WORLDWIDE SECURITIES SERVICES

J.P.Morgan

Developments in Governance – A Year On

Pension Funds and Charities Annual Summit Voting Results

MAY 2010

On 28 April 2010, J.P. Morgan hosted our third annual Pension Funds and Charities Summit in London.

We took advantage of having assembled representatives from more than 60 pension funds across Europe – principally the UK, Ireland and the Netherlands – using the opportunity to canvas opinion on a number of subjects. We have reproduced the results of our survey below, along with some of the sentiments expressed during the Summit discussions, and hope that you will be interested to compare your thinking with that of your peer group.*

The theme of this year's Summit was '*Developments in governance – a year on*', and the programme addressed some of the key challenges facing pension funds in the current environment. This event brought together some of the most influential voices in the UK and European pensions community and created a forum to share industry expertise at a time when all aspects of pensions provision, affordability and regulation are in the political and economic spotlight.

*Our survey results represent the views of managers of more than 60 pension funds with an average asset value of £1bn and the top end of the range at around £30bn.

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Voting Results and Key Discussion Themes

SELF-MANAGE OR OUTSOURCE – THE DEBATE CONTINUES

A relatively high proportion of survey respondents represented pension funds which manage their assets in-house (45%) with the remainder having outsourced to third-party fund managers. The majority of those that have outsourced (54%) receive reporting to give them oversight of their fund managers' activity on a monthly basis. Only 12% receive such reporting daily – understandably, perhaps, given the constant struggle for resources.

However, somewhat surprising in today's environment of shortening the reins on risk control - a recurring theme throughout the Summit- was the fact that 34% of respondents reviewed their fund manager activity only quarterly. Of course, perhaps those funds are using other control methods, such as compliance monitoring tools?

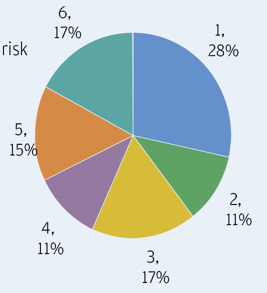
RISK CONTROLS A KEY PRIORITY

Continuing on risk control, one of the clearest messages of the day was that for 84% of pension funds at the Summit, improved risk control was a more important outcome of outsourcing investment management than cost control.

The chart below shows the order of priority our survey respondents would give to controlling various types of risk.

Q4. Rank the following risks in order of priority you would give to control them, with the most important first:

1. Market risk
2. Interest risk
3. Inflation risk
4. Balance sheet risk
5. Longevity risk
6. Solvency risk



LONGEVITY ON THE RADAR

Unsurprisingly longevity risk is now beginning to feature on the radar of pension fund professionals. With life expectancy continuing to increase at a pace that outstrips our expectations, the gap between pension assets and liabilities is widening all the time.

One of the Summit presentations that particularly captured attention dealt with a new cross-industry initiative called the Life and Longevity Markets Association. The LLMA brings together leading participants in the longevity market (insurers, reinsurers and banks) to develop standards, documentation and best practice for pension funds wishing to manage their longevity risk.

Risk has always been under the microscope when it comes to pension fund investment, but now it is certainly being looked at under an even more powerful lens. This focus was echoed later in the day by the conviction that, if you look after the risks, then the returns will look after themselves.

GOVERNANCE MODEL STILL A MUST

In summing up the debate on outsourced versus in-house asset management it was agreed that there was no right or wrong model, as long as a governance model is in place which secures correct delegation. Never should an outsourcing model be used to delegate the important fiduciaries' responsibilities, such as in the arena of asset allocation. Outsourcing should be focused on policy implementation in order to enable fiduciaries to spend enough time on evaluating internal thoughts and external advice on risk budgeting, policy strategy and tactics, and on communication.

It was acknowledged in discussions that it is difficult to do a good job in terms of performance in such a difficult environment. That said, sound advice was that all pension funds should be aiming for sensible management and the ability to adapt over time.

FIDUCIARY MANAGEMENT STALLS

Fiduciary management was once again explored as an agenda item of the Summit. We thought it would be interesting to see how this trend is growing - or otherwise - by comparing the picture today with last year's Summit.

This year 11% of our voters had already appointed a fiduciary manager and a further 23% were considering such an appointment. However, a sizeable majority (66%) this year are not using one, and have no intention of considering this option for the time being. Last year, 27% of respondents had a fiduciary management mandate in place and 26% were considering this option.

Aligning a fiduciary management mandate to the overall investment strategy and goals of the pension fund is critical for it to be effective. Perhaps, as was the case in the Netherlands last year, the industry is pausing to reflect on the growth in fiduciary management and contemplating how the goals and objectives of the fiduciary manager can be better aligned with that of the pension fund?

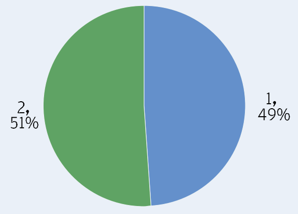
ASSET ALLOCATION MOVING TO BONDS

Just prior to the Pensions Summit, Mercer's *European Asset Allocation Survey 2010* found that pension funds across Europe continue to shy away from equity investment, despite last year's recovery in the global equity market.

Our audience seemed fairly representative of this trend, with almost half planning to reduce their allocation to equities.

Q6. Are you planning to reduce your allocation to equities?

1. Yes
2. No



The favourite asset class for redistributing this equity disinvestment was government bonds. Some of these funds will be redirected to real estate, hedge funds, fund of hedge funds and emerging market debt, bearing out another finding of the Mercer study that many pension funds are becoming more proactive in their search for new investment opportunities.

SECURITIES LENDING RETURNING

Not as many pension funds at the Summit as predicted had exited their securities lending programmes as a result of the Lehmans collapse: 25% have exited in the last 12 to 24 months - and the majority plan to start lending assets again, 38% in less than a year. This renewed confidence is underlined by the fact that 52% of those who lend, or plan to start lending again, will take cash collateral.

AIFM DIRECTIVE AWARENESS AND ENGAGEMENT APPEARS LOW

It is widely acknowledged in the pensions industry that regulation - ever-increasing and ever-changing – is a broad issue to get one's arms around and a tough one with which to keep pace. We posed some questions on the Alternative Investment Fund Managers Directive as one example which illustrates this struggle.

Summit attendees revealed that they have not, on the whole, been engaging on the draft directive: 45% did not know whether the directive in its current form will hamper their ability to access the investment strategies they need, and the majority have not been involved in lobbying on AIFMD, or know whether their concerns have been properly addressed by the EU.

SUMMARY – TO BE CONTINUED …

Our only challenge at the summit was the perennial one of time. For this reason, not all discussions ran their full course, inevitably. What is clear, though, over the years that the Pensions Summit has been running, is that there is a continuation of certain themes and trends in the pension fund industry, and all participants are highly motivated and proactive in their approach towards them. That is not to say that, despite year-on-year progress, we can ever expect these themes to disappear completely – such is the nature of the financial markets beast. Yet we all know where best to focus our resources, and that we need to be prudent and adaptable.

We look forward to continuing to work with you on tackling some of these issues and to seeing you at next year's Summit.