

BANKINVEST

The State of the Fund Management Industry

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Financial Analysts Society

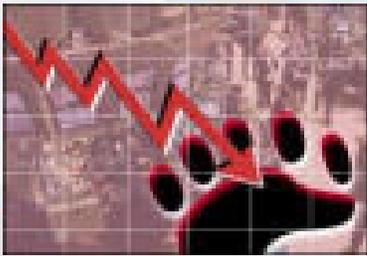
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The bear outside....



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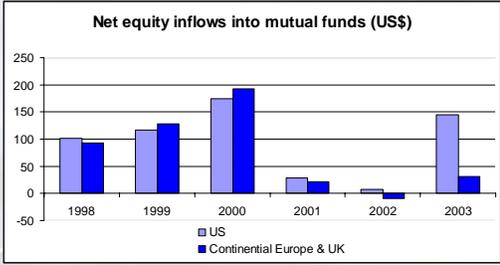
The real bear.



The first three years of the 21st century brought one of the worst bear markets in history with equity markets falling by some 40% in real terms

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Equity demand is cyclical



Year	US	Continental Europe & UK
1998	100	100
1999	120	130
2000	180	200
2001	40	30
2002	10	-10
2003	150	40

Source: Morgan Stanley

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Last decades concerns..



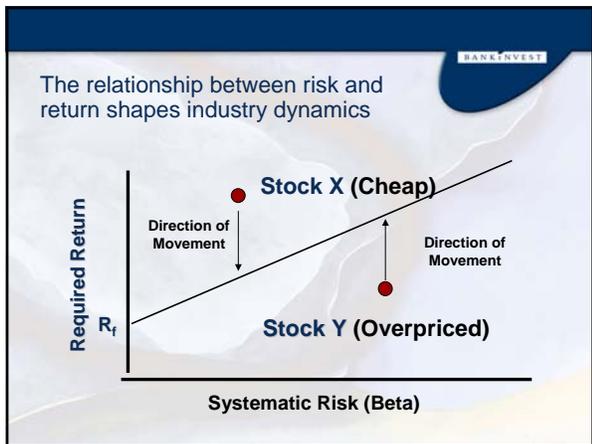
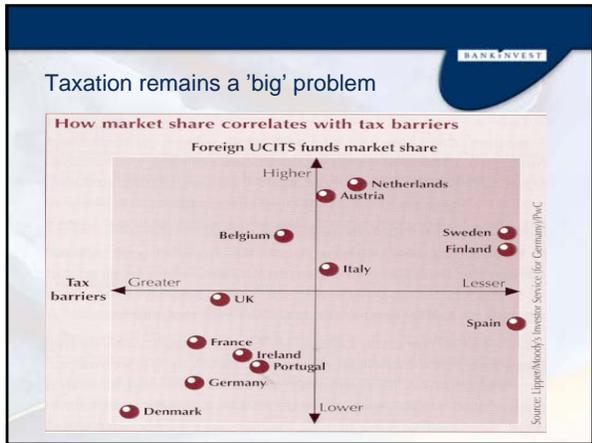
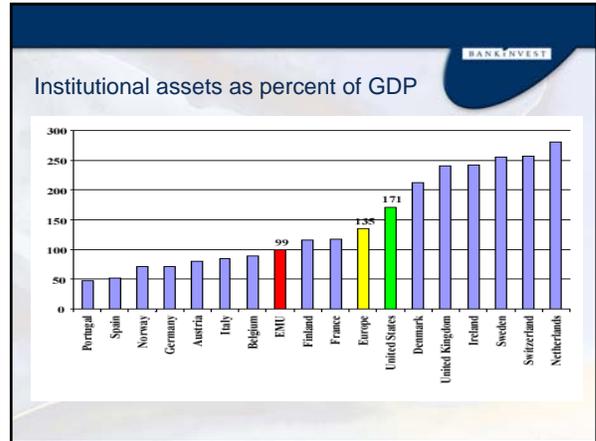
- Active versus passive management
- Fees
- Fund performance
- Fund cost structure
- Role of advisers, consultants and investment banks
- Product differentiation

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But, is Europe really a single marketplace?



- Language
- Taxation
- Culture
- Savings patterns
- Distribution system
- Product recognition
- Brand awareness



Cyclical and secular trends

- Cyclical - Amount of equity exposure
- Cyclical - Appetite for aggressive growth
- Secular - Indexation (size bias)
- Secular - Globalisation of mandates
- Secular - Move to sector or specialisation

3 bps or 100bps?

Now - fees are under even more pressure

	Q4 2003	Q1 2004
Equity funds	33,7%	33,3%
Bond funds	25,4%	25,9%
Money market funds	24,8%	24,8%

- The negative mix shift in assets (equity to index and money market funds) have put pressure on margins.
- The negative mix shift does, however, seem to be reversing.
- Overall industry AUM is up about 5% in the same period.
- Increased competition among fund providers, as investors become more aware of alternatives.

Source: Deutsche Bank

Performance has become the 'product'.

What's most important for a distributor when selling a 3rd party fund in Europe?

Factor	Percentage
Client pressure	4%
Service	9%
All other	11%
Fund strategy & structure	14%
Quality of Manager (-ment)	18%
Performance	45%

Source: Morgan Stanley

At the same time, we are witnessing the evolution of new forms of competition

Source: M&C Research

This decades concerns - what performance?

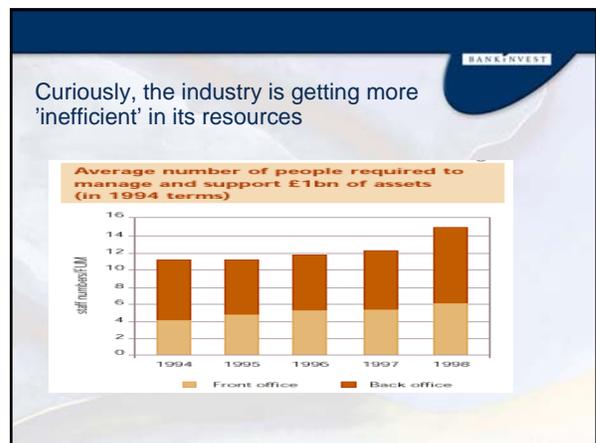
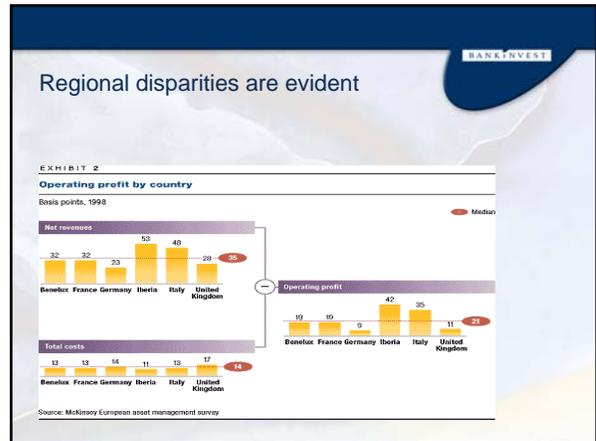
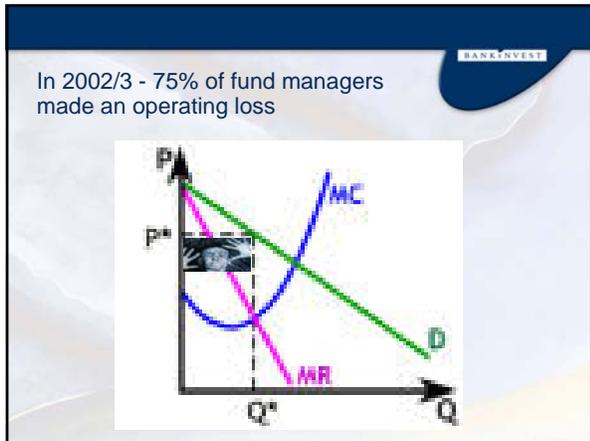
- Alpha and beta are being separated
- Alpha and beta are being leveraged
- Paying for beta is not economic

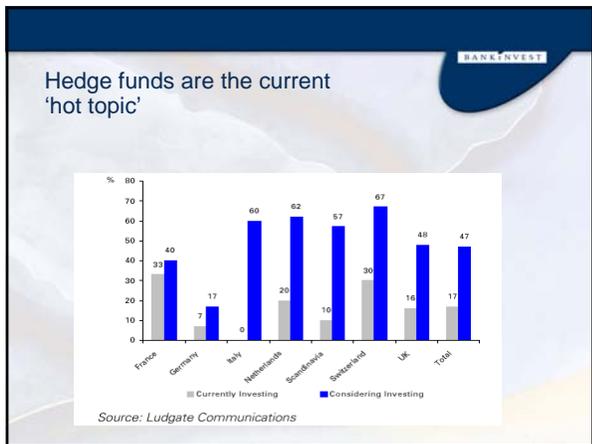
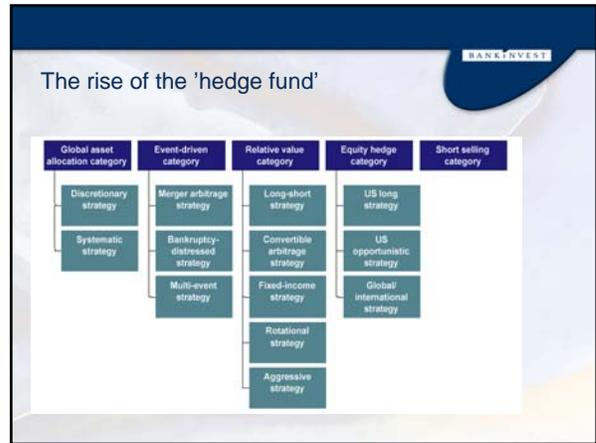
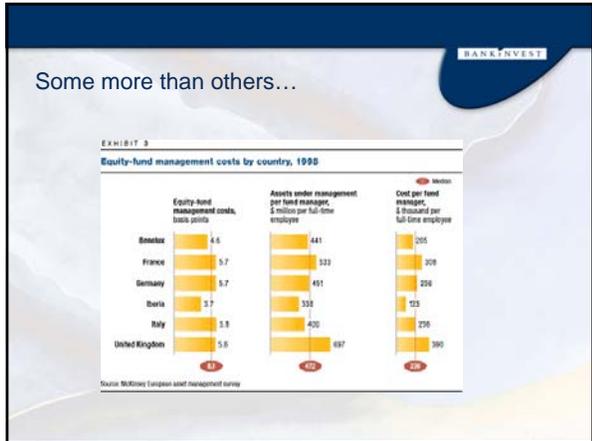


Compensation

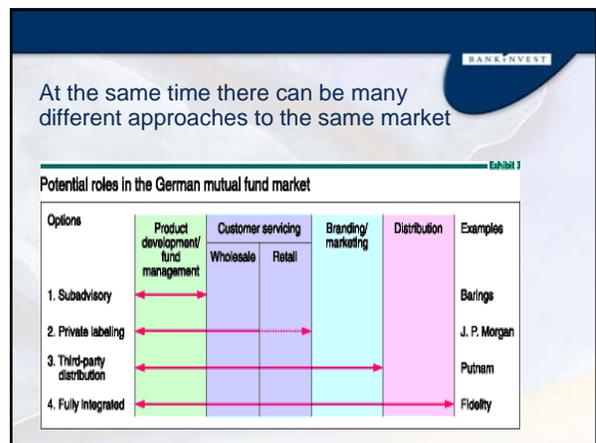
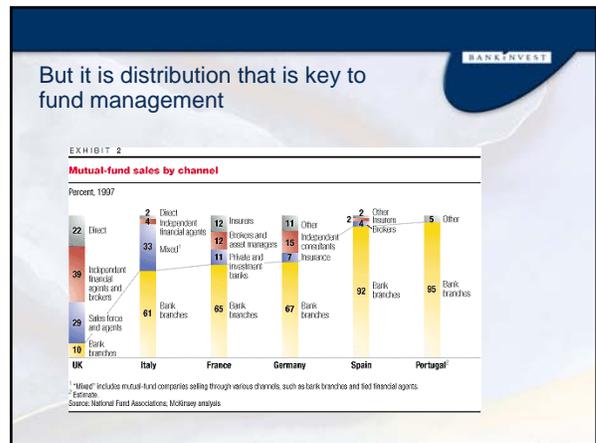
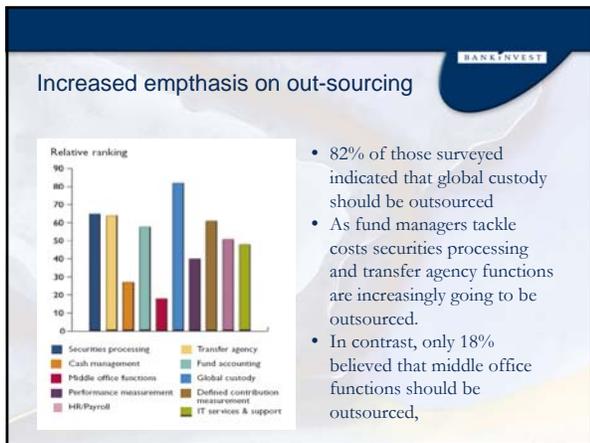
Country Differences – 10+ years experience only
US\$

	Total	Canada	Hong Kong	Japan	Singapore	Switzerland	United Kingdom	United States
2003 Median Salary	\$131,000	\$ 82,040	\$129,100	\$119,000	\$129,850	\$128,680	\$146,680	\$140,000
2003 Median Bonus	\$ 48,000	\$ 32,815	\$ 38,460	\$ 26,775	\$ 49,145	\$ 36,765	\$ 64,925	\$ 50,000
2002 Median Non-Cash Compensation	\$ 15,000	\$ 6,565	\$ 6,410	\$ 0*	\$ 17,345	\$ 7,355	\$ 20,095	\$ 15,000
Median Total Compensation	\$190,000	\$124,700	\$179,480	\$144,500	\$190,165	\$169,120	\$227,235	\$200,000
90 th Percentile	\$596,000	\$420,690	\$807,660	\$480,000	\$552,600	\$325,005	\$625,000	\$615,000





>Libor + 25% participation



Consultants and transparency on the rise

Country	Percentage
UK	~95%
Canada	~75%
US	~65%
Netherlands	~55%
Germany / Switzerland	~45%
France	~25%
Italy	~15%

Need for transparency pushed partly by regulation and partly by greater investor awareness

Source: Morgan Stanley

The industry under a microscope

- Stock picking
Improving understanding of market dynamics and communicating recommendations
- Removing conflict of interests
Remove bias and create a level playing field
- Active risk
Getting analysts to understand the tradeoff between risk and reward.
- Improve forecasting
Better understanding cash flow

A failure in governance...

The story so far...

Aided by an abused reporting system

ACCOUNTING FOR DUMMIES

A Reference for Greedy CEO's
...and other financial insiders

Where the rich slash their tax-base
How to make accounting "errors"

Independence and quality of research are on the agenda

Tom Ichniowski, CFA, testifies before the U.S. House of Representatives Subcommittee on Capital Markets.

- Relationship between Research and Investment Banking
- Relationship between Research and Issuers
- Personal and firm investing and trading
- Rating systems
- Relationship between buy-side and sell-side

Just when we thought the crisis was over...

Trading in and out of mutual fund at the expense of other fund shareholders.

Buy (sells) funds following positive (negative) market movements, when the current fund value is above (below) the NAV.

Zitzewitz (2003) found that annual long term shareholder losses due to late trading of 5bp in international equity funds and 0.6bp in domestic equity funds.

Same sample found evidence of late trading in 15 of 50 fund families.

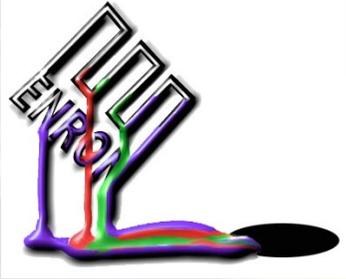
Putman Investments recently settled a lawsuit with the SEC to pay back US\$50 million to mutual fund holders in damages.

Two options

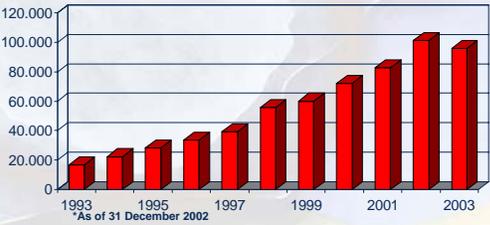


- Better-enforced "Chinese walls" to solve the problem of conflicts of interest between investment banking and equity research.
- Research business completely divorced from investment banking to ensure independence?

You can't regulate away corporate fraud



One solution is greater professionalism.....



Year	Number of Reports
1993	20,000
1995	30,000
1997	40,000
1999	60,000
2001	80,000
2003	100,000

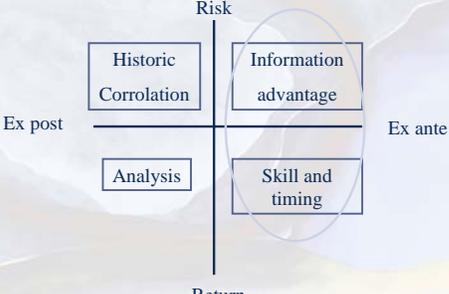
Another solution is setting global standards

- CFA Institute has already defined a global level playing field in performance measurement
- Research Objectivity Standards will address
 - Sell side
 - Buy side
 - Investment banks
 - Media

Global Investment Performance Standards™ (GIPS™)

The GIPS standards are ethical standards to be used by investment managers for creating performance presentations that ensure fair representation and full disclosure. Global standardization of investment performance reporting will allow investors to compare investment managers and will allow managers to compete for new business in foreign markets.

Also, the industry must change the way it views forecasting.



And as shareholders we must accept more responsibility!



- Myners report (2001) Pension mandates should have an explicit strategy,
 - elucidating the circumstances in which they will intervene in a company;
 - the approach they will use in doing so;
 - and how they measure the effectiveness of this strategy

Passive versus Pro-active boards

Passive	Proactive
<ul style="list-style-type: none"> ceremonial, turn up for meetings & buffet. Collect fees acquiesce in strategic decisions - rubber-stamp mgt policies poor access to information, no MIS 	<ul style="list-style-type: none"> executive, directors manage actual functions /operations lead on strategic analysis monitor mgt. performances for shareholders analyse and question. Mine for data effective communication - directors & managers.
<p>Position on continuum depends on</p> <ul style="list-style-type: none"> company size & type, industry category stage in company lifecycle whether in stable or crisis conditions composition of board & dispositions of directors locus of power 	

Conclusion



- Growing professionalism
- Passive versus Active management – alpha versus beta
- Saving for retirement
- Low barriers to entry
- The war for talent
- New products and innovation
- Focus on risk
- Distribution

Forecast *The fund management industry will emerge from the current crisis more professional and with better information to enable more precise alpha generation and leaner business models.*



Mission Statement

Lead the investment profession globally by setting the highest standards of education, integrity, and professional excellence.

Slides: email to iassa@iafrica.com (and Comments please)



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