Rating Perimeter:
Rotterdam

Robeco Asset Management

Asset Manager Rating
Previous Rating: **AM2** (Nov. 2004)
Rating Upgraded: **AM2+** (Nov. 2005)

FitchRatings
AM2+
Asset Manager Rating

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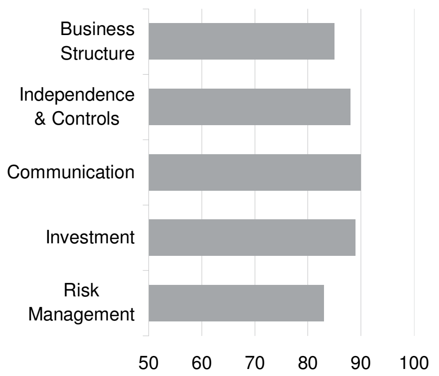
Rating Criteria



■ Summary

Fitch Ratings has upgraded the Asset Manager Rating assigned to Robeco Asset Management's ("RAM") Rotterdam-based activities to 'AM2+' from 'AM2'.

The upgrade reflects the strengthening of RAM's internal structure to ensure compliance with investment guidelines, the enhancement of equity investment decision-making processes further to the continuation of the equity team reshuffling, as well as the stabilisation of the senior management structure. The 'AM2+' rating also reflects RAM's well-established fixed income processes run by experienced investment professionals, efficient portfolio and risk management tools, extensive investment risk management culture and solid experience in managing institutional assets. It also highlights disappointing net asset inflows and that operational risk management could be strengthened further.

Initiated in 2003, the reshuffling of the equity department clarified responsibilities and introduced greater people-accountability among the core equity teams. It resulted in the creation of a European equity team and two global equity teams with distinct investment styles: Global Stability and Global Opportunity. Independent from each other, the three teams have tailored the articulation of their decision-making process according to markets covered and investment style, although underlying inputs remain unchanged. On the fixed income side, credit risk management tools have been enhanced and the duration decision-making process revisited with portfolio managers and the quantitative model now independently contributing directly to portfolio performance, within a set risk budget. Responsibilities have also been clarified for balanced strategies as staff implementing investment decisions relating to those portfolios are now part of the Asset Mix group. RAM's robust IT platform has been bolstered with the installation of Sentinel for pre- and post-trade compliance checks against investment guidelines for equity and balanced portfolios, an area where it was previously lacking. RAM has yet to strengthen operational risk management, as projects in this domain have been delayed. Second-level trade processing controls would also deserve to be formally implemented. Assets managed by RAM grew 8.7% in 2004 with net inflows of EUR1.5 billion stemming primarily from group insurance assets and institutional investors. Net asset flows in the year to end-June were disappointing.

Robeco has been managing assets for 75 years and, since 2001, has been a wholly-owned subsidiary of Rabobank, the second largest Dutch banking group. Within Robeco, RAM regroups the traditional asset management activities conducted from Rotterdam. At end-June 2005, Robeco assets under management amounted to EUR120bn, of which RAM managed 47% (EUR56bn). Based on a combination of quantitative and fundamental market analysis, RAM manages a broad array of equity, fixed income and balanced products covering global and European markets.

■ Strengths

- Robust fixed income processes run by experienced teams
- High-quality quantitative research supporting investment processes
- Strong investment risk culture
- Efficient and fully integrated portfolio and risk management systems

■ Concerns

- Operational risk management to be strengthened further
- Disappointing net asset flows
- Improving equity performances to be confirmed

Business Structure

Viability

Founded in 1929 in Rotterdam, Robeco has been managing assets for 75 years on behalf of retail clients, and has more than 30 years' experience with institutional investors. Fully independent until 1997, in 2001 it became a wholly-owned subsidiary of Rabobank, and is now positioned as the core competence centre for the group's asset management business. The group, which consists of 288 local cooperative banks, is the second largest Dutch banking group, with a substantial market share of residential mortgages and loans to the agricultural sector and small and medium-sized businesses. The bank 'AA+' Long-term rating reflects its low-risk approach, good capitalisation, well-rooted franchise in the Netherlands and international diversification. Since first acquiring a 50% stake in Robeco in 1997, Rabobank has demonstrated a strong commitment to the asset management business. Through a series of acquisitions in the US, which led in 2003 to the official creation of Robeco Investment Management ("RIM"), regrouping Boston Partners, Robeco-Sage and Weiss, Peck & Greer, Robeco's capabilities in the US have expanded rapidly. Among the seven business units of Robeco, including RIM and Robeco Alternative Investments ("RAI"), RAM regroups the traditional asset management activities conducted in Rotterdam for an institutional and retail client base.

Robeco continued to deliver strong profitability in 2004 as the collateralised debt obligations ("CDOs") activities within RAI enjoyed a further success. After reported a decline in operating revenues in 2003 due to a shift from high-margin to lower-margin products, RAM managed to reverse the trend in 2004 with a 25% rise in operating revenues. An increase in management fees on the mutual fund range, which brought them to standard industry practices, helped compensate for the lower revenue stream resulting from a less favourable asset mix. Additionally, staff cuts in 2004 led to reduced operating expenses.

At end-December 2004, Robeco was managing assets of EUR113bn globally, a 5% increase year-on-year, with net cash inflows in 2004 amounting to EUR1.1bn. US mutual funds and structured products attracted most of these new assets. Assets managed by RAM grew 8.7% in 2004 and a further 5.9% over H105, reaching EUR55.7bn at end-June. RAM's net cash flows over the 18 months though were disappointing, at EUR1.5bn. Most of the new assets stemmed from fixed income and balanced products, which more that offset the large outflows suffered on the equity side, as investors withdrew on the back of the poor performance delivered in the three years to end-2004, affecting especially the two global equity flagship funds.

The senior management structures at Robeco and RAM were simplified in 2004 and have now settled down. Appointed in September 2004, RAM's Managing Director has set a clear strategy in the continuity of what had started prior to his arrival with regard to investment team organisation as well as business development priorities. Robeco's Supervisory Board has oversight of the company's results, strategy and developments from an independent perspective as five of its seven members do not have any operational responsibilities within the Rabobank group. An Audit & Remuneration Committee made up of three supervisory directors is also in place.

Scope of Activities

Robeco offers equity, fixed income, money market and balanced products covering all major markets, with RAM managing all European and global portfolios from Rotterdam, which represented 47% of Robeco's assets under management ("AUMs") at end-June 2005. Although RAM was traditionally an equity manager, today it has a well balanced asset mix: in June 2005 equity and fixed income investments accounted for 37% and 47% respectively of total assets managed within RAM. Balanced funds have remained stable at around 13%, while guaranteed products amounted to the remaining 3%.

A large portion of RAM's clientele, 61% of AUM, is based in the Netherlands, where the company has historically retained a significant market share. Approximately half of these Dutch assets are sourced from the group insurance company. Other European countries account for the majority of the remaining 39%. Robeco has vast experience of managing assets on behalf of institutional investors, which represented 52% of AUM at end-June 2005, i.e. EUR29bn, including EUR16bn from Rabobank. To expand its business further, RAM needs to extend its scope beyond the mature Dutch market. Aware of this challenge, the asset manager wants to expand its presence elsewhere through institutional developments and strengthened relationships with third-party distributors in targeted European countries (the Benelux region, France, Switzerland and Germany).

Business Management

Robeco has had efficient and well-integrated portfolio management systems for some time. Efficient risk-monitoring tools allow detailed analysis of *ex ante* tracking-error at portfolio level. Equity and government bond portfolios are covered through the Algorithmics risk management software. On the credit side, RAM has developed a proprietary tool for high-yield portfolios that is more reactive to changes in these markets, the High Yield Risk Model ("HYRM"), which uses current spreads and interest rates to predict risks at market, sector and issuer level. Implemented in 2004 for high yield, it is in the process of being extended to investment grade credits with a view to replacing the in-house Spread Tracking-Error System ("STES"), which is still used to monitor risk in investment grade portfolios. The Long View Trading System ("LVTS") provides a robust platform for portfolio modelling as well as day-to-day position management and order processing on the equities side. For fixed income portfolios, XPO and Bloomberg POMS are used as modelling and portfolio construction/transaction management tools respectively. Portfolio positions in all these portfolio and risk management systems are automatically updated daily from the in-house administration system, Portfolio Information & Administration ("PIA"), ensuring the accuracy and consistency of data used.

Highly-integrated transaction platforms ensure full straight through processing ("STP") as LVTS and Bloomberg POMS facilitate electronic order management for equity and fixed income portfolios respectively. 80% of trades are automatically matched within Oasys Global and all transaction details are then sent to fund administrators and custodians via Swift.

Robeco employed an average of 1,539 staff in 2004 between its various offices in Europe and the US, the vast majority (64%) being based in the Netherlands. RAM groups 380 staff, of which around 100 were investment professionals, including portfolio managers, research analysts, quantitative analysts and traders. The staff reorganisation and cultural shift initiated in 2003 within the equities department resulted in some staff turnover. The institutional sales team covering the Dutch and Nordic markets has been rebuilt in 2005 further to staff resignations over the previous years, but has yet to strengthen its presence in the market. In contrast, commercial forces deployed elsewhere in Europe to target both institutional investors and distributor platforms have continued to expand.

Following preliminary approval from the Risk Management department based on creditworthiness, financial intermediaries are selected and reviewed by portfolio managers and traders at least on an annual basis according to their performance and ability to provide high-quality services.

Independence and Controls

Independence

Until 1997, Robeco was an independent asset manager and has maintained its autonomy from the Rabobank group, minimising the risk of conflicts of interest. Robeco relies on its own investment research resources, portfolio management systems, fund administration tools and control structure. The volume of trades placed with group affiliate financial intermediaries represents a marginal portion of total volumes both for equity and fixed income orders. Robeco directly employs the sales staff and client relationship managers responsible for institutional investor relationships as well as management of retail development. While distribution of mutual funds to retail clients is supported by Rabobank's solid network in the Netherlands, Robeco has developed external partnerships in other European markets. Additionally, cross-selling activities between European and US offices are already attracting new assets. The custody of assets is totally independent of the Rabobank group, and the Swift platform allows the asset manager to establish an STP connection with any third-party custodian. With the exception of the Luxemburg fund range, for which administration has been outsourced to Dexia since 2003, all other products are administered through Robeco's back-office.

Controls

Control functions within Robeco are the responsibility of three teams, all independent of operational functions: Compliance, Risk Management and Internal Audit. Formal annual plans define the controls enforced by the three. At the RAM level, the Risk Management Committee, grouping the CFO, the two CIOs and the heads of Account Management, Risk Management, Compliance and Audit, meets bi-monthly to ensure consistency of risk management within the organisation and that all risks are identified and monitored.

The Compliance team is in charge of ethical issues and adherence to investment constraints. It has been strengthened in 2005 with the creation of a local compliance team of four within RAM itself, reporting to the central compliance group who coordinates and oversees local officers based within the various business units. The RAM-dedicated local team has been managing the implementation of the Sentinel application for pre- and post-trade compliance management. It also assumes responsibility for the coding and day-to-day monitoring of compliance with investment restrictions. These additional resources and new organisation structures provide greater security to managing investment constraints, which had relied heavily on portfolio managers themselves. Staff integrity rules and principles are made available on-line to employees through the regularly-updated internal code of conduct, and are subject to thorough controls by the compliance team, which checks personal trading activities on a monthly basis. Assets managed for the group are subject to the same efficient and secured systems as any third-party assets but are not subject to specific controls.

The Risk Management team is made up of eight staff reporting to the CFO, with responsibilities covering market, counterparty and operational risks for Robeco. As RAM adopted early a risk-budgeting approach based on multi-level analysis of *ex ante* tracking-error to manage and monitor market risk at portfolio level, the asset manager has developed a solid structure involving both portfolio and risk managers. The latter approve risk limits, measure risk exposure and report back weekly.

Additionally, the Internal Audit team, reporting directly to Robeco's CEO, acts as an independent monitor of third-level controls.

Together with the Internal Audit department, Robeco's Risk Management group participates in group operational risk monitoring efforts to comply with Basel II requirements. Rabobank has opted for the Standardised Approach, although the Advanced Measurement Approach may be used internally. RAM's operational risk management projects initiated in this context have been delayed in 2005, postponing until 2006 the finalisation of top-down and bottom-up risk assessment exercises. Once completed, these should provide control functions with a solid basis for enhancing their current risk-mapping and control plans, which are not particularly detailed at this stage. Despite this delay, the Risk Management team already reports on the group generic key risk indicators as well as on several RAM-specific indicators and an incident database has been maintained since 1999 within RAM.

Since January 2004, RAM has engaged in active proxy voting, gradually expanding coverage through time. At end-June 2005, assets covered reached EUR16bn, i.e. 80% of total equity assets, from EUR10bn a year before. This rapid policy change has been achieved through the development of a formal system involving custodians, responsible for communicating portfolio holdings, Institutional Shareholder Services ("ISS"), which provides information on forthcoming shareholder meetings as well as their voting advice, and finally Robeco's Corporate Governance team, which exercises the votes through an ISS web-based application in line with the asset manager's internal principles and advice received. In addition to the efficiency of this new process, Fitch noted Robeco's efforts to make voting activities transparent to investors through the publication of quarterly reports.

■ Communication

Products and Services

Account managers, the primary point of contact for investors, liaise with the investment departments with a view to freeing up portfolio managers' time to concentrate on investing. Upon receipt of new mandates or client requests, the Compliance team coordinates the 'client routing' process, which involves Account Management, Legal, Accounting and the Investment department to ensure that all instructions can be met. The Compliance department is also responsible for keeping contractual information up to date in the client database, Siebel, which makes all client-related information available to every interested party within RAM, including portfolio managers. This aids client awareness at all levels of the organisation. A dedicated team handles answers to RFPs through an efficient proprietary system, which facilitates the delivery of consistent, timely and focused answers.

Reporting

Institutional clients are provided with monthly accounting and quarterly performance reports showing detailed information on the investment strategy followed as well as impact on relative performance. A dedicated team calculates performance attributions on every portfolio for inclusion in reporting documents. The analysis provided on fixed income portfolios could go down to finer granularity level, as is already done for internal purposes. Risk indicators such as volatility and tracking-error are included in standard reports. More detailed risk analyses breaking down tracking-error or value-at-risk ("VaR"), such as those already used internally, are provided on a regular basis to those few clients who requested it. Reporting transparency could be enhanced if this were more often added to reports. For efficiency reasons, reports are as standardised as possible, and Robeco can also provide clients with more tailor-made documents. Automation of production of these quarterly reports could be increased to maximise information accuracy and delivery timeframe. With regard to RAM's mutual funds, a monthly factsheet gives valuable information on fund performance, allocation, benchmark, major positions and risk indicators. The Institute for Research and Investment Services, a joint-venture between Robeco and Rabobank, produces these monthly factsheets through a highly automated process. At end-2004, RAM was certified GIPS-compliant.

Investment

Investment Process

Based on a combination of quantitative and fundamental analysis, RAM's investment decision-making processes are disciplined, structured and integrate risk management.

Equity portfolios are actively managed through a bottom-up investment approach that combines fundamental research analysis and quantitative indicators provided by the proprietary multi-factor model. Further to changes initiated in 2003, the process has been revisited, increasing the focus and accountability of every investment professional to tackle disappointing performance on the equity side. As a result, the core equity team has been reorganised along three sub-teams. The first covers European equities while the other two manage global equities according to two distinct investment strategies: Global Stability, with a relatively low risk profile and no style bias; and Global Opportunity, which is a more aggressive process with larger portfolio tracking errors and managed with a growth style. Independent from each other, the three sub-teams have tailored the articulation of their decision-making processes according to markets covered and investment style. In this evolving environment, underlying inputs have, nevertheless, remained unchanged, namely fundamental analysis, the Robeco valuation tool and the proprietary quantitative multi-factor model, which help capture short-term market deviations according to value, momentum, earnings revisions and management quality parameters. The global sector team, renamed the Alpha Group, is now more focused on managing Robeco's global sector funds. The specialist equity teams and processes, which include disciplined equity (i.e. enhanced indexing), managed according to a purely quantitative process, European small and mid-cap and emerging markets, have been more stable. Further to this reshuffling of the equity department, Fitch will be attentive to the results that will be delivered.

Efficient and well structured, the fixed income investment processes are run by a stable team of experienced investment professionals. They are driven by fundamental and quantitative analysis, with government bond portfolios following a top-down approach while credit portfolios combine a top-down and bottom-up approach. Within the fixed income department, the duration team, made up of four portfolio managers/analysts, researches the government bond market and constructs model portfolios for duration, yield curve and country positions in the form of 'preferred bond lists'. The duration decision-making process has been revisited with the proprietary duration quantitative model, which has always been a key input, and portfolio managers now both contributing directly to portfolio performance, independently from each other, within a set risk budget. This gives more flexibility to portfolio managers and allows RAM to make greater use of the bets identified by the model. Yield curve positioning is primarily managed through futures as an overlay to duration decisions, and also benefits also from inputs of a quantitative model, but to a lesser extent than on the duration side. The credit team, a group of 12 portfolio managers/analysts, is responsible for the construction of credit model portfolios as well as the analysis of investment-grade and high-yield markets on the basis of bottom-up issuer selection, quantitative analysis through a proprietary credit model, CoALA, and a top-down view. The latter serves as the basis for the management of the overall market exposure, which is being more actively managed as an overlay through index or single name credit default swaps. To enhance the coverage of their universe, high yield portfolio managers/analysts are now focusing on the 50 most liquid names, while the remainder are covered purely quantitatively with CoALA. For all fixed income products, the portfolio engineering and trading team ensures automated implementation of investment decisions within all portfolios.

The management of balanced strategies has been fully centralised within the Asset Mix group, which implements asset allocation decisions set by the Asset Mix committee. This committee groups the equity and fixed income CIOs together with Asset Mix team head, who provides a top-down view.

The move in 2004 of US products previously managed by RAM to RIM has opened the door to co-operation between the Dutch and US teams, although interactions on research or investment management remain limited at this stage.

Measuring Efficiency

Performance attribution for all portfolios is calculated monthly by the performance measurement team, independently of the investment department, based on a proprietary tool, which uses a defined methodology for each asset class. In addition, the performance team reports on a quarterly basis to Robeco's Executive Board on all portfolios. Although portfolio managers do not have direct access to the performance attribution system they monitor the performance of their portfolios and key contributors through the various portfolio management systems intra-monthly. The performance of equity analysts' recommendations is directly measurable through the sector funds they manage, while that of the quantitative models supporting equity and fixed income investment decision-making processes is regularly assessed by Quantitative Strategies, the quantitative research department. Recently refined, the credit model is based on three equally-weighted factors: equity momentum, spread and balance sheet ratios, which replace the earning revisions factor previously used. This adjustment resulted in enhanced model performance and declining portfolio turnover.

The performance of equity portfolios has improved over the past year with positive relative returns, the exception being European large cap equities as well as European small and mid-caps. Equities are, however, still underperforming over three and five years. Negative duration effects in 2005 so far have dampened the year-to-date performance of euro fixed income portfolios but their long-term track record remains ahead of benchmark. Global bond portfolios are still outperforming their benchmarks over the one and five-year periods.

Investment Constraints & Risk Indicators

RAM's preferred indicator is *ex ante* tracking-error, although VaR is used when deemed more appropriate. Each fund and mandate is assigned a general tracking-error (or VaR), which is then defined further within portfolios at asset, region, sector, duration, term structure, spread or currency levels, depending on the strategy. External and internal limits are assigned based on comparable portfolios, expected and simulated information ratios as well as client risk appetite. The Algorithmics Risk Portal provides an efficient support mechanism to this process for balanced, equity and government bond products and allows users to run scenario analysis. Proprietary risk systems are used for investment grade and high yield credits, offering better response time to volatility within these markets. As investment staff have direct access to these systems, each portfolio bucket is managed according to its allocated risk budget under the oversight of the risk management department, which monitors and reports on a weekly basis the *ex ante* risk versus the relevant limits to both the portfolio managers and the RAM risk management committee for all portfolios. In addition, *ex post* tracking-error and information ratios are compared to *ex ante* risk, both at overall portfolio level and for each sub-part. This process ensures adherence to client risk constraints and is also an efficient internal tool for monitoring consistency across portfolios. RAM has proved its ability to tailor implementation of its investment process according to client guidelines.

Trading

Dedicated trading desks are in charge of order execution. All equity orders are centralised by a team of four traders focusing on orders where they can really add value, i.e. less liquid stocks and reasonably large trades. This implies automating trade execution whenever possible. RAM is therefore segmenting its equity orders to increasingly use electronic trading facilities and program trades. This approach, combined with a quarterly post-trade analysis based on a Plexus benchmark, provides RAM with an efficient equity trade execution environment. On the fixed income side, the portfolio engineering and trading team executes orders on the basis of model portfolios for credit and 'preferred bond lists' for government bonds. The team selects the most appropriate securities based on relative value and liquidity analysis out of these lists. Market prices are compared through Reuters, Bloomberg or an electronic trading platform, such as Tradeweb, and several counterparties are placed in competition whenever possible.

■ Risk Management

Internal Controls

Tools supporting the investment decision-making process have either been set up internally by a dedicated team of developers or acquired from software providers. In any case, tools are tested before implementation and all are subject to regular reviews for performance issues. As part of the group-wide Business Continuity Plan ("BCP"), RAM has implemented adequate measures to guarantee the continuity of services provided to clients under the supervision of a dedicated Business Continuity Manager. Critical applications are backed up at an external site, where physical relocation is possible, resulting in the restoration of critical systems within 24 hours.

Compliance with authorised brokers and counterparties is enforced through the portfolio administration system, PIA, which prevents settlements of any trade with unauthorised financial intermediaries. The lists of authorised financial intermediaries are also coded within the portfolio management systems, Landmark and Bloomberg POMS. The risks associated with trade processing are limited thanks to the dedicated trading desks in place and solid portfolio management systems where trades have to be pre-allocated. Fitch regrets, however, that no second-level controls are in place to monitor fair allocation of orders *a posteriori*, portfolio turnover or treatment of exceptional orders. Information flows with all custodians are highly integrated, allowing automated cash and stock reconciliations.

Controls on External Service Providers

Volumes and commissions per broker on the equity side are formally monitored on a monthly basis by the trading desk according to the target allocation, which is reviewed at least annually and according to the quality of services provided. Control of broker allocations could be strengthened on the fixed income side, where the link between volumes traded and the counterparty evaluation process is less formal given that RAM does not define target allocations for fixed income orders. Service Level Agreements provide a formal framework to relationships with custodians, except for those that are client-directed. In all cases, service quality is closely followed by a dedicated staff member through quarterly key performance indicators and formal reviews at least twice a year, from which a custodian ranking is produced. Regardless of whether the NAV calculations are produced internally or externally, they are systematically checked by a dedicated team as well as portfolio managers.

Compliance with Investment Constraints

RAM has recently strengthened its internal structure ensuring compliance with investment guidelines through the creation of a local compliance team of four focusing on this and the implementation of the Sentinel application. Integrated with the order management system and PIA, Sentinel allows automated pre- and post-trade compliance checks for equities, an area where it was previously lacking. Balanced portfolios should also soon be covered by Sentinel, once further adjustments have been made to feed the system with all information relating to these portfolios. On the fixed income side, Bloomberg POMS still automatically checks most constraints (80%) on a pre-trade basis, but has been replaced by Sentinel for all post-trade compliance monitoring as the latter offers enhanced flexibility and coverage.

Market Risk Monitoring

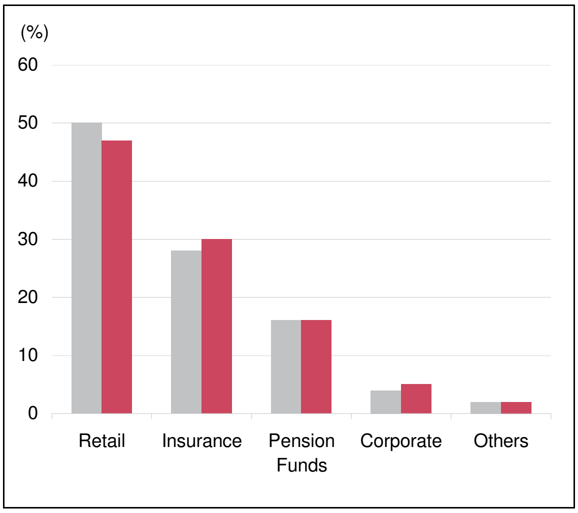
Currency exposures are managed as an overlay throughout RAM within the same risk-monitoring framework as other asset classes. The Currency committee, chaired by the fixed income CIO, constructs a currency model portfolio based on the recommendations of Robeco’s treasury team. Portfolio managers are then responsible for implementation, which is primarily through forward currency contracts. Cash management is centralised within Robeco’s treasury department in collaboration with portfolio managers. The use of derivative instruments across RAM has recently been extended to credit default swaps beyond futures and currency forwards, which were already commonly used. To properly cover these instruments, RAM implemented the required enhancements to its risk monitoring tools. Although market risk is monitored closely at portfolio level, this is currently not computed on an aggregate basis; however, the systems in place can easily provide this information. Counterparty risk is controlled by the Risk Management team at portfolio level based on a proprietary system directly interfaced with PIA, while internal guidelines coded within Bloomberg restrict credit risk within portfolios. Liquidity risk is monitored for fixed income positions through Bloomberg as well by limiting the maximum position allowed in one issue across all portfolios to 15%. In contrast, liquidity risk for equities is not subject to any monitoring.

ASSETS BREAKDOWN

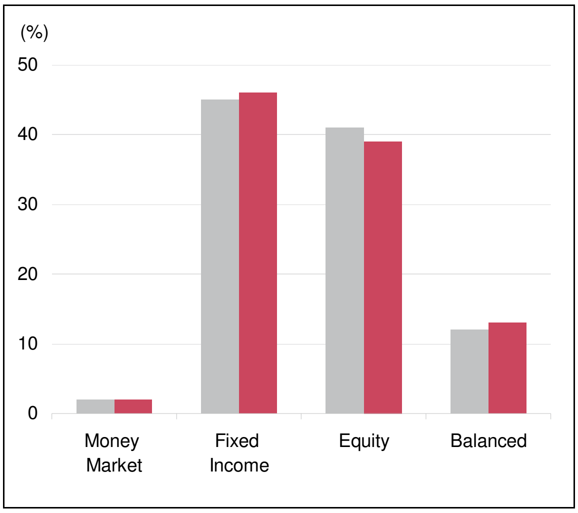
RAM's assets under management, at 31 December 2004: EUR52.6bn
(versus EUR48.4bn at 31 December 2003)

■ 31 Dec 2003 ■ 31 Dec 2004

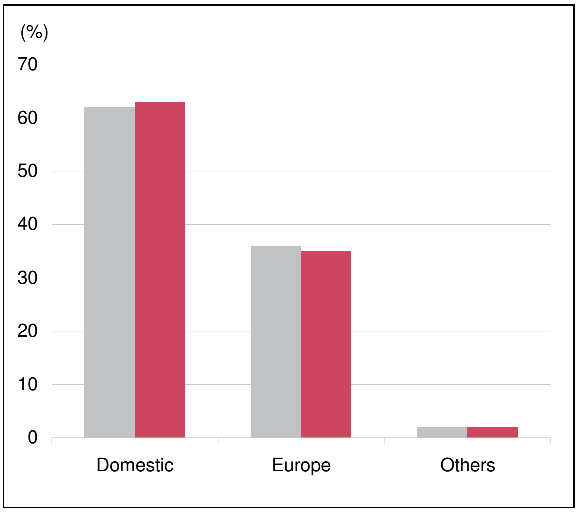
Breakdown of Assets Under Management by Type of Client



Breakdown of Assets Under Management by Asset Class



Breakdown of Assets Under Management by Location of Investment



Breakdown of Assets Under Management by Investment Vehicle