

2011 Challenges and Priorities: German Market Survey Voting Results

JUNE 2011

J. P. Morgan conducted its first annual German Market Survey earlier this year. The focus of the study was to understand challenges and priorities in the German pensions market and to assess alternative views on issues the industry practitioners are facing and their key priorities for this and the coming year.

We report on the results of the survey below and hope that you would be interested to compare your thinking with that of some of your peers.

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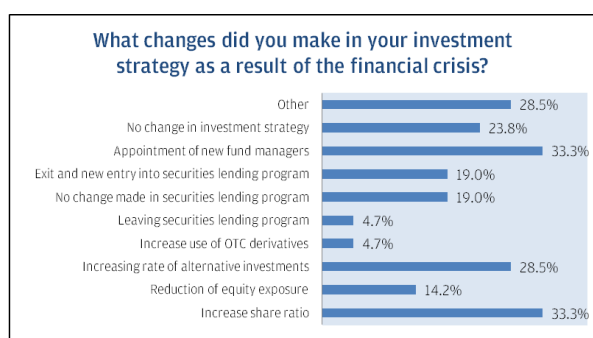
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Survey Results and Key Discussion Themes

Late in 2010 the investment consultant, Mercer, published their European Asset Allocation Survey. One of the findings was that pension funds across Europe were shying away from equity investment, despite the recovery in the global equity market. Not so the German pension funds, who responded to our own survey early this year. Thirty-three percent (33%) of those who responded had actually increased their allocation to shares as a result of the recent financial crisis, with only just over 14% reducing equity exposure. Other responses to the crisis included 28.5% increasing their allocation to alternative investments and 33% appointing new fund managers, while just fewer than 24% decided to make no change to their investment strategy.

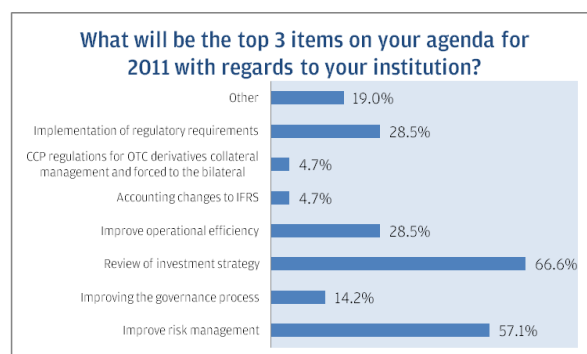


Greater focus on risk management

Another reaction for many - over a third of our respondents - has been the introduction of new risk controls. The appearance of risk in the list of concerns is unsurprising, although strength of concern is noteworthy, with a 73% majority now monitoring various risks either daily or weekly. The risks they listed included interest rate risk, inflation, country risk, liquidity risk, credit risk, funding level volatility, regulatory risks, investment risk, operational risk, underwriting risk, tail risk, market risk and geopolitical risk.

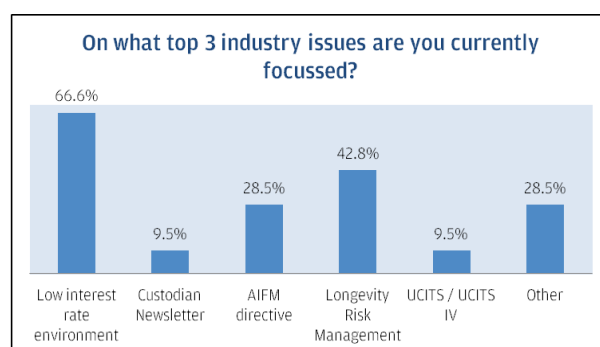
Improving risk management was among the top 3 items on the 2011 agendas of 57% of respondents. Plans to mitigate risk included overlay, asset diversification, and tactical portfolio management. At our Pension Funds and Charities Annual Summit in London in April of this year, the subject was discussed at several levels: at the macro-economic with the warning that global risks have worsened severely in the last few months; at the industry level with the opinion that the focus of debate on risk should really be on the transfer of risk from the pension fund to the agent or consultant, and the fact that agency risk has not been properly understood until

now and needs to be addressed; and also at the pensions manager level with the basic risk, not of balancing the responsibility of different participants, but whether the fund's revenues will be sufficient to meet its liabilities.



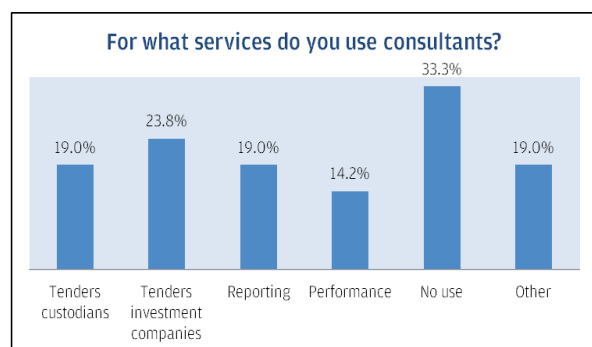
Interest rate level and other challenges

In terms of issues affecting, not just their own individual pension funds, but the wider pensions industry, the low interest rate environment is by far the biggest concern (for 66% of respondents). Longevity risk management ranks second in importance. This shows more common ground with our audience at the London Pension Funds and Charities Annual Summit (who came from the U.K., Netherlands and France, as well as Germany), who agreed that longevity was already a concern and showed significant willingness to consider a longevity swap for their pension schemes.



Regulation - specifically the AIFM directive, UCITS and Solvency II - is the other industry issue demanding the attention of a significant number of German pension funds, according to our survey results. This level of concern is in line with the response we have seen from their counterparts in other parts of Europe to regulatory webinars and educational forums we have hosted and advisory notes we have issued on these subjects. Now, in addition, the European Markets Infrastructure Regulations and MIFID II are attracting the same levels of concern.

Generally, investment consultants are not used as widely by German pension funds as they are by their counterparts in other parts of Europe and if used, then it is mainly for periodical reviews of asset allocation with regards to an ALM survey and relevant test in subsequent years. Thirty-three percent (33%) of our survey respondents do not use consultants at all. Compare this with over 90% of U.K pension funds who regularly engage consultants for investment and custody decisions and more. Where consultants are used by German pension funds, it is for investment decisions, including asset manager selection and tendering, custody searches, reporting and performance reporting.



Summary

It would seem the main focus of activity this year for the majority of pension funds we questioned (67%) will be reviewing their investment strategy. Also featuring in their "to do" lists for this year will be, for the majority, as mentioned earlier, improving risk management, and, for 29%, improving operational efficiency and implementing regulatory requirements (principally Solvency II). Half of respondents did not foresee any constraints to achieving the objectives they have identified for their pension fund this year. The other half felt that the uncertain economic outlook, misalignment with the sponsoring company's objectives and the regulatory environment might prove to be obstacles.