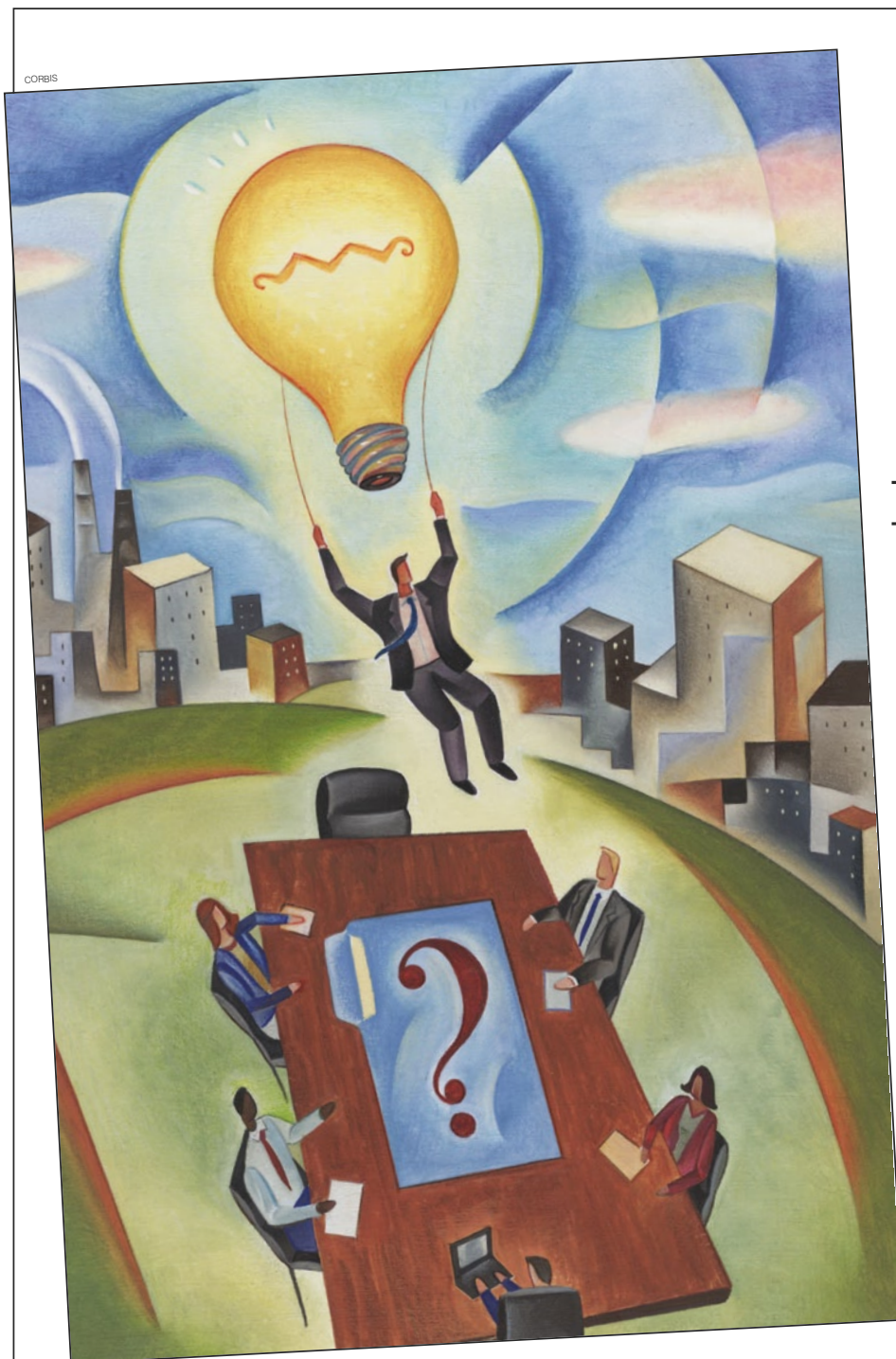


# FINANCIAL NEWS REPORT

21 June 2010

## Fund Management Quarterly



## Fund chiefs need bright new ideas to rebuild assets

Confidence teeters on the edge as industry faces its greatest period of change, writes William Hutchings

Chief executives of asset management companies are experiencing an existential crisis.

The question of how they rebuild assets and their reputations when strong and consistent performance appears so difficult to achieve, is leading to a collapse of confidence.

Kevin Quirk, a founding partner of management consultant Casey Quirk, said: "I hear the urgency in the voices of the industry's leaders. It's not panic, but whereas they used to feel highly confident of their business models, that confidence has now seeped away."

"The industry is facing the greatest change it has ever seen. If chief executives don't take action in the next year or two, it will be too late, the decline will be too extensive."

As a result, chief executives are hoping for a bright idea to lift them out of the gloom. As Financial News' annual CEO Snapshot survey shows, leaders of Europe's largest asset management firms are investing in sales, marketing and fund manager expertise, new products and markets to prompt growth and reverse poor performance while they attempt to ward off economic, regulatory and operational risk.

Continued on page 18

### CEO Snapshot

Every year Financial News conducts a survey of asset management chief executives to gauge their views on the health of the industry.

The year's survey, sponsored by JP Morgan, asked what was worrying chief executives, their reactions to the next wave of regulation and where they were looking for growth.



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# Regaining confidence of investors is key to the industry's survival

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But chief executives are worried by the idea that, collectively, investors are disappointed with the asset management industry and, if the disappointment is severe enough, some asset management companies will disappear.

The shift is one of perspective. Since at least the early 1970s, institutional and retail investors have been switching their money out of mainly government bonds and bank accounts and into equity or corporate bond funds run, for a fee, by asset managers. The generally rising markets over that period seemed to justify their decisions. But investors could only watch in dismay in late 2008 and early 2009 as the financial crisis wiped out a decade's worth of investment gains, with their asset managers seemingly powerless to do anything about it.

As a result, investors wonder whether asset managers are worth the cost. They wonder whether it might be better to invest in the markets directly, through the inexpensive exchange-traded funds that began appearing a decade ago; or, at the other extreme, to seek out alternative investment managers, even if they cost more. Either way, many chief executives of mainstream asset managers will need

investment and commitment to prevent the foundations of their business crumbling.

The results of the Financial News 2010 CEO Snapshot, sponsored by JP Morgan, bear this out, with investment performance topping the list of chief executives' business worries – almost 40% of the 35 respondents cited it as their biggest concern. The economy was voted the second-biggest business worry alongside regulatory intrusion, with both attracting more than a quarter of the votes.

These fears are, no doubt, in part a reflection of their views on whether the worst of the credit crisis is over. Despite roaring equity markets in the last nine months of last year, more than half (57%) of CEO respondents do not believe the worst is over, and expect growth to be depressed for the medium term. Only 5.7%, however, expect a double-dip recession and more than a third (37%) remain positive that the worst is behind them.

Asset managers understand that market falls have provoked investors into asking what their managers have been doing for them. Any further sustained periods of indifferent investment returns by fund managers will prompt more clients to leave. Claude Chene,

On the edge: the industry is facing up to its greatest period of change, and must invest to stop its foundations crumbling



European chief executive of US asset manager AllianceBernstein, said: "Markets have made things more challenging, with investors wondering what to do. There is a tentativeness right now with a continuing process of derisking and a move into passive."

Nonetheless asset managers do have a fighting chance of getting through this period intact.

Most of them have established good relationships with institutional investors, some of which have lasted decades, and the bigger firms in particular can afford to retain their best staff even during a period of decline (see remuneration results, page 20).

Indeed, none of the 35 asset management chiefs surveyed cited pressure on fees as a business concern and fewer than 9% said they

were worried about staff retention.

Businesses will look to expand into different product areas or new markets. Chene said: "The important things are getting our investment decisions right and getting our products right. Clients want managers to deliver on their expectations of outcomes from their investments, and managers have to develop products that appeal to their clients. It requires some thinking about."

AllianceBernstein said institutional investors wanted more help deciding on their asset allocation. Financial News' CEO Snapshot bears this out, with asset-allocation products ranked the third most popular driver of business growth, just behind absolute-return and Ucits products (see page 21).

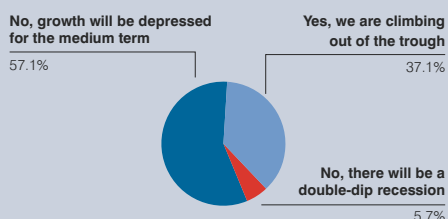
Bob Parker, a former vice-chair-

man of Credit Suisse Asset Management and now senior adviser to Credit Suisse, and chairman of the Asset Management and Investors Council of the International Capital Market Association, said: "There is a very strong trend of asset managers providing asset-allocation advice, and there's a strong theme of sales of asset-allocation products. That competes directly with the investment consulting industry. Absolute-return products are another area for growth."

Parker warned, however, that managers needed to pay more attention to their clients. "Asset managers need to explain risks much more clearly than they do. For example, I want to raise the issue of the structure of funds: you're storing up a problem if

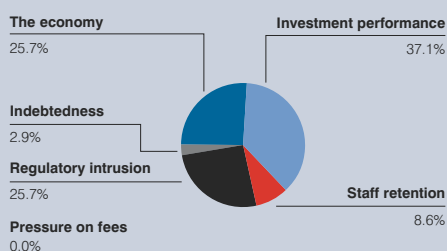
## Highlights from the CEO Snapshot

### Is the worst of the credit crisis behind us?



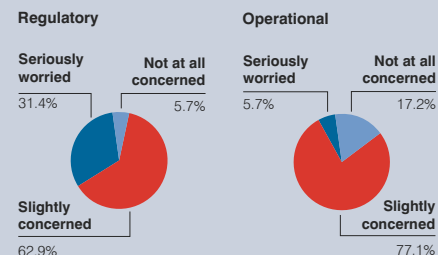
Source: Financial News

### What business worry causes you most concern?



Source: Financial News

### How concerned are you about the different types of risk your business faces?



Source: Financial News





CORBIS

## Mergers and acquisitions

## Takeovers drop down the agenda

William Hutchings

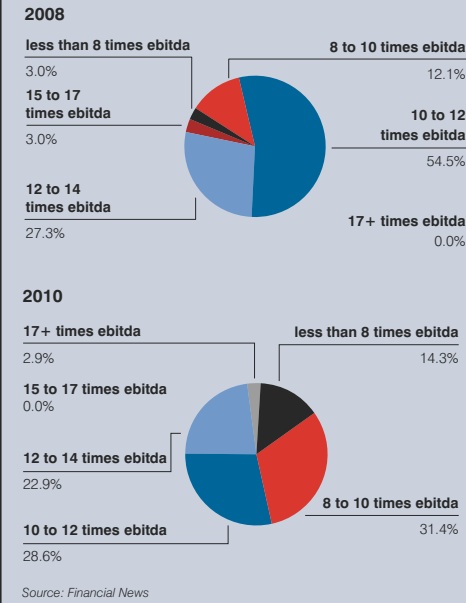
Competition to buy traditional asset managers has fallen in the past two years. Just over half of the asset management chief executives surveyed in Financial News's CEO Snapshot survey said they were not interested in acquisitions, compared with only 15% ruling out the idea in 2008. The number of respondents open to acquisition ideas has also roughly halved in the past two years, from 48.5% of respondents to 25.7% in 2010.

Martin Gilbert, chief executive of UK-quoted fund manager Aberdeen Asset Management – and probably the most prolific dealmaker in the asset management industry – said this year he had all but ruled out M&A, focusing rather on strengthening Aberdeen's balance sheet.

Equally, the banks that for most of the last decade were actively buying asset management companies have stopped doing so, and in some cases begun looking at the possibility of selling their asset management arms. In Italy, for example, UniCredit has said it is considering strategic options for Pioneer Investments, while Intesa Sanpaolo is looking at a flotation or disposal of Banca Fideuram.

The price of buying a fund manager appears to have come down since Financial News's last survey, which was carried out during the credit crisis two years ago. Chief executives think a fair valuation of the European asset management sector as a whole has fallen, with the most popular answer being "eight to 10 times ebitda [earnings before interest, tax, depreciation and amortisation]", down from "10 to 12 times" two years ago. Almost a third of the respondents thought "eight to 10 times" represented fair value, almost three times as

## Pre and post-crises valuations of the European asset management industry



many as in 2008. The fall is all the more dramatic compared to three years ago, when more than half of chief executives said that 12 to 15 times ebitda was a fair value for the industry. Chief executives then and now said that M&A in asset management rarely works, with 60% of respondents not interested in acquisitions citing this as a their main reason for not pursuing deals.

Alain Grisay, chief executive of F&C Asset Management and a former investment banker, said it could work, provided the aim was to grow revenues. This was the rationale behind F&C's agreement in April to purchase boutique Thames River Asset Management. Thames River brings products and distribution expertise that

F&C feels it needs. Grisay said: "We would only acquire to boost revenues, not to cut costs. I do not think we will see consolidation based on cutting costs in the next 12 months, although consolidation to increase revenues possibly is on the cards."

Claude Chene, European chief executive of US asset manager AllianceBernstein, said: "Boutique asset managers will be acquired because larger managers need more products to offer. However, many of the banks have been talking about selling their asset management arms. A lot of them are wondering why they were in that business in the first place."

Chene thinks the industry may be overly pessimistic

about its valuation. He said: "Asset managers are well off their share price highs. I wonder if people recognised the potential volatility in earnings; once they saw that volatility, they downgraded price/earnings ratios. I think the volatility in earnings is exaggerated a bit by current market conditions."

This quarter's largest asset management takeover came not in the mainstream industry, but in hedge funds: in May, UK-quoted Man Group agreed to purchase UK-based, US-quoted GLG Partners, for \$1.6bn.

It may be a sign of things to come. Hedge fund managers, and fund of hedge funds managers, may have become more likely than mainstream asset managers to make acquisitions, according to Kevin Quirk, co-founding partner of management consultant Casey Quirk. They certainly have the ambition to act as a consolidator.

Quirk said: "I wouldn't be surprised to see a fund of hedge funds manager buying an investment consultant, particularly in the US, where the consulting industry is quite fragmented. I certainly think the sight of hedge funds buying asset managers will become more frequent. They recognise that they need to improve their distribution and they envy the relationships that traditional asset managers possess."

He said he would expect to see mainstream asset managers making acquisitions of hedge funds or funds of hedge funds as they seek to offer clients alternative investment products to complement the low-risk, long-only active products with which investors have become disenchanted.

But if the results of Financial News's CEO Snapshot is anything to go by, many managers will instead be looking to buy in talent by hiring more teams rather than hit the acquisition trail.

you're giving clients liquidity and investing in illiquid assets such as real estate."

Chief executives appear to have got these messages, and are taking action. Three quarters of them said they planned to increase their spending on sales and marketing staff – substantially more than any other area – and only one out of 35 said their firm planned a decrease in this area.

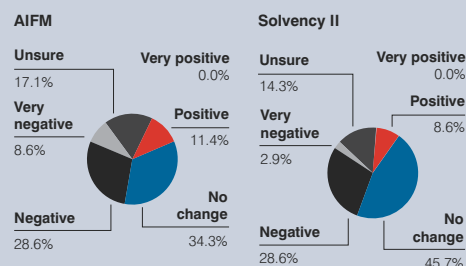
But political and regulatory interference could still get in the way of chief executives' plans for a fightback. When asked to vote on the different types of risk facing their businesses, regulatory risk was top of the list, with 31% of chief executives saying they were "seriously worried" about regulatory risk. A further 63% said they were slightly concerned about it.

Of the seven major pieces of new regulation being debated by politicians and bureaucrats, the Alternative Investment Fund Managers directive and Solvency II – both of which could have the effect of reducing investors' allocations to risky assets – pose the greatest concern to chief executives.

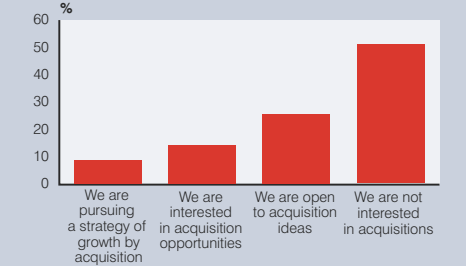
Ucits IV, meanwhile, is expected to be the most beneficial, with more than 60% of fund managers saying it will have a positive or very positive impact on their businesses.

Nevertheless, chief executives remain determinedly optimistic. One said: "It's a large industry, and it will only grow as wealth returns. I expect the names of the top players will change drastically over the next five to 10 years, but the industry itself will continue."

## How do you expect new regulation to impact your business?



## What is your company's current stance on mergers and acquisitions in the fund management industry?



## If you said you are not interested in acquisitions, please say why



Full results at efinancialnews.com



## Remuneration

# Clawbacks take a back seat

Performance fees, deferred pay and phantom equity are being widely used by managers to reward their staff, writes Phil Craig

The majority of asset managers will not be following the lead of investment banks and applying clawbacks to employees' compensation, according to the Financial News CEO Snapshot survey.

Clawbacks are mechanisms by which an employer reclaims compensation from an employee if certain targets or conditions are not met. Sellside firms have widely

implemented the structure as a mechanism to encourage longer-term performance in the wake of pressure to reform remuneration since the financial crisis. The survey found that fewer than one in five asset managers use clawbacks.

Magnus Spence, a partner at Dalton Strategic Partnership, said: "They are very difficult to implement when you have high-water marks. Asset managers are much less interested in clawbacks, and much more interested in performance fees."

Almost 60% of respondents to the survey already use performance fees to reward managers, and another one in five are considering making use of such structures. Deferred pay, as well as payment in real or phantom equity, is widely used. Phantom equity schemes are effectively deferred cash bonus schemes that aim to emulate the link to business growth that real equity would offer.

The survey findings come as fund managers move towards offering broader-based pay to employees, as reported by Financial News last month. Schroders, Standard Life Investments, and Alliance-Bernstein have all instituted models this year by which employees are rewarded with equity as long as broader targets are met across the business.

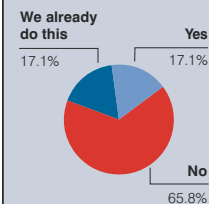
Such a model is gaining wider acceptance, according to Udo Frank, chief executive at RCM. He said: "Our compensation policy is very much team-based, so it has always tied remuneration to the success of the broader business as well."

"We are still in conversations about where we need to be: we have about

**Dromer: developed a scheme to share in the profitability of the firm over the long term**

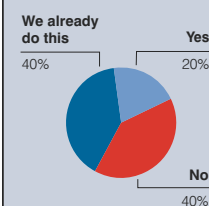


## Are you considering clawbacks?



Source: Financial News

## Are you considering compelling managers to invest in funds they run?



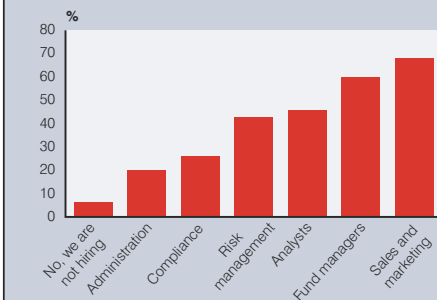
Source: Financial News

30% of compensation linked to broader measures."

Alain Dromer, chief executive at Aviva Investors, introduced a global performance pool when he established the asset manager, offering deferred cash bonuses linked to the wider performance of the business. He said: "I was not in a position to offer equity in the firm. I couldn't do so at HSBC either, and I developed a scheme to share in the profitability of the firm over the long term."

## Highlights from the CEO Snapshot

### Are you hiring and if so, in which areas?



Source: Financial News

## New challenges. New answers

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## Growth sources

## Managers launch a renewed sales drive

Funds eroded by the financial crisis are raising their marketing efforts, writes Phil Craig



Asset managers are on a growth path again. They are spending more on sales and marketing and expect institutional investors to be the primary source of growth in the near term, according to the latest Financial News CEO Snapshot.

Over two thirds of chief executives taking part in the survey said they were hiring salespeople and marketers, and over three quarters said they expect to increase their overall spending on sales and marketing over the next 12 months. In the CEO Snapshot of early 2008, chief executives rated increased spending on product launches and international expansion above sales and marketing.

The need to rebuild assets and earnings, which plunged across the industry in the wake of the financial crisis, is still driving asset managers' decisions, according to senior executives.

Magnus Spence, a partner at London boutique Dalton Strategic Partnership, said: "We are looking to expand our sales and marketing efforts. Our asset base and those of our competitors have all eroded. If you are used to running £10bn and you are down to £7bn, you want to grow those assets again."

Udo Frank, chief executive of equities specialist RCM, which is owned by Allianz Global Investors, agreed. He said asset managers were increasing their sales and marketing teams after cutting back staff last year to maintain profits after falling markets. He said: "We have learned over the last few years that client servicing is critical. There is nothing worse than losing the trust of your client."

The increasing diversity of clients is also driving hiring trends. Frank said: "If growth is happening outside the areas with big defined-benefit pension schemes, you will

probably need people in cross-border territories. Only a few asset managers have had the opportunity to build a global presence up to now."

While most of the industry is planning to spend more on sales and marketing, about half of respondents said they would increase spending in all the other areas surveyed, including technology, international expansion, compliance, risk management and product launches.

The survey also found that asset managers believe institutional investors will be the most likely source of new assets. Almost two thirds of asset management chief executives declared that institutions were attractive in terms of business growth, compared with just under half for retail and wealthy investors.

Spence agreed: "Retail investors who have been brutalised by the markets in the last two years are thinking more about reducing their debt, held in credit cards and mortgages, than investing in equities."

Frank said while institutional growth would continue, it would differ according to region: "Through our parent Allianz Global Investors, our institutional assets are focused on Asia and the US. We have already made quite substantial progress in the UK, and are working with AGI to grow in the US retail market."

Retail investors are expected to gain increasing influence in the long term, as traditional defined-benefit pensions give way to defined contribution schemes. Frank said: "It is important not to lose sight of the changes that are happening in the retirement world – there is a shift from defined benefit to defined contribution. Growth rates are more substantial



Encouraging growth: managers are cultivating new clients

in defined contribution, though dollar amounts are more significant in the institutional marketplace."

The growing need to deal with struggling defined benefit schemes is one focus of Aviva Investors. Its chief executive Alain Dromer said: "The growth of our business is predicated specifically on retirement and how governments are having difficulty funding existing schemes. This is the main source of growth that I see over the next few years."

About half the respondents said sub-advisory relationships would also be an attractive source of growth. Dromer believes this is driven by the tendency of firms to turn to established and trusted names for expertise rather than incurring the cost of developing their own retail brand. Consolidation among bank-owned asset managers could also highlight the attractiveness of white-label products, which can change their underlying management team

without potentially confusing investors by changing the name of the products.

Chris Oulton, chief executive of London-based Prime Rate Capital Management, added: "There is definitely a tendency to use specialist advisers for specialist asset classes. I think that the volatility we've seen in the last three or four years has certainly concentrated people's attention on the fact that you can't be a master of everything. Even something that seems relatively safe, like cash management, has been shown to be extremely volatile, which has played into the hands of those with skills and experience. But I think the market for white-labelling is slightly different from straight sub-advisory agreements. In the post-Lehman world, people prefer to be transparent about who is sub-advising on a fund."

Other results from the survey reflect today's sentiment towards the markets. Well over half of the

respondents said that emerging markets products will be the most attractive driver for business growth over the next two years.

The asset class with the least potential for growth, according to the survey, was private equity. It was the only asset class deemed unattractive by most respondents.

James Norris, managing director of investment manager Vanguard's business outside the US, said he believes bond products will grow, even if sophisticated investors place their money elsewhere. "I would be more optimistic about fixed income. There are more compelling reasons to be buying equities, but there is still reluctance to do so. There is a difference between what people should and will do."

Regionally, the survey showed most respondents are focusing on the UK and Europe. Asia, excluding Japan, was the next most popular focus for fund houses.

Norris said Asia remains attrac-

tive, especially for passive managers like Vanguard. He said: "In the US there is an oligopoly; in Europe there is intense competition. I would guess it is more likely that exchange-traded fund competition will heat up more in Asia than in the US. In Asia, the market is wide open."

Bob Parker, a senior adviser to Credit Suisse and chairman of the Asset Management and Investors Council of the International Capital Market Association, said: "Another trend is investing in emerging markets or setting up asset management businesses in emerging markets, especially where the savings rate is high or there are flows into pension funds, such as China or Chile."

Most respondents said absolute-return products and Ucits funds would be a good source of growth over the next two years, and a majority were positive about asset allocation products.

Spence said the popularity of absolute-return and Ucits funds was a result of hedge fund industry initiatives.

He said: "It is fantastic that our industry is taking something new, interesting and of value to the UK marketplace. Now you can buy a product designed to produce a return every year – in a low-interest rate, low-inflation environment, that is very attractive. I think it is a really important development for our industry."

Liability-driven investments were the least attractive product over the next two years, with 40% of respondents deeming them unattractive and 37% neutral. This result suggests a reversal in sentiment, after consultants told Financial News in April that LDI had become increasingly popular since the financial crisis.

They said the downturn had led some pension funds to reassess their strategies, and several companies closed their pension schemes which further encouraged a change in approach.

However, the poll result could reflect the concentration of LDI strategies among a few dominant participants in Europe, such as Legal & General Investment Management and Insight Investment.

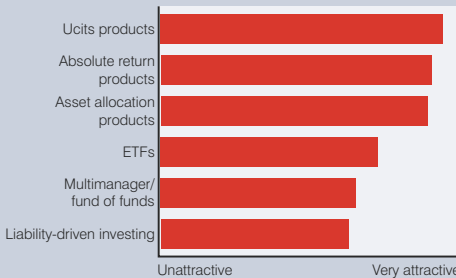
## Full results at efinancialnews.com

## How do you rate the following asset classes for new business growth in the next 12 to 24 months?



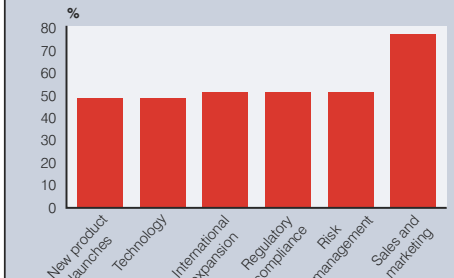
Source: Financial News

## How do you rate the following product areas for new business growth in the next 12 to 24 months?



Source: Financial News

## Do you expect your spending in the following areas to increase in the next 12 months?



Source: Financial News