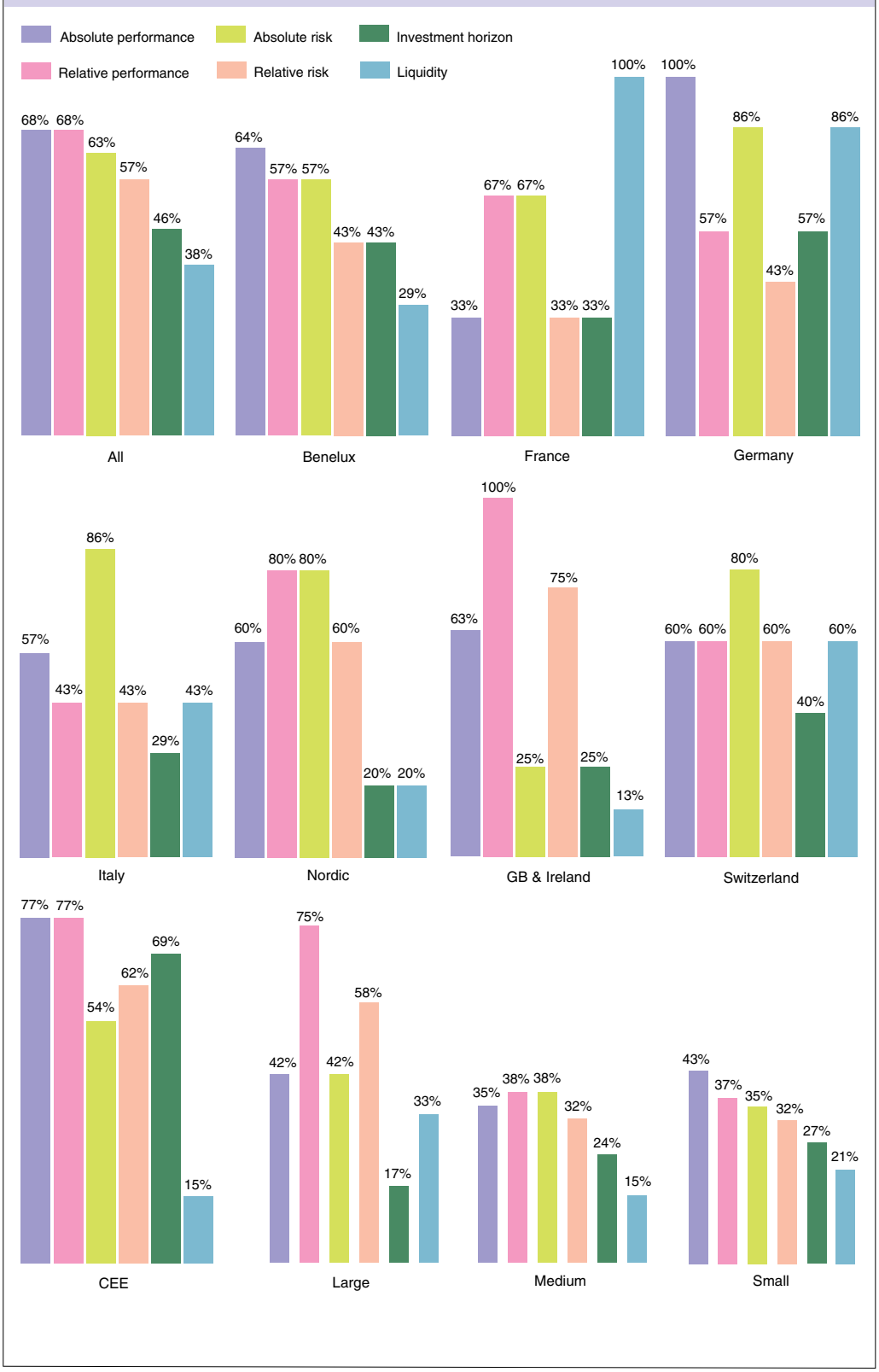
Germany has long been a marketplace with an investor predeliction for absolute returns from traditional portfolios and, if anything, the trend has become stronger (100%) as compared to the previous survey findings (circa 80%). This time around the Benelux participants have changed their previous stance of being equally focused on both types of performance at around 60% to currently being 64% fixed on absolute returns compared with 57% for relative.

British and Irish investors are showing stronger interest in absolute return strategies, again reflecting at 63%, as funds now are pursuing alpha by turning increasingly to

alternatives. The volte face by French investors moving from a situation of being highly committed to seeking absolute returns (c 80%) and only partially interested in relative (50%) returns in the previous survey, to having a 67% figure for relative performance and just 33% absolute return, could be due more to the limited numbers in the sample and reflecting the circumstances of the five investors who responded from France. This is also reflected on the high weighting given to liquidity as an investment objective by these French investors (Figure 2.3).

2.3 Important internally managed assets investment objectives by country and size category

% of 65 respondents



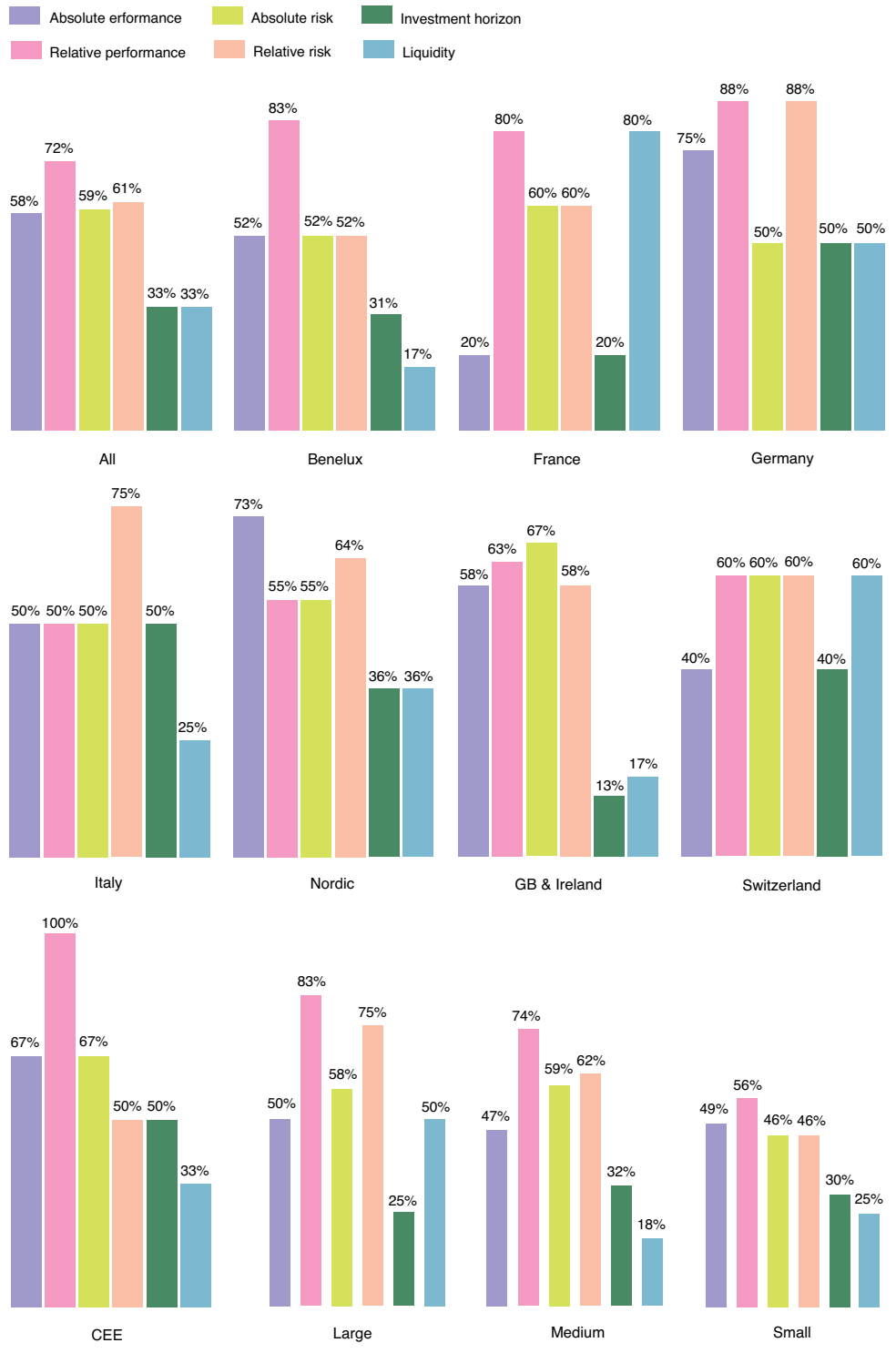
Italian and German investors are clearly most concerned with the absolute levels of risk in portfolios. In fact these are not much different from the high rating they gave to risk concerns in the last survey for their internally managed assets. The Swiss and Nordics are marginally less risk fixated at 80%, well above the average 63% for all respondents.

When it comes to externally managed portfolios, relative returns are a more dominant objective. This is particularly noticeable in countries with a high level of internally managed portfolios, often concentrated in the fixed income classes. On average, relative performance becomes the most important objective.This is reflected by a number of countries, previously in the other camp, including Germany, Benelux and France (with previously stated reservations).

Not surprisingly, the British and Irish continue to rate relative performance strongly, for externally managed accounts, which now make up the large bulk of assets (Figure 2.4).The inclusion of responses from a range of CEE countries reveals these countries to be very performance focused, whether their internal or

2.4 Important externally managed assets investment objectives by country and size category

% of 98 respondents



externally managed assets are being considered. Their commitment when both internal and external assets are considered together is probably among the highest.

3. Investment Assets

Overall compositions of portfolios

The strategic asset allocation decisions taken by investors does bear some resemblance to an army commander disposing of his forces in the best way to win his country's objectives. In the case of pension funds, it is to have the resources to make their payments on the due date as pensions, lump sums or other benefits, similarly for insurance companies, charities and foundations.

How investors approach this strategic disposal of their assets will very much depend on what they see as the future payments picture. So, funds in countries with maturing age profiles will change their allocations to reflect this, moving usually to a higher proportion of fixed income. While countries with younger workforces will feel less constrained and more return-oriented. These will be able to take a longer-term view and invest in assets which are less liquid, such as alternatives, or have returns that are volatile whilst being very liquid, such as equities.

Of course, funds may be doing both at the same time, such as immunising part of their portfolios by increased fixed income allocations, but needing to have returns-based allocations to provide for factors such as inflation or longevity risks that are hard to hedge. But asset allocators are creatures of the environment in which they invest and they can move from being more to less risk averse, which will impact their strategic allocations. This certainly seems to have occurred over the past few years in Europe, but affecting marketplaces in different ways.

How and why portfolios are rebalanced will play a part in the final asset allocation. Those funds, which regularly rebalance portfolios to keep the strategic alignments in the same proportions, will adjust their investments to take account of market movements. But not all funds will be so diligent in undertaking this realignment.

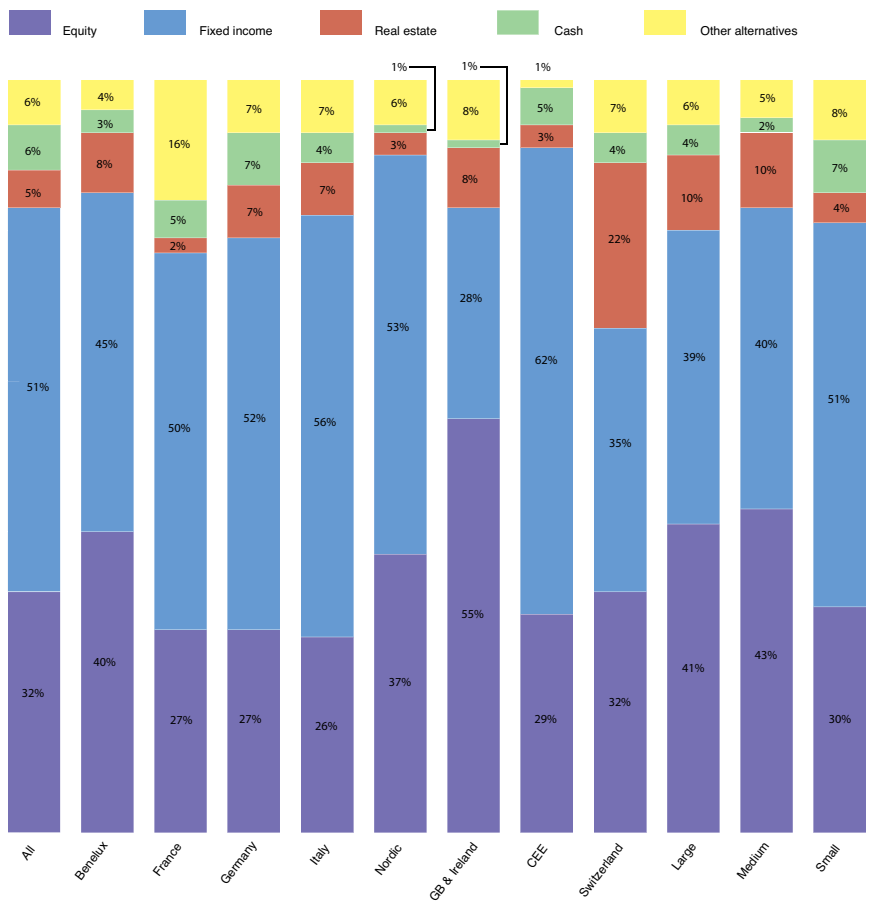
Regulatory changes will also influence the asset mix, as will the composition of the boards and committees which determine the investment strategy. Holdings of certain assets, particularly cash, can be determined by market conditions.

We noted earlier in the survey (Section 2) that investors have changed their investment priorities. How will this impact the future shape of their portfolios? Very significantly, the survey's findings seem to indicate. The knock-on impact could be dramatic for the future shape of portfolios.

An 'All countries' snapshot of the asset allocation landscape in Europe, as shown in Figure 3.1, indicates

3.1 Investment allocation by country and size category

Average % of assets



3.2 Detailed investment asset allocation

Average % of assets

	Own country	Rest of Europe	Europe	USA	Asia (inc Japan)	Other markets	All assets
Equity	9.0%	12.0%	21.0%	5.8%	2.4%	2.4%	31.6%
Fixed income:							
Government bonds	19.8%	8.9%	28.7%	0.8%	0.1%	1.2%	30.8%
Corporate bonds	6.1%	4.5%	10.6%	1.0%	0.1%	1.2%	12.9%
Other	5.2%	1.4%	6.6%	0.4%	0.1%	0.6%	7.7%
Real estate	3.5%	1.1%	4.6%	0.1%	0.1%		4.8%
Cash	4.9%	0.8%	5.7%	0.1%			5.8%
Private equity	0.2%	0.5%	0.7%	0.3%	0.0%	0.0%	1.0%
Hedge fund	0.1%	0.7%	0.8%	0.6%	0.0%	0.2%	1.6%
Commodities	0.2%	0.2%	0.4%	0.3%		0.3%	1.0%
Other alternatives	2.1%	0.2%	2.3%	0.0%		0.5%	2.8%
Total	47%	32%	80%	10%	3%	7%	100%

that around one third (32%) of assets are in equities, one half in fixed income (51%) and the balance divided pretty equally at around 5% in each of real estate, cash and alternatives.

Compared with the previous survey, where the equities allocation was at a third (29%), fixed income at well over half (56%), with the balance divided equally between the other classes. But the change in equity allocations is more likely to have been as a result of the inclusion in the survey of British and Irish, Nordic and CEE investors, with higher allocations to the asset class traditionally than the main continental countries.

Comparing by investor size, some differences do occur with smaller institutions being much more heavily weighted (at 51%) to fixed income than the larger and medium funds (at 41% and 43%, respectively), as shown in Figure 3.1. As a generalisation, it may be fair to say that, because of size, smaller funds necessarily have to be more cautious when it comes to the real asset classes with equity and real estate at well below the levels of their bigger brethren. That their cash positions are appreciably higher might too be attributable to their need for caution. Under the heading 'Other alternatives', smaller investors seem to throw all restraint to the wind and allocate 8%, higher than the large investors (6%) and the medium (5%). Whatever the reason for this, it is a trend picked up in the previous survey, which indicated small funds had 7% of assets in 'Alternatives', with the big funds allocating 3% and the medium-sized 6%.

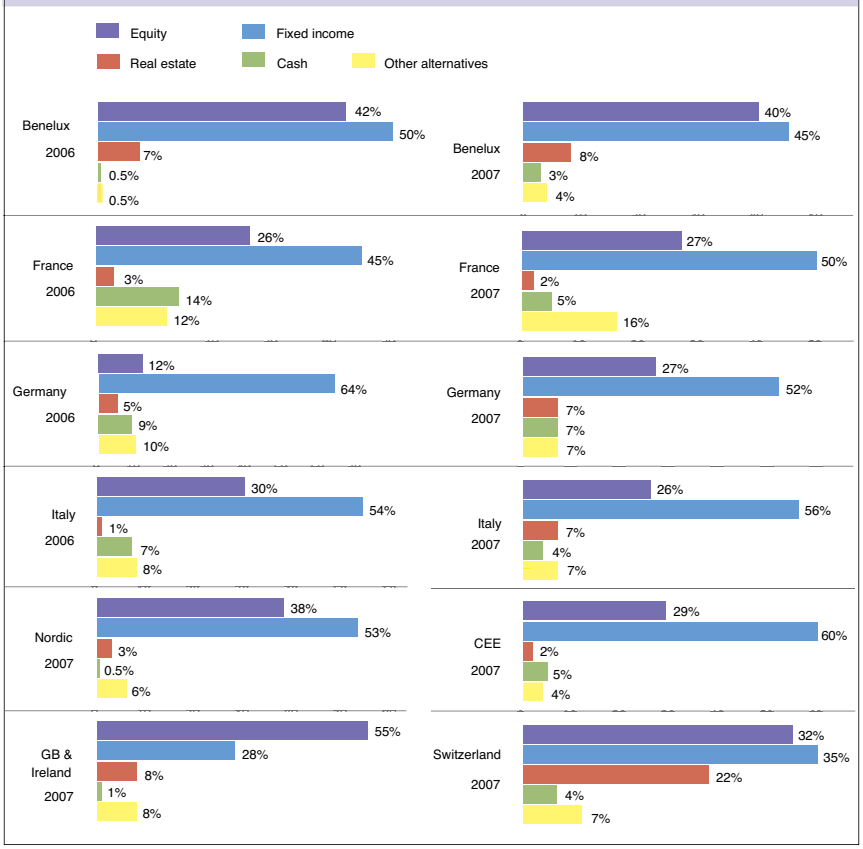
A more detailed breakdown of the table is shown in Figure 3.2, which indicates that 80% of assets were invested in Europe, 10% in the US, 3% in Asia (including Japan) and 7% in other markets globally. There is almost three times as much investment in corporate bonds, suggesting little change from the previous survey.

Whilst we must be cautious about interpolating too much from different surveys, there is a shift away from investing domestically and in the rest of Europe and towards the rest of the world, where the allocation has risen from 14% to 20%.

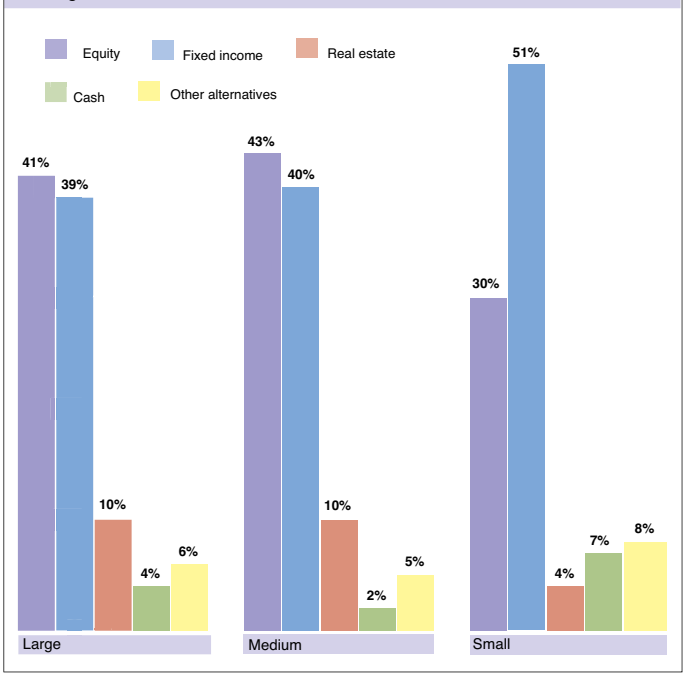
For the first time in this survey, we specifically identified the US and Asia as investment destinations, enabling us to pick up in the future the trends in allocations on a regional basis (Figure 3.5).

When it comes to individual countries (Figure 3.1), the equity and fixed income difference is still the major determinant of the character of portfolios. Someday, we may see this split also include alternatives in the 20% to 30% range. The split is also apparent between countries that were more 'Anglo-Saxon' in investment approach with a greater appetite for equity exposure. The British and Irish were traditionally in this mould and their current exposure of 55% would testify to this – though by historical standards this is well down from levels of 60% to 70% in rela-

3.3 Investment asset allocation by country 2006-2007
Average % of assets



3.4 Investment asset allocation by size
Average % of assets



tion to equities, where pension funds in these countries were some years ago. Maturing liabilities within defined benefit schemes are changing allocations. This is likely to be more of a feature for the UK than Ireland, where the average age of the workforce is younger.

The Nordic countries also mask differences, with the Swedes being much more equity oriented than the Danes or Norwegians. Within the Benelux grouping, despite the small size of their funds, Belgians have long been committed to equities, while the Dutch have been major equity investors as well, though not to quite the levels of the Belgium funds. These countries' equity ratios have not changed much since the last survey.

While France and Italy have kept the equity ratios at much the same levels between the two surveys, it is in Germany where the most pronounced change has occurred with equity levels moving up from 12% to 27% in the period, as shown in Figure 3.3. While survey sample composition changes could well have played a part in this, with more insurance respondents in the earlier survey and more pension funds in the current one, anecdotally, German institutions generally have seen a return of their equity risk appetite after the total collapse in demand for shares following the dotcom bust earlier in the decade.

Swiss investors have never been equity-shy, as the results show, and the CEE institutions do not seem to be far behind as these countries build up their institutional portfolios.

Of the other classes, real estate can be seen in this survey as the strongest runner in most countries, with the particular place it holds in Swiss portfolios showing up clearly. In some markets, real estate is certainly regarded as an alternative still, while others are seeing it as a main asset class in its own right.

Its mainstream credentials are apparent with some 8% allocation in each of Benelux, Germany, Italy and GB & Ireland. In British portfolios, where real estate traditionally had a key place, which it then lost, it now seems to be reasserting its 'rightful' place.

The separating out of real estate in the current survey from the all-embracing 'alternatives' in the previous survey, makes comparison between the two surveys difficult on this point. In 2006, at an 'All country' level 'Alternatives', including real estate, came to 8% of portfolios - in the current survey, real estate comes to 5% and 'Other alternatives' to 6%, indicating something of a shift to alternatives when the two are re-combined.

So at an individual country level, by combining the two to form an 'Alternatives', Benelux has 12% (previous survey 5%); France 18% (10%), Germany 14% (4%) and Italy 14% (9%).

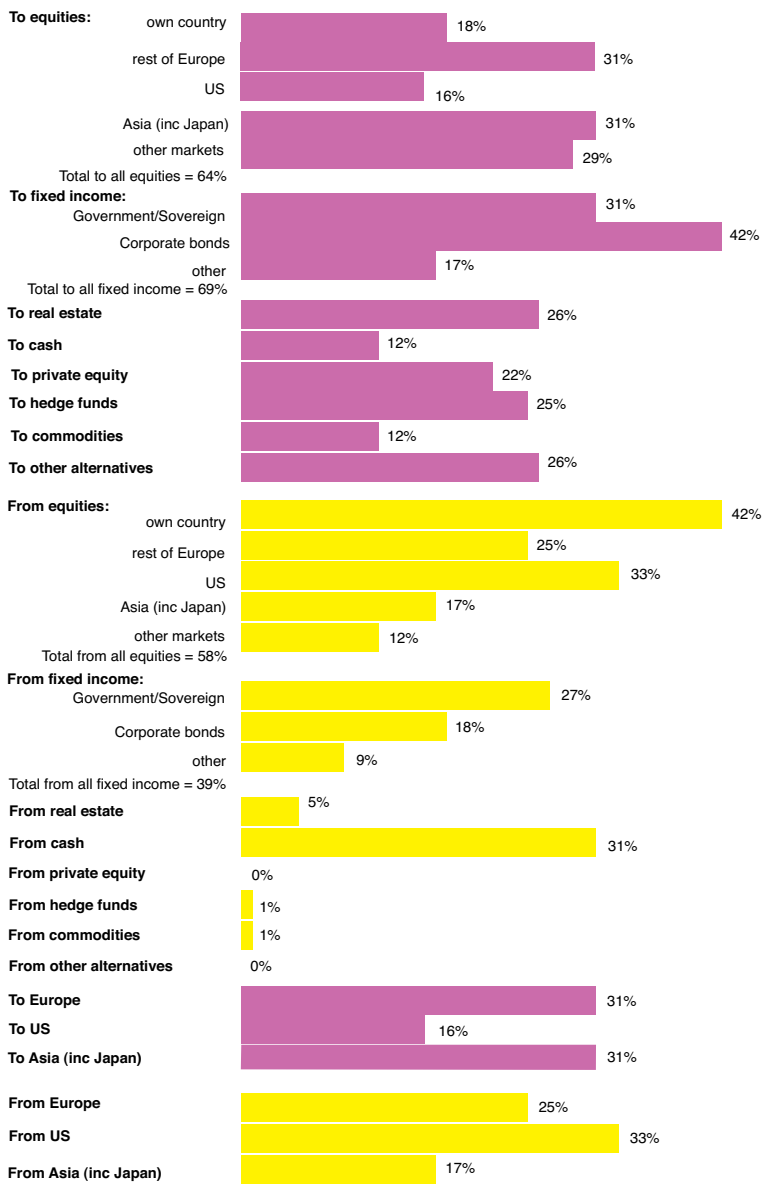
Changes in strategic asset allocation

Consistent with the change in European institutions' investment objectives, where investors prioritised performance over risk, this survey's findings show how investors are predicting substantial increases in allocations to equity, real estate and, in particular, to alternatives (Figure 3.5).

Some 64% of respondents are predicting an increase in equity allocations - this contrasts with the 18% that were planning such moves in the 2006 responses. As they do so, they will reshape their equity portfolios as 31% will

3.5 Changes planned to strategic asset allocation in 2008

% of 77 respondents to question



be increasing allocations to the rest of Europe, while just 18% will be increasing allocations to their own country, where 42% expect to move from their domestic equity market and 25% from Europe (Figure 3.4 refers).

Also indicative of redirection of equity is that 31% expect to up their Asian (including Japan) exposure, with just 17% shifting assets from this region, as shows in Figure 3.5. Similarly, it is a bullish 29% that are looking to 'Other markets', with a mere 12% selling off holdings in these. The US is clearly out of favour with investors with 33% saying they will move money out and just 16% are moving funds in.

Again with real estate, investors are taking a very bullish stance with 26% saying allocations are on the increase, and 5% cutting back. The story is the same for private equity, with 22% intending allocations and no investors planning to pull money. Hedge funds are in an even stronger net position with 25% seeing their allocations rise and just 1% expecting to reduce their commitments. A very similar positive scenario is unfolding for commodities and other alternatives.

Fixed income is also poised for growth, judging by investor intentions as 69% of respondents predict increasing their exposure, with government bonds seeing a massive 31% rise and corporate bonds an even bigger one with 42% of investors poised to buy more of these. Fixed income is an all-weather component of institutional portfolios and, as indicated before, with a maturing and ageing population the demand for bonds increases inexorably.

A sizeable number of investors (27%) expect to sell government bonds, but for corporate bonds this is much less the case.

The net cash positions of funds could change dramatically, as 12% of investors plan to increase the cash in their portfolios, while nearly a third (31%) intend to reduce this. This is probably strong confirmation.

Our table summarises the net position for investor intentions:

European pension funds intend to increase their allocation to alternatives

	To	From	Difference
Equities	64%	58%	6%
Fixed income	69%	39%	30%
Real estate	26%	5%	21%
Cash	12%	31%	-19%
Private equity	22%	0%	22%
Hedge funds	25%	1%	24%
Commodities	12%	1%	11%
Other alternatives	26%	0%	26%

4. Sources of absolute and relative returns

A tale of two cultures

For a long period, Europe's investors have been divided into two: the Absolutists and the Relativists. For many, it was the divide between the Anglo Saxon and the continental investing cultures, the more equity-favouring nations and those that traditionally saw investment in fixed income terms as their natural environment. With the bull market of the late 1990s and early into this decade, much of the resistance to the 'equity' culture was dissipated and the regime of relative return made inroads into the territory of the absolutists. The bursting of the high tech bubble pretty well stopped this trend in its tracks, with many investors, both absolutist and relativist, reassessing where they stood.

For many pension funds with defined benefit obligations, the new benchmark became the individual fund's pension liabilities - and returns absolute and positive, and not relative and negative, became the new watchwords. Only "positive returns could pay pensions" became the mantra.

In this quest, funds were prepared to widen their investment horizons and look at new sources of absolute return emanating from the alternative investment opportunities. Here, relativists and absolutists met in the absolute return zone.

This was accompanied by another trend from the US to Europe, the widening of fixed income offerings to include credits of all types. Though this ultimately was the Trojan horse to let in the subprime exposures currently rocking financial markets, few would dispute that the inclusion of credits is irreversible.

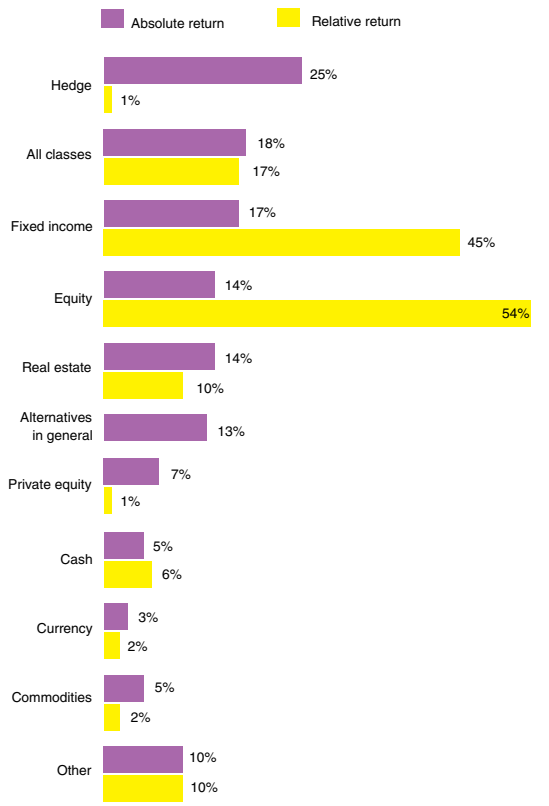
The other major change in source of returns has been the re-emergence of real estate, often revisited by pension funds in its new guise as an alternative, but that view has to be tempered by which market is being referred to. But in the real world of investing currently, particularly since recovery in the equity markets and the boom in real estate, equities are very much back in favour. So what are investors looking for from their portfolios - what type of returns are they looking for from which type of asset?

A tale of two camps

Where investors stated that they were looking to all asset classes – and these were under one fifth of investors responding, they were pretty evenly divided between those who were looking for absolute returns (18%) and those who were in the relativist camp (17%) (Figure 4.1). The picture has become less clear cut since the last survey when fixed income and equity were unambiguously the two most mentioned sources of both absolute and relative return. While both fixed income and equity are strongly seen as sources of relative returns, compared with the 2006 survey, their role as an absolute return source has taken a knock.

4.1 Sources of absolute and relative return

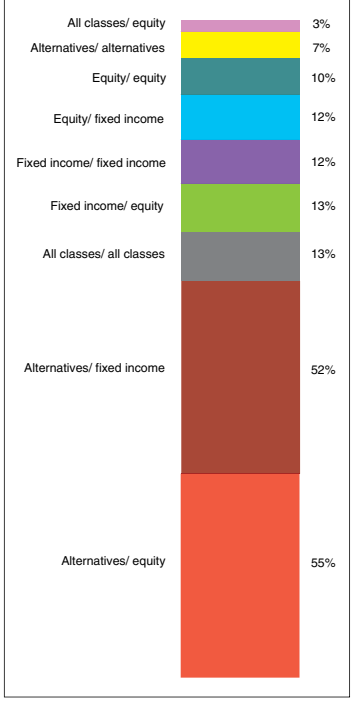
% of 87 respondents answering question



Within these classes, the specific areas seen as producing returns in portfolios include, on the relative side, small cap equities, high yield and emerging debt, as well as interest and inflation swaps. Within the absolute return fold, infrastructure, timberland, energy, structured credits, convertibles and global tactical asset allocation products are regarded as contributors. In the current findings, alternatives in general are seen as the source of the absolute, with no contribution to relative returns. Hedge funds are now the main originator of absolute returns in portfolios at 25%. Private equity trails considerably behind at 7%, but it too is seen as almost completely in the absolute camp, as only 1% see it as a source of relative return.

4.4 Variety of combinations of sources of absolute/ relative return

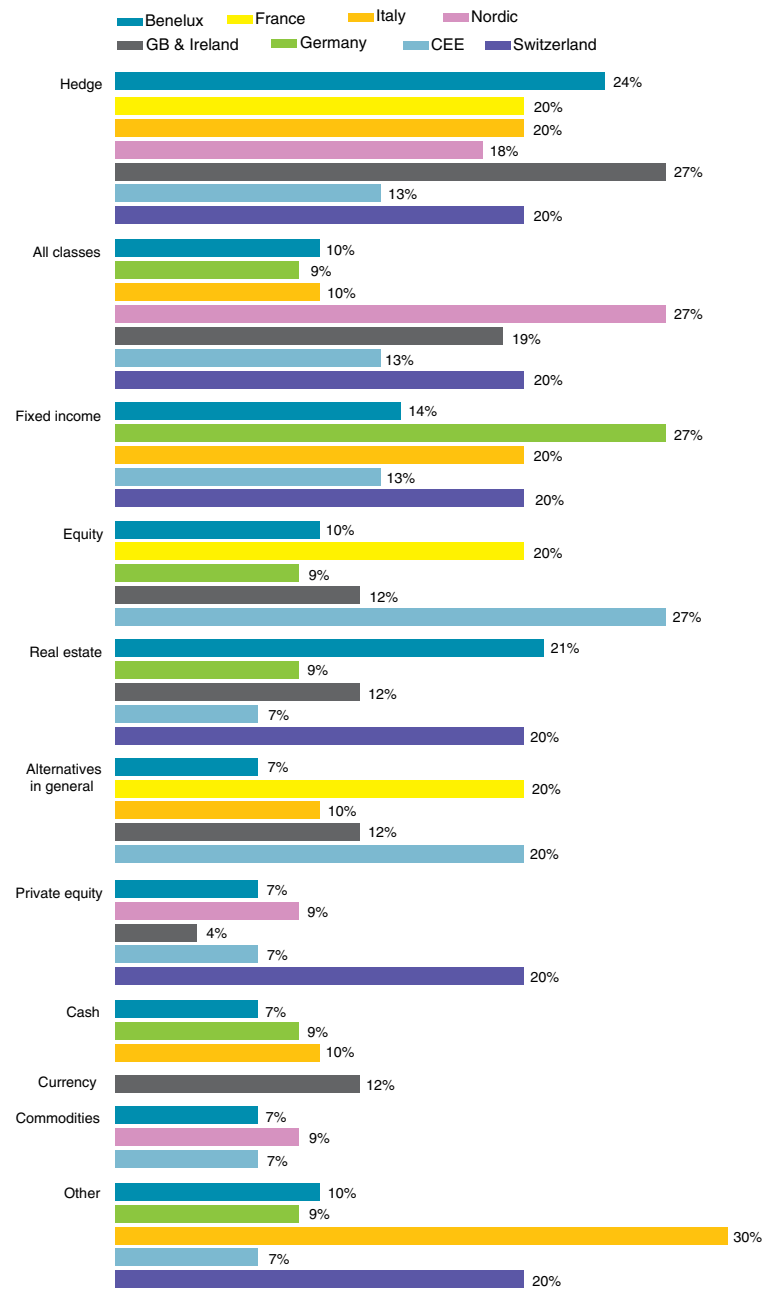
% of 60 respondents looking for both absolute/ relative return



Real estate is more ambivalent in investors' eyes. While its 'alternatives'

4.2 Sources of absolute return by country

% of 74 respondents answering question



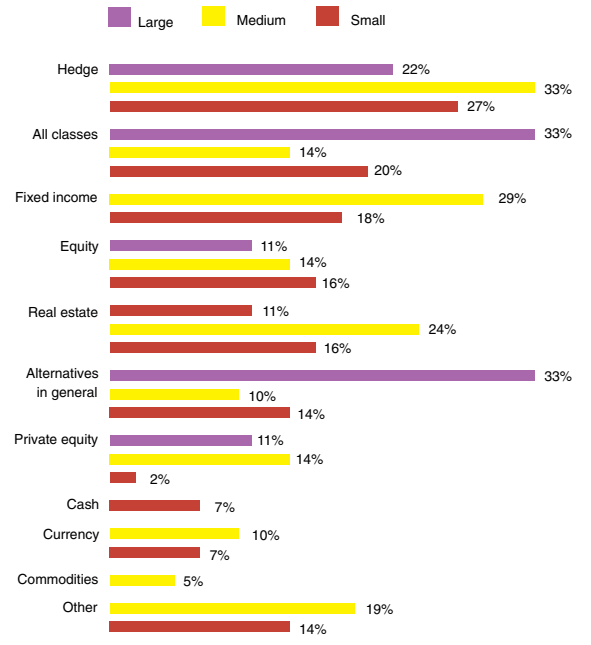
credential sees most investors regarding it as an absolute return play, with the development of real estate investment trusts and other investment vehicles making the market more liquid and subject to relative returns. The arrival of more indices and the wider use of more standardised valuation techniques within portfolios means that, with greater transparency and liquidity, real estate as a relative returns player will increase in importance.

It is clear from the range of returns sources (commodities is regarded by many as not being an asset class) mentioned by investors, that absolute returns can be derived quite widely nowadays.

Figure 4.2 gives the breakdown as to where absolute returns are being sourced in the different countries. It may come as a surprise that Nordic investors' enthusiasm at

4.3 Sources of absolute return by size category

% of 74 respondents answering question



27% overall has outstripped that of other countries in their overall commitment and very focused approach to where they source these returns: hedge funds, private equity and commodities are where they concentrate their assets. But the Swiss investors, long regarded as the master players in this arena, are not that far behind and they take a more across-the-board approach with a consistent 20% response for all sources of absolute return, being reflected in the individual areas of hedge funds, real estate, private equity and others. Swiss conservatism seems to eschew commodities.

But investors across Europe play their hands selectively when it comes to sourcing these returns: in Germany, hedge funds are avoided by our sample, while the Benelux countries are committed, as they are too to real estate and with a reasonable exposure to commodities and private equity, among others, when on the trail of absolute returns.

Variety of combinations

More than half of the survey respondents, 60 in fact, said they pursued absolute and or relative strategies at the same time. We have summarised the strategies adopted by this group of 60 respondents (Figure 4.4). The most popular combination of the nine summaries, by a short margin and indicated by 55%, is alternatives (absolute return), combined with equity (relative return). The second most popular (indicated by 52%) is alternatives (absolute) combined with fixed income (relative). The third most popular were all classes (for both absolute and relative) and fixed income (absolute) combined with equity (relative).

5. Alternative Assets

Looking to diversify

Alternatives have come more and more into their own as portfolio diversifiers, particularly where equity markets were perceived to be more and more correlated. In addition, there was the unkindest correlation of all where fixed income returns declined with equity markets earlier in this decade.

For liability-related investors, this posed the dilemma of equity assets declining in value while liabilities were rising relentlessly as interest rates fell to their lowest levels in decades, outside Japan.

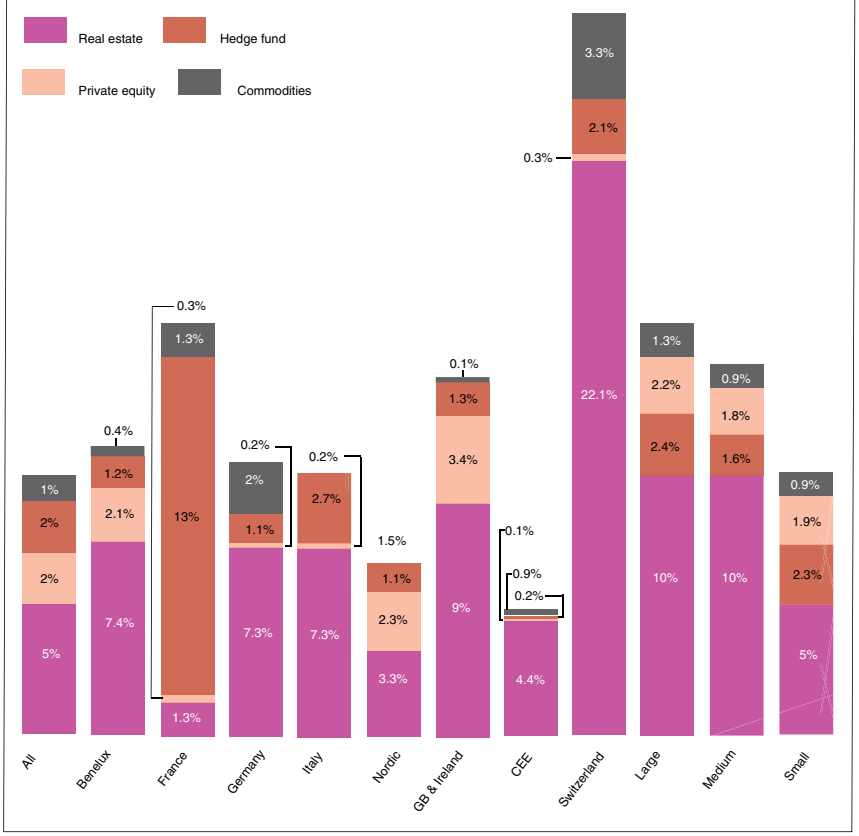
Then the story came from the experience of the US endowment funds, where long-term commitments of sizeable proportions of their portfolios to alternatives, particularly hedge funds, had paid back in terms of superlative returns. Not that European investors were unfamiliar with alternatives, particularly where core-satellite structures were in place. But the figures were generally in lower single digits as to the proportions alternatives made, compared with the 25% plus within the portfolio of serious players in the US.

So in a low return environment, alternatives are attractive for their return potential as well as for diversification and their longstanding drawbacks of being generally less transparent and less marketable became enshrined in the 'illiquidity premium'. Here, longer-term funds were deemed to be particularly appropriate for investors as they could take the longer-term view. Even investors who are aiming to match their liabilities are keen to build return-style portfolios to help hedge their liabilities for inflation and, increasingly, longevity risks.

The array of alternatives that are emerging into the alternatives space also include infrastructure, forestry and timberland, agricultural land, with some of the new environmental technologies, as well as private commercial loans and art. With European funding and

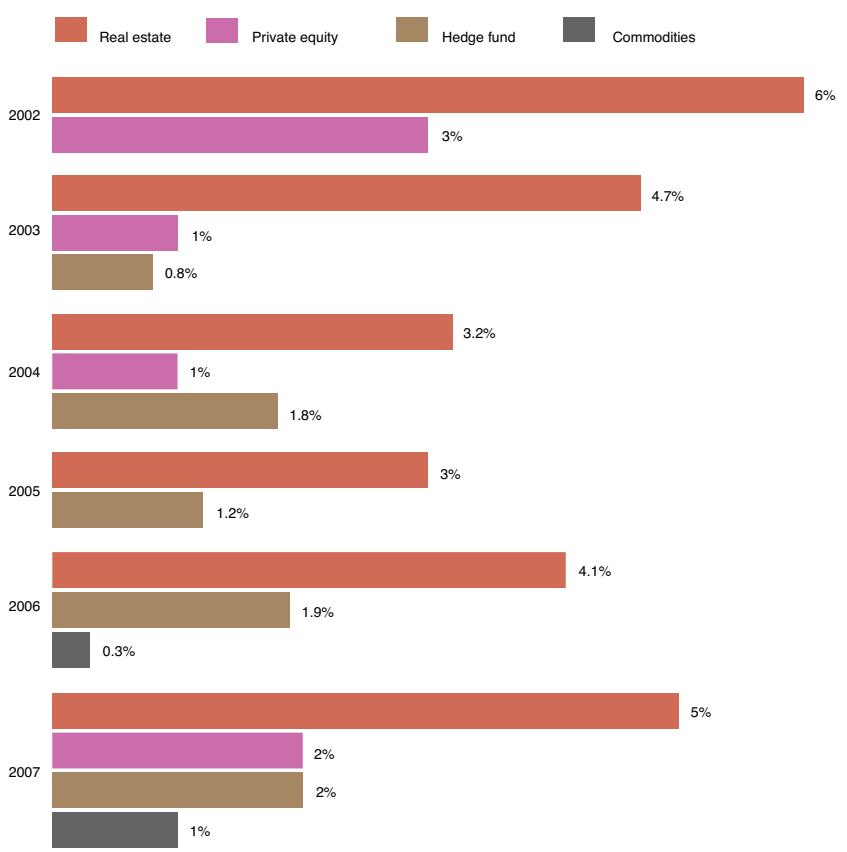
5.1 Selected alternative assets by country and size category

Average % of assets



5.2 Selected alternative assets 2002-2007

Average % of assets



solvency regulations there will inevitably be limits as to how much illiquid investments can be put into portfolios. To achieve the high levels that endowments in the US have may be unrealistic, should investors want to go that far.

But alternatives are set to grow and grow exponentially. If investors' intentions are to be believed, the numbers using these asset classes will rise significantly, with the strongest support coming from investors interested in real estate, private equity, hedge funds, and other unspecified alternatives.

Proponents of alternative assets often stress that small allocations are not enough to have any real impact on portfolios. But a note of caution needs to be entered that there can be a significant gap between investors deciding to increase their alternatives exposures and actually achieving that level of investment.

Real estate direct investment is a clear example of something that inevitably takes time and effort, compared with buying a bond or equity which can be instantaneous. Private equity is a class almost notorious as to the effort it takes to build up exposures. Forestry and timberland can involve similar time lags. Hedge funds require heavy due diligence and commodities can mean new trading and monitoring requirements, depending on how the strategy is implemented.

The alternatives story

Real estate is the floor that underpins European investors' alternatives credentials, as without this exposure the actual amounts committed to alternatives, as it accounts for 5% of the total of 10%.

The overall investment trend in alternatives has been upwards, with real estate holdings up by 1 percentage point, compared with the previous survey, with commodities and private equity showing determined growth to 1% and 2%, respectively. Hedge funds' 2% allocation is the same as in the previous survey. This may suggest a stalling of interest in the asset class - for the time being at least. Commodities are still making progress, but retain a modest allocation overall (Figure 5.1 refers).

But the EIAMS survey has tracked the development of the alternatives story since 2002, as is shown in Figure 5.2. Great care must be taken in drawing conclusions because of the changes in the samples over the years. The figures show the constant presence of real estate, some wavering when it comes to private equity, the emergence of hedge funds as a distinct trend and the more recent identification of commodities as a player, but a minority one at that. It is when we come to individual countries that even more caution has to be exercised in drawing conclusions. In France, the low interest in real estate (down to 1.3% from 3% in 2006) and the exceptional shift to hedge funds from 5% to 13% may be due to the sample of particular respondents rather than representing the market as a whole. Among other interpretations are that investors may view some of their allocations to cash and enhanced cash products – always a feature of the French market – as being regarded by investors as hedge strategies.

Elsewhere, real estate is still the most popular alternative, with GB & Irish and Swiss investors with 9% and 22%, respectively. The survey results do point to the fact that the class is increasing in popularity among the larger and medium-sized funds, though with wide variations from country to country. In a reversal of the previous survey's findings, it is now twice as popular with the large and medium investors than with the smaller funds.

Benelux saw hedge fund allocations grow, as did Germany and Italy, where both marketplaces are hampered by regulatory conditions, though the Germans have managed to ease the insurmountable problems that existed a little time ago.

Private equity has represented 1% or below of average assets for each of the past five years up to the 2006 EIAMS survey. Whilst its average popularity appears to have increased to 2% in the current survey, the British and Irish being the biggest investors, there is little sign of a breakthrough, whether by country or size.

Hedge funds

Hedge funds have been a feature of institutional investment agendas for less than a decade, but they probably have posed more challenges than any other asset, particularly for pension fund investors.

Indeed, were they an asset class at all was one line of attack for hedge fund detractors. The argument here was that they were a range of strategies using mainly traditional assets such as equities and bonds. That they added leverage and used derivatives only compounded the issues for many institutions, many of whom were constrained from such exposure.

Then hedge funds were perceived as being risky, with Long Term Capital Management's history being seen as the bogeyman. The counter arguments were that they were designed to hedge their risks and so helped to reduce volatility by their strategies.

For many institutional investors, the lack of transparency was the killer. How could a pension fund fulfil its fiduciary responsibilities by investing in a black box with an opaque investment process. Hedge funds maintained their raison d'être was to be secretive about their process as this gave them their performance edge.

Then there were the high entry, high annual management and hefty performance fees. And where this was

directed towards achieving a return mid-way between bonds and equities, the prospects for investors did not look that attractive.

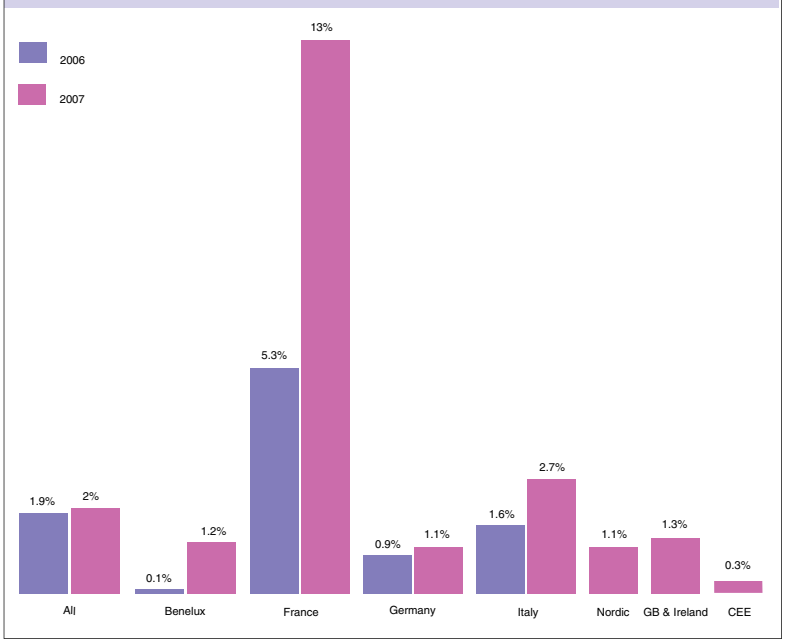
Not all in the hedge fund industry were that sure they wanted institutions as investors at all. In fact, there was a real danger that their abilities to finesse the markets could be endangered by the sums that institutions might want to invest. Could their strategies absorb tens of millions or even hundreds of millions?

But when the dotcom boom burst, the charms of hedge funds became more apparent. In a low yield environment no one was expecting the lights to be shot out in performance terms, and the forgotten charms of absolute returns, where hedge funds had pretensions, meant more of a re-evaluation by institutions. Undoubtedly, the level of knowledge about hedge funds has increased, with some of this being learned the hard way more recently.

Also, the industry moved by having investible hedge fund indices - some seeing this as a contradiction in terms, it also adapted the fund of fund structure to hedge funds to help institutions build portfolios that used hedge funds that were well researched and monitored by expert groups. These are seen in the survey as the most popular hedge fund product. Often now for singleton hedge funds much more information can be provided about their investment positions and levels of risk to their investors on even a daily basis.

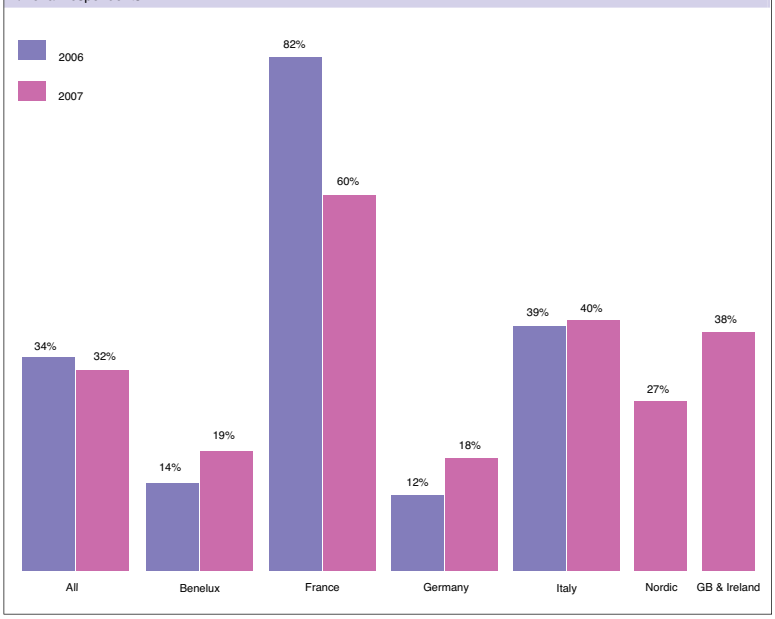
5.3 Hedge fund assets by country 2006-2007

Average % of assets



5.4 Hedge fund users by country 2006-2007

% of all respondents



That said, the survey shows that the conquest of institutions' understanding and their deep pockets has still a long way to go. Yes, there has been growth but this is only very marginal between this and the 2006 survey. Size of investors seems to be much less of an issue with both the large and small investors making much the same allocations in both surveys of just under 2.5% (Figure 5.1 refers). Medium sized funds trail this at a 1.6% allocation.

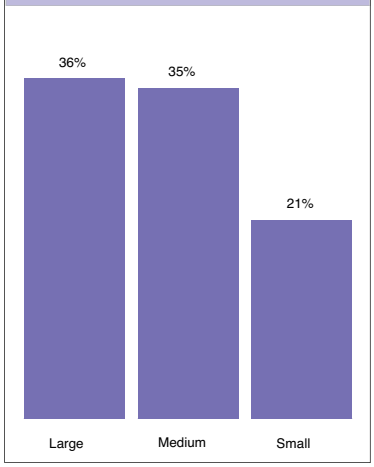
As to the assets in hedge funds on a country by country basis, the growth has been most significant in Benelux and Italy, with Germany coming in significantly behind (Figure 5.3). The French again would seem to be an anomaly, even given the fact that they had an exceptionally high commitment to hedge funds in the previous survey and granted the general trend to increased exposure, which may well be more pronounced in France than elsewhere, nonetheless the 13% seems to be a result attributable to the particular sample surveyed.

Given the small proportions hedge funds make up of portfolios, the actual numbers of investors using them is relatively high. The small decrease from the previous survey overall could well be attributable to the change in the composition of the survey sample, with the shift from bank and insurance investors to more pension funds, which are perceived to be behind the curve here to a degree when compared with other institutions.

On a country breakdown, there has been a noticeable rise in the numbers of investors using hedge funds in Benelux and Germany over the period between the surveys. Though the French are the only investors to show a decline it still is the highest level, but again a note of caution relating to sample size has to be sounded (Figure 5.4).

Looking at the investor-size dimension, over one third of the larger and medium sized investors said that they em-

5.5 Hedge fund users by size
% of all respondents

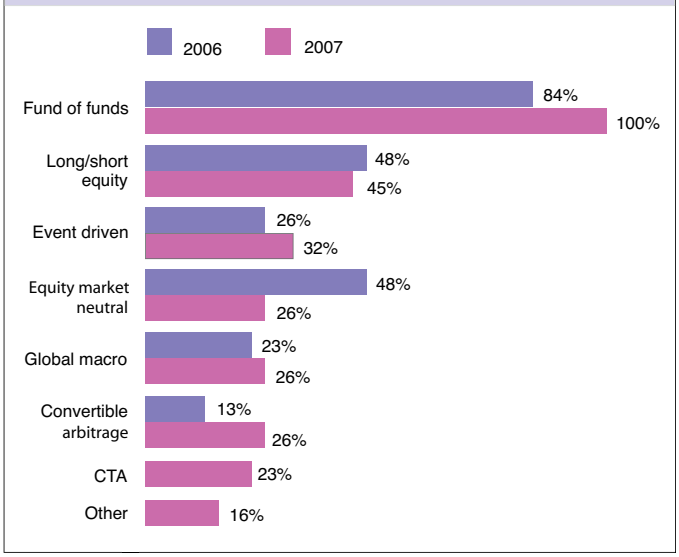


ploy hedge fund strategies and only one-fifth of the smaller investors (Figure 5.5).

Hedge funds of funds remain the vehicle of choice, being the most popular by far and used by 100% of those who used hedge funds in this survey, up from 84% previously. After this in terms of popularity come equity long/short funds, event driven and equity market neutral. Interest in convertible arbitrage, now equal fourth in the hedge fund popularity stakes, has attracted a doubling of users (Figure 5.6).

The shift in usage has been mainly away from strategies involving equities, which may be related to difficulties in the equity markets. Those in more favour in the current survey include Global Macro and Convertible Arbitrage, where the cyclical conditions are favourable. The interest in CTA strategies is not surprising given the commodities boom.

5.6 Users of different hedge fund products 2006-2007
% of users of hedge funds



6. Portfolio tools and instruments

The use of derivative-based products by investing institutions has been very much dependent on their sophistication and size. Certainly, corporates and insurance companies have been actively involved in the market for some time, as have been the larger pension funds.

In fact, it was often said that corporate sponsors would be very involved in using derivative instruments within their treasury and finance departments, whilst the pension fund situated down the corridor might even have a covenant restricting or forbidding the use of any derivatives. These conditions seem to be disappearing and products such as swaps are being used increasingly. Our findings about the duration gaps that investors are facing (Section 7) are likely to mean that these investors will turn to swaps as among the instruments appropriate to meeting their needs.

However, when pension funds use investment funds, including hedge funds, there are often no restrictions on the use of instruments within these by third party managers, though there could be when using segregated accounts with an external manager.

a. Structured products

We defined these as instruments including non-standard features, such as capital protection, warrant and loan gearing, commodity hedge arbitrage, and share index style investment.

Slightly more investors use structured products, some 32, or 28% of the respondents (Figure 6.1 refers). As a proportion this is a fall from the 33% of users in the previous survey. Again, this is likely to be a reflection of the change in the database responding.

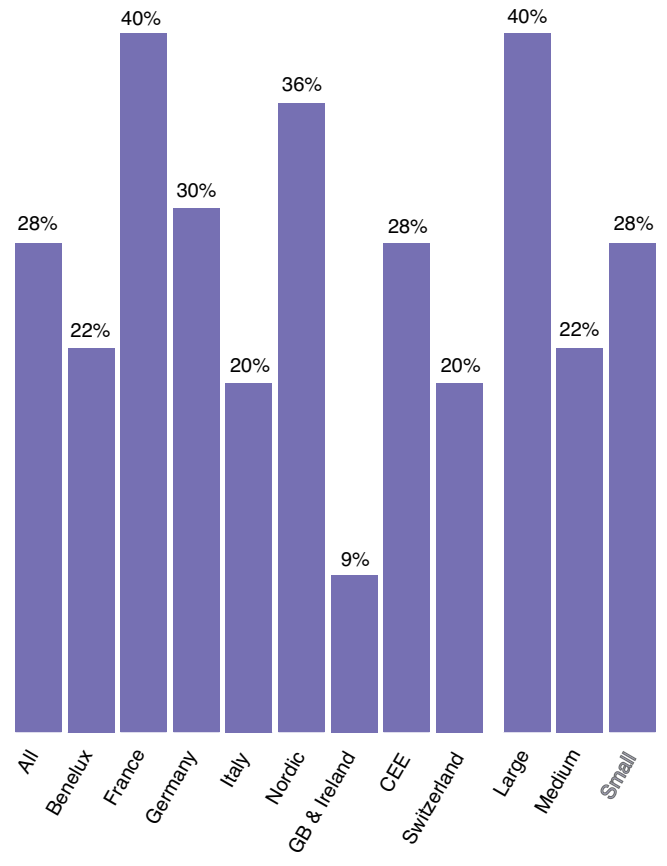
On a country-basis (Figure 6.1), the French investors remain the biggest users, at 40%. Given the traditions of financially engineered products in France, including the dynamic cash funds, this high usage may not be surprising, but it is significantly down from the previous survey's 59% level. The difference in response rate from the French market and size of respondents is likely to account for this drop.

German investors, with their interest in portfolio protection products and certificate investing, are indicating growth in this area and creeping up on the Nordic investors' 36% exposure. Other responses are a bit more mixed, with Benelux up and Italy down on the earlier survey's findings.

Of the country's newly included, it is interesting that the CEE countries are seriously involved in such products, while the Swiss are somewhat lower, with the British and

6.1 Structured product users by country and size category

% of all respondents



Irish investors being well behind the curve, with just 9% level of use among investors. This illustrates the fact that the putting together of structures in this way has not really penetrated the institutional market.

As might be expected (Figure 6.1), the larger funds at 40% are well above average in their usage of structured products, while the small funds hit the average figure of 28%. When it comes to institutions' reasons for using them, Figure 6.2 indicates the main reason was to increase capital protection, followed in equal measure by higher income and diversification.

In fact, demand for capital protection has risen from third place in 2006, while risk reduction has fallen from first to fourth. Included in 'Other' are: exposure to niche markets with security of capital, and obtaining added value from derivatives embedded in the structure.

b. Exchange traded funds

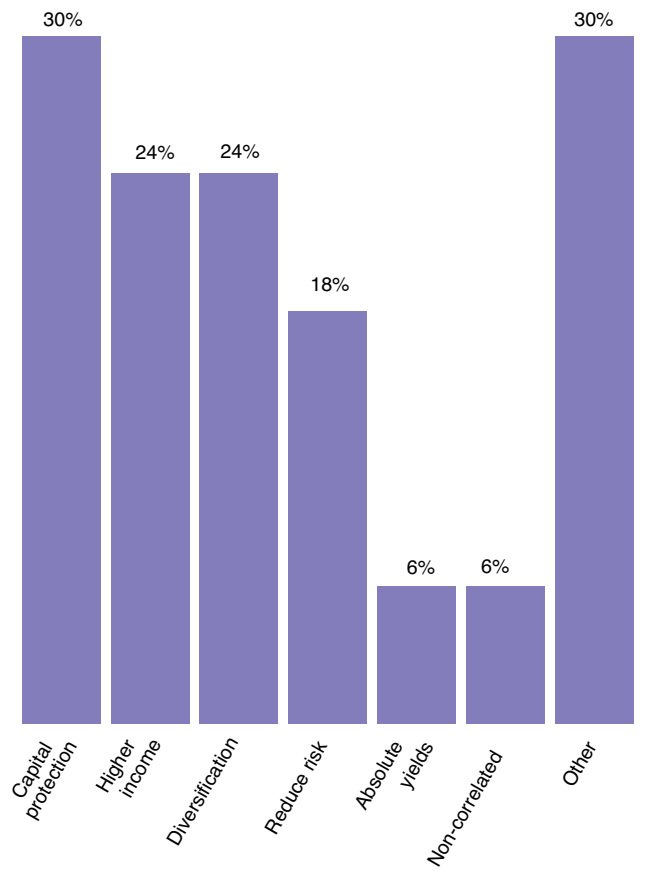
Institutions' acceptance of exchange traded funds (ETFs) in Europe could not be described as an overnight success, no more than they were in the US, where they too took time to earn their place.

But between this EIAMS and the previous one the picture has changed completely, as our results below show.

ETFs have a number of remarkable characteristics from

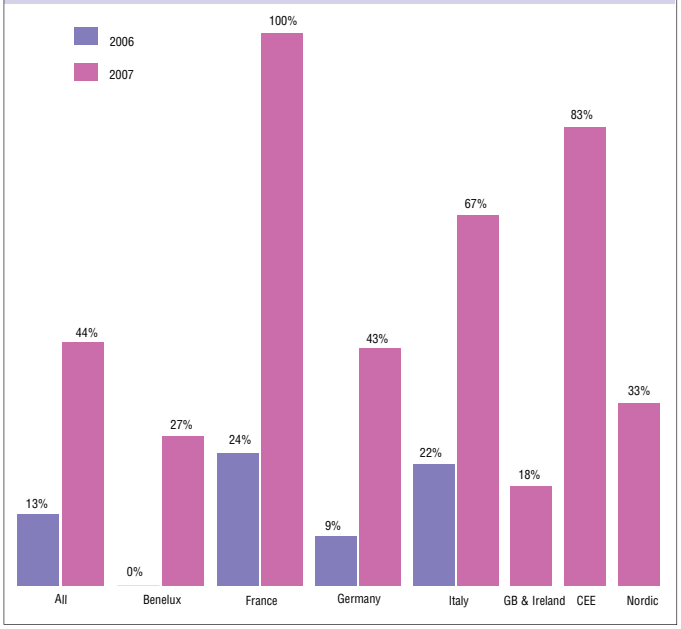
6.2 Reasons for using structured products

% of users of structured products



6.3 Exchange traded funds (ETF) users 2006-2007

% of all respondents



the investor viewpoint, particularly as they enable institutions to perform a number of the functions they could only do previously through derivatives. The importance of this is that for funds with constraints about using derivatives, this gave them the flexibility in obtaining, say, index market exposures without having recourse to forwards.

To some extent it has been a product provider development in Europe, with an ever-increasing range of innovative products, giving investors access to the widest range of liquid and not so liquid investment choices. The picture now seems to be changing with investors using these tools as never before.

The current survey also looks at how ETFs are being used as one of the techniques to obtain index exposure, because this, as mentioned above, is one of the drivers of the ETF evolution – or is it going to be a revolution?

The increase in use of ETFs anticipated in 2006, which did not then materialise, took place in 2007. Growth has more than trebled from 13% in 2006 to 44% in this survey (Figure 6.3).

All markets covered in the previous survey are showing very substantial increases in usage, though some doubts have to be expressed as to how representative our sample is of the French market. Anecdotally, there have been significant increases amongst the French institutions, but 100% coverage of the market has not occurred, which is a product of the sample size.

Of the newcomers to EIAMS, the CEE countries have taken to using ETFs extensively, judging by the results. Perhaps because these markets will come with little baggage, they may have viewed the instruments purely on their merits and so moved ahead of the crowd. The perhaps more hide-bound British and Irish investors are certainly being judicious as to their ETF take-up.

ETFs were employed by one half of the larger investors, which represented about twice the usage by medium and smaller funds (Figure 6.4) .

c. Fundamental indexing

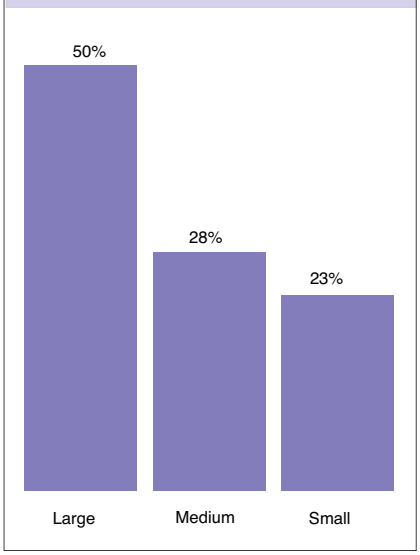
The arrival of 'fundamental indexing' concepts within institutional investing has initiated considerable discussion and challenges to the established universes of market capitalisation weighting, used very much by investors with relative return benchmarks.

One of the resulting discussions has been about 'fundamental indexing' as an investment strategy rather than as a 'neutral index'.

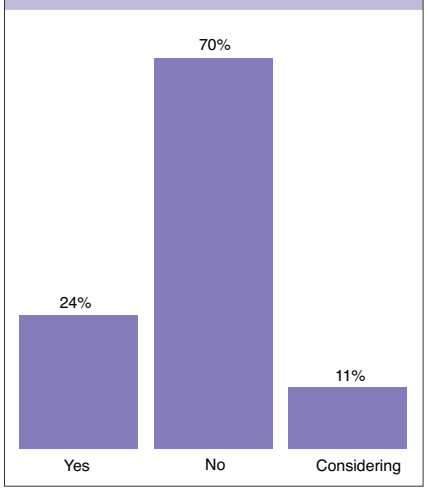
But the term "fundamental indexing" can easily mean different things to different people, so when we put a question on the topic in the survey for the first time, we made sure to include a definition as follows: 'an index where the weighting of individual stocks is composed using factors such as level of sales, cash flow, dividends and book value rather than using market capitalisation as with traditional indices'.

The survey question as to 'Use of fundamental indexing strategies' had a high level of responses, with 105 out the 115 responding. We have no way of telling whether the definition provided accorded with respondents' own understanding of the term. Some 70% said

6.4 Exchange traded funds (ETFs) users by size
% of all respondents



6.5 Use of fundamental indexing strategies
% of 105 respondents to question

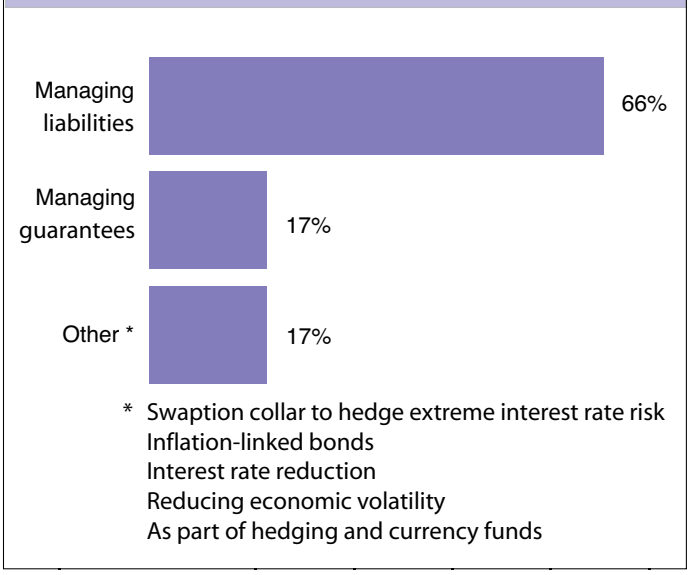


that they do not use them, almost three times as many as did (24%), with just 11% saying that such strategies were under consideration (Figure 6.5).

d. Interest and inflation rate swaps

For the first time in the EIAMS, we asked respondents, who employ interest rate or inflation rate swaps, to tell us their reasons for doing so. The fact that only 30 of the 115 survey respondents overall replied to this question indicates that there is still some distance to be travelled before usage becomes universal within institutional investing, particularly among pension funds.

6.6 Reason for implementation of interest or inflation rate swap approaches
% of 30 respondents to question

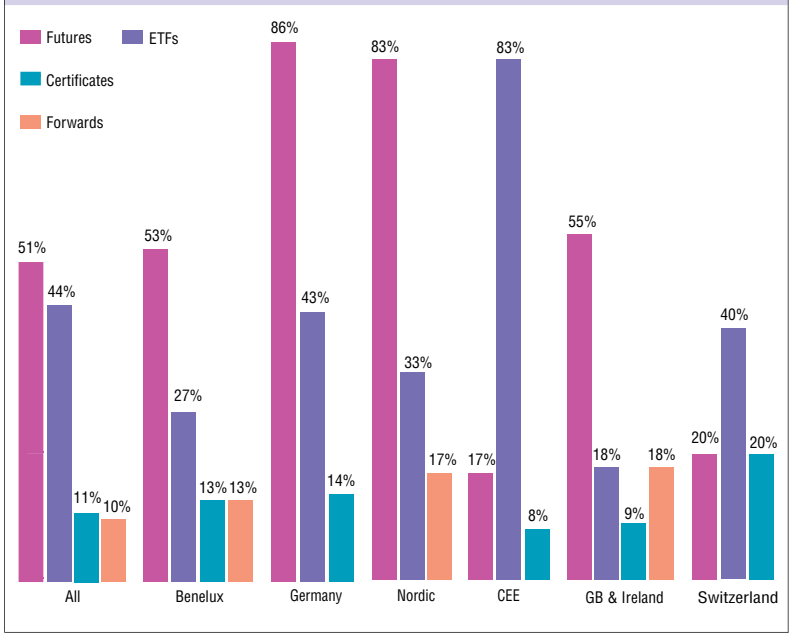


Of those that do use them, the main rationale, expressed by two thirds (66%) of respondents (Figure 6.6), was to manage liabilities. Some 17% said it was to manage guarantees, given by insurers and a range of pension funds in certain countries.

This latter figure is the same as those under the umbrella of 'Other' and included a variety of reasons, such as:

- 'swaptions to hedge extreme interest rate risk',
- 'inflation-linked bonds',
- 'interest rate reduction',
- 'reducing economic volatility',
- 'part of hedging and currency funds'

6.7 Techniques used to gain index exposure
% of 63 respondents to question



e. Index exposure

For the first time, we asked respondents which techniques they used to obtain index exposure. According to Figure 6.7, futures were most popular with 51% overall, the Germans and Nordics using them most, with figures of 86% and 83%, respectively. The Swiss and the CEE countries were least likely to be users of futures.

ETFs were the second-most used way of obtaining this index exposure, but there were wide regional variations with, as seen from our earlier comments, the CEE countries being big users. It is interesting to note the limited usage of certificates on a country basis.

In future surveys, it will be interesting to follow through and see how far the ETF penetration will take over from the now traditional futures.

7. Duration gap

Mind the gap

Where investors are investing to meet a predetermined set of liabilities in the future, they need to make sure that not only are there sufficient assets to meet these, but that there is a match between liabilities and the assets, both from their nature and their timing.

As fixed income is widely regarded as being most likely to be the asset with the 'best fit' to the liabilities faced by pension funds or insurance companies, one measure increasingly being used is to see how well the average length or duration of fixed income portfolios meets the average length of the liabilities. The closer they are together, the less of a risk of a mismatch and the securer the institution is in being able to meet the anticipated liabilities as they fall in the future.

In the equity boom, sufficient attention was not paid to the liabilities, as the gushing well of investment returns seemed more than capable of covering liabilities and everything else. There was rude awakening in this decade with lower returns impacting liability levels, plus the increasing longevity scenario has resulted in pension funds and insurers having to pay much more attention to their liabilities. Regulators in a number of countries made their moves in response, notably Scandinavia where they required liabilities be marked to market, and they imposed new funding requirements in the Netherlands and the UK.

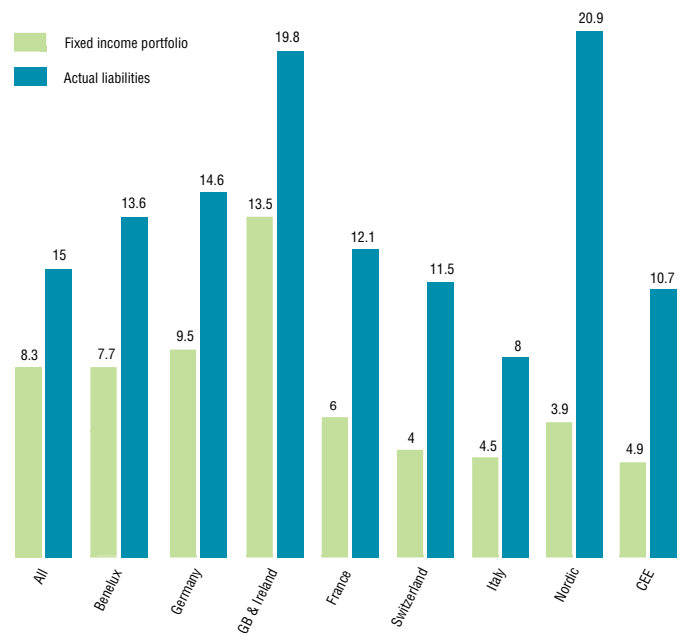
Investors rediscovered the merits of matching their liabilities, and the product providers developed a range of offerings under the broadly based liability-driven investing (LDI) strategies label. While there have been some high profile adopters of full LDI strategies by investors, others have made partial moves to immunise their portfolios, using a range of techniques.

The impact on the fixed income market has been noticeable, with a shortage in the availability of long-dated stock by governments as, generally, they were not issuing debt to any great extent. In the UK, the demand for long-dated stock by pension funds, for example, inverted the yield curve at the longer maturities.

Another effect was to open the door to the investment banking community, which arrived on the scene ready to tailor portfolios to liabilities by use of swaps and other products involving derivatives, thus taking a number of institutional investors into terra incognita.

So how far have Europe's institutions moved in this direction? In the previous survey, we asked explicitly about LDI strategies and found that by then there had not been really significant implementation. We decided to ask the question that lay behind, that of the overall duration of fixed income portfolios and the actual liabilities, just concentrating on looking at how investors in the different markets were focused (Figure 7.1).

7.1 Overall duration of fixed income portfolio and actual liabilities by country
Average number of years for 64 respondents to question



This is obviously a snapshot taken at a certain moment, but we intend this to be a benchmark for future years to judge how the picture changes from this year's survey. We only used the answers of the 64 investors who gave the duration figures for both the fixed income portfolio and their liabilities. The table below sets out the difference between the two figures for each country's average - in all cases the duration of the liabilities exceeded the fixed income portfolios duration:

Country	Difference in years
Benelux	5.9
Germany	5.1
GB and Ireland	6.3
France	6.1
Switzerland	7.5
Italy	3.5
Nordic	17.0
CEE	5.8
All countries	6.7

Comparisons between markets are difficult due to the varying regulatory regimes and the extent of the involvement in defined benefit type business, so obviously these ratios are key for the British, Irish and Dutch investors on this count and these figures are not that far apart. In Germany, where a more insurance-based approach is used, the gap is even narrower, while Italy has the least. In the Nordics, the regimes are different, especially so in Denmark, where achieving the fund stipulated guaranteed rates of return can be the key objective.

Our hunch is that had we attempted to measure this figure in earlier surveys, the gap would have been significantly wider absolutely and between countries. This crucial endeavour of investors to bring the two more into line is work in progress and our aim is to monitor how this is happening.

8. Performance attribution

Having the key information about portfolios is essential to the successful running of any investments. So, it is critical to know what the investment performance has been and which elements of the portfolio were responsible for both the good and not so good results achieved.

Now, with the more sophisticated techniques and technology available, the breakdowns and analysis of the sources of returns within portfolios can enable investors to drill down to the components responsible for both outperformance and under-performance.

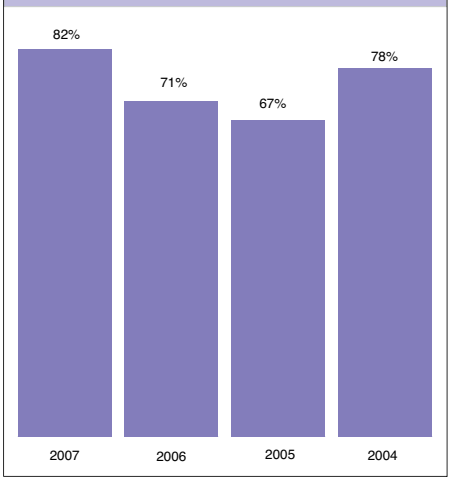
The 2008 survey finds that performance attribution is used by 82% of respondents, which is 11% higher than the previous survey (Figure 8.1). This is almost universal usage, which is an indicator of the importance attached to this aspect of portfolio analysis.

Whilst investment managers remain the single largest providers of performance attribution, they are doing less of it overall, as in the 2006 survey they were doing 61% of the analysis, whereas in the current findings, this has fallen to 41%.

As Figure 8.2 shows, this has been picked up, fairly uniformly, by the other contenders: internal departments, custodians and external performance analysts.

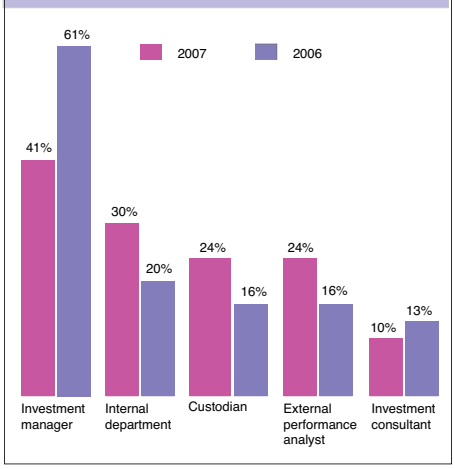
8.1 Users of performance attribution 2004-2007

% of all respondents



8.2 Suppliers of performance attribution 2006-2007

% of users of performance attribution



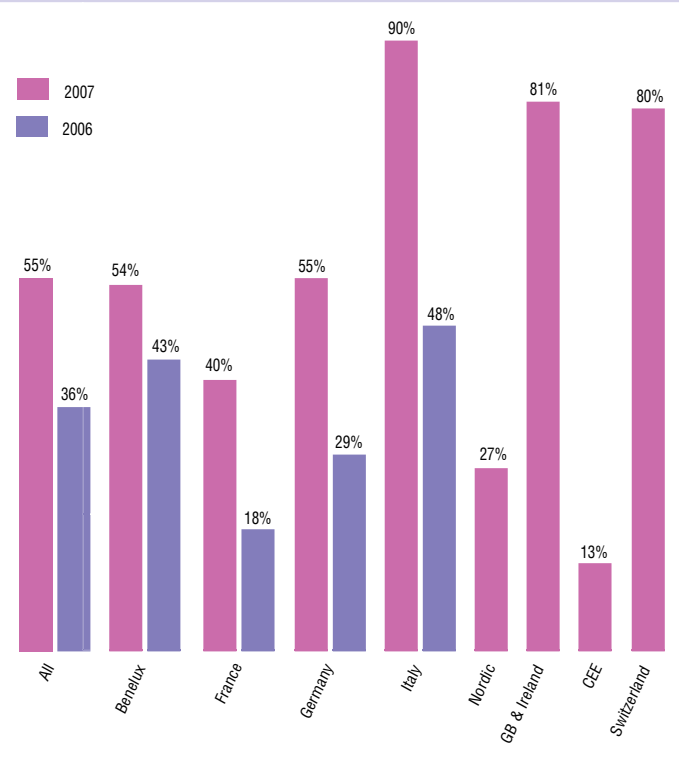
9. Investment consultants

The emergence of consultants onto the European institutional scene has long been predicted and the EIAMS results confirm that this is now happening. The consultant community exists in some form in most countries in Europe, but their representation depends on a variety of factors, not least the size of pension assets within the country.

While external actuarial consultants have long been a feature of the continental European scene active in advising pension funds and insurers on their liabilities, the rise of investment consultants advising on the assets side has been much more varied, sometimes seeming to rest on cultural issues as much as the volume of the assets and the number of institutions in the particular market.

Practices vary as to how consultants are used, whether as part of one-off assignments or ongoing relationships and, indeed, the degree of regulation within the market. In a few countries there are explicit requirements to use them.

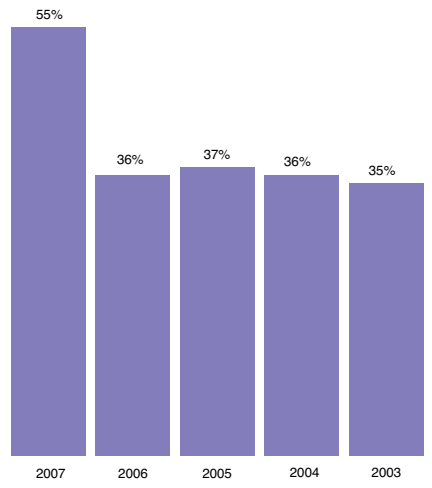
9.2 Users of consultants by country 2006-2007
% of all respondents



More in demand

The use of consultants by our respondents has grown considerably from about one-third in each of the previous years' surveys to over one-half in our current findings (Figure 9.1). The small variations between survey in the years 2003 to 2006 should not be taken as significant. The real jump has been in this current survey.

9.1 Users of consultants 2003-2007
% of all respondents

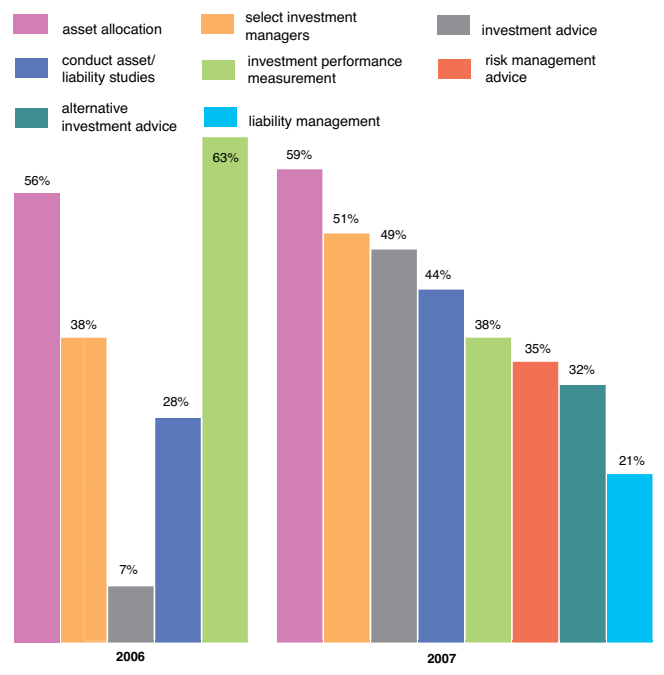


While it may herald the expected increase, it may also be explained partially by the higher proportion of pension funds respondent this time around, together with the inclusion for the first time of responses from the British, Irish and Swiss markets, all of which are high consumers of consultancy services. But additionally, there seems to have been a significant uptake in France, Germany and Italy.

When we look in more detail at the country level results (Figure 9.2), compared with the previous survey, it is the Italians, who remain most likely to use consultants, thanks in part to their detailed regulation for the conduct of pension funds.

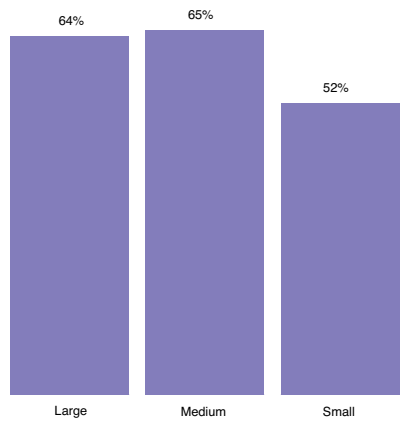
The usage by Italians is almost matched by the new countries covered, the British and Irish investors are loath to make moves without their consultants and with the Swiss almost matching the Italians. The Nordic countries vary, with Denmark and Finland less involved in consultants, while the Norwegians and Swedes are

9.4 Reasons for usage of consultants 2006-2007
% of respondents who use consultants



9.3 Users of consultants by size

% of all respondents



more open to working with outside advisers.

Judging by Figure 9.3, size does not seem to matter when it comes to using consultants. Two thirds of both the larger and medium-sized respondents are users, with just over one half of the smaller players.

Consultants were most in demand, according to the findings of the current survey, for asset allocation advice, with 59% giving this as their number one reason, followed closely by manager selection and investment advice, at 51% and 49%, respectively, as in Figure 9.4.

In 2006, investment performance monitoring had occasioned the most demand for consultants, but this had reduced from 63% to 38% in 2007.

10. External managers: usage and change

Increasing complexity

Institutional investors' relationships with the external asset management industry have of necessity to be very close, as what is not done internally has to be done externally.

Throughout Europe, the trend has been to outsource investment management, as our survey's findings confirm. In some marketplaces, the trend has been more pronounced and longer established than in others.

The move to externalise the asset management function has been partly in response to the increasing complexity of institutional portfolios, with the growing number of asset classes and specialist mandates used. Previously, when investments were largely restricted to domestic assets, whether fixed income or equities, the in-house teams were well placed to deliver an effective investment solution in terms of costs and performance.

The arrival of the euro, widening the 'domestic' opportunity sets for continental investors, was a major driver for outside management. For example, equity portfolios became not just regional and sectoral, but also global.

On the fixed income side, the widening of the market coincided with the arrival of the credits approach which dramatically widens the fixed income opportunities.

Large institutions still keep significant proportions under internal management, the survey confirms, but continue to actively scour the world for those managers that can provide the alpha they need in sufficient quantities.

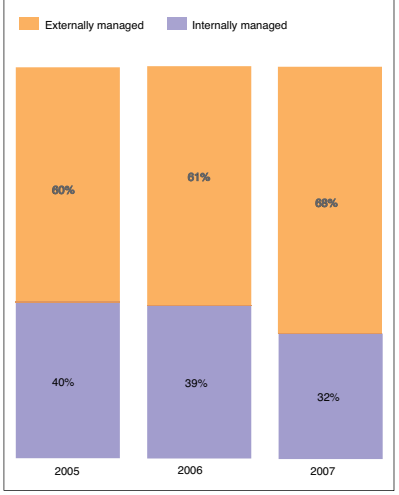
Where more sophisticated approaches are being used, such as liability matching and liability-driven strategies, the use of external managers is considered essential, but even investment processes such as passive or enhanced indexing, with their use of sophisticated technology, require outsourcing.

Another factor encouraging outsourcing is the difficulty of remunerating asset managers at current market rates within the constraints of pension fund or insurance company traditional pay scales. Too often, these investors find they are the training ground for young managers who leave to join commercial managers and enhance their prospects.

We are now seeing the full extent of outsourcing with a number of pension funds hiving off their asset management arms as separate entities and intending to grow these as stand-alone operations servicing their internal clients and seeking third-party business in the marketplace.

10.1 Users of external investment managers by vehicle

% of 89 respondents to question

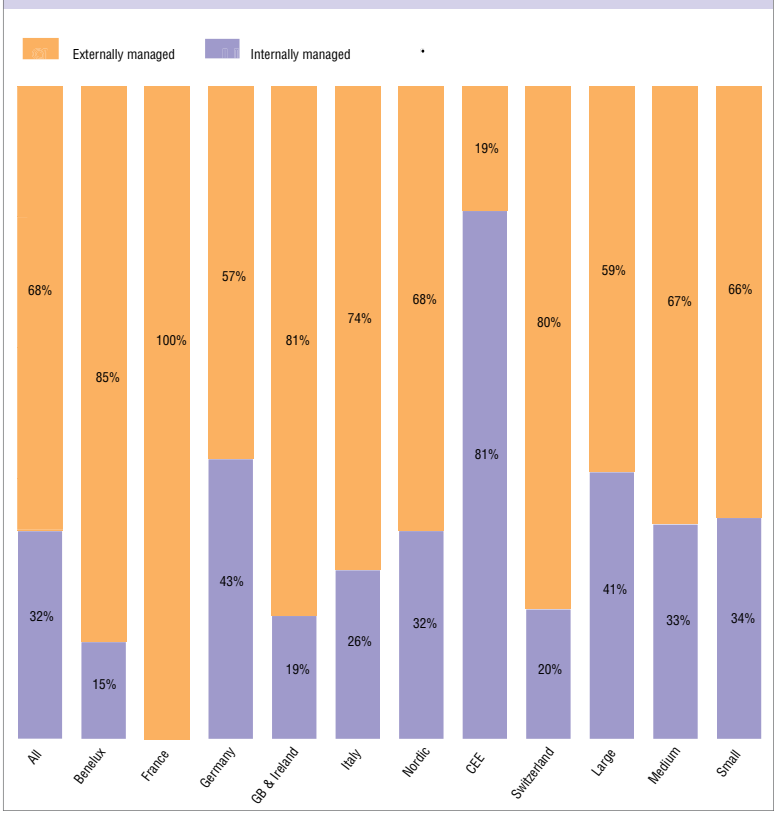


The gradual trend to more external asset management took a big jump according to the 2008 survey results. There are problems in comparing the results as it is likely, with the latest sample including British, Irish and Swiss investors who favour external managers, to have given the results a tilt in that direction. Also, with more pension funds and less insurance companies and banks among the respondents, there is likely to be a bias towards external managers, as previous surveys have disclosed.

Though it is impossible to quantify the impact of these influences, there must still be an inherent presumption that the move to external management is a trend in its own right (Figure 10.1).

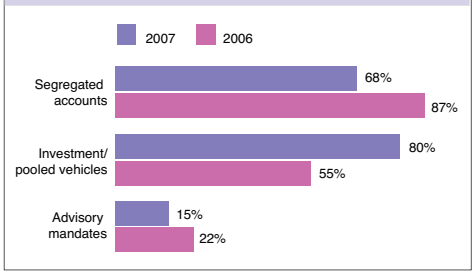
10.2 Assets delegated to external investment managers by country and size

Average % of assets of 89 respondents to question



10.3 Users of external investment managers by vehicle

% of 94 respondents to question

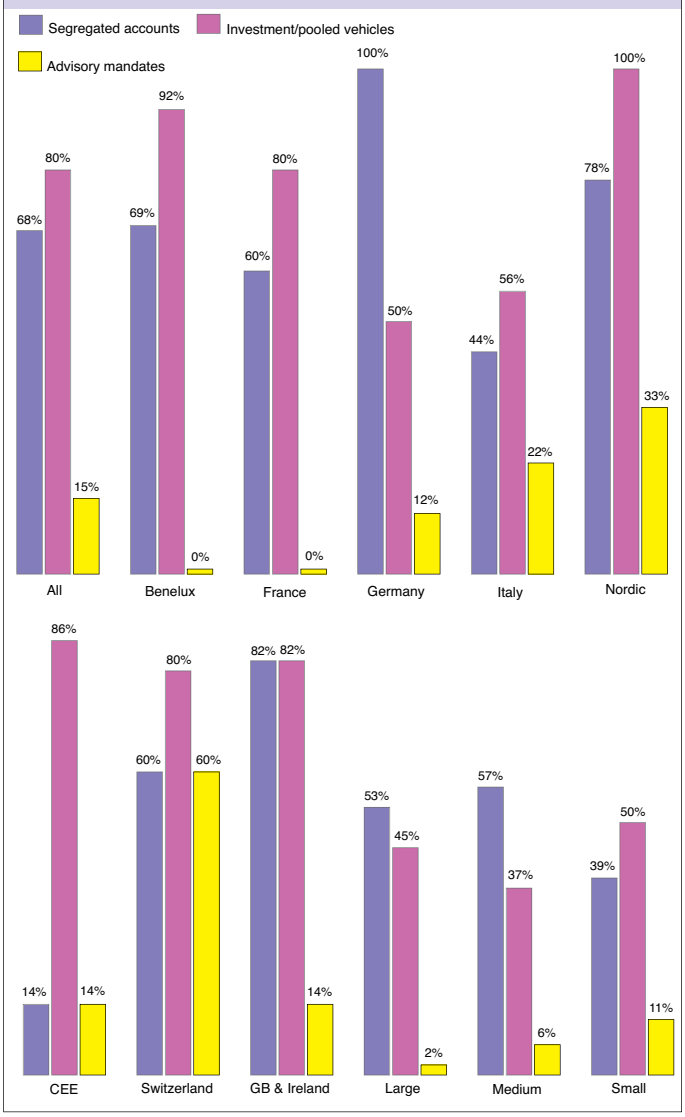


When focusing on individual countries, the problem referred to earlier with the French sample must be acknowledged again, as this conclusion of 100% being outsourced is unlikely to square with what is happening on the ground (Figure 10.2).

The small amount of outsourcing within the CEE area reflects the situation in many of these markets, where the main pension institutions are in the hands of the banking groups which are capable of undertaking their own investments. An additional factor could be the limitations on investing domestically, which favours internal management of assets.

10.4 Users of external investment vehicles by country and size category

% of 94 respondents to question



German investors have maintained their dedicated stance to delegating least to external managers.

On the size-related aspects (Figure 10.2 refers), compared with the previous survey when twice as many smaller investors said they delegated to outside managers than larger investors, respondents to the latest survey are indicating a much closer pattern between large, medium and small investors. As mentioned, sample shifts are likely to have played a part here.

The pooling plunge

We have again explored demand for the different types of vehicles offered by external managers, looking in particular at segregated accounts, investment funds/pooled vehicles and advisory mandates. Again, sample changes may have resulted in more apparent use of funds and pooled vehicles, at the expense of segregated mandates, with a fall from 87% to 68% over the surveys (Figure 10.3).

But by the same token, there is reckoned to be an increased willingness on the part of investors of all sizes to consider managers' funds over segregated accounts (Figure 10.4). Due to increasingly flexible fee structures, funds are now used where before they would have been shunned as being for retail investors. Segregated accounts are used most by Germans (presumably treating Spezialfonds as segregated accounts, which they are in all but name) and British and Irish investors, and least by the Italians and CEE respondents. Funds or pooled vehicles are favoured most by Benelux and Nordic investors. Advisory mandates seem to have fallen in popularity right across the board.

11. External managers: asset allocation

So how do internally managed portfolios compare with external (Figure 11.1)? The equity proportion of externally managed funds comes to 27%, compared with 11% for internal assets - it is interesting to compare this figure with that in Figure 3.2, where the equity proportion invested in investors' domestic markets is put at 9%.

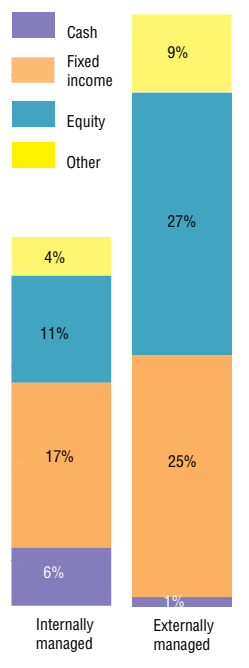
For government bonds invested domestically the proportion is 19.8% (Figure 3.2), while the proportion that is internally managed is 17%. Domestic cash runs to 4.9% of portfolios, while the proportion invested internally comes out at 6% in the survey.

The highest proportions of fixed income assets delegated to external managers are in Benelux, Germany, the Nordic countries and Switzerland (Figure 11.2), while British and Irish investors delegate the most equity assets at 37% which is more than twice the asset levels passed out by German investors.

The larger and smaller investors are allocating substantially more fixed income assets to external managers (Figure 11.3), but proportionately less of their equity assets. Most use is made of segregated accounts by medium-sized investors, while the smaller funds are biggest users of pooled vehicles (Figure 10.4).

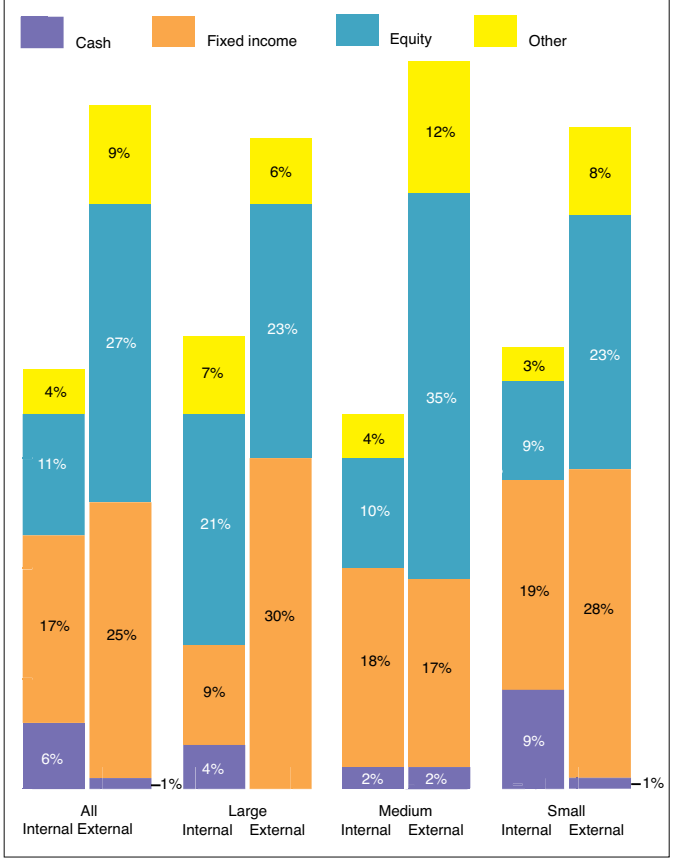
11.1 Asset allocation by internal and external management

Average % of assets



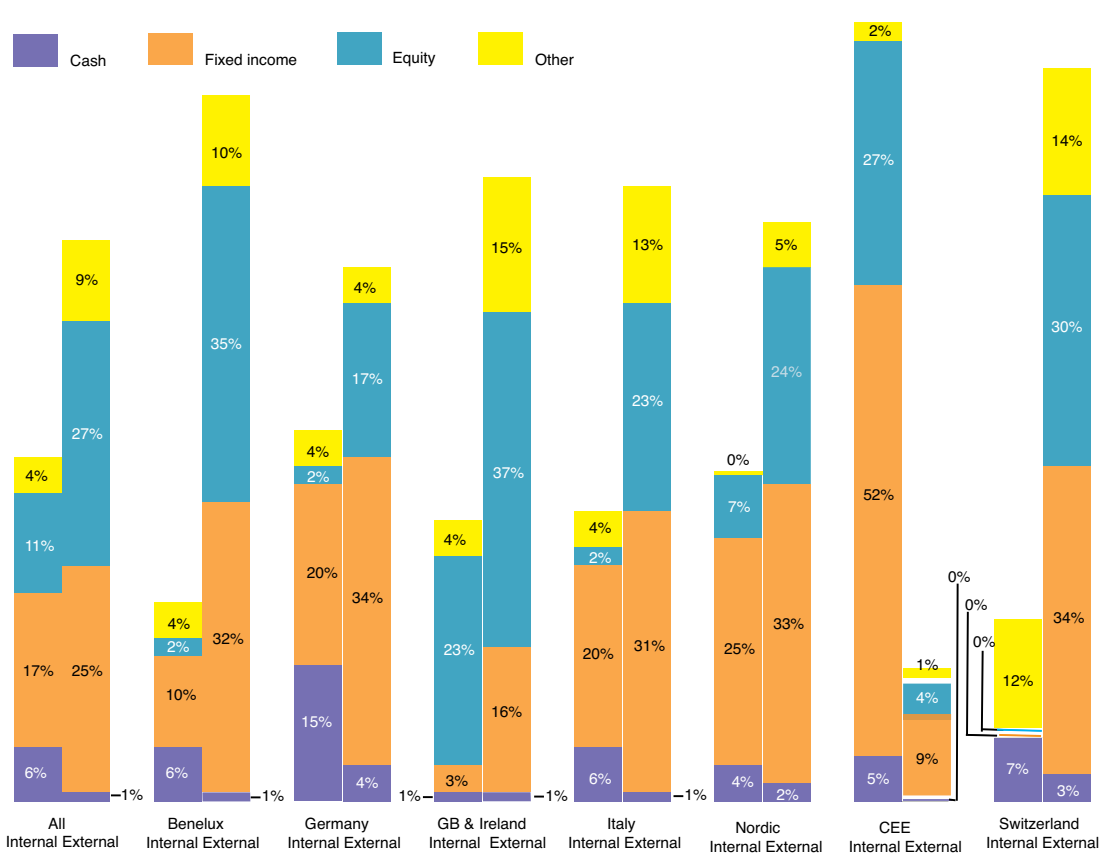
11.3 Asset allocation by internal and external management by size

Average % of assets



11.2 Asset allocation by internal and external management by country

Average % of assets



12. External managers: selection

Role of beauty parades

For outsourced mandates, selecting an asset manager is seen as one of the most important issues facing investors, particularly so among pension funds, with their extra propensity to use external managers.

During the equity boom in particular, the main focus of funds in certain countries was on this issue, to the detriment of other aspects of the portfolio and what was trying to be achieved. The question of running beauty parades to ensure that the best of breed was selected became a very high preoccupation, especially among pension trustees and investment committees.

In this climate, the emphasis was directed at finding the manager who could produce those extra basis points, but probably without sufficient attention being paid, for example, to the changes on the liability side. When shifts occur here, such as due to interest rate movements or marking of liabilities to market, they can have dramatic effects on the institution's balance sheet, easily swamping out any beneficial effects of manager out-performance.

During this decade, there has been a greater realisation that the asset side of institutions' balance sheets are not the only concern. But for those institutions, such as endowments, national reserve funds and, increasingly, sovereign wealth funds, where there may not be specific liabilities to be matched, the return aspect will always be as crucial. Again in this period, the great alpha hunt has been on and those asset managers with the ability to produce it have been the clear key target of investors. But as our survey results demonstrate, it is not the only thing investors have in mind and need to be convinced about before entering into any relationship with a manager.

This section of the survey analyses in detail the daunting array of attributes and points where reassurance will be required.

Performance, performance and performance

However investors try to dress it up - the main criterion in choosing managers is performance and has been so consistently for the past three years of this survey. But it is not performance without any qualification.

Risk control has featured highly, just behind performance among the dominant considerations in investors' minds. In the period after the dotcom bust, risk moved to the number one slot, as investors, perhaps for the first time in some cases, realised the true levels of risks they were exposed to in their portfolios. In this environment, control and management of risk became the number one priority. That it has remained a top order priority makes perfect sense.

12.1 Criteria when selecting an external investment manager 2004-2007

Degree of importance (ranking)

	2007	2006	2005	2004
Performance	1	1	1	2
Risk control	2	3	2	1
Clarity of investment process	3	2	3	3
Stability of investment team	4	5	5	4
Investment management fees: transparency of fees	5	n/a	n/a	n/a
Quality of reporting	6	8	6	5
Client service	7	6	7	10
Investment management fees: level of fees	8=	7	8	8
Understanding of your organisation's goals & needs	8=	4	4	6
Financial strength of external manager	10	11	9	7
Asset manager rating	11	20	19	18
Professional rating of external manager	12	16	11	11
Reputation of asset manager (brand)	13	14	15	14
Segregation of fund management function	14	9	12	9
GIPS/AIMR compliance	15=	15	18	15
Product innovation	15=	12	14	17
Total size of AuMs of external manager	17	17	16	16
Ownership/structure	18	n/a	n/a	n/a
Ability to provide advisory service	19	10	10	12
Existing commercial relationship (banking, commercial)	20	21	20	20
Presence in your country: sales office presence	21	13	13	13
Presence in your country: investment team presence	22	18	17	19
Non-competitor	23	19	21	21
Parent group is international	24	23	23	23
Other	25	24	24	24
Parent group is domestic	26	22	22	22

We show in Figure 12.1 all 26 of the factors which respondents were asked to score. After the crucial performance and risk criteria at the top come what might be called the 'no surprises' attributes of running the relationship: looking at the information and day-to-day aspects, covering such points as clarity of process, stability of team, transparency regarding fees, quality of reporting and client service, which make up the ranked list of virtues expected.

A number of differences have emerged from the previous survey in how the different factors are ranked: risk control and clarity of investment process are in second and third place, reversing their positions in the previous survey. Stability of investment team has moved up one place to fourth.

This year, we added a new question, the transparency of investment fees, which is becoming more of a concern as hedge funds, private equity and other more opaque alternatives are considered for inclusion in portfolios. But generally, the level of fees remains outside the top five criteria, as it has since 2003, giving hopefully the response to the charge that investors are obsessed with fee levels.

Anecdotally, other more detailed points mentioned by respondents, outside the 26 criteria listed as being part of

the selection processes mix, are the originality of managers' investment processes, quality and experience of the management team and its leadership, flexibility and the ability to deliver sustainable alpha. To make comparison easier, we looked at the top 10 criteria in selecting external managers on a country basis, as in Figure 12.2, where there is quite a range of differences. Notably, German investors are more interested in the financial strength of their external managers, a criterion which only just registers in the top ten for most other countries. Risk scores consistently highly, particularly in those countries where investors could be considered more risk averse than the Nordics or British and Irish investors.

While the medium and smaller investors (Figure 12.2) rate performance and clarity as their top two criteria, the larger investors have relegated performance to outside the top five and are attaching much more importance to clarity of investment process and risk control.

12.2 Top 10 criteria when selecting an external investment manager by country and size category

Degree of importance (ranking)

	All	Benelux	France	Germany	Italy	Nordic	GB & Ireland	CEE	Switzerland	Large	Medium	Small
Performance	1	3	4	6	2	1	1	1	6=	7	1	1
Risk control	2	2	2	4	1	4=	4	3	3	2	4	3
Clarity of investment process	3	5	3	5	3	2=	2	2	1=	1	2	2
Stability of investment team	4	1	6	2	6=	2=	3	4	1=	5	3	4
Investment management fees: transparency	5	6	8=	8	9	8	5	6	6=	6	6	5
Quality of reporting	6	4	1	3	10	7	8	5	6=	9	8	7
Client service	7	9	5	7	6=	6	6	9	4=	3	5	6
Investment management fees: level	8=	7	10	10	8	4=	10	7	4=	8	9	8
Understanding your organisation's goals & needs	8=	8	7	9	5	9	7	8	9	12	7	9
Financial strength of external manager	10	10	8=	1	4	10	9	10	10	11	14	11
Reputation of asset manager (brand)										4		
Total size of AuMs of external manager										10		
Asset manager rating											10	
Professional rating of external manager												10

13. External managers: fees

Performance fees ideal

Of all the aspects that cause difficulties in the relationship between external managers and the mandate providers, the areas of performance and fees are the biggest causes of aggravation. Nor are they unrelated, as a very typical comment from investors is that of paying active fees for index tracking performance.

There have been moves to change this aspect of the relationship by considering other arrangements, in particular, to move to more performance-related approaches. The aspiration here is to align both managers' and investors' interests.

But institutions often forget that, in contrast to their retail cousins, they often obtain a level of fees that leaves little margin for the manager. In other words, there has to be a level of fee sufficient to ensure it is worth the manager's while.

The signal from investors responding to the survey is that they continue to pay most of their fees to their external managers as fixed fees, as shown in Figure 13.1.

How this works out in practice is by mandate type, with 80% of those paying fees for the running of their cash mandates with fixed fees and, not surprisingly, only 7% currently paying performance fees on this class.

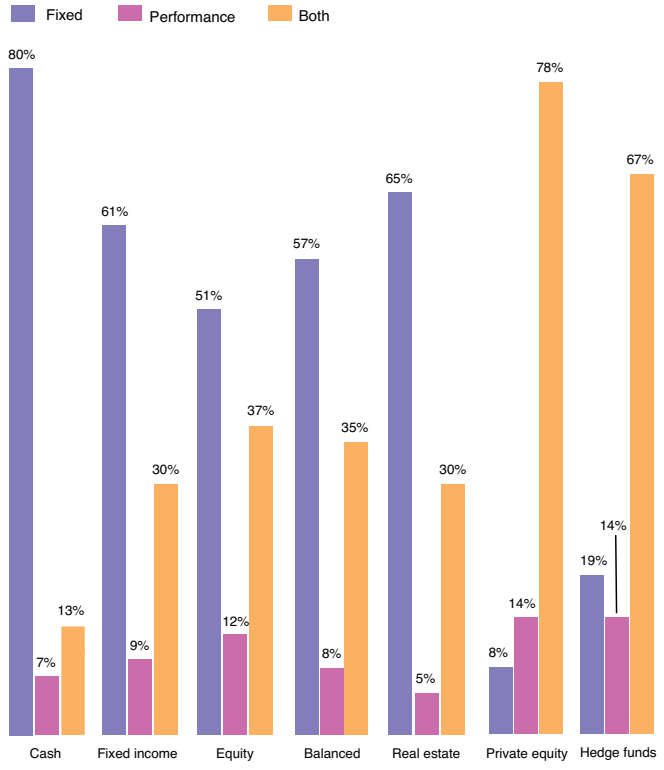
Fixed income, equity, real estate and balanced mandates seem to be in the same rough ballpark when it comes to the split between fixed and performance fees. But there are some trends worth picking up from the current survey, notably for example that 51% of equity mandates are on a fixed basis compared with 63% in the previous results.

When it comes to alternatives, real estate seems to be the odd one out, as 65% of the fees are on a fixed basis, whereas hedge funds and private equity have only 19% and 8%, respectively, being predominately a mixture of both fixed and performance fees.

We went on to ascertain what their current and ideal compensation arrangements for external managers might be. Figure 13.2 shows how many respondents currently pay performance fees (the same number as in Figure 13.1) and compares this to the number of respondents who would like to see performance fees in the future.

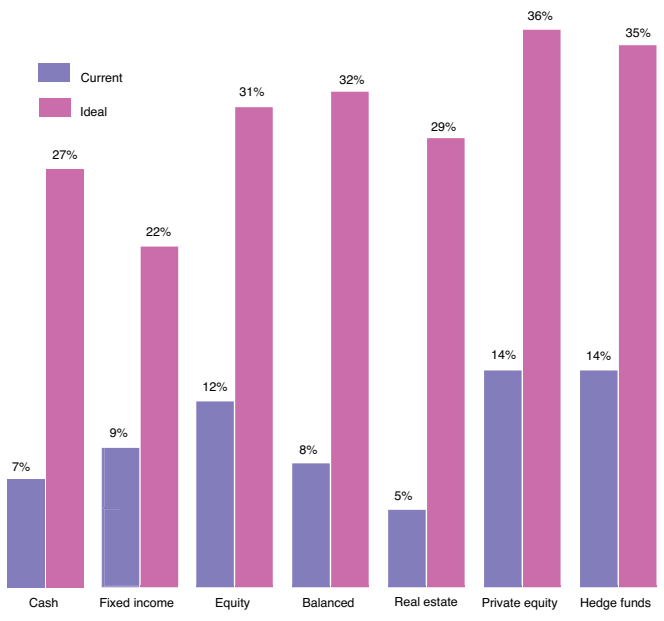
13.1 Current compensation of external managers

% of respondents to question



13.2 Current and ideal performance compensation of external investment managers

% of respondents to question



13.3 Ideal compensation of external investment managers 2006-2007

% of respondents to question

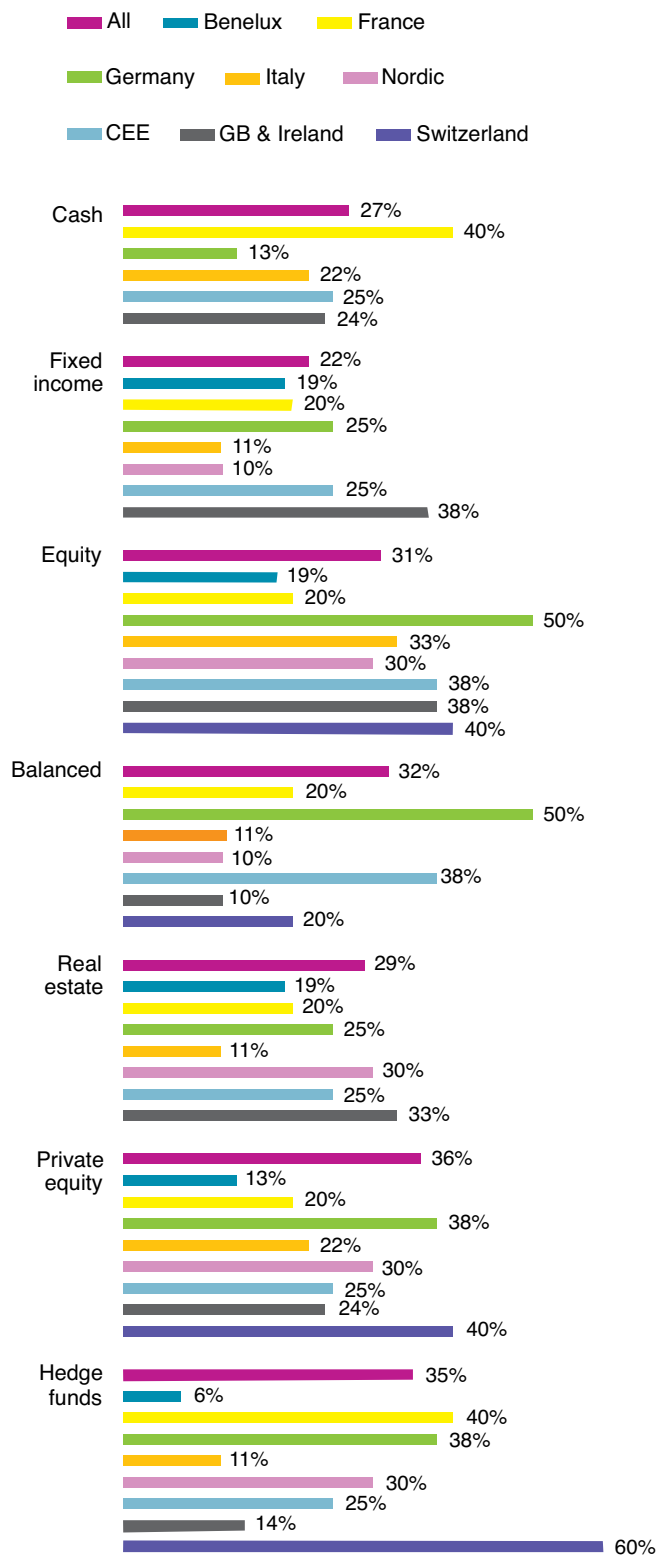
	Fee type	2006	2007
Cash	Fixed	64%	49%
	Performance	25%	27%
	Both	11%	24%
Fixed income	Fixed	44%	41%
	Performance	39%	22%
	Both	17%	37%
Balanced	Fixed	20%	23%
	Performance	59%	32%
	Both	22%	45%

So 12% are currently paying performance fees for equity mandates, but 31% would like to be doing so in future. Some 14% are currently paying performance fees for private equity, which contrasts with the 36% who would like to do so.

The differential between these current and preferred positions has narrowed markedly since the 2006 survey, which may be due in part to the sample, but also to the

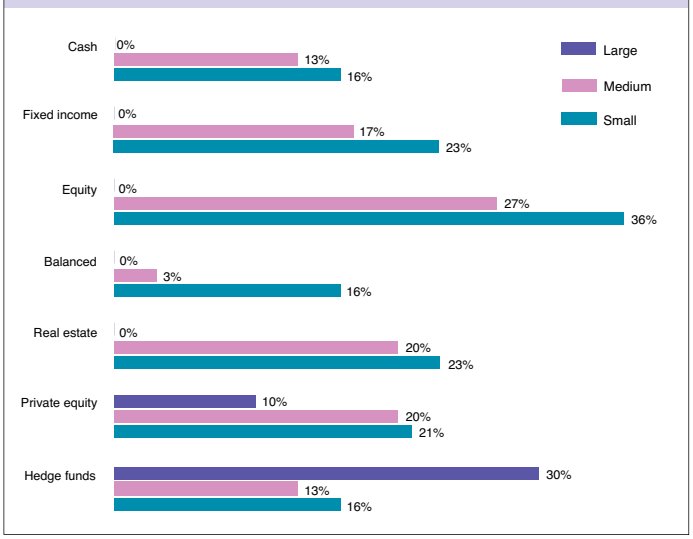
13.4 Ideal performance compensation of external managers by country

% of respondents to question



13.5 Ideal performance compensation of external managers by size category

% of respondents to question



fact that increasing numbers have met their aspiration of shifting investment manager compensation towards performance-related fees (Figure 13.3).

When this topic is looked at on a country-related basis (Figure 13.4), the most persistent demands for performance fees come from Germany, as well as Britain and Ireland, with 25% of German investors and 38% of British and Irish wanting performance fees for fixed income, compared to just 11% and 10% for Italy and Nordic countries, respectively. In the case of equity, 50% of German investors and, again, 38% of British and Irish want performance fees, as opposed to 19% and 20% for Benelux and France, respectively.

On investor size-related criteria, the smaller investors are perhaps surprisingly strong in their desire for performance-related fees. This may be accounted for by the fact that, by the very nature of their size, they are less able than the larger and medium investors to meet their aspirations (Figure 13.5).

14. External managers: constraints

Straining at the constraints

When entering a relationship with external managers, it behoves investors to give clear indications of what is expected of the manager and what criteria will be used to assess satisfactory implementation of the mandate.

Not to have been specific can result, where performance or risk control aspects have not been met, in the manager saying that the results were because the terms of the mandates had never been communicated properly.

Likewise, to impose excessive constraints can result in managers arguing that, had the constraints been less, the required performance criteria would have been met.

One visible example of this concern was the move to having investors in the UK marketplace issue 'unconstrained' mandates to overcome the danger of investors smothering manager initiative by too many conditions and requirements.

In Figure 14.1, we show an array of portfolio constraints that can be used for a variety of reasons by investors to meet their concerns when outsourcing externally.

In line with the use of relative return objectives in portfolios (see Section 2 'Investment objectives') benchmarks are the usual measure of satisfactory performance. Additionally, with the continued growth of specialist mandates, the use of benchmarks is highly relevant and may be a contributory factor to the jump in the numbers of those ranking benchmarks to 94% from 79% in the 2006 survey.

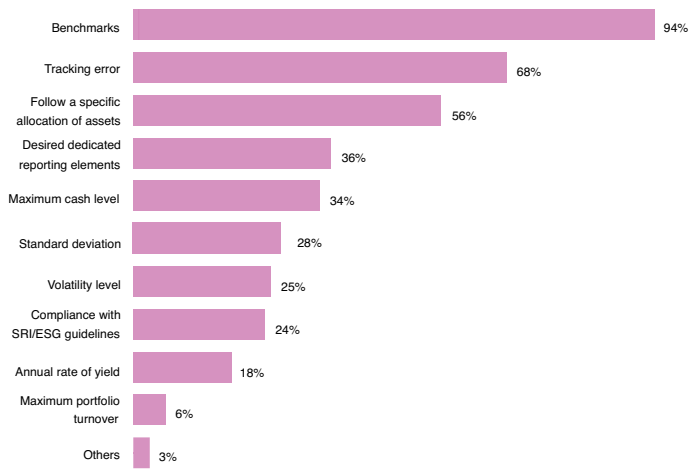
Another factor for the increased use of benchmarks may be the inclusion of a greater number of pension funds among the respondents, as these investors are regarded as being very benchmark orientated.

The next most used restrictions relate to tracking error, which is a new possible answer included in this year's survey. This displaced the constraint of 'Needing to follow a specific asset allocation', the latter slipping down from 68% in 2006 to 56% of responses in the current survey.

Compared with the previous survey, the reduction in volatility level as a constraint may be a concomitant of less volatility in the markets, as has been the case until recently. The use of maximum cash levels in the portfolio has been increased from 29% in 2006 to 34% currently.

14.1 Types of constraints given to managers

% of 100 respondents to question



15. External managers: breaking relationships

Ebb and flow

Business relationships do not last forever and the partnership between an investor and their external manager is no different - and should be no different - from that general rule.

While interest is perennial as to who is winning and who is losing mandates, the parting of the ways, whether at the end of the stipulated period or before the due date, is always a disruption.

For the investor there can be the inevitable costs of a new search and those of transitioning of assets; for the managers the loss of fee income that has to be replaced elsewhere.

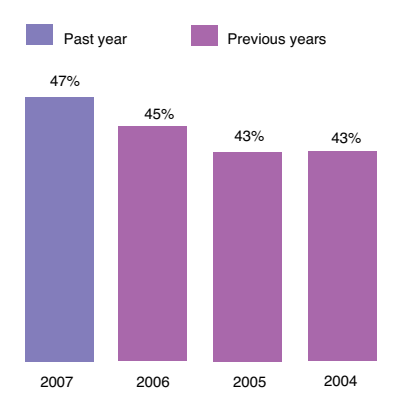
So the financial logic is for both sides to keep the relationship intact and to have terminations as the last resort. What do the survey findings tell us about this relationship – are the accusations of a short-term mentality on the part of investors justified?

Judging by the survey respondents, relationships seem to be pretty stable, as shown in Figure 15.1, with just under half of investors ending a manager's contract in the past year. Around 47% told us that they had broken a relationship with at least one manager in 2007, very similar to the number for 2006, when 45% said they had done so. Again, this proportion has only increased marginally in recent years.

As to the number of relationships disrupted, this averaged out at just over one relationship terminated in 2007, according to the survey responses. It was just under one in 2006 (Figure 15.2). This compares with an average of one in 2005, but almost two in the previous two years, so we seem to be experiencing a more stable time than in the past for the investor-manager relationship.

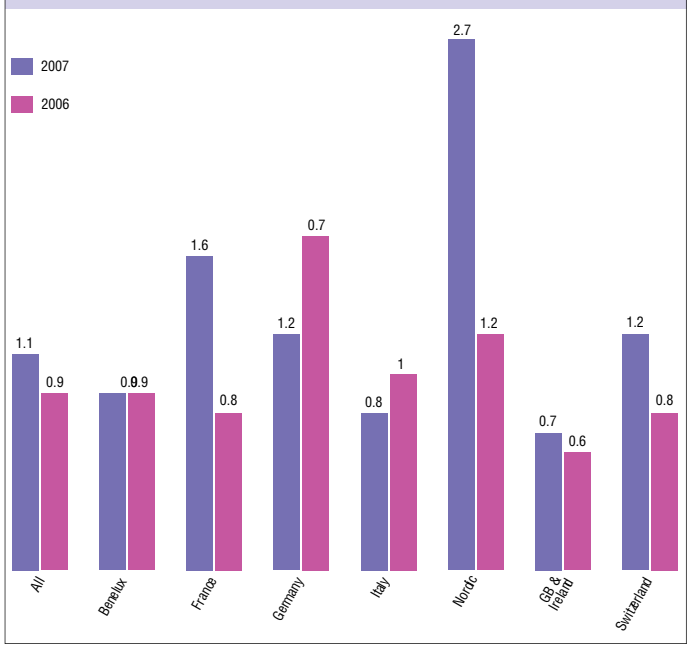
15.1 Relationships with a manager terminated 2004-2007

% of all respondents



15.2 Relationships with a manager terminated in 2007 and 2006

Average number of relationships



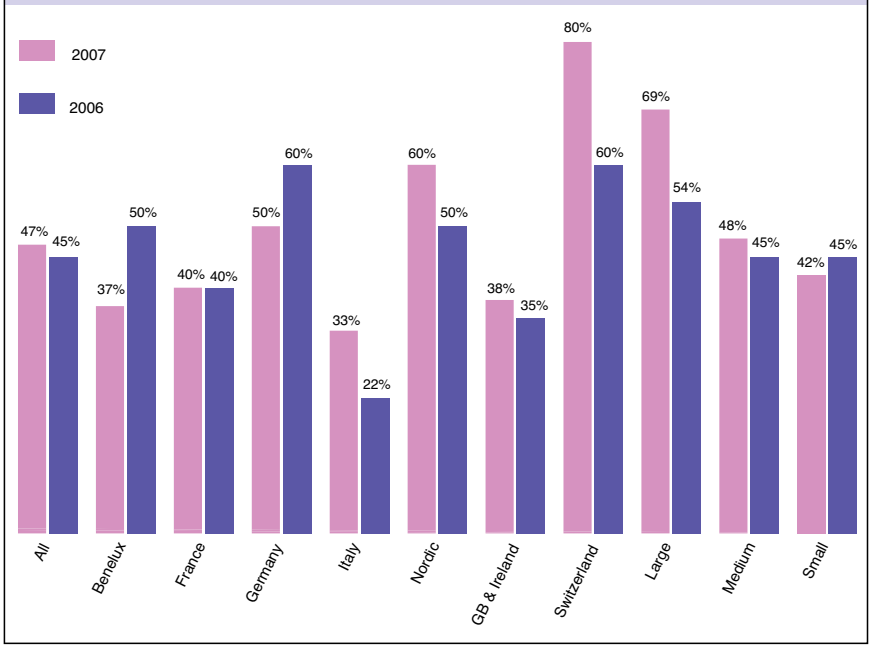
15.4 Factors which play a role in the decision to remove a manager 2006–2007

Degree of importance (ranking)

	2007	2006
Unsatisfactory performance	1	1
Failure to control risk	2	6
Change of investment strategy or asset allocation	3	7
Lack of clarity in fund management policy	4	2
Strategy or asset allocation	5	n/a
Breach of investment constraints	6	3
Excessive turnover of investment team	7	8
Level of costs	8	10
Reorganisation of investment manager's group	9	5
Internal reorganisation of your group	10	13
Inadequate reporting/contact	11	4
Inability of investment manager to advise on investment	12	11
Excessive turnover of contact personnel	13	9

15.3 Relationships with a manager terminated in the past two years by country and size category

% of all respondents



15.5 Factors which play a role in the decision to remove an external manager by country

Degree of importance (ranking)

	All	Benelux	France	Germany	Italy	Nordic	GB & Ireland	Switzerland
Unsatisfactory performance	1	1	12=	1	1	1	1	1
Failure to control risk	2	2	7=	4	3	3	6	11
Change of investment strategy or asset allocation	3	3	5	2	7=	5	4	2
Lack of clarity in fund management policy	4	6	2	11	9	13	2	3=
Strategy or asset allocation	5	7	4	3	6	6	8	7=
Breach of investment constraints	6	4	1	5	10=	8=	7	3=
Excessive turnover of investment team	7	5	6	9=	12	4	3	9
Level of costs	8	8	7=	8	5	8=	9	3=
Reorganisation of investment manager's group	9	9	7=	12	7=	2	5	10
Internal reorganisation of your group	10	12	7=	13	2	7	12	3=
Inadequate reporting/contact	11	10	11	6	4	8=	10	
Inability of investment manager to advise on investment	12	11	3	7	10=	12	13	7=

At a country level, the responses show that the British and Irish investors have broken the fewest relationships, with just an average of 0.7 managers. But when it comes to the Nordics, it appears to be a different picture with 2.7 managers on average sent on their way by local investors.

Following the pattern of previous years' surveys, it is the larger investors who have broken most relationships, and it is the Italians, overall who have been the most loyal, as shown by Figure 15.3.

As in previous years, we asked respondents to tell us which were the factors that were influential in their decision to remove a manager. The four most important factors given by respondents were: unsatisfactory performance, failure to control risk, change of investment strategy, or asset allocation and lack of clarity in fund management (Figure 15.4).

Among the changes from the previous year are that the failure to control risk fell outside of the top five in 2006, whereas breach of investment constraints came in the top three factors.

When we look at the results from a country perspective (Figure 15.5) unsatisfactory performance is given as the primary reason for dismissal across the board. Below this headline factor, there is a wide diversity in the responses given by different countries.

16. Other findings

SRI and ESG

The emergence of Socially Responsible Investing (SRI) or Environmental, Social and Governance (ESG) criteria as part of the investment world is increasing by large strides.

There are many influences at work, not least the fears about climate change, but also increased awareness of corporate responsibilities as a result of more active shareholder actions by institutional investors.

Another potent force has been the initiative by the United Nations among large investors with its principles of responsible investment which has attracted a range of institutions to join up world-wide. With investors such as pension funds, where often there is a mutual or non profit ethos prevailing, or it is run on a paritarian basis with equal representation from the employees and the employers involved, SRI/ESG principles have come through more quickly than they would with more commercially structured operations, such as insurance companies.

Increased dramatically

Socially responsible investing and corporate governance strategies were in place among two fifths of the sample, a dramatic increase on the previous survey, when only one fifth said they had a position on SRI. This may be explained in part by the fact that a higher proportion of pension funds responded to the 2008 survey.

The main reason for taking such a step is that it reflected the beliefs of owners and boards, which in mutual organisations can often be tracked back to the membership. This was the same as last year, when the question was differently phrased referring to 'religious ideals'.

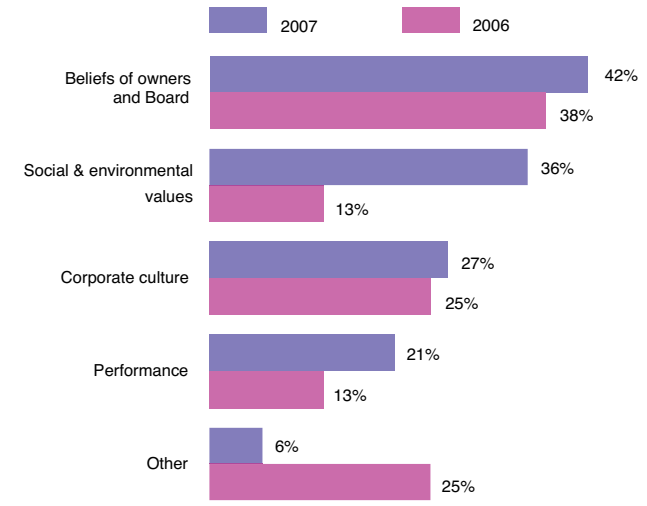
In this survey, social and environmental values has replaced corporate culture as the next most important reason (Figure 16.1). There was a very big drop in the number indicating they had 'other' reasons, which in the previous survey amounted to 25% of those responding - this has fallen to 6% in this year's survey, perhaps indicating a clearer focus among investors about their reasons for involvement.

Also encouraging is the fact that the written policies are gaining ground. Two fifths of respondents told us that they now have these policies for both SRI and corporate governance strategies, and almost one third for voting policies (Figure 16.2)

Written policies were the most popular among British and Irish and Nordic institutions, (as in Figure 16.3). Legislation in some countries, such as in the UK, requires written statements from pension funds on the area. In Germany, there seems to be little appetite for such policies.

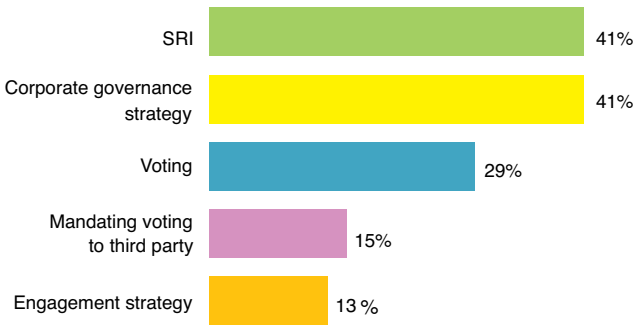
16.1 Reasons for pursuing SRI/ESG strategies

% of pursuers of SRI/ESG strategies



16.2 Frequency of written policies

% of all respondents to question



16.3 Frequency of written policies by country

% of all respondents

Securities lending

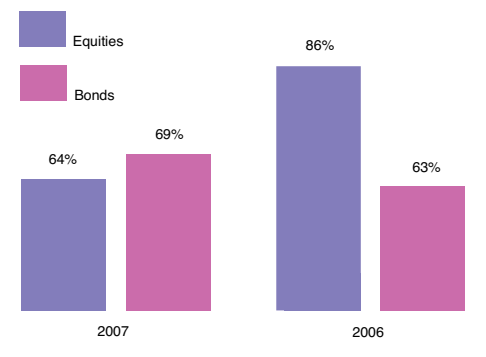
Securities lending has been regarded by institutions as something of a free lunch, a way of obtaining an extra turn on assets without significant extra risk. But take up has been patchy both as to marketplaces and players making use of the facility to loan their stocks.

More recently, there has been the concern amongst investors that main borrowers were hedge funds, which were frequently involved in shorting stocks that institutions were likely to have in their long-only portfolios. The upshot was that some investors did indicate a shift in their policy towards securities lending against their portfolios.

The extent to which securities lending is available to investors will depend on the composition of their portfolios and whether they contain the types of securities that are in demand from the lending side.

There has been a slight increase in investor interest with 19% saying in the 2006 survey that they did securities lending, whilst the latest survey puts the number at just 21%, though the numbers responding have also increased.

16.4 Asset classes used for securities lending 2006-2007
% of respondents to question



The range of percentages that investors permit for equities, averaged at 86% in the 2006 survey but at 64% in the 2008 survey. The limits allowed to be loaned of the equity portfolio ranged from 50% to 100% in 2006, and from 10% to 100% in the current survey.

The fixed income limit ranged from 10% to 100% currently (5% to 100% in 2006), with an average limit of 69% as shown in Figure 16.4. The most frequent limit is for 100% of the portfolio to be available to be loaned.

List of charts and tables

List of charts and tables continued