INVESTMENT
& PENSIONS
EUROPE

IPE European Institutional Asset Management Survey 2011

Invesco

Research supported by Invesco

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FOREWORD

This year we are very pleased to report two milestones in the development of the European Institutional Asset Management Survey (EIAMS). Firstly, institutional assets now covered by the survey exceed one trillion euros. Secondly, there has been a 20% jump in the number of investors responding.

Now in its eleventh year, EIAMS provides a pan-European overview of the state of institutional investment across 25 countries, some grouped into a number of key regions, enabling comparisons to be drawn between the current and previous years.

We at Invesco are proud to have been the originators of this survey and for the past four years have partnered with Investment & Pensions Europe (IPE), which again undertook the surveying of investors and analysed the results on an independent and confidential basis.

In this endeavour, we have received outstanding support from the Association Française de la Gestion Financière (AFG). Thanks to the association's efforts we increased the participation of French institutions very significantly, both in terms of numbers of respondents and the asset base. We would like to acknowledge their tremendous contribution.

We thank NYSE Euronext as well as AFG for their extremely helpful input when designing this year's questionnaire and their comments at the stage of analysing the preliminary findings. In order to encourage responses, we simplified and streamlined the questionnaire as much as we could, while keeping a core of perennial questions, enabling the changes between one year and the next to be tracked, which is such a key feature of the EIAMS approach and makes it different to many other surveys.

Except for a number of responses where the data is analysed on an asset basis, most of the survey responses give each investor responding the same weighting. The actual proportion of respondents is shown in each of the charts. This, we believe, helps to provide continuity and comparability between one year and the next, even if there are significant changes in the composition of the sample, as happened this year. Continuity is also provided in making a very determined effort to obtain responses from those who previously took part. So this year, some 69% of the 2010 respondents completed the survey against around 60% last year, which we are delighted about and take as an endorsement of the benefit of participating in investors' eyes.

This is an appropriate moment to thank not only all those who responded again, but also the newcomers to this year's survey. We very much appreciate the time and effort taken to complete the questionnaire – it is certainly not effortless, no matter what we do to make it as easy as we can.

Of course, EIAMS respondents help a much wider public than just themselves in sharing their information. Thousands of investors make use of the IPE website download (ipe.com/whitepapers) facility to access the report (there have been some 4,000 downloads of the 2010 report). A hardcopy of the EIAMS report is available by approaching IPE directly and requesting one.

As to this year's findings – a key result is the extent to which fixed income is in the ascendant, accounting for 58% of institutional portfolios' assets, compared with 51% in 2010. But there are undercurrents, in that while 22% of investors are aiming to increase their fixed income component, 31% are reducing their government bond holdings. Corporate bonds appear to be the main beneficiary of this switch, as 30% of investors are opting for these.

However, the real assets story is far from over, although equities were pared back somewhat from 29% to 27% of assets and real estate only maintained its position in portfolios at 7%, between 2010 and the previous year. But a key survey finding is that nearly a fifth of investors (19%) are poised to raise their equity and 26% their real estate exposure.

We thank IPE for its work in collecting and analysing the EIAMS data and promoting the survey on the IPE.com website.

As always, we welcome your feedback and would be delighted to hear from you as to how useful you found the results and if you have any suggestions for improvements.

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EIAMS Executive Summary

1. Survey parameters

The 2011 survey received responses from 148 investors from 25 countries, with total assets under management of €1,194bn, which have jumped threefold. French assets at €732bn represent 62% of the sample. Sixty nine per cent of the previous year's respondents completed the survey. Just under half of the investors were small (under €1bn), 34 were large (over €5bn) and 45 were in between. The greatest number of responses again came from Benelux and Great Britain & Ireland. With two or more categories to choose, 75% described themselves as pension funds, 6% as insurers and almost 17% as others.

2. Investment of assets

A toe in the water

The flight to safety continues with fixed income gaining more ground with investors, but last year's freefall in equities appears to have been halted with just a small decline, and the sharp reduction in cash suggests that investors are increasingly less risk averse. However, any boldness appears more confined to the medium and smaller investors which are investing twice as much as their larger counterparts in other alternatives. A small net increase in equity investment is forecast, but this is likely to occur outside of domestic markets. Fixed income looks to gain further ground with corporate bonds the big likely winner at the expense of government debt.

3. Alternatives

The good news gets better

Alternative portfolios, overall, have further improved on last year's recovery, except for hedge funds which dashed previous bullish predictions by halving its allocation, and now sits behind commodities. Real estate continues to dominate the sector, accounting for two-thirds of total allocation. It is now most popular with Benelux, displacing Switzerland into second place, followed by GB & Ireland.

4. ETFs and Indices

Could do better

Last year's resurgence of interest in ETFs has faltered with usage dropping to its lowest level in four years. However, this masks two distinct camps with Benelux, Nordics, Switzerland and GB & Ireland making large reductions, while CEE, France and Italy made bold increases. The large investors are the smallest users of ETFs and have significantly reduced their usage whilst the smaller investors remain the most supportive, albeit less so than last year. Benchmark indexes were by far the most popular type of index used, and by a factor of eight compared with the next most popular of enhanced index products and fundamental index/products. Open-ended mutual funds remained by a large margin the most popular technique to gain index exposure, despite a large drop in interest.

5. Duration & LDI

The gap widens

The overall duration gap has grown by more than 12 months, with the average for fixed income duration shortening by 5 months and actual liabilities lengthening by more than 8 months. The gap widened most noticeably for Germany and Switzerland, and narrowed only for CEE countries. LDI strategies remain the most popular way of matching liabilities, being used by over half of investors, and are most sought by smaller investors.

6. Consultants

Down but not out

Use of consultants has continued its decline, now standing at below 50%. The Italians, who experienced a dramatic reduction in their use of consultants last year, are now the biggest users, followed closely by the British & Irish. However, the only major fall in interest came from CEE countries. Medium investors remain the largest users of consultants, with both the larger and smaller investors showing steady declines in usage over the last three years. Following the crisis, risk management advice is increasingly being sought. Investors are also obtaining more advice on their 'internal processes'.

7. External managers: usage

Still on the upswing

Use of external managers seems to swing up and down most years, with this year's increase indicating modest gains. The move towards the use of external managers is reflected across all sizes of investors. There was no clear trend on a country basis, with Benelux and Italy increasing usage, and Switzerland remaining unchanged, while Germany, Nordics and GB & Ireland all reduced their involvement. In the case of France, the swing from the use of internal to external managers was marginal despite the significant increase in the sample, both in numbers and assets.

8. External managers: asset allocation

The grass is always greener

There has been a sharp increase in the switch of fixed income assets to external managers so that it now significantly exceeds the total for equities. Benelux and France delegate the most fixed income and equity. All sizes of investors now allocate some two-thirds of their assets externally.

9. External managers: selection criteria

Clarity of thinking

Clarity of investment process remains most in demand for the third successive year, followed by risk control and performance, all having shared the top three places for the last seven years. Countries followed these preferences, although CEE countries favoured client service and, together with the Germans, quality of reporting.

10. External managers: fees

Fixed is safest

The ideal of fixed fees continues to grow for both fixed income and balanced investors, and now also includes real estate, while the preference for equities, by a slightly narrower margin than last year, remains for a combination of fixed and performance-related fees. The gap between current and ideal has continued to shrink. Smaller investors are once again in the ascendancy over medium investors, as they are the keenest on performance-related fees.

11. External managers: breaking relationships

Marital woes deepen

After several years of relative harmony, and with dismissals reported last year at their lowest level for at least five years, the divorce rate has shot up. In France, there was a reversal of the previous position, possibly because of the nature and size of investors in that country's sample. The Swiss and British & Irish were also active in changing managers. The Italians remained the most loyal. Large investors have reversed places this year with medium funds as the most hard-hearted. The two most critical factors triggering a dismissal remain unsatisfactory performance and failure to control risk. Inability to advise on investment has surged from 10th place last year to third, displacing lack of clarity into fourth place. However, change of strategy remained of much more importance to the Italians, Swiss and CEE countries.

12. Other findings: SRI/ESG/Securities lending

SRI/ESG: Governance a bet for the future

Social and environmental values and owners' beliefs currently remain the most important drivers behind the pursuit of SRI/ESG strategies. However, governance has now moved firmly into third place, pushing corporate culture into fourth position. Corporate governance strategies remain the most popular, but much less so than last year, with SRI/ESG strategies strengthening their second place.

Securities lending: reports of its death exaggerated

Equities and bonds used for securities lending have gained ground for the first time in five years, but both remain at low levels.

1. Our respondents

Surge in assets

The 2011 European Institutional Asset Management Survey saw a major surge in the total invested assets managed by respondents. This figure passed the €1trn mark for the first time, due chiefly to the inclusion of some very large investors in France, representing over 60% of the assets sample. There was also a marked increase in responses to the survey, outstripping the rises seen in the previous two polls. This year, 148 institutions gave their input – 22% more than 2010.

The size of total invested assets has more than tripled to €1,194bn in the 2011 survey from €333bn last time. France more than doubled its number of EIAMS respondents to 16 from seven last time. Although 16 institutions is a small proportion of the overall number of 148 survey respondents, those 16 commanded total invested assets of some €732bn – more than half of the total invested assets included in the survey.

This inclusion of heavyweights from France is mirrored in the groupings of institutions into three size categories. Institutions with assets under management of more than €5bn are classified as large, those with €1-5bn as medium and those with less than €1bn as small. The number of respondents in the large category increased to 34 this time (up 142%), while those in the medium group rose in number to 45 (up 18%), and those in the small category were unchanged at 69 institutions.

In terms of total invested assets, however, the large category now represents almost €1,066bn, which is more than four times as much as seen in the 2010 survey. By comparison, within the medium category, total invested assets are up 31%, and those in the small category are 9% higher than before.

After France, the country groups with the most significant increases in average AuM from last time are Nordic (up 83%) and Switzerland (up 80%).

In this year's survey, 11 of the respondents came from Belgium and 24 from the Netherlands (forming Benelux), 14 from Croatia, Czech Republic, Estonia, Latvia, Lithuania and Romania (Central & Eastern Europe), 16 from the UK and 8 from Ireland (GB & Ireland), and 20 from Denmark, Finland, Iceland, Norway and Sweden (Nordic).

The 12 respondents from countries that did not fit into the eight geographical categories (Austria, Cyprus, Portugal, Liechtenstein and Spain) are shown in the table below as 'Others' and together they manage investment assets of €31.47bn.

As in previous years, data from institutions in these countries was included in the EIAMS findings other than where the data is analysed on a geographical basis.

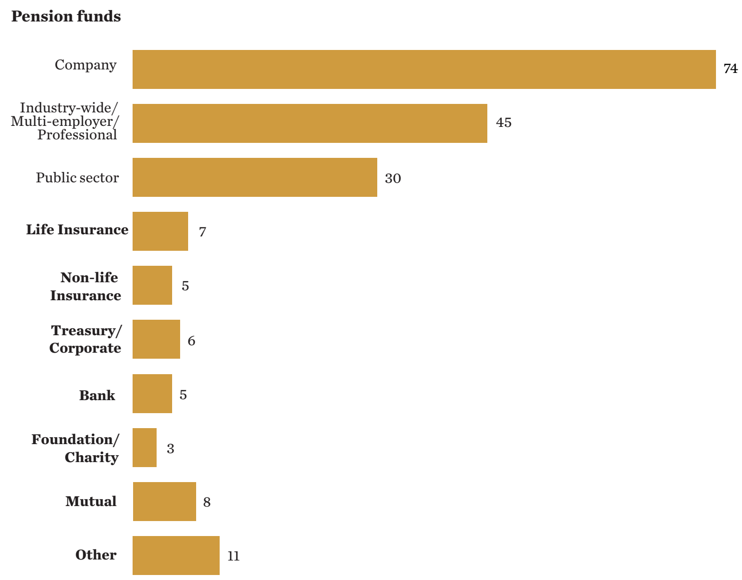
Most of the survey's respondents were once again pension funds, but within this group, company pension funds increased their weighting at the expense of public sector pension funds.

Among other types of institution, the division was not significantly different from last time, although the Caisse de Retraite category was abandoned – only one institution having chosen to describe itself thus in 2010.

Where a 'zero' is shown in some charts, this indicates either that no respondent answered the question, or did actually indicate a 'zero'; this will reflect, in the case of some countries, the small sample size.

1.1 Respondents by type of institution

Number of respondents (total 148). Two or more categories could be chosen



Key takeaways

- responses from 148 institutions, mainly from Benelux, GB & Ireland and Nordic countries, though France led in terms of assets under management
- respondents are pension funds, insurance companies and other types of institutional investor
- respondents had total investment assets of €1,194bn, or an average of some €8.1bn

1.2 AuM and number of respondents

	All	Benelux	CEE	France	GB & Ireland	Germany	Italy	Nordic	Switzerland	Others	Large	Medium	Small
Respondents	148	35	14	16	24	11	7	20	9	12	34	45	69
Total invested assets (€bn)	1,194	194.23	7.19	732.33	63.06	17.42	6.79	94.52	47.28	31.47	1,065.97	98.74	29.57
% of total invested assets	100	16.3	0.6	61.3	5.3	1.5	0.6	7.8	4	2.6	89.3	8.2	2.5
Average AuM (€bn)	8.07	5.55	0.51	45.77	2.63	1.58	0.97	4.73	5.25	2.62	31.35	2.19	0.43

2. Investment of assets

Caution but with some daring

Assets at European institutional investors shifted more heavily towards fixed-income instruments in 2010, in a development that could be said to signal a cautious view on the global economic recovery. In particular, the insurance sector will be influenced by the impact of the Solvency II requirements. But, taken as a whole, the data gives a mixed picture of investor confidence; equity allocations are only slightly lower than the year before, and pension funds, insurance companies and others now appear ready to step into the fray, spending most of their cash holdings on more adventurous investments.

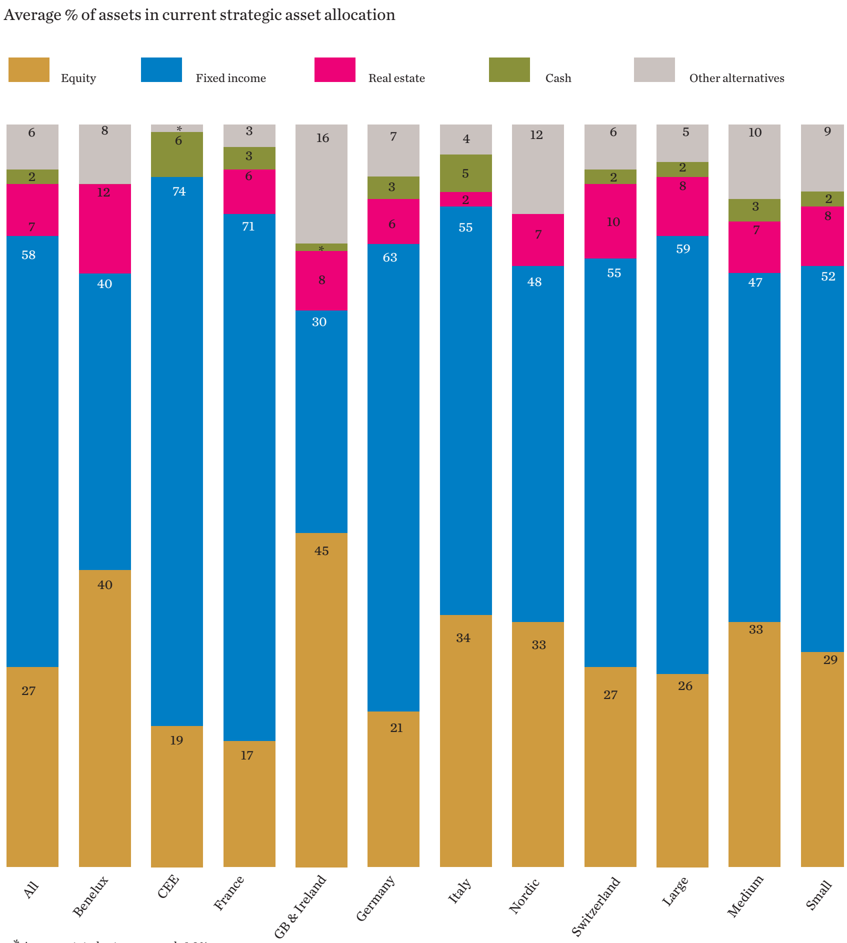
Seen across all countries, there has been a marked increase in allocations to fixed income, with average allocations to the asset class at 58% in 2010, as seen in Fig 2.1 – the highest level seen in any of the last four EIAMS surveys. Allocations to equity have fallen back slightly to 27%, down from 2009's level of 29%, and well below the 32% average allocation institutions reported having in 2007. Institutions have also shrunk their cash positions to 2%, perhaps offering a sign they have spotted more attractive opportunities and so finally been willing to leave the sidelines.

Real estate has retained its average 7% share of portfolios, while allocations to other alternatives have fallen back to 6% in 2010 from 8% last time, thus reverting to the proportion held in the asset class in the previous two surveys.

Behind the overall European picture lie material differences in allocation splits between country groups.

Great Britain & Ireland remain true to their traditionally high equities weightings, with shares creeping back up to stand at 45% of portfolios this time after slipping to 44% in 2009, though they are still below the 55% weighting seen in 2007. Other alternatives are gaining ground in Great Britain & Ireland's institutional asset mixes, having risen steadily since 2007 from 8% to stand at 16% in 2010. This time, the gain seems to have been at the

2.1 Investment allocation by country and size

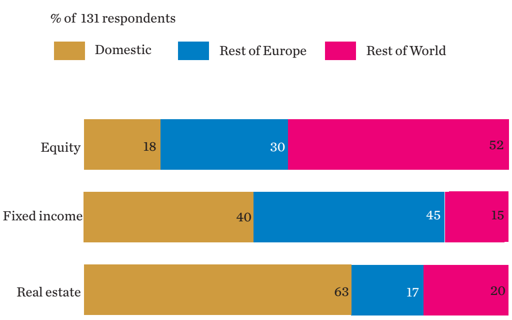


* Any unnotated category equals 1.0%

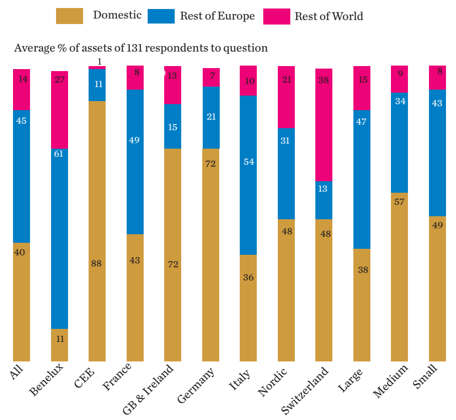
Key takeaways

- bonds continue as the dominant asset class, strengthening their position from 51% to 58%
- allocation to real estate remains unchanged at 7%, but other alternatives have reverted to their 2008 reported level of 6%
- cash deposits have more than halved compared with the previous year and are now one fifth of the 2008 level, only the Nordic countries increasing their holdings
- equity holdings have declined marginally overall, but with large increases for Benelux, Germany and Italy
- only the large investors have reduced their equity holdings while significantly increasing their fixed income holdings. The smaller investors appear to be showing increased confidence in real estate, while the large investors have doubled their exposure to other alternatives
- equity is invested mostly in the rest of the world, and fixed income mostly domestically

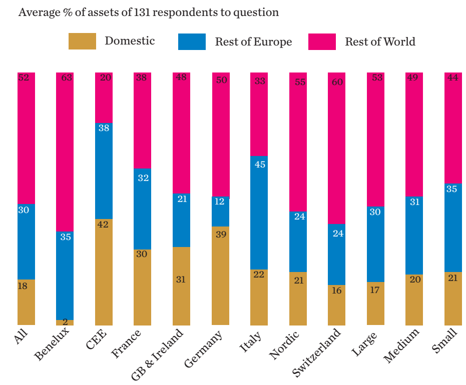
2.2 Regional investment asset allocation



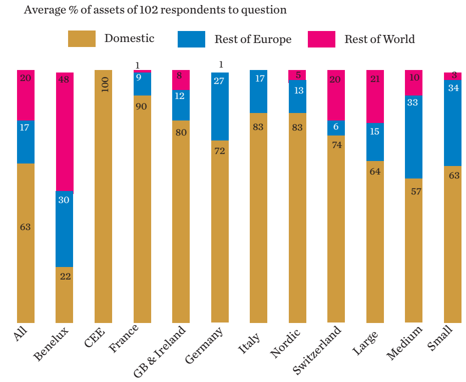
2.2a Regional investment fixed income



2.2b Regional investment equities



2.2c Regional investment real estate



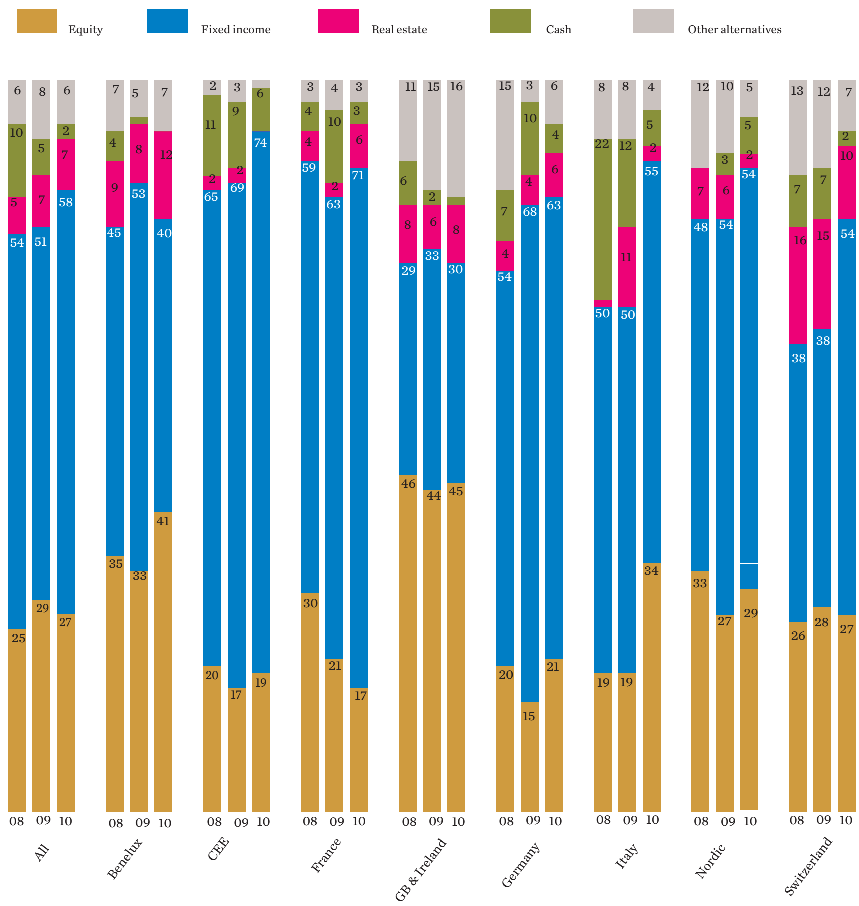
expense of bonds and cash. Two country groups – Benelux and Italy – have lifted their equity allocations markedly in 2010, with Italy's up to 34% from 19% in the previous two surveys, and Benelux seeing an increase to 40% from 33%, taking it back to just above the 2007 level, mirroring, perhaps the rebound in equity markets as well as an increase in risk appetite.

On the other hand, French institutions and those from CEE have expanded their commitment to fixed income this year. In France, respondents held an average of 71% of assets in fixed income, reflecting the traditional allocation of the larger institutions there but investors have boosted the bond proportion of portfolios for the fourth year in a row, though the change in the size and nature of the investor sample is a factor. CEE meanwhile reported an even higher 74% fixed income weighting, having similarly built this up in increments since 2007.

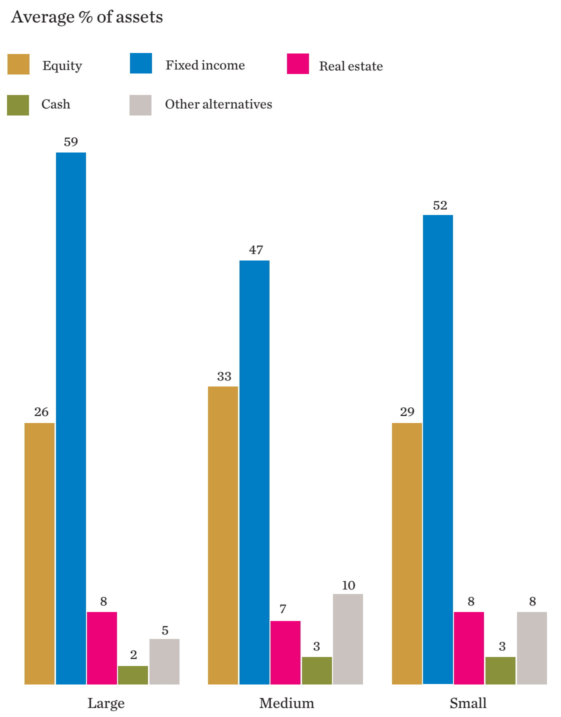
Large institutional investors, with 59% in fixed income, have now shown themselves to be keener holders of these assets than their medium (47%) and small (52%) counterparts, reversing the picture seen in the previous survey, when small institutions had the heaviest fixed income weightings (54%). Large institutions seem to be the group to blame for the overall dip in allocations to alternatives, with this size group showing the biggest fall in "Other alternatives" out of the three – to 5%

2.3 Investment asset allocation by country 2008-2010

Average % of assets (any unnotated category equals 1.0%)



2.4 Investment asset allocation by size



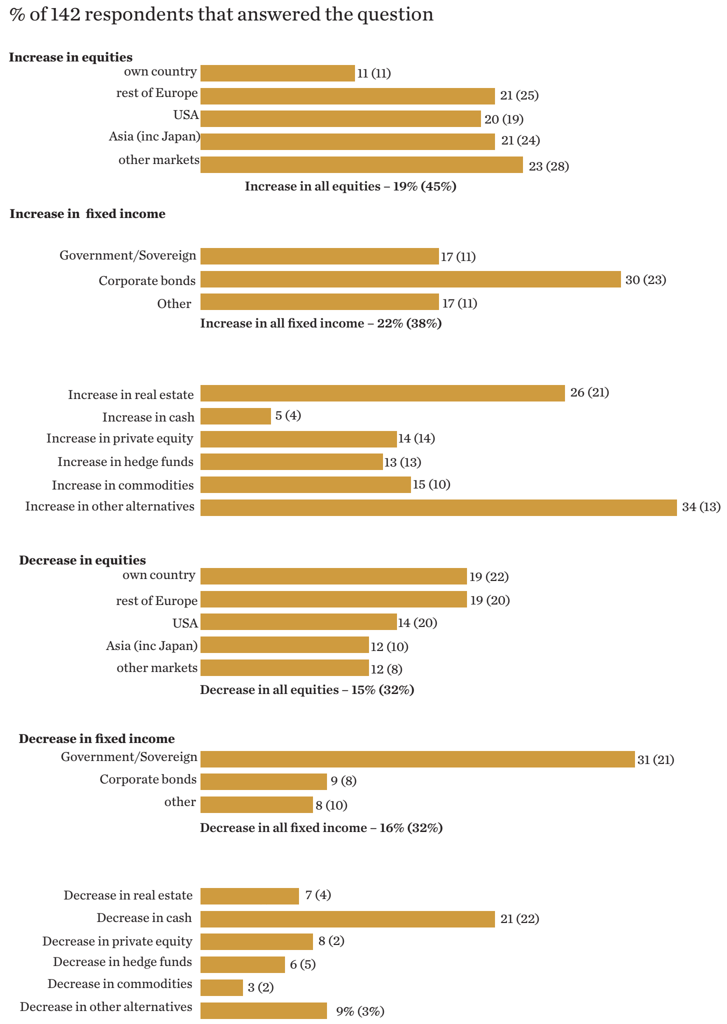
from 10%. A reason for this development could be a strong insurance component within the larger investor group which is affected by the imposition of Solvency II and the global economic situation.

Looking ahead through 2011, fixed income allocations look more likely to continue growing than fall back to previous levels, judging from responses about planned changes to strategic asset allocation in 2011 (Fig 2.5a).

Twenty-two per cent of the 142 respondents plan an increase in all fixed income, against 16% who said they planned to shrink their allocation to the asset class. Within the fixed income category, the weight of responses showed corporate bonds as the main gainer this year and government and sovereign debt the prime loser. Portfolios could see net inflows of equities this year, too; 19% of respondents planned to boost the asset class against 15% who signalled an intention to sell.

More marked, though, is the likely swing away from domestic shares towards those in other Euro-

2.5a Changes planned to strategic asset allocation in 2011 (2010)



2.5b Differences* in strategic asset allocation 2011 (2010)

% of 142 (112) respondents that answered the question

Category	To 2011 (10)	From 2011 (10)	Difference 2011 (10)
Equities	19% (45%)	15% (32%)	4% (13%)
Fixed income	22% (38%)	16% (32%)	6% (6%)
Real estate	26% (21%)	7% (4%)	19% (17%)
Cash	5% (4%)	21% (22%)	-16% (-18%)
Private equity	14% (14%)	8% (2%)	6% (12%)
Hedge funds	13% (13%)	6% (5%)	7% (8%)
Commodities	15% (10%)	3% (2%)	12% (8%)
Other alternatives	34% (13%)	9% (3%)	25% (10%)

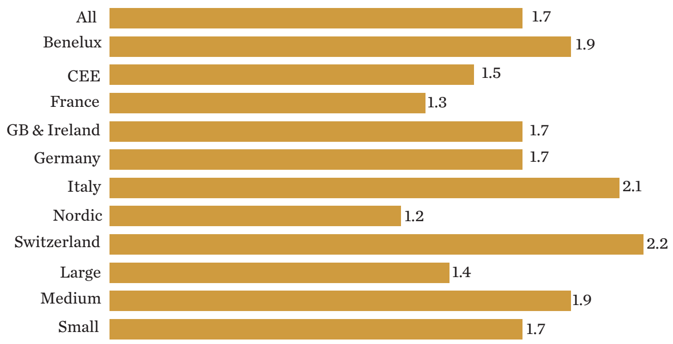
*To 2011 refers to planned increases, from 2011 to planned decreases. Difference 2011 shows investors net planned movement.

Key takeaways

- the outlook for equities is uncertain with only 19% anticipating increasing their holdings (45%). Forward interest in all fixed income has also reduced, from 38% to 22%
- only one-half of the number reported previously plan to decrease their holdings in equities and fixed income
- overall, confidence in real estate looks to grow marginally, commodities more so but with less interest in private equity
- average time for investors to review their strategic asset allocation is 1.7 years
- Switzerland has the longest period (2.2 years) and Nordics the shortest (1.2 years)
- the larger funds are the most frequent reviewers (1.4 years) and medium the least (1.9 years)
- reviews on an interim basis are conducted overall every 7.3 months, with Benelux having the longest gap at 9.9 months and France the shortest at 4.5

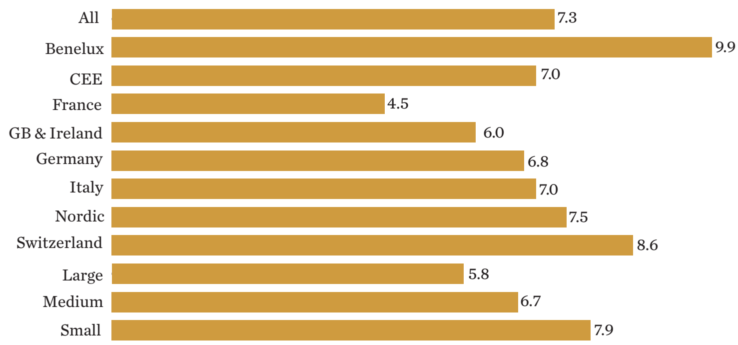
2.6 Frequency of strategic asset allocation review

% of respondents (total 140). Average review period in years



2.7 Frequency of interim asset allocation review

% of respondents (total 88). Average review period in months



pean countries, the USA, Asia and other markets (Fig 2.5a). Only 11% of respondents planned to increase equities from their home market, while 21% intended to up the proportion of other European equities as well as those from Asia, while 20% planned to lift USA equity allocations and 23% aimed to boost their "other markets" stock holdings. Institutions are clearly turning away from home markets in equity and fixed income investment, as the regional asset allocation breakdown shows (Fig 2.2).

Average domestic equity allocation has fallen to 18% of the total equity slice from 23.5%, while investment in domestic fixed income has declined to 40% from 49.2% last time (Fig 2.2a). But real estate is another story. Home-market real estate investment now makes up 63% of the average institution's overall property allocation, up from 60% last time (Fig 2.2c). Country groups obviously have very different attitudes to the benefits or otherwise of parking assets in their home market.

CEE holds on average 42% of shares in the domestic market and Germany has 39%, but Benelux has only 2% of equities issued by companies within its borders (Fig 2.2b). Already slim in this year's survey, average cash allocations could be narrowed to negligible levels during the course of this year if planned changes take place. Twenty-one per cent of respondents said they intend to decrease their strategic cash allocation this year, while only 5% said they would increase it.

In the last survey, as seen in Fig 2.5b, intentions to reduce cash holdings grew to 21% of respondents from just 5% in 2009, and that reversal is now continuing.

This year's EIAMS survey asked respondents how often they held Strategic Asset Allocation reviews, as well as interim reviews (Fig 2.6).

Main reviews took place on average between 1.0 and 3.0 years, with France, Nordics and CEE putting their asset mixes under official scrutiny, every 1.5 years.

Great Britain & Ireland and Germany matched the average frequency of 1.7 years, Benelux reviewed every 1.9 years, and Italy and Switzerland reviewed every 2.1 and 2.2 years, respectively. Interim reviews happened on average every 7.3 months (Fig 2.7).

3. Alternatives

Embracing alternatives

The crisis revealed some unsuspected elements of alternative investments, which turned out to be not so alternative after all, and in turn led to a loss of faith in the alternatives sector. This seems to have been a temporary view, however, among institutional investors, who are once again increasing their allocation to the sector in the hope of adding value to their portfolios.

This year's survey shows that European institutional investors are again embracing alternatives with a total allocation of 12% (Fig 3.1) of respondents' portfolios invested in the sector. The allocation level is back up to and beyond the levels of 2007, when 10% was allocated to the sector, marginally above the 11.7% figure in the previous year's survey.

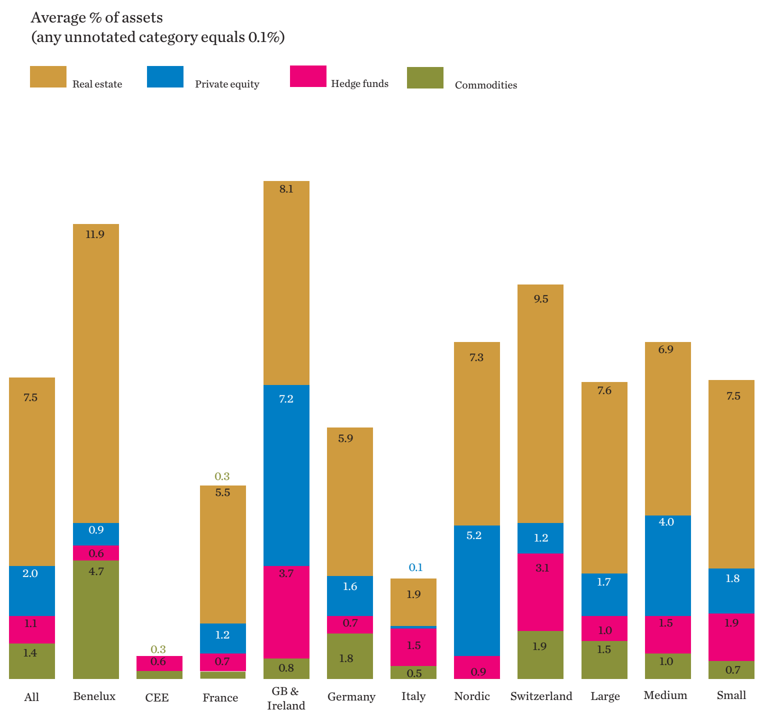
As in the previous two years, real estate forms the lion's share of this allocation, with 7.5% of investors' total assets – almost two-thirds the percentage held in alternatives – in this category, compared with 6.6% in 2009.

Indeed, real estate is now at its highest level for the past three years (Fig 3.2). While real estate remains the cornerstone of alternatives investing, the overall increase in allocation masks the fact that some countries have made significant reductions in their allocations. Italy reduced its allocation to 4% from 13.4% last year and the Swiss reduced their allocation from 25.6% to 15.7%.

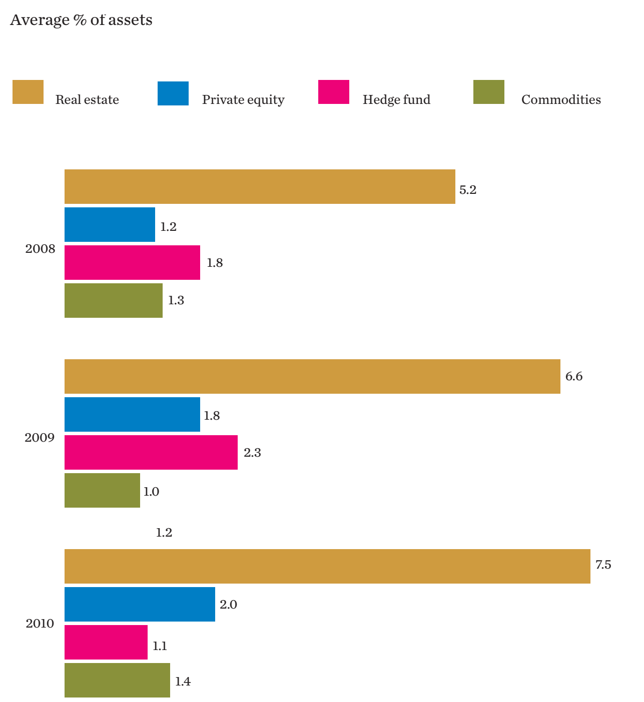
Hedge funds were again the big mover but this year exposure among respondents more than halved to 1.1% from 2.3%, making it the least considered alternative asset class (Fig 3.3). In France, the effect of the change in the composition of the sample will have been significant.

Private equity is now the second largest category with a 2% allocation, an increase of 0.2% from last year. In particular, Great Britain & Ireland investors increased their private equity allocation to 7.2% compared with 2.6% last year, making it again the top allocator in the sector.

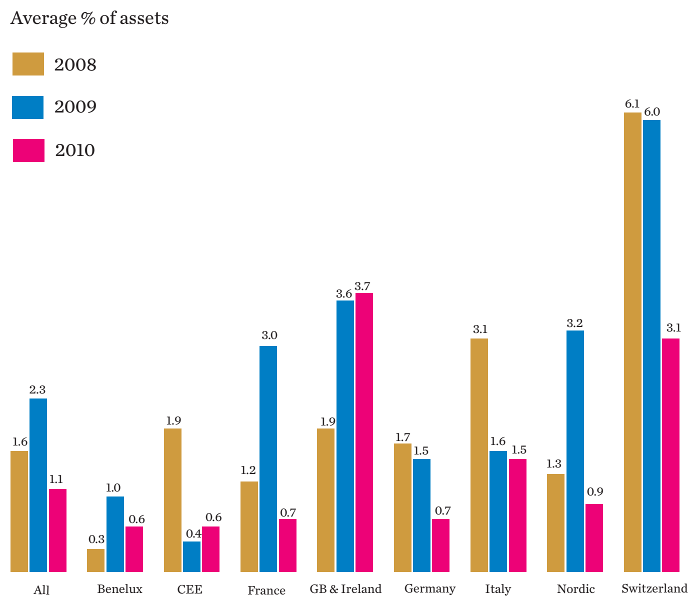
3.1 Selected alternative assets by country and size



3.2 Selected alternative assets 2008-2010



3.3 Hedge fund assets by country 2008-2010



Key takeaways

- real estate continues as by far the single largest investment, and is now at its highest level (7.5%) for at least three years, surpassing the previous year's high of 6.6%
- most countries have made very large increases in their real estate allocations, in contrast with Italy (a five-fold decrease)
- hedge fund allocation has more than halved to 1.1%, with GB & Ireland and Switzerland having by far the largest allocations at 3.7% and 3.1% respectively
- overall interest in private equity has improved marginally to 2.0%, but with GB & Ireland making an almost three-fold increase to its allocation (7.2%)
- commodities have now overtaken hedge funds at 1.4%, with Benelux being the biggest convert at 4.7%
- only smaller investors have increased their allocation to real estate
- the small overall increase in private equity reflects the fact that large funds have halved their allocation whereas, in percentage terms, the medium and small funds have made large increases

The Nordic countries also boosted their private equity allocation by 1% to 5.2%, making them the second largest allocator, having temporarily dethroned Great Britain & Ireland investors last year.

Meanwhile, commodities continue to attract investor interest, having lost ground during the crisis. This class is now more popular than hedge funds, making up 1.4% of portfolios, compared to 1% last year. The popularity of each of the four alternative classes continues to vary according to the size of the investor.

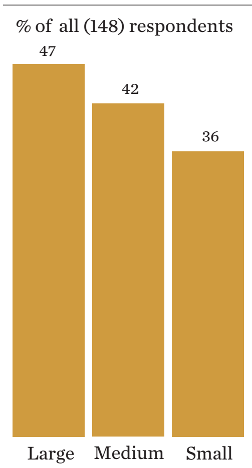
Large and medium-sized investors have reduced their overall allocation whereas smaller players have increased theirs.

In particular, smaller investors' increase of real estate and private equities boosted their overall allocation.

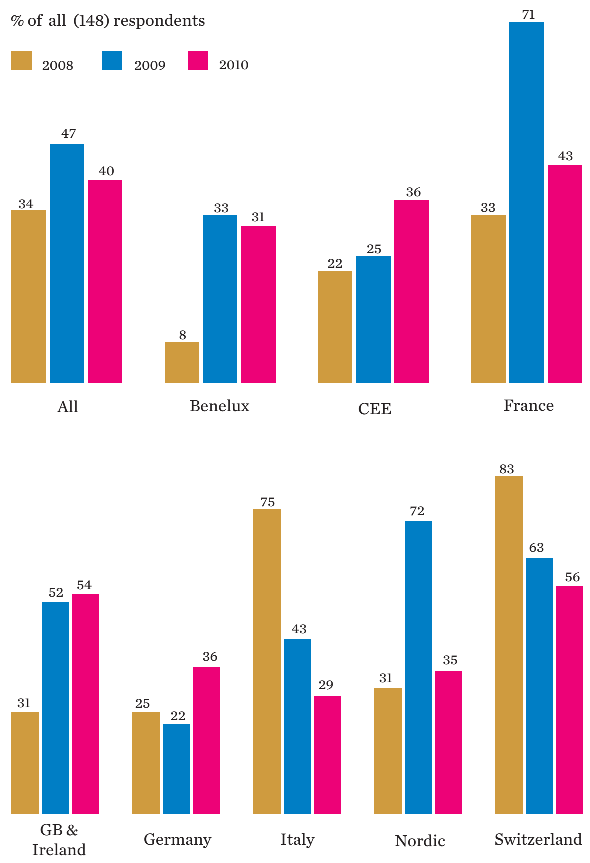
While medium and large-sized investors also increased allocation to real estate, their reduction of the other alternative asset classes brought down their overall allocation to the sector. Medium-sized investors reduced all but real estate allocations and larger players only added to commodities, apart from real estate.

The survey highlights the use of hedge funds by country and region (Fig 3.3), giving some insight into the rise in popularity of this asset class. Great Britain & Ireland investors are the largest allocators to hedge funds, and the average allocation increased slightly from 3.6% to 3.7% in 2010, and has nearly doubled since 2008. The only other countries that boosted their hedge fund allocation was CEE, which now allocates 0.6% to hedge funds, com-

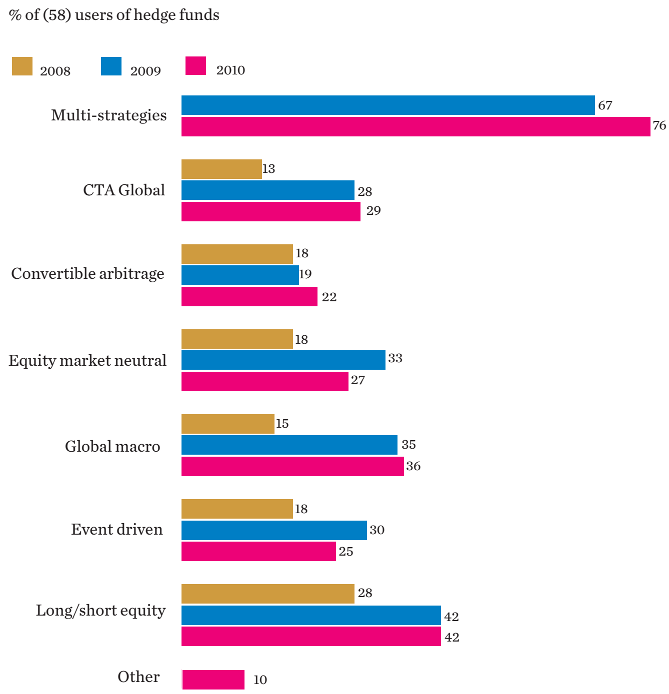
3.5 Hedge fund users by size 2010



3.4 Hedge fund users by country 2008-2010



3.6 Users of different hedge fund products 2008-2010



pared with 0.4% last year. France and the Nordic countries reduced their allocations significantly, to 0.7% and 0.9%, respectively, having invested 3% and 3.2% in the asset class, respectively, the previous year.

While individual country allocations to hedge funds have decreased, there has also been a decrease in the percentage of investors using them (Fig 3.4).

In 2010, 40% of respondents were investing in hedge funds, compared with 47% in 2009. Again, there was a significant reduction in uptake in France (possibly because of sample effect) and the Nordic countries but an increase in the number of users in Germany (from 22% to 36%) and the CEE countries (from 25% to 36%). Among Great Britain & Ireland investors, uptake has also increased slightly (from 52% to 54%).

Compared with 2008, the percentage of Swiss investors allocating to hedge funds has fallen dramatically from 83% to 56% as has Italian allocators (from 75% to 29%).

In terms of the size of institutional investors, hedge funds have seen the most dramatic decrease in usage among large investors (Fig 3.5). However, 42% of medium investors still use hedge funds, whereas the popularity among the larger investors has fallen from 86% to 47%. There has also been a decline among smaller investors where 36% use hedge funds now compared to 42% last year.

Turning to the ways in which the different hedge fund products are used, Fig 3.6 shows that multi-strategy products continue to dominate. These are now employed by 76% of hedge fund investors in this survey, which investors will access through fund of funds but also increasingly through direct investments. Increasingly, institutional investors are building their own capabilities and fund of hedge fund-like portfolios by using single managers.

Long/short equity is the second most popular product for the third year running, but usage has not increased since last year (42%). Not surprisingly, considering the market movement and increased volatility, event driven and equity market neutral strategies have reduced in popularity in favour of trading strategies such as global macro, CTA global and convertible arbitrage.

Key takeaways

- **hedge fund assets are more than half the previous year's allocation and are now at their lowest for at least three years**
- **40% of respondents used hedge funds in 2010, compared with almost one half the previous year**
- **Germany and CEE countries had significant uptakes, compared with France and Nordics which halved their allocations**
- **large investors have almost halved their allocation to hedge funds, reversing all of the previous gains reported the previous year. Medium investors are unchanged with smaller funds making a reduction**
- **multi-strategies remain favourite, and have increased in popularity from 67% to 76%**
- **equity long/short is third for third successive year but with no movement on the previous total of 42%**

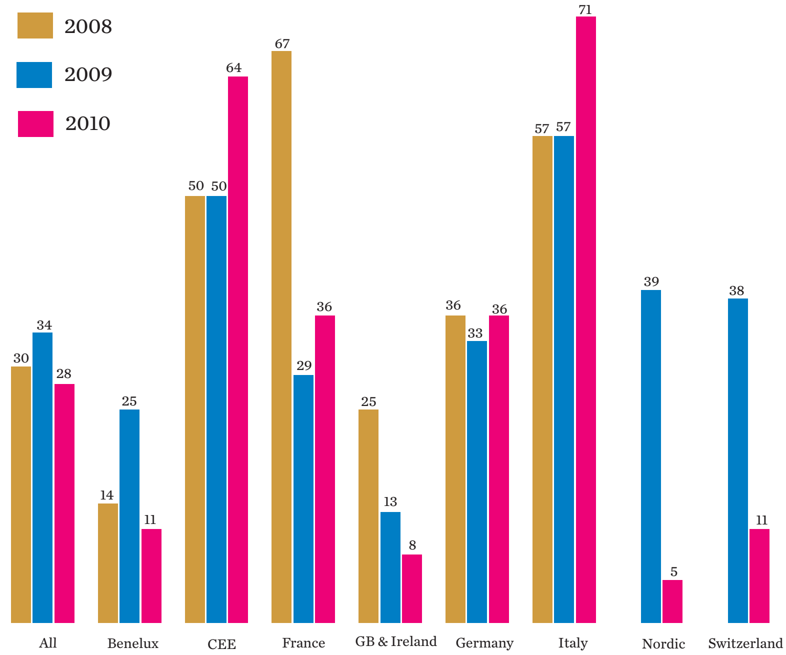
4. ETFs and Indices

Has interest peaked?

Institutional investors' interest and activity in using ETFs seem to have tailed off after a few years of increasing asset flows into these instruments. Less than a third of respondents report using them in 2010, down from over a third in the previous year, with active use peaking at 44% in 2007. Among retail investors, however, the sector goes from strength to strength, attracting record assets. Meanwhile, for institutional investors the financial crisis brought many other concerns and issues to the fore and cost savings offered by the bread-and butter ETF market is much less compelling than those achieved with alternative solutions such as segregated passive accounts or derivatives like forwards, futures and options.

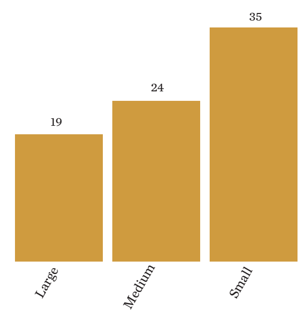
4.1 Exchange traded funds (ETF) users 2008-2010

% of 118 respondents



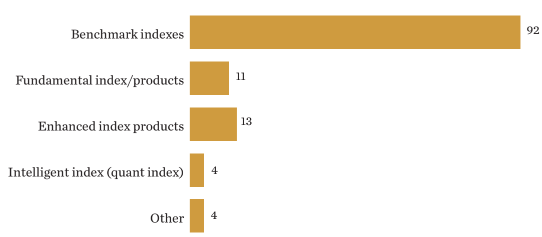
4.2 Exchange traded funds (ETF) users by size

% of 118 respondents



4.3 Use of new types of indices

% of 98 respondents



Index tracking mutual funds remain the favoured way to gain passive exposure, particularly among French, German, Swiss and Nordic investors. Although ETFs are generally less popular, they have gained popularity in the CEE countries and Italy where they are the main way to get passive exposure. Segregated index-tracking accounts also continue to attract investors from Benelux, in particular, where this is the second-most favoured method after passive mutual funds. In the Nordic countries, derivatives have overtaken mutual funds in popularity for gaining index exposure.

Although ETF use across Europe in general has fallen from 2009, 28% of investors now report using them, down from 34% (Fig 4.1), the CEE countries continue to like ETFs, with 64% putting them to use. However, Italy is now the country where they are most popular with 71% of respondents, albeit a small sample, saying they use ETFs as the main way of gaining passive exposure.

In 2007, it was the larger investors which were more inclined to use ETFs – perhaps because large institutions tend to be first movers and adopters of new strategies and technologies (Fig 4.2).

By 2010, a larger proportion of smaller investors report using them, a result more consistent with the fact that they are a more expensive but arguably a less governance-intensive index exposure solution than derivatives. Among small and medium-sized investors open-ended mutual funds is the most commonly used strategy, whereas large investors tend to use segregated index-tracking equity accounts. Medium-sized investors also use derivatives to a greater extent than their larger or smaller peers. In addition to an increasing array of alternative asset class ETFs, in the last few years there has been an inevitable rise of ETFs tracking alternative equity indices. Last year's survey showed that the most notable addition was the fundamentally-weighted indices.

Although European institutional investors have certainly been experimenting with segregated mandates based on various fundamental and/or equally-weighted indexation methodologies, they appear not to be interested in the ETF versions. This is not wholly surprising: those that have looked at alternative indexation tend to be large, sophisticated investors focused on optimising big beta exposures – not the natural constituency for ETFs (only 19% of large investors report using them at all) (Fig 4.2).

On the wider question of the use of indices as part of a portfolio (Fig 4.3), the vast majority of investors, 92%, use benchmark indexes. Enhanced index products are used to some extent (13%) whereas of the more recent newcomers, fundamental indexing seems to be taking a backseat (11%).

Passive and tactical

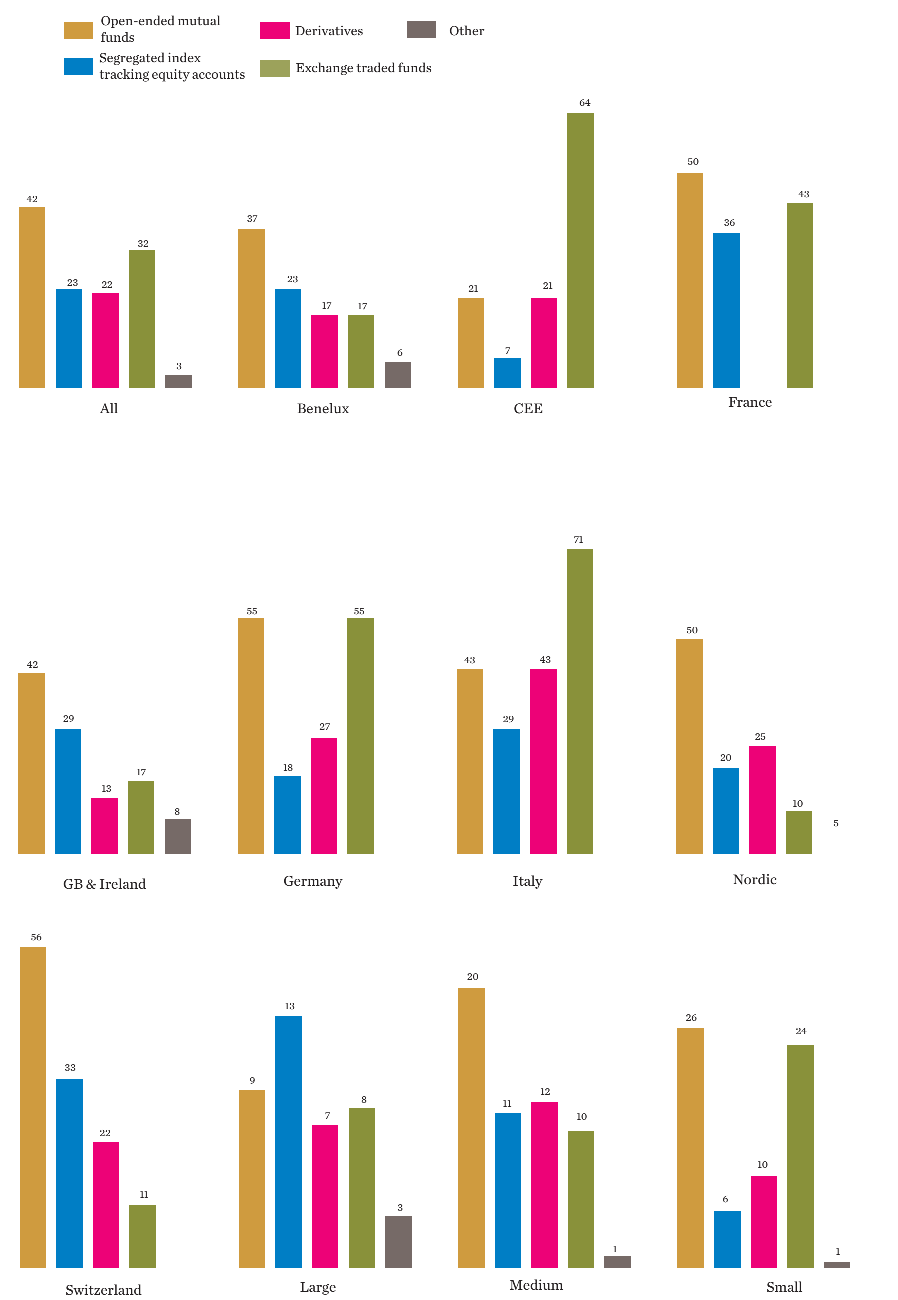
Passive core holdings are one side of the index investment coin: their popularity has increased for pension funds, particularly in equities. The other side of the passive coin is the use of techniques to take a tactical position in the portfolio through instruments such as derivatives.

Bearing in mind that survey respondents could select multiple options to reflect the strategies they deploy (Fig 4.4), 42% said they used open-ended mutual funds for passive exposure, 32% used exchange traded funds, while 23% used segregated accounts for this purpose. Derivatives are used by almost as many, 22%.

The use of ETFs has decreased from 34% to 28% compared with last year's survey. Use of the various techniques and vehicles varies significantly across the countries and regions covered in the survey, with as few as 21% of CEE respondents using open-ended mutual funds for passive exposure. However, while only 18% of German investors and 7% of CEE respondents used segregated accounts, for French investors the figure is 36%.

4.4 Techniques used to gain index exposure

% of 112 respondents



In the Nordic region, the total percentage of investors using open-ended mutual funds has fallen from 71% last year to 50%, although the category still remains the most popular. Derivatives appeared the least popular way of gaining passive exposure (22%), followed closely (23%) by use of segregated accounts. Italians (based on a small sample size) have overtaken the investors in the CEE region as the biggest users of ETFs – at 71% – with mutual funds and derivatives also used by 43%, respectively. CEE investors are now the second largest ETF users at 64%, a growth from last year (60%). In Italy, only 29% use segregated accounts. British and Irish investors remain the lowest users of ETFs, at 4%, perhaps representing some consultants' hostility to the vehicle.

Derivatives are deployed in all regions and countries, except France, with usage varying from 3% in Great Britain & Ireland to 43% in Italy, also the highest users, followed by German investors (27%).

Key takeaways

- the survey finds Italy to be the biggest user of ETFs at 71% (40%)
- usage of open-ended mutual funds has declined considerably but this technique remains by far the most popular (42%), followed by ETFs (32%)
- Switzerland, Germany and France are the biggest users of open-ended mutual funds, with least use being made by Benelux and CEE countries

5. Duration and LDI

Gaps widening

The maturity of many defined benefit pension funds and other longer term portfolios has led to an increasing focus on liabilities, and the ability of investors' bond portfolios to broadly match future commitments to pensioners. This is why the EIAMS survey measures the duration of participants' fixed income portfolios. On average, the duration of fixed income assets has fallen while the time horizon for actual liabilities has moved out. On the question of liability driven investment (LDI), maturing pension funds, the closure of defined benefit pension schemes in some countries, mark-to-market regulations and historically low current interest rates, in combination with the market crash of autumn 2008, have all led to an even more increased focus on the management of liabilities.

Sensitivity to interest rates is a particular issue at the moment, and might be a factor helping to drive down the overall duration of fixed income portfolios in the most recent study. The historic low interest rates that we currently see have meant that taking risk at the long end of the interest rate curve becomes a less attractive proposition in terms of risk and return.

Concerns over inflation and low government bond yields have prompted investors to continue to look at alternative debt markets. There has been an increased focus on emerging market debt due to the growing perception that European sovereign debt can no longer be viewed as a risk-free asset class.

In short, credit has become more of a risk asset than one that can be deployed broadly to match pension fund liabilities over time, albeit one that has enjoyed attractive risk-return characteristics.

As last year, with the exception of Italy, the duration of investors' actual liabilities exceeds the duration of their fixed income portfolios (Fig 5.1). On aggregate, all countries and regions represented in the survey have seen an increase in the duration of liabilities, rising from 15.69 years in 2009 to 16.37 this year. This marks a turnaround on previous years when the duration of liabilities seemed to be gradually falling (15.7 years in 2009 and 16.6 years in 2008).

Unfortunately, the aggregate duration of fixed income assets for all countries and regions has not matched the turnaround and continued to fall when measured against last year, dropping from 7.84 years to 7.42 years. The gap between the two was 7.9 years for the last two years running, but this year it has increased to 8.95.

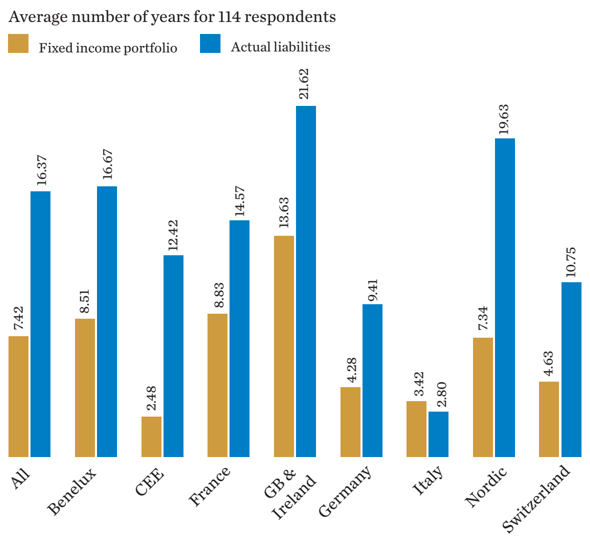
Differences are to be found in the various countries and regions covered in the survey, reflecting local conditions, debt issuance and investors' preferences. Only one bucked the above trend and saw the shortfall between the duration of liabilities and duration of fixed income assets decrease: CEE region fell from 10.75 years in 2010 to 9.94 years, as duration of liabilities fell at a faster rate than that of assets. Only the Nordic region had a larger gap last year (10.96 years), but this actually increased further to 12.29 years, as the duration of liabilities rose considerably and the duration of assets fell.

In terms of the length of actual liabilities, the Nordic region is second only to Great Britain & Ireland, which stands at 21.62 years in 2010, but the gap between liabilities and fixed income assets rose from 7.69 years to 7.99 years, thanks to the duration of fixed income assets almost keeping pace (Fig 5.1).

By far the biggest shifts took place in Switzerland and Germany. The former saw the duration of its liabilities shoot up from 4.67 years in 2009 to 10.75 years, while the duration of fixed income assets increased only slightly from 4.26 years to 4.63 years.

This resulted in a massive jump in the duration gap between liabilities and fixed income assets, from a mere 0.41 years in 2010 to 6.12 years.

5.1 Overall duration of fixed income portfolio and actual liabilities, in years, by country



Key takeaways

- in all cases, as last year, and again with the exception of Italy with -0.62 years, the duration of the liabilities exceeded the fixed income portfolio duration
- the overall average for fixed income duration shortened again, but more narrowly by five months, while the period for actual liabilities lengthened by eight months
- the negative gap has widened in all cases, except for CEE countries, with the average increasing from 7.9 to 9.0 years

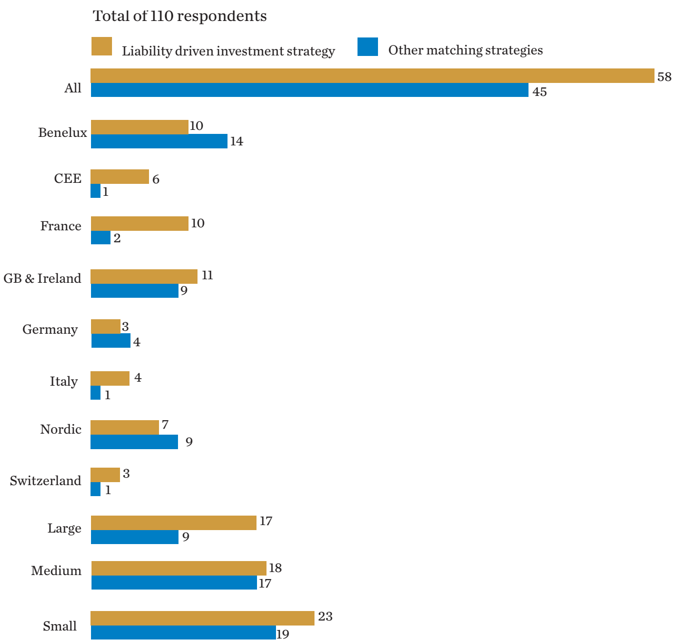
Germany saw the duration of its fixed income assets drop from 5.4 years to 4.28 years, while the duration of liabilities rose considerably more from 6.87 years to 9.41 years. This saw the shortfall between the two jump from 1.47 years to 5.13 years.

Liability driven investing

Asset managers have developed so-called pooled liability driven investment (LDI) vehicles in recent years, which have attracted many smaller investors. Larger investors have preferred to deal directly with investment banks to implement interest rate swap strategies or alternatives, such as swaptions.

This is in combination with an increased focus on counterparty strength and the robustness of standard agreements. UK pension funds, which are obliged to increase benefits in line with inflation up to a 5% cap, have also become users of interest rate swaps. Accordingly, we have asked investors in the last four surveys to tell us about their liability management policies and the techniques used to achieve this. This year, we asked respondents to choose between specific LDI strategies and other liability matching techniques.

5.2 Approach/techniques employed to manage liabilities/guarantees



The results show that LDI strategies are the most popular method with 58 of the 110 respondents (53%) employing this method (Fig 5.2). LDI seemed to be particularly popular in France, Italy and the CEE region, but there is a mixed picture across the other countries and regions.

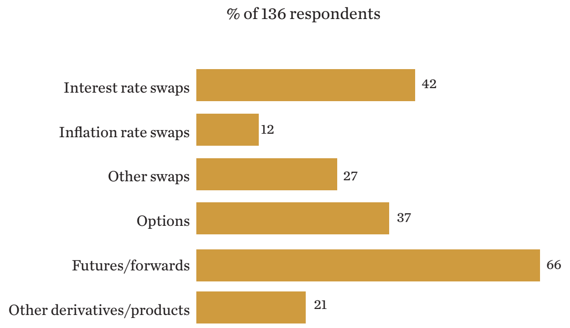
Key takeaways

➔ use of LDI to manage liabilities/ guarantees was most used by GB & Ireland, Benelux and France, but at a low level

Most large investors preferred to employ LDI strategies, whereas medium and smaller sized institutions were slightly more split, although the majority in these categories still subscribed to LDI techniques. Accordingly, we have asked investors in the last three surveys to tell us about their liability management policies and the techniques used to achieve this.

The use of derivatives is very much part of implementing LDI strategies and Fig. 5.3 shows the extent to which different types of derivatives are used within investors' portfolios.

5.3 Types of derivatives or derivative products used within portfolio



6. Consultants

Downward trajectory?

It is generally thought that during tougher times the external consultant business booms. However, it is noticeable that there has been a significant fall-off in the use of consultants since the crisis year of 2008.

In this year's survey, the use of external investment consultants among the respondents has fallen below the 50% mark for the first time since 2006, with this year's level at 49% (Fig 6.1).

In terms of proportion of investors using consultant services it now seems very unlikely that the proportion using consultants services across all countries will exceed the levels achieved in 2008 any time soon, despite the emergence of new types of services on offer.

Looking at the country and region-specific statistics, the majority have seen a decline in the overall use of consultants (Fig 6.2) and France again shows a sizeable down swing – probably due to the greater presence of larger investors among this year's respondents.

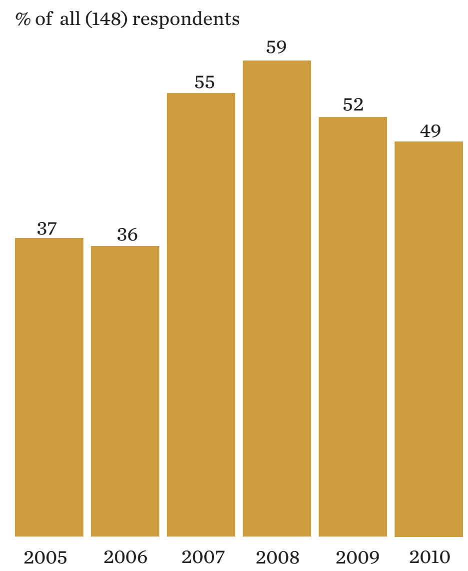
However, the largest fall in the use of consultants is in the CEE countries, down to only 7% from 33%. In part, this might be a reflection of the changes in the sample of respondents in this year's survey compared with last year. The overall fall in usage has been driven not only by the CEE countries and France but also by the German, Swiss and Nordic investors. On the other hand, the use of consultants in Italy has increased significantly and is almost back to 2008 levels, now standing at 87% compared with 57% last year, making them once again the biggest users of consultants.

The level of consultant use in Great Britain & Ireland, another stronghold of consultancy use, is level with last year at 83%, ie back up and beyond 2007 levels of usage, showing that the fall in 2008 may have been a short-term reaction to the recession. British and Irish investors are now the second biggest users of consulting services, having temporarily dethroned Italy last year.

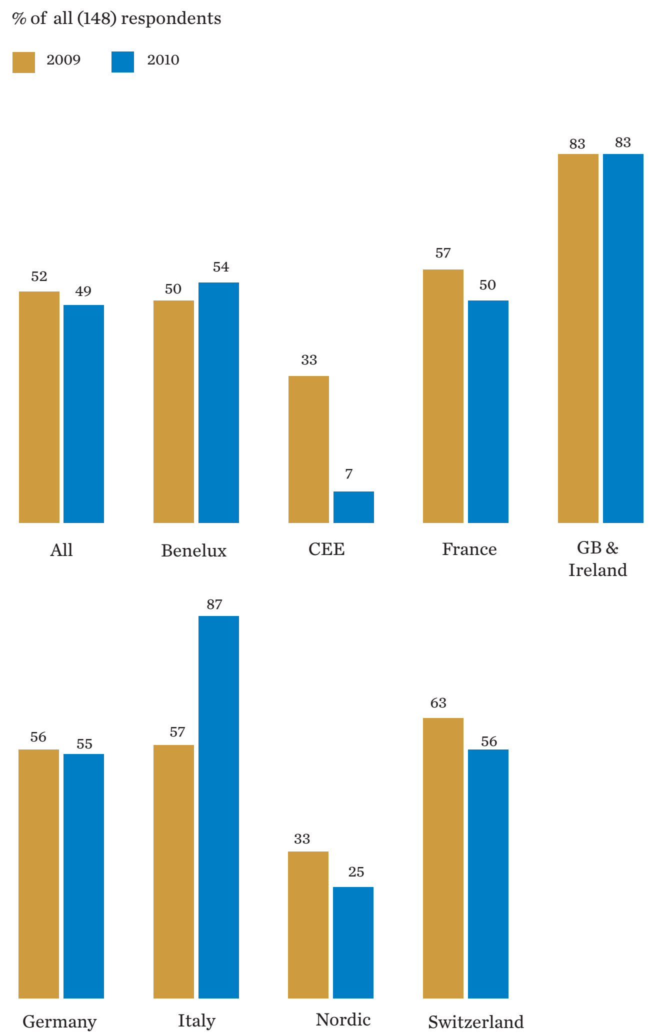
The investors in the Benelux countries are also increasing their reliance on consultants but the levels remain below 2008 levels.

In the Nordic region, which saw a swing back to beyond 2007 levels last year, only a quarter of respondents use consultants compared with last year when a third did. Again, this may be a reflection of the sample of respondents compared with last year which was influenced by Denmark, where labour-market and other pension funds have a very high level of in-house capabilities, which has hindered the development of consultancy in that country. When

6.1 Users of consultants 2005-2010



6.2 Users of consultants by country 2009-2010

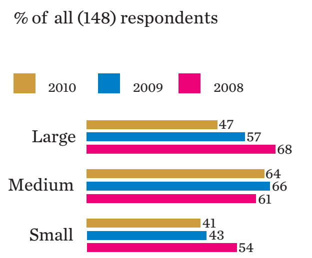


it comes to the consideration of size (Fig 6.3), the separate groupings continue to show some distinctions and both large and small investors are using consultants to a much lesser extent.

In the case of smaller investors this may be a reflection of limited resources and with the larger players it might be an effect of the recession and a need to curb costs. It may also be the timing of the survey, as regular reviews might not be on an annual basis. Medium-sized investors are also using consultants less but the fall in usage is not as dramatic as for the other two categories.

Some explanations to the changes may be gleaned from the analysis of the reasons why consultants are used (Fig 6.4). In previous years' survey reports the top reason for hiring consultants has consistently been that of 'investment advice', which does not feature at all in this year's results. This we have to acknowledge as an oversight resulting in this question being omitted from this year's EIAMS survey. Had this question been included, we believe that investment advice would still have ranked as the number one reason for using consultants' services.

6.3 Users of consultants by size 2008-2010



Another reason that featured in previous years' surveys which did not appear this year is to 'reorganise your business' which again is a sign of the recession. This question was removed deliberately this year.

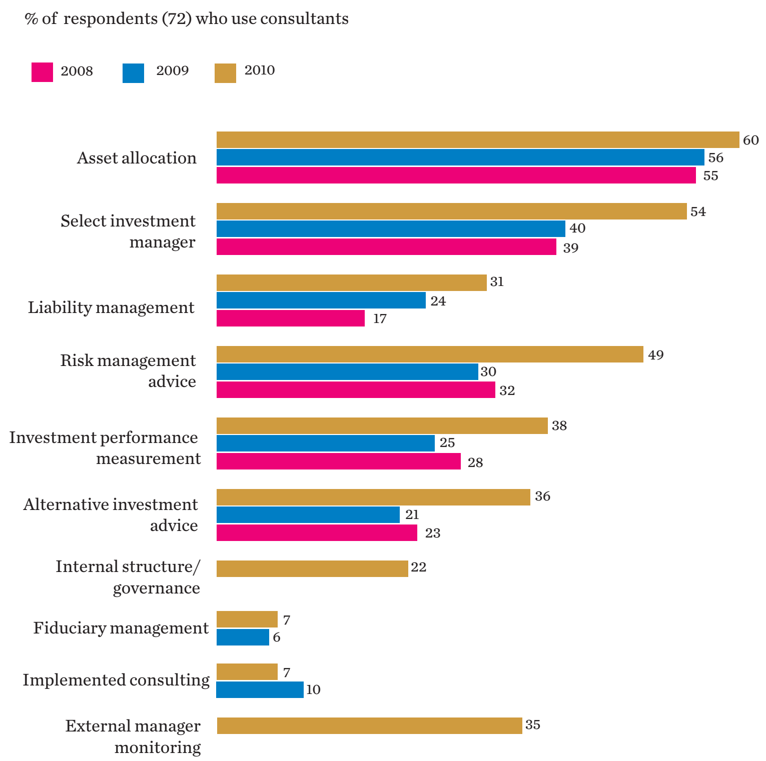
New reasons for seeking advice in this year's survey are 'external manager monitoring' and 'internal structure/ governance', which have for the first time been mentioned by the participants as reasons for approaching a consultant.

As a result of the financial crisis, risk management has been pushed to the fore, with this advice now being sought by 49%, compared with 30% last year. Portfolio activity is slowly increasing as the recession eases, with external manager monitoring, a new category for this year, being used by 35% of respondents.

Another result of the crisis is that internal processes are also increasingly scrutinised, with 22% using consultants for internal structures/governance, again a new category for this year.

Most categories that remain from last year show an increase, albeit small, apart from implemented consulting which shows a decrease (7% compared with 10% last year). Now, 7% use fiduciary management, a small increase on last year. It also seems that the traditional providers have caught on and are perhaps now better at competing with the new breed of advisers that emerged a few years ago offering fiduciary management and implemented consulting, the latter declining in popularity compared with last year.

6.4 Reasons for usage of consultants 2008-2010



Asset allocation is now the top reason for using consultants, followed by selecting investment manager and risk management advice. Investment performance measurement and alternative investment advice show an increase again, indicating that the overall fall in usage may have been a short-term reflection of the recession.

Key takeaways

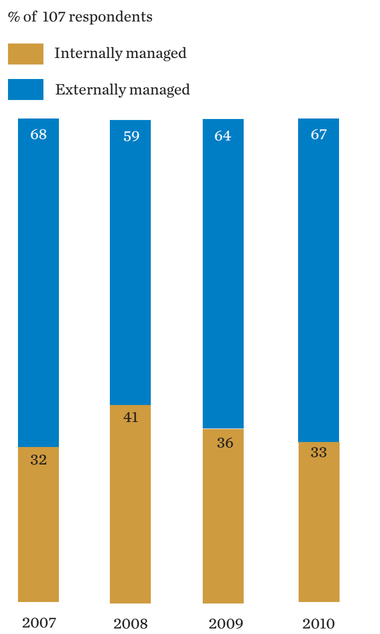
- **use of consultants has continued its fall from the reported high of 59% in 2008, now standing at 49%**
- **on a country basis, there is no clear pattern with a small increase by Benelux, small decreases by France, Switzerland and Nordics, dramatic increase by Italy (87% from 57%) and the reverse by CEE (7% from 33%), and with little or no significant movement from Germany and GB & Ireland**
- **Italy has surpassed GB & Ireland (83%) as the biggest user**
- **medium investors remain by far the biggest users. Both large and small investors have decreased their usage in each of the last three years**

7. External managers: usage

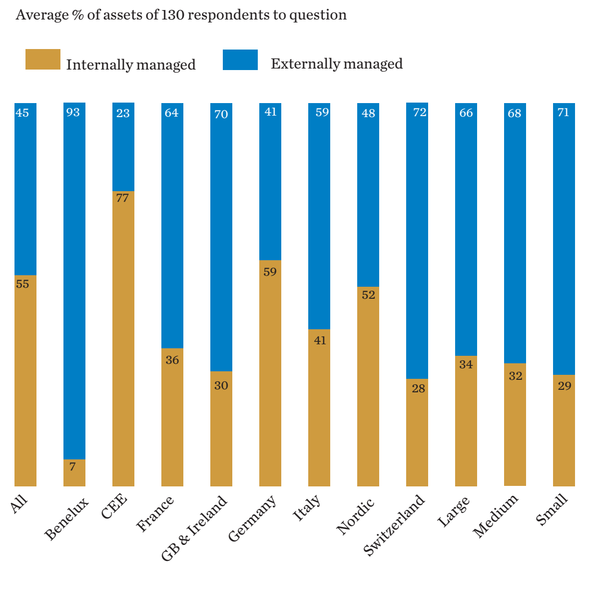
Investors moving away from home

The survey finds that internal management continues to lose popularity with the trend towards external management now well entrenched, but care needs to be taken in interpreting the figures, as the pattern varies across Europe from country to country. Meanwhile, among external management mandates, pooled investment funds continue to dominate over segregated accounts, although findings differ according to the various regions covered.

7.1 Users of external investment managers



7.2 Assets delegated to external investment managers by country and size



The long-term trend towards external managers over in-house management of assets appears to be continuing and, indeed, increasing. The majority of respondents (67%) now manage externally. This is marginally higher than in 2009 when 64% of assets were being managed externally (Fig 7.1). A case in point is in relation to France where, despite the large increase in sample size and assets over the previous year, when 37% of their assets were managed internally, much in line with the average figure for all countries that year of 36%, in 2010 the proportion internally managed just dropped by one percentage point to 36%.

The shift away from internal management in 2010 is also reflected in the figures for large investors, where 66% of their assets were managed externally (Fig 7.2), a significant jump over the 56% in 2009. But this shift is even more true for both medium and small investors who have moved to external management, at 68% and 71% in 2010, respectively, compared with 65% and 66% the previous year.

Key takeaways

- **the trend towards the use of external managers appears to be continuing unabated**
- **small and medium investors have maintained their relatively high usage of external managers, now being joined by large investors at 66% (previously 56%)**

However, outside of France, the majority of countries and regions covered by the survey saw the proportion of assets managed internally increase in 2010. For example, while investors in Great Britain & Ireland still have the majority (70%) of their assets managed externally, this is a massive decrease from 90% in 2009. For Germany and the Nordics the proportion of assets managed internally also increases: from 46% to 59%, and from 46% to 52%, respectively.

Only Italy, Benelux and the CEE region have bucked this trend. The majority (81%) of assets in CEE were managed internally in 2009, but this has been reduced to a smaller majority (77%) in 2010.

Meanwhile, Benelux, which was heavily weighted (83%) to external management in 2009, saw the proportion of assets managed externally rise to a massive 93%. The Swiss remained unperturbed by all of this and maintained the proportion externally managed at 72% for both years.

Using a vehicle

Here we look at how investors hold the assets they place with external managers, which have traditionally been held mainly in segregated accounts, although the arrival of funds catering for the special requirements of institutional investors in recent years have showed signs of becoming the most popular investment structure.

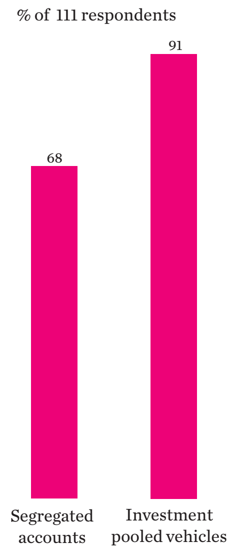
After initially surging in popularity in 2007 to become the most widely used structure (used by 80% of investors versus 68% for segregated accounts), pooled investment vehicles dropped significantly in 2008 (to 69% versus 72% for segregated accounts). In 2009, pooled funds reclaimed their dominance with 88% of investors using them, versus

70% using segregated accounts. In 2010 their dominance continued with 91% of investors using them, versus 68% using segregated accounts (Fig 7.3).

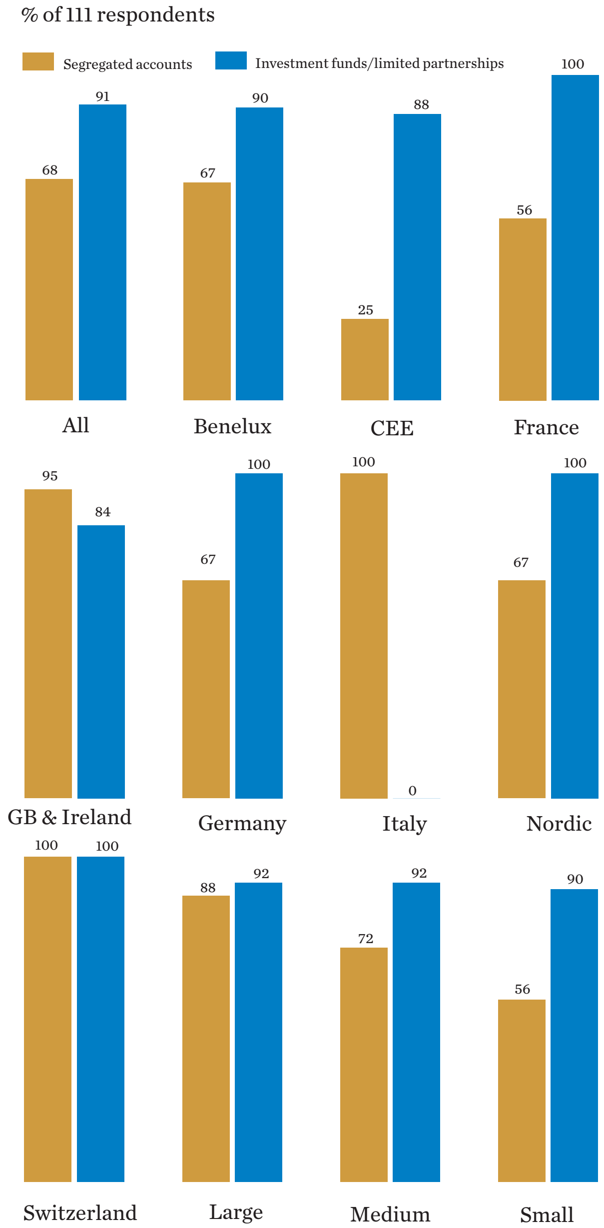
It is a mixed picture when broken down by country and region. The growing popularity of funds is demonstrated by the fact that several regional categories saw 100% response rates for funds, namely France, Germany, the Nordics and Switzerland; in 2009, only 100% of Nordic investors used funds. The pendulum swung the other way in Italy, however, with no investors using funds, in comparison to 40% in 2009.

Great Britain & Ireland was historically one of the biggest users of funds, according to the survey, but in 2010 this was no longer the case with 84% of investors in this category voting for funds, down from 90% in 2009. More investors (95%) in this region used segregated accounts than funds in 2010, marking a reversal of the picture in 2009 when a smaller proportion (86%) used them. Only Italy and Switzerland saw 100% of respondents using segregated accounts, up significantly from 40% and 57%, respectively, in 2009. When broken down by investor size, there seemed to be little change in terms of the use of segregated accounts and investment funds (Fig 7.4). The biggest shift happened among small investors with segregated accounts becoming less popular (down from 65% in 2009 to 56%). Medium-sized investors remained the same with 72% using segregated accounts and 92% using funds. Large investors continued to be the most common users of segregated accounts at 88% (up from 85% in 2009).

7.3 Users of external investment managers by vehicle 2010



7.4 Users of external investment vehicles by country and size



Key takeaways

- use of segregated accounts has continued its slow slide, now from 70% to 68%
- investment/pooled vehicles remain the most used, increasing from 88% to 91%
- segregated accounts used most by Italy and Switzerland, and least by CEE countries
- investment funds/limited partnerships used most by France, Germany, Nordics and Switzerland, and least by GB & Ireland, albeit still high at 84%
- all sizes of investors are significant users of investment funds, with smaller investors making the least use of segregated accounts

8. External managers: asset allocation

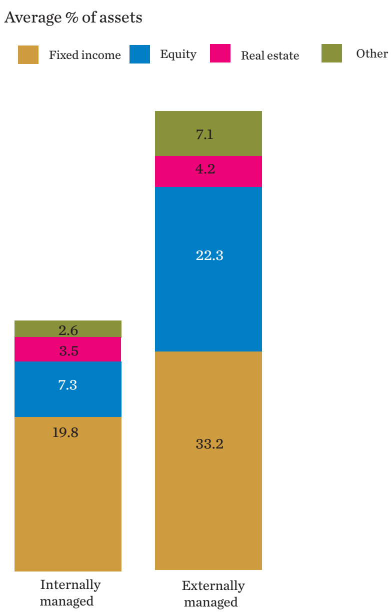
Shifting balance to external management

The proportion of equities investments managed internally decreased significantly in 2010, and fixed income by a much narrower margin, although there were deviations to this trend in different countries and regions. Fixed income is now managed externally more than any other asset class. Large French investors have been the biggest drivers of this trend, managing much more of their equities externally compared with last year's survey.

The survey findings suggest that the proportion of assets now managed externally was double (66.8%) those internally managed (33.2%) in 2010, the majority of which were fixed income assets (Fig 8.1).

The dominance of fixed income for external investments diverges from previous years' findings, and may be predominately attributable to the large French investors.

8.1 Asset allocation by internal and external management



The proportion of internally managed equity assets grew by almost 50% in 2010, albeit from a lower base, from 5% in 2009 to 7.3% in 2010, suggesting that equities are the only area of growth amongst the main asset classes in internal management.

At 33.2%, fixed income remains the largest segment of assets managed externally, and by a considerable margin over 2009, with equities some distance behind at 22.3%. Last year, the proportion of externally managed fixed income assets was 26%, while the proportion for equities was 25%.

For the first time this year, the survey included real estate assets in this analysis. The data suggests real estate assets are split fairly evenly between internal management and external mandates, albeit with the latter in the ascendancy at 3.5% and 4.2%, respectively.

In line with previous surveys, investors in Great Britain & Ireland, Benelux and Switzerland outsourced their fixed income investments the most, with only 0.1% of the former's assets in internally managed fixed income assets (Fig 8.2). The CEE region continued to be one of the biggest exponents of internally managed fixed income investments at 59.4% (versus 17% managed externally). Nordic investors saw their internal fixed income investments increase from 31.7% in 2009 to 39.5% in 2010 (versus 14% managed externally). But the biggest shift was in France where internally managed fixed income assets fell from 33.7% in 2009 to 23.1% in 2010, while their externally managed fixed income assets rose from 24.6% in 2009 to 43.8% in 2010.

French investors also saw externally managed equities fall from 20.7% in 2009 to 12.1% in 2010, while internally managed equities rose from 0.3% to 4.8% over the same period, again probably reflecting the changes in the respondent base. Meanwhile, investors in Great Britain & Ireland favoured a move into internally managed fixed income in 2010, with the proportion rising from 2.3% in 2009 to 22.7%. At the same time, externally managed equities fell from 43.6% to 27.7%.

According to last year's survey, large investors resumed their long-term move towards outsourcing the majority of their investments (55.7%), and this has continued in 2010 with an increase to 66% of their investments managed externally.

How the balance has changed

	2010		2009		2008	
	Int	Ext	Int	Ext	Int	Ext
Benelux	7	93	17	83	14	86
CEE	77	23	81	19	81	19
France	36	64	37	63	34	66
Germany	59	41	46	54	60	40
Italy	41	59	44	56	59	41
Nordic	52	48	46	54	55	45
Switzerland	28	72	28	72	43	57
GB & Ireland	30	70	10	90	16	84
All Countries:	33	67	36	64	41	59

Key takeaways

- **internally managed assets, for at least the fourth year, continue to be most heavily focused on fixed income but by less than the amount reported previously (from 21% to 19.8%)**
- **externally managed assets remain more focused on fixed income than equity, the former increasing from 26% to 33.2%**
- **Italy, Switzerland, Benelux and France delegate most fixed income**
- **Benelux, GB & Ireland and the Nordics delegate most equity**
- **Benelux, displacing GB & Ireland, now have the highest proportion of equity among externally managed assets**
- **all sizes of investors allocate most fixed income to external managers**
- **all sizes of investors are now allocating at least two-thirds of assets to external managers**

The proportion of internally managed equities increased modestly for larger investors in 2010, from 6.4% to 7.5%, while fixed income fell from 25.8% to 19.7%. There has been less change among small and medium-sized investors, both of which still outsource the majority of their equities and fixed income investments, and both have seen a measureable increase in externally managed assets.

Benelux investors are the biggest outsourcers of real estate investments, with such investments representing 12.9% of assets. Swiss investors are comparable with outsourced real estate investments representing 11.2%, although their internal investments are also fairly high at 6.2%.

Italian investors favour internal management (1.9% versus 0% for external real estate), as do their French (4.1% versus 0.9%) and German (4.3% versus 1%) counterparts. Investors in Great Britain & Ireland and the Nordics are more evenly split between the two.

Large investors are fairly evenly split between managing their real estate investments internally or externally. But more real estate assets of medium- and small investors are outsourced (6.3% versus 2.6% and 4.6% versus 1.4%, respectively).

8.2 Asset allocation by internal and external management by country and size

Average % of assets

9. External managers: selection criteria

9.1 Criteria when selecting an external investment manager 2008-2010

Degree of importance for 126 respondents (Ranking)
1= most important

	2010	2009	2008
Clarity of investment process	1	1	1
Risk control	2	3	2
Performance	3	2	3
Investment management fees - transparency of fees	4	5	4
Stability of investment team	5	4	5
Client service	6	6	6
Quality of reporting	7	10	8
Investment management fees - level of fees	8	7	9
Financial strength of external manager	9	8	10
Corporate governance	10	9	11
Understanding of your organisation's goals and needs	11	11	7
Reputation of asset manager (brand)	12	12	12
SRI/ESG credentials	13	n/a	23
Other criteria	14	13	28

Investors are still battening down the hatches when selecting investment managers. They prefer to understand how a manager proposes to get results, rather than be impressed by a spectacular track record without knowing how it was achieved. Transparency of fees is also becoming more important. Meanwhile, larger investors have become more security-conscious than their smaller counterparts.

The past few years have clearly concentrated investors' minds on what is really important when selecting an external investment manager (Fig 9.1).

The same five criteria have held the top slots – albeit in a different order – for the last three years. However, 'clarity of investment process' has now been top dog for all three years.

Previously, 'performance' had been the most important single criterion, claiming top place from 2005 to 2007. Since then, it has always retained a top three ranking, moving from third to second place in 2009, and back to third again in this year's survey.

This shift in emphasis suggests that investors now accept that performance can be misleading; even after the financial earthquakes of the past few years, there are still likely to be shocks in store. And while absolute return policies might protect against downside risk, they have to be balanced against long-only strategies, which can exploit upturns in the markets. Failing to benefit from these amounts to lost money.

So, given the continuing unpredictability of the global economic backdrop, investors are placing more importance on understanding the investment process used by their managers, than on a quest for returns which may never live up to expectations.

Replacing 'performance' in this year's second place is 'risk control', moving up one slot from last year. Again, this suggests a 'safety first' approach by investors, indeed a hardening of that line over the past year. A major factor behind this has undoubtedly been the problems of government debt.

The fourth-placed criterion – 'investment management fees – transparency of fees' – has played change-and-change-alike with 'stability of investment team' for three years now, each switching between fourth and fifth places, with 'transparency of fees' getting the upper hand this time.

While continuity within an investment team is important, and can ultimately affect performance, it seems that

Key takeaways

- clarity of investment process' has now retained its first place for the third successive year, followed by 'risk control' and 'performance' in second and third place, respectively, a pattern emerging of an annual reversal of position
- those top three have kept their top three positions, but not always in the same order, for the past 7 years
- 'transparency of fees' has moved up to fourth place, replacing 'stability of investment team' in fifth
- 'client service' retained its sixth position, with 'quality of reporting' rising three places (and showing the biggest top 10 increase) to seventh place
- on a country basis, again broad concurrence that 'clarity of investment process' is paramount, except for CEE countries which favour 'client service'
- CEE countries and Germany are both much more focused than others on 'quality of reporting', placing it in joint first and third place, respectively
- there is broad agreement on the top four criteria, but with 'level of fees' rising one place to fifth for large investors, in contrast to the medium and smaller investors who now regard it as less important

9.2 Criteria when selecting an external investment manager by country and size

Degree of importance for 126 respondents (Ranking)
1= most important

	All	Benelux	CEE	France	Germany	Italy	Nordic	Switzer-land	GB & Ireland	Large	Medium	Small
Clarity of investment process	1	1	6	1	1=	1	2	1	1	2	1	1
Risk control	2	2	5	2=	1=	2=	3	3	2	1	2	2
Performance	3	3	2=	2=	2	2=	1	2=	3	3	3	3
Investment management fees - transparency of fees	4	4	4	3	3=	3=	4	2=	7=	4=	5	4
Stability of investment team	5	5	3=	4	3=	6	5	4=	4	4=	4	5
Client service	6	8	1=	6=	3=	4	7=	4=	8	6	6	6
Quality of reporting	7	6	1=	9	3=	7	8=	8	7=	7	8	7
Investment management fees - level of fees	8	9	1=	5	6	5	6	4=	7=	5	11	8
Financial strength of external manager	9	10	3=	7	4	9	7=	6=	5	8	9	9
Corporate governance	10	7	7	10	5=	10	8=	5	6	9	7	10
Understanding of your organisation's goals and needs	11	11	8=	8	5=	3=	10	7	7=	11	10	12
Reputation of asset manager (brand)	12	12	2=	6=	7	8	9	6=	9	10	12	11
SRI/ESG credentials	13	14	8=	11	8	11	11	9	10	13	13	14
Other criteria	14	13	9	12	9	12	12	10	11	12	14	13

investors are again looking to their wallets as the most obvious thing to protect. However, the actual level of fees is seen as even less important than last year, ranking eighth instead of seventh. Again, investors are learning that understanding how fees are calculated, and paying a fair price for hopefully a good performance, is more important than paying cut-rate fees: you may well get what you pay for.

Interestingly, the customer-focused criteria such as 'client service' (sixth) and 'quality of reporting' (seventh) are considered more important than 'financial strength of external manager' (ninth) and 'corporate governance' (tenth).

This suggests that asset managers are almost considered to be better bets than some small European countries. Or perhaps investors are confident that no manager would be allowed to lose clients' money if it went bust.

Not surprisingly – given the overall result – 'clarity of investment process' was the top criterion for manager selection for investors in most countries covered by the survey (Fig 9.2), the exceptions being the Nordic nations (which ranked it second, behind 'performance') and the CEE countries (sixth, with 'investment management fees – level of fees', 'client service' and 'quality of reporting' joint top).

Also in line with last year, there was no clear-cut runner-up: Germany, France, Italy and the CEE countries plumped for 'performance', while Great Britain & Ireland, Benelux countries, and France and Italy (again) went for risk control.

A more defined situation emerges in terms of criteria according to the size of investors, with large investors seemingly more security-conscious than last year.

As in 2009, 'clarity of investment process' was the top priority for medium and small investors. But while for large investors it had also been joint top last year, along with 'performance' and 'risk control', it is now the latter which is considered paramount, with 'clarity of investment process' second and 'performance' third.

Perhaps the larger institutions feel they lack the ability to act as nimbly as their smaller brethren in the face of unwelcome developments.

10. External managers: fees

Hot and cold on performance fees

The long march towards acceptance of performance fees continues, particularly in real estate management, and by smaller investors. But while performance fees are also gaining support in more conservative markets such as Germany and Central and Eastern Europe, old hands like Great Britain and the Benelux countries have become less keen.

As last year, performance fees on their own were generally shunned except for managing private equity and hedge funds, although their use in real estate management moved up by 3% to 8%. But performance fees were slightly less popular among private equity investors, with 16% paying managers on this basis, a 2% fall on 2010. However, there was a 2% rise – to 24% – in their use by hedge fund investors (Fig 10.1).

The most striking change for fixed fees was a 15% slump, to 58%, in the proportion of balanced investors using this form of remuneration. But fixed fees were further embraced by real estate investors, the proportion using them rising 8% to 67%, while usage also rose for private equity investors, up 6% to 31%.

Balanced investment saw the biggest shift towards both fixed and performance fees, with 35% of investors now using a combination of the two. Apart from cash, which showed an increase, investors in all other asset classes shifted away from using a combination of remuneration methods; the biggest changes were for equity investment (down 7% to 43%) and fixed income (down 5% to 26%).

Overall, fixed fees continue to dominate remuneration policy for cash, fixed income and real estate investment management, while all other asset classes display more of a mixed bag of fee structures.

As last year, many investors would like to see performance-related fees in place for more fixed income, equity, balanced and real estate funds (Fig 10.2).

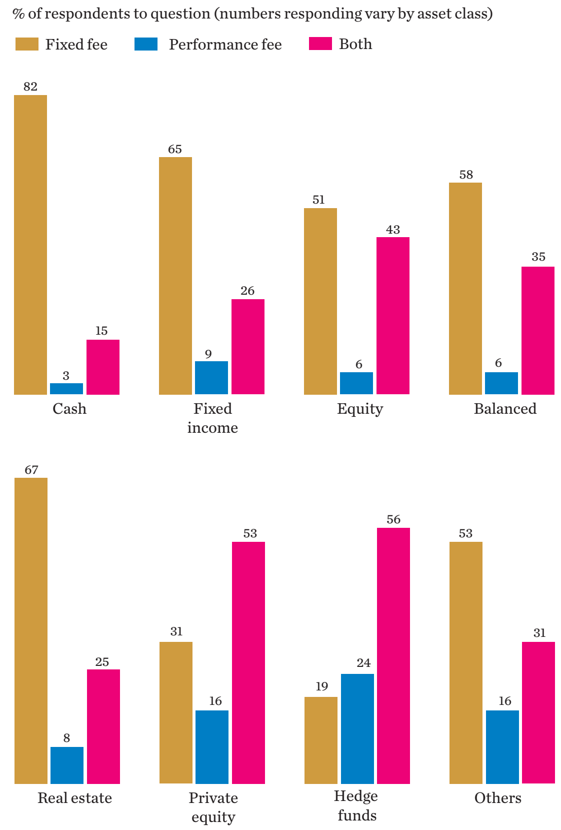
However, there has been a shift towards realising these goals. All four asset classes show an increase in current usage, especially fixed income (from 4% to 9%), equity (2% to 6%) and real estate (4% to 8%). As in 2009, however, the disparity between current and ideal usage is still greatest for balanced and equity funds.

When asked their views on the ideal compensation for external investment managers, 52% believe that fixed fees are the best form of compensation, the third year in a row that this figure has risen (Fig 10.3).

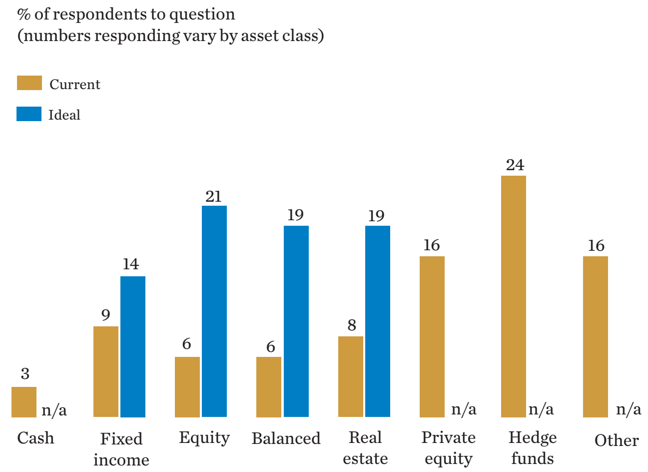
Performance fees on their own continue to fall in popularity, favoured by 13% of investors in 2010. The combination of both maintains the same level of popularity (35%) as in 2009. Among balanced fund investors, fixed fees have now established a commanding lead over performance fees in terms of popularity. Fixed fees have leapt from a 23% preference in 2007 to a high of 42% in 2010, while performance fees, which were ahead in 2007 and 2008, have fallen from 36% two years ago to 19% in this survey.

Fixed fees have also, for the first time in four years, overtaken a combination of both types of structure, the latter having plateaued at 39% both this year and last.

10.1 Current compensation of external managers



10.2 Current and ideal performance fee usage for external investment managers by asset class



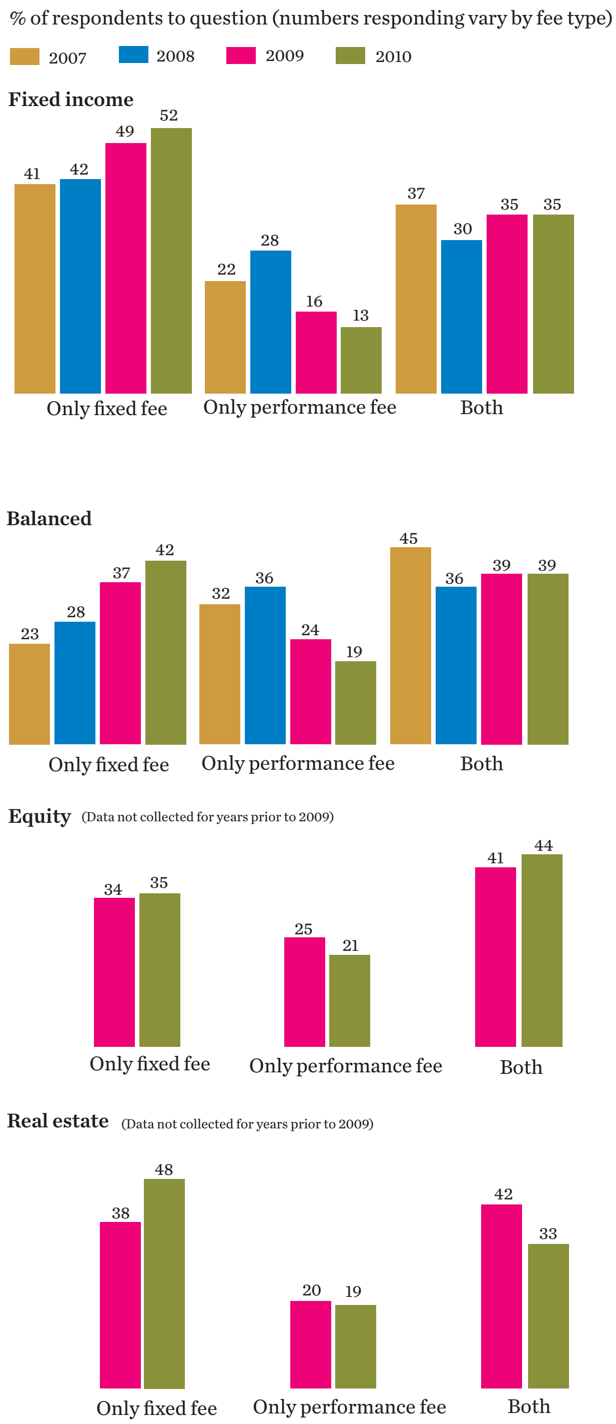
Views on ideal compensation for equity and real estate managers have only been collected for two years, but already there are noticeable trends. For both asset classes, fixed fees have grown in popularity over the past year; for real estate management, they are still the most popular form of compensation at 48%, while for equity management they are in second place (at 36%) to the most popular structure, a combination of fixed and performance-related. But performance fees are the least popular, declining to 21% (equity) and 19% (real estate) from the previous year.

Germany is by far the biggest champion of performance fees (Fig 10.4). Half of German investors named performance fees as their ideal compensation for fixed income, balanced and real estate assets, with 40% favouring it for equities. The only countries showing a similar enthusiasm were CEE investors, 50% of whom voted for performance fees for real estate and 33% for balanced funds. Over the past year, the Nordic countries have also shown more enthusiasm for performance fees in all asset classes except real estate, where the level of interest remains the same.

Only the Benelux countries (22% in favour for equity funds) and Italy (33% support in real estate management) sneaked into the top three places in support of performance fees. But, conversely, in the Benelux countries, performance fees have become less popular across all asset classes, with support plummeting by half to 14% for real estate.

A similar situation exists in Great Britain & Ireland, with falls in popularity for fixed income (dropping by two-thirds to 10%), balanced funds and real estate. Breaking down the support for ideal performance fee

10.3 Ideal compensation of external investment managers 2007-2010



usage by size of investor shows a stark change compared with last year (Fig 10.5). Small investors have replaced medium investors as the most in favour of performance fees across all asset classes, especially for equity and balanced funds, at 29% each.

Last year, only 19% were in favour for equity funds, and 21% for balanced funds. Real estate also shot up, from 12% to 28%. In contrast, medium investors are now the

Key takeaways

- **remuneration preference remains mostly for fixed fees, but with a large reduction for balanced at 58% (73%), and with increases for real estate at 67% (59%) and private equity at 31% (25%)**
- **a mixture of both fixed and performance fees continues to be sought mainly for equity, private equity and hedge funds.**
- **current performance compensation has increased for all traditional asset classes (doubling for fixed income and trebling for equity), and decreased marginally for private equity and hedge funds**
- **reflecting a three-year trend, the gap between current and ideal compensation has shrunk, most noticeably for equity (by 15%), followed by balanced (13%), real estate (11%) and fixed income (5%)**
- **for the second year running, there is growing evidence that respondents' aspirations are being met**

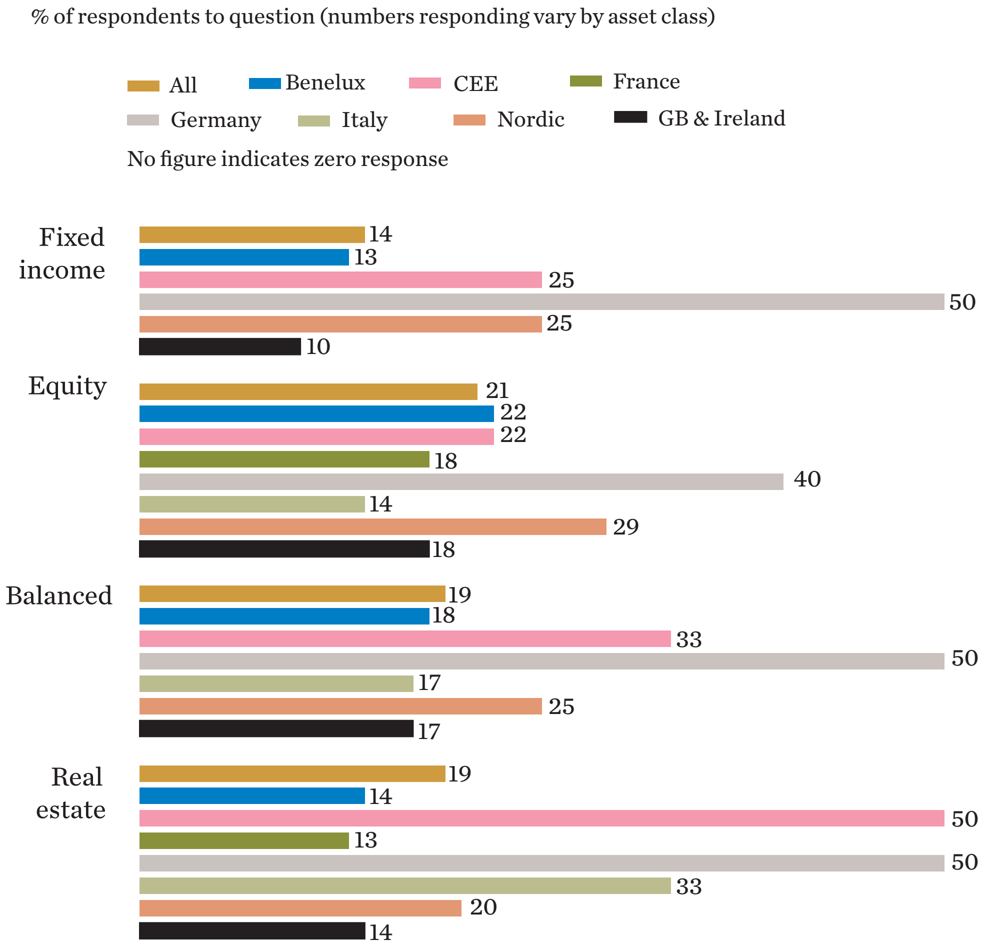
least favourably disposed towards performance fees, the most dramatic fall being for equity funds (38% last year to 8% this year), followed by balanced funds (37% to 11%) and fixed income (23% to 6%). The large funds maintained their middling position, on the whole showing far smaller swings than the medium and smaller pension funds.

However, the biggest change was in real estate, down from 27% to 13% support. This contrasts with last year's sudden increased appetite for performance fees in this asset class from both medium-sized and large investors.

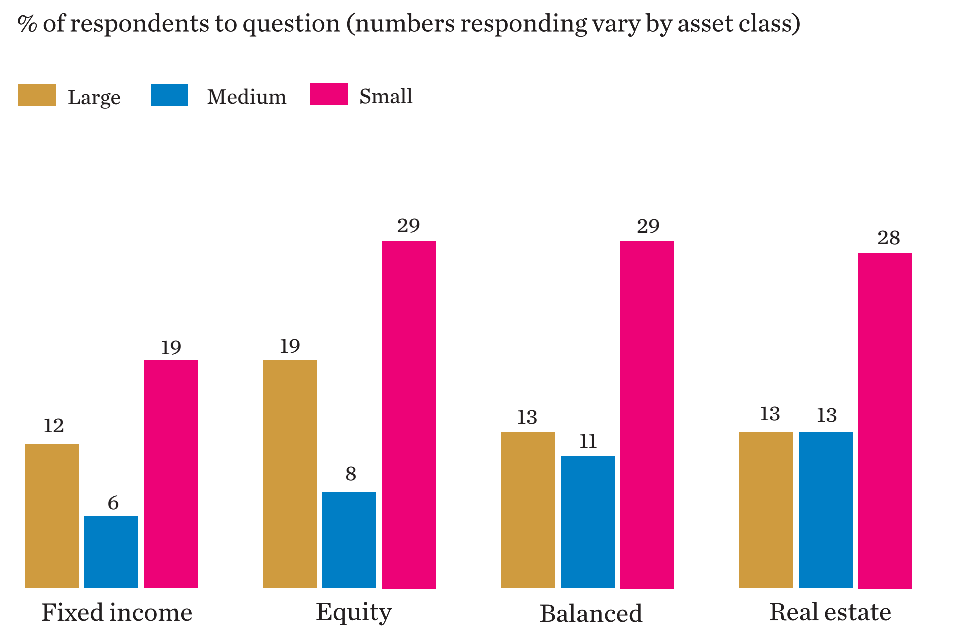
Key takeaways

- ideal of fixed fees for fixed income has increased in each of the last four years, now standing at 52%. Performance fees, meanwhile, having fallen sharply in 2009 (16%), have continued to decline (14%). Interest in a combination of fixed and performance fees remains steady at 35%
- ideal of fixed fees for balanced has also increased in each of the last four years (42%), with a steady decline in interest in performance fees at 19% (24%), and the move towards a combination of both remaining at 39%
- the ideal for equities remains a combination of both (44%), followed by fixed fees (36%)
- the view of real estate seems to have changed markedly with fixed fees preferred at 48% (38%), followed by a combination of both at 33% (42%)
- most demand for performance fees for fixed income is from Germany (50%), followed by the CEE and Nordic countries (both 25%)

10.4 Ideal performance fee usage for external managers by country



10.5 Ideal performance fee usage for external managers by size



11. External managers: breaking relationships

Breaking up not so hard to do

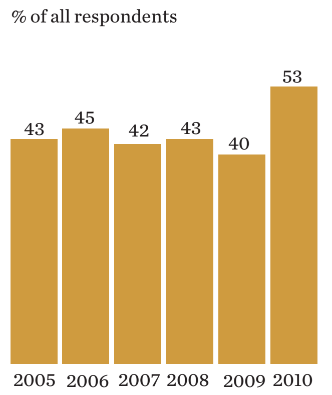
After a period of relative harmony with their external managers, more investors are willing and able to play the field, ditching current partners in the hope of finding something better. Poor performance as ever is usually the trigger, but many investors seem to be venturing into new territory – and will sack those managers who cannot chart the way.

Last year was the calm before the storm in terms of manager-client break-ups. After recording the lowest proportion of investors – 40% – from the previous five surveys who had ended their agreements with external managers, clients turned nasty, with 53% of respondents sacking at least one manager in 2010 (Fig 11.1).

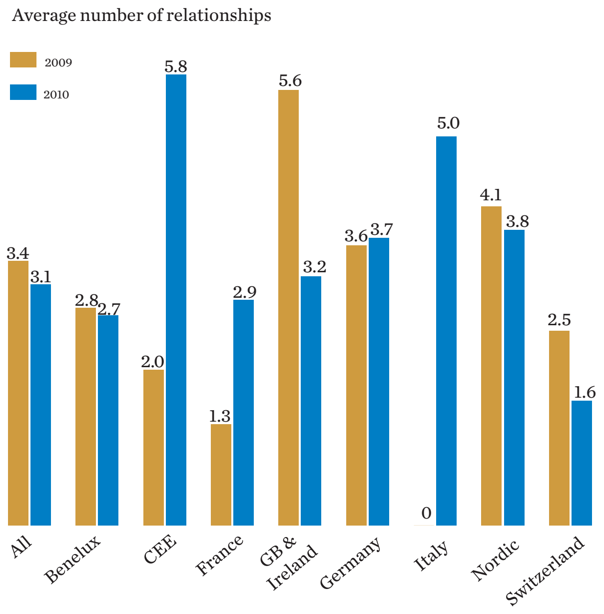
However, there were striking differences between countries, as shown in Fig 11.3. Relative to the previous year, the most ruthless investors were the French (57% of respondents having dispensed with at least one manager, compared with 29% in 2009), the British and Irish (54% compared with 26%), the Swiss (56% and 25%) and the Italians (14%, compared with none last year).

Perhaps the new willingness in these countries to ring the changes reflects a more confident attitude towards investing; having weathered the first storms of the recent financial crisis by sticking to the tried and tested, investors now feel they are in a position to flex their muscles. This also applies to large investors, who have overtaken medium-sized investors – just – in their keenness for a clear-out. Last year, the proportion of large investors who had sacked at least one manager rocketed to 50% of respondents. The figure has now risen

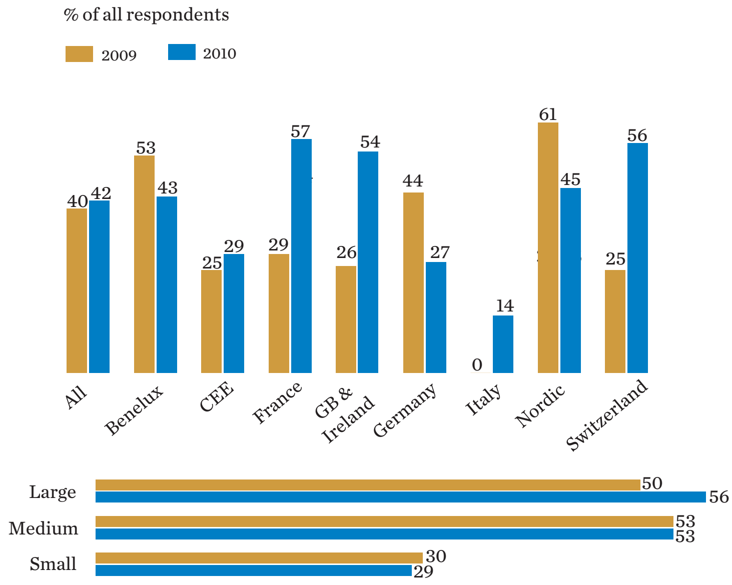
11.1 Relationships with a manager terminated 2005-2010



11.2 Relationships with a manager terminated in 2009 and 2010



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



Key takeaways

- 53% have broken a relationship, a major increase on the previous year (40%) and by far the highest figure for at least six years
- the average number of terminations has again decreased slightly to 3.1 per year (3.4 in the previous year)
- Swiss and Benelux most loyal, with 1.6 and 2.7 broken relationships; Italy (previously the most loyal) and CEE countries most ruthless, with 5.0 and 5.8, respectively
- France, Italy, GB & Ireland and Switzerland were much more aggressive, whereas Benelux, Germany and Nordic appear more satisfied than the previous year
- larger investors have broken the most relationships, followed closely by medium investors. Smaller investors have become increasingly tolerant in each of the last three years, perhaps reflecting either their growing satisfaction or reducing strength

further to 56%, with medium-sized investors treading water on 53%. Small investors remain less hard-hearted, at 29%, compared with 30% in 2009. Perhaps this shows that those with fewer resources are more timid about altering the status quo.

The more sophisticated investors such as the Benelux and Nordic countries, Switzerland and Great Britain & Ireland, let go, on average, fewer managers in 2010 than in the previous year, underlining the trend towards stability.

However, investors in the CEE countries, which as a whole might be considered less experienced in investing terms, dismissed an average 5.8 managers each, compared with 2.0 the year before; this was the highest number of all the countries surveyed (Fig 11.2).

Perhaps this chop-and-change attitude reflects a steep learning curve, as these investors find what works and what does not, by trial and error.

There were also notable increases in manager relationships terminated by Italian investors (from zero last year to 5.0 in 2010) and in France (from 1.3 to 2.9).

There are no surprises in terms of the salient factors behind the decision to remove a manager (Fig 11.4). As in the previous three years, the most important factor was poor performance, followed by failure to control risk.

'Inability of investment manager to advise on investment' has now become the third most crucial factor, up from tenth place last year. Perhaps this means clients have become more adventurous in seeking new types of assets to invest in. 'Lack of clarity in fund management policy' has slipped down from third to fourth spot, but 'internal reorganisation of your group' is now fifth, a massive leap from its twelfth place over the previous two years. This suggests that more investors are reacting to the current financial crisis by downsizing or otherwise changing their structure, which presents threats as well as opportunities to external advisers.

When broken down by country (Fig 11.5), it's now back to basics, with all except Italy and the CEE countries rating 'unsatisfactory performance' as the most important factor in sacking a manager.

However, compared with last year, there is a wider spread of subsidiary factors, with 'lack of clarity in fund management policy', and 'reorganisation of investment manager's group' now appearing in second place, for France and the Nordics, respectively.

11.4 Factors which play a role in the decision to remove a manager 2008–2010

Degree of importance for 95 respondents (Ranking)
1= most important

	2010	2009	2008
Unsatisfactory performance	1	1	1
Failure to control risk	2	2	2
Inability of investment manager to advise on investment	3	10	9=
Lack of clarity in fund management policy	4	3	4
Internal reorganisation of your group	5	12	12
Cost competition	6	11	n/a
Breach of investment constraints	7	7	11
Inadequate reporting/contact	8	8	7
Change of investment strategy or asset re-allocation	9	5	3
Reorganisation of investment manager's group	10	6	6
Excessive turnover of investment team	11	9	8
Strategy or asset allocation	12	4	5

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

Degree of importance for 95 respondents (Ranking)
1= most important

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

12. Other findings: SRI/ESG/Securities lending

Global disasters set the agenda

Despite environmental disasters such as the BP oil spill off the coast of Mexico and wild fires raging across the globe, institutional investor interest in extra-financials, such as socially responsible investments (SRI) or environmental, social, governance (ESG), seems to have cooled dramatically recently. In the aftermath of the global financial crisis, as markets continue their roller-coaster ride, institutional investors are clearly focusing on financials to a greater extent than ever. However, because of the headlines about various global disasters it is not surprising that environmental concerns continue to be the main drivers behind SRI/ESG.

As was the case last year, 'social and environmental values' were again cited as the number one reason (Fig 12.1) why respondents follow these types of investment strategies. However, compared with the previous year's survey, fewer respondents named this factor as a reason for pursuing SRI/ESG strategies. In fact, the number was the lowest since 2007, with only a quarter citing this as a top factor.

Less than a quarter of respondents attributed their ESG strategy to the belief of owners and the board and only 16% to the corporate culture, but again this was lower than previous years. In last year's survey governance was included as an option for the first time, and although the number of respondents naming this as a reason fell, it was not as dramatic as for the other top options, with over a fifth still citing this as a reason.

For the first time, 3% named other reasons than the listed ones for pursuing SRI/ESG strategies.

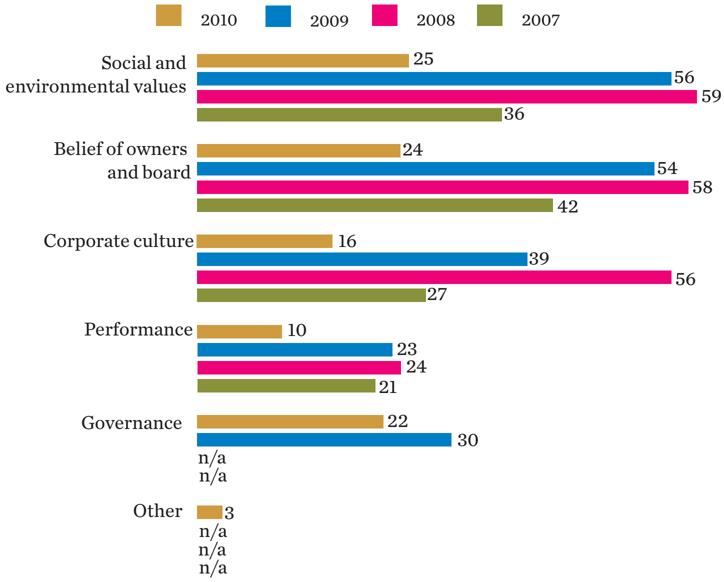
There is a widespread belief that the majority of institutional investors are driven towards SRI/ESG for reasons other than performance, which is again confirmed by the survey. Nevertheless, performance undoubtedly remains an important factor for many respondents. A large majority of respondents have no plans to increase assets governed by SRI/ESG in 2011 (Fig 12.2), with just over a quarter planning to do so.

Fewer written SRI/ESG policies are in place compared with the previous year, suggesting that SRI/ESG continued to take a backseat for many investors. However, again the written policies most respondents had in place were corporate governance strategies, at 64%, though this number was also down by 6% on 2009 (Fig 12.3).

A significant change to last year is that the number of respondents that have written policies in place for an engagement strategy increased from 19% to 31%. Written policies are also in place to a greater extent for SRI and mandating voting to third party, whereas policies for voting and requiring external managers to be signatories to UN Principles of Responsible Investment (UNPRI) remain

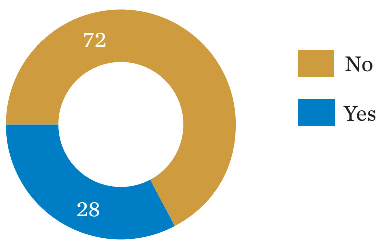
12.1 Reasons for pursuing SRI/ESG strategies

% of 144 respondents
Two or more strategies could be chosen



12.2 Plans to increase assets percentage governed by SRI policy in next year

% of 51 respondents to the question



Key takeaways

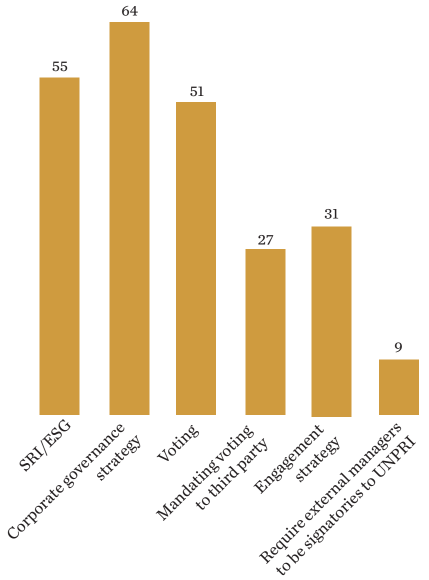
➔ **main reason, for third consecutive year, is social and environmental values ahead of belief of owners and boards, and again by the narrowest of margins. However, for both strategies, the percentage has more than halved compared with the previous year**

➔ **written policies for corporate governance strategies remain, at 64%, the most prevalent among respondents (a decrease from 70% and 72%, respectively, on the previous two surveys). This is followed, as last year, by SRI/ESG at 55% (52%) and voting at 51% (52%). Engagement strategy, while remaining firmly in fourth place, has more than recovered the ground lost in the previous two years (19% and 27%, respectively)**

➔ **written policies are again most popular in GB & Ireland. The Swiss appear less interested than before in written corporate governance strategies but, with GB & Ireland, lead the way on voting. The Italians have moved from 0% to 57% for written policies in SRI, although this may reflect differences in the sample**

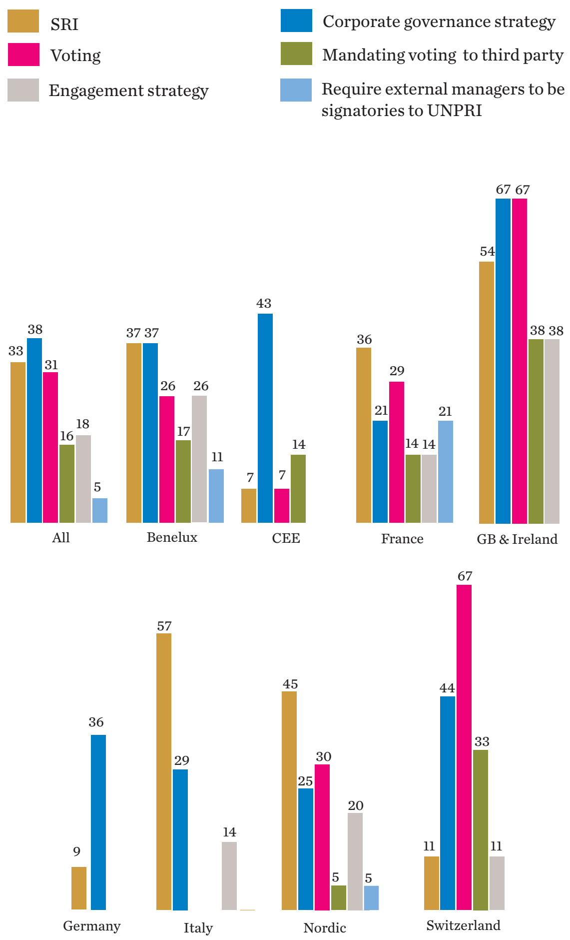
12.3 Frequency of written policies

% of 81 respondents to the question



12.4 Frequency of written policies by country

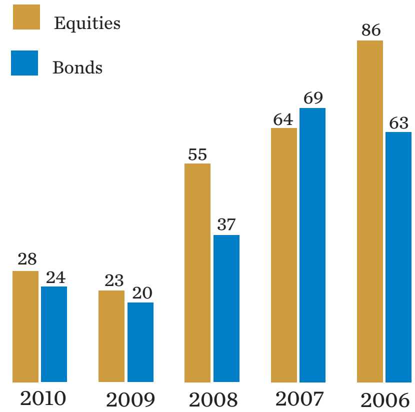
% of all respondents



fairly level, compared with 2010. Corporate governance strategies were the most common written policies used to gain index exposure – with the exception of France, Switzerland, Italy and the Nordic countries. SRI leads the

12.5 Asset classes used for securities lending 2006-2010

% of all respondents



way in all but Switzerland, where voting is the most common area for written policies (Fig 12.4). Written corporate governance policies were slightly lower compared with the previous year in the Benelux, Germany, Great Britain & Ireland and the CEE countries. In Italy, corporate governance strategies by respondents more than doubled from 14% in the previous year to 29%, and they were up 3% in Germany to 36%. In Great Britain & Ireland, they continue to be popular but fell slightly from 83% to 67%.

In the Benelux countries the largest change was the decrease in SRI written policies from 50% to 37% and the decrease in mandating voting to third party written policies from 33% to 17%. Within the CEE countries the biggest changes were increases to voting and SRI written policies. France had a significant increase in written policies in SRI, voting and engagement strategy.

The most dramatic changes occurred in Italy which saw written policies in the area of SRI go from 0% to 57% and engagement from 0% to 14%, a move mirrored by the Nordic region where written policies also went from 0% to 20%. Membership of the UNPRI continues to grow, but at this stage it only occasionally appears to make it into written policies, most frequently in France.

Securities lending

Although securities lending increased last year, levels remain low compared with 2008 and earlier, as a result of the global financial crisis, the emergence of counterparty risk and the ban on the short selling of stocks. Equities used for securities lending increased slightly as did bonds, however levels are only a third of the peaks of 2007 and 2006, respectively (Fig 12.5).

Key takeaways

➔ equities and bonds used for securities lending have risen for the first time in five years to 28% and 24%, respectively, although equities usage remains at half the level of 2008

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