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Trustees learn to up their exposure

HEDGE FUNDS

In spite of fear and ignorance demand from pensions funds is growing, writes Ruth Emery

The European hedge fund industry has grown from \$64bn to more than \$450bn in just five years, according to the Alternative Investment Management Association.

It is clear some UK pension funds are slowly upping their exposure to hedge funds, or investing in them for the first time: the annual survey from the National Association of Pension Funds found 8 per cent of UK defined benefit schemes invested more in hedge funds last year than in 2005.

At a hedge funds roundtable organised by Pensions Management, the six experts agreed institutional demand was accelerating. Four of the attendees were hedge fund providers, so no surprise there, but the two consultants were also positive about future growth.

Yusuf Samad, associate in Hewitt's investment consulting practice, said: "In terms of growth it is accelerating already. In fact it is snowballing."

Des Hogan, business development manager at Liability Solutions, said: "We've definitely seen an increased acceptance of hedge funds as a way of investing for pension schemes."

In spite of the upbeat attitude at the event it was agreed that further work was needed to overcome some of the barriers that make pension schemes reluctant or nervous about using hedge funds.

Donny Hay, director of institutional business at Martin Currie, identified trustee education as the main barrier to growth in adoption of hedge funds by pension schemes. He said Warren Buffett's comment that "risk comes from not knowing what you are doing" explained how many trustees felt.

Mr Samad warned that take-up could be hindered by the "headline effect", when hedge fund losses hit the front pages of newspapers.

"In some instances, people still think of hedge funds as money run by a lone ranger who calls all the shots and makes big bets that can lose a lot of money or win a lot of money.

"This view makes them a bit wary of going into such investments. You can imagine trustees of a manufacturing company who say, 'We invested in a hedge fund that blew up,

and there's the manager, who still drives a Ferrari,'" said Mr Samad.

One issue the industry could work on was definitions, as the title "hedge funds" covers a whole range of risk returns and diversifications.

"You can go from one end of a very volatile macro fund to the other end of a very low volatility, multi-strategy fund with an enormous range of underlying managers. That's one aspect that the industry has got to work with," said Graham Martin, managing director of Optima Investment Management.

High fees are often given as a reason hedge funds may look unattractive.

Alan Brown, head of investment at Schroders, and Roger Urwin, global practice director at Watson Wyatt, have both said publicly fees are too high: they are a barrier for pension funds interested in investing and should come down.

However, the roundtable participants were not so worried about charges.

Mr Samad believed the market was responding well to the matter and was getting better at negotiating fees for institutional clients.

Mr Hogan agreed: "What we are seeing is fund of hedge funds being very willing to negotiate their fees and contractual terms,

including levels of transparency to facilitate the needs of the institutional client."

Transparency and advice are further issues that need to be tackled to help pension schemes.

But while a consultant requires transparency to give the best advice to the client, there could be problems with giving a trustee full details of a hedge fund.

Mr Hogan said he heard that one fund of hedge funds went to its 40 largest institutional clients and offered them full transparency. Four clients requested the information but the fund felt only one was able to use the data in a meaningful way.

As to giving advice, the participants concurred that consultants were under-resourced in advising schemes on hedge funds, but they expected soon to see them remedying that, going into more analysis of the products on offer, and aiding the dialogue with trustees.

As with all investments viewed as a bit new and rather risky, dialogue is important to break down barriers and boost take-up, and, Mr Samad noted, getting rid of "jargon and clutter" should strengthen the upward trend of pension funds plumping for hedge funds.

The writer is assistant editor of Pensions Management