

Transparency versus returns:
The institutional investor view of alternative assets*





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Welcome to the 16th report in our global financial services briefing programme, entitled **Transparency versus returns: The institutional investor view of alternative assets.**

Executive summary

PricewaterhouseCoopers Global Financial Services Briefing Programme

This briefing, written in cooperation with the Economist Intelligence Unit (EIU), looks at the Alternatives market from the perspectives of institutional investors and alternative investment providers.

As private equity, hedge funds and real estate become more deeply embedded in the mainstream asset class mix, there are growing calls for alternative investment providers to step up their levels of transparency, disclosure and risk management. Are these calls justified? Are investors satisfied with the relationship with alternative investment providers? And are the providers themselves confident that they are providing the right levels of reporting and disclosure? Would greater levels of regulation be welcomed? This briefing provides insights into the views of institutional investors and alternative investment providers on the regulatory, risk management and reporting environment for hedge funds, private equity and real estate.

The research effort for this briefing comprised two global initiatives:

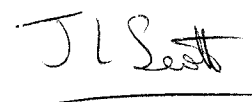
- The EIU and PricewaterhouseCoopers¹ conducted a special online survey of senior executives from institutional investors and alternative investment providers. Over 220 executives from the Americas, Asia and Europe participated in the survey, which was conducted between December 2007 and January 2008.
- The EIU held 30 one-to-one interviews with senior executives from institutional investors and alternative investment providers in the Americas, Asia and Europe.

The survey findings and interviews were further supplemented by significant desk research.

I am confident that you will find this briefing thought-provoking and insightful. Copies of this, along with our previous briefings on **Wealth Management, Economic Capital, Risk**

Management, The Trust Challenge, IFRS, Compliance, Restructuring, Governance, Performance Improvement, Growth, Offshoring, Customer-centric Growth and Risk Management are all available, free of charge from our website (www.pwc.com/financialservices).

If you would like to discuss any of the issues raised in this briefing in more detail, please speak with your usual contact at PricewaterhouseCoopers or one of the editorial board members listed at the end of this briefing. We would also appreciate your feedback on this briefing as it helps us to ensure that we are addressing the issues that you are focusing on.



Jeremy Scott
Chairman, Global Financial Services
Leadership Team

¹ PricewaterhouseCoopers refers to the global network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Executive summary continued

The alternative investments industry, which covers hedge funds, private equity, real estate, infrastructure and commodities, is still relatively new but, in recent years, it has grown at an astounding rate. Institutional investors now see an allocation to alternatives as a mainstream part of their portfolio and there is every indication that they plan to increase their exposure in the near future. As a result, investment providers have seen their assets swell accordingly.

But while the industry itself has seen rapid growth, the development of the infrastructure that supports it has not always kept pace, and the channels of communication between providers and investors are not always as open and effective as they could be. At a time when many alternative investment providers are suffering from the after-effects of the global 'credit crunch', such deficiencies could well be detrimental to the business model. According to a survey of 226 institutional investors and alternative investment providers carried out exclusively for this briefing by the Economist Intelligence Unit (EIU) on behalf of PricewaterhouseCoopers, there are several key areas that would benefit from closer attention:

Investors expect to make a higher allocation to alternative assets, but are nevertheless frequently dissatisfied with performance.

A significant proportion of respondents report that they plan to increase their allocation to alternative investments over the next three years, with between 30% and 40% expecting a greater exposure to real estate, private equity,

commodities and hedge funds. Given this trend for increased allocation to alternatives, one might expect that investors have been happy with the performance of these investments. The survey reveals, however, that this is often not the case. Less than half of respondents are currently happy with the performance of their hedge fund investments, while private equity and real estate fare somewhat better, with 67% and 57% reporting satisfaction.

There is a growing focus on governance, but the processes to make an assessment may be lacking. Investors have tolerated weak governance and risk management in the past few years as returns have been good and the sector has been evolving. Now that returns are moderating and the sector has matured somewhat, the survey reveals that investors are going to be more exacting. Asked about the criteria behind a decision to deselect a provider, the key driver is not performance, as it is when respondents are making a selection, but transparency and the quality of risk management. This suggests that providers will need to focus

more intently on operational infrastructure and the recruitment of experienced professionals who can meet investor needs in order to retain assets in a more subdued environment. For their part, investors will need to develop additional knowledge and the ability to make a formal assessment of their providers' operational and risk management infrastructure. Currently, more than half say that they have made no change to their risk management policies, despite an increased allocation to alternatives.

The quality and scope of reporting needs attention, but investors must also learn to ask the right questions. The quality and scope of information provided to investors by hedge funds, private equity funds and other alternative asset providers remains somewhat patchy. While most will report on performance and investment strategy, only a small minority volunteer information on a number of key operational metrics, such as back-office operations, risk and controls and valuation techniques. The latter is a particular concern, given the appetite among investors for investments where valuations are

not straightforward. Although this situation requires attention, investors themselves must also ensure that they seek the relevant information. The impact of recent global accounting standards will compel both providers and investors to raise their game.

There is dissatisfaction among investors with some aspects of the current regulatory regime.

The survey finds that just over one-quarter of institutional investors is happy with the regulatory regime for hedge funds, and less than one-half for private equity. A high proportion of investors report difficulties with comparing and benchmarking performance, and would like to see more done to standardise valuations, which both suggest that more regulation – whether by the industry itself, or by external regulators – would be welcomed. For their part, alternative investment providers are less enthusiastic proponents of change, with much higher proportions satisfied with the status quo. As the industry matures, this is a debate that will continue to attract opposing views.

Not so long ago, investing was a relatively simple affair. For pension funds and insurance companies, there was essentially a choice between equities, bonds and a dusting of real estate.

Introduction

The main tasks for custodians of retirement money were to decide on the allocations and select an appropriate manager for each asset class. The job was, certainly, one for professionals, but did not involve the sheer choice and complexity that exists today.

In recent years, alternative assets have proliferated in number and sophistication, not because advanced financial techniques have enabled their creation, but because the changing attitudes of investors have generated a demand. Today, the benefits of diversification and absolute, rather than relative, returns are held dear by many institutions. And, in an era of low inflation and high asset prices, alternatives hold out the promise of superior returns. In the case of corporate defined benefit pension funds, whose subscriptions are falling as the active workforce declines, higher returns are essential in the battle to meet liabilities.

Institutional investors have moved billions of dollars out of mainstream markets and into alternative assets. For example, ABP, the Dutch pension fund, plans to invest over one-quarter of its €200bn portfolio in alternatives by the end of 2009. The Yale endowment fund allocates

one-quarter of its assets to alternatives. The Wellcome Trust, the world's second largest endowment fund and the UK's biggest charity, has allocated more than 40% to alternative investments.

Many other institutions are also starting, cautiously, to select these asset classes. As a result, assets managed by alternative investment companies worldwide have rocketed. Hedge funds now control nearly US\$2 trillion, according to Chicago-based Hedge Fund Research. In terms of private equity, in the US alone there were US\$521.8bn worth of deals last year, more than double the US\$240.4bn recorded for 2006, according to data provider Dealogic. And, as an example of the success of infrastructure funds, at the end of 2007, US\$200bn of money earmarked for infrastructure assets worldwide had not yet found a home.

Sovereign wealth funds, which have traditionally been conservative investors, are also increasing their allocation to alternative assets. Information on the investment strategy of these funds is very scarce, but estimates suggest that some funds have substantial allocations to alternatives – in some cases, as much as 20%. Given that one

fund alone, the Abu Dhabi Investment Authority, is estimated by Morgan Stanley Research and PIMCO to hold up to US\$875bn in assets, it is clear that sovereign wealth funds are rapidly becoming an important part of the client base for alternative investment providers.

Investment firms have not only witnessed a dramatic rise in the amount of assets they manage, but they have also seen a change in the composition of their investor base. Whereas a decade ago, 60% of hedge fund assets worldwide were owned by high-net-worth individuals and 40% by institutions, today the reverse is true, with institutions providing 60% of the money managed.

This trend is set to continue. A global survey of investors and investment providers conducted by the EIU on behalf of PricewaterhouseCoopers predicts a far greater exposure to alternatives over the next three years. Among investors, 41% expect to increase their allocation to real estate, 40% to private equity, 35% to commodities and 33% to hedge funds. Very few plan a smaller allocation to any of these sectors.

Introduction continued

In the next three years, what change do you expect your company to make to its allocation to the following categories of alternative investment?

	Greater allocation	No change	Smaller allocation	Don't know	Total
Hedge funds	33 %	39 %	16 %	12 %	100 %
Private equity	40 %	46 %	11 %	4 %	100 %
Real estate	41 %	36 %	21 %	2 %	100 %
Infrastructure	35 %	46 %	10 %	9 %	100 %
Commodities	35 %	37 %	15 %	13 %	100 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

More assets equal greater responsibility

Rather than predominantly managing the money of wealthy individuals and families, alternative investment managers now find themselves the guardians of ordinary people's long-term savings and retirement capital. The pension funds and other institutions that make these investments are seeking at least the same degree of assurance about the people and processes that manage the money as they receive from traditional asset managers. In many cases, governance – the umbrella term for all these processes – has become as important as returns.

'If you are a trustee of a pension fund, you don't want to take unnecessary risks', says Eric Scheurer, head of planning at Man Group, the world's biggest hedge fund management firm, with assets under management estimated at US\$71.7bn. 'In the alternatives space, these funds are looking for big players that have a full infrastructure set. They can, and sometimes do, choose smaller managers with higher performance. But the infrastructure is often not there and many do not want to take that risk.'

Risk management, reporting, transparency and corporate governance are today's watchwords and any investment firm that does not match up

to requirements is likely to see assets drop, even if returns are acceptable. 'As hedge funds become more mature, institutions demand the same level of service as they get from traditional fund managers', continues Mr Scheurer. 'They require the same kind of reporting, governance and transparency.'

Despite the growing focus on risk and operational processes across all alternative asset classes, there is evidence that not all firms are meeting investors' requirements. The survey reveals significant areas of dissatisfaction among investors across a range of issues associated with reporting, risk management and disclosure.

Investors look beyond performance – key findings from the survey

The widely accepted premise that performance is the key driver behind most decisions to invest in alternative funds is, remarkably, not the case. The survey revealed that investors consider risk management, compliance and transparency to be as important, if not more important, than returns.

When selecting a provider, respondents consider performance to be the main criterion by some margin, but when deselecting, transparency and quality of risk management have a narrow lead over performance. This is indeed a surprising finding, but it does back up the belief among some commentators that when returns start to flatten – as they have in many asset classes – investors focus more intently on operational infrastructure. The survey reveals that this is not just an element in retaining assets in a subdued environment – it is the key ingredient.

What do you consider to be the main criteria for considering a third-party provider of alternative investments?

Performance	72 %
Quality of compliance and risk management process	49 %
Transparency	46 %
Quality of reporting	33 %
Product innovation	27 %
Independence from large financial services institutions	18 %
Size	14 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

What do you consider to be the main criteria for deselecting a provider?

Quality of compliance and risk management process	41 %
Transparency	41 %
Performance	40 %
Quality of reporting	39 %
Size	24 %
Independence from large financial services institutions	14 %
Product innovation	6 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

Introduction continued

And yet, despite recognising the importance of factors other than performance, only a minority of investors has the processes in place to make the appropriate assessment of them. A slim majority of 53% says that they have not made changes to their risk management policies as a result of increased exposure to alternatives. A further 17% did not know if they had made changes or not. No wonder then that, according to anecdotal evidence, many hedge fund managers need to be convinced that they need formal risk systems at all.

Have you made any change to your internal risk management framework as a result of an increased exposure to alternatives?

No	53 %
Yes	30 %
Don't know	17 %
Total	100 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

Olivier Le Marois, Chief Executive of Riskdata, a Paris-based technology provider, believes that there is a gradual trend among providers towards taking a more systematic approach to risk. 'Hedge fund managers have previously viewed risk as their business and something that they

are there to manage on a case by case basis', he says. 'But today, with the increasing sophistication and speed of markets, most managers are recognising that the case by case approach is insufficient and that the best way to avoid a nasty surprise is to identify, measure and control risk through a systematic process.'

According to Ton Berendsen, Chief Financial Officer of ABP, which handles more than €200bn of clients' money, the failure to adopt formal risk management processes indicates an absence of joined-up thinking. 'Risk management and investment management are two sides of the same coin', he says.

He points out that risk assessment is broader than simply protecting against dangers. 'Risk is not just one thing', says Mr Berendsen. 'Sometimes it is also about not missing great opportunities – that is, ensuring that we take adequate risk. If you want high returns, you need to take a certain amount of risk. At other times it is about risks that we should not take.'

While this is a seemingly simple recipe for putting together a portfolio of alternative investments, in practice ABP has an extensive risk assessment and monitoring process that has evolved over many years. Its principle is to perform due diligence that is 'more than sufficient', given the illiquid nature of the investment.

But due diligence requires a certain quality of information and investment firms do not always provide clarity and accessibility in this regard. According to the survey, formal reporting to clients is less than satisfactory in some areas. While the vast majority of investment firms provide reporting on the performance of funds and their investment strategy, just one-quarter report on their back-office operations, only 34% on their valuation techniques and 41% on possible conflicts of interest.

Of course, putting in place good governance and clear processes to communicate with investors depends on having the right people in place. As such, human resources issues are increasingly playing a vital role in raising standards of transparency and disclosure in the alternative investments industry. It is no longer enough for a hedge fund to consist of a handful of star traders. Given the more stringent requirements of institutional investors, it is also essential to recruit professionals who have the skills to manage risk, ensure good relations with investors and communicate clearly the firm's ethos and strategy. A similar focus on talent is being seen among institutional investors, who increasingly require professionals with the expertise to evaluate, select and monitor alternative investment providers.

In which of the following areas does your company provide formal reporting to clients?

Performance of funds	87 %
Investment strategy	76 %
Management fee structure	49 %
Composition of leadership team (general partners)	45 %
Leverage levels	45 %
Risk and controls	44 %
Possible conflicts of interest	41 %
Valuation techniques	34 %
Back-office operations	25 %
Use of third-party administrators	34 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

In the case of reporting to investors, clearly there is a balance to be struck between providing too little information and too much. Nick Minogue, Chief Risk Officer of Macquarie Bank, says that the key is not to provide more information or provide it more often, but to get the right information to the right investor. 'Just telling people more stuff is not helpful', he says. 'In fact, it's the reverse, particularly when the inclination is to create a story to explain poor performance or uncertainty. Uncertainty is bad, but it is worse for investors to get a story that is not credible.'

One trend that might accelerate the pace of disclosure is the recent wave of stock market listings by a number of alternative investment firms, such as Fortress, Och Ziff and Blackstone. While a stock market listing does not necessarily mandate the disclosure of underlying assets or investment strategy, shareholders in public companies will expect some form of commentary about operational issues, such as the composition of the leadership team, risk management and governance. If this trend for

IPOs continues, it will be interesting to see what impact it might have on disclosure levels in the industry as a whole.

North American firms are judged to take the broadest approach to reporting, with 60% of investors saying, for instance, that information was provided about potential conflicts of interest. Asian firms are also generally adequate in their breadth of reporting. But European firms are found to be less open, with just 19% reporting on back-office operations and 35% on conflicts of interest.¹

These findings may go some way towards explaining the backlash felt by some European alternative investment categories in the past few years. The perceived lack of transparency and accountability moved a German minister to label private equity firms as 'locusts'. In February 2007, just before he became French president, Nicolas Sarkozy scathingly said of hedge funds: 'In that economy, there is no wealth creation.' And in the UK, Brendon Barber, head of the powerful Trades Union Congress, called private equity firms 'amoral asset strippers' and 'casino capitalists'.

¹ We should qualify the regional findings by pointing out that while European investors have heavy weightings to European assets – pension fund consultants report that clients are largely exposed to local and neighbouring markets – they may also invest globally. Therefore, European investors' belief that hedge funds' reporting is poor could also indicate they are more demanding than US and Asian investors. This qualification will apply to all following regional references.

Miscommunication to blame for discord?

After extensive lobbying by the private equity industry, the German government has softened its stance and has shied away from direct intervention in the way alternative investments are run. In France, the industry has had some success in promoting the benefits that can be brought to the economy by the private equity community. It is clear that communication between industry exponents and politicians has narrowed the differences, but to a certain degree, the issue of communication remains a cause for dissatisfaction among investors.

There is often a disconnection between the perceptions of investors and those of providers, which highlights the shortcomings in communication. For example, we see that investment firms largely believe that they are good at managing risk. According to the survey, 70% rate themselves 'effective' in the accounting and reporting of transactions and 66% think that they are effective with policies to protect against fraud. A slightly lower proportion of 63% think that they are effective at valuation policies, 59% at IT security and 57% with conflicts of interest.

In which of the following areas would you consider your organisation to be effective at managing risk?

Accounting and reporting of transactions	70 %
Policies to protect against fraud, money laundering and insider trading	66 %
Valuation policies	63 %
IT security	59 %
Conflicts of interest	57 %
Segregation of roles and responsibilities	55 %
Formulation of formal risk management policy	49 %
Use of third-party administrators	47 %
Setting and maintaining position limits	45 %
Disaster recovery	45 %
Use of Value at Risk (VaR)	41 %
Sign-off on controls environment	37 %
Stress testing	36 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

But investors largely disagree. For instance, just 18% of hedge fund investors think that valuation policies are effective and only 16% think IT security at their investment advisers is good. And while non-hedge fund firms were viewed more positively, more than one-fifth of investors think

that stress-testing by private equity funds is poor or very poor. These are just a sample of many issues where investors feel their providers fall short.

Investors advocate greater regulation

Communication issues can have a real impact on portfolios. The right information is important for investors to take critical decisions. But nearly three-quarters of investors in the survey say that a lack of transparency makes it difficult to compare or benchmark performance, while two-thirds would like to see more work done to standardise valuations.

This suggests that regulation might be welcomed, whether it is delivered through political channels or from within the industry. Indeed, among institutional investors, just 28% are happy with the current regulatory regime for hedge funds and 42% with private equity. Alternative investment providers were less enthusiastic proponents of change, with 69% happy with the regulatory environment for hedge funds and 55% with the private equity status quo.

In general, are you satisfied with the regulatory environment for the following alternative vehicles? (Institutional investors only)

	Yes	No	Don't know	Total
Hedge funds	28 %	63 %	9 %	100 %
Private equity	42 %	52 %	6 %	100 %
Real estate	70 %	27 %	2 %	100 %
Infrastructure	53 %	26 %	22 %	100 %
Commodities	55 %	24 %	22 %	100 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

The industry believes that any drive towards greater regulation is misguided. The Alternative Investment Management Association, for instance, believes that calls for formal oversight in Europe are based on a lack of understanding about alternative providers. 'It is a total misconception to say that the industry in Europe is not regulated', says Florence Lombard, chief executive of AIMA. 'Hedge fund managers are already registered in all European Union states and in most other European countries.'

Issues associated with tax may also be seen as part of the regulatory universe. These can be highly complex and require careful monitoring on the part of both providers and investors, according to Florence Yip, Asia Pacific Investment Management Group Tax Leader of PricewaterhouseCoopers, based in Hong Kong. 'The world of alternative investments is both global

and fluid', she explains. 'Funds may be based in one jurisdiction, have fund managers in a number of others, who are investing in underlying assets in yet other countries. This means that there can be a number of different countries that want to have a claim from a tax perspective.'

Moreover, the tax treatment in individual countries can vary considerably and be subject to abrupt change. 'Investors and providers need to pay close attention to changes in tax law and tax treaties as they can have an impact on performance', continues Ms Yip. 'It can be a challenge for fund managers to disclose tax issues and, in particular, international tax issues, to investors because it is sometimes difficult for them to know. At the very least, their disclosure should spell out the uncertainty.'

In general, are you satisfied with the regulatory environment for the following alternative vehicles? (Alternative investment providers only)

	Yes	No	Don't know	Total
Hedge funds	69 %	21 %	10 %	100 %
Private equity	55 %	25 %	21 %	100 %
Real estate	58 %	22 %	20 %	100 %
Infrastructure	47 %	6 %	47 %	100 %
Commodities	52 %	15 %	33 %	100 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

An industry in the throes of change

While a lack of communication may well be behind many of the issues thrown up by the survey, it is nevertheless incumbent on investment firms to meet the challenge of investors' growing expectations. After all, investment firms have the expertise and

experience to set a higher benchmark and educate investors, some of whom are new to the alternative investments arena.

In the following sections, we will examine just how important non-performance issues are in each of the main alternative asset sectors: hedge funds; private equity; real estate and

infrastructure. The report will look at investors' attitudes, explore investment firms' efforts to achieve best practice and look at the impact of regional differences.

ABP – A committed alternatives investor

ABP, the giant Dutch fund manager with a portfolio of more than €200bn, has adopted an enthusiastic approach to alternatives over the past seven years. Whereas most European custodians of pension fund money have restricted their allocations to a tiny proportion of their total assets, nearly one-fifth of ABP's portfolio is invested in alternatives and this is due to rise to 26% by 2009. This will make it one of the world's biggest investors in alternatives alongside US endowment funds such as Harvard and Yale.

Ton Berendsen, Chief Financial Officer and Chief Operations Officer of ABP, believes that a high proportion of alternatives will help to provide the best possible returns for the 2.7m pension scheme members that represent ABP's client group. 'We have to be a world-class investor for the pension fund so it is not enough

to replicate the market benchmarks', he says. 'Our liability structure is our ultimate benchmark and that means real returns that are as high as possible given our risk budgets.'

One of the biggest issues for pension funds is rising inflation, which inflates the liabilities of the scheme. ABP hopes that, by investing in asset classes such as unlisted real estate, infrastructure, private holdings and commodities, it will help its assets to keep pace with liabilities. Since ABP has a long-term outlook – given its low short-term liquidity needs – it can afford to invest in illiquid assets and ride out any medium-term volatility.

The quality of the third-party investment managers – only used when in-house skills or scale is not available – is seen as paramount if the pension fund is to meet its obligation to members. ABP will usually only do business with firms that provide adequate transparency, risk management reporting and provide regular

valuations. 'We would need quarterly valuations on all illiquid assets and daily reporting for listed securities', says Mr Berendsen. 'And given the illiquid nature of many of these investments, we pay a lot of additional attention to governance issues in our due diligence process.' ABP has a committee staffed by board members that assesses every new potential investment and demands a high degree of evidence as to the suitability of the investment.

The fund sets an example to its underlying investment managers by providing high levels of transparency and reporting to its own clients. 'We are very open about our processes and principles', says Mr Berendsen. 'We are one of the few pension funds that publish the full costs we pay to underlying managers.' However, it stops short of publishing the details of each mandate, given that the information could be used by the managers' rivals to price their products more keenly.



In recent years, hedge funds have attracted an exponential increase in assets and now wield considerable power as they deploy those assets to drive trading and markets around the globe.

Hedge funds – A story of power and control

As a result, the sector has attracted both controversy and interest in equal measure.

In the face of a barrage of media coverage and political scrutiny, hedge funds' primary concern is to keep investors happy. But, at the moment, there are doubts that they are performing this function adequately. Less than half of respondents are currently satisfied with the performance of hedge funds (46%). Private equity and real estate, on the other hand, fare better at 67% and 57%.

With many arbitrage strategies suffering from overcapacity and returns from stock markets sluggish, hedge funds can no longer routinely provide double-digit returns. In this low-return environment, the ability of providers to demonstrate superior governance, transparency and reporting is likely to bear dividends. After all, if investors are resigned to single-digit returns from their alternative investments, they at least expect operational excellence to mitigate the effects of any blow-up.

Valuation matters

In any form of asset management, valuation of the assets is crucial. The ability to value assets and liabilities appropriately and accurately underpins the investment process and trust that investors have in their advisers.

The survey reveals the extent of the anxiety that exists, with 21% of investors in hedge funds saying that information provided about valuation techniques is poor or very poor.

In general, how satisfied have you been with the performance of the following assets?

	Very satisfied 1	2	3	4	Very dissatisfied 5	Total
Hedge funds	14 %	32 %	35 %	10 %	9 %	100 %
Private equity	23 %	44 %	26 %	6 %	1 %	100 %
Real estate	26 %	31 %	32 %	6 %	5 %	100 %
Infrastructure	10 %	28 %	49 %	8 %	6 %	100 %
Commodities	11 %	35 %	41 %	8 %	5 %	100 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

Hedge funds – A story of power and control continued

This compares with just 14% who believe that information on valuation from real estate was poor, and 12% for private equity.

The issue is so crucial to trust within the sector that last year saw the publication of valuation guidelines from two influential organisations. In February 2007, the International Organisation of Securities Commissions (IOSCO) published nine principles for hedge fund managers. The main recommendations were that funds should draw up policies for valuing investments, ensure that they are used properly and apply them as independently as possible. Valuation methods should also be made clear to investors.

Then in March 2007, The Alternative Investment Management Association Limited (AIMA) produced a complementary set of guidelines. Among them, it recommended that hedge fund governing bodies put in place detailed valuation policies, appoint independent valuers and tell investors about any involvement of the manager in pricing.

Emerging market valuations

Emerging market assets can often be hard to value because of the lack of price history and high volatility. But, over the long term, these difficulties are easing as domestic and foreign investors increasingly trade emerging market assets.

Dhir India, a hedge fund that focuses on distressed assets, believes that valuation is today no more of an issue in emerging markets than elsewhere. The hedge fund was set up to buy non-performing debt from banks following two severe downturns in India: the first in the 1980s and the second in the 1990s. Dhir, which is listed on London's Alternative Investment Market, typically buys into companies that have significant land assets, with the intention of selling them off or redeveloping them.

'Land, in particular, is not hard to value', says Alok Dhir, manager of the fund. 'We do a lot of business in Jaipur and land is bought and sold every day in Jaipur, so there is a strong sense of what it is worth.'

Mr Dhir says valuation is a key issue for investors. 'Many of them already have interests in India and will often perform quick checks themselves', he says.

While a fund's net asset value is instructive and can be used as a marketing tool, Mr Dhir points out that attempts at manipulation would not be productive in any case. 'The incentive for the asset manager is not linked to the NAV. It is all about the cash that the fund produces on the sale of assets.'

Reporting

While valuation methods are a crucial first step, valuations then need to be reported in a sufficiently accessible and timely fashion if they are to be useful. According to the survey, firms generally do this well. Investors view the quality of information they receive from hedge funds as reasonably good, but not perfect. In the best-performing area – reporting on the performance of funds – still less than half of investors think the quality of information is excellent or good.

Some of the larger hedge funds have taken up the cudgel ahead of regulators and are making concerted efforts to provide more and better information to investors and, where relevant, shareholders. Man Group, for example, devotes a whole section in its annual report to risk management, addressing issues such as risk infrastructure, risk identification, credit risk, market risk and risk mitigation.

Detailed reporting is essential for shareholders and investors to understand a firm as diverse as Man Group. Mr Scheurer says that Man Group

has long realised that it has a higher duty of care, given its high profile and the sheer size of assets it manages. 'We are often lumped in together with the universe of 10,000 hedge funds but we are a very different kettle of fish in terms of our infrastructure', he says.

The shape of Man Group's reports to individual clients depends on the type of investor, the types of risk involved and, to an extent, the demands of particular investors. 'Reporting ranges from high-level information on managers down to specific portfolio positions', says Mr Scheurer.

The most detailed reporting can often be obtained by investors with managed accounts. These have become popular among investors because the assets are ring-fenced from the manager's main fund and are available at as little as a day's notice. 'With this model, institutional investors can choose their level of disclosure', says Mr Scheurer.

Transparency

Much is talked of hedge fund transparency, but it can have different meanings depending on the type of fund and the third-party viewpoint. For an investor in a long-short equity fund, the most relevant aspect may be the compensation structure, but for a politician or trade union looking at an activist fund, it could mean being able to assess the fund's intentions towards staff at investee companies.

In the absence of a precise definition, a shorthand term for transparency could be 'trust'. After all, if two parties trust each other, they are likely to disclose more information, and vice versa.

Trust between hedge funds and investors appears to be on a knife edge. For example, 43% of investors think that providers are good or very good at communicating investment criteria. However, just 22% think that their investment providers are good at communicating possible deviation from investment strategy. In other words, few investors trust hedge funds to stick absolutely to the agreed mandate.

Hedge funds – A story of power and control continued

Thinking of your company's hedge fund investments, how transparent are they in the following areas?

	Very good or good transparency	Average transparency	Poor or very poor transparency	Don't know	Total
Investment criteria	43 %	43 %	13 %	2 %	100 %
Investment risk	26 %	48 %	25 %	2 %	100 %
Deviation from investment strategy	22 %	50 %	27 %	2 %	100 %
Management fees and compensation	30 %	50 %	18 %	2 %	100 %
Valuation approaches	20 %	61 %	18 %	2 %	100 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

Trust, or transparency, tends to vary according to region. US firms are viewed as reasonably transparent, but 38% of European investors say that their hedge fund investments are poor at communicating the risk of strategy deviation, for instance. And nearly one-quarter say that European hedge funds are poor at communicating investment risk. This compares to just 21% of Asian funds.

Justin Ong, head of investment management for PricewaterhouseCoopers in Singapore, says that there has been a strong incentive for Asian funds to improve. 'Clients and auditors are increasingly asking for more information', he explains. 'The risk management and back-office structures are under particular scrutiny.'

The emphasis on greater transparency among investors worldwide is hardly surprising. Many are highly exposed to strategies with significant tail risk – that is, the probability of a big hit to the assets. In this scenario, the managers collect their fees and bonuses over a number of months and years and retain that compensation even if the strategy fails. On the other hand, investors make steady returns until the tail-risk event occurs, when they suddenly lose a sizeable chunk of their capital.

Peyton Young, the James Meade Professor of Economics at the University of Oxford, says that designing a compensation structure to combat behaviour that knowingly runs tail risks is fraught with difficulty. 'Even with longer deferral times

and claw-back provisions, it is very difficult to fix the problem by redesigning the incentive structure', he says. 'A better remedy is for investors to insist on greater transparency so that they know what risks are lurking in the tails.'

Increased transparency places new burdens on investors, too. As Meredith Jones, managing director of PerTrac Financial Solutions, a US-based hedge fund technology provider, says: 'If you are a fund of hedge funds, you could be opening yourself up to liability if you know something and are found not to have acted on it. In that scenario, a lawsuit is more than likely.'

Risk

Risk is another catch-all term. Many banks now have chief risk officers and larger alternative asset firms are following suit. The newly created role is long overdue, given that there are infinite ways to slice and dice risk.

The proliferation of risk technology providers is testament to the growing recognition that risk needs to be managed. Mr Le Marois of Riskdata

likens managing assets without a risk system to driving a car without a speedometer. 'There is always the possibility that you are mistaking your speed', he says. 'You want to believe in what you do so you under-rate the risk.'

Risk management among hedge funds is patchy, according to the survey. One-third is reckoned to be good or very good at accounting and reporting of transactions and 31% have good policies to protect against fraud and money

laundering. There are particular weaknesses in IT security, where only 15% of hedge funds excel, in the segregation of roles and responsibilities, where just 16% score well, and in valuation policies, where only 16% are seen as good or very good.

Thinking of your company's hedge fund investments, how effective is their risk management in the following areas?

	Very good or good	Average	Poor or very poor	Don't know	Total
IT security	15 %	50 %	16 %	19 %	100 %
Accounting and reporting of transactions	33 %	43 %	13 %	10 %	100 %
Disaster recovery	21 %	39 %	20 %	20 %	100 %
Segregation of roles and responsibilities	16 %	48 %	23 %	13 %	100 %
Valuation policies	16 %	59 %	15 %	10 %	100 %
Policies to protect against fraud, money laundering and insider trading	31 %	33 %	21 %	15 %	100 %
Formulation of formal risk management policy	21 %	57 %	11 %	10 %	100 %
Stress testing	25 %	40 %	25 %	10 %	100 %
Use of Value at Risk (VaR)	26 %	52 %	15 %	7 %	100 %
Setting and maintaining position limits	33 %	43 %	13 %	11 %	100 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

Hedge funds – A story of power and control continued

The changing face of risk management

ABS Investment Management: A diligent approach to allocation

ABS Investment Management, a Greenwich, Connecticut fund of hedge funds firm, believes that, as competition intensifies, funds of hedge funds face a more difficult environment in which to assess risk in underlying funds. With 4,500 long-short funds to choose from for its portfolios, it is already difficult to gauge which ones will succeed. But Alain De Coster, co-founder of ABS, says that the task is becoming more difficult and that the prime brokers are, in part, to blame. 'Prime brokers are very good at telling new hedge funds what songs to sing and at what time', says Mr De Coster. 'It means that they all look very much alike.'

The geographical spread of hedge funds has also made the funds of funds' task more challenging. 'Once, Asian hedge funds were all based in London', says Mr De Coster. 'Now they are in Hong Kong, Singapore, Shanghai and beyond.'

The answer for ABS is to filter out the 'background noise' and perform an intensive bottom-up due diligence process on every manager to which it is considering an allocation. The first test relates to the abilities of the managers. 'Many managers are good stock pickers but few are excellent portfolio managers and even fewer are good businessmen', explains Mr De Coster. 'And if they are only doing it for the money, they won't last very long.'

After initial selection comes monitoring and this is the most time-consuming part of ABS's service. 'It is not like comparing returns to an index', says Mr De Coster. 'You need to understand the strategy and the environment, and how the managers react in different environments. We compare the reactions of people doing similar things.'

ABS asks every manager for a monthly report on its underlying assets so that correlation across the ABS fund can be assessed. It also ensures that no style becomes over-dominant. For instance, there could be too much emphasis on a particular sector or on growth versus value.

Regulatory scrutiny

If proof were needed that hedge funds have become a political hot potato, then one need look no further than last year's G8 Summit of Developed Nations, at which world leaders discussed the possible regulation of the industry. Although the German proposal to improve standards of transparency was effectively withdrawn, the issue remains 'on the table' for future G8 discussion.

If regulation were likely, it may not encounter overly vociferous opposition. Nearly half of all industry participants would support guidelines on reporting to investors and 36% would support formal disclosures to regulatory bodies. While there is slightly less support for regulation among alternative investment providers themselves, 45% said that they would support guidelines on reporting to investors and 35% would support a code of ethics.

Moves toward self-regulation have been made in several regions. In the US, the President's Working Group on Financial Markets, led by Treasury Secretary Hank Paulson, has created two committees: one to represent the interests of investors and the other to give a voice to advisers. The aim is to develop a series of recommendations that will be adopted as best

practice and the Working Group plans to report back by the end of this year. 'It is the first move towards self-regulation of the hedge fund sector in the US', says Mark Casella, head of the US alternative investments practice at PricewaterhouseCoopers (US).

In the UK, the Hedge Fund Working Group (HFWG), headed by Sir Andrew Large, former deputy governor of the Bank of England, published a series of recommendations in January. London's biggest hedge funds agreed to disclose more information about the risks they run, the fees they charge and how they value their assets. The HFWG attracted widespread praise from investors and regulators for its voluntary guidelines to fund managers.

Sir Andrew says it will rely on investors for enforcement of the 'comply or explain' rules. 'It is a market discipline process and a large portion of that discipline is going to be led by investors', he says.

AIMA, which has 1,280 corporate members in 47 countries and 4,500 member contacts, is convinced that self-regulation will be sufficient to appease politicians. 'Pressure from the G8 is only really coming from the German side, which has not been specific about what it expects', says Ms Lombard of AIMA. 'Of course there is always room for more clarification in some areas – side letters being an example – but sweeping new regulation is not necessary.'

But pressure has not abated for tougher regulation than is currently on the table. The influential Chartered Institute of Analysts is pressing for greater rigour. It says it will lobby for 'a consistent set of global standards in the hedge funds industry and wants greater emphasis on investor protection and ethical and professional conduct'.

And London-based Albourne Partners, which advises investors including Hermes, Fleming Family & Partners and Caisse de Dépôt et Placement du Québec, says that more detailed

standards are needed to ensure that hedge funds comply with the spirit of the voluntary rules laid down by the HFWG.

At least one country has already taken the plunge and implemented full-scale formal regulation, using it as a selling point for cautious investors. In December 2007, the Dubai Financial Services Authority (DFSA) unveiled its Hedge Fund Code of Practice. 'While there are a number of industry-based hedge fund codes, the DFSA's is the first of its kind to be issued by a regulator', explains David Knott, chief executive of the DFSA.

Which of the following regulatory initiatives would you most strongly support with respect to hedge funds?

Guidelines on reporting to investors	43 %
Formal disclosures to regulatory bodies	36 %
Guidelines on valuation techniques	31 %
Code of ethics	31 %
Disclosure by banks of finance arrangements with hedge funds	18 %
Guidelines on leverage thresholds	17 %
Guidelines on manager compensation	11 %
Guidelines on investment fees	11 %
Recruitment of a chief compliance officer	10 %
Disclosure of derivative holdings by activist funds	8 %
Disclosure of equity holdings by activist funds	5 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

Private equity has also come under pressure for greater regulation as its financial muscle has enabled it to buy companies worth billions of dollars.

Private equity under the spotlight

Although there is little or no evidence that companies run by private equity funds fare worse than their counterparts, opinion has turned against the big buyout funds because of the huge wealth accumulated by their general partners, the aggressive cost-cutting measures they often employ and their perceived lack of transparency.

Europe, in particular, has seen a forceful reaction against the sector. But it is instructive to gauge whether the popular outcry against private equity is based on reality or a misperception.

Reporting standards in private equity

Investors certainly seem to be reasonably sanguine about their private equity providers. The quality of information provided is generally deemed satisfactory. In terms of reporting on performance, 45% are happy while 48% think reporting on investment strategy is good or very good. Far fewer, however, give good ratings for reporting on possible conflicts of interest (12%), use of third party-administrators (11%), leverage levels (15%), back-office operations (15%) and risk and controls (18%).

As in the hedge fund sector, US investors are most content with their private equity fund managers. More than one-half thinks that reporting of investment strategy, for instance, deserves the highest mark.

And, once again, Europe is the ugly duckling. Although half of European investors are satisfied with performance reporting, a huge 46% say that their managers are poor at reporting management fee structures, 35% accuse them of disseminating substandard back-office information, and 35% say they are poor at highlighting possible conflicts of interest.

How would you rate the quality of the information that the private equity funds in which you invest provide in the following areas?

	Excellent or good	Average	Poor or very poor	Don't know	Total
Investment strategy	48 %	43 %	5 %	4 %	100 %
Back-office operations	15 %	53 %	23 %	9 %	100 %
Risk and controls	18 %	65 %	11 %	6 %	100 %
Performance of funds	45 %	45 %	7 %	4 %	100 %
Composition of leadership team (general partners)	32 %	52 %	11 %	5 %	100 %
Valuation techniques	22 %	59 %	12 %	7 %	100 %
Management fee structure	20 %	49 %	24 %	7 %	100 %
Possible conflicts of interest	12 %	54 %	24 %	9 %	100 %
Leverage levels	15 %	52 %	19 %	14 %	100 %
Use of third-party administrators	11 %	50 %	20 %	19 %	100 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

Private equity under the spotlight continued

The mistrust manifested in the European media and among the political classes is therefore not without foundation. This should give private equity groups further pause for thought.

One way they could help improve their image is by adopting recent accounting standards that have been designed to help protect investors and counterparties. Take FAS 157, the new US financial accounting standard for mark-to-market and mark-to-model. Many US banks have adopted it already, but private equity and hedge fund firms, along with their investors and auditors, would do well to pay attention too.

Equally, few alternative asset providers have familiarised themselves with the auditing standard, SAS 70, which provides for reporting

on the effectiveness of controls and processes. Any fund providers that took account of this standard would undoubtedly soothe the nerves of investors and regulatory bodies alike.

Transparency

If there is one word that crops up time and again among detractors of private equity, it is 'transparency' or the perceived lack of it. According to our respondents, private equity firms are good with some aspects of transparency, but poor with others. For example, nearly one-half thinks that firms' transparency on investment criteria merits the highest praise. On the other hand, just 21% think that they are good or very good at disclosing clear policies on

management fees and structure, and only 18% believes that they are transparent over potential deviation from investment strategy.

US investors are, again, most positive, while Asian investors are the most critical, with nearly one-quarter (23%) saying that funds are poor at transparency with management fees and compensation disclosure. A sizeable 27% say that private equity firms are poor at transparency over how they value assets. This may well reflect the immaturity of the sector in Asia and the relative difficulty, in the absence of established benchmarks, to put in place valuation frameworks. However, Asian-focused funds might be advised to respond to a high degree of investor disenchantment on this issue.

Thinking of your company's private equity investments, how transparent are they in the following areas?

	Very good or good transparency	Average transparency	Poor or very poor transparency	Don't know	Total
Investment criteria	45 %	50 %	3 %	3 %	100 %
Investment risk	29 %	63 %	5 %	3 %	100 %
Deviation from investment strategy	18 %	61 %	17 %	4 %	100 %
Management fees and compensation	21 %	60 %	13 %	5 %	100 %
Valuation approaches	26 %	53 %	17 %	4 %	100 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

Risk management

Risk management, as noted in the previous section, is a nebulous concept. Although investors generally recognise its importance, they are less sure how to assess their fund managers' capabilities. For example, a full 26% say that they

do not know how effective their private equity providers are with their disaster recovery policies. Of course, disaster recovery reporting often comes a long way down in the prospectus, but it would seem sensible for investment firms to communicate clearly on this important issue and for clients to have at least examined the issue.

Otherwise, there are perceived weaknesses in the reporting of segregation of roles and responsibilities and stress testing, but few alarm bells overall in the risk area.

Thinking of your private equity investments, how effective is their risk management in the following areas?

	Very good or good	Average	Poor or very poor	Don't know	Total
IT security	25 %	43 %	11 %	21 %	100 %
Accounting and reporting of transactions	29 %	60 %	4 %	7 %	100 %
Disaster recovery	14 %	43 %	18 %	26 %	100 %
Segregation of roles and responsibilities	17 %	59 %	8 %	16 %	100 %
Valuation policies	25 %	59 %	11 %	5 %	100 %
Policies to protect against fraud, money laundering and insider trading	27 %	43 %	15 %	16 %	100 %
Formulation of formal risk management policy	24 %	50 %	16 %	9 %	100 %
Stress testing	18 %	45 %	22 %	16 %	100 %
Use of Value at Risk (VaR)	19 %	49 %	15 %	18 %	100 %
Setting and maintaining position limits	19 %	60 %	8 %	13 %	100 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

Private equity under the spotlight continued

Regulation

While there may be sound reasons for tightening regulation of the private equity industry, the most vociferous calls have tended to come from parties with fairly entrenched viewpoints. Trade union officials, for example, must be seen to be protecting the livelihoods of their members. The same is true of some local politicians, particularly when a buyout firm purchases a local corporate champion and restructures its workforce.

Carlyle Group, for instance, was warned at the end of last year to take care over personnel issues as it completed a US\$6.3bn takeover of Manor Care, the largest nursing home chain in the US. Pete Stark, chairman of the House Ways and Means subcommittee on health, called for the Government Accountability Office to examine the ownership structures of nursing homes and how they affect transparency, staffing levels and quality of care. 'I am concerned about quality issues and lack of accountability, particularly as more and more beneficiaries are now living in private-equity-owned homes', said Mr Stark.

Regulation, perhaps piecemeal, is certainly not unthinkable. And the private equity industry is not totally averse to it, with 40% of firms in our survey supporting the introduction of reporting guidelines. However, just 28% would give their blessing for formal disclosure to regulatory bodies and the same proportion would support guidelines on valuation techniques.

The more mature economies are least in favour of regulatory moves, with 43% of US private equity participants supporting guidelines on reporting and just 35% in Europe. By contrast, in Asia, 55% would like to see guidelines on reporting and 48% want formal disclosures to regulatory bodies. This clear desire for a strong framework is suggestive of an emerging regional industry seeking a fast-track route to global recognition.

While there appears to be considerable support for regulatory intervention, not everyone believes it would be conducive to the continuing evolution of the sector. 'Some measures taken by the European Union have been useful for the investment sector', says Mr Berendsen of ABP,

'but politicians and other parties putting pressure on private equity firms is not very helpful. Private equity firms and hedge funds provide liquidity and better pricing to the markets – they have an important role to play.'

According to Mr Berendsen, greater transparency is only possible when investment firms and their clients work together. No amount of political pressure or regulatory intervention will work on its own. 'The functioning of financial markets is based on trust', he says. 'When this happens, they are more efficient and more liquid. You only have to look at recent events in credit markets to realise that trust is crucial.'

Worldwide, the industry is hoping that trust is enough to ward off formal regulation. This hope was the main driver behind last year's Walker Report on private equity in the UK, and the setting up of the Private Equity Council in the US. Such initiatives, which encourage dialogue between stakeholders, can surely only help to foster better understanding of private equity in general and buyouts in particular.



Real estate is not subject to the level of scrutiny that hedge funds and private equity have attracted. Rental income that rises with inflation makes real estate an attractive investment for pension funds and other institutions with long-term liabilities.

Real estate – The turning of a tail wind?

In addition, there tends to be stability of ownership and low turnover relative to, say, hedge funds and even traditional asset management. While ‘special situations’ funds, which tend to invest in riskier assets, are on the rise, they represent a tiny proportion of the real estate universe.

Given real estate investors’ tolerance to volatility, there are few instances of great angst in the sector. There have, of course, been sharp falls in value and the occasional bona fide crash, but rarely have these been attributable to inadequacies in the way the sector is managed.

Reporting

Investors are by and large satisfied with the quality of information from real estate funds, but there is still no category in which more than half of them award top marks. The reporting of investment strategy comes closest at 45% and fund performance weighs in at 42%, but funds receive low ratings for the use of third-party administrators at 16%, reporting on conflicts of interest at 18%, leverage levels at 19% and management fee structure at 22%.

Some investors have complained that it is not always clear if the fees apply to equity-backed or leveraged assets. In terms of leverage, some investors may be looking in vain to see a separate section in the report. This is almost never the case.

Transparency

Transparency in real estate is less of an issue than in other alternative sectors. For example, 52% of investors say that transparency on investment criteria is excellent. The sector, of

How would you rate the quality of the information that the real estate funds in which you invest provide in the following areas?

	Excellent or good	Average	Poor or very poor	Don't know	Total
Investment strategy	45 %	43 %	4 %	8 %	100 %
Back-office operations	22 %	51 %	15 %	12 %	100 %
Risk and controls	24 %	50 %	16 %	9 %	100 %
Performance of funds	42 %	49 %	1 %	8 %	100 %
Composition of leadership team (general partners)	30 %	53 %	7 %	11 %	100 %
Valuation techniques	27 %	50 %	14 %	9 %	100 %
Management fee structure	22 %	55 %	12 %	11 %	100 %
Possible conflicts of interest	18 %	42 %	21 %	19 %	100 %
Leverage levels	19 %	53 %	18 %	10 %	100 %
Use of third-party administrators	16 %	49 %	14 %	21 %	100 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

Real estate – The turning of a tail wind? continued

course, has enjoyed great popularity, with prices and rents around the world benefiting from globalisation and continuing economic growth. JP Morgan Asset Management, for one, has been a beneficiary of investors' positive view of real estate. It manages US\$56bn of real estate assets in 80 pooled funds and 20 segregated mandates. Joe Azelby, head of real estate and infrastructure for JP Morgan Asset Management in New York, says that real estate has been an easy sell in recent years. 'It offers attractive income, low correlation to other assets and good total returns', he says.

US pension funds are increasingly looking abroad both to diversify their portfolios and to enhance returns that have been eroded by increasing asset flows into the sector. Europe is a popular target for US retirement money and, in the past few years, Asia has taken over as the destination of choice.

But returns are flattening everywhere and the search for yield is becoming more challenging. In some countries, such as the UK, commercial property is even falling in value. 'There has been a tremendous tail wind in the past few years but that has since passed', says Mr Azelby. 'Returns in the short and medium term will be made in the old-fashioned way – improving operational income

through good leasing decisions and tremendous tenant services.' In short, managing client expectations through relevant reporting and transparency could be a key differentiating factor.

Regulation

The industry's considered stance on regulation is indicative of a desire to keep the 'golden goose' laying over the long term. Among all industry participants in the survey, 40% would support guidelines on reporting and 38% would support guidelines on valuation techniques. Slightly less than one-third – 31% – would support formal disclosure to regulatory bodies, although this drops to 25% among alternative investment providers.

As in the private equity sector, demand for regulation among investors in Asia is higher than in other regions. In Asia, 52% of investors and investment firms would like to see guidelines on reporting to investors and 45% support formal disclosure to regulators. Again, this represents evidence of a young industry seeking a framework to allow it to advance. While property has been bought and sold in Asia for as long as anywhere else, the rapid development of many Asian economies has opened up many more opportunities, turning a niche opportunity into a fully functioning marketplace.

Mark Haberlin, head of infrastructure and real estate at the Sydney office of PricewaterhouseCoopers (Australia), outlines why regulation is relatively attractive for the real estate sector. 'Real estate is more homogenous than hedge funds', says Mr Haberlin. 'I can see the value in standardising because it could comfortably apply to 70% of situations and would work reasonably well in the other 30%. The point is that you are always dealing with the same half dozen issues. This is clearly not the case with hedge funds when one is managing long-short Japanese equities and another is trading wheat futures.'

Which of the following regulatory initiatives would you most strongly support with respect to real estate?

Guidelines on reporting to investors	40 %
Guidelines on valuation techniques	38 %
Disclosures to regulatory bodies	31 %
Code of ethics	25 %
Guidelines on investment fees	21 %
Guidelines on manager compensation	14 %
Recruitment of a chief compliance officer	11 %

Source: PricewaterhouseCoopers/EIU survey, January 2008

Valuation

Regulation might also provide the answer to the problem of valuation in highly volatile markets. In common with many other areas of the world, Australia has seen powerful increases in property prices and large capital inflows in recent years. The risk arises that new investors buy into open-ended funds at stale prices, disadvantaging existing investors. The reverse is true when prices are falling fast, as they did in Japan in the 1990s and, more recently, in the UK. The answer, says Mr Haberlin, is to value assets more often and avoid different timeframes for valuations and dealing.

Valuation was also at the centre of a nationwide scandal in Germany in 2006, when fraudulent valuations were detected in a number of funds. Although the scandal was associated predominantly with the retail market, tough new rules being enacted in Germany this year will also apply to funds targeted at institutional investors. Funds will have to obtain independent valuations when they buy a new asset and implement a full risk management system to assess and monitor volatility, cash flow and valuation issues. The rules do not only benefit investors, however. Fund managers will be allowed to defer redemptions in exceptional circumstances, such as in periods of volatility.

‘The idea is to reduce the concentration of risks and provide an early warning system’, says Uwe Stoschek, global real estate tax leader at PricewaterhouseCoopers (Germany). ‘The net result is better corporate governance across German real estate.’

Corporate governance

Of course, valuation is just one part of the corporate governance jigsaw. The wider structures around which property portfolios are built worry some investors, with one-fifth rating property funds ‘poor’ at reporting on potential conflicts of interest.

Concerns centre on the proliferation of roles that some large financial institutions perform in the property market. A fund manager may, for example, take a fee for managing assets and also hire a developer to enhance the value of those assets. If the institution concerned also offers development services, the contract could be awarded to the institution’s own development business rather than to a third-party developer, creating the appearance of unfair practice.

JP Morgan Asset Management plays down worries over governance. ‘There are few secrets in real estate as there can be in other asset classes’, says Mr Azelby. ‘We can provide as much transparency as investors can handle.’

We can give them all the information about the building itself, the rent roll, the cost of land, the cost of construction, the construction schedule and so on.’

Over the past year, liquidity has also emerged as a significant corporate governance issue in the real estate sector. A number of funds have effectively been forced to close after they were unable to meet strong demand for redemptions. More recently, bank funding has become less freely available. ‘Liquidity is a big issue that has not always been adequately managed and properly reported to investors’, says Mr Haberlin. ‘Equity investors need to look at bank funding. If it only has, say, 15 months to run, what is the fund planning after that? Investors should really be asking about this, as it’s a key corporate governance issue.’

So even in a sector that is long-established and well understood by most of its participants, there is still a degree of complexity. Issues surrounding reporting and transparency can suddenly appear that have the potential to erode investors’ confidence. For real estate funds, it is essential to allay the reasonable fears of their clients.

Infrastructure is the dark horse of the alternative assets industry. While hedge funds and private equity have grabbed the headlines and the attention of pension fund consultants, infrastructure funds have been quietly honing their skills and gathering assets.

Infrastructure – The dark horse of the alternatives industry

Nearly US\$28bn was raised last year for infrastructure investment, a fraction of the amount raised by hedge funds. But growth is accelerating and Private Equity Intelligence, a data provider, estimates that there are 48 infrastructure funds planning to raise another US\$46bn this year. Former state-held assets, ranging from airports and highways to water networks, have been taken into private hands by funds with the know-how to 'make the assets work harder'.

Australian groups, such as Babcock & Brown and Macquarie Bank, are credited with kick-starting the recent surge in infrastructure investment, but many others have followed suit. CVC Capital Partners, for example, is the latest in a long line of private equity houses to launch an infrastructure fund.

The assets are often impressive in scale, with recent deals including the Chicago Skyway toll road, the Indiana toll road, Thames Water and Associated British Ports. Financial sponsors, including the big pension funds, now account for one-fifth of global infrastructure deals, according to Standard & Poor's, compared with just 6%

two years ago. Among large investors, the Washington State Investment Board and California Public Employees' Retirement System, to name but two, have recently indicated they will increase their investment in this area.

With the scale of projects involved, investors accept the lack of liquidity. After all, most are primarily looking for income and an inflation hedge rather than quick-fire capital gains. But there are, however, some warning signs for the industry. Just one in ten investors is 'very satisfied' with performance, compared with one in five for private equity and an impressive 26% for real estate.

This implies two issues: first, that infrastructure funds may not be sufficiently managing investors' expectations for returns; second, in the absence of returns that meet widespread approval, non-financial aspects are thrown to the fore. At the moment, fewer investors are planning to decrease their exposure to infrastructure than to any other alternative sector, but that cannot be taken for granted and efforts to improve non-performance related issues could assist the retention of assets.

Managing risk in infrastructure funds

The twin pillars of corporate governance and risk management are of paramount importance to ensure that infrastructure projects, which tend to be large-scale and of very long duration, have a high probability of success.

Mr Minogue at Macquarie Bank, which manages over US\$100bn of infrastructure assets, steers as safe a course as possible, personally signing off on all major balance sheet items. He and his team of 340 risk professionals see their remit as ensuring transactions are fully understood before commitments are made. 'I focus on the potential downside', he says. 'My business is to look into the abyss and view the worst possible outcome and make sure it is survivable. As a bank we are not always risk averse, but we are very focused on making sure that risks are recognised and quantified.'

The main areas of risk that Mr Minogue's team evaluates are: credit, market, operational and equity. In effect, it performs a second layer of due diligence on deals. 'We look at whether the due diligence covers the right things and whether

Infrastructure – The dark horse of the alternatives industry continued

the right people have signed off on the deal', he says. 'We look to see if the character of the asset is right and whether the benchmarks for value are really comparable.'

At times, this means overruling or threatening to overrule an autonomous business unit, which can be complicated. 'Our work is mainly collaborative but it can be confrontational', says Mr Minogue. The most extreme outcome is that a deal is pulled. 'Due diligence can always result in a withdrawal or the decision not to pay more', he says. 'We have lost deals where we would not pay more.'

The chief risk officer also has an input into the overall strategy of Macquarie Group. If he believes a business line is no longer sustainable from a risk viewpoint, it is within his remit to report this at board level and seek change. This could even apply within infrastructure, the bank's flagship division. Mr Minogue insists that no strategy is sacred. 'Our businesses constantly change so it is fair in a way to view them as temporary. Infrastructure is currently interesting, but the group is also growing fast in other areas. In the risk functions, if we think a business has

crossed a line and the assessment of risk is flawed we would take that to the relevant business managers.'

Mr Minogue is confident that Macquarie can weather the avalanche of assets into the infrastructure sector. 'We think our business model is distinctive and we have access to the best management in the sector', he says. 'Of course, more competition can be a threat, but it does validate the whole space and raises investor awareness. And the amount of available assets will increase manifold in the future. In Europe, for example, most of the infrastructure is in need of investment – look at utilities. They need serious dollars and the idea that these can be raised in the private sector is gaining credence.'

Harder to legislate for is a severe downturn in the world economy. While nearly all companies suffer in such a scenario, Macquarie is conscious that investors still expect returns and shareholders do not tolerate capital losses. Mr Minogue's team stress tests the entire balance sheet against a sharp economic reverse and is satisfied with the results. 'We would experience some losses under the stresses but acceptable ones for extreme

circumstances', he says. 'But we are not talking about a problem next week, we are talking about modelling three years of profound depression. In that case our earnings might be hit, but not our capital.'



This report sheds light on the importance in the alternatives sector of issues other than performance.

Conclusion

‘In a relatively young industry, it might be expected that participants will not have worked through all the difficulties implied by a whole new set of business relationships’, says Marc Saluzzi, Global Investment Management & Real Estate Leader at PricewaterhouseCoopers (Luxembourg). ‘Our survey suggests that this is indeed the case.’

It should be noted that there were very few instances where investors expressed great alarm over the quality of transparency, reporting and risk management, provided by their investment managers. At the same time, however, there exists a degree of dissatisfaction with certain practices over the spectrum of investment types. US investors are the least concerned about their providers’ infrastructure, but European and Asian investors express quite pronounced worries about some aspects.

There are two distinct ways of interpreting the concerns expressed in this report. The first is to assume that alternative assets and their providers are mistrusted and that the industry is unlikely to sustain its strong growth trajectory.

This hypothesis, however, is likely to be wide of the mark. The more likely interpretation is that investors and investment firms alike are feeling their way in a half-formed industry. Alternative investment funds are sometimes run by traders with little prior knowledge of running businesses and it can take some time before they develop the level of infrastructure their institutional clients expect. Acquiring the skills to explain and communicate this infrastructure takes longer still.

Most firms are now aware of investors’ demands for greater transparency, but do not always respond to them, as the survey results indicate. However, this is quite possibly a failing on the part of investors, too. In a recent JP Morgan report (The Alternative Asset Survey 2007), many institutions admitted they did not have the knowledge or resources to make allocations to private equity and hedge funds. It is clear that institutional investors need to ask more and better questions of their alternative asset providers, and that investment firms need to explain themselves better to their clients.

Investment firms that can create sound and well-communicated policies are likely to succeed in this new marketplace. With outstanding systems and processes in place, they will be better placed to convince regulators and investors alike of their credibility. And with billions of new assets up for grabs in the months and years to come, credibility is paramount. □

The Economist Intelligence Unit and PricewaterhouseCoopers conducted a special online survey of senior executives from institutional investors and alternative investment providers. Over 220 executives from the Americas, Asia and Europe participated in the survey, which was conducted between December 2007 and January 2008.

Appendix: Survey results

Our thanks are due to all those who participated, for sharing their insights with us.

Please note that totals do not always add up to 100 because of rounding, or because respondents could choose more than one answer. Questions 1-17 were directed at institutional investors, question 18 was directed at alternative investment providers and questions 19-24 were directed at all respondents.

Which of the following best describes your company?

Alternative investment provider	57 %
Institutional investor	43 %
Total	100 %

1. In percentage terms, what is your approximate current allocation to the following categories of alternative assets as part of your company's overall portfolio? (Total need not equal 100%.)

	Not applicable	0-5%	10%	15%	20%	25%	30%	35%	40%	45%	50% or more
Hedge funds	15 %	40 %	9 %	9 %	11 %	2 %	1 %	4 %	1 %	0 %	7 %
Private equity	12 %	25 %	14 %	11 %	13 %	4 %	4 %	0 %	2 %	1 %	13 %
Real estate	2 %	28 %	24 %	10 %	15 %	2 %	9 %	1 %	0 %	1 %	7 %
Infrastructure	15 %	41 %	10 %	13 %	11 %	2 %	3 %	0 %	0 %	1 %	2 %
Commodities	16 %	40 %	16 %	5 %	6 %	2 %	2 %	2 %	5 %	2 %	3 %

Appendix: Survey results continued

2a. What do you consider to be the main criteria for considering a third-party provider of alternative investments?

Performance	72 %
Quality of compliance and risk management process	49 %
Transparency	46 %
Quality of reporting	33 %
Product innovation	27 %
Independence from large financial services institutions	18 %
Size	14 %

2b. What do you consider to be the main criteria for deselecting a provider?

Quality of compliance and risk management process	41 %
Transparency	41 %
Performance	40 %
Quality of reporting	39 %
Size	24 %
Independence from large financial services institutions	14 %
Product innovation	6 %

3. In general, how satisfied have you been with the performance of the following assets?

Rate 1 to 5 where 1 is very satisfied and 5 is not at all satisfied. If you do not currently have an allocation to a particular asset, please leave it blank.

	Very satisfied 1	2	3	4	Very dissatisfied 5	Total
Hedge funds	14 %	32 %	35 %	10 %	9 %	100 %
Private equity	23 %	44 %	26 %	6 %	1 %	100 %
Real estate	26 %	31 %	32 %	6 %	5 %	100 %
Infrastructure	10 %	28 %	49 %	8 %	6 %	100 %
Commodities	11 %	35 %	41 %	8 %	5 %	100 %

4. In the next three years, what change do you expect your company to make to its allocation to the following categories of alternative investment?

	Greater allocation	No change	Smaller allocation	Don't know	Total
Hedge funds	33 %	39 %	16 %	12 %	100 %
Private equity	40 %	46 %	11 %	4 %	100 %
Real estate	41 %	36 %	21 %	2 %	100 %
Infrastructure	35 %	46 %	10 %	9 %	100 %
Commodities	35 %	37 %	15 %	13 %	100 %

5. What impact do you expect recent market conditions to have on your company's alternative investments?

We expect many new opportunities	46 %
We will be more cautious in our commitment of funds	36 %
No impact	15 %
Don't know	3 %
Total	100 %

6. Which people-related issue do you consider to be the most critical in achieving your company's current business performance objectives?

Attracting and retaining talent	45 %
Leadership development	18 %
Balancing and communicating an appropriate risk culture	18 %
Performance management	11 %
Effective training and development programmes (eg, training existing staff on new products)	8 %
Other, please specify	0 %
Total	100 %

Appendix: Survey results continued

7. On average, how frequently do the managers responsible for your alternative investments provide formal reports to you?

	Daily	Weekly	Monthly	Quarterly	Occasionally	Not applicable	Total
Hedge funds	14 %	16 %	33 %	12 %	3 %	22 %	100 %
Private equity	16 %	10 %	33 %	23 %	10 %	9 %	100 %
Real estate	4 %	15 %	42 %	20 %	8 %	11 %	100 %
Infrastructure	4 %	13 %	21 %	30 %	10 %	21 %	100 %
Commodities	16 %	22 %	23 %	7 %	7 %	26 %	100 %

8. What is your view of the frequency of this communication?

	Too frequent	About right	Not frequent enough	Total
Hedge funds	11 %	66 %	23 %	100 %
Private equity	9 %	78 %	13 %	100 %
Real estate	9 %	82 %	9 %	100 %
Infrastructure	2 %	90 %	8 %	100 %
Commodities	8 %	83 %	10 %	100 %

9. How would you rate the quality of the information that the hedge funds in which you invest provide in the following areas?

	Excellent or good	Average	Poor or very poor	Don't know	Total
Investment strategy	40 %	49 %	4 %	6 %	100 %
Back-office operations	14 %	56 %	20 %	11 %	100 %
Risk and controls	33 %	47 %	12 %	8 %	100 %
Performance of funds	45 %	42 %	6 %	6 %	100 %
Composition of leadership team (general partners)	42 %	41 %	8 %	9 %	100 %
Valuation techniques	14 %	56 %	21 %	9 %	100 %
Management fee structure	20 %	58 %	18 %	5 %	100 %
Possible conflicts of interest	14 %	47 %	27 %	12 %	100 %
Leverage levels	29 %	50 %	15 %	6 %	100 %
Use of third-party administrators	15 %	54 %	15 %	15 %	100 %

10. How would you rate the quality of the information that the private equity funds in which you invest provide in the following areas?

	Excellent or good	Average	Poor or very poor	Don't know	Total
Investment strategy	48 %	43 %	5 %	4 %	100 %
Back-office operations	15 %	53 %	23 %	9 %	100 %
Risk and controls	18 %	65 %	11 %	6 %	100 %
Performance of funds	45 %	45 %	7 %	4 %	100 %
Composition of leadership team (general partners)	32 %	52 %	11 %	5 %	100 %
Valuation techniques	22 %	59 %	12 %	7 %	100 %
Management fee structure	20 %	49 %	24 %	7 %	100 %
Possible conflicts of interest	12 %	54 %	24 %	9 %	100 %
Leverage levels	15 %	52 %	19 %	14 %	100 %
Use of third-party administrators	11 %	50 %	20 %	19 %	100 %

Appendix: Survey results continued

11. How would you rate the quality of the information that the real estate funds in which you invest provide in the following areas?

	Excellent or good	Average	Poor or very poor	Don't know	Total
Investment strategy	45 %	43 %	4 %	8 %	100 %
Back-office operations	22 %	51 %	15 %	12 %	100 %
Risk and controls	24 %	50 %	16 %	9 %	100 %
Performance of funds	42 %	49 %	1 %	8 %	100 %
Composition of leadership team (general partners)	30 %	53 %	7 %	11 %	100 %
Valuation techniques	27 %	50 %	14 %	9 %	100 %
Management fee structure	22 %	55 %	12 %	11 %	100 %
Possible conflicts of interest	18 %	42 %	21 %	19 %	100 %
Leverage levels	19 %	53 %	18 %	10 %	100 %
Use of third-party administrators	16 %	49 %	14 %	21 %	100 %

12. Thinking of your company's hedge fund investments, how transparent are they in the following areas?

	Very good or good transparency	Average transparency	Poor or very poor transparency	Don't know	Total
Investment criteria	43 %	43 %	13 %	2 %	100 %
Investment risk	26 %	48 %	25 %	2 %	100 %
Deviation from investment strategy	22 %	50 %	27 %	2 %	100 %
Management fees and compensation	30 %	50 %	18 %	2 %	100 %
Valuation approaches	20 %	61 %	18 %	2 %	100 %

13. Thinking of your company's private equity investments, how transparent are they in the following areas?

	Very good or good transparency	Average transparency	Poor or very poor transparency	Don't know	Total
Investment criteria	45 %	50 %	3 %	3 %	100 %
Investment risk	29 %	63 %	5 %	3 %	100 %
Deviation from investment strategy	18 %	61 %	17 %	4 %	100 %
Management fees and compensation	21 %	60 %	13 %	5 %	100 %
Valuation approaches	26 %	53 %	17 %	4 %	100 %

14. Thinking of your company's real estate investments, how transparent are they in the following areas?

	Very good or good transparency	Average transparency	Poor or very poor transparency	Don't know	Total
Investment criteria	50 %	40 %	8 %	1 %	100 %
Investment risk	38 %	54 %	7 %	1 %	100 %
Deviation from investment strategy	21 %	60 %	15 %	4 %	100 %
Management fees and compensation	27 %	54 %	15 %	4 %	100 %
Valuation approaches	28 %	55 %	13 %	4 %	100 %

Appendix: Survey results continued

15. Thinking of your company's hedge fund investments, how effective is their risk management in the following areas?

	Very good or good	Average	Poor or very poor	Don't know	Total
IT security	15 %	50 %	16 %	19 %	100 %
Accounting and reporting of transactions	33 %	43 %	13 %	10 %	100 %
Disaster recovery	21 %	39 %	20 %	20 %	100 %
Segregation of roles and responsibilities	16 %	48 %	23 %	13 %	100 %
Valuation policies	16 %	59 %	15 %	10 %	100 %
Policies to protect against fraud, money laundering and insider trading	31 %	33 %	21 %	15 %	100 %
Formulation of formal risk management policy	21 %	57 %	11 %	10 %	100 %
Stress testing	25 %	40 %	25 %	10 %	100 %
Use of Value at Risk (VaR)	26 %	52 %	15 %	7 %	100 %
Setting and maintaining position limits	33 %	43 %	13 %	11 %	100 %

16. Thinking of your private equity investments, how effective is their risk management in the following areas?

	Very good or good	Average	Poor or very poor	Don't know	Total
IT security	25 %	43 %	11 %	21 %	100 %
Accounting and reporting of transactions	29 %	60 %	4 %	7 %	100 %
Disaster recovery	14 %	43 %	18 %	26 %	100 %
Segregation of roles and responsibilities	17 %	59 %	8 %	16 %	100 %
Valuation policies	25 %	59 %	11 %	5 %	100 %
Policies to protect against fraud, money laundering and insider trading	27 %	43 %	15 %	16 %	100 %
Formulation of formal risk management policy	24 %	50 %	16 %	9 %	100 %
Stress testing	18 %	45 %	22 %	16 %	100 %
Use of Value at Risk (VaR)	19 %	49 %	15 %	18 %	100 %
Setting and maintaining position limits	19 %	60 %	8 %	13 %	100 %

17. Have you made any change to your internal risk management framework as a result of an increased exposure to alternatives?

No	53 %
Yes	30 %
Don't know	17 %
Total	100 %

18i. Which of the following categories of alternative asset classes does your company currently manage on behalf of third parties?
Select all that apply.

Hedge funds	58 %
Private equity	46 %
Real estate	32 %
Commodities	21 %
Infrastructure	15 %

Appendix: Survey results continued

18ii. For each of the items you selected above, what proportion do retail, high-net-worth individuals (HNWIs) and institutional investors represent in your company's total investor base?

	HNWIs	Retail	Institutional
Hedge funds	27 %	13 %	60 %
Private equity	40 %	15 %	45 %
Real estate	27 %	20 %	53 %
Infrastructure	20 %	19 %	61 %
Commodities	31 %	14 %	55 %

18iii. How much of an impact have recent market conditions had on your company's asset base?

	Significantly positive	Little or no impact	Significantly negative	Total
Hedge funds	19 %	61 %	19 %	100 %
Private equity	25 %	60 %	14 %	100 %
Real estate	11 %	61 %	28 %	100 %
Infrastructure	14 %	75 %	11 %	100 %
Commodities	31 %	64 %	5 %	100 %

18iv. For the asset categories your company manages, how often does it generally report to investors?

	Daily	Weekly	Monthly	Quarterly	Occasionally	Not applicable	Total
Hedge funds	9 %	19 %	57 %	10 %	1 %	5 %	100 %
Private equity	4 %	12 %	27 %	45 %	4 %	7 %	100 %
Real estate	9 %	13 %	20 %	42 %	5 %	11 %	100 %
Infrastructure	9 %	9 %	18 %	24 %	12 %	29 %	100 %
Commodities	20 %	15 %	29 %	12 %	5 %	20 %	100 %

18v. In which of the following areas does your company provide formal reporting to clients? Select all that apply.

Performance of funds	87 %
Investment strategy	76 %
Management fee structure	49 %
Composition of leadership team (general partners)	45 %
Leverage levels	45 %
Risk and controls	44 %
Possible conflicts of interest	41 %
Valuation techniques	34 %
Back-office operations	25 %
Use of third-party administrators	34 %

18vi. In which of the following areas would you consider your organisation to be effective at managing risk? Select all that apply.

Accounting and reporting of transactions	70 %
Policies to protect against fraud, money laundering and insider trading	66 %
Valuation policies	63 %
IT security	59 %
Conflicts of interest	57 %
Segregation of roles and responsibilities	55 %
Formulation of formal risk management policy	49 %
Use of third-party administrators	47 %
Setting and maintaining position limits	45 %
Disaster recovery	45 %
Use of Value at Risk (VaR)	41 %
Sign-off on controls environment	37 %
Stress testing	36 %

Appendix: Survey results continued

19. In general, are you satisfied with the regulatory environment for the following alternative vehicles?

	Yes	No	Don't know	Total
Hedge funds	50 %	40 %	9 %	100 %
Private equity	48 %	39 %	13 %	100 %
Real estate	65 %	24 %	10 %	100 %
Infrastructure	51 %	18 %	31 %	100 %
Commodities	54 %	20 %	26 %	100 %

20. Which of the following regulatory initiatives would you most strongly support with respect to hedge funds? Please select up to three.

Guidelines on reporting to investors	43 %
Formal disclosures to regulatory bodies	36 %
Guidelines on valuation techniques	31 %
Code of ethics	31 %
Disclosure by banks of finance arrangements with hedge funds	18 %
Guidelines on leverage thresholds	17 %
Guidelines on manager compensation	11 %
Guidelines on investment fees	11 %
Recruitment of a chief compliance officer	10 %
Disclosure of derivative holdings by activist funds	8 %
Disclosure of equity holdings by activist funds	5 %

21. Which of the following regulatory initiatives would you most strongly support with respect to private equity? Please select up to three.

Guidelines on reporting to investors	39 %
Formal disclosures to regulatory bodies	32 %
Guidelines on valuation techniques	32 %
Code of ethics	25 %
Guidelines on leverage thresholds	18 %
Disclosure by banks of dealings with private equity	17 %
Guidelines on investment fees	14 %
Guidelines on manager compensation	11 %
Recruitment of a chief compliance officer	9 %

22. Which of the following regulatory initiatives would you most strongly support with respect to real estate? Please select up to three.

Guidelines on reporting to investors	40 %
Guidelines on valuation techniques	38 %
Disclosures to regulatory bodies	31 %
Code of ethics	25 %
Guidelines on investment fees	21 %
Guidelines on manager compensation	14 %
Recruitment of a chief compliance officer	11 %

23. Do you think that greater regulatory scrutiny of the following alternative investments would adversely affect performance?

	Yes	No	Don't know	Total
Hedge funds	45 %	44 %	11 %	100 %
Private equity	36 %	52 %	12 %	100 %
Real estate	26 %	58 %	16 %	100 %

24. Please indicate whether you agree or disagree with the following statements.

	Agree	Neither agree nor disagree	Disagree	Total
We would welcome greater involvement by rating agencies in rating alternative investments	46 %	24 %	30 %	100 %
We currently participate in an advisory board for some of our hedge fund and private equity investments	33 %	42 %	25 %	100 %
A lack of transparency makes it difficult to benchmark or compare performance of private equity, real estate and hedge funds	70 %	22 %	8 %	100 %
More work should be done to standardise valuation approaches	64 %	24 %	11 %	100 %
We can expect more examples of alternative fund providers seeking IPOs in the next few years	65 %	30 %	6 %	100 %
Institutional investors will benefit from the trend for alternative fund providers to seek IPOs in terms of greater levels of disclosure	60 %	33 %	7 %	100 %

Appendix: Survey results continued

In which region are you personally located?

Asia-Pacific	34 %
Western Europe	33 %
North America	18 %
Eastern Europe	8 %
Middle East and Africa	4 %
Latin America	2 %
Total	100 %

In which area of financial services do you work?

Asset management/custodian	20 %
Hedge fund	14 %
Private equity/venture capital	11 %
Investment banking	9 %
Private banking/wealth management	7 %
Investment consulting	6 %
Retail banking	5 %
Corporate banking	5 %
Broker/dealer	4 %
Pension fund trustee	4 %
Life insurance	3 %
Capital markets	3 %
Non-life insurance	2 %
Real estate/leasing	2 %
Trading	2 %
Mutual fund	1 %
Reinsurance	0 %
Stock exchange/trading system	0 %
Total	100 %

What is your title?

CEO/President/Managing Director	23 %
Manager	17 %
CFO/Treasurer/Comptroller	11 %
SVP/VP/Director	11 %
Other C-level executive	8 %
Head of department	7 %
Other, please specify	6 %
Head of business unit	6 %
Board member	5 %
CRO/Chief Risk Officer	3 %
Chief Compliance Officer	2 %
Total	100 %

What are your company's annual global revenues in US dollars?

\$500m or less	44 %
\$500m to \$1bn	19 %
\$1bn to \$5bn	14 %
\$5bn to \$10bn	6 %
\$10bn or more	17 %
Total	100 %

What are your main functional roles?

Finance	42 %
General management	34 %
Strategy and business development	28 %
Marketing and sales	19 %
Risk	18 %
Operations and production	12 %
Customer service	10 %
Information and research	8 %
Legal	5 %
IT	4 %
R&D	3 %
Human resources	3 %
Procurement	2 %
Supply-chain management	0 %
Other (please specify)	5 %

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