Asset Management in the UK 2012–2013

The IMA Annual Survey

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About the Survey

The survey captures asset management activity in the UK undertaken on behalf of domestic and overseas clients. It is based on the results of questionnaire responses from 72 IMA member firms, who between them manage £3.9trn in this country (82% of total UK assets under management by the entire IMA membership base).

We also conducted in-depth interviews with 27 senior figures from 21 IMA member firms. Their views are reflected both in the commentary and in the direct quotations, reproduced on an anonymous basis.

The survey is in six chapters:

1. **Industry Overview**
2. **Serving Client Needs**
3. **UK Institutional Market**
4. **UK Fund Market**
5. **International Dimension**
6. **Operational and Structural Issues**

A summary of the results can be found in Appendices 1-3. Appendix 4 provides definitions for the categories most frequently used in the report. Appendix 5 lists the firms that responded to the questionnaire and Appendix 6 provides the names of firms whose senior managers participated in the interviews.

A number of general points should be noted:

- Unless otherwise specified, all references to 'UK assets under management' refer to assets, wherever domiciled, where the day-to-day management is undertaken in-house by individuals based in the UK. The asset value is stated as at December 2012. For a more detailed explanation of the term please refer to Appendix Four.
- Unless otherwise specified, the IMA survey questionnaire results and internal databases are the source of all data cited.
- Not all respondents were able to provide a response to all questions and response samples, therefore, differ across questions.
- The survey has been designed with comparability to previous years in mind. However, even where firms replied in both years, some may have responded to a question in one year but not in the other or vice versa. Where meaningful comparisons were possible, they have been made.
- Due to rounding, numbers presented throughout this document may not add up precisely to the totals provided and percentages may not precisely reflect the absolute figure.

The IMA would like to express its gratitude to the member firms who provided detailed questionnaire information, as well as to the individuals who gave their time for interviews.

Survey Foreword

Daniel Godfrey
Chief Executive

The IMA asset management survey is now in its eleventh year, and the headline figures for 2012 tell a good story. The UK continues to be the second largest centre for asset management in the world, with a breadth and depth of expertise that are the envy of rival financial centres globally. While the majority of activity is concentrated in London, Scotland continues to be a significant regional hub.

It is not just overall assets under management that are at record levels. Funds under management – the bellwether of the UK retail market – are also at historic highs. While sales rates have fallen back from the exceptional period of 2009-2010, the past year saw robust retail sales, notably relative to pre-2008 experience.

The industry, however, is not and should not be complacent. Apart from the sheer speed, scale and geographical reach of regulatory change, firms face a range of other, equally pressing, issues. In this year's survey, we decided to look more specifically at changing client needs and the challenge of how managers can communicate more clearly how they operate on clients' behalf. It is interesting to see how strongly the emphasis on building client trust is reflected in the views of key industry figures with whom we spoke this year. This is consistent with the range of initiatives the IMA is undertaking to try to tackle this issue, including new proposals on the explanation of charges and costs.

There is a lot at stake, particularly as automatic enrolment in the United Kingdom starts to bring millions of new participants into a long-term investment process. The survey shows how a combination of factors is prompting asset managers to think differently about product delivery, particularly in terms of a focus on more solutions or outcome-based objectives.

If this shift turns out to be permanent rather than cyclical, as many firms believe it will, expectations of the industry are likely to evolve further. But whether firms are delivering components or solutions, or both, clients need every confidence that this is an industry that is fully transparent and has their interests at the heart of its operations.

I hope you find the report interesting reading.

Daniel Godfrey
Chief Executive

Key Statistics

£4.5trn

[£4.2trn in 2011]

Total assets managed in the UK by IMA member firms as at December 2012

£660bn

[£577bn in 2011]

Managed in UK authorised funds (OEICs and unit trusts)

£1.8trn

[£1.6trn in 2011]

Assets managed in the UK on behalf of overseas clients

£721bn

[£703bn in 2011]

UK-managed funds domiciled overseas

£2.5trn

[£2.4trn in 2011]

Assets managed worldwide on behalf of UK institutional clients

£13bn

[£12bn in 2011]

Revenue earned by UK-based asset management firms

Survey Summary

- UK assets under management and funds under management are at record levels, and the UK retains its position as the second largest asset management centre in the world after the US. This is seen in both the scale of the asset base and the breadth of activity.

- Institutional and retail asset allocation is characterised by increasing diversification, both in asset class and geographic terms, and a continuing move away from the equity-dominated culture of the 1990s. IMA fund flow analysis shows retail investors strongly focused on a set of objectives relating to income, capital preservation and asset allocation.

- The industry remains comparatively unconcentrated, with the top ten firms managing 54% of total assets and a long tail of smaller asset management firms. Investment fund flows are showing signs of greater concentration at the level of the top 100 funds.

- Overseas clients account for 40% of total assets under management, and a significant part of the asset base (£721bn) is managed on behalf of overseas-domiciled funds. In a comparative EU perspective, the UK is fifth in the fund domicile league table, accounting for 11% of total funds under management.

- The predominant industry theme remains one of **seeking better to serve specific client objectives**. Client needs are changing due to a combination of factors including recent financial market conditions, regulation and accounting rules, and the evolution of the pension delivery architecture internationally.

- A **greater focus on investor trust** is evident across the industry, and firms report significant efforts to change the nature of their interaction with end-investors, both in the institutional and retail space. Much of this is about communication and has multiple levels from better disclosure to a more innovative use of media channels.

- There is **increasing interest in the long-term finance debate**, with firms generally positive about the opportunities arising from investors, asset managers and Government working together in areas such as infrastructure. However, there is considerable caution about some of the ramifications, particularly any political pressure to influence the direction of investment flows.

- Adaptation to **regulatory change presents an ongoing challenge**. In the context of the UK's Retail Distribution Review, firms are concerned about the implications of less accessible advice, both for overall saving behaviour and for product development for an unadvised market. In particular, they wish for greater clarity about regulatory expectations in the area of product suitability.

1 Industry Overview

Key Findings

1

Industry size

- As at December 2012, IMA members managed a total of £4.5trn assets in the UK; an increase of around £300bn on a headline and 7.9% on a matched basis.
- This represents an estimated 85% of the £5.2trn in total assets managed by the wider UK asset management industry. The remainder is accounted for by niche players and a minority of traditional long-only firms outside IMA membership.

Management location

- As in previous years, asset management activity continued to be concentrated in London. However, 11% or nearly £500bn of total assets was managed in Scotland.

Client type

- There was little change year-on-year in the composition of client types, with institutional clients accounting for 81% of total UK assets under management. Retail and private clients represented 17% and 1.6%, respectively.
- Pension funds, as the largest client type (38%), continued their long-term increase relative to other client types. Insurance companies (22%) are the second largest client group.

Asset allocation

- Of the £4.5trn in assets managed in the UK, the largest proportion was invested in equities (42%), followed by fixed income (37%), cash/money market funds (7.0%) and property (2.7%). The 'Other' category continued to grow (11%), and included primarily a range of alternative asset classes and structured solutions.
- UK equity holdings decreased to their lowest proportion seen in the survey, accounting for 33% of total equities managed in the UK (30% of total domestic market capitalisation). European and emerging market equities represented 22% and 14% of the total, respectively. The remaining 31% consisted of a number of smaller geographic locations.
- The largest fixed income category was '£ Sterling Corporate' (26%). Together with gilts (18%), index-linked gilts (16%) and other UK bonds (3%) it accounted for 63% of total fixed income holdings.

Type of management

- Segregated mandates decreased to 52% of total assets; only marginally bigger than pooled assets with 48%.
- Passively managed assets remained at 22% of the total.

1 Industry Overview

The UK continues to be the second largest asset management centre in the world after the US. While industry activity is largely concentrated in London, there is also a significant Scottish cluster. The industry provides a wide range of services to the full client spectrum from both the UK and abroad. Figure 1 provides a broad overview of the IMA membership base.

Figure 1: IMA member characteristics

IMA members fall into five general categories:

1. **Asset managers with a large global asset and client base.** These firms undertake a wide range of asset management activities across the institutional and retail market in the UK and abroad. They also tend to manage substantial amounts of overseas client assets in the UK.
2. **Large and medium-sized firms**, which offer a diverse range of services but are primarily UK- and/or Europe-focused at client level.
3. **Fund managers**, whose business is based primarily on investment funds.
4. **Specialist boutiques and private client managers** with a smaller asset base and typically a specific investment and/or client focus.
5. **Occupational pension scheme (OPS) managers** running in-house asset management operations.

The survey focuses on this diverse client spectrum from a number of angles, among others the two broad ways in which investment services are provided: pooled vehicles, which combine assets from different investors, and segregated mandates, where the client's assets are managed separately. 'UK assets under management'[1] is used as a 'catch-all' term covering all forms of asset management activity, including funds and segregated mandates. This term comprises both in-house and third party client business.

The pooled vehicles include:

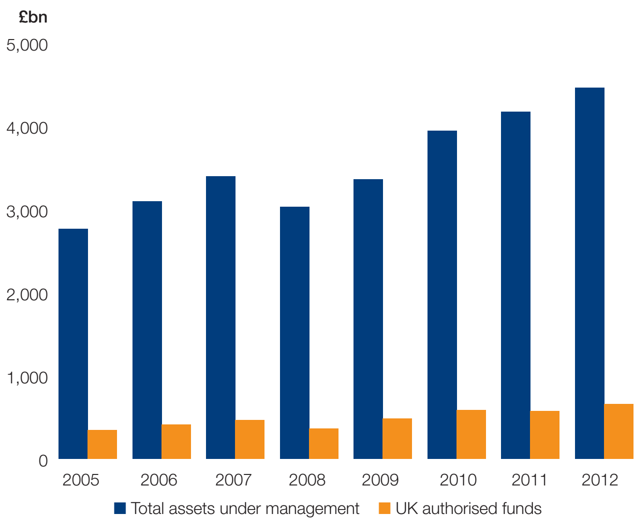
- Authorised unit trusts.
- Open-ended investment companies (OEICs).
- Unauthorised investment vehicles (eg. unauthorised unit trusts).
- Life funds.

'UK authorised funds', in contrast, is used specifically for UK OEICs and authorised unit trusts, which in aggregate are also referred to as the 'fund industry'.

Total Assets under Management

Looking at the entire range of discretionary asset management in the UK, IMA members had a total of £4.5trn in UK-managed assets at the end of 2012. Chart 1 illustrates the development of assets and funds under management over the seven-year period since December 2005.

Chart 1: Total assets under management in the UK and in UK authorised funds (2005–2012)



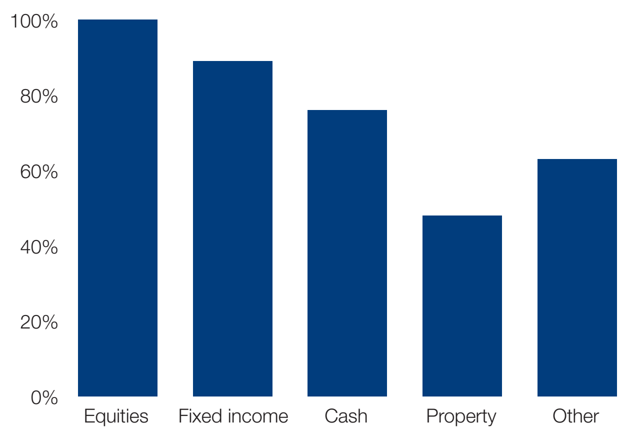
[1] Defined as assets where the day-to-day management is undertaken by managers within the firm and based in the UK. For a more detailed definition please refer to Appendix Four.

In the 12 months to December 2012, assets under management increased 7.9% year-on-year. This brings the asset base managed by IMA members to a new record high, with a 7.1% annual rate of growth experienced since 2005. The growth has primarily been driven by a combination of net flows, market movements and, to a smaller extent, increases in the IMA membership base.[2]

UK authorised funds under management, which continue to represent around 15% of the total UK asset base managed by IMA members, grew to £660bn at the end of 2012, 14% year-on-year. This exceeded the annual average growth rate between 2005 and 2012 (9.6%), and represents a particularly strong showing after the 2% fall between 2010 and 2011. This and other developments in the UK fund industry will be elaborated on in greater detail in Chapter Four.

Although our membership comprises firms from the entire spectrum of asset management activity, investments are predominantly in the more mainstream asset classes. As seen in Chart 2, all our respondents managed equities and nearly 90% invested in fixed income assets. Around three-quarters of our respondents held cash assets and nearly one-half invested in property assets. A growing proportion of firms have holdings in the 'Other' category, which includes both alternatives and structured solutions.

Chart 2: Proportion of respondents managing different asset classes in the UK



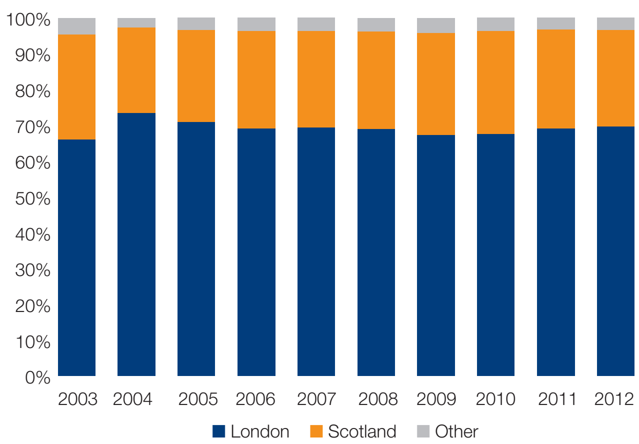
Scottish business

In recent years, we have developed estimates of total assets managed in Scotland, which represents a significant sub-cluster of the UK asset management industry. These suggest that Scottish assets under management represent 10-15% of the total. Our latest estimate of £494bn, 11% of the total, represents a fall in relative rather than absolute terms and may be attributed to faster growth elsewhere in the UK.

When looking at UK assets under management in terms of the location of company headquarters, rather than the location of asset management, the proportion of assets represented by Scottish firms increases to 26% of that managed by UK-headquartered firms (see Chart 3 and Chart 72 on p.80). This higher figure, equating to £520bn, is explained by the fact that the location of company headquarters and the location of asset managers is often not the same, and Scottish firms undertake asset management in the City of London just as London-based investment houses manage part of their client assets in Scotland.

As can be seen from the chart, there has been little change in the relative market share of regional headquarters over the past decade, with the majority (65-75%) still represented by London-based groups.

Chart 3: UK-managed assets by UK regional headquarters (2003–2012)



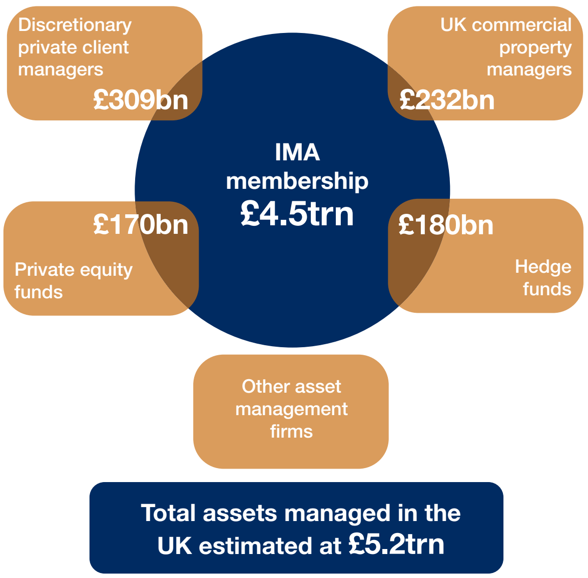
[2] We do not collect fund data at a level of granularity that would allow us to distinguish between the impact of flows and market movements. Flow is driven by client decisions, and changes in business organisation (ie. decisions as to where the money is actually managed) by the many global firms operating in the UK.

Wider industry

The wider UK asset management industry stood at an estimated £5.2trn as at the end of 2012, of which around 85% was represented by IMA member firms. The wider industry consists primarily of mainstream investment, estimated at £4.3trn, where IMA members represent the overwhelming majority. The remainder, nearly £900bn, can be broadly categorised into the following (see Figure 2):

- Hedge funds.
- Private equity funds.
- Commercial property management.
- Discretionary private client management.

Figure 2: Wider UK asset management industry



Source: BVCA, ComPeer, HedgeFund Intelligence/EuroHedge, IMA, IPD

There is a great deal of overlap between the mainstream industry and the more niche areas of asset management, and it is therefore unsurprising that IMA members manage an estimated £250bn in the latter types of activities:

- As at the end of 2012, our respondents managed nearly £35bn in hedge funds which, albeit a slight decrease on the year before (2011: £40bn), represents 18% of the estimated UK total of £180bn.[3]
- IMA firms managed a quarter of UK discretionary private client assets.[4]
- While there is a significant specialist commercial property management sector, our respondents account for over one-half (52%) of the value of UK investible commercial property (including directly held property).[5]

[3] Source: HedgeFund Intelligence/EuroHedge.
[4] Source: ComPeer.
[5] Source: IPD.

Client Type

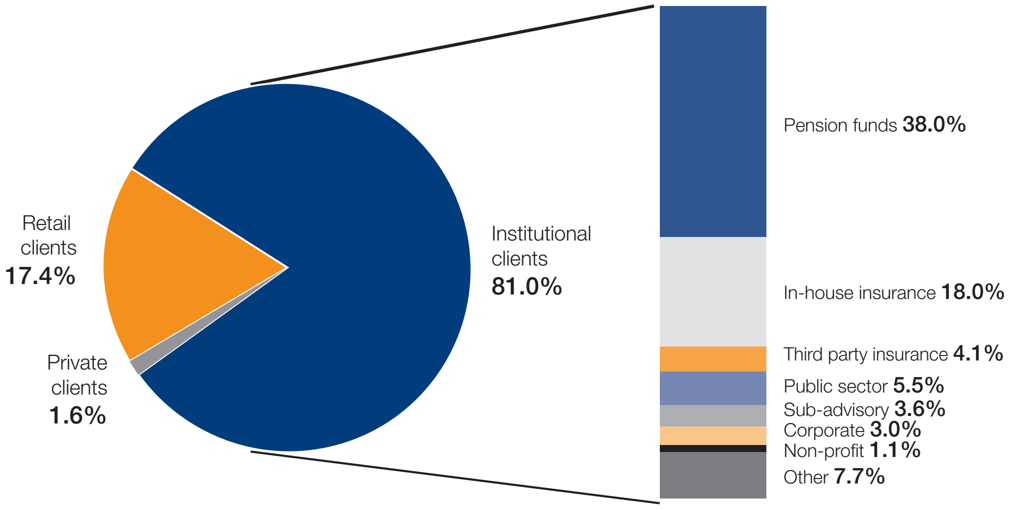
As reported in previous years, changes in the relative size of client types have taken place at a slower rate than changes in other areas. Chart 4 shows that the vast majority of UK assets under management (81%) continues to be managed on behalf of institutional clients, both UK and overseas. Assets managed on behalf of UK and overseas retail clients stood at 17% (2011: 18%).

While the overall picture appears static, a closer look at the institutional category reveals some changes. In particular, insurance companies saw a decrease in assets to 22% (2011: 24%). In-house insurance assets represented 18% of the total and, on a matched basis, also largely accounted for the decrease.[6]

Other institutional client types from the public sector (5.5%), sub-advisory business (3.6%), corporate or non-profit areas (3.0% and 1.1%, respectively) have experienced little change year-on-year. The 'Other client' category continued to increase and at end-2012 stood at 7.7% (2011: 6.0%). As in previous years, this category has increasingly been populated by different types of pooled vehicles, such as investment trusts and commingled funds, where it was not possible to identify the underlying client type.

Private client assets accounted for 1.6% of the total. This category continues to capture only those parts of the private client market where IMA members provide specific private client investment services. Overall UK-managed discretionary private client assets are about four times the size at £309bn (see p.14).[7]

Chart 4: Assets managed in the UK by client type



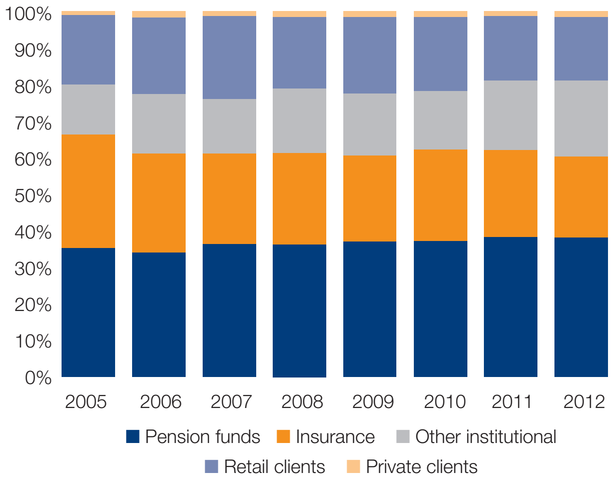
[6] The survey somewhat overstates the size of in-house insurance assets as a result of the presence of a large number of insurance-owned firms in the sample. The actual size of the in-house insurance space is therefore likely to be smaller and direct extrapolations of its size should be undertaken with caution. Sample-adjusted estimates suggest that total insurance assets are closer to 20%.

[7] Source: ComPeer.

Historic evolution

Chart 5 shows the evolution of different client types since 2005 on a headline basis. Over the seven-year period to 2012, pension funds continued to increase in significance, reflective of an average annual growth rate of 8.2%.

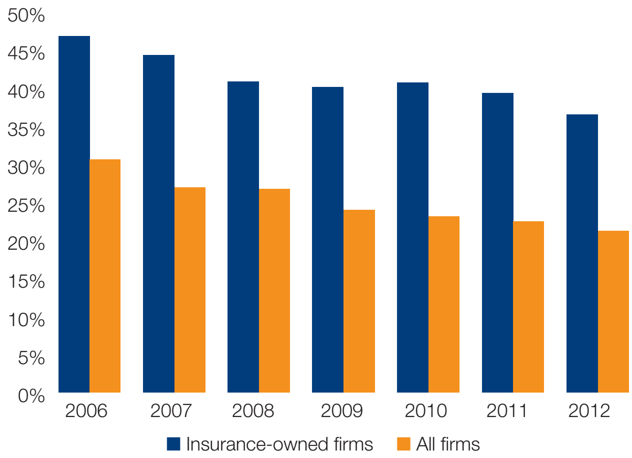
Chart 5: Assets managed in the UK by client type (2005–2012)



Insurance assets, in contrast, grew by only 2.1% annually. As a proportion of UK assets under management, they decreased from 31% in 2005 to 22% in 2012, as other parts of the client base have grown more quickly.

Chart 6 reflects this decrease also across a matched sample of insurance-owned firms, which saw insurance client assets fall by nearly a quarter, from 47% in 2006 to 37%. Albeit uneven across the sector, the change here reflects an evolution in the business development of in-house insurance asset managers, where a number of firms have been relying less on in-house flows for growth strategies, looking instead to external clients.

Chart 6: Insurance assets as proportion of total assets under management by firm type (2006–2012)



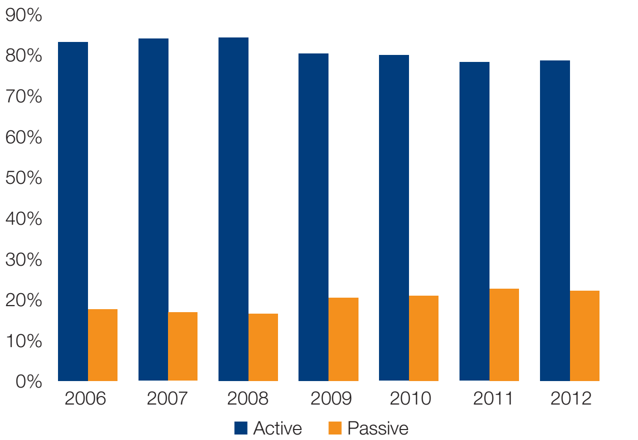
In contrast, there is no clear long-term trend in the share of the retail client base, which has experienced significant fluctuations. Given the greater sensitivity of retail flows to market conditions, this is to be expected.[8] Moreover, the continuing uncertainty as to the impact of the Retail Distribution Review (RDR) in the UK is raising a question mark over the levels and shape of retail investment going forward (see further discussion in Chapter Two).

[8] While institutional investors, such as pension funds, are by their nature fully invested, retail investors are not. Fund investment may sit alongside other financial (eg. cash deposits) and non-financial holdings (eg. property).

Type of Management

For a number of years we have reported the growing role of passive management across UK assets under management. As shown in Chart 7, this seems to have reached a peak at 22% at the end of 2011, where it has remained since. While actively managed assets still account for a clear majority of industry activity in the UK, the annual growth rate of 11% in assets subject to passive mandates exceeded that of actively managed assets (5.4%). Attributable to the prevalence of passive management in the UK institutional space, a continuation of this trend might, in time, shift the balance between active and passive management more significantly.

Chart 7: Active and passive assets as proportion of total UK assets under management (2006–2012)



A substantial part of the wider passive space is represented by exchange-traded funds (ETFs), which are run by a small number of IMA members; only 12% of our respondents were running these types of vehicle as at the end of 2012, accounting for £108bn of UK assets under management. Given the size of the UK ETF space and its growth in recent years, the survey therefore captures only part of the UK passive asset base.

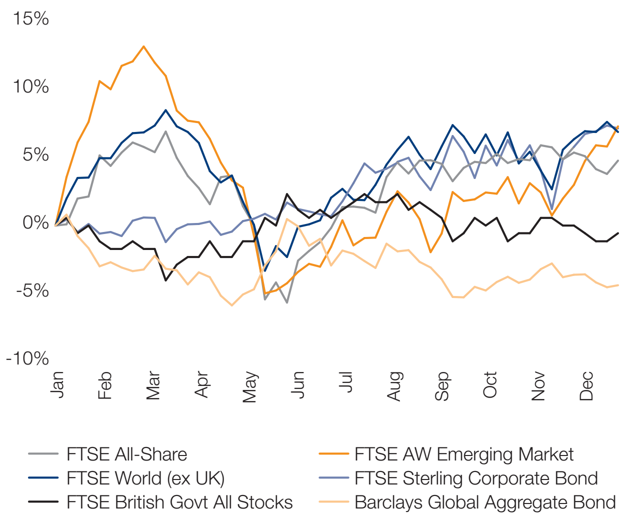
Segregated vs pooled

In recent years, the balance between segregated and pooled assets has remained relatively stable, representing around 55% and 45% of total UK assets under management, respectively. As at 2012 this has changed somewhat with the increase of pooled assets to 48%, both on a headline and on a matched basis. While it may be too soon to make conclusions about the direction of travel going forward, the strong growth experienced by UK authorised funds, further elaborated on in Chapter Four, was clearly a supporting factor.

Asset Allocation

Equity market performance exceeded that of 2011, with both UK and international indices recording near double digit growth on a capital return basis (see Chart 8). While equity markets remained volatile, they picked up in the second half of the year as doubts over the stability of the eurozone began to fade.

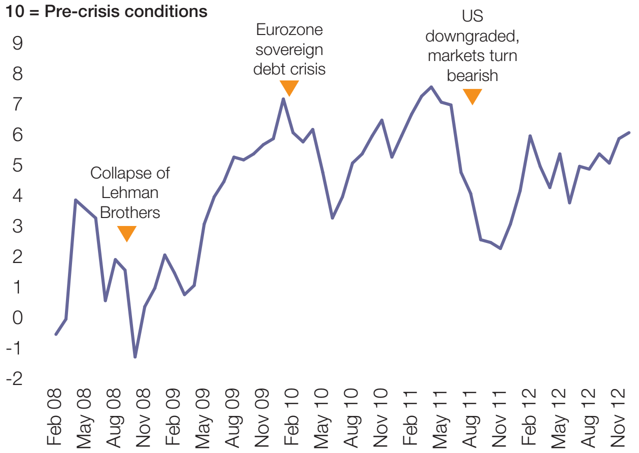
Chart 8: Monthly performance of selected equity and bond indices (2012)



Source: Lipper IM (calculated on a capital return basis)

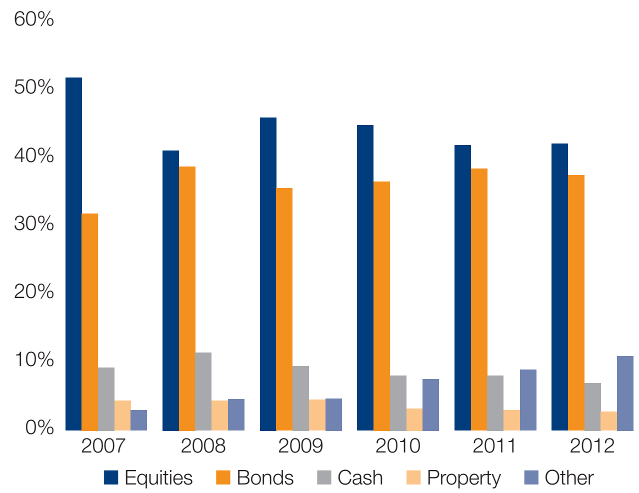
This robust performance is also reflected in corporate bonds, which significantly out-performed government indices. Chart 9 shows the positive evolution of sentiment in the fixed income markets in the second half of 2012, drawing on an IMA monthly survey of fixed income managers.

Chart 9: Asset manager assessment of general conditions in fixed income markets (2008–2012)



As we pointed out in our 2011 report, some firms we spoke to observe a continuing disconnect between economic fundamentals and market behaviour, particularly in the context of ongoing unorthodox measures undertaken by central banks (see further discussion on p.27).

Chart 10: Overall allocation of UK-managed assets (2007–2012)



While our aggregate asset allocation data do not allow us to distinguish between market performance and flows (see Chart 10), the UK-managed asset base is characterised by a number of features.

Equity holdings, which in 2011 experienced the largest decrease of any single asset class, recorded a marginal increase on a headline basis. However, given market movements, this implies ongoing outflows into other asset classes. In stark contrast to the 1990s, equities continue to account for less than 50% of total UK assets under management, reflecting in strong measure a very different approach to investment by institutional clients.

Fixed income holdings fell by one percentage point to 37%. This fall in relative terms is still consistent with the ‘flight from equities’ identified in this and previous surveys.

industry**view**

Regulation and the move into fixed income

“To the extent that it’s about pension schemes and insurance companies, it’s not cyclical as it’s regulation driven. Most of the switch to fixed income has come about because people have been worried about the volatility of their funding levels and been looking to have an investment policy that doesn’t leave them exposed, and the long fixed income bias is an obvious manifestation of that. If the regulators decide there’s too much pain in this mark-to-market approach and you are allowed to smooth things and amortise and price to model, some of that could go the other way.”

The relative size of the ‘Other’ category increased from 3.0% in 2007 to 11% at the end of 2012. While alternative assets such as currency, private equity and commodities continue to constitute part of this category, this is increasingly a minority. Indeed, the growth is largely attributable to the increasing popularity of derivatives, overlay assets and liability driven investment (LDI) hedges entailed in different types of structured solutions.

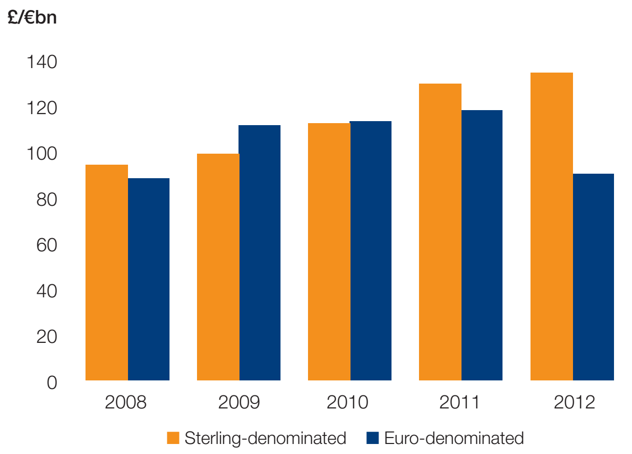
Property assets stood at 2.7% (2011: 3.0%). While a relatively small part of the overall asset base managed by IMA members, a number of firms have very significant property management businesses.

1

Cash continued to fall from its high of 11% in 2008 to 7.0% in 2012.[9] This is both due to a gradual shift away from the 'flight to safety' that we reported on in previous years and clients' increased focus on generating returns above inflation levels.

IMMF assets were managed by a marginally smaller proportion of respondents (33% as opposed to 34% in 2011) and decreased to £140bn (2011: £174bn). This is partly supported by data from the Institutional Money Market Fund Association (IMMFA), which show that Euro-denominated IMMF assets fell over 2012 on the back of decreasing interest rates, especially for government bonds (see Chart 11).

Chart 11: Growth of Sterling- and Euro-denominated IMMF assets (2008–2012)



Source: IMMFA

Regulatory discussions in the US and the EU are focused on the risks to financial stability that widespread redemption demands could have on money market funds, especially those which offer a stable net asset value. Some fear that significant redemptions could not be supported and could transmit shocks to those parts of the financial markets that are particularly central in the provision of short-term liquidity for banks. Others, however, fear that the solutions suggested might themselves damage the very role that money market funds have as a 'cash-like' product for treasurers, thus increasing exposure to individual banks whilst reducing available yield.

industry**view**

Regulatory impact on money market funds

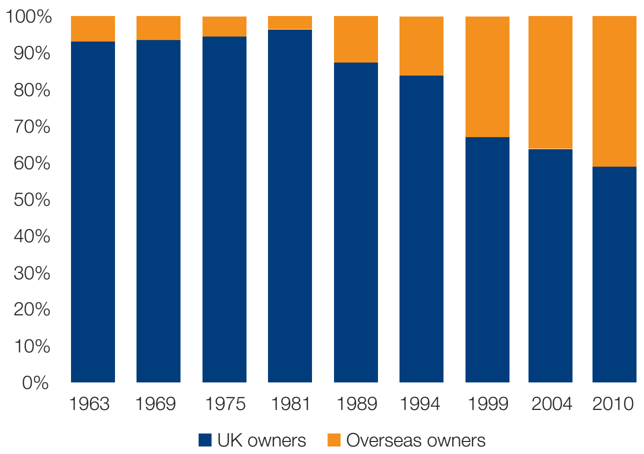
"I can understand capital adequacy rules and the separation of banking activities. However, when we come to some of the specific measures, the focus disappears. Money market funds, for example, have acted as a really good innovation and have enabled us to mitigate some of the challenges that we would otherwise have with bank concentration, but they are going to be 'driven out of the well' by some of the things that are going on. The rules are just going to destroy what is actually a very valuable, well-received and well-perceived market."

[9] Includes assets held in institutional money market funds (IMMFs), other money market funds and uninvested cash held in other forms.

Geographic equity split

Despite the relatively good year that equities have had compared to 2011, UK equity holdings continued to decrease as a proportion of total equities. Both IMA and external data confirm that UK institutional and retail equity flows are concentrated increasingly on international markets.[10] This represents a widely recognised longer-term trend that has also resulted in a significant increase in the overseas ownership of UK equities (see Chart 12).

Chart 12: Ownership of UK equities (1963–2010)



Source: ONS

*industry***view**

Globalisation of investment process

"There is a permanent shift from domesticity to internationalisation. This is very different to the US or Europe, where the vast majority of stocks would be in domestic products."

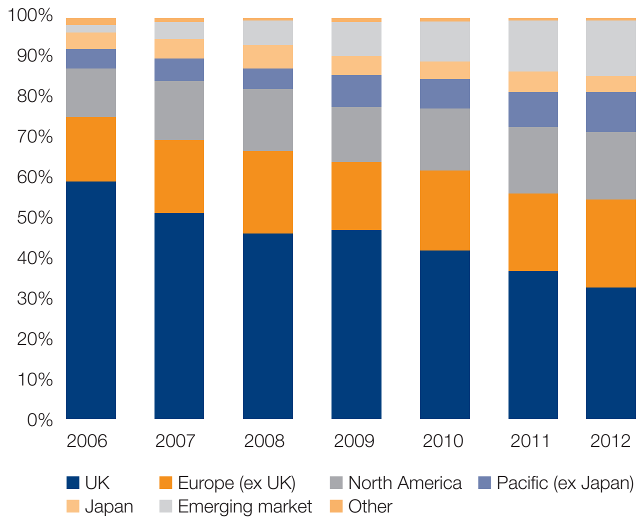
"The greatest shift that we have seen post-crisis is a growing recognition that significant components of the emerging market debt asset class have become investment grade. In that sense, they are seen as an investment grade opportunity which, in contrast to the developed world, still offers good yield."

Compared to 2006, some striking changes can be observed in the relative composition of equity holdings (see Chart 13):

- By the end of 2012, emerging market equity holdings had increased more than six-fold to 14% (2011: 13%).
- Pacific (excluding Japanese) equities accounted for 10% of all equity holdings, doubling from 2006.
- European equities represented 22% of total equity holdings, up from 16% in 2006.
- North American equity holdings increased to 17%, having grown from 12%.

Other regions mostly consist of investments in Middle Eastern, African and Latin American equities, and they remain below 1%.

Chart 13: UK-managed equities by region (2006–2012)



[10] The IMA only has flow data for UK-domiciled investment funds. Institutional client flows are sourced from the ONS, *MQ5: Investment by Insurance Companies, Pension Funds and Trusts,* Q4 2012.

Fixed income

Given the nature of the liabilities of large UK institutional investors, fixed income exposure remains heavily domestically focused. The '£ Sterling corporate bond' category grew marginally to 26% (2011: 25%) on a headline basis, and modest growth was also seen in index-linked gilts (16% compared with 14% in 2011).

In contrast, gilts (excluding index-linked gilts) declined from 21% in 2011 to 18% in 2012. The 'Other UK bonds' category has fallen to 3.0% of the total (2011: 6.0%), although given its size and the small number of firms reporting holdings, this category is more susceptible to year-on-year changes.

Increasing globalisation of the investment process is also evident in the fixed income space, with overseas bonds reaching 37% of total fixed income assets (2011: 34%). This is consistent with institutional flow data from the ONS and IMA retail flow data, which suggest strong net investment in overseas corporate and government securities.

The headline split in fixed income holdings, outlined in Chart 14, is an unadjusted sample. As would be expected, looking at this through the lens of firm type shows greater fixed income holdings among the insurance-owned groups and much heavier exposure to £ Sterling corporate bonds and index-linked gilts. This is shown in Chart 15. Adjustment for the over-representation of insurance-owned asset managers in the respondent base would give a different split in fixed income (see Table 1), reducing the £ Sterling corporate bond, and increasing the overseas fixed income exposure.

Table 1: Headline vs sample-adjusted fixed income ownership[11]

	Headline	Sample-adjusted
UK government (ex index-linked)	18.4%	18.3%
£ Sterling corporate	25.6%	22.4%
UK index-linked	16.2%	15.1%
Other UK	3.0%	3.4%
Overseas	36.8%	40.7%

Chart 14: Fixed income allocation of UK-managed assets by type and region (2011–2012)

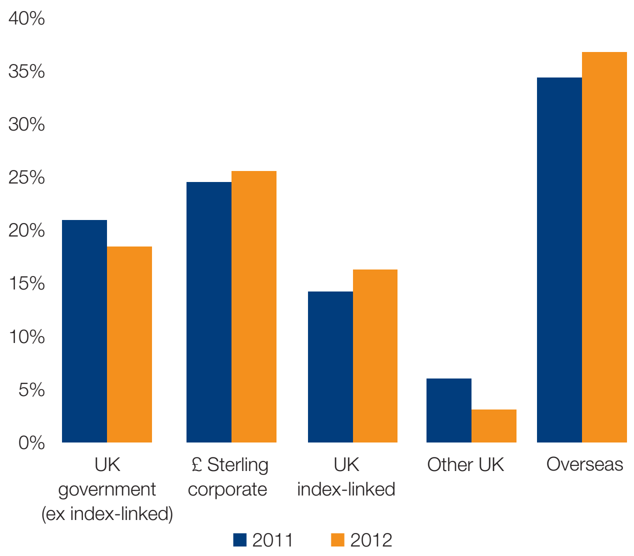
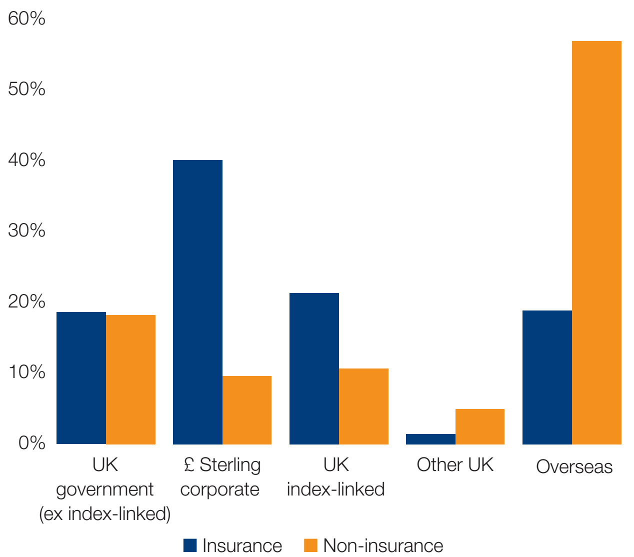


Chart 15: UK-managed fixed income allocation split by insurance vs non-insurance parent



[11] Results are adjusted to reflect the characteristics of the overall IMA membership base, which has a lower proportion of insurance-owned firms than the respondent sample within the survey.

2 Serving Client Needs

Key Findings

Changing client needs

- Asset management firms and their clients face a complex combination of regulatory changes, uncertain market conditions and evolving public policy environments.
- Whether looking at the institutional market in general, the emerging DC market in particular or the traditional retail fund market, the need to focus more specifically on client outcomes is intensifying.
- While one significant sub-theme is the 'hunt for yield' in a low-return environment, asset managers are also concerned about the effect of unorthodox central bank activity – and its eventual unwinding – on markets and clients.

The long-term finance debate

- The long-term finance debate has intensified over the past twelve months, both at the UK and European level, with constrained government and bank lending capability a key driver.
- Firms express an openness to explore diverse aspects of long-term financing, including non-bank finance and public infrastructure projects, but also voice concerns, particularly to ensure that client interest is put at the heart of the debate.

Building client trust

- Firms recognise the challenge, both in the retail and institutional markets, of ensuring that client trust is maintained in an environment characterised by significant and widespread mistrust of the financial services industry.
- An emphasis on better client communication is at the heart of the actions taken by firms, but other areas, such as internal monitoring and operating culture, are also being looked at.
- One significant preoccupation is to ensure greater clarity around regulatory expectations of firms with respect to their knowledge of end-clients' individual needs and circumstances. This issue arises particularly in the context of a move towards more outcome-focused products.

The implications of RDR

- There is a range of operational frustrations with RDR, but firms also have concerns about the consequences of individuals potentially having reduced access to financial advice.
- The possibility of greater numbers of financially less sophisticated individuals purchasing fund products has significant ramifications. It may strengthen the focus on areas such as embedded advice products. At the same time, some firms worry that regulatory suitability-like requirements will force the market into simple product offerings that may not best serve client needs.

2 Serving Client Needs

In recent years, we have pointed to an increasingly complex operating environment for the UK asset management industry. In Figure 3, we set out its key features. This chapter explores four aspects of these:

- Changing client needs.
- The long-term finance debate.
- Building client trust.
- The implications of RDR.

Changing Client Needs

Chapter One showed asset allocation trends consistent with an environment that had a bias towards 'de-risking' and more solutions-focused asset management approaches. Firms interviewed confirm previous findings about the causes of these trends:

- Regulatory and accounting requirements affecting the composition of the natural buyers of equities, ie. institutional investors such as pension schemes and insurance companies.
- Poor equity market returns in the aftermath of the dot.com bubble, compounded by the market instability of the global financial crisis.
- The evolving profile of DB schemes, both in the UK and other jurisdictions such as the Netherlands and the US, as many schemes enter a more mature phase.
- A generational shift internationally as more baby boomers near or enter retirement and start to move out of risk assets in defined contribution (DC) schemes. At the same time, potentially more risk-averse generations are starting to enter DC schemes.

Figure 3: Key features of the UK asset management operating environment

INTENSE REGULATORY CHANGE

- Global, regional and national regulatory initiatives affecting almost all areas of the value chain, both directly and indirectly
- Major evolution in the UK distribution market resulting from RDR

POLITICAL SCRUTINY

- Regulatory initiatives in part driven by a domestic and wider international political focus on the role of financial services post-2008
- Growing political attention on the asset and fund management industry specifically
- Charges and costs (both transparency and levels of remuneration) and the long-term finance agenda are two central themes

UNSETTLED GLOBAL MARKETS AND MACROECONOMIC UNCERTAINTY

- Significant ongoing market and macroeconomic dislocation
- Ultra-low interest rates amid unorthodox central bank policy mechanisms
- Constrained bank balance sheets and high government debt shifting attention to alternative conduits for investment capital

EVOLVING CLIENT BASE

- Greater focus on trust and transparency issues post-2008, both among retail and institutional clients
- Maturing DB market and accelerating shift to DC putting greater emphasis on individual funded arrangements
- Baby boomer generation moving into retirement, with implications for retirement income strategies and investment in later life
- Possible emergence of a larger unadvised and/or self-directed retail market in the UK

TECHNOLOGICAL ADVANCES

- Technological advances affecting all aspects of asset management activity from client reporting to distribution and communication

2

Move towards client-focused solutions

Some of this is cyclical, both in terms of equity market behaviour and credit cycles. However, senior industry figures believe that market conditions of recent years, taken together with factors identified above such as changing pension scheme maturity, will have long-term structural implications for client expectations and product demand.

This is already creating a changing focus in all parts of the market:

- The institutional DB pensions market has experienced a strong rise of LDI approaches, with liabilities subject to LDI mandates at record levels (see p.44).
- The debate in the UK DC market is increasingly revolving around the provision of better developed default strategies, with asset managers reflecting on the role they can play beyond specialist services defined solely by asset class and/or geography (see p.40). Target-date funds, which embed asset allocation, are seen as likely to become more prevalent in the UK.
- The retail fund market continues to see strong growth in absolute return and so-called 'asset allocation funds' (see p.57).

industry**view**

A bias towards de-risking

"The rise in fixed income has been driven by the inevitable combination of pro-cyclical regulation and investor risk aversion following the global financial crisis. The phrase 'risk-on / risk-off' was doing the rounds. Where that left us by 2011-2012 was a high appetite for fixed income and an environment that, from a regulatory perspective, was seen as 'risk-off'."

"Equities for DB schemes are in permanent decline. There might be tactical opportunities when you might take advantage of periods when equities look like good value. But in terms of the long-term change towards fixed income, that's a done deal. Where you need growth, you need risk-managed growth and you should have a diversified portfolio of risk assets. With the globalisation of markets, equities are a less good diversifier than they used to be, so you need other approaches."

industry**view**

Changing asset management focus

"You could argue that the cause of where we are now is the result of a giant cycle where we see returns crushed and the value of liabilities inflated because of what has happened to interest rates. However, those causes have been so great that this cycle has now become structural. The focus within the institutional space is towards liability-led and outcome-oriented journey plans with dynamic asset allocation and less reliance on traditional assets, such as equities, because of their volatility."

"On some level, all portfolios are multi-asset so the only question is who is making the decision. In the institutional market, the asset manager would have traditionally been doing the asset allocation as well as stock-picking. Eventually, that process went 'upstream' and you had managers doing specialist jobs. But some managers do have the necessary asset allocation skill, both on a tactical as well as a strategic basis; for example, in target-date funds. That is an investment activity that I would argue has gone upstream prematurely."

In such an environment, the 'natural buyers' of equities are re-defined, making the scale of traditional institutional holdings in equities seen in the 1980s and 1990s unlikely to return (see Chart 16).

Instead, different constituencies, such as sovereign wealth funds or high-net-worth individuals, are identified as being well-positioned to take advantage of some of the opportunities provided by recent market conditions. At the same time, both institutional and retail investors may use equity exposure far more selectively, and with different objectives, such as income generation.

Nonetheless, there are concerns among those we interviewed about the implications of an excessively cautious investment environment that is at danger of arising both at a regulatory and client level.

Finally, the broad evolution of client demand described above is serving in some respects to re-define the debate over 'active vs passive'. The bifurcation between beta and alpha, which has recently seen strong flows into passive strategies, is still a clear feature of the market.

However, active management appears increasingly characterised by alternative asset classes, multi-asset offerings and solutions or outcome-oriented strategies, as well as stocks and securities selection more traditionally associated with 'alpha'.

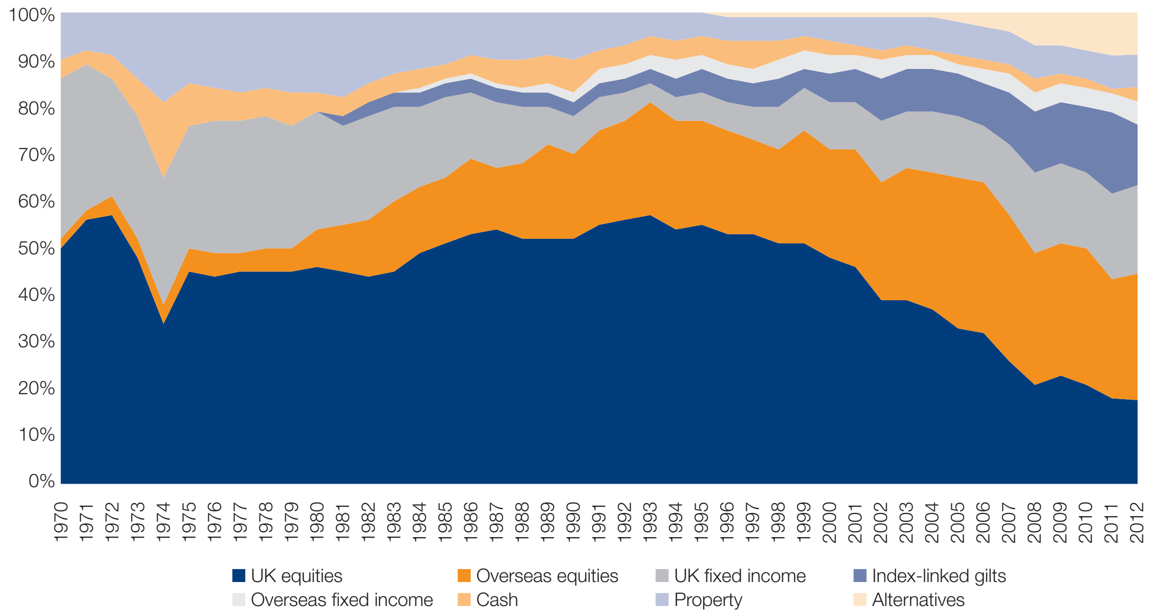
industry**view**

Dangers of excessive caution

"Every day our life expectancy increases by 5.5 hrs. How are you going to invest for increasing life expectancy where people need growth without some amount of equity? How do you create a reasonable lifestyle where you will not run out of money and you want to retire for as long as you've worked? This equation is a very difficult one to solve, and virtually impossible to solve with an interest rate of 1.6% on 10-year government bonds. You've got to take some risk."

"Taking no risk is not the answer; it is actually the biggest risk. That is why the regulator has to play a part in educating investors about long-term retirement saving, and we are very engaged with them on this point. Currently, they are just forcing more risk aversion, and more short-term decisions to be taken."

Chart 16: Overall UK pension fund asset allocation (1970–2012)



Source: UBS *Pension Fund Indicators*

The 'hunt for yield' and record low interest rates

Investor behaviour is also being driven by factors directly related to the immediate monetary policy environment. With the equity market in long-term stagnation (see Chart 17) and interest rates at record lows (see Chart 18), parts of the UK client market have been characterised by a so-called 'hunt for yield'. Indeed, record levels of retail sales between 2009 and 2010 in the authorised funds space were partly driven by significant flows into corporate, and then strategic and global bond funds (see p.62).

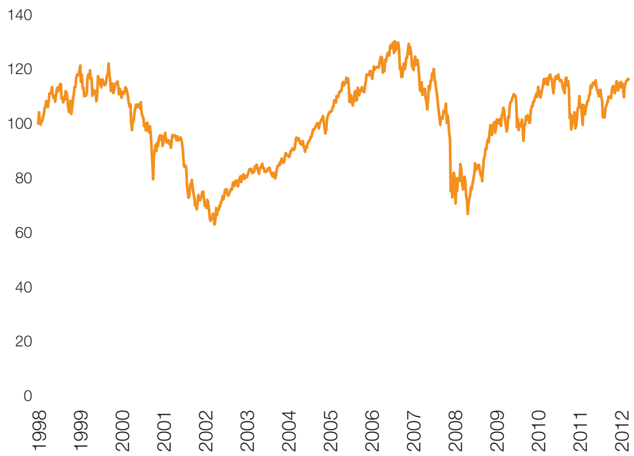
The 'hunt for yield' adds another layer of complexity to the narrative outlined above, in particular equity market disinvestment. Those we interviewed, together with flow data from the fund market, confirm the importance of equity exposure for income generation, rather than a focus on capital growth. However, certainly in the retail fund market, equity income sales remain low relative to fixed income sales (see p.57).

industry**view**

The attraction of equity income

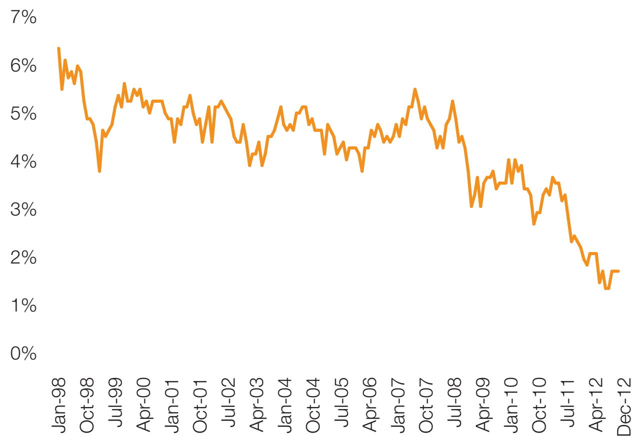
"The cult of the equity may have died, but I think the equity culture hasn't. I certainly do not believe the phrase about the 'Great Rotation'. It is more than a 'rotation'; there is a higher degree of sophistication. We have clients talking to us about buying and holding equities to generate income. They don't want the highest yielders – 'the needy, the seedy, the greedy' – they want a solid dividend."

Chart 17: Performance of FTSE All-Share index (1998–2012)



Source: Lipper IM (calculated on a capital return basis, rebased to 100)

Chart 18: Ten-year gilt yield (1998–2012)



Source: Lipper IM

We also spoke to firms about the impact of Quantitative Easing (QE) on clients and markets. The responses can be summarised in four points:

- In terms of helping to ease extraordinarily stressed market conditions, QE averted a potentially far worse set of consequences for the markets and the economy more broadly. In that respect, there has been a broad societal benefit.
- With respect to specific client groups, there was a consensus that both DB pension schemes and pensioners more broadly have been particularly badly hit. A very low interest rate environment has consequences for the valuation of liabilities, the pricing of annuities and the return on capital for those using savings to generate retirement income.
- Many firms expressed the view that QE has contributed to a degree of opacity in market pricing, particularly in the fixed income markets, with concerns about the distortive impact of central bank activity on market fundamentals.
- The manner of the eventual unwinding of QE is a source of considerable unease, and firms this year and last expressed the view that a snap back in inflation and interest rates could generate significant turbulence for investors.

This concern is exacerbated by what many firms see as a momentum among a range of investors into fixed income for a reason that may not accord with the potential experience ahead, notably to de-risk. However, this is not a view universally shared by respondents, some of whom articulate a need for institutional investors such as pension schemes with very specific liability streams to carry high exposure to fixed income.

industry**view**

Impact of Government intervention

“As rates have been depressed artificially, savers have had a tough time while borrowers have benefited. The other beneficiaries were people who have been long in equities and bonds. But what would have happened had you not had QE? The world would, at first, be in a very nasty place.”

“While I would be a supporter of the initial phases of QE because they were about effectively shoring up the financial system, my concern now is that the financial system is ever more dependent on these injections of liquidity, which are bringing about more and more distortion. This is leading to incorrect pricing signals, which in turn leads to inappropriate asset allocation decisions, which in turn leads to poor capital allocation decisions. Ultimately, none of this is good for the long-term health of the economy and at some stage this disconnect will have to be unwound, and nobody has any idea how it will play out and how disruptive it will be.”

industry**view**

Different views about the ongoing move into fixed income

“The huge structural problem for the government is that the whole system is loaded up on bonds and underweight in equities. It’s partly regulatory, partly accounting policies and partly fashion. But I would say that, from a macro-prudential, systemic risk point of view, the system is overweight the wrong asset class.”

“If you’re a DB pension scheme, you could say that a portfolio of long-dated index-linked gilts and gilts is dreadful value and isn’t yielding anything. But if you were a shareholder of that company, you might prefer the scheme to just close down your risk through liability hedging even though it might reduce your expected return.”

2

The Long-term Finance Debate

Last year we reported how a number of asset managers were beginning to enter the space that had been created by banks retreating from traditional credit intermediation activity. We concluded that, for various reasons, a wholescale blurring of the asset manager and banking business model was unlikely, pointing to a range of regulatory and more practical operational issues.

The past twelve months saw a broadening of the long-term finance debate, both in the UK and in continental Europe:

- In the UK, the final report of the Kay Review was published in July 2012, focusing on how best to align incentives in UK equity markets to support long-term value creation.
- In March 2013 the European Commission published its Green Paper on the Long-term Financing of the European Economy, with the promotion of long-term financing and diversification of the financial intermediation system at its heart.

We asked interviewees how they planned to adapt to this change in emphasis. Firms generally saw long-term finance as having a wide range of meanings, but identified three areas in particular:

- 'Long-termist' behaviour, emphasising engagement in corporate governance, stewardship and socially responsible investment (SRI).
- Long-term finance provision, such as direct lending to business, through credit intermediation outside of traditional bank finance channels.
- Long-term financing projects, most typically through infrastructure or project finance.

The UK political focus on corporate governance is not new and other IMA research captures in more detail the level of engagement on these issues, confirming growth in firms' corporate governance functions and the continued integration of stewardship into the wider investment process.[12]

industry**view**

Increase in corporate governance

"Pension funds have long-term liabilities, so why not provide long-term finance for the economy that you have people saving into? And corporate governance is closely linked to this and changing already. Fund managers are increasingly looking not only at turnover but – from our experience – spending much more time with the non-Execs and the Chairmen trying to understand the sustainability of businesses in the wider sense."

More novel from an asset management perspective is the increasing government and regulatory focus on the need for greater market-based finance to fill perceived gaps in bank and government funding for infrastructure.

In this context, interviewees confirmed their belief that market-based financing would increase in future and that this was a healthy development. Firms expressed the view that asset managers could step into some of this space, to fill the existing gap created by bank and government deleveraging, and to help facilitate a more robust financial system including the opening of new conduits for capital flows.

industry**view**

Growing role of non-bank finance

"Asset management can most definitely play a role in terms of joining up the natural long-term investors with those who are seeking investment for long-term projects. Government is obviously quite prominent in that, particularly when it comes to infrastructure. The big challenge is simply finding a way in which those two agendas can get connected."

"There will be more market finance than bank financing and we are well-placed for this, especially on behalf of our clients. There is a very high alignment of interests to co-invest, particularly with very long-term projects, where you are going in with a very stable structure."

[12] See the IMA's *Third Report on Adherence to the FRC's Stewardship Code,* published in June 2013.

Despite significant willingness to get involved in different forms of market-based finance if this reflected client demand, a number of reservations were raised, particularly around the prospect of a government-driven increase in infrastructure investment. Some of those reservations were raised last year while some are newly articulated and may reflect more detailed analysis of the investment opportunities themselves:

- **Client interest.** In the light of the fact that asset managers invest their clients' money, there were serious concerns about any attempt to shift their primary duty towards the client to one of serving the interests of the wider economy.
- **Expected returns.** Some interviewees did not see the expected returns, especially combined with the extended time horizons, as attractive enough to generate sufficient client interest.
- **Liquidity.** The illiquidity of infrastructure projects was in many cases seen as an obstacle, both in terms of client demand for these types of products and existing expectations of daily pricing and dealing in parts of the investment market. In this respect, it was suggested that certain structures such as closed-ended funds would be better suited for channelling these types of investment.
- **Scale and skill sets.** Similar to last year, interviewees raised the issue both of skill sets and scale (ie. the size of firm that would be able to channel these sorts of funding commitments). While not a majority view, firms mentioned the advantage of having a parent, such as an insurer, to fulfil the function of a 'natural buyer'.
- **Political risk.** The continued security of investment across political cycles was an additional concern, particularly where investment was channelled into potentially sensitive projects such as transport or energy.

For these reasons, firms would welcome firmer commitment by the government and regulators to work with the industry on improving the environment for infrastructure investment. Potential ways would include, but would not be restricted to, the consideration of guarantees for certain kinds of project and enabling the creation of appropriate investment vehicles where they were not currently available.

industry**view**

Different approaches to liquidity

"It's important that everyone understands that knowing exactly what you own and being able to sell it at any point are valuable but potentially costly protections, because they exclude you from a lot of investment opportunities. Whether you'd want your default DC option to be illiquid is another question. And the worst of all worlds is liquidity you don't need but at a high price. In my view, you're better to be open and say 'this is a ten-year product and you won't get your money back for ten years – if you don't like that, here's the daily liquidity product.'"

"We've concluded that most of our client base wants liquidity – they typically invest with us through funds where, if something goes wrong, they will get their money back. And that makes it a bit difficult because you need some sort of closed-ended structure or permanent capital to access those opportunities in infrastructure, trade finance and other areas."

industry**view**

Caution about implications of public infrastructure focus

"The asset manager will always have to look at the investment opportunities offered for their client base and PFI initiatives could quite easily be a part of that. But it depends on what the commercial opportunity is to create value for the client, rather than the philanthropic good of being involved in a longer-term asset class.

Asset managers are not a pool of capital there to support cash-strapped governments – it is the client's money and one must look to what provides benefit to the client. If it meets a client need and provides the right return, then you can clearly utilise it in a portfolio, but simply saying there is a Government need on the other side is not a good enough argument."

With respect to client behaviour, a number of those we spoke to drew attention to the potential implications of the globally diversified nature of the investment outlook that we have already highlighted in Chapter One. Investment in infrastructure or other forms of long-term project might become more popular among institutional investors, who could in turn direct it towards non-domestic offerings. Equally, UK or European jurisdictions could then expect interest from overseas investors, something that is already in evidence. However, a number of interviewees pointed out that property investment was still characterised by a markedly domestic focus in certain areas, eg. social housing.

industry**view**

Infrastructure and home bias

"There is a potential conflict between the Government's objective in promoting infrastructure investment and modern portfolio theory driving everyone into global opportunity sets. We could end up in a position where people fundamentally accept that long-term infrastructure is a great place for DB pension schemes but, for example, put their money into Norwegian oil pipe lines."

"In areas like social housing, for example, we can make a difference if the industry and Government help each other. Property is very interesting also because it is seemingly the only asset class that isn't global. People will still buy domestic property as their number one choice."

Building Client Trust

Client trust and confidence has become an increasing theme for the industry, which differentiates itself strongly from banks in the context of the current difficulties faced by the financial system. However, given a combination of mistrust of financial services, changing client needs and a decade of challenging market conditions, firms recognise that improvements must be made in reassuring clients about how both products and firms themselves operate. We spoke to firms about the specific measures they were taking to build client trust.

Client communication

Client communication emerged as a highly important focus. Firms strongly expressed the view that, despite the uncertainties of the investment markets, they should be able to demonstrate to their clients that they conduct their business in a transparent and accountable way, and that the client is kept informed at every step of the journey.

Institutional clients

In the institutional space, firms reported adapting their communication to be much more client-focused, from the start of the proposition throughout the course of the relationship. This included greater emphasis on the clients' objectives, candidness about the firms' underlying investment beliefs and the feasibility of meeting client expectations. Firms also reported having more in-depth conversations, both during regular updates and in response to specific market conditions, with more time spent on explaining the process around transaction costs or securities lending.

industry**view**

Changes in institutional client communication

"The people we brought on board are not salespeople; they go out and talk to clients and help them work out what to do. We've had to do things like trustee training sessions and asset liability work, basically going out and presenting ideas and solutions. It was about trying to help clients without necessarily having a specific product focus in mind."

As reported last year, in some cases the change in communication developed hand-in-hand with increased client scrutiny. A number of firms stated that clients across the institutional spectrum now asked for more detailed and bespoke information more frequently, which in turn drove improved reporting and emphasis on management information.

Retail clients

Due to the expanding intermediation chain that separates asset managers from their end-clients, trust-building in the retail space has taken a distinct form, communicating through advisers and distributors, as well as through client-facing materials. There are various ways in which firms work with intermediaries in this area, be it through events, client road shows or educational seminars about broader aspects of the investment process.

Especially in the light of the increased regulatory emphasis on fund manager responsibility for suitable product design and potential misselling, firms are more acutely aware of the challenges in ensuring that independent advisers and other intermediaries are well-equipped to distribute their products.

With respect to specific approaches to client communication itself, a number of common themes emerged:

- **Quality of information**. Substantial resource is being spent on ensuring the high quality of information made available to the end-client. This most often includes processes such as feedback learning or checking client material for plain English and appropriateness for audiences of different levels of financial sophistication.
- **Charges and costs.** At both firm and industry level, there is an intensifying focus on how better to communicate product charges and costs, notably transaction costs. The IMA Enhanced Disclosure Guidance is one example of this.[13]
- **Delivery channels.** Firms are innovating in their broader communication strategies, adapting not only their websites but also expanding into mobile applications, Twitter or YouTube.
- **Moving beyond product.** Communication strategies are expanding their focus increasingly beyond product information into education on personal investing, market behaviour and related areas of investor interest.
- **External presentation and brand**. There is a greater focus on whether branding and messaging is sufficiently aligned with the type of relationship firms want to have with their clients. In the context of brand, a number of larger firms also reported benefitting from client flows as a consequence of having a recognised and trusted name.

industry**view**

More innovative approaches to communication

“We have moved forward in a softer way, and our whole emphasis is on partnership and how to be more engaging and transparent. A lot of this is easier to do institutionally, but we are also trying to make it more accessible to the retail side. Our interactive website holds relevant interviews with fund managers and you don’t need to be a member to access them. We also use social media to get our message out there. That is how you build trust, when people can hear you and talk to you.”

“The asset manager typically wants to talk about the product, and the customer normally wants to talk about what’s happening in the market cycle, what’s right for them as an individual; this is where the alignment needs to happen. We’ve increasingly tried working on how to bridge that gap and package what we do as an investment house to ensure it aligns back to what the investor wants from us. We’ve tried to provide help around asset allocation, and how to think about portfolio construction.”

[13] The IMA Enhanced Disclosure Guidance recommends a focus on the ongoing charges figure (OCF) rather than the annual management charge (AMC) and provides more accessible information on transaction costs.

Other trust-building measures

Trust-building measures extend beyond client communication to other areas:

- **Operating culture.** A number of firms undertook wholescale reviews of their values and culture resulting in greater emphasis on partnership, and the firms' role as problem-solvers, rather than purely product manufacturers.
- **Internal monitoring processes.** Enhancements covered many areas, from reporting through to conflict of interest management, operational risk controls and internal audit functions.
- **External quality checks.** A number of firms also undertake 'mystery shopping' and other quality checks among platform providers and distributors to ensure their products are being presented accurately and appropriately.

Question of sophistication vs simplicity

Part of the discussion is also about the potential conflict between the demand for sophistication in product development and the calls for transparency and simplicity of delivery:

- This did not seem to present a conflict in the institutional space, as the client-manager conversation around product features could usually be undertaken at a sufficiently high level.
- Retail clients posed a greater challenge in this respect, both due to different levels of intermediation and financial sophistication. A number of firms therefore preferred more 'vanilla' retail offerings, with an emphasis on transparency of charging and simple product messaging.
- Others believed products did not have to be made simpler to be suitable for retail clients, but they agreed retail client communication had to be accessible and transparent.

Irrespective of the view espoused, firms emphasised the need for continued client education so as to enable investors to make an informed choice.

industry**view**

Different forms of quality check

“We have, for years, run a process where we take a group of less financially qualified people in our company to look at our product descriptions to see whether they're clear and people understand them. We also have people call up our platform providers and distributors to see what they say to us in the sales process to make sure we're happy with that.”

industry**view**

Different views on the role of more complex products

“The issue is that delivering against a simple cash benchmark can require an awful lot of complexity in the return manufacture process. The real question that we are trying to answer here is: how do you get customers and clients to trust that the necessary complexity will deliver what they need at an appropriate price? Brand is becoming increasingly important and is all about trustworthiness. In the retail world, success is dependent on brands that people can trust.”

“This is the unintended consequence of policies that are trying to make the world perfect and safe but at the end perhaps take away opportunities for investors. Sophistication requires some amount of uncertainty about what the outcome is going to be, and it is harder to explain if something goes wrong. Regulators or politicians who hate to have to defend that position would rather have to defend the guy who got you the cheapest price and it was very straightforward but the markets did not behave as expected.”

“I have a preference for simpler products because the communication is easier. Communication with the client needs to be more than how much you can deliver every year; now it has to include what we do in the fund, charges and fees, commissions and related issues. It's a challenge particularly in light of UCITS wider powers. In fact, as far as I can see, you have wider powers for an ever decreasing client group who are either uninformed or disengaged.”

Regulation and client suitability

One significant challenge as firms move from pure component manufacture to a greater focus on asset allocation or specific outcomes is the level of knowledge and research that may be required with respect to the suitable design of the product for a specific target audience.

While they did not wish to absolve themselves from responsibility over the products they bring to the market as expressed under existing Treating Customers Fairly (TCF) guidance, firms expressed concerns that regulatory expectation should not drive manufacturers into having to second-guess the specific suitability assessments for individual investors which advisers have to make. This was particularly the case given the layers of intermediation and the likelihood that many retail clients have taken independent financial advice. The issue also arises in the context of retail clients, who may increasingly use 'execution-only' or even direct means to access fund products.

industry**view**

Responsibility despite intermediation

"All our products are basically intermediated, so there is someone between us and the client. But even in our case, the regulators are becoming much stricter by telling us 'you may be going through a distributor but it's still your product and you are responsible for making sure the end-client is a suitable buyer of your product.' And addressing that presents a huge challenge for us, because we can do training, we can do education for distributors but, ultimately, we don't control what they do."

"Manufacturers at our end need to be very clear about what they are doing. When they produce a target volatility product, what is the premise on which that is based? What is the analytical process that is producing the asset allocation that will in turn produce the outcome? What is the range of uncertainty about whether that will be delivered? And the discriminating intermediary should have the capability to ask the right questions and also ensure the onward transmission of the message in a very effective way."

Retail Investment and RDR

In force since 31 December 2012, RDR is expected to have significant implications for both retail clients and the industry. As reported in previous years, the industry is broadly supportive of the overall aims of RDR. However, there has been considerable criticism of the regulatory process, which is seen to have created a high degree of uncertainty and complexity around the direction of travel.

At the time of undertaking the survey, a number of operational issues, such as the likely number of RDR share classes, and the broader commercial relationship between platforms and fund management companies, remains difficult to predict. Another question mark will be over the consumers' ability to assess the total cost of ownership through the product manufacture, distribution and advice chain and thus to arrive at a better-informed investment decision.

Interviews focused on the likely ramifications of RDR in terms of anticipated retail client behaviour, and particularly the consequences of a move towards more explicit charging structures and further consolidation in the independent financial adviser (IFA) community. As in the operational and commercial areas, there is considerable uncertainty about outcomes.

Investment flows

Some firms believe that an 'advice gap' might simply result in more unadvised retail clients, who could choose to purchase financial products through 'execution-only' platforms or go direct.

Depending on the types of investment made by an unadvised retail investor, RDR could impact on the shape of the retail product landscape:

- Some expected that the result would be excessive conservatism, due to investors having insufficient experience in taking calculated risks.
- Others predicted growth across outcome-oriented products or offerings with advice built in.
- A 'flight to trust' towards large, well-established brands, already seen in some quarters, was raising the question of further concentration at fund or firm level.

Information and product design

The question of how to channel products to investors most appropriately in an environment where more products may be sold to the market advice-free raises issues in two areas:

- How to educate and communicate with investors who may no longer be able or willing to rely on an adviser (so-called 'orphaned investors') or where there never has been an adviser available. In this respect, firms have been faced with a specific challenge of how to devise effective information strategies for investors whose level of engagement and financial sophistication may vary considerably.
- Firms are seeing the potential for what might become excessive conservatism in product design among fund managers due to fears about a regulatory 'rear-view mirror' approach to product suitability.

As such, interviewees saw a potential disconnect between the needs of the unadvised retail client market and the ability of asset managers to meet those needs in the current regulatory environment.

industry**view**

Distortive impact on product choice

"I find it very depressing that we have this huge swathe of the marketplace that has no friend to help it. And the main organisations are now so scared to try and sell any form of investment product because they believe that, at some point in the future, they will be accused of misselling, that instead they're withdrawing and concentrating on other areas. It also seems to go completely against the government policy of making people more informed and better equipped to make the right decisions about their financial future."

"If you take this to its extreme you will be left with dull, 'vanilla' products underpinned by a guarantee. People do not seem to realise that a lot of products have to be complex, very structured and sophisticated to generate what looks like a simple line. A lot of us are concerned about where the FCA is going with this."

Impact on savings rates

There is also a view that an advice gap would result in a reduction in the number of actual and potential fund investors, creating limitations on overall growth in investment fund flows and, possibly, overall savings rates. This is because the perceived absence of affordable advice is expected to be felt most at the less financially sophisticated end of the retail investor spectrum, which would benefit most from both investment advice and a nudge towards more saving. As a result, some potential investors are expected to prefer consumption over addressing the question of self-directed investment, thus decreasing aggregate savings rates.

industry**view**

Impact of the advice gap

"Large swathes of the population will be unadvised, but I am not sure that they would be saving anyway. Unfortunately, these are the people that need the most help, both in saving and investing. Among existing fund investors, there will be a pick-up in the unadvised market, but not as great as one might think, because people will just leave. There needs to be some thought given, in the advice market, to the creation of a cost-efficient mechanism to help such clients."

"In the UK it has been observed that when advice, even IFA advice, is taken out of the mix, clients don't self-direct. In the US, meanwhile, they have reported growth in advice-based selling, as opposed to self-directed investment. Retail investors need good quality advice, or they need an 'embedded advice' product."

Looking Ahead

Pulling the themes discussed in this chapter together, Figure 4 sets out a range of conclusions for the institutional and retail markets. The industry clearly expects the diversification away from high allocations to equities historically to continue, alongside an emphasis on more solution-based products. This is generally seen as likely to be more of a permanent than a purely cyclical phenomenon.

In reality, this will mean asset management firms choosing a range of approaches. Some will continue to focus mainly or even exclusively on component manufacture, serving end-clients with specialised investment portfolio needs as well as asset allocators or product manufacturers downstream. Others will combine component manufacture and solution provision, with active management defined more broadly than pure stocks and securities selection.

As we also explore in the next chapter, the question of who undertakes asset allocation will be particularly significant for the DC market, which will start to grow far more rapidly in the coming years with a growing focus expected on the accumulation as well as retirement income phase.

At the same time, the role of asset managers within the broader economy is expected to evolve as a policy emphasis on market-based finance develops further in the context of constrained government and bank balance sheets.

Figure 4: Major themes in the UK institutional and retail markets

INSTITUTIONAL

1. DB de-risking irreversible due to a combination of mortality expectations, regulation, accounting requirements and scheme maturity.
2. Very long end-game in DB liability management, with UK-developed skill sets exportable to other jurisdictions.
3. Specialisation no longer a desirable direction of travel for many asset managers, who are seeking a broader dialogue with clients.
4. Ongoing bifurcation between passive and active. Active to be increasingly characterised by alternative asset classes, multi-asset offerings and solutions or outcome-oriented strategies.
5. Some firms to move further into areas such as infrastructure or loans as part of a re-intermediation within the capital chain.
6. Greater client scrutiny in areas of risk and operational management to continue.

RETAIL

1. Increasing focus on solutions and multi-asset capabilities copying the trend in institutional and retirement markets.
2. RDR a massive shift, but fraught with complications for end-investors:
   a. Clarity over cost of fund product potentially offset by the lack of clarity over the total cost of the end-to-end investment process.
   b. Ability for parts of the existing or potential long-term savings market to access advice will probably diminish.
   c. A number of firms exploring growth of the direct book, although others not convinced.
3. Need to rebuild trust and communicate differently with end-investors a major priority within the industry.
4. Technological change, both in terms of distribution and communication possibilities, a significant driver of innovation.

3 UK Institutional Client Market

Key Findings

Market overview

- IMA members managed a total of £2.5trn in UK institutional client assets around the world.
- Of the £2.5trn, £1.7trn is accounted for by the third party market.
- In-house mandates are estimated at £788bn, with the majority being run for insurance clients (£671bn) and the rest represented by occupational pension schemes (£116bn).
- The wider UK institutional market (including non-IMA members) is estimated at £2.7trn of which pension assets account for £2.0trn.

Pensions market

- While the largest UK client group is corporate pension funds, IMA member firms also manage significant assets for local authority and other types of pension scheme (eg. managed on behalf of charities).
- With the shift to DC provision intensifying, asset managers are increasingly focused on how to provide services to clients during both the accumulation and retirement income phase.
- The question of ensuring trust and confidence in DC is a critical challenge for the UK, linking to wider reputational issues faced by the financial services industry.

Third party mandates

- Pension funds are by far the largest third party client category (69% of mandates by value), followed by insurance (11%) and sub-advisory business (6.7%).
- The proportion of specialist (single-asset) mandates remained practically unchanged, representing 87% of the third party client market. This, however, does not take into account LDI mandates, whose size is estimated at nearly £300bn.
- Of the 87% in specialist mandates, 40% were equity-focused and 38% were fixed income-focused. Cash mandates represented the third largest category with 9.3%.
- Within specialist equity mandates, the largest category continues to be ‘Global’, which increased to 39% of the total. UK equity mandates, on the other hand, marginally decreased to 29%.
- Fixed income continues to be dominated by £ Sterling corporate bond mandates with 30%, followed by gilt mandates with 20%.

3 UK Institutional Client Market

Market Overview

This chapter focuses specifically on the UK institutional client market. The methodology differs from the analysis in Chapter One in two important ways:

- It focuses on the nature of mandates rather than the underlying assets, which is also the way in which results are being reported.
- It looks at the UK institutional client market regardless of management location (ie. not focusing exclusively on mandates managed in the UK).

This is only the third time that we have collected data for this market, and we are still in the process of developing the dataset. Historical comparisons should therefore be undertaken with caution. This year's responses suggested that, at the end of 2012, IMA members managed £2,479bn in UK institutional client mandates around the world.

While this section looks at UK institutional client mandates irrespective of the location of management, an overwhelming majority in asset terms (94%) continues to be managed in the UK. Following a number of revisions in respondent data, 0.5% is managed out of other EU locations, with the remaining 5.0% managed in other overseas locations.

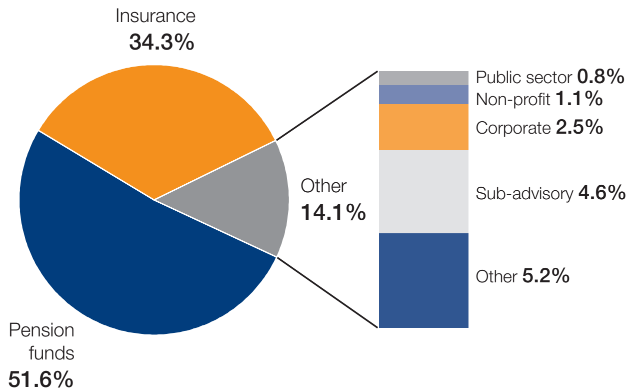
Chart 19 shows the breakdown of the UK institutional client market, including both in-house and third party mandates:

- Pension fund clients represent 52%, or an estimated £1.3trn of the UK institutional client market managed by IMA members. They are discussed in more detail in the next section.
- With 34% of UK institutional client mandates, insurance continues to be the second largest client category with an estimated £851bn. Looking at its two main sub-categories, in-house insurance accounts for the majority with 27% (£671bn) and third party business represents the remaining 7.3% (£180bn).

The UK institutional client space also includes a smaller proportion of other client types:

- Of these, the largest single category was 'Sub-advisory,' amounting to 4.6% of mandates.
- Corporate (non-pension) client mandates represented 2.5% of the total.
- Non-profit and public sector client mandates accounted for 1.1% and 0.8%, respectively.
- 'Other' came to 5.2%. This category mostly consists of various open- and closed-ended pooled vehicles and more niche clients from the private equity, venture capital and property spectrum.

Chart 19: UK institutional market by client type



The total UK institutional client market including mandates managed by non-IMA members is estimated at £2.7trn. Pension assets amount to £2.0trn of the total and are explored in more detail in the next section.

Pensions Market

Pension fund clients of IMA members fall into three categories:

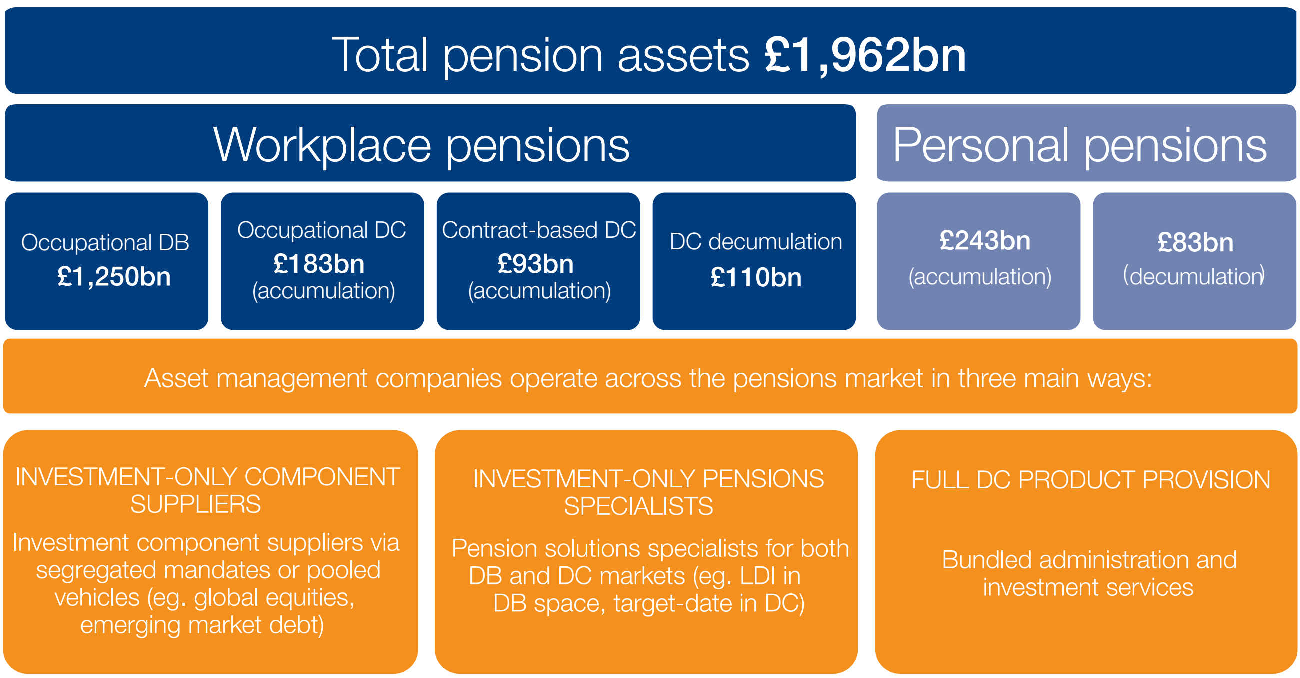
- Corporate pension funds, traditionally the largest pension fund category, which continue to account for £1.0trn or 42% of total UK institutional mandates. This includes a number of OPS managers together estimated at around £116bn.
- UK-based local government pension schemes (LGPS) represent 6.9% of total mandates, amounting to £171bn.
- Some 2.4% is accounted for by other types of pension funds (mostly run for trade unions and not-for-profit organisations), translating into an estimated £58bn of UK institutional client mandates.

The pension fund category includes both DB and DC assets. While these largely represent trust-based DB and DC, we are unable to break out DC and personal pension assets in this report due to the complex nature of the DC and personal pension distribution structure. The latter are mainly accounted for in the insurance client category.

Using third party sources,[14] we are able to make the following estimates of the total UK pension market as at December 2012 (see Figure 5):

- Total UK pension fund assets stood at £2.0trn.[15]
- The overall DB / DC split is 64% / 36% (with the latter including personal pensions).
- The workplace DB / DC split is still heavily weighted towards DB, which accounts for 76% of total workplace pension assets under management.

Figure 5: The UK pensions landscape



Note: Figures based on UK client assets, not location of asset management. Some of the DC data is based on estimates from December 2010.

[14] Source: SpenceJohnson, official and unofficial ONS figures (DC); DCLG, PPF (DB).

[15] In the survey, these assets are split between our pensions and insurance reporting channels, with the remaining assets managed outside the membership base (eg. hedge funds and private equity investment).

Across the trust-based and contract-based environment, fund and asset managers are highly intermediated by different combinations of platforms, consultants and advisers. The shape of this intermediation continues to evolve in both the DC and DB environments.

Over the past few years, the survey has reflected a particular evolution with respect to a blurring of traditional roles in the pensions market. Investment consultants have expanded their product offering via so-called implemented consulting services. But as the asset management product offering evolves, so asset management firms see different patterns of relationships emerge with both trustees and consultants, particularly in the DB market.

industry**view**

Evolutions of relationships across the intermediation chain

"You are getting much more consultant competition into the asset management industry. At the same time, if you are involved in liability hedging, you tend to become more directly involved with your clients, and get to know them far better as you are getting to know the profile of their scheme rather than simply an investment portfolio that you are managing for them. As a result, you are able to get closer to the mindset of the trustees."

"One of the weaknesses of the asset manager business model is that there can be an underappreciation of the importance of distribution. For example, I find it hard to identify a large fund manager which has had great success in the UK institutional market without working with consultants. That is a very powerful position for consultants to be in, albeit one also fraught with conflicts of interest that need to be managed."

Towards DC

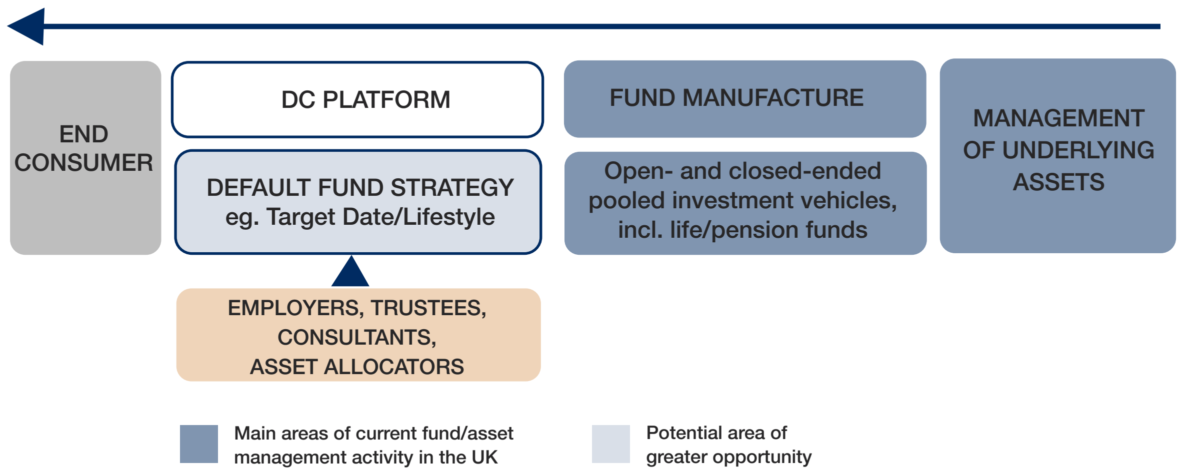
While DB assets remain a significant proportion of the overall UK institutional market, the direction of travel in terms of new members and future flows is expected to be into DC schemes. This trend is likely to be dramatically accelerated by automatic enrolment, which began in October 2012. It also raises a number of issues for UK asset and fund managers, many of whom are currently considering how to position themselves in this market.

As we reported last year, firms fall into three broad groups, with some firms sitting in more than one segment:

- The majority of asset managers will remain providers of segregated or pooled investment services to a variety of schemes and platforms.
- A small group are currently offering more tailored investment-only services (eg. target-date funds or specific DC accumulation strategies).
- A minority offer DC investment platforms and/or bundled DC (ie. both administration and investment).

Figure 6 offers a stylised overview of the value chain from underlying portfolio management through to product distribution. In the light of the breadth of international evidence pointing to high take-ups of default strategies (aimed at individuals who do not make an active investment decision), the shape of this part of the market will be of critical importance.

Figure 6: Potential opportunities in the DC environment



A number of drivers are starting to focus the thinking of asset managers on the retirement income phase itself, in part also as a result of unusually low interest rates. But the structural elements have been apparent for some time as demographic shifts lead to significant increases in those aged 65 and over. OECD projections suggest that, by 2050, almost a quarter of the UK population will be in this category.

The potential role - and responsibility - of asset management firms in this retirement income space is increasingly recognised within the industry as part of a broader financial services product offering that gives people the trust and confidence to save and make adequate provision for retirement.

industry**view**

"The baby boomers will be looking for downside protection for their retirement and what they don't want is old-fashioned 60:40 diversification. They want something much more sophisticated than that, and they want to be able to understand it as well."

The challenges of ensuring confidence in the DC market are significant, particularly given the dramatically different funding positions for individuals in DB and DC, both in terms of current contribution rates (see Table 2), but also accrued pension wealth (see Table 3). While investment processes matter hugely, persuading individuals to make appropriate contribution rates to build up DC pots is critical.

Table 2: Contribution rates of active members to private sector occupational pension schemes (2010)

Contribution rate	Proportion of DB members	Proportion of DC members
<2%	1.8%	2.3%
2-3%	1.0%	18.3%
3-4%	5.6%	26.9%
4-5%	5.4%	21.8%
5-6%	23.7%	17.9%
≥6%	62.6%	12.8%

Source: ONS

Table 3: Private pension saving among households where head is aged 50-64 (2008/2010)

	Proportion of households	Mean (£)
DB pension saving:	48%	324,200
Current occupational DB pensions	36%	315,600
Retained rights in DB pensions	22%	197,700
DC pension saving:	51%	73,000
Current occupational DC pensions	16%	45,500
Retained rights in DC pensions	22%	51,600
Personal pensions	27%	61,400
Additional voluntary contributions	3%	19,000
Pensions expected from spouse or partner	2%	96,200
Total (ex pensions in payment)	**73%**	**267,400**

Source: ONS

3

In this respect, the trust debate is multi-faceted. At a basic level, it involves questions around financial services transparency and disclosure. However, for DC, a critical element will also involve ensuring that appropriate governance and oversight mechanisms are in place for schemes, whatever the legal delivery structure. And these, in turn, involve being able to ensure that individuals take the appropriate level of risk relative to their long-term retirement income aims. While there is not a consensus view within the industry about the investment exposure that this implies, there is a concern that market performance of the past decade will make it difficult to persuade individuals to tolerate significant volatility.

industry**view**

Building a DC savings and investment culture

"We have a brand campaign, which is about a journey, not a product. Raising people's awareness that a longer life is a beautiful thing but then to spend the last 15 years of your life with inadequate funding is a prospect that you need to think about and take action to avoid it."

"In terms of saving in the UK, all the asset class issues aside, we need to figure out the right blueprint, and that means taking the appropriate amount of risk when one is younger and dialling it down as one gets older. And having a goal to be saving, and saving in the right way, in a diversified way, will be beneficial for this country in the long-term, but a consensus view needs to coalesce around that."

A number of observations in interviews contrasted the relatively sophisticated nature of the UK institutional DB market to the less developed nature of the DC market. While LDI was seen as advanced and a potentially exportable skill set to the US and other jurisdictions, the UK DC environment might be an importer of best practice in some areas, eg. greater use of target-date funds.

industry**view**

UK comparatively behind on DC

"The UK market has been ahead in things like LDI, interest in emerging markets, international investing generally and relative lack of home bias. It's in an immature state when it comes to DC."

Figure 7 provides a summary of industry views on the likely evolution of the DC market, and should be read in conjunction with the broader trends described in Chapter Two.

Figure 7: Asset management views on UK DC market

1. DC continuing to blur boundaries between institutional and retail. Asset management firms likely to be highly intermediated and play different roles, supplying both components and solutions.

2. Default arrangements to attract large majority of flows. Multi-asset and solutions-oriented products of great importance.

3. Scheme governance a critical issue to avoid further erosion of individual scheme member confidence and improve trust.

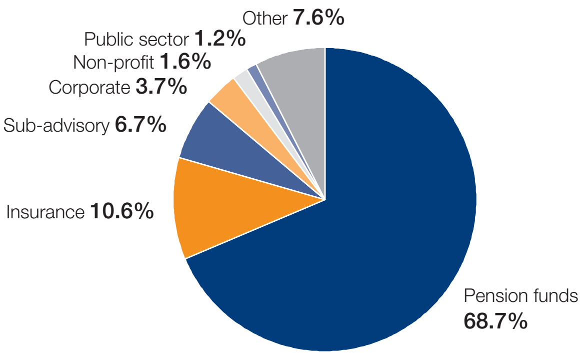
4. Changing saving and retirement patterns to drive greater focus on retirement income phase.

5. Member communication a critical challenge.

Third Party Institutional Market

Most of the UK institutional client analysis focuses on the market that is available to third parties, therefore excluding mandates managed in-house for insurance parent groups or occupational pension schemes. As at the end of 2012, this market came to £1.7trn and, as might be expected, looks considerably different in composition to the total UK institutional market (see Chart 20).

Chart 20: Third party UK institutional market by client type



A comparison with the breakdown of the total institutional client market shows the overwhelming dominance of insurance mandates in the in-house space, without which pension fund mandates increased their share to 69%. Insurance client mandates, while larger than in 2011, accounted for only 11% of the third party market.[16] The third largest area was sub-advisory business (6.7%).

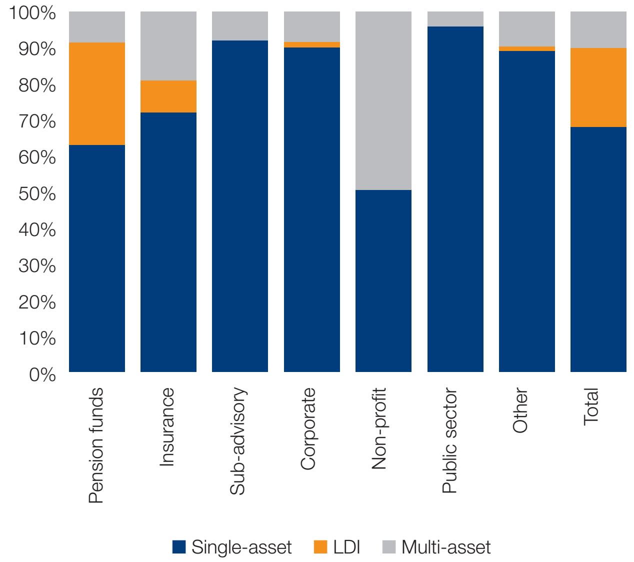
Mandate breakdown

One way in which we look at the institutional client market is by type of mandate. In this respect we categorise mandates into:

- Single-asset (also called 'specialist') mandates, which focus predominantly on a specific investment universe, be it asset class-focused, regional or both.
- Multi-asset (or 'balanced') mandates, which can work across a variety of asset classes and geographies.
- LDI mandates, which are focused specifically on helping clients meet liability structures, typically involving extensive hedging of risk.

As shown in Chart 21, single-asset mandates continue to be the most widely used mandate type, accounting for 68% of third party institutional client mandates. This compares with 10% of balanced and 22% in LDI mandates. Excluding LDI would increase the proportion of specialist mandates to 87%, similar to 2011.

Chart 21: UK third party institutional client mandates



[16] Third party insurance includes both unit-linked business (ie. funds manufactured by firms and distributed with their brand through a life platform) and other third party assets.

While single-asset mandates appear to have high take-up across all asset classes, multi-asset mandates are particularly evident in non-profit and third party insurance mandates (accounting for 50% and 19%, respectively). The nature of LDI mandates makes them used almost exclusively by pension funds (29%) and insurance clients (9.0%).

If in-house mandates were included in the breakdown, the total share of multi-asset mandates would rise to 21% while total LDI mandates would decrease to 16%; this is due to the predominance of balanced mandates in the in-house insurance category (52%).

Last year we reported ongoing growth in LDI mandates in the context of increasing 'limits of specialisation' within the asset management industry and a continued shift away from component manufacture towards solution provision. Measured purely in terms of size, with £302bn, in-house and third party LDI mandates fell by 5% year-on-year. However, this data should be treated with care due to the use of different reporting methodologies. External estimates based on the total notional value of liabilities hedged by LDI strategies show an increase of 11% during 2012, from £403bn to £446bn, driven by a rise in the overall number of mandates.[17]

The pension fund LDI market remains very concentrated, with the top three respondents accounting for 96% of total LDI mandates in terms of reported assets.

industry**view**

Wider acceptance of LDI approaches

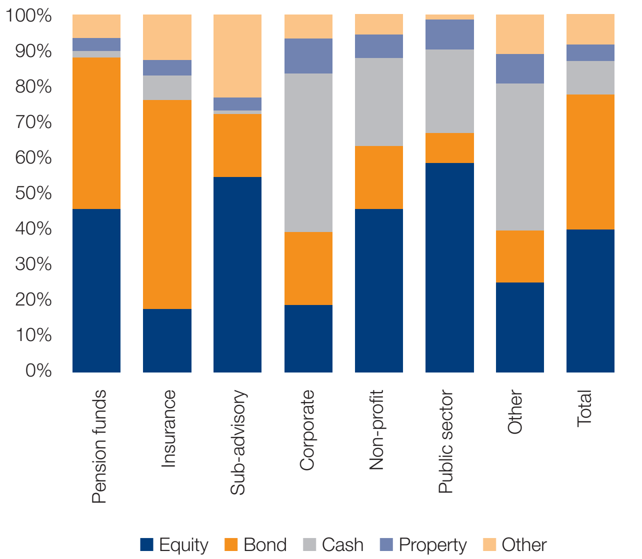
"For the most part you've got pension schemes that are under-funded, they need a solution to stop that getting worse and/or becoming more volatile, and LDI seems to be the most effective way that anybody has come up with so far."

Specialist mandates

This year's headline findings suggest that specialist equity mandates account for 40% of the total in the third party institutional market, only slightly ahead of fixed income (38%). As might be expected, including in-house mandates into the breakdown would increase the proportion of fixed income mandates to 42%, and therefore above equities with 36%. Chart 22 shows the split of third party specialist mandates by client type.

In terms of other asset classes, the corporate client category, in particular, reflects significant use of money market funds for cash management purposes, while the large proportion of cash in the 'Other' client category is a result of firms being unable to identify precisely the client types within money market funds.

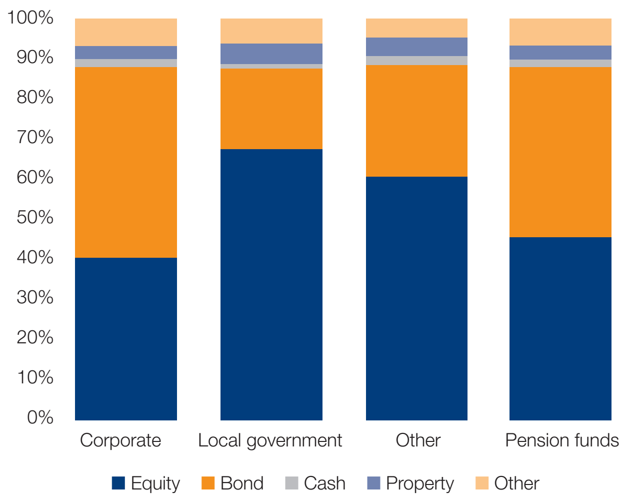
Chart 22: Specialist mandate breakdown by asset class



[17] See KPMG *2013 LDI Survey.*

As shown in Chart 23, de-risking approaches among different types of pension funds are also reflected in the proportions of specialist fixed income mandates. As expected, corporate pension funds continue to be the most heavily bond-focused (48%), while LGPS and others are still heavily equity-focused (67% and 61%, respectively). This is likely to reflect different funding, regulatory and accounting pressures.

Chart 23: Specialist mandate breakdown by asset class among UK pension funds



An increasing number of firms have recently expressed themselves in favour of a rethink around traditional approaches to mandate design, calling for a shift away from benchmark-centricity and in favour of a less constrained, more dynamic process that allowed managers greater freedom in portfolio construction.

This is reflected not only in interview responses but also in the prevalence of unconstrained equity mandates in the UK institutional client space. These types of mandates were run by 30% of respondents (2011: 22%) and accounted for 41% of their specialist equity mandates in asset terms. This is lower than in 2011 (46%), and is largely attributable to subsequent revisions of respondent data.

Several of those interviewed also pointed to the need for more dynamic asset allocation approaches by pension schemes, breaking away again from the specialisation among managers employed on the basis of very specific skill sets.

industry**view**

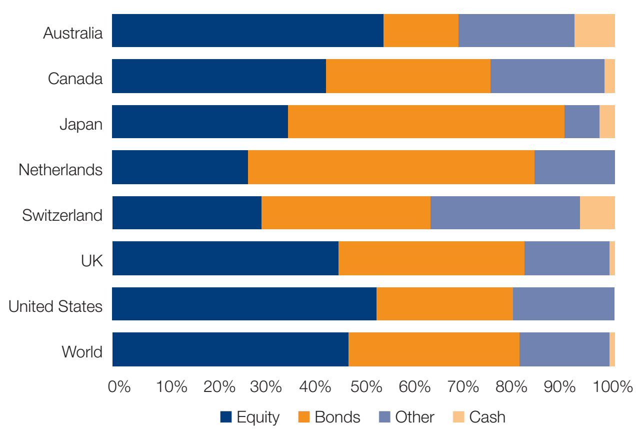
Emphasis on dynamic asset allocation

"Asset allocation decisions have been driven by regulation and accounting rather than economics. The best practice standards for institutional asset management, as employed here and in most parts of the world, should be significantly more dynamic.

To do that, however, you have to change the whole governance structure of the fund, with all stakeholders collectively involved in the key decisions. But normally, you have the sponsor kept partially at arm's length, the fund managers definitely kept at arm's length, and the investment committee and the consultant work out their strategic plan on their own."

In terms of asset allocation in international comparison, UK pension funds (combined DB and DC) are still relatively strong holders of equity, despite the heavy de-risking by corporate DB plans. This is in contrast with the equity focus present in the US and Australia (both more mature DC markets), and the greater fixed income focus across continental Europe, particularly the Netherlands (see Chart 24).

Chart 24: Pension fund asset allocation, selected countries (2011)



Source: Towers Watson *Global Pension Assets Study 2013*

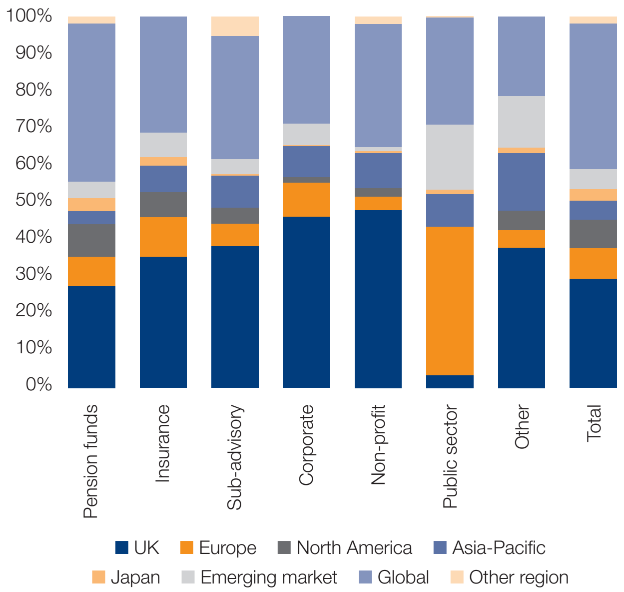
Note: DC assets in Switzerland are cash balance plans and are excluded from this analysis.

Geographic allocation

The continuing erosion of 'home bias' and growing globalisation of investment horizons is well reflected in the relative size of third party equity mandates (see Chart 25). UK equity mandates represented 29% while global mandates accounted for 39% of the total at the end of 2012. The next largest regional categories were European (excluding UK) and North American equity mandates with 8.2% and 7.7%, respectively.

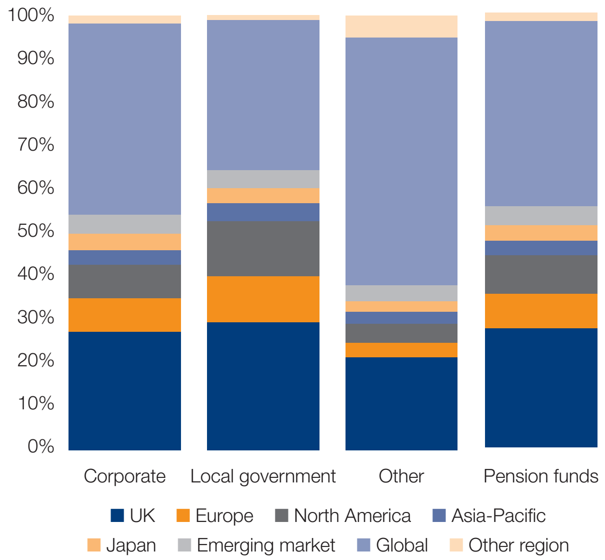
Inclusion of in-house mandates would increase the proportion of UK equity mandates to 33%, with global mandates at 35%. This is due to the higher proportion of specialist domestic equity mandates in the in-house insurance category, where they take up 61% of the total (see Appendix 2).

Chart 25: Geographical equity allocation of specialist mandates by client type



A closer look at the composition of different pension funds again shows interesting variations, primarily around the proportion of UK and global mandates, and around the size of other regional equity mandates (see Chart 26). This year's responses suggest that LGPS are more UK-focused than corporate pension funds, representing 29% compared with 27%. They also appear more inclined to be using regional rather than global mandates.

Chart 26: Geographical equity allocation of specialist mandates among UK pension funds



As shown in Chart 27, fixed income mandates are dominated by a domestic focus, with the '£ Sterling corporate' bond category amounting to 30%, followed by 20% for gilt and 15% for index-linked gilt mandates. In contrast to equity mandates, global and other bond mandates represent a much lower 15% and 13%, respectively.

A breakdown of fixed income mandate types across third party pension funds is shown in Chart 28. The trend towards globalisation of investment opportunities has advanced the most among corporate and local authority schemes, where global and other fixed income mandates come to a total of 27% and 31%, respectively.

Chart 27: Fixed income allocation of specialist mandates by client type

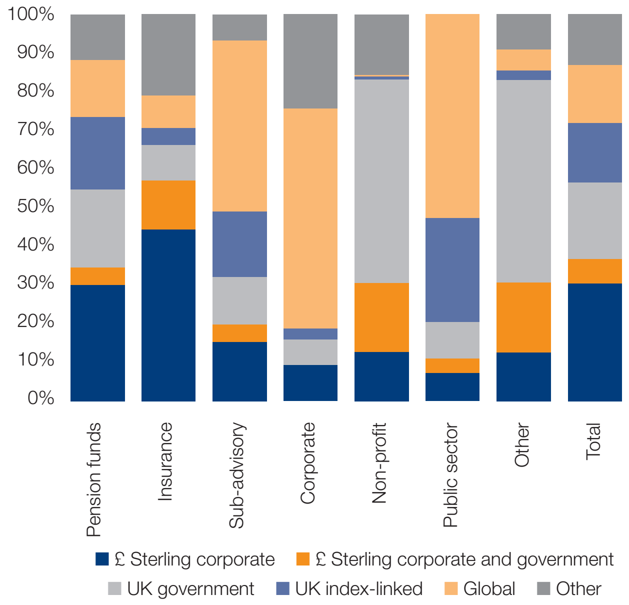
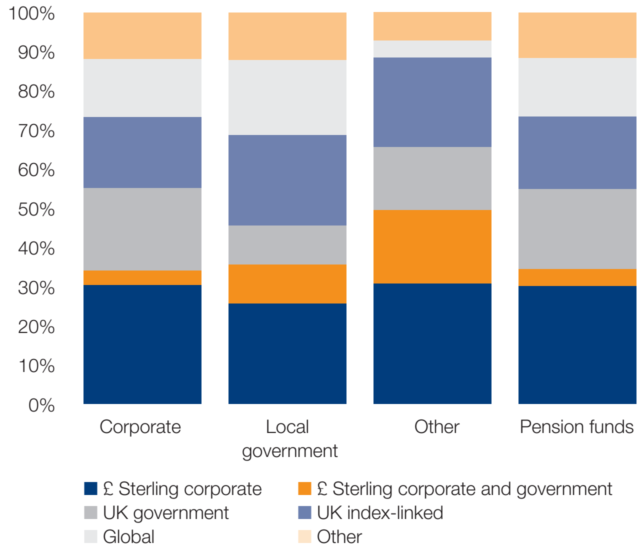


Chart 28: Fixed income allocation of specialist mandate types among UK pension funds



If in-house mandates were included in the breakdown, £ Sterling corporate bond mandates would decrease to 27% while index-linked gilt mandates would increase to 21%. This is due to the high proportion of index-linked gilt mandates within the in-house insurance category (35%).

3

Active vs passive

As shown in Chart 29, 61% of total third party mandates were managed on an active basis. While this represents a slight decrease on the 64% in 2011, the difference all but disappears when looked at on a matched basis. The two parts of the market where active mandates fall below 60% of the total are pension funds (54%) and sub-advisory business (46%). This is not surprising given the widespread use of passive management among DB and DC corporate pension funds, where passive mandates account for 46% (see Chart 30).[18]

Across the UK institutional client market as a whole, the total for actively managed mandates would increase to 69%, mostly due to in-house insurance clients having the largest proportion of actively managed mandates of the entire client spectrum (90%).

Chart 29: Active and passive mandates by client type

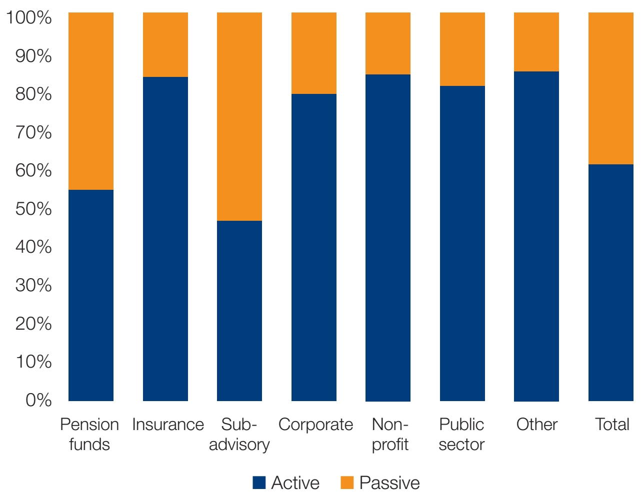
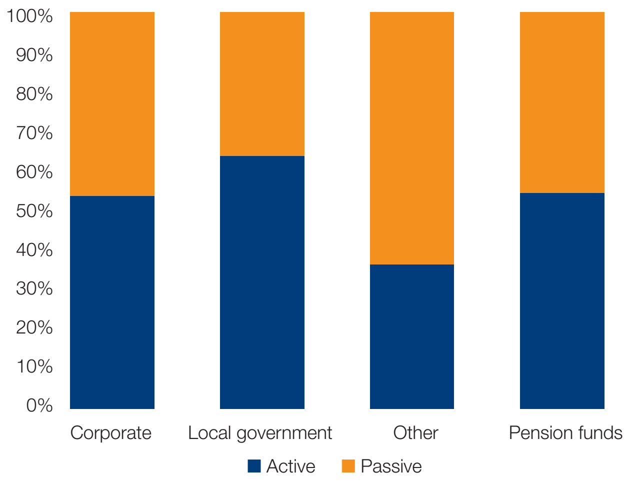


Chart 30: Active and passive mandates among UK pension funds



Those we spoke to believe that the trend towards a decomposition of beta and alpha would continue, but noted that in the institutional market, the nature of the conversation about alpha was also changing and becoming more sophisticated.

industry**view**

Increased focus on alpha and beta

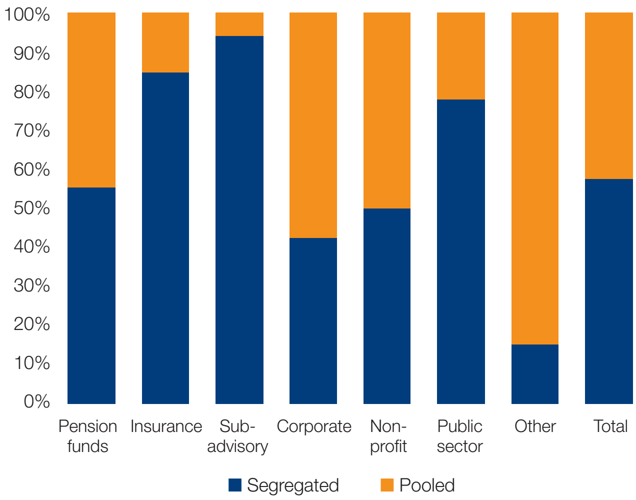
"We see alpha/beta separation and more and more inflows coming into the beta space. On the institutional side we are also seeing a decomposition and closer look at alpha. How is it being generated, is it systematic and can it be repeated? What we labelled as alpha in the past is changing, and institutional clients are looking to redefine that even further going forward."

[18] Given the presence of large indexing houses in the respondent sample, these headline data almost certainly overstate passive exposure among UK institutional client groups.

Segregated vs pooled

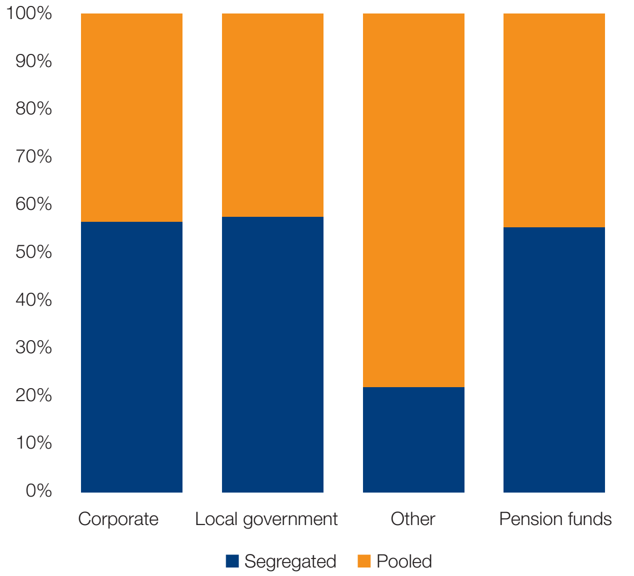
Segregated mandates continue to represent over one-half (57%) of third party institutional mandates. As shown in Chart 31, every single client category except for 'Corporate' and 'Other' has a substantial proportion of segregated mandates, most prevalent in the sub-advisory and third party insurance space (94% and 88%, respectively, similar to 2011).

Chart 31: Segregated and pooled mandates by client type



Pension funds continue to have among the largest proportions of pooled assets, a trend likely to reflect greater use of indexing vehicles. As shown in Chart 32, this is particularly true among other pension funds, although even corporate and LGPS with 42% and 43%, respectively, are favourably inclined to pooled investment.

Chart 32: Segregated and pooled mandates among third party pension funds



3

4 UK Fund Market

Key Findings

Total funds under management

- Total investment funds (including both UK authorised and overseas funds) managed in the UK are estimated at £1.4trn.
- UK authorised funds totalled £660bn as at December 2012, 14% higher than the previous year.

Sales trends

- Total net sales (retail and institutional) of UK authorised funds showed an inflow of £22bn compared to £24bn in 2011.
- This was driven primarily by retail investors who contributed £14bn of new money, compared to £18bn in 2011. The remaining £8.1bn came from institutional investors.
- Fixed income funds were the best-selling fund type in 2012, attracting £5.6bn of new retail investment.
- Equity funds sold well in the last four months of 2012, which helped them to attract £3.7bn of new retail investment overall.
- Mixed asset funds did not fare as well in 2012 as they did in the previous year. They were the third most popular fund type with £2.7bn of net retail sales (2011: £5.6bn).
- Interest in absolute return funds continues, with UK-domiciled absolute return funds representing 3.9% of total funds under management.

Asset mix in investment funds

- Equity funds accounted for the largest proportion of funds under management at 52%, with fixed income funds at 18% and mixed asset funds at 14%. Property funds represented 2.0% of total funds under management.

UK industry concentration and structure

- The fund industry remains very unconcentrated compared to other parts of the financial services industry.
- While the top ten firms' share of the fund market is steady, the share of the next ten firms is increasing at the expense of the smallest firms.

European comparisons

- European investment fund assets stood at €8.9trn (£7.3trn) at the end of 2012, an increase from €8.0trn (£6.5trn) a year earlier.
- The UK continues to have a much higher equity allocation (59% of UCITS funds) compared to the European average (29% excluding the UK). On the contrary, money market funds continue to have minimal uptake in the UK (0.6%) compared to the rest of Europe (16%).

4 UK Fund Market

This part of the survey covers UK-domiciled authorised unit trusts and OEICs, which are by far the largest part of the UK fund market. A small but growing part of the fund market is represented by funds domiciled overseas although often with portfolio management performed in the UK. There are also some UK-domiciled funds that are sold into overseas markets.

Unit trusts and OEICs are thought of primarily as retail vehicles, although institutional investors also invest in them for a variety of reasons; for example, for access to certain portfolio manager skills or to reflect investor preferences within unit-linked life products that offer access to third party funds.

The analysis in this section is based mainly on IMA fund data, which are both more detailed and have a longer history than the survey (which started in 2002). Most importantly, they capture funds under management and flows on a monthly basis. In 2012, the IMA collected this data on 2,493 funds.

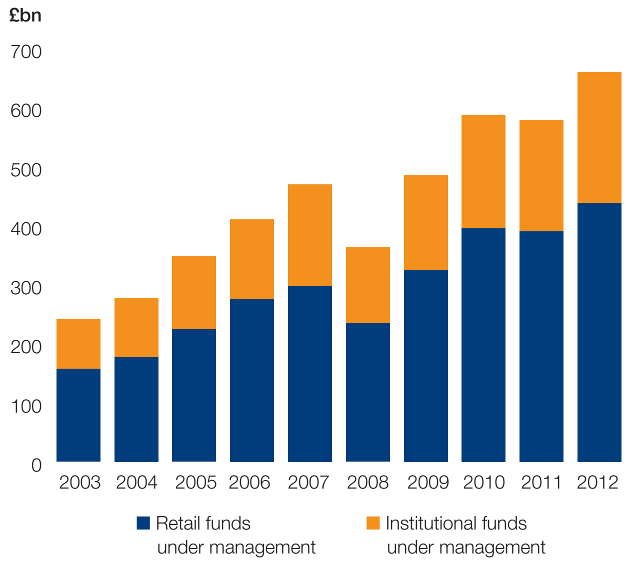
Total Funds under Management

At the end of 2012, total funds under management of UK-domiciled funds were £660bn (see Chart 33), up by 14% from £577bn a year earlier. Retail funds under management accounted for 66% of the industry total, a similar level to ten years ago (65%).[19] UK investor holdings of overseas-domiciled funds[20] totalled £50bn at the end of 2012. Including all assets of overseas-domiciled funds managed in the UK (£721bn) increases the total to £1.4trn.

As Chart 33 shows, the industry has grown in nominal terms by 41% over the last five years and by 239% since 2003. The latter highlights strong industry growth over the last decade as well as the economic dislocation of the early 2000s, which depressed asset values to a four-year low at the end of 2002.

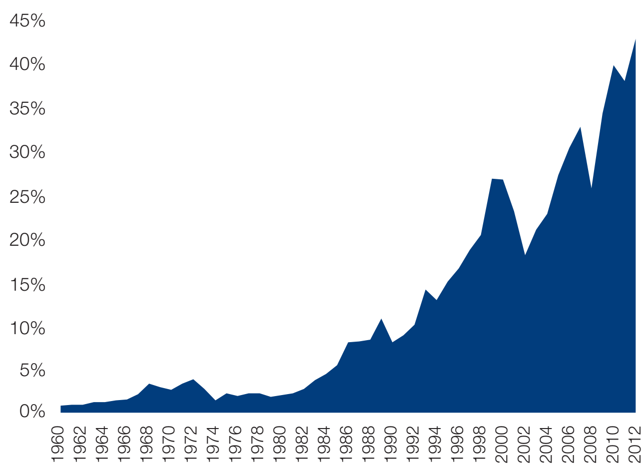
These figures translate into a compound annual growth rate of 13% over the last ten years in nominal terms and 10% when adjusted for inflation. The comparable figure for the FTSE All-Share index was 5.0% in nominal terms, including re-invested income.

Chart 33: Industry funds under management (2003–2012)



Looking back over a longer period, the annualised growth rate from 1960 to 2012 was 17% in nominal terms and 10% in real terms. Such expansion rates are clearly greater than those of the UK GDP rate, with fund industry growth rates particularly strong in the 1980s. At the end of 1960, funds under management equated to less than 1.0% of GDP (see Chart 34). By the end of 2012, the figure was over 43%.

Chart 34: Funds under management as percentage of GDP (1960–2012)



Source: IMA, ONS

[19] In this context, 'retail funds under management' comprises assets held by retail funds. These are defined as funds with a minimum lump sum investment amount of up to £50,000 and with at least one-third of gross sales over the preceding three years being retail.

[20] These funds comprise open-ended investment funds that are domiciled outside the UK, are FCA-recognised and sold into the UK with reporting fund status or UK distributor status.

4

The growth of the fund management industry over this period reflects a number of factors:

- While unit trusts have been in existence since the 1930s, it was only in the late 1950s and early 1960s that the industry started to develop more rapidly.
- Industry growth rates throughout the 1980s and 1990s benefited from strong demand for equity funds and buoyant equity markets.
- Growth rates over the last decade have been robust, albeit with a significant boost in 2009-2010 as retail investors reacted to the first years of the global financial crisis (see p.54).
- Periodical restructuring of insurance assets into OEICs has also helped the fund industry expand in recent years.

Flows vs performance

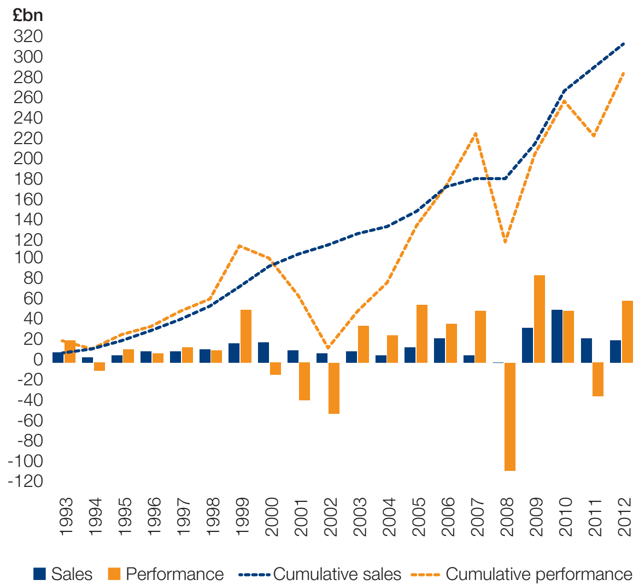
Total net investment (retail and institutional) into the UK fund industry was £22bn during 2012, similar to the 2011 figure of £24bn:

- The main proportion of total net sales in 2012 came from retail investors who invested a net amount of £14bn (2011: £18bn).
- At £8.1bn, net institutional investment in 2012 was higher than in 2011. The main driver of this was the restructuring of insurance products into OEICs, something that has occurred intermittently over recent years.

UK financial markets fared better in 2012 than in 2011. Despite a downturn midway through the year, equity indices picked up following ECB reassurance about the future of the Euro. Market movements accounted for a £61bn increase in funds under management with net investor inflows amounting to a further £22bn.

Chart 35 shows the changes in funds under management since 1993, broken down into net flows and performance of the underlying assets. Market fluctuations have a significant impact on asset values year-on-year whereas, over the long term, consistently positive annual net sales have driven the majority of industry growth.

Chart 35: Changes in funds under management by sales and performance (1993–2012)



Asset mix

The overall asset mix of UK authorised funds as at the end of December 2012 is shown in Chart 36:

- Equity funds continued to account for the largest proportion of funds under management at 52%, down slightly from 53% last year.
- Funds under management of fixed income funds represented 18% of the total, unchanged from a year earlier.
- Mixed asset funds made up 14% of the market, the same as the year before.
- The market share of property funds decreased slightly to 2.0% (from 2.2% in 2011). These funds peaked in 2006 when they represented 3.0% of the total.
- UK authorised absolute return funds continued to increase in significance, up from 3.3% in 2011 to 3.9% of total funds under management.[21]
- Retail money market funds (as distinct from the very large IMMF business managed out of the UK, see p.19) continued to account for a tiny proportion of funds under management at 0.6%.

Chart 36: Funds under management by fund/asset type

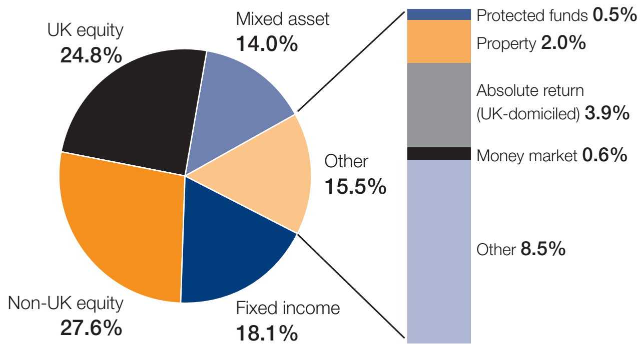
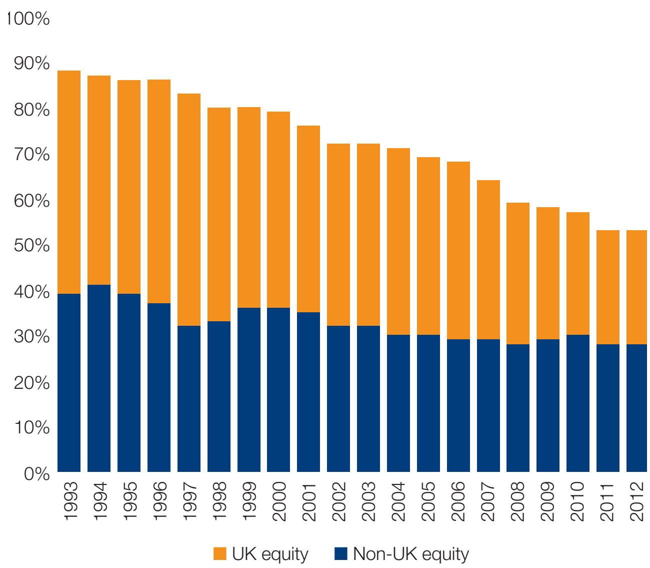


Chart 37 shows that the proportion of total funds under management represented by equity funds decreased from 89% in 1993 to 52% at the end of 2012. Also highlighted is the erosion of 'home bias' in terms of investor preferences, with the proportion of non-UK equity funds exceeding those focused on UK equity for the third consecutive year. It is important to emphasise that these are relative and not absolute changes. The fund market in 1993 totalled only £95bn in assets, compared to £660bn at the end of 2012. In real terms, total equity fund holdings are therefore still much higher now than in 1993, even as overall fund preferences become more diversified. This is true for both UK- and overseas-focused equity funds.

UK equity funds accounted for 6% of domestic market capitalisation in 1993; this has risen steadily to around 9% at the end of 2012. Including other sectors that have some UK equity exposure, the figure is likely to be closer to 10% at a time when UK institutional ownership as a proportion of total ownership has been falling.

Chart 37: Proportion of industry funds under management represented by equity funds (1993–2012)



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[21] The IMA's Absolute Return sector was renamed Targeted Absolute Return in June 2013.

Retail Investor Flows

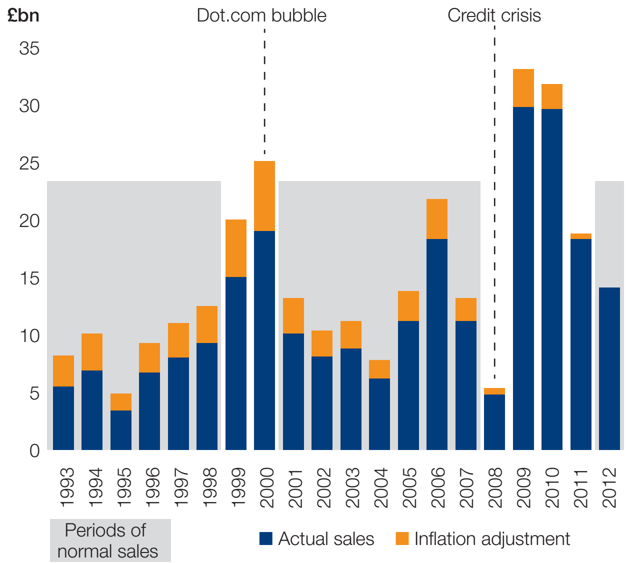
The main focus of this chapter is on retail investor behaviour. IMA figures on retail investment include sales through fund platforms, other intermediaries such as wealth managers, stockbrokers, tied agents and IFAs, as well as direct sales. Sales to investors through insurance companies, whether as investment bonds or as part of pension arrangements (including personal pensions) are classified as institutional.

Retail investors invested a total of £14bn in 2012 compared to £18bn in 2011. This reinforces our observation about the conclusion of a sustained period of high net inflows in 2009, 2010 and part of 2011 (see Chart 38):

- In nominal terms, average monthly net retail sales from January 2009 to June 2011 were over £2.4bn; a stark contrast to the monthly average of £0.8bn in the eight years prior to this.
- From July 2011 to December 2012, the monthly average was just £1.0bn, which seems to signify a reversion to what may be considered a more normal level of net retail sales.

Chart 38 includes an adjustment for inflation to illustrate purchasing power in 2012 money values. In a comparative historical perspective, recent flows have still been robust.

Chart 38: Net retail sales (1993–2012)

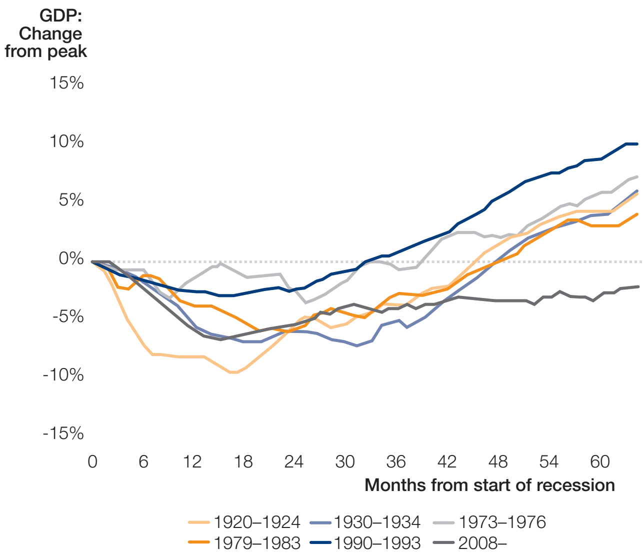


Source: IMA, ONS

Investment landscape

UK savers and investors have faced a tough macroeconomic environment since 2008 (see Chart 39). Real household disposable income has barely increased over the last five years, rising at an average of just 0.6% annually compared to 1.9% in the previous five years and 3.7% over the five years before that. Over the past five years, wages and salaries have risen less than prices.

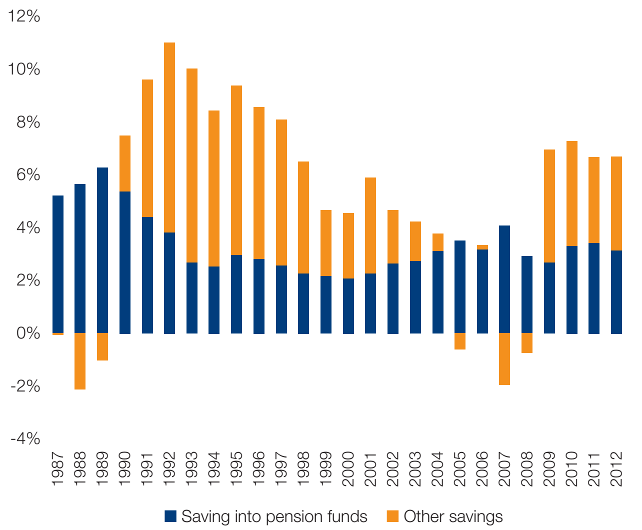
Chart 39: The profile of UK recession and recovery



Source: NIESR

As a result, households have not felt confident about the future and have increased their rate of saving since the beginning of the recession, repeating a pattern seen in the last recession in the early 1990s (see Chart 40).

Chart 40: Household savings as percentage of household resources (1987–2012)



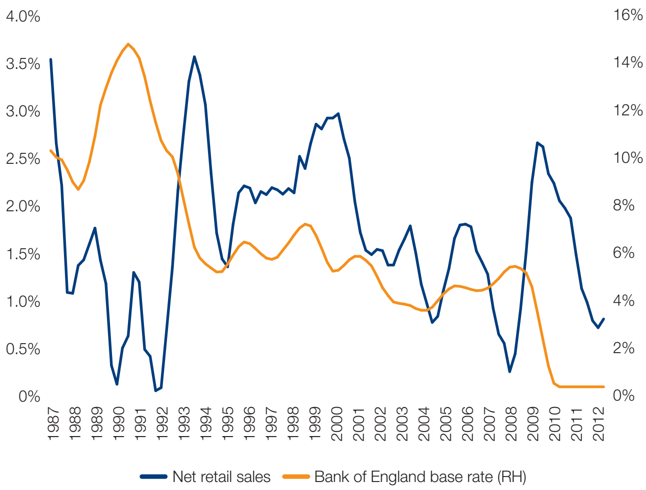
Source: ONS

This increased saving may well have benefitted the fund industry, but perhaps more important has been an increase in the relative competitiveness of funds as a home for retail savings in a low interest rate environment. The credit crisis led to a very sharp reduction in the interest rates offered by banks and building societies, thus encouraging retail investors to look elsewhere for decent returns on their savings.

Determinants of flows

As Chart 41 shows, interest rates appear to bear a historical relationship to fund flows. Following the recession of the early 1990s in particular, high interest rates were mirrored by low net retail sales. There are a number of possible reasons for this, eg. constrained discretionary saving as mortgage repayments rose, product substitution given high-yielding savings accounts and/or the need for precautionary saving held in liquid vehicles.

Chart 41: Net retail sales as percentage of retail funds under management vs Bank of England base rate (1987–2012)

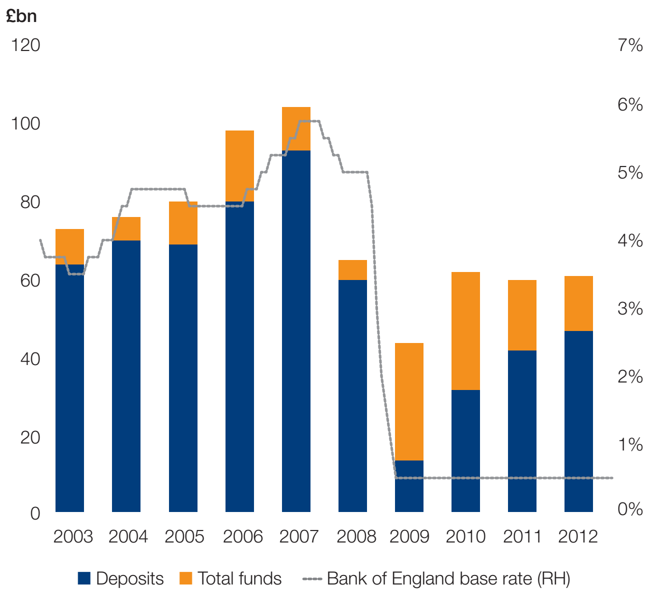


Source: IMA, ONS

As shown in last year's report, it is very difficult to reach firm conclusions about what determines saving behaviour from data that aggregate the decisions of a wide variety of investors. Nonetheless, following the onset of the financial crisis one can observe an inverse relationship historically between net retail flows into banks and building societies and into UK authorised funds.

Chart 42 shows this relationship over the last ten years along with the movement of the base rate. Growth in net bank and building society deposits fell sharply with the onset of the financial crisis, and appeared to be directly correlated with the falling base rate.[22] At the same time, from January 2009 to June 2011, the fund industry experienced the highest monthly net retail inflows on record.

Chart 42: Net acquisition of currency and deposits by UK households and net retail sales of UK authorised funds vs Bank of England base rate (2003–2012)



Source: IMA, ONS

There are several possible explanations for the patterns observed after 2008:

- **Diversion of new savings flows.** As returns on bank deposits fell in line with the base rate during 2008-09, investors may have sought higher returns by choosing investment funds. Money that would have previously flowed into banks was instead being invested into funds. In the immediate aftermath of the Lehman Brothers collapse and wider bank turmoil, a lack of trust in the banking sector may have also been a factor.

- **Reallocation of existing saving.** A period of reallocation of portfolio assets (from bank accounts and into funds) may have taken place from 2009 to mid-2011, again driven by the historically low base rate. This would also explain the apparent reduction in fund flows from the second half of 2011 and throughout 2012 despite the base rate remaining at 0.5%. The availability of assets to reallocate appears to have eroded.

- **Macroeconomic concern displacing bank solvency anxiety.** The slowing of fund flows from July 2011 and the corresponding increase in bank deposits may have been the result of macroeconomic concerns about the eurozone. Flows into equity funds, which had bounced back strongly in 2009-10 did not recover until the last four months of 2012, subsequent to ECB President Mario Draghi's reassurance about the future of the Euro.

[22] The net deposit data include interest payments. Therefore, all things being equal, such a sharp fall in interest rates would exercise a downward influence.

The direction of flows has also been important and several patterns are observable:

- **Hunt for yield.** For many retail investors, income return is a very important factor in their choice of investments. With returns on bank and building society accounts falling dramatically, investors looked for income elsewhere. Following the extreme volatility of 2008, investors committed record levels of new retail money to fixed income funds and continued to invest in equity income funds (see Chart 43).

- **Outcome-oriented investing.** Faced with disappointing and uncertain returns on equities, and the volatility of stock markets, some investors have also looked to funds where managers focus more on outcomes, both in terms of targeted return and, to a lesser extent, capital protection.

- **Asset allocation funds.** While outcome-oriented funds have done well recently, this is not the only approach that retail investors have taken to handle the uncertainty created by volatile markets. Another approach was to buy funds where asset managers can exercise greater discretion over asset allocation. These include two types of fund; those categorised as mixed asset funds and those in the IMA's Unclassified sector, which allocate across assets within a risk-return framework. Together, these so-called 'asset allocation funds' have grown substantially in recent years. Net retail sales of these funds have been at record levels and reached over £10bn in 2010 although falling back somewhat by 2012 (see p.54).

Chart 43: Net retail sales of fixed income funds and equity income funds (2003–2012)

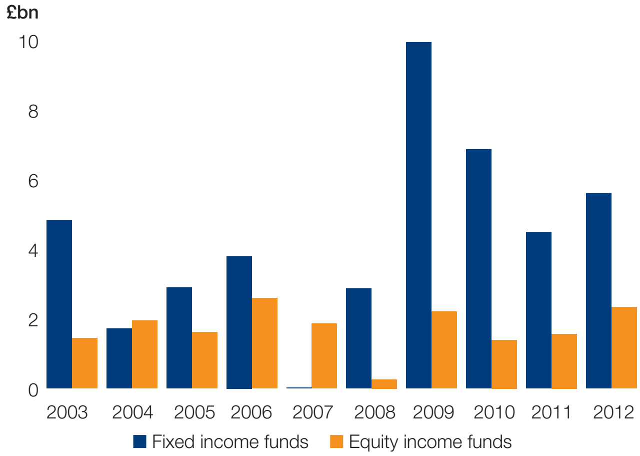


Chart 44 shows how investors' fund choices have developed over the last 20 years. Whilst equity growth funds were dominant throughout the 1990s, since 2001 investors have shown increased desire for income generating products as well as outcome and allocation type funds. These preferences have recently been more pronounced, with flows into equity growth funds dwarfed by flows into other funds in 2011 and 2012.

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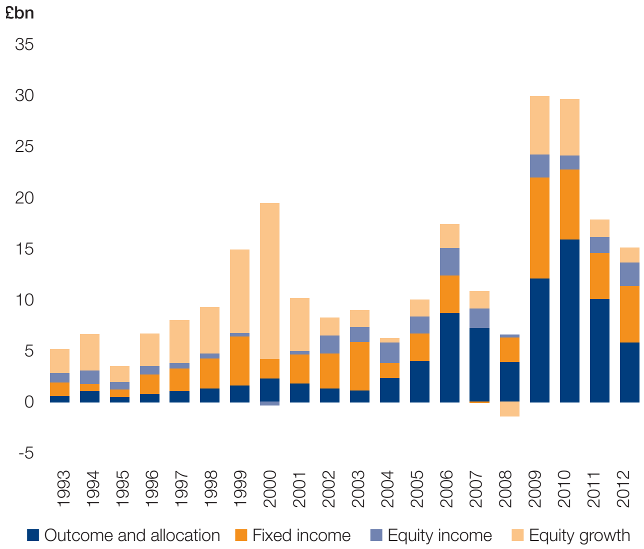
Chart 44: Net retail sales by investment objective (1993–2012)



Source: IMA, Morningstar Direct

Looking back at the main asset categories historically, retail investor choices have changed substantially. Net retail sales of equity funds decreased from 59% of total net retail sales in the 1990s to just 21% by 2011-12, while fixed income funds have increased their share from 21% to 31%. More striking still has been the progression of mixed asset and other funds, from 20% to 47%.

industry**view**

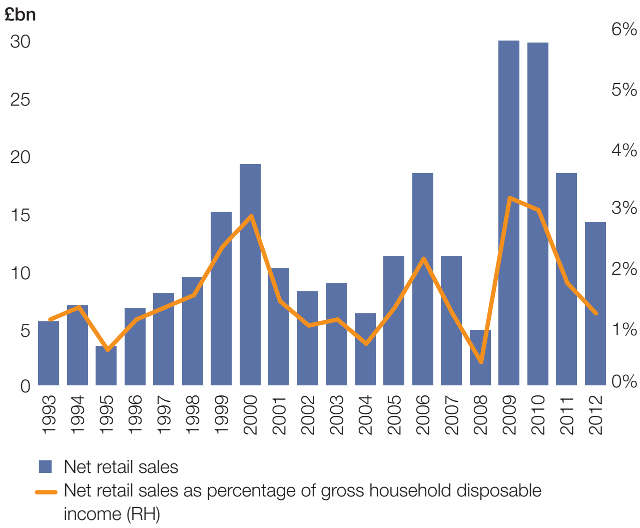
Ongoing move towards solutions

"The days when people bought single-strategy funds are over. RDR has definitely increased the emphasis on solution-type products, be it advisers seeking to outsource actual asset allocation and fund selection through solution products or individual customers wanting to outsource portfolio construction and asset allocation through solution products. We're convinced that, at the lower end of the spectrum at least, the retail market will shift towards asset allocated and solutions."

Funds in the broader savings context

As already noted, net retail sales of funds were at a broadly similar level in 2012 to the years before the financial crisis. This can also be seen in Chart 45 which shows that, apart from a brief increase following the dot.com boom and the onset of the crisis, net retail sales of funds as a percentage of household gross disposable income averaged 1.3% over the twenty-year period between 1993 and 2012.

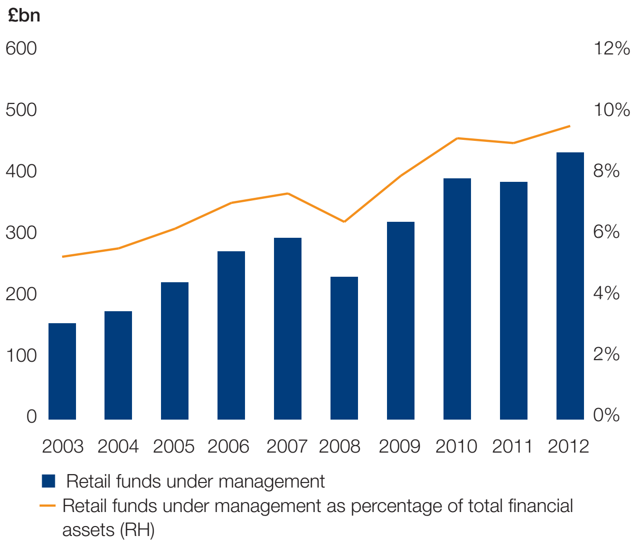
Chart 45: Household saving into funds as percentage of disposable income (1993–2012)



Source: IMA, ONS

Chart 46 shows that retail funds under management grew to £438bn at the end of 2012 (2011: £390bn), thereby increasing their significance as a proportion of total gross financial assets.

Chart 46: Retail funds under management as percentage of total financial assets (2003–2012)

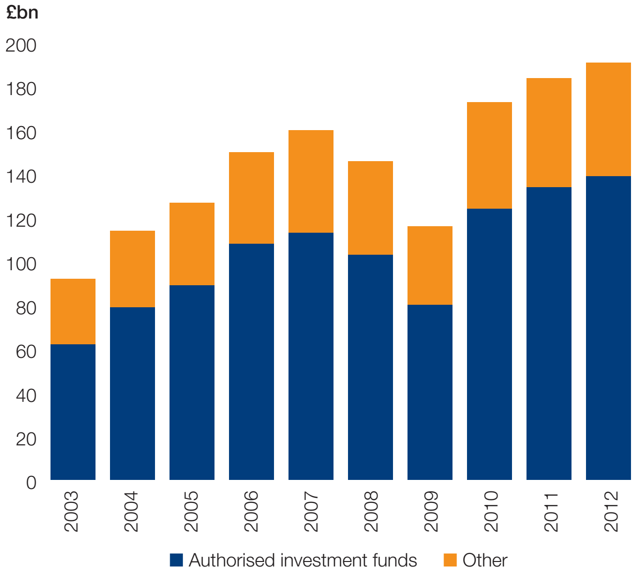


Source: IMA, ONS

Individual savings accounts (ISAs)

A substantial proportion of retail investment is held within stocks and shares ISAs. Fund holdings represent three-quarters of this, with the remainder accounted for by direct holdings of securities. At the end of the 2011/12 tax year, HMRC data show that investors owned funds valued at £139bn out of a total investment of £190bn in stocks and shares ISAs (see Chart 47).

Chart 47: Funds under management in ISAs by investment type (tax year ending April 2003–2012)



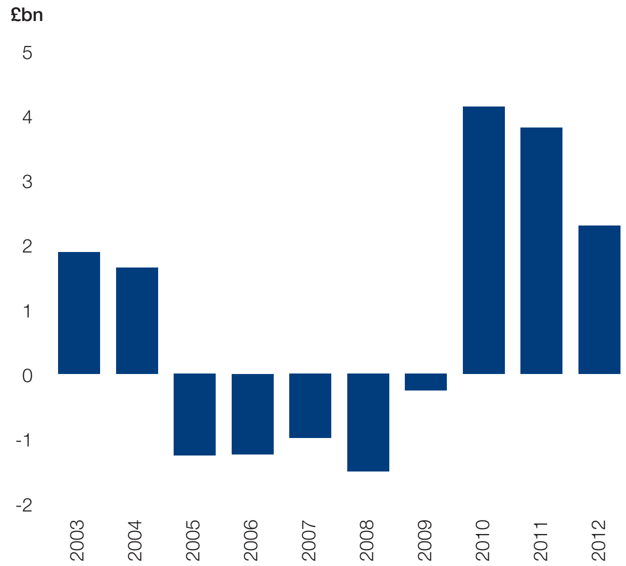
Source: HMRC

As a proportion of industry funds under management, ISAs have been falling from 33% in March 2003 to 22% at the end of March 2012.

IMA figures in Chart 48 show sales of ISAs provided by fund managers and five larger fund platforms since 2002/03:

- Net sales of funds within ISA wrappers fell sharply after the dot.com boom and from 2004 turned negative.
- In 2009, ISA investment limits were increased substantially for investors over 50 years of age, which caused an immediate increase in ISA fund sales. From 2010, the ISA allowance increase was extended to all investors.
- The stronger trend in fund sales through ISA wrappers in the 2009/10 and 2010/11 tax years continued into 2011/12, although the pace slowed down in line with overall fund sales. As the survey went to print, HMRC figures for 2012/13 were not yet available.

Chart 48: Net ISA sales (tax year ending 2003–2012)[23]



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[23] For the purposes of this chart, the tax year is defined as 1st April to 31st March.

Distribution Dynamics and their Implications

Fund platforms continued to gain market share in terms of gross retail fund sales, accounting for 45% of the total (up from 41% in 2011 and from 37% in 2010).[24] Such a strong increase in a short space of time suggests that these platforms are fast becoming the dominant distribution channel.

Total net retail sales through fund platforms were £11.5bn, which in monetary terms was in line with the previous year. However, this represented 81% of total net retail sales in 2012 compared to 63% in 2011.

The increasing popularity of platforms as a distribution channel is also supported by the data we collect directly from five fund platform operators.[25] These platforms account for three-quarters of the platform market in terms of total transactions. By the end of 2012, they had fund holdings of £132bn, up 21% on the year before (2011: £109bn).

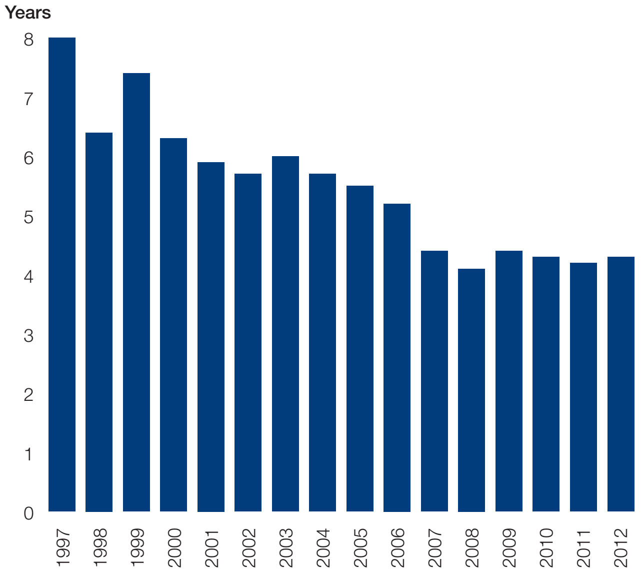
The latest funds under administration figure supports the increasing popularity of fund platforms seen in the sales figures. The overall industry grew by 14% in the same period showing an increasing market share of platforms. In 2011, funds administered on platforms were up 1.9% year-on-year whereas overall funds under management actually fell.

The majority of the gross sales reported by the five platforms were through tax-efficient wrappers, with personal pensions making up the largest share of the total (29%). Sales of ISA-wrapped products made up 26% of the total, down from 28% in 2011. Our figures indicate that these five fund platforms held around 42% of the total ISA-wrapped funds in March 2012, up from 32% four years earlier when this information was first collected.

Technological advances have made it easier for investors and financial advisers to buy and sell funds, as well as monitor their performance, and fund platforms have played a big part in this change. These developments are likely to be one reason why fund managers have been experiencing greater flow volatility.

The average time for which investors hold funds has declined in recent years. As shown in Chart 49, the average holding period for funds (calculated as the inverse of the average redemption rate for retail funds) halved from around eight years in 1997 to around four years in 2007. Since then it appears to have stabilised around this level.

Chart 49: Average holding periods of retail investors (1997–2012)



Holding periods have been relatively unaffected by the recent financial crisis. One might expect redemption rates to increase dramatically during or following periods of economic turmoil as investors seek to remove their money from risky investments. Redemption rates in 2008 remained at a similar level to previous years and, as described earlier, preceded some of the strongest monthly inflows on record from 2009 to 2011. This may be explained by the diminishing returns on deposit accounts which left return-seeking investors with limited options.

[24] For these figures, we count the following as fund platforms: Ascentric, AXA-Elevate, Cofunds, Fidelity, Hargreaves Lansdown, James Hay Wrap, Novia, Nucleus, Skandia (including Selestia, Skandia Multifunds and Skandia Life), Standard Life Savings and Transact.

[25] These platforms are Cofunds, Fidelity Platform, Hargreaves Lansdown, Skandia and Transact.

Asset Class Choices

Table 4 shows net retail sales broken down by fund type, and highlights a number of key features:

- Fixed income funds were the best-selling fund type in 2012 with £5.6bn; a year-on-year increase of over £1bn. This is despite lower industry net retail sales overall.
- Equity funds were the second highest selling fund type in 2012, buoyed by strong sales in the last four months of the year. Funds under management in non-UK equity funds surpassed those in UK equity funds for the first time in 2010. This trend continued until the end of 2012.
- Mixed asset funds did not fare as well in 2012 as they did in the previous year. They were the third most popular fund type with many investors continuing to access them through funds of funds.
- Net retail sales of funds of funds represented almost a quarter of total net retail sales. This helped funds under management in funds of funds reach their highest level on record.
- Net retail sales of tracker funds in equity sectors fell slightly year-on-year, from £1.3bn to £1.2bn in 2012.
- UK-domiciled absolute return funds continued to be popular and matched the net inflows of £0.9bn seen in 2011.

Table 4: Net retail sales by fund type (2010–2012)

Fund type	**Net retail sales (£bn)**		
	2010	**2011**	**2012**
Fixed income funds	6.9	4.5	5.6
Of which trackers	0.7	0.7	0.3
Equity funds	6.8	3.2	3.7
Of which trackers	1.3	1.3	1.2
Mixed asset funds	7.9	5.6	2.7
Absolute return funds	2.3	0.9	0.9
Property funds	1.8	0.6	0.4
Money market funds	0	0.2	-0.1
Other funds	4	3.3	0.8
TOTAL	**29.6**	**18.3**	**14.1**
Of which funds of funds	**6.6**	**5.2**	**3.4**

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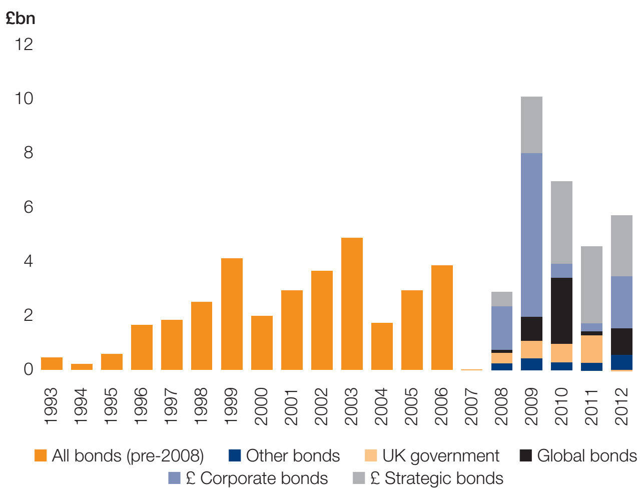
Fixed income fund sales

Fixed income funds were the best-selling fund type in 2012. This was driven by strong net retail sales in the first eight months of the year with the monthly average exceeding £600m. By the end of the year net retail sales totalled £5.6bn compared to £4.5bn in 2011. The persistently low interest rates discussed earlier may have contributed to fund inflows as the search for yield continued in lieu of returns on bank and building society accounts.

Chart 50 shows net retail sales of fixed income funds since 1993 with a sector breakdown from 2008 onwards.

Chart 50: Net retail sales of fixed income funds (1993–2012)



In terms of net retail sales, the best-selling fixed income sector in 2012 was £ Strategic Bond. Indeed, this was the best-selling sector overall in that year, with net retail inflows of £2.2bn, down from £2.8bn in 2011 when it was the second highest selling sector overall. The funds in this sector may hold a range of different bonds, with no limit on levels of exposure.

There was renewed interest in the £ Corporate Bond sector following two years of low net retail sales, with £1.9bn in 2012 compared to only £267m in 2011 and £505m in 2010. Historically, corporate bond funds have been popular among investors and the corporate bond sectors have accounted for almost half of the net retail inflows into bond funds since 1993.

Global bond funds resumed stronger flows in 2012 with net retail sales of £966m, up from £159m the previous year. The increasing popularity of global bond funds has been evident since 2008 and reinforces the global bias that we see in other asset categories.

Gilt funds had a net outflow of £41m in 2012, in stark contrast with the inflow of £995m in 2011.

industry**view**

Continued interest in fixed income

“In 2008 we saw the start of what became a huge flood of money into fixed interest funds – pretty smart money if you think about it – and I don’t see that coming out.”

“You can no longer get a real return on cash. How much is that driving investor behaviour in terms of fixed income sales because people want yield? We see the demand for income as a long-term trend, and certainly a lot of our competitors have launched a range of income funds, be it global or regional.”

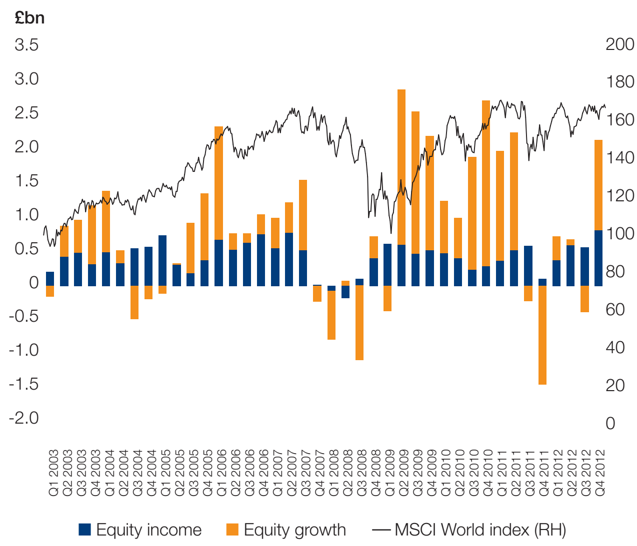
Renewed appetite for equities

Equity funds experienced mixed flows throughout 2012 but finished the year strongly amid favourable market conditions. The last four months saw over £500m of net retail sales each. By the end of the year, net retail flows totalled £3.7bn, slightly higher than the previous year when they were £3.2bn. This is significant in light of a reduction in net retail sales across the industry overall.

Chart 51 shows quarterly equity net retail sales over the last ten years along with the movement of the MSCI World index over the same period. This ten-year perspective indicates a correlation between equity net retail sales and the movement of the market. Concerns about the eurozone had a major impact on markets during 2011 and into 2012. However, policy announcements by the ECB helped to reassure markets and flows into equity funds moved upwards towards the end of the year.

Chart 52 shows that, for the sixth year in a row, non-UK equity funds outsold UK equity funds, which actually experienced net retail outflows. In contrast, net retail sales of non-UK focused funds almost doubled in 2012 from 2011. Chart 52 includes an adjustment for inflation to illustrate purchasing power in 2012 money values.

Chart 51: Quarterly net retail sales of equity funds vs MSCI World index (2003–2012)



Source: IMA, Lipper IM (calculated on a capital return basis, rebased to 100)

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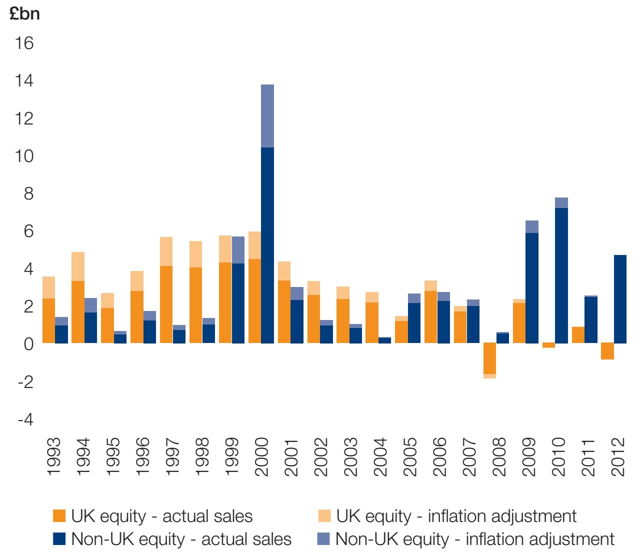
Chart 52: Net retail sales of UK and non-UK equity funds (1993–2012)



Source: IMA, ONS

Table 5 shows that Global Emerging Markets was the best-selling equity sector in 2012 with £1.7bn of net retail inflows, more than double the £749m that came in during 2011. Global Equity Income launched in January 2012 and took £1.3bn, making it the second highest selling equity sector. Most of these sales included funds that were previously in the Global (formerly Global Growth) sector and were moved into Global Equity Income at launch. This also accounts for much of the reduction in net retail sales of the Global sector year-on-year.

Three IMA equity sectors are purely UK-focused: UK All Companies, UK Smaller Companies and UK Equity Income. For the third time in the last five years, funds with a UK equity focus experienced net outflows totalling £900m in 2012. The UK All Companies sector was the driver of this and experienced outflows of £2.0bn in 2012, its worst year since the IMA started collating sector data in 1992.

Despite these outflows, the UK All Companies sector remained the largest IMA sector, representing 15% of industry funds under management at the end of 2012. Index-tracking funds made up 32% of it and for the second consecutive year, it experienced a divergence in the sales of active and passive funds. Active fund outflows totalled £2.3bn, which was offset slightly by inflows into trackers of £297m.

Table 5: Net retail sales and funds under management among equity sectors (2011–2012)

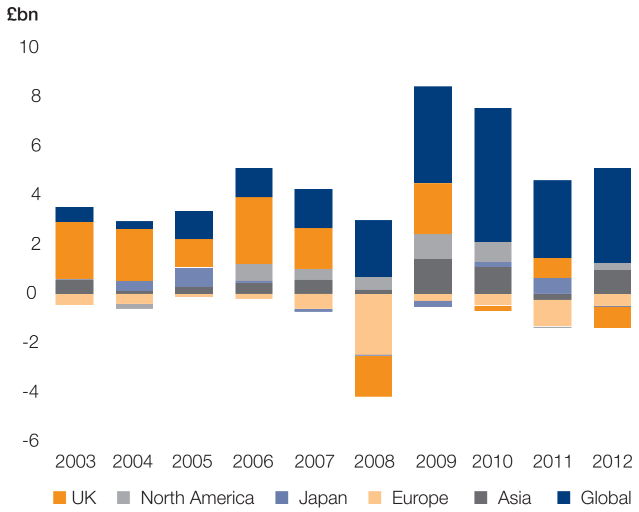
Sector	**Net retail sales (£m)**		**Funds under management (£m)**
	2011	**2012**	**2012**
Global Emerging Markets	749	1,652	16,947
Global Equity Income	–	1,348	6,245
UK Equity Income	909	993	59,654
Asia Pacific Excluding Japan	-250	965	26,625
Specialist	297	695	25,057
North America	-126	378	22,434
Global	2,245	376	54,817
European Smaller Companies	-315	278	3,122
UK Smaller Companies	47	82	7,721
Technology and Telecommunications	7	50	772
Japanese Smaller Companies	-27	8	154
Asia Pacific Including Japan	21	-8	1,859
Japan	675	-41	6,869
North American Smaller Companies	60	-67	1,012
Europe Including UK	-109	-128	1,643
China/Greater China	-152	-258	1,599
Europe Excluding UK	-665	-628	30,895
UK All Companies	-136	-1,975	112,288
TOTAL	**3,227**	**3,722**	**379,711**

The UK Equity Income sector, which concentrates on dividend income to investors rather than capital appreciation, saw strong inflows similar to last year. Sales were £993m in 2012 compared to £909m in 2011. With dividends relatively stable, the steady income stream from UK equity income funds can be beneficial in times of market volatility. The popularity of the sector may also reflect the 'hunt for yield' in the context of low interest rates, further elaborated on in Chapter Two.

European equity sectors had mixed flows, with European Smaller Companies reporting an inflow of £278m compared to a £315m outflow in 2011. Europe Excluding UK reported an outflow of £628m.

Chart 53 looks further at the regional focus of equity fund flows over the last ten years, categorised by equity sectors. 'Global', which represents geographically diverse equity sectors that do not fall into the other categories, has been resilient over the period shown below. From 2003 to 2007, UK-focused funds enjoyed strong flows averaging £2.0bn annually but, following the crisis, these have been much more volatile. Particularly striking are the persistent outflows from European equity funds, averaging £659m annually over the past ten years.

Chart 53: Net retail sales of equity funds by regional focus (2003–2012)



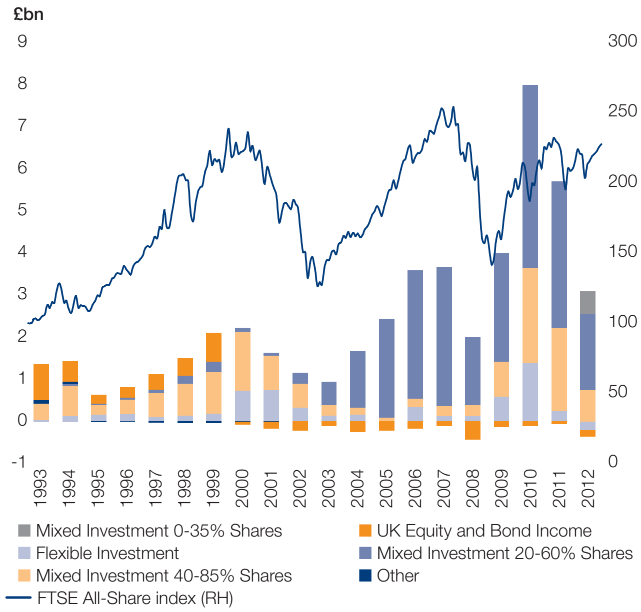
Mixed asset funds

Total net retail sales of mixed asset funds were £2.7bn compared to £5.6bn the year before. Changing preferences hindered mixed asset sales in 2012; investors appeared to favour fixed income funds in the first part of the year and subsequently turned to equity funds as markets improved.

A number of changes to the mixed asset sectors were implemented at the start of 2012. Mixed Investment 0-35% Shares was launched and the Active, Cautious and Balanced Managed sectors were renamed Flexible Investment, Mixed Investment 20-60% Shares and Mixed Investment 40-85% Shares, respectively.

Chart 54 shows the progress in net retail sales of mixed asset funds since 1993. Whilst they have been selling well since 2003, the latest net retail sales figure falls below the annual average of the previous ten years (£2.7bn compared to £3.1bn). Included in this period, however, were also the impressive inflows seen in 2010 and 2011, when mixed asset funds attracted £7.9bn and £5.6bn of net retail inflows, respectively.

Chart 54: Net retail sales of mixed asset funds by sector vs FTSE All-Share index (1993–2012)



Source: IMA, Lipper IM (calculated on a capital return basis, rebased to 100)

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Chart 54 shows that up until 2003, retail investors in mixed asset funds favoured the Mixed Investment 40-85% Shares sector. Since then, however, the Mixed Investment 20-60% Shares sector has been attracting the majority of flows, and 2012 was no exception to this; mixed asset funds had total inflows of £2.7bn, of which £1.8bn was into Mixed Investment 20-60% Shares. This sector has been the best-selling IMA sector in five of the eight years since 2004. As the name suggests, funds in this sector have a cap of 60% on the proportion of equities that can be held at a given time.

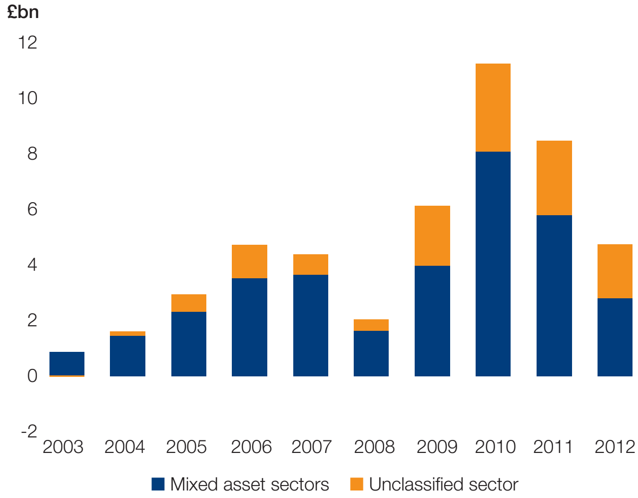
Table 6 shows the full breakdown of net retail sales of the mixed asset sectors over the last two years. The second highest selling was the Mixed Investment 40-85% Share sector, which saw inflows of £743m, down over one-half from £2.0bn the previous year. This was followed by the newly launched Mixed Investment 0-35% Shares sector, which took £520m in its debut year.

Two mixed asset sectors experienced net outflows. Flexible Investment lost £205m compared to an inflow of similar proportions in 2011. UK Equity and Bond Income reported its thirteenth year of net outflows.

In addition to the funds in the mixed asset sectors above, over one-half (58%) of the value of funds in the Unclassified sector are categorised by Morningstar as 'asset allocation funds'. Often, these are risk-targeted funds that aim to maximise investment returns to retail investors within risk constraints matched to investors' risk profiles.

The mixed asset sectors and asset allocation funds in the Unclassified sector have been combined in Chart 55. Both have seen strong growth in net retail sales in recent years although 2012 was relatively disappointing compared to 2010 and 2011.

Chart 55: Net retail sales of asset allocation funds by sector (2003–2012)



Source: IMA, Morningstar Direct

Table 6: Net retail sales and funds under management among mixed asset sectors (2011–2012)

Sector	**Net retail sales (£m)**		**Funds under management (£m)**
	2011	**2012**	**2012**
Mixed Investment 20-60% Shares	3,459	1,805	36,334
Mixed Investment 40-85% Shares	1,968	743	40,782
Mixed Investment 0-35% Shares	–	520	4,009
UK Equity and Bond Income	-58	-152	3,279
Flexible Investment	244	-205	16,853
TOTAL	**5,614**	**2,712**	**101,257**

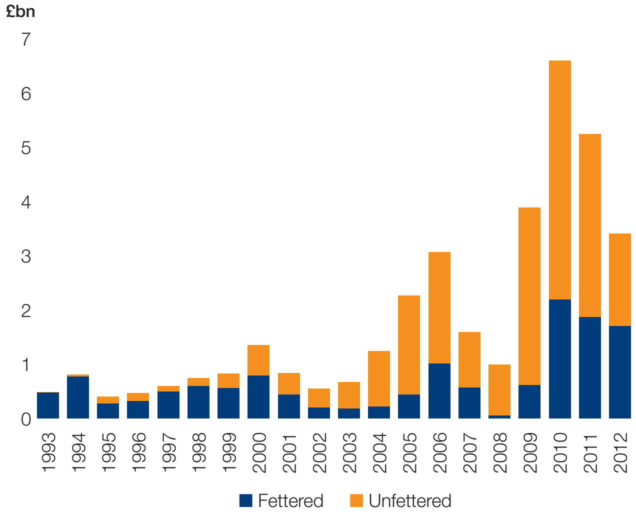
One way to offer investors a multi-asset product is through a fund of funds that holds a range of funds that can be invested across different assets. For this reason, we find that a large proportion of the mixed asset category is made up of funds of funds. At the end of 2012 they represented 40% of mixed asset funds under management. Conversely, mixed asset funds accounted for 57% of the total funds under management among funds of funds.

- Funds under management of funds of funds increased to a record £72bn at the end of 2012, an increase of 18% from the end of 2011.
- Funds of funds represented 11% of the total funds under management at the end of 2012.
- Net retail investment into funds of funds totalled £3.4bn in 2012 compared to £5.2bn in 2011.

In terms of net retail sales, Chart 56 shows unfettered funds of funds (ie. those predominantly investing in funds run by managers outside the group, rather than internal funds) have been the most popular over the ten years to the end of 2012. In 2012, however, one-half of net retail sales were invested in fettered funds of funds. In the ten years prior to 2012, fettered funds of funds took on average only about one-quarter of annual net retail sales into funds of funds.

In terms of funds under management, fettered funds of funds now represent one-half of the total holdings in funds of funds, up from 49% at the end of 2011. This figure has fallen considerably from ten years ago when it was 61%.

Chart 56: Net retail sales of fettered and unfettered funds of funds (1993–2012)



Index-tracking funds

The IMA collects data only on UK authorised index-tracking funds, but not on the wider ETF market, which has become a very significant part of the indexing market. By the end of the year, the size of ETFs with a primary London listing reached £81bn, up from £65bn at the end of 2011.[26] In the retail market, as in the institutional market, firms point out that the decision between active and passive is not a binary one. Clients, through advisers and product providers, are increasingly exposed to investment processes in which passive components may be used within a wider strategy.

industryview

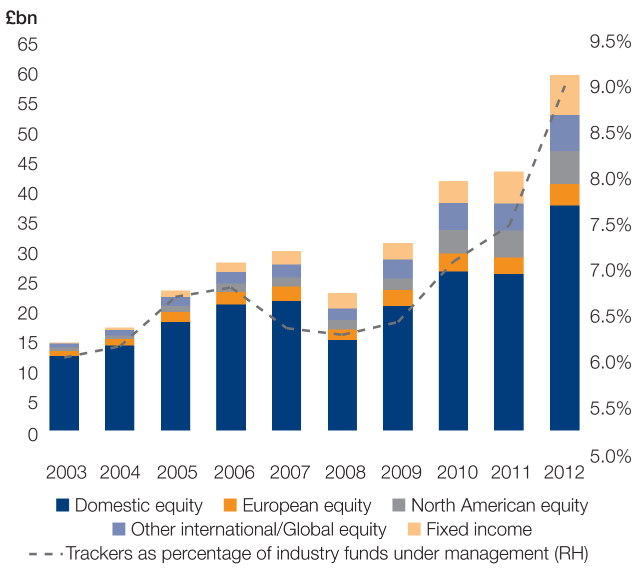
Use of ETFs in portfolios

"What we are definitely seeing are beta and alpha combinations, using ETFs or passive funds. Just by viewing the way people are using multi-asset or multi-manager strategies or are building portfolios through platforms, you can observe this blending of alpha and beta to come up with lower volatility and cheaper portfolios."

[26] Source: Blackrock Investment Institute, Bloomberg.

In terms of funds under management, trackers benefited from favourable market conditions during 2012 (see Chart 57). In particular, domestic equity trackers increased by 44% to £38bn at the end of 2012. Over the same period, global equity trackers increased by 34% to £6.0bn. Fixed income trackers increased to £6.7bn (2011: £5.4bn). Overall, index-tracking funds represented 9.0% of industry total funds under management at the end of 2012, up from 6.1% in 2003.

Chart 57: Funds under management of tracker funds by index investment type (2003–2012)



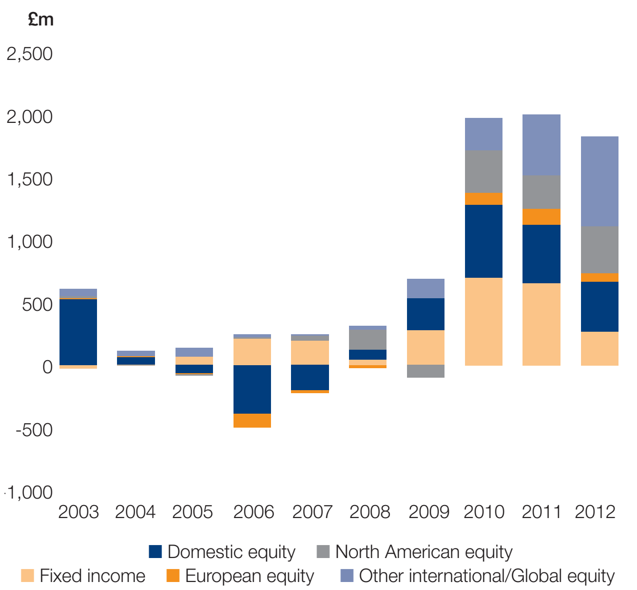
Net retail sales of tracker funds were £1.8bn in 2012 compared to £2.0bn the previous year. The most recent annual figure is the third highest since records began in 1992 and it represents a very strong showing given that industry net retail sales decreased from 2011.

Chart 58 shows net retail sales of tracker funds broken down by the type of index that they track. At £1.6bn, the largest proportion of the flows continues to go into equity trackers:

- Flows in 2012 echo what we saw in equity fund sales with global equity trackers reporting strong net inflows (£725m in 2012 compared to £492m in 2011). This indicates particular resilience considering tracker fund sales were down on 2011.
- North American equity trackers also performed well with net retail sales of £373m, up from £265m the previous year.

Fixed income trackers had a disappointing year with net retail inflows of £271m, £390m less than in 2011.

Chart 58: Net retail sales of tracker funds by index investment type (2003–2012)

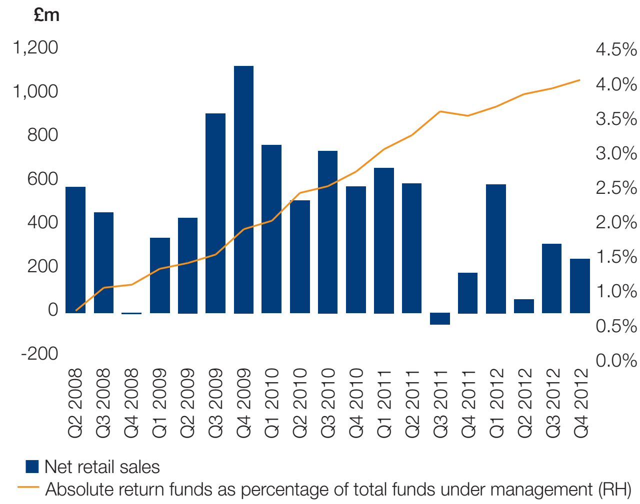


Ongoing move towards absolute return

A designated IMA sector for UK- and overseas-domiciled absolute return funds was created in April 2008. Absolute return funds increased their share of industry (UK- and overseas-domiciled) funds under management in 2012, and by the end of the year represented 4.1% (2011: 3.5%). Net retail sales among these types of funds were strong at the beginning of the year, but subsequently tailed off (see Chart 59). Total net retail sales for the sector were £1.2bn compared to £1.4bn the previous year. Funds under management increased to £31bn, a 32% increase from the end of 2011.

As we note earlier in the report, in the context of a low interest rate environment and with concerns about volatility in the markets, investor demand for return-based or outcome-oriented products may continue.

Chart 59: Quarterly net retail sales of absolute return funds vs absolute return funds under management as percentage of total funds under management (Q2 2008–Q4 2012)

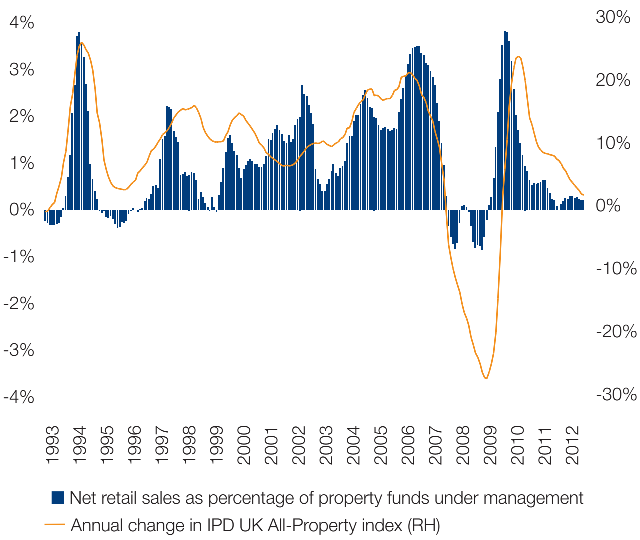


Property funds

Net retail sales of property funds totalled £405m in 2012, down from £564m in 2011. These are the lowest annual property fund sales since the outflows experienced in 2008 during the credit crisis. Following a rebound through 2009 and 2010, flows were lower in 2011 and this continued during 2012.

As Chart 60 shows, net retail sales as a percentage of property funds under management closely tracked movements in the property market. The recovery experienced by the property market following the 2007-08 crash peaked in 2010 and has lost steam since.

Chart 60: Net retail sales of property funds vs IPD UK All-Property index (1993–2012)[27]



Source: IMA, Lipper IM

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[27] Net retail sales of property funds are charted as a six-month moving average of net retail sales as a percentage of property funds under management over the period. The IPD UK All-Property index performance is charted as the year-on-year change of the IPD UK All-Property monthly total return index.

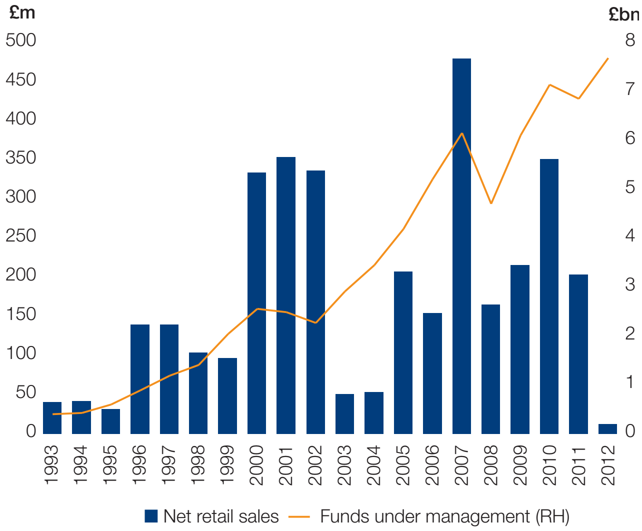
Ethical funds

We flag ethical funds in accordance with the Experts in Responsible Investment Solutions (EIRIS) classification. There are a number of definitional issues in this area, but the ethical flag essentially covers SRI funds.

Chart 61 shows the progression of ethical funds under management and net retail sales from 1993 to 2012. Net retail sales were only £12m in 2012, much lower than the 2011 figure (£201m) and the average of the ten years prior to 2012 of £219m.

Despite low net retail sales, funds under management of ethical funds stood at £7.6bn at the end of 2012, a 12% increase on the end-2011 figure. The majority of ethical funds are concentrated in the UK All Companies and Global sectors, which between them account for 54% of the total. Positive market conditions benefited both of these sectors and buoyed the ethical funds within.

Chart 61: Ethical net retail sales vs ethical funds under management (1993–2012)



Other funds

Over the past ten years, there has been an increase in the significance of the Unclassified sector both in terms of funds under management and sales flows. Funds allocated to this sector are part of the UK-authorised funds universe but are not allocated to any other IMA sector.

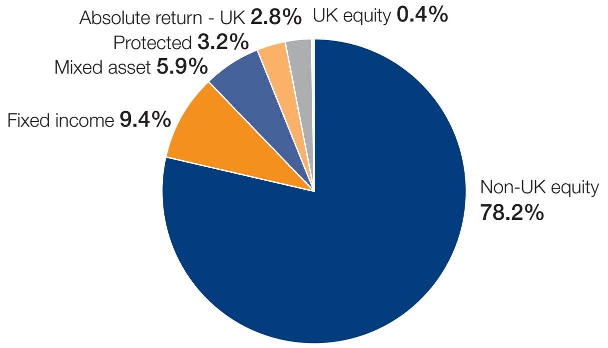
Non-classification occurs for a number of reasons (eg. if the fund is not marketed to retail investors or if it follows a risk-targeted strategy for which peer group comparisons are not appropriate), but is primarily driven by the choice of the fund manager. The proportion of industry funds under management represented by unclassified funds has increased from 1.3% at the end of 2003 to 8.3% at the end of 2012.

Newly-launched funds

In 2012, the IMA classified 98 newly-launched funds, which between them reported £1.7bn of net retail sales throughout the year. Chart 62 shows how these net retail sales were distributed over various categories:

- Non-UK equity funds represented the largest proportion of net inflows at 78%. This was partly driven by one fund that made up over 40% of the flows into non-UK equity funds.
- The second highest share of inflows was into fixed income funds (9.4%).
- Mixed asset funds represented 5.9% of the total.
- UK authorised absolute return funds and protected funds accounted for 2.8% and 3.2% of the total, respectively.

Chart 62: Net retail sales of newly-launched funds by fund/asset type



UK Industry Concentration and Structure

By the end of 2012, we collected data on 106 fund operators (ie. companies operating funds but not necessarily performing the investment function). This reflects a steady decline over recent years, down from 118 companies seven years ago.

At the end of 2012, the UK fund management industry remains a highly competitive environment, with the top ten firms representing approximately 45% of total UK authorised funds under management; a similar level to the early 1990s. Chart 63 shows the top ten fund operators by total retail and institutional funds under management, while Chart 64 shows the top ten firms only in terms of retail funds under management.[28]

Chart 63: Top ten UK fund operators by total funds under management

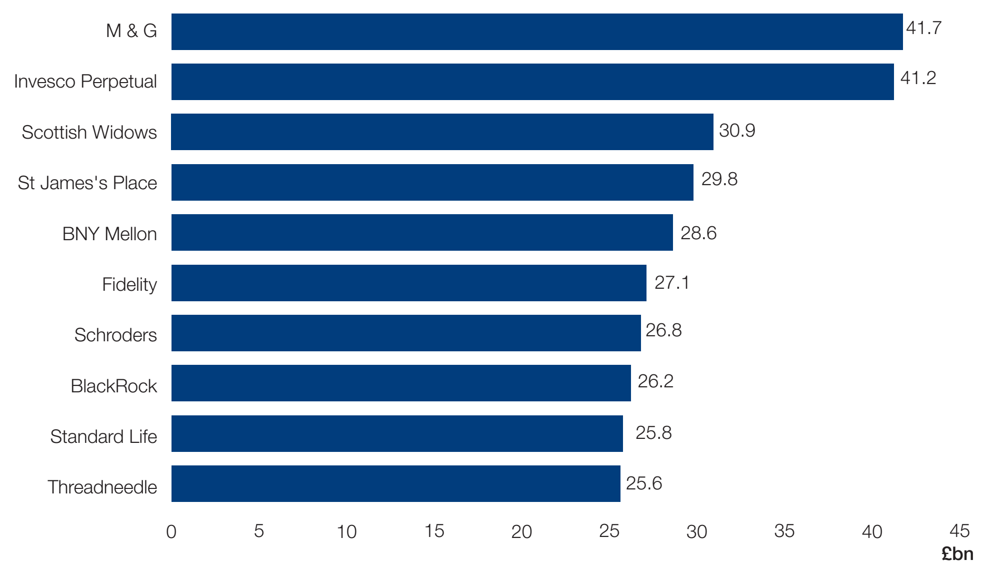
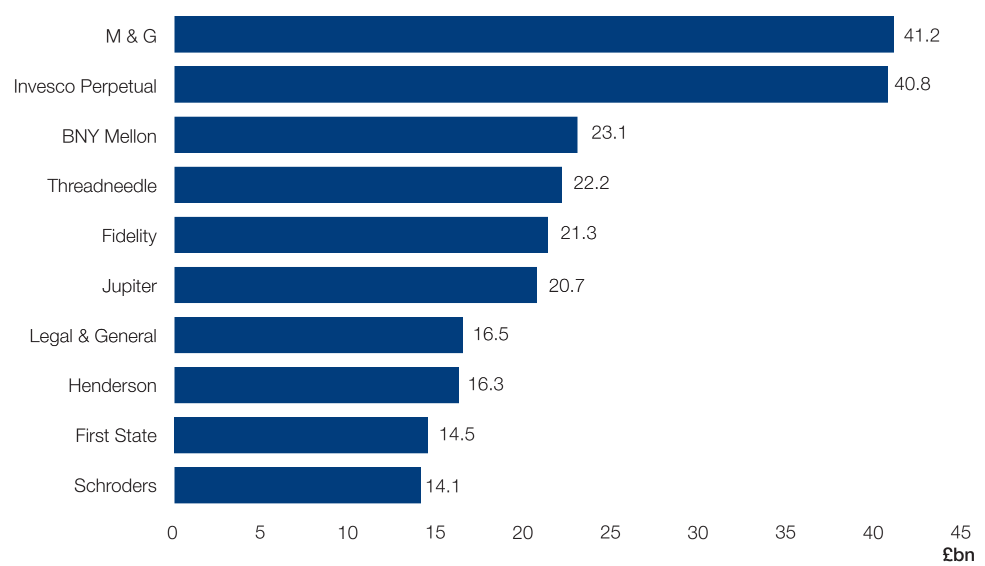


Chart 64: Top ten UK fund operators by retail funds under management



[28] Retail funds are defined as funds with a minimum lump sum investment amount of up to £50,000 with at least one-third of gross sales over the preceding three years being retail.

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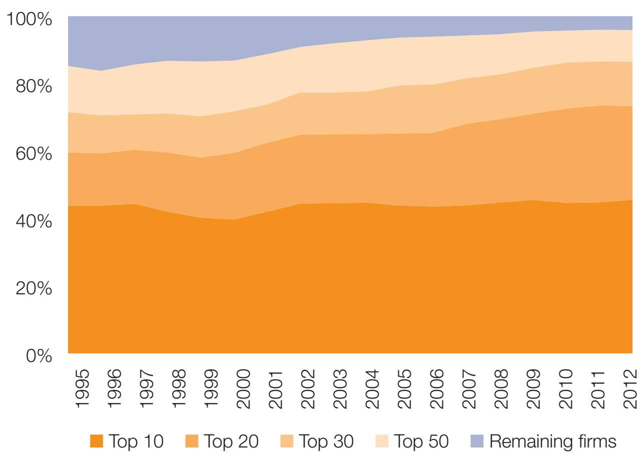
While the share of the top ten firms in terms of total funds under management has changed little over the last seventeen years (see Chart 65), the composition has changed significantly. Only five companies have remained in the top ten since 1995. The top ten companies in 2012 between them had 33% of the market in 1995.

Chart 65: Combined market shares of top firms by funds under management (1995–2012)



Bigger changes have taken place outside the top ten. The combined market share of the fund companies ranked between 11th and 20th increased from 16% to 28% between 1995 and 2012. Thus, the top 20 companies increased their share from 60% to 73%.

The market share of companies ranked between 21st and 30th increased marginally, from 12% to 13% over the same period. Overall, the top 30 companies took 86% of the market at the end of 2012. However, the market share of companies outside the top 30 declined substantially, from 29% in 1995 to 14% in 2012.

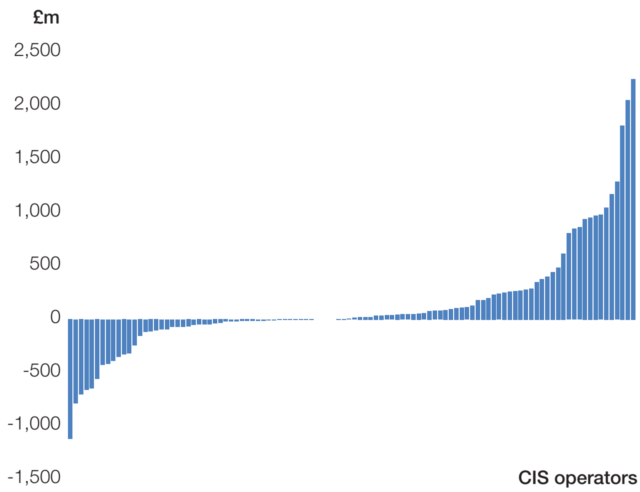
Measuring concentration

Using the Herfindahl-Hirschmann Index (HHI) as a measure of concentration provides further evidence of the industry as a highly competitive environment. A reading of over 1,000 on this index (out of a maximum of 10,000) is usually taken to indicate moderate concentration and a value of over 1,800 indicates high concentration. The reading at the end of 2012 for the UK fund industry was 308, the same as in the previous year.

In measuring concentration, we have used market shares of funds under management (rather than sales, for example). This is because funds under management are the main determinant of the industry's revenue stream, and are most representative of the service that the industry delivers to its investors – the management of their money.

Chart 66 shows the net retail sales of the 106 fund operators that we collected data on in 2012, with positive net retail sales reported by 56 operators. This highlights an important point; whilst industry net retail sales were positive overall, only around half of the fund operators actually took money in. These operators reported net retail inflows of £23bn, offset by outflows of £8.8bn.

Chart 66: CIS operator ranking by net retail sales



As well as sales performance, there are other factors that affect the evolution of firms' shares of industry funds under management; the rate of redemption of their units by investors, the investment performance of their funds and company takeovers.

Chart 67: Combined market share of top funds by funds under management (1995–2012)

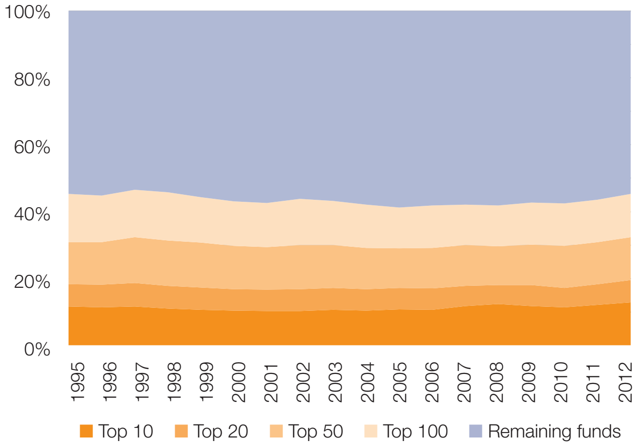
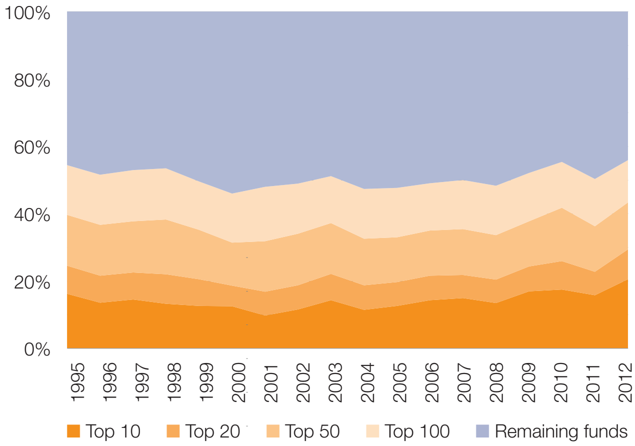


Chart 68: Combined share of top funds by gross sales (1995–2012)



One can also look at whether flows into individual funds have become more concentrated in recent years. Chart 67 shows the shares of the top 10, 20, 50 and 100 funds in terms of funds under management and Chart 68 does this in terms of gross sales:

- As noted earlier, the IMA collected data on 2,493 funds in 2012. Just 10 of these funds accounted for 13% of funds under management, with the top 100 funds taking 45%. Both were slightly up on 2011 but in line with the figures over most of the last 15 years.

- Fund sales are more concentrated than funds under management and the market share of sales of the top funds has fluctuated over the years. During 2012, the top 10 funds accounted for 21% of total gross sales, up from 16% a year earlier. The top 100 funds took 56%, up from 50% in 2011.

- Gross sales concentration is susceptible to intermittent large inflows. The higher concentration of gross sales into the top 10 funds in 2012 was partly driven by very significant inflows into a small number of funds.

A trend towards greater concentration can be seen in a slower increase in the median relative to the mean fund size. Whilst the top 10 funds in 2012 had an average £8.4bn funds under management, one-half of all funds managed less than £73m. The distribution of fund sizes is highly skewed. Some of those we spoke to in interviews this year expressed the view that RDR could eventually bring about further concentration of fund flows, as distributors consolidated and acquired greater pricing power over fund managers.

Table 7: Mean and median fund sizes (2003–2012)

Year	No. of funds	Mean (£m)	Median (£m)
2003	1,929	131.1	40.6
2004	1,970	147.6	47.2
2005	2,003	185.1	63.0
2006	2,034	215.9	71.3
2007	2,178	230.6	69.6
2008	2,366	165.5	46.6
2009	2,411	217.0	59.6
2010	2,447	260.4	69.1
2011	2,463	256.2	66.2
2012	2,493	290.7	73.2

In summary:

- The top ten firms control around 45% of funds under management, similar to 17 years ago.
- There is a trend towards greater concentration in the mid-market, and in particular firms ranked between 11th and 20th place, at the expense of the smallest firms. However, the HHI shows that the industry continues to be very unconcentrated.
- Gross fund flows have become somewhat more concentrated in recent years with the top 100 funds taking 56% of sales in 2012, compared with 48% in 2005.

The European Context

Investment funds under management increased to €8.9trn (£7.3trn) at the end of 2012, a 12% increase on a year earlier. Undertakings for Collective Investment in Transferable Securities (UCITS) accounted for 70% of the total and, when considered in isolation, increased 12% from the end of 2011 to €6.3trn (£5.2trn).

In terms of UCITS distribution across Europe, the UK continues to be an exception to the most commonly used distribution channels. As shown in Table 8 overleaf, retail and private banks are the dominant distribution channel for UCITS; eight out of the top ten European countries in terms of UCITS distribution use them as their main channel. In the UK, retail funds are primarily distributed through IFAs and are now further intermediated by platforms.

The difference in distribution has a number of implications, both domestically for asset management firms, but also internationally, as UK-based fund managers export products into markets where they have to compete with funds and other products from vertically integrated financial institutions (eg. banks and insurance companies).

industry**view**

Different European distribution patterns

“Compared to Europe, distribution in the UK is much more fragmented and you don’t have big bank distributors. In any one European country, you may have three to four big players who absolutely control your flows, whereas in the UK it’s a much broader spectrum of distribution business that you can work with as an asset manager. In this sense, and in terms of general behaviours, we see more parallels with the US than Europe.”

Table 8: Distribution channels for the top 10 UCITS distribution countries

Country	Retail banks	Insurance companies /Wrappers	Private banks	Funds of funds	Pensions/Institutions	Fund supermarkets /Platforms	IFAs/Brokers	Main channels
1. Germany	✔	✔	✔	✔	✔	✔	✔	Retail banks (over 40%) followed by private banks and a growing number of IFAs.
2. Switzerland	✔	✔	✔	✔	✔	✔	✔	Private banks (over 40%) and, to a lesser extent, retail banks. IFAs and fund platforms/supermarkets exist but account for only 6.5% of assets collected.
3. Austria	✔	✔	✔	✔	✔	✔	✔	Banks, particularly private banks.
4. United Kingdom	✔	✔	✔	✔	✔	✔	✔	Local IFAs and brokers (55.6%). Retail banks account for only 2.3% of the market.
5. Netherlands	✔	✔	✔				✔	Retail banks (80%).
6. France	✔	✔	✔				✔	Banks (over 20%), insurance groups (over 20%) and private banks (over 10%).
7. Spain	✔		✔	✔		✔		Retail banks (over 60%).
8. Italy	✔	✔	✔	✔		✔		Retail banks (67%) and insurance groups (13%).
9. Sweden	✔	✔	✔	✔	✔	✔	✔	National pension scheme (PPM), IFAs or management companies and retail banks.
10. Finland	✔	✔						Banks and insurance companies.

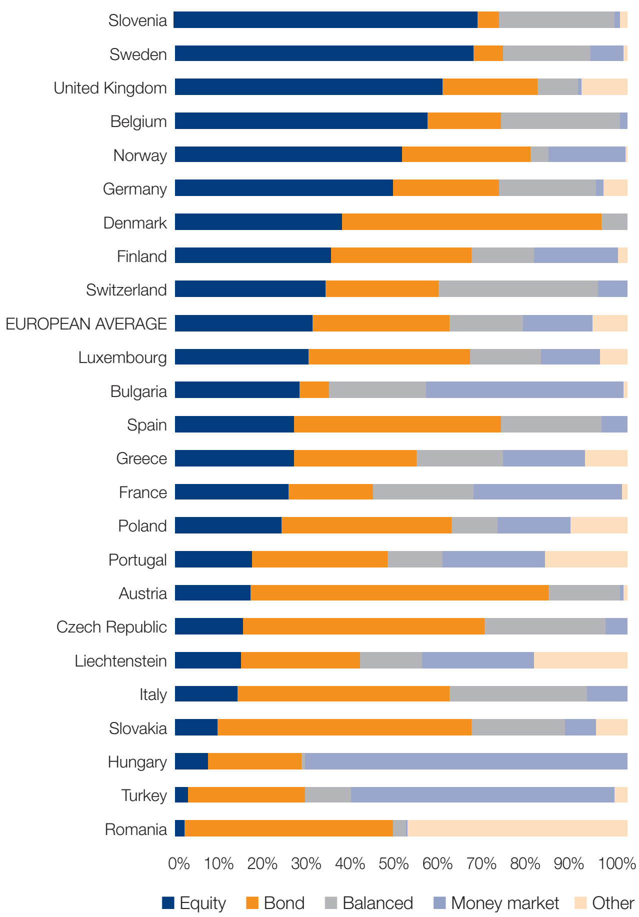
Source: PWC Research

Another clear distinction between the UK and the rest of Europe is the popularity of money market funds. Some European retail investors use money market funds as many UK investors would use bank or building society deposit accounts. The European average (excluding the UK) for funds under management in money market funds was 16% at the end of 2012, while the UK figure remained at less than 1%. However, at the institutional level, money market funds are a significant part of the UK asset management market, with several hundred billion of Sterling- and Euro-denominated money market funds managed in the UK (see p.19).

As shown in Chart 69 overleaf, UK investors had the third highest holdings of equity in Europe. Traditionally, equities have been popular in the UK, with only Slovenia and Sweden reporting a higher equity market share. Sweden is a much larger market than Slovenia, and has been boosted by compulsory funded pension contributions. The European average equity exposure (excluding the UK) is only 29% compared with 59% in the UK.

This is not necessarily a reflection of high risk-taking among UK retail investors, but rather the fact that fund holdings and overall wealth and risk exposure should be assessed in terms of other holdings, such as bank and building society savings or property ownership. Nonetheless, it is widely observed that, historically, UK (and US) retail investors have a tolerance of equity risk that is generally unmatched in other large European markets, such as France, Germany and Italy.

Chart 69: Breakdown of funds under management by fund domicile, selected countries

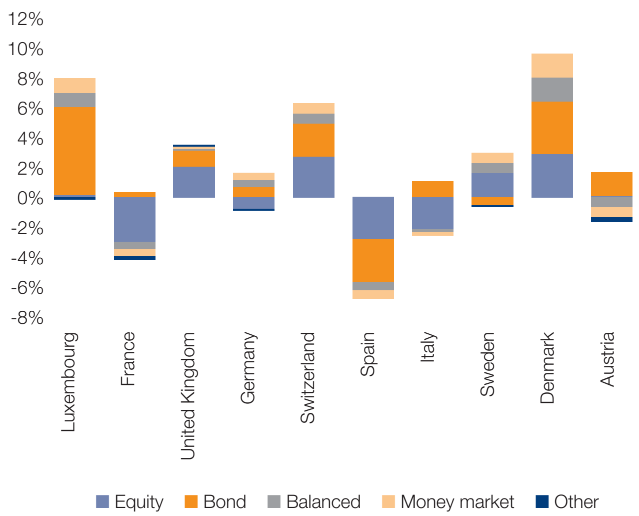


Source: EFAMA

In terms of sales, European UCITS experienced net inflows of €201bn (£164bn) during 2012. This inflow reverses an outflow of €88bn (£74bn) seen in 2011. Bonds were the big winners in 2012, experiencing €203bn (£166bn) of net inflows. Balanced funds took in €27bn (£22bn) and equity funds had a small inflow of €2.2bn (£1.8bn). Only one asset class had an outflow; money market funds lost €39bn (£32bn), marking the fourth consecutive year of outflows.

Chart 70 displays net sales of UCITS by asset class for the top ten countries (by the size of their total funds under management), expressed as a percentage of average UCITS assets during 2012.

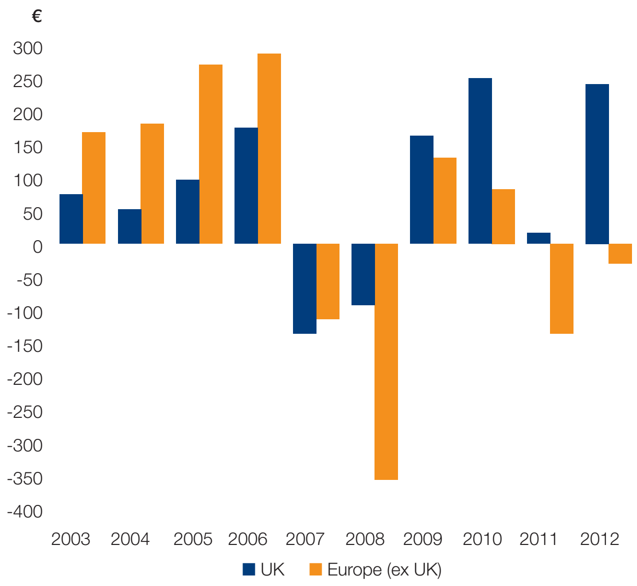
Chart 70: Net sales of UCITS by asset class as percentage of total UCITS funds under management, selected countries



Source: EFAMA

Despite the contrasting cultures, European investors were putting increasing amounts into equity funds ahead of the financial crisis, catching up with the UK in terms of equity investment. This can be seen from Chart 71 which shows net sales of UCITS equity funds per capita in the UK and in Europe over the last 10 years.

Chart 71: Net sales of equity funds per capita, UK and Europe (ex UK) (2003–2012)



Source: IMA, EFAMA, Eurostat

As seen in Chart 71, both UK and other European investors began to sell equity funds during 2007. The following year, European investors sold equity funds worth €356 (£291) per capita compared with €92 (£75) per capita in the case of UK investors. These net redemptions by European investors amounted to 6% of funds under management in equity funds at the beginning of the year compared with 1% for UK investors calculated on the same basis.

While UK and other European investors returned to net investment in equity funds in 2009 and 2010, UK investors showed greater confidence by adding to their equity fund holdings at a higher rate. Both 2011 and 2012 saw a reversal of this on the part of European investors. Despite the rallying of markets towards the end of 2012, European investors still sold equity funds worth €30 (£25) per capita.

These observations reinforce the view that UK retail investors remain both more focused on risk assets and more resilient to equity market volatility than their European counterparts. Among those we spoke to, there was some support for this view. Equally, a number of firms drew attention to the broader trends highlighted throughout the chapter about a more diversified, and often outcome- or yield-focused approach. In this respect, client needs both in the UK and in European and international markets are seen as aligning.

industry**view**

UK retail stereotypes challenged

“We have the same conversations with clients worldwide as in Europe. On the retail side, the idea of ‘hit and hope’, or just investing for pure capital gain is dwindling. Underlying client needs and conversations are the same.”

“The UK retail investor, despite a lot of press to the contrary, is actually quite a canny beast. If you have a look where retail flows are going, you do see good diversification and you see people being very clever as to where they go to access yield.”

4

5 International Dimension

Key Findings

Four international dimensions

- IMA members managed in the UK 40% of assets on behalf of overseas clients, of which 53% were from the EU and the remaining 47% were from other international locations.
- UK-headquartered firms managed 47% of total UK assets, compared with 41% by North American and 10% by European groups.
- Overseas-domiciled funds totalled £721bn or 45% of the investment fund spectrum managed by IMA members. The majority of overseas-domiciled funds (71%) with portfolio management in the UK are from Dublin and Luxembourg.
- IMA members and the groups of which they are part manage an estimated £24trn in assets worldwide. Of these, UK-headquartered firms manage an estimated £3.9trn.

UK in a comparative context

- The UK represented 36% of European assets under management, solidifying its position as the largest European, and the second largest asset management centre in the world after the US.
- As a fund domicile, the UK is at an unchanged fifth place, accounting for 11% of the European investment fund industry.
- After a fall in 2011, asset management centres in Hong Kong and Singapore recorded an increase in assets in 2012, thus resuming the recent growth trend.

Relationship with the EU

- Despite persisting frustration with EU legislation, firms expressed a number of concerns at the potential impact of a UK exit from the EU.
- These mostly revolved around continued access to the Single Market, ongoing competitiveness of the UK as a financial centre and wider economic impacts.

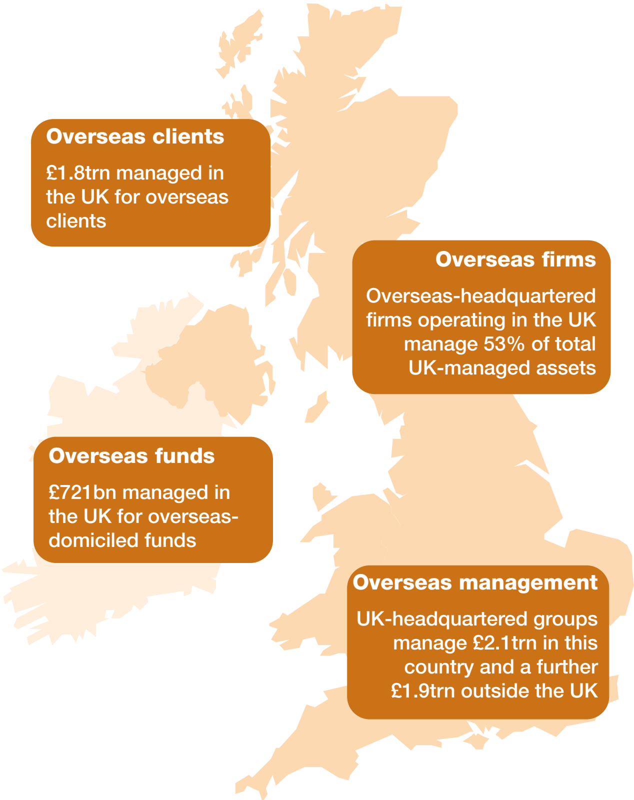
5 International Dimension

Four International Dimensions

For a number of years now we have reported on the various ways in which international factors interplay with the UK asset management industry. As Figure 8 shows, these are reflected in almost every component of the industry:

- Overseas clients.
- Overseas-headquartered firms.
- Overseas fund domiciles.
- Overseas locations for asset management.

Figure 8: International dimensions of the UK asset management industry



Overseas clients

The growth in the overseas client base reported in previous years continued throughout 2012, as a result of which overseas client assets grew to 40% or £1.8trn of total UK assets under management. This is up from 39% at the end of 2011, following a number of revisions in respondent data.

While the share of overseas client assets has been increasing, their composition remains broadly unchanged, with 53% (£930bn) managed on behalf of European and 47% (£835bn) on behalf of other overseas clients.

As we have commented for a number of years, asset managers based in the UK are tapping into a number of opportunities internationally:

- At a general level, changing growth dynamics and global demographics are creating opportunities for the export of investment services. Some are classically institutional, while others are more retail.
- At the same time, previously 'closed-architecture' distribution networks have become more accessible. This has been particularly evident in Europe, as bank and insurance networks have increasingly opened up to third party offerings.
- In the funds environment specifically, UCITS is seen as an extremely successful European and global brand.

None of these trends is irreversible, and as we noted in last year's report, there is increasing concern about some of the potential consequences of current regulatory change for the openness of the international investment services market.

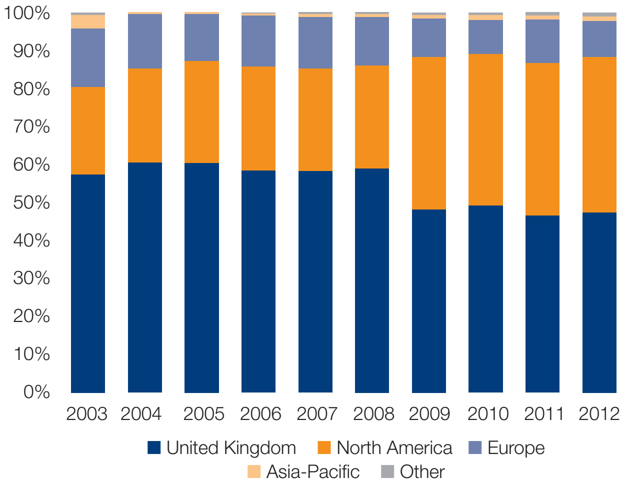
Some firms this year also expressed worries about the future of UCITS as a global brand, amid suggestions that regional alternatives may emerge, notably in South East Asia. The drivers for this might be both negative perceptions of UCITS (eg. implications of UCITS III powers, operational ramifications of the current 'UCITS V' debate) and a desire for regional trading blocs to develop further. See further discussion on p.85.

5

Overseas-headquartered firms

Another reflection of the increasingly international shape of the UK asset management industry is the growing proportion of overseas-headquartered firms and parent groups which, in asset terms, grew from 43% in 2003 to 53% at the end of 2012 (see Chart 72).

Chart 72: UK assets under management by region of parent group headquarters (2003–2012)



As such, the trend away from the domestic and towards the international continues also in the corporate dimension, with the asset base of UK-headquartered firms decreasing by 17% over the eleven-year period to 47% at end-2012, albeit with modest change compared with 2011.

The biggest winners in this respect were North American firms and their parent groups which, between 2003 and 2012, increased their size by over three-quarters. As mentioned in previous years, the route to this position was not as much through organic growth as through a series of large-scale deals. The most notable one of these was the merger between BlackRock and Barclays Global Investors (BGI) in 2009 as a result of which the share of North American-headquartered firms increased from 27% to 40%, further growing to 41% at end-2012.

European firms, on the other hand, have recorded a fall in market share since 2003. While partly due to long-term sluggish asset growth compared to firms headquartered in other regions, the relative decline was accentuated by the impact of the crisis on the European banking industry. Given the bank-dominated asset manager model present in continental Europe, it is unsurprising that the partial or whole divestment of asset management arms by their banking parent groups since 2008 has served gradually to decrease their market share to 10% at end-2012.

Firms in the Asia-Pacific and other regions have been growing steadily in recent years, although given their relatively small size (1.2% and 1.0% of total UK assets under management, respectively), they have been increasing from a very low asset base.

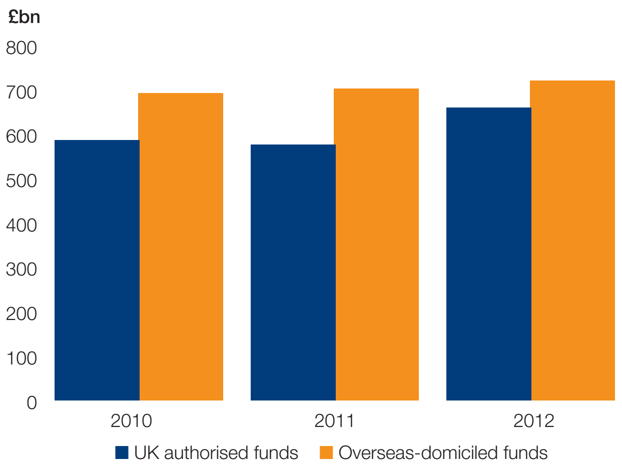
While the shifts in the relative size of UK, US and European asset management firms are interesting in themselves, a more significant change, linked to the geographical evolution, is the emergence of a larger body of independent asset management firms (see p.97).

Overseas fund domiciles

The UK's attractiveness as a location for asset management is reflected also in the proportion of overseas-domiciled funds that continue to be managed from the UK. At the end of 2012 this was 45% or £721bn, up from a revised £703bn in 2011.

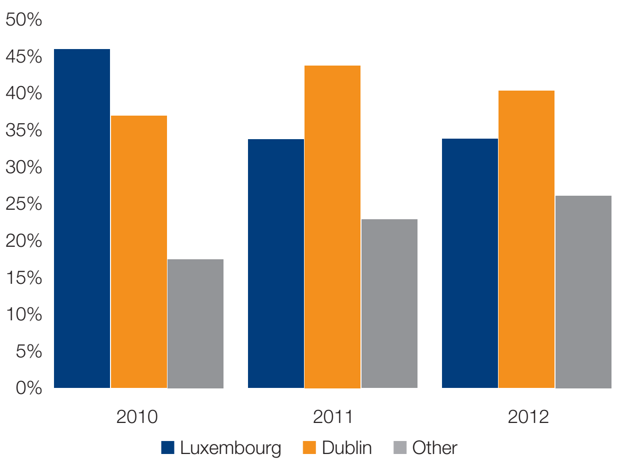
While overseas-domiciled funds represent a considerable part of the pooled UK-managed asset universe, it appears that UK authorised funds have been slowly gaining ground against their overseas counterparts (see Chart 73).

Chart 73: UK authorised funds and UK-managed overseas-domiciled funds (2010–2012)



Alongside the relationship between UK authorised funds and overseas-domiciled funds, the relative size of overseas fund domiciles seems to be changing too. The traditional overseas domiciles, Dublin and Luxembourg, continue to be the most popular, representing 36% and 35%, respectively. Over time, however, there has been greater representation from 'other' domicile locations, growing to 29% at the end of 2012. This is shown more clearly in a like-for-like comparison of the composition of overseas-domiciled funds (see Chart 74).

Chart 74: Composition of overseas-domiciled funds (2010–2012)



North America (and therein predominantly the US) is the most frequently mentioned fund domicile location aside from Dublin and Luxembourg, reported by over two-thirds of respondents. There is a range of other jurisdictions internationally, including the Channel and Cayman Islands. One of the largest single components of overseas-domiciled funds is IMMFs, with the remainder comprising a range of institutional and retail products, including hedge funds and ETFs.

Overseas locations for asset management

The relationship between client and management location has always been very fluid in the UK asset management industry. While UK institutional client assets remain overwhelmingly managed in the UK (see Chapter Three), firms can decide not to synchronise the location of clients and managers, and there is plenty of evidence for both.

While some firms centralise their asset management, many have the reverse philosophy and prefer portfolio management and trading to be located in the region of the asset or the client. The latter will either delegate formally or manage the assets directly in overseas offices in the relevant region. Hence, many firms manage assets outside the UK on behalf of both UK and international clients.

In the case of IMA members and their parent groups, global assets under management far outweigh those managed in the UK. Our estimates show that IMA members managed £24trn around the world at end-2012, 12% more on a matched basis, than in 2011 when the figure was £22trn.

Of these, UK-headquartered firms managed £2.1trn in the UK, and £3.9trn worldwide (2011: £3.7trn). As in previous years, year-on-year comparisons in both cases continue to be affected by changes in the IMA membership and corporate activity at parent group level.

The UK in a Comparative Context

In a worldwide context, the UK is the second largest asset management centre in the world after the US, which accounted for 45% of global assets under management as at end-2012. This translates into £18trn ($28.3trn) in US assets under management.[29]

In the European context, on the contrary, the UK managed to solidify its position as the largest asset management centre in Europe by increasing its market share to 36% of total European assets at end-2011 (2010: 33%).[30] As shown in Figure 9, there has been very little change in the composition of the country rankings, indicating broad stability despite changes in the UK share. Swiss assets under management were estimated at £3.6trn (CHF 5.3trn),[31] although a significant proportion of these is likely to be accounted for by advisory business.

Outside Europe and the US, the closest rival to the UK industry in terms of size is Japan with an estimated £2.8trn (¥399trn) in assets under management as at March 2013, up from £2.7trn (¥361trn) the year before.[32]

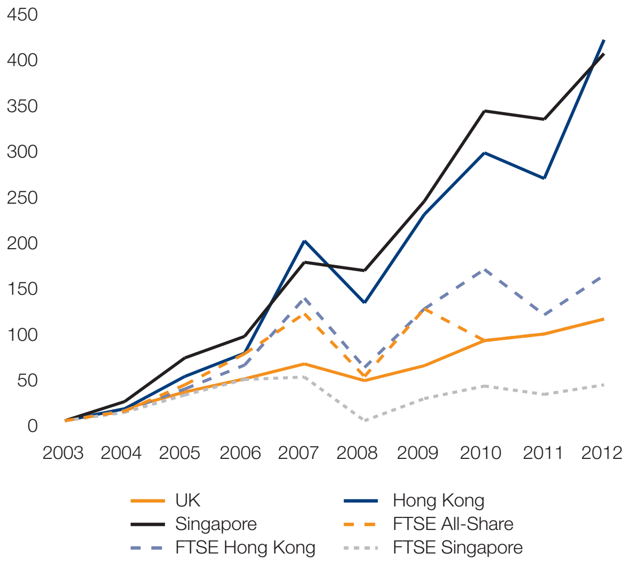
Recently, we have started charting the UK industry relative to other emerging asset management centres, namely Hong Kong and Singapore. Although, in 2011, these experienced negative growth rates, positive market movements and flows during 2012 saw robust asset growth resume in both Hong Kong and Singapore (see Chart 75).[33]

Figure 9: Assets under management in Europe (December 2011)

	Country	Net assets (€bn)	Market share
1	UK	4,977	36%
2	France	2,756	20%
3	Germany	1,438	10%
4	Italy	611	4%
5	Netherlands	462	3%
6	Belgium	217	2%
7	Other	3,315	24%

Source: EFAMA

Chart 75: Comparative asset growth, UK, Hong Kong, Singapore (2003–2012)

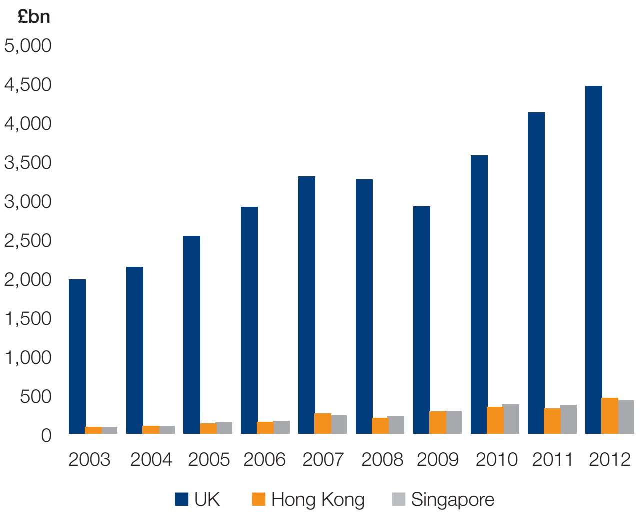


Source: IMA, Lipper IM, MAS, SFC (rebased to 0)

[29] Source: BCG *Capitalising on the Recovery, Global Asset Management 2013* ('US assets under management' figures based on the location of the client, not the location of the asset manager).
[30] Source: EFAMA.
[31] Source: Swiss Bankers Association.
[32] Source: Nomura Research Institute.
[33] Source: MAS.

Over the past few years, the increasing attractiveness of Asian asset management locations has also been reflected in our interviews, highlighting in particular the favourable corporate environment and potential for future growth. In spite of the development seen over the past decade, however, these locations still represent only a fraction of the asset base managed in the UK (see Chart 76).

Chart 76: Assets under management, UK, Hong Kong, Singapore (2003–2012)



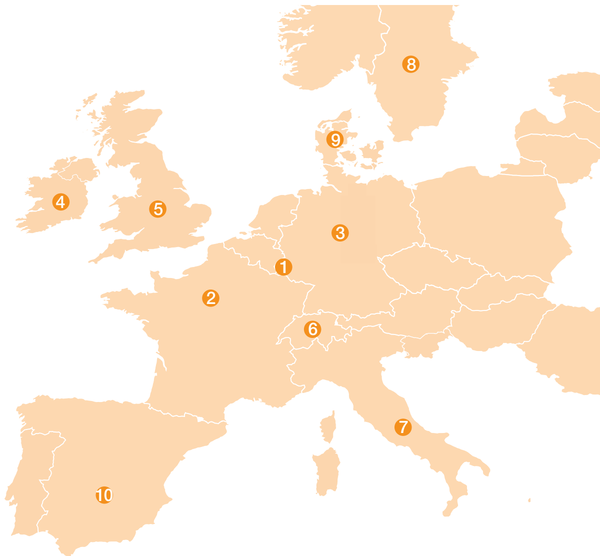
Source: IMA, MAS, SFC

Fund management

The UK continues to be the fifth largest location for fund domiciliation in Europe, representing 11% of the total European investment fund industry as at end-2012 (see Figure 10). Including the £721bn in overseas-domiciled funds whose assets are managed in the UK (see p.80), the total for UK-managed investment funds would increase to £1.4trn.

While the UK's market share is marginally higher than in 2011, the relative size of the top five European fund domiciles has remained virtually unchanged over the past three years. As mentioned in Chapter Four, total European investment fund assets (including both UCITS and non-UCITS) have grown to €8.9trn (£7.3trn), up from €8.0trn (£6.5trn) at the end of 2011,[34] representing a year-on-year increase of 12%.

Figure 10: European investment funds by country of domicile



Country		Net assets (€bn)	Market share
1	Luxembourg	2,384	27%
2	France	1,506	17%
3	Germany	1,286	14%
4	Ireland	1,227	14%
5	United Kingdom	970	11%
6	Switzerland	297	3%
7	Italy	190	2%
8	Sweden	172	2%
9	Denmark	164	2%
10	Spain	150	2%

Source: EFAMA

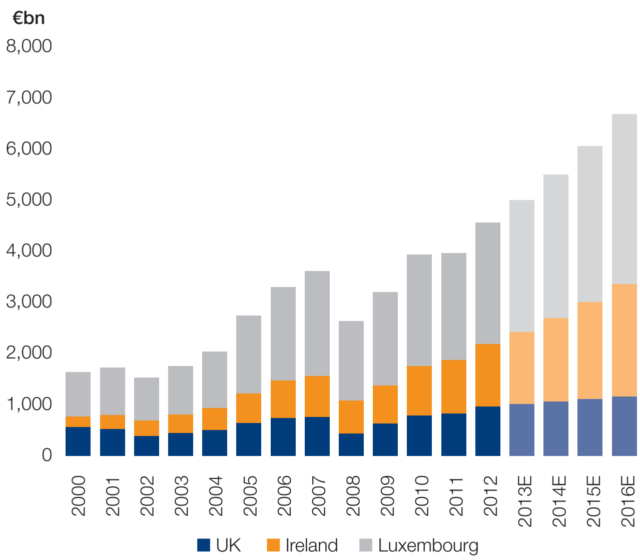
As in previous years, Luxembourg is in an undisputed first place within the European investment fund industry, followed by France, Germany and Ireland; altogether they accounted for nearly three-quarters of European funds under management.

Of these four countries, we make specific comparisons with Luxembourg and Ireland which have established themselves as extremely attractive fund domiciles for overseas promoters and, over the past decade, have grown considerably in the value and number of funds domiciled.

[34] Source: EFAMA.

As shown in Chart 77, the UK has been gradually overshadowed in terms of fund domiciliation by Luxembourg and, in recent years, Ireland. This is largely due to successful marketing strategies and favourable regulatory and corporate environments, which boosted average growth rates to 9% in Luxembourg and 16% in Ireland (compared with 5% in the UK). If recent growth rates were to be sustained, funds domiciled in Ireland and Luxembourg would, by 2016, increase to an estimated total of €5.5trn compared with €1.2trn in the UK.

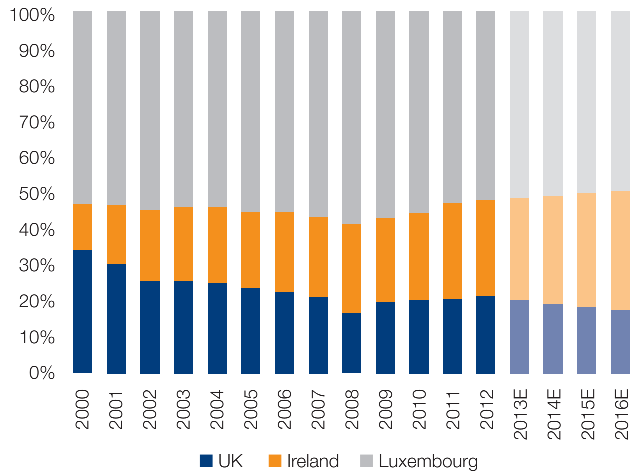
Chart 77: Fund assets by domicile, UK, Ireland, Luxembourg (2000–2012, projected to 2016)



Source: IMA, EFAMA

Converting the above chart into percentages enables us to see historical developments in the relative market share of the three domiciles (see Chart 78) as a proportion of their combined total funds under management. This shows that, while Luxembourg has maintained a stable 50-60% market share, that of the UK has gradually eroded from 34% in 2000 to 21% in 2012, while Ireland's has increased from 13% to 27%. Again, if growth rates were to be sustained, by 2016, Ireland's share would increase to one-third while the UK's relative share would decrease to 17%.

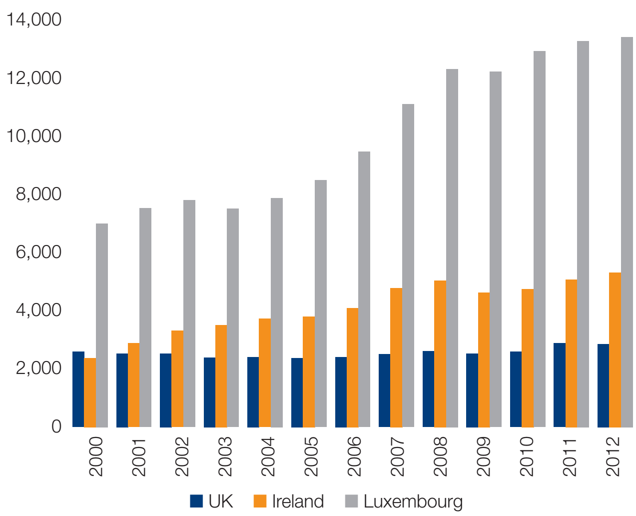
Chart 78: Proportion of fund assets by domicile, UK, Ireland, Luxembourg (2000–2012, projected to 2016)



Source: IMA, EFAMA

Another way of comparing the three fund domiciles is by the number of funds, which further illustrates the stronger growth experienced in Luxembourg and Ireland (see Chart 79). While, in terms of fund numbers, the UK has increased by less than 1%, Irish funds have increased by 7.0% and Luxembourg by 5.6%.

Chart 79: Total number of funds by domicile, UK, Ireland, Luxembourg (2000–2012)



Source: IMA, EFAMA

Regulation and the UK's Relationship with the EU

A further dimension to the international discussion is the increasing regulation of the UK asset and fund management industry under EU financial services legislation. As we reported last year, there is quite a variety of views within the industry about the consequences of this. While firms have generally been very strong supporters of the further development of the European Single Market, frustration has grown as a result of a multitude of difficult legislative proposals facing the industry, ranging from the Alternative Investment Fund Managers Directive (AIFMD) to components of UCITS V. We list these in greater detail in Figure 11 overleaf.

In the interviews carried out this year, firms once again expressed their concern about the direction of travel taken by European regulators. In particular, they articulated a worry that the UCITS export brand, which has been successfully built up over a long period of time, could be damaged. One consequence of this could be rival regional initiatives emerging, notably in South East Asia.

industry**view**

Continuing concerns around EU regulation

"UCITS was aiming to give a single playing field in Europe, and even globally, for distribution. That's breaking up and individual regulators are now making it much harder to achieve economies of scale even within Europe. As a result we're getting diseconomies of scale in the UCITS product."

"I am concerned about what the EU is doing to UCITS. It takes a long time to build up a competitive industry and a competitive position, and UCITS enabled innovations to happen. If you look at AIFMD, CRD IV, UCITS V and VI, and all the stuff around shadow banking insofar as it affects money market funds, I'm not sure what problem they're trying to solve. It's not about protecting the investor, not about enhancing investor returns, not about making the businesses robust - they've done that already."

Reflecting on some of the political attention that the issue of a possible UK exit from the EU has recently received, firms expressed a number of concerns:

- The greatest of these was the question of continued access to the Single Market and close connection to one of the largest financial markets in the world which, according to many, has been a great benefit to the UK asset management industry.
- Of concern were also the potential negative consequences for the UK economy, in particular market dislocation and an adverse impact on UK firms in which a number of IMA members are heavily invested.
- A related issue was the question mark that this would raise over the UK's competitiveness as a leading financial services centre.

At the same time it was argued that UK firms seeking to operate on a global level would still be impacted by EU regulation, although there was hope that some of the more onerous areas of regulatory focus might be avoided.

industry**view**

Potential consequences of a UK exit from the EU

"We aren't here just for the domestic opportunity; we are here because it is the equivalent of the Silicon Valley for this part of the world. If Britain did not renegotiate a way to still have passporting into these countries, if we had to start registering in a different way or if we lost our passport, it would have serious implications, one of which would be a shifting resource balance towards our offices remaining in the EU. It is a serious concern from our perspective. We are not complacent on this issue."

"The structural impact of the UK leaving the EU is much less important for us; the uncertainty would be around the competitiveness of the UK versus other alternatives. Broadly speaking, leaving the EU might appear to be the greatest idea ever until you find that a new pan-European financial centre has just developed outside Brussels, the City has shrunk and everybody has moved their business to the continent."

5

Figure 11: Major UK and EU asset management regulatory developments

Regulators	
New UK financial services regulatory structure	■ Following consultation, discussion and lobbying in 2012, the transition from the Financial Services Authority (FSA) into two sucessor organisations was completed on 1 April 2013. ■ The Prudential Regulation Authority (PRA) has responsibility for systemically important firms (mainly banks and insurers) while the Financial Conduct Authority (FCA) regulates markets and conduct. ■ Most IMA firms are regulated solely by the FCA, although some are part of PRA regulatory groups.
New regulatory focus on asset management sector	■ As set out by Martin Wheatley in September 2012, the FCA's intended focus areas for the asset management sector are charging, competition, and understanding customers.
European Securities and Markets Authority (ESMA)	■ ESMA, and European supervisory authorities (ESAs) in general, are growing in resources, responsibilities and workload as part of adopting a more direct role in regulation. ■ ESMA assumes responsibility for the regulation of credit rating agencies. ■ In November 2012, the UK launched a legal case against the discretionary powers of ESMA under the Meroni principle.

Capital markets and investments	
European Market Infrastructure Regulation (EMIR)	■ After substantial consultation in 2012, it will have a staggered implementation with many rules coming into force in Sept 2013. ■ Requires most over-the-counter (OTC) derivatives to be cleared through central clearing houses. ■ Also introduces: ■ A reporting obligation for all derivatives contracts (exchange-traded and OTC). ■ Mandatory risk mitigation requirements for uncleared OTC derivatives contracts. ■ A regulatory regime for central clearing houses and trade repositories across Europe.
Markets in Financial Instruments Directive (MiFID) II	■ Issued by the Commission in October 2011, the proposals will amend the 2004 MiFID I, implementing numerous changes to financial services firms and markets. ■ The objective is to fill gaps, remove national flexibilities and implement some of the G20 requirements on derivatives trading. ■ Estimated implementation is in early 2016.
Market Abuse Directive (MAD) II	■ Issued by the Commission in October 2011, the proposals will replace the 2003 MAD I with a Regulation and a Directive. ■ Lobbying during 2012 targeted numerous issues including the nature of inside information, Chinese walls and exemptions/'safe harbours' from the abuse regime. ■ Its implementation is linked to MiFID II.
Short Selling Regulation	■ Implemented in November 2012, it regulates short sales, requires the disclosure of significant short positions, bans uncovered short positions in sovereign credit default swaps and grants significant emergency powers to ESMA. ■ A review of the implementation was undertaken by ESMA in early 2013.
LIBOR	■ Following the Wheatley Review, International Organization of Securities Commissions (IOSCO) consultation and work by ESMA in 2012, there is a continued move to regulating indices and their use. ■ The British Bankers' Association is to transfer responsibility for LIBOR in 2013, with regulatory oversight given to the FCA.
Regulation of Indices and Benchmarks	■ The European Commission proposal that ESAs should regulate benchmarks is expected during the course of 2013.
Solvency II	■ Implemented in October 2012, it imposes capital requirements, qualitative requirements for risk management and governance, and market disclosure on insurance companies. ■ It has implications for asset managers in terms of disclosure requirements, service-level agreements and asset allocation.

Funds and distribution	
Packaged Retail Investment Products (PRIPs)	■ Published in 2012, the proposal applies to all packaged investment products sold in Europe to retail investors, irrespective of the legal nature of the product (ie. whether it is a non-UCITS fund, an insurance contract, or a bank product). ■ This seeks to provide a level playing field for product disclosure broadly equivalent to the UCITS Key Investor Information Document (KIID) requirements.
UCITS V	■ UCITS V, which covers management company remuneration policy, depositary requirements and provisions relating to regulatory sanctions, is progressing through the legislative process with possible implementation by 2015. ■ The money market funds element of an expected UCITS VI proposal is, together with other elements, including long-term finance, to follow in late 2013.
RDR	■ Implemented by the FSA on 31 December 2012, it imposes requirements on the qualifications and capital adequacy of advisers, and bans advisers from receiving commission from product providers or out of product charges. ■ There are also rules, which will come into force in 2014, banning platforms from receiving payment out of product charges. ■ It requires asset managers to introduce RDR-compliant unit/share classes alongside legacy share classes. ■ The application of RDR for platforms will follow from 2014.
Unauthorised Collective Investment Schemes (UCIS)	■ Following consultation in 2012, the FCA's June 2013 Policy Statement proposes severe restrictions on marketing UCIS to retail customers.
AIFMD	■ The Directive and related Regulation must be implemented by Member States by July 2013. ■ Alternative investment funds (AIFs) are *any* collective investment undertaking that is not a UCITS (irrespective of legal structure, listing, authorisation or domicile). ■ The Directive therefore captures a wide range of UK vehicles, including non-UCITS retail schemes, qualified investor schemes, unauthorised unit trusts, charity funds, investment trusts, and specialist vehicles (eg. hedge funds, private equity funds, venture capital funds and real estate funds). ■ It provides a passport for the marketing of AIFs to professional investors and imposes detailed regulation on the managers of AIFs (AIFMs), including requirements on organisation, remuneration, safekeeping of assets, liquidity management, valuation and pricing, disclosures to investors and extensive reporting to regulators.
Venture Capital Funds and Social Entrepreneurship Funds	■ These two new EU fund regimes are to be implemented in Member States by July 2013. ■ The regimes are optional and open to smaller fund management companies which are below the size threshold of the AIFMD and which do not wish to opt to comply with its full provisions. ■ If the funds comply with certain investment requirements, and if the managers comply with a lighter set of requirements than the full AIFMD ones, then the funds may use the 'EuVECA' or 'EuSEF' labels and have a passport to market the funds across Europe to professional and semi-professional investors.
Long-Term Investment Funds	■ In July 2013, the Commission issued legislative proposals for a subset of AIFs that invest into unlisted companies and long-term projects in sectors such as real estate, infrastructure, sustainable energy and transport. ■ The fund must be domiciled in the EU, have an EU manager and be closed-ended and of a fixed term. ■ Funds that comply with the investment restrictions will be able to use the label 'ELTIF' and market across Europe to both retail and professional investors.
Money Market Funds	■ The Commission is expected to issue by July 2013 legislative proposals relating to UCITS and non-UCITS money market funds.

Firm regulation	
Capital Requirements Directive (CRD) IV	■ Following lobbying in 2012, it is to be implemented in January 2014. ■ It affects firms offering discretionary management services to a range of clients. ■ It transposes Basel II, requires all managers to carry more base capital, sets a new, narrower definition of what qualifies as 'capital' for some managers, and requires pension fund deficits to be deducted from capital.

Remuneration	■ Different pieces of regulation are becoming increasingly focused on remuneration:
	  ■ ESMA under AIFMD (remuneration guidelines issued in February 2013 following consultation in 2012).
	  ■ CRD IV (new remuneration requirements to be implemented in January 2014).
	  ■ UCITS V (still being negotiated and implementation date or final provisions not yet known).
	  ■ MiFID II (proposed remuneration elements to be in force by 2016).
	■ Whilst directives target different key staff, and may overlap in specifics, all of them apply on a firm-wide basis and focus on greater alignment between remuneration, risk-taking and the client's best interests.

AIFMD	(see also under 'Funds and distribution') ■ Also affects how managers are regulated across areas beyond remuneration.

International issues	
Foreign Account Tax Compliance Act (FATCA)	■ Following publication of a model intergovernmental agreement in July 2012, FATCA is in force since January 2013. ■ It impacts funds, their operators, asset managers, platforms and distributors, which are required to report information about US nationals to their tax authorities, which exchange information with the US under existing double taxation treaties and transfer of information exchange agreements.
Dodd-Frank	■ Dodd-Frank introduces extra-territorial rules for firms operating in the US or selling to US citizens.

6 Operational and Structural Issues

Key Findings

Revenue and costs

- Industry revenue has increased to £13bn, up by 3.2% year-on-year. As in previous years, however, there has been hardly any change when expressed as a proportion of average assets under management (30bps).
- The cost base has grown by 2.4% on a matched basis to £8.3bn. This represents a smaller increase than in 2011 and, expressed as a proportion of average assets, falls to 19bps.
- The gross operating margin was at 35% slightly higher than the 2011 figure. Headline profitability remained at 10bps.

Performance fees

- The use of performance fees remained at 81% across our respondent base, and the share of assets under management subject to these types of fees has increased to 17%. On the other hand, a lower proportion of respondents (44%) state they use performance-based fees on some of their retail products.
- The majority of respondents do not think that the prevalence of performance-based fees has increased and the most widespread areas of use remain institutional product offerings.

Employment

- Total industry headcount has grown to an estimated 30,800 at end-2012, 4.4% on a like-for-like basis. Over 13% of total UK-based staff are foreign nationals.
- Increasing use of outsourcing makes the total indirect headcount figure considerably higher; 79% of our respondents outsource some part of their business activity.

Industry concentration

- The proportion of assets represented by the five and ten largest firms was 35% and 54%, respectively, unchanged from 2011.
- Autonomous asset managers continued to represent 37% of total UK assets under management, unchanged from a revised figure last year. Insurance companies, in contrast, marginally increased their asset base to 29% while the market share of banks fell to 17%.
- Following the slowdown in 2011, M&A activity among IMA members seems to have picked up in 2012, consisting of a number of strategic sell-offs and acquisitions.
- The boutique end of the IMA membership base has increased by 3.9%, falling behind overall industry growth of 7.9%.

6 Operational and Structural Issues

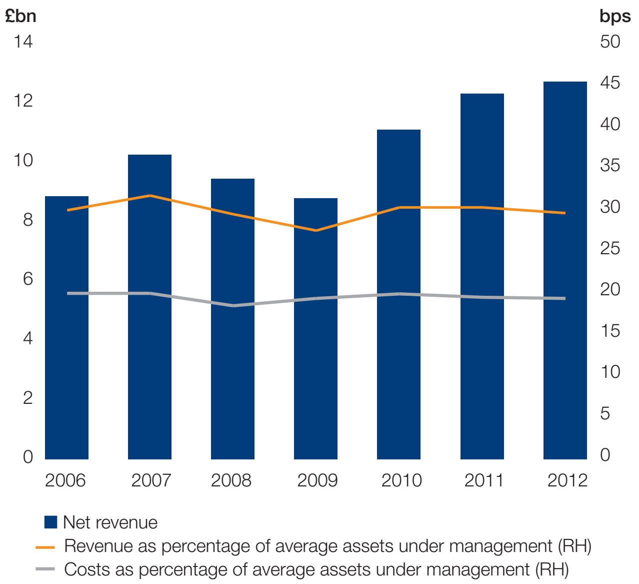
Revenue and Costs

At the end of 2012, industry revenue and costs for in-house and third party business were in line with total asset growth (see Chart 80):

- Total industry revenue (net of commission) rose to £13bn over this period, up from £12bn in 2011. This represents growth of 3.2% on a like-for-like basis.
- As a proportion of average assets under management, this accounts for 30bps, which is virtually unchanged from the 2011 figure, and lower than the 32bps at the start of the crisis in 2007.
- Total operating costs came to £8.3bn (2011: £8.1bn) which, on a matched basis, represents growth of 2.4%. This is considerably lower than the 11% seen over 2011.
- As a proportion of average assets under management, the total cost figure accounts for 19bps, a marginal decrease on the 20bps seen over the previous two years.
- The above data suggest that the industry's operating margin was 35%.[35] Headline profitability remained at 10bps.

Industry revenue remained at 0.7% of GDP (2011: 0.7%), following the gradual increase seen over recent years, driven primarily by faster revenue than GDP growth.

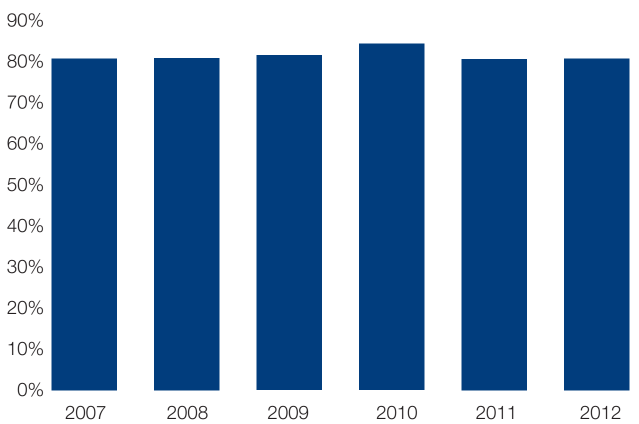
Chart 80: Industry net revenue vs revenue and costs as percentage of average assets under management (2006–2012)



Performance Fees

Performance-based fees were used by 81% of respondents, in line with 2011 (see Chart 81). While this is relatively high, these types of fees continue to account for a comparatively small proportion of total assets. Among those firms who use performance fees, they account on average for 22% of assets suggesting a total of 17% of industry assets subject to performance-based fees.

Chart 81: Proportion of respondents using performance-based fees (2007–2012)



[35] Calculated as net revenue less costs divided by net revenue.

Looking at the proportion of assets subject to performance fees, Table 9 shows a lot of variation among firms. While one-fifth of respondents do not charge performance fees at all, another 19% use these types of fees on up to 5% of their assets.

Looking at this distribution historically (see Chart 82), one can see that, on a like-for-like basis, performance fees are being increasingly used on smaller proportions of assets under management when taken at individual company level.

As in previous years, performance-based fees are most prevalent across institutional product offerings, with the majority of respondents mentioning segregated mandates and hedge fund-like strategies. Nevertheless, some 44% also use performance fees in retail product ranges (2011: 45%).

Chart 82: Proportion of companies using performance fees split by share of assets to which such fees apply (2007–2012)

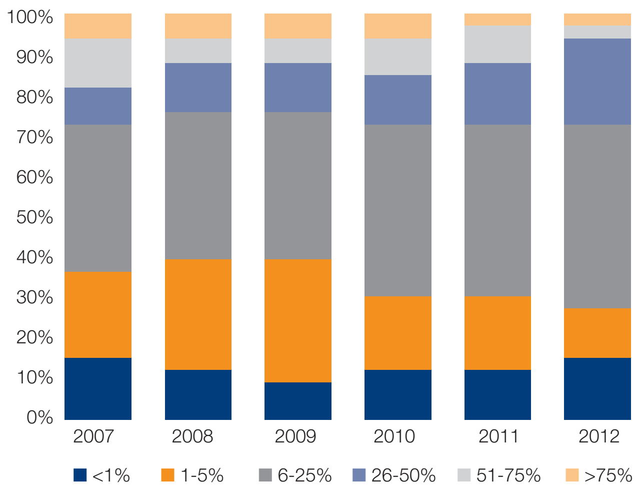


Table 9: Proportion of assets under management subject to performance fees

Proportion of assets under management subject to performance fees	Percentage of respondents	Total UK assets under management (£bn)	Assets under management subject to performance fees (£bn)
0%	20%	100	
1-5%	19%	799	18
6-10%	17%	977	76
11-25%	19%	427	58
26-50%	17%	837	310
>50%	9%	111	77
TOTAL	**81%**	**3,252**	**539**

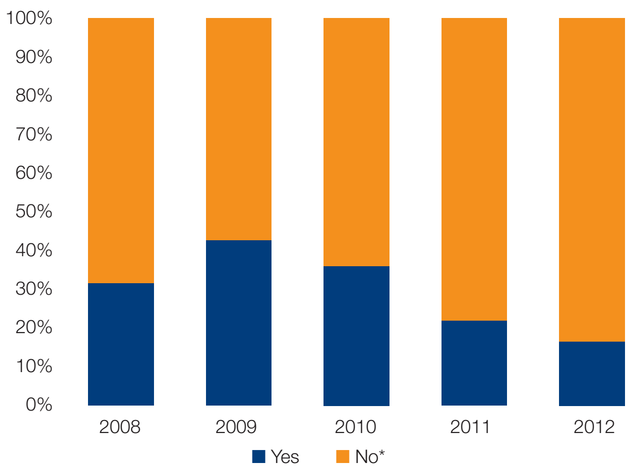
Table 10: Views on the prevalence of performance fees

Has the use of performance-based fees in your product range become more prevalent over the past year?	Percentage of respondents	Percentage of assets under management subject to performance fees	Total UK assets under management (£bn)
Yes	16%	24%	685
No	43%	22%	840
Same	41%	10%	1,821
TOTAL	**100%**		**3,346**

We asked respondents whether they thought performance fees had increased in prevalence over 2012. The overwhelming majority (84%) said that they had not, or that they remained the same (see Table 10); an increase of six percentage points on 2011.

Indeed, a look at the historical responses in Chart 83 points to a growing consensus that performance fees are becoming less prevalent across the industry; a fact that is supported by the trend towards smaller proportions of assets subject to these types of fees.

Chart 83: Increase in prevalence of performance fees (2008–2012)



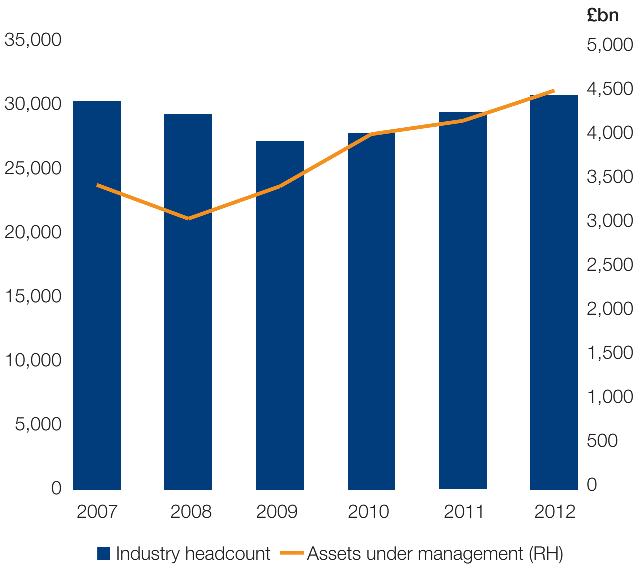
* Includes those who answered 'Same' in 2011 and 2012.

Employment

Direct industry headcount increased by 4.4% on a matched basis to an estimated total of 30,800, thus for the first time exceeding pre-crisis levels. Looking at the historical data in Chart 84, this is a continuation of the recovery after the significant layoffs in 2008 and 2009.

Scottish headcount represented over 15% of the total, unchanged from 2011. Alongside Scottish-headquartered firms, a number of UK- and overseas-headquartered IMA firms also have significant operations in Scotland, for both their front and back office functions.

Chart 84: Industry headcount estimate vs UK assets under management (2006–2012)



There is a number of reasons behind the recent headcount growth. In some respects, it reflects industry recovery, with some firms performing particularly strongly. However, there is also evidence to suggest that the regulatory environment, be it on a national, regional or global level, has boosted growth across particular staff sectors as firms face a range of challenges, including greater operational complexity and regulatory compliance requirements.

A breakdown by staff segment in Table 11 shows that core functions such as investment management, research and dealing continue to represent 27% of the headcount. 'Business development and client services' account for the second largest staff segment (20%), closely followed by 'Operations and fund administration' with 18%. 'IT services' grew to 13% and 'Compliance, legal and audit', which this year also includes 'Risk', represents 6.1%.

As in previous years, the 'Other' sector was mostly made up of senior management and support functions as well as a number of more specialised areas, such as corporate governance or communications. At the end of 2012, it represented a slightly lower, 5.0% of the total headcount, partly as a result of the introduction of 'Risk' as an individual category.

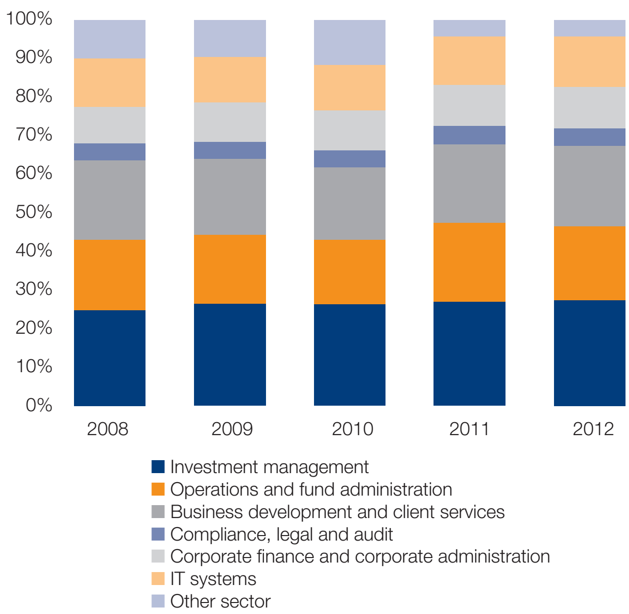
Table 11: Distribution of staff by activity (direct employment)

Activity	Percentage of total headcount
Investment management *of which:*	**27%**
Investment management (asset allocation, stock selection)	68%
Research, analysis	25%
Dealing	7%
Operations and fund administration *of which:*	**18%**
Investment transaction processing, settlement, asset servicing	27%
Investment accounting, performance measurement, client reporting	39%
Other fund administration (CIS transfer agency, ISA administration etc.)	34%
Business development and client services *of which:*	**20%**
Marketing, sales, business development	71%
Client services	29%
Compliance, legal and audit *of which:*	**6%**
Compliance	41%
Risk	26%
Legal	24%
Internal audit	9%
Corporate finance and corporate administration *of which:*	**11%**
Corporate finance	45%
HR, training	22%
Other corporate administration	34%
IT systems	**13%**
Other sector	**5%**
Total industry headcount	**30,800**

Looked at over a number of years (see Chart 85), the largest increases on a matched basis have been across the 'Corporate finance and corporate administration' functions (13%) and the core 'Investment management' function (10%). 'Compliance, legal and audit' grew by 5.7%, although incorporation of the 'Risk' function would likely accentuate growth given the recent emphasis on it across a number of business areas.

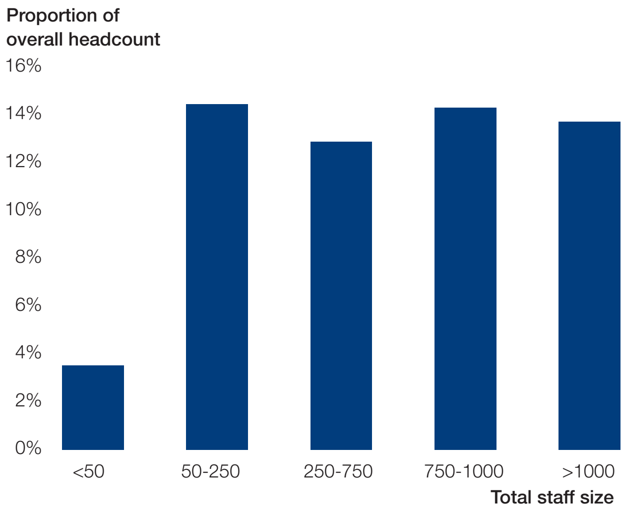
'Operations and fund administration' increased by 5.1%. This percentage does not seem high, when put in the context of our conclusions about increased operational complexity and regulatory change. However, if we consider the high proportion of back office functions that firms outsource, this percentage is likely to significantly understate the actual changes taking place in this staff segment.

Chart 85: Direct employment by staff segment (2008–2012)



A second year of charting the proportion of foreign nationals in the directly employed UK industry headcount results in a somewhat lower 13%. This is down from a revised 16% in 2011, and is likely attributable to a more complete dataset. Broken down by total staff size, non-UK staff seem to be relatively evenly distributed across all except the smallest firms (see Chart 86). This is unsurprising both because of the international nature of the industry and the proportion of large overseas-headquartered firms among the IMA membership base.

Chart 86: Percentage of non-UK nationals in respondent firms by staff size



An estimation of total industry headcount is difficult as a result of outsourcing, of which a growing proportion of firms appears to be taking advantage. At the end of 2012, 79% of our respondents outsourced some part of their business; a proportion that has been growing over recent years (see Table 12). As mentioned in the past, however, it is unclear to what extent this is coincidental, and to what extent there is any connection with the financial crisis.

Table 12: Use of outsourcing in the industry (2007–2012)

	2007	2008	2009	2010	2011	2012
Proportion of firms outsourcing part of their activity	74%	74%	75%	76%	78%	79%

Looking at staff sectors more specifically, the most frequently outsourced continue to be various back office functions. Of these, it is mostly transaction processing and settlement, followed by fund administration and investment accounting, performance measurement and client reporting. These areas are outsourced by around one-half of our respondents and most of them entirely. While the majority of firms seem to outsource these functions within the UK, a small number of respondents delegate them to Ireland.

A minority of firms also outsource parts of their business development, client or IT services, although usually only to a small extent. Outsourcing of corporate finance, compliance and investment management functions seems to be limited, and where present, at least partly reflects the distribution of functions between the firms and their parent groups.

As noted in previous years, outsourcing does not seem to depend on firm size and is typically undertaken by specialist third party administrators or other asset management firms offering such services.

Industry Concentration

The UK asset management industry continues to be characterised by a 'long tail' of medium- to small-sized firms, which is typical for a highly unconcentrated industry (see Chart 87).

With average assets under management of £28bn as at June 2012 (2011: £30bn), the median decreased again to £6.4bn (2011: £7.6bn). This represents little change year-on-year and is mostly the result of new additions to our membership base.

Table 13 shows the composition of IMA member firms by the size of their assets under management and supports our conclusions about a highly unconcentrated industry.

Chart 87: IMA member firms ranked by UK assets under management (June 2012)

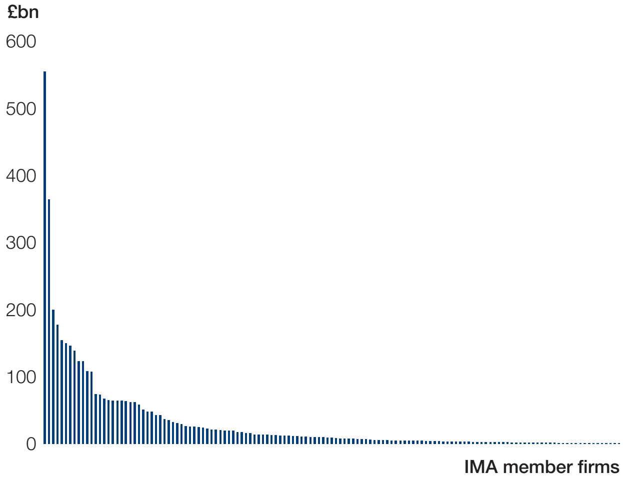


Table 13: Assets managed in the UK by IMA firm size[36]

Assets under management	Member firms (Jun 2012)	Survey respondents (Dec 2012)
>£100bn	12	12
£50-100bn	12	10
£25-50bn	10	13
£15-25bn	15	7
£1-15bn	72	23
<£1bn	22	5
TOTAL	**143**	**70**

6

[36] Only includes firms with in-house asset management capability.

The level of industry concentration as measured by the HHI stood at 415, in line with the 422 in 2011 (see Chart 88).

As regards the share of UK assets under management represented by the largest firms, the top five remained at 35% while the top 10 increased their share to 54% (2011: 35% and 51%, respectively). This is the same level as in 2009 when the increase was caused by the merger between BlackRock and BGI.

Chart 89 lists the ten largest firms in asset terms. Across a number of firms there continues to be a big difference between the size of UK and worldwide assets under management; most notably among those overseas-headquartered.

Chart 88: Market share of largest firms by UK assets under management vs HHI (June 2003–2012)

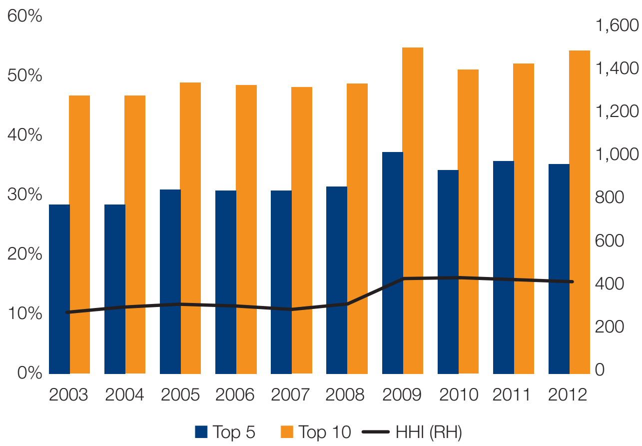
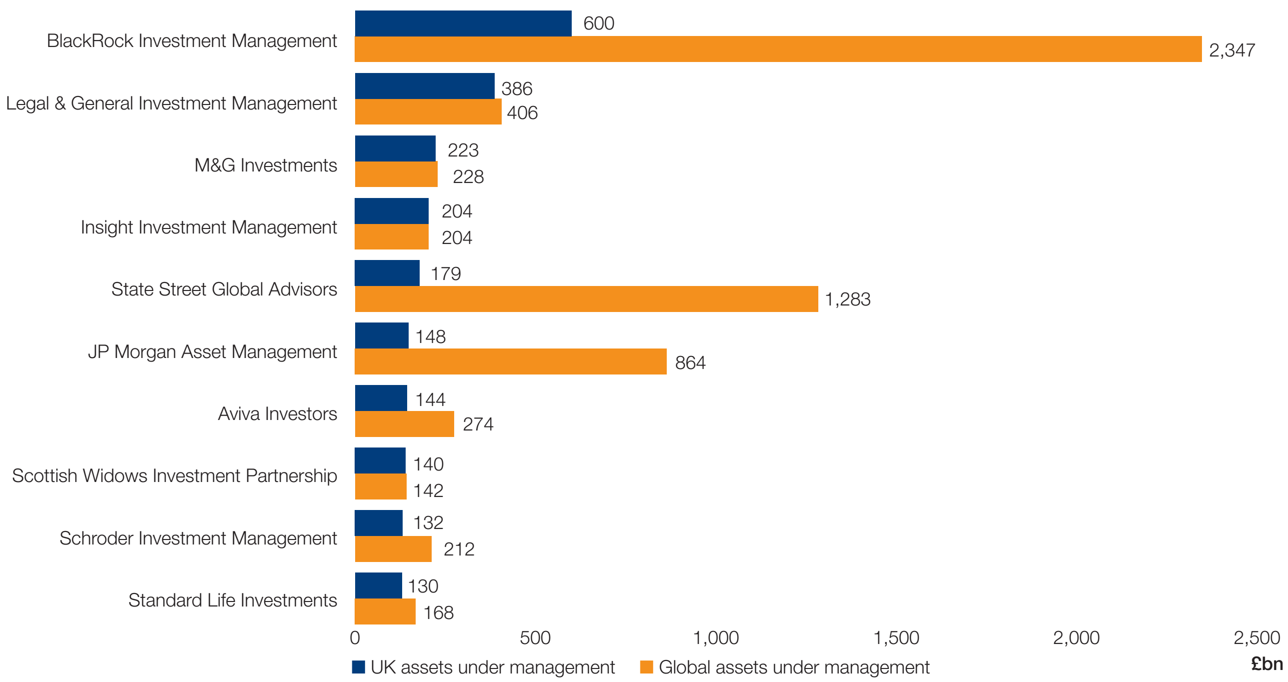


Chart 89: Top ten firms by UK and global assets under management



Changing Ownership

As in previous years, we continue to track the breakdown of UK assets under management by the type of parent group, with the aim of comparing the size of assets managed by autonomous asset managers as opposed to the subsidiaries of more traditional parent firms, namely banks (both investment and retail) and insurance companies (see Chart 90).

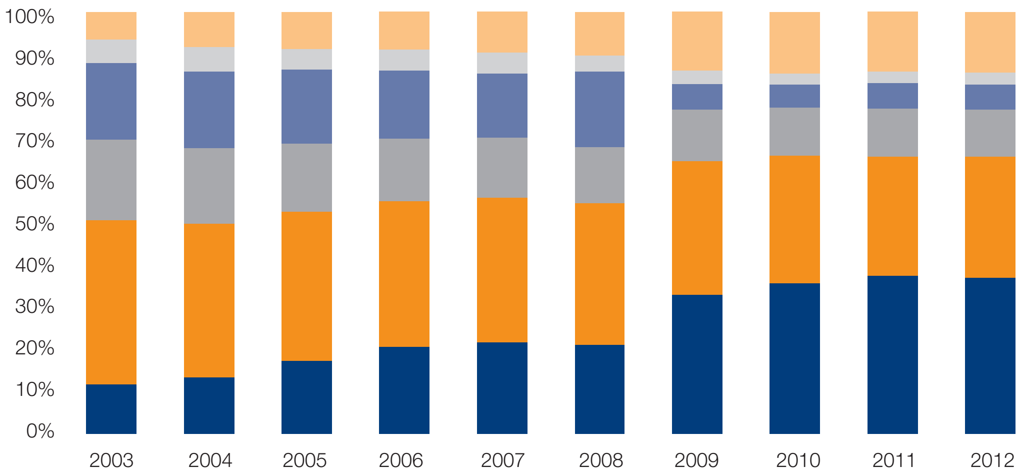
The past decade has seen significant growth among autonomous asset managers, up from 11% in 2003 to 37% in 2012 (2011: 37%). Insurance companies and banking groups (both investment and retail) have over the same period shrunk from 39% and 37% to 29% and 17%, respectively.

It is noteworthy that the development among investment bank and retail bank groups has not been the same, either. From roughly the same proportions in 2003 (19% in the case of investment banks and 18% in the case of retail banks), investment banks fell to 11% while retail banks decreased to 6.0%.

This, like the decrease among insurance and bank groups in general, was driven by a variety of factors, not least the significant divestment of asset management arms following the onset of the crisis.

An interesting parallel development has been the gradual growth in the market share of 'Other' parent groups, increasing from 6.4% in 2003 to 14% in 2012. This category is mainly composed of large diversified financial corporations, custodian banks and increasingly also a small number of consultants.

Chart 90: Breakdown of UK assets under management by parent type (2003–2012)



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Asset / Fund manager	11.4%	13.2%	17.2%	20.5%	21.6%	20.9%	32.8%	35.6%	37.4%	36.9%
Insurance company	39.3%	36.4%	35.3%	34.6%	34.4%	33.8%	31.6%	30.2%	28.1%	28.7%
Investment bank	18.9%	18.1%	16.2%	14.8%	14.1%	13.2%	12.6%	11.5%	11.5%	11.2%
Retail bank	18.2%	18.1%	17.6%	16.1%	15.3%	17.9%	5.9%	5.3%	6.1%	6.0%
Pension fund manager	5.7%	6.0%	4.9%	4.9%	4.9%	3.9%	3.3%	2.9%	2.6%	2.8%
Other (incl. custodian banks)	6.4%	8.2%	8.7%	9.0%	9.7%	10.4%	13.9%	14.5%	14.2%	14.5%

Table 14 shows a list of the most notable M&A deals that have affected the IMA membership base since 2009. Following 2011, a comparatively slow year in terms of M&A deals involving IMA members, activity seems to have picked up in 2012. These transactions were pursued for strategic reasons, mostly to gain access to foreign markets, buy into new capabilities or refocus on specific business areas.

Table 14: Notable M&A deals in the UK asset management sector (2009–2012)

Year	Acquirer	Purchase
2012	Baring	SEI Asset Korea
2012	Bridgepoint & Quilter	Quilter (MBO)
2012	Broadstone	UBS Wealth (corp. pensions arm)
2012	Brooks Macdonald	Spearpoint
2012	Franklin Templeton	K2 Advisors
2012	Goldman Sachs	Dwight
2012	Insight	Pareto
2012	Legg Mason	Fouchier Partners
2012	Liontrust	Walker Crips
2012	Natixis	McDonnell
2012	Punter Southall	PSigma (remaining 50%)
2012	Rathbone	Taylor Young
2011	BT	JO Hambro
2011	Close	Cavanagh Wealth
2011	Close	Allenbridge Group
2011	Cyrun Finance	SVM (52%)
2011	Franklin Templeton	Rensburg
2011	Henderson	Gartmore
2011	Investec	Evolution
2011	Liontrust	Occam
2011	Principal	Origin (74%)
2011	Punter Southall	Brewin Dolphin's (corp. pensions arm)
2011	Royal London	Royal Liver
2011	SGBP Hambros	Barings (private client arm)
2011	Threadneedle	Liverpool Victoria
2011	Williams de Broe	BNP Paribas (private client arm)
2010	Aberdeen	RBS (multi-manager and alternatives business)
2010	Alpha Real Capital	Close Brothers (property fund arm)
2010	AMG	Artemis
2010	Aviva Investors	River Road
2010	Close	Chartwell Group
2010	F&C	Thames River Capital
2010	Investec	Rensburg Sheppards
2010	Man Group	GLG Partners
2010	Marlborough	SunLife Financial of Canada (fund arm)
2010	Schroders	RWC Partners (49%)
2010	State Street	Bank of Ireland
2009	BlackRock	BGI
2009	BNP Paribas	Fortis
2009	BNY Mellon	Insight
2009	Henderson	New Star
2009	Ignis	Axial
2009	Invesco	Morgan Stanley (retail fund business)
2009	Marlborough	Apollo
2009	Neuberger Berman Group	Lehman Brothers asset management (MBO)
2009	Rathbone	RBS (PMS and two Lloyds private client portfolios)
2009	Sumimoto Trust	Nikko

Boutiques

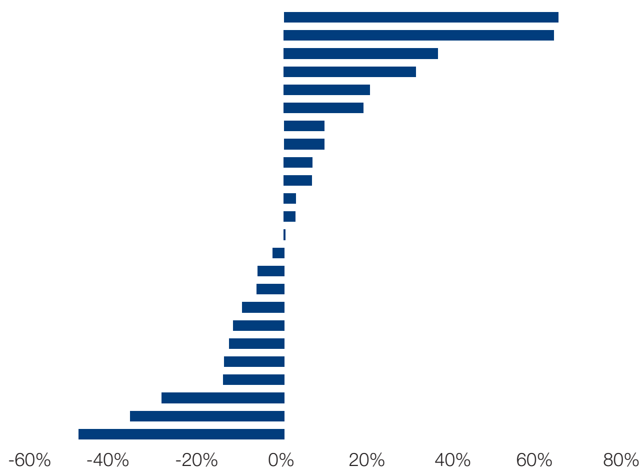
Compared with previous years, the growth of the boutique end of the IMA membership base has, with 3.9% year-on-year, for the first time lagged behind the industry as a whole (7.9%). This may suggest a more challenging commercial and operating environment for smaller players, which is now also increasingly coupled with growing regulatory burdens. However, more evidence is needed before such a conclusion can be drawn.

We broadly define boutique firms as having the following characteristics:

- UK assets under management of less than £5bn (allowing for a degree of short-term growth beyond that limit).
- Independent ownership.
- A degree of specialisation.
- Self-definition.

The IMA membership base included 27 such firms as at June 2012, of which three were new members. As shown in Chart 91, performance varied considerably between firms, with the best performers growing their assets by over 60% year-on-year while those at the bottom of the growth ladder experienced outflows of around 40%.

Chart 91: Percentage change in UK-managed assets across boutique IMA members (2011–2012)



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APPENDICES

Appendix One: Summary of Main Responses – Assets Under Management in the UK[1]

Data as at December 2012. Sample sizes vary between categories.

	TOTAL
Assets under management in the UK (£m)	**4,459,050**
Segregated (directly invested) or pooled (%)	
Directly invested on a segregated basis	51.5%
Managed on a pooled basis	48.5%
Active or passive (%)	
Actively managed	78.1%
Passively managed	21.9%
Asset allocation (%)	
Equities *of which:*	**42.0%**
UK	32.8%
Europe (ex UK)	22.0%
North America	16.8%
Pacific (ex Japan)	10.1%
Japan	3.9%
Emerging market	13.9%
Other	0.5%
Fixed income[2] *of which:*	**37.3%**
£ Sterling corporate	25.6%
UK government	18.4%
UK index-linked	16.2%
Other UK	3.0%
Overseas	36.8%
Cash/Money market	**7.0%**
Property	**2.7%**
Other	**10.9%**

[1] For a definition of the term please refer to Appendix Four. Caution should be used in undertaking direct comparisons with previous years. Where relevant or possible, we have used matched results in the survey analysis to validate observations of change.

[2] With holdings of UK government and corporate debt quite concentrated among IMA members, direct extrapolations from the survey headline findings are likely to overstate the value of the securities held. Please refer to Chapter 1 (p.21) for a sample-adjusted breakdown of fixed income holdings.

INSTITUTIONAL								ALL INSTITUTIONAL	RETAIL	PRIVATE CLIENT
Pension fund	Public sector	Corporate	Non-profit	Sub-advisory	In-house insurance	Third party insurance	Other institutional			
1,694,510	244,935	132,429	47,156	162,184	802,093	184,949	343,301	3,611,555	777,593	69,903
38.0%	5.5%	3.0%	1.1%	3.6%	18.0%	4.1%	7.7%	81.0%	17.4%	1.6%

Appendix Two: Summary of Main Responses – UK Institutional Client Market[1]

Date as at December 2012. Sample sizes vary between categories.

	TOTAL
Total UK institutional client market (£m)	**2,479,049**
Segregated or pooled (%)	
Directly invested on a segregated basis	62.6%
Managed on a pooled basis	37.4%
Active or passive (%)	
Actively managed	68.6%
Passively managed	31.4%
Multi-asset, LDI or specialist (%)	
Multi-asset (balanced)	**20.8%**
LDI	**16.3%**
Single-asset (specialist) *of which:*	**62.9%**
Equities *of which:*	**35.6%**
UK	32.9%
Europe (ex UK)	8.6%
North America	8.2%
Asia-Pacific	5.3%
Japan	2.9%
Emerging market	5.6%
Global	35.0%
Other	1.6%
Fixed income *of which:*	**42.3%**
£ Sterling corporate	27.2%
£ Sterling corporate and government	8.6%
UK government	17.3%
UK index-linked	21.3%
Global	12.4%
Other	13.1%
Cash/Money market	**9.1%**
Property	**5.7%**
Other	**7.2%**

[1] This includes UK institutional client mandates irrespective of where they are managed.

Pension funds			Public sector	Corporate	Non-profit	Sub-advisory	In-house insurance	Third party insurance	Other institutional
Corporate	Local government	Other							
1,049,400	170,528	58,290	19,842	61,982	26,267	113,558	671,305	180,064	127,813
42.3%	6.9%	2.4%	0.8%	2.5%	1.1%	4.6%	27.1%	7.3%	5.2%
57.4%	57.5%	22.0%	77.8%	42.3%	49.8%	94.1%	77.6%	88.3%	15.0%
42.6%	42.5%	78.0%	22.2%	57.7%	50.2%	5.9%	22.4%	11.7%	85.0%
55.3%	63.7%	36.3%	81.3%	79.1%	84.1%	46.3%	89.9%	83.4%	84.9%
44.7%	36.3%	63.7%	18.7%	20.9%	15.9%	53.7%	10.1%	16.6%	15.1%
8.1%	**8.8%**	**8.7%**	**4.1%**	**8.4%**	**49.6%**	**8.0%**	**51.8%**	**19.1%**	**9.6%**
30.0%	**18.3%**	**6.3%**	**0.0%**	**1.5%**	**0.0%**	**0.0%**	**2.2%**	**9.0%**	**1.4%**
61.9%	**72.9%**	**85.0%**	**95.9%**	**90.1%**	**50.4%**	**92.0%**	**46.0%**	**71.9%**	**89.0%**
38.9%	**67.4%**	**60.5%**	**58.5%**	**18.7%**	**45.6%**	**54.5%**	**21.8%**	**17.5%**	**25.1%**
26.9%	29.4%	21.4%	3.3%	46.2%	47.8%	38.1%	60.6%	35.3%	37.6%
8.1%	10.6%	3.3%	40.0%	9.1%	3.7%	6.0%	10.0%	10.6%	4.7%
8.3%	12.6%	4.4%	0.0%	1.5%	2.3%	4.4%	9.6%	6.7%	5.4%
3.2%	4.2%	2.7%	8.8%	8.4%	9.4%	8.6%	7.1%	7.2%	15.5%
3.9%	3.4%	2.5%	1.2%	0.2%	0.6%	0.4%	1.1%	2.2%	1.4%
4.5%	4.1%	3.6%	17.7%	5.8%	1.2%	4.1%	7.0%	6.7%	13.9%
43.4%	34.6%	57.1%	28.7%	28.8%	33.0%	33.2%	4.3%	31.3%	21.4%
1.8%	1.1%	5.1%	0.3%	0.0%	2.1%	5.2%	0.2%	0.0%	0.0%
47.8%	**20.2%**	**27.9%**	**8.5%**	**20.4%**	**17.6%**	**17.5%**	**59.1%**	**58.5%**	**14.5%**
29.8%	25.6%	30.7%	7.2%	9.2%	12.6%	15.2%	19.5%	44.2%	12.5%
3.7%	9.8%	18.9%	3.8%	0.0%	18.0%	4.6%	14.7%	12.8%	18.2%
21.5%	10.2%	16.0%	9.5%	6.8%	52.7%	12.3%	10.0%	9.2%	52.3%
19.7%	23.0%	23.0%	26.9%	2.9%	0.6%	16.9%	34.7%	4.4%	2.6%
14.3%	19.3%	4.2%	52.6%	56.8%	0.5%	44.4%	6.5%	8.3%	5.4%
11.0%	12.1%	7.3%	0.0%	24.4%	15.6%	6.7%	14.7%	21.0%	9.0%
2.2%	**1.1%**	**2.3%**	**23.3%**	**44.4%**	**24.7%**	**1.1%**	**9.0%**	**6.9%**	**41.1%**
4.0%	**5.0%**	**4.7%**	**8.4%**	**9.9%**	**6.5%**	**3.6%**	**8.6%**	**4.4%**	**8.4%**
7.1%	**6.2%**	**4.6%**	**1.4%**	**6.6%**	**5.7%**	**23.2%**	**1.5%**	**12.6%**	**11.0%**

Appendix Three: Summary of Main Responses – UK Third Party Institutional Client Market[1]

Date as at December 2012. Sample sizes vary between categories.

	TOTAL
Total third party institutional market (£m)	**1,691,275**
Segregated or pooled (%)	
Directly invested on a segregated basis	57.3%
Managed on a pooled basis	42.7%
Active or passive (%)	
Actively managed	61.0%
Passively managed	39.0%
Multi-asset, LDI or specialist (%)	
Multi-asset (balanced)	**10.1%**
LDI	**21.9%**
Single-asset (specialist) *of which:*	**68.1%**
Equities *of which:*	**39.7%**
UK	29.4%
Europe (ex UK)	8.2%
North America	7.7%
Asia-Pacific	5.1%
Japan	3.0%
Emerging market	5.3%
Global	39.4%
Other	1.8%
Fixed income *of which:*	**37.9%**
£ Sterling corporate	30.4%
£ Sterling corporate and government	6.4%
UK government	19.8%
UK index-linked	15.3%
Global	15.0%
Other	13.1%
Cash/Money market	**9.3%**
Property	**4.6%**
Other	**8.4%**

[1] This includes UK institutional client mandates irrespective of where they are managed. Third party institutional business is defined here as total UK institutional business minus in-house insurance and in-house managed OPS mandates. We do not have additional granularity.

Third party pension funds			Public sector	Corporate	Non-profit	Sub-advisory	Third party insurance	Other institutional
Corporate	Local government	Other						
932,930	170,528	58,290	19,842	61,982	26,267	113,558	180,064	127,813
55.2%	10.1%	3.4%	1.2%	3.7%	1.6%	6.7%	10.6%	7.6%
56.5%	57.5%	22.0%	77.8%	42.3%	49.8%	94.1%	88.3%	15.0%
43.5%	42.5%	78.0%	22.2%	57.7%	50.2%	5.9%	11.7%	85.0%
53.6%	63.7%	36.3%	81.3%	79.1%	84.1%	46.3%	83.4%	84.9%
46.4%	36.3%	63.7%	18.7%	20.9%	15.9%	53.7%	16.6%	15.1%
8.4%	**8.8%**	**8.7%**	**4.1%**	**8.4%**	**49.6%**	**8.0%**	**19.1%**	**9.6%**
31.3%	**18.3%**	**6.3%**	**0.0%**	**1.5%**	**0.0%**	**0.0%**	**9.0%**	**1.4%**
60.3%	**72.9%**	**85.0%**	**95.9%**	**90.1%**	**50.4%**	**92.0%**	**71.9%**	**89.0%**
40.4%	**67.4%**	**60.5%**	**58.5%**	**18.7%**	**45.6%**	**54.5%**	**17.5%**	**25.1%**
27.2%	29.4%	21.4%	3.3%	46.2%	47.8%	38.1%	35.3%	37.6%
7.7%	10.6%	3.3%	40.0%	9.1%	3.7%	6.0%	10.6%	4.7%
7.8%	12.6%	4.4%	0.0%	1.5%	2.3%	4.4%	6.7%	5.4%
3.3%	4.2%	2.7%	8.8%	8.4%	9.4%	8.6%	7.2%	15.5%
3.8%	3.4%	2.5%	1.2%	0.2%	0.6%	0.4%	2.2%	1.4%
4.4%	4.1%	3.6%	17.7%	5.8%	1.2%	4.1%	6.7%	13.9%
44.1%	34.6%	57.1%	28.7%	28.8%	33.0%	33.2%	31.3%	21.4%
1.8%	1.1%	5.1%	0.3%	0.0%	2.1%	5.2%	0.0%	0.0%
47.6%	**20.2%**	**27.9%**	**8.5%**	**20.4%**	**17.6%**	**17.5%**	**58.5%**	**14.5%**
30.3%	25.6%	30.7%	7.2%	9.2%	12.6%	15.2%	44.2%	12.5%
3.6%	9.8%	18.9%	3.8%	0.0%	18.0%	4.6%	12.8%	18.2%
21.2%	10.2%	16.0%	9.5%	6.8%	52.7%	12.3%	9.2%	52.3%
18.2%	23.0%	23.0%	26.9%	2.9%	0.6%	16.9%	4.4%	2.6%
14.8%	19.3%	4.2%	52.6%	56.8%	0.5%	44.4%	8.3%	5.4%
11.8%	12.1%	7.3%	0.0%	24.4%	15.6%	6.7%	21.0%	9.0%
2.0%	**1.1%**	**2.3%**	**23.3%**	**44.4%**	**24.7%**	**1.1%**	**6.9%**	**41.1%**
3.3%	**5.0%**	**4.7%**	**8.4%**	**9.9%**	**6.5%**	**3.6%**	**4.4%**	**8.4%**
6.7%	**6.2%**	**4.6%**	**1.4%**	**6.6%**	**5.7%**	**23.2%**	**12.6%**	**11.0%**

Appendix Four: Category Definitions

Corporate client

Comprises institutions such as banks, financial corporations, corporate treasuries, financial intermediaries and other private sector clients. Asset management services for fund products operated by financial corporations are included under 'Sub-advisory'.

In-house insurance

Refers to assets that insurance-owned asset management firms manage for their parent company or an insurance company within the parent group.

Investment fund

Includes all pooled and listed vehicles regardless of the domicile of the client or fund (ie. unit trusts, investment companies with variable capital including ETFs, contractual funds, investment trusts, hedge funds etc.) except for life or insurance funds.

Liability driven investment (LDI)

An approach where investment objectives and risks are calculated explicitly with respect to individual client liabilities.

Multi-asset

Also called 'balanced', this type of mandate invests across a range of asset classes and geographies without a specific focus on a particular universe.

Non-profit client

Includes charities, endowments, foundations and other not-for-profit organisations.

Other client

Includes client types that cannot be classified under any other category as well as unidentifiable client types, eg. closed-ended funds or institutional pooling vehicles.

Overseas client assets

Assets managed on behalf of non-UK clients. Includes assets delegated to the firm from overseas offices and assets directly contracted in the UK.

Pension fund client

Incorporates both defined benefit (DB) and defined contribution (DC) provision, where the respondent has a relationship with a pension fund, irrespective of type. Where the DC provision is operated via a life company structure, the assets are reflected in 'Insurance'.

Public sector client

Encompasses central banks, supranational bodies, public sector financial institutions, governmental bodies, public treasuries and sovereign wealth funds as well as the non-pension assets of local authorities and other public sector clients.

Private client

Includes assets managed on behalf of high-net-worth and ultra-high-net-worth individuals as well as family offices.

Pooled

Comprises investment vehicles operated by a manager for multiple clients whose investments are managed on a collective basis.

Retail client

Includes investment into unit trusts, OEICs and other open-ended investment funds irrespective of domicile. It incorporates assets sourced through both intermediated sales (ie. made through fund platforms, supermarkets and other third parties) and direct retail sales. It does not include life-wrapped funds, which are classified under 'Third party insurance'.

Segregated

Assets directly invested within segregated portfolios, and managed on behalf of one client. Includes mandates run on behalf of a single pooled vehicle (eg. a 'pooled' insurance fund run for an insurance parent company).

Single-asset

Also called 'specialist', this type of mandate is overwhelmingly focused on one asset class, and therein usually a specific sub-type (either geographic or other; eg. a US equity mandate or an index-linked gilt mandate).

Socially responsible investment (SRI)

Mandate or fund focused on investment in companies where environmental, social and governance principles are incorporated into the nature of the business.

Sub-advisory

Business as part of which the respondent provides investment management services to third party fund products. It may therefore include business that is institutional to the respondent, but may ultimately be retail (eg. 'white-labelled' funds or manager of managers products).

Third party insurance

Assets sourced from third party insurance companies (ie. from outside the respondent's group), where the mandates are seen as institutional. It includes both unit-linked assets (ie. funds manufactured by the respondent and distributed with the respondent's brand through a life platform) and other third party assets.

UK assets under management

Assets where the day-to-day management is undertaken by managers (ie. the individuals who make the decisions to invest under discretion) within the firm and based in the UK. Includes assets managed by the firm in the UK whether for UK or overseas clients contracted with the firm. Also includes assets delegated to the firm's UK-based asset managers by either third party asset managers or overseas offices of the company or group. With respect to fund of funds and manager of managers products, the figure should only include the size of the underlying funds managed by the firm's UK-based managers.

Unconstrained

Also called 'benchmark-unaware', refers to products or strategies that are not measured against any specific market or asset class index.

Appendix Five: Survey Respondents

Aberdeen Asset Management

Aberforth Partners

Aerion Fund Management

Alliance Trust Investments

AllianceBernstein

Allianz Global Investors

Architas Multi-Manager

Ashmore Investment Management

Aviva Investors

Baillie Gifford & Co

Baring Asset Management

BlackRock Investment Management

Brooks Macdonald Asset Management

Canada Life Asset Management

Carvetian Capital Management

Cazenove Capital Management

CCLA Investment Management

CIS Unit Managers

Edinburgh Partners

F & C Asset Management

Family Investment Management

FIL Investments International

Franklin Templeton Investment Management

GAM

GLG Partners Investment Funds

Guinness Asset Management

Henderson Global Investors

Hermes Fund Managers

HSBC Global Asset Management

Ignis Asset Management

Independent Franchise Partners

Insight Investment Management

Invesco Perpetual

Investec Asset Management

JO Hambro Capital Management

JP Morgan Asset Management

Jupiter Asset Management

Kames Capital

Lazard Asset Management

Legal & General Investment Management

Liontrust Fund Partners

M & G Investments

Margetts Fund Management

Martin Currie Unit Trusts

McInroy & Wood

Morgan Stanley Investment Management

Natixis Global Asset Management

Newton Investment Management

Nomura Asset Management

Old Mutual Global Investors

Pictet Asset Management

PIMCO Europe

Premier Portfolio Managers

Principal Global Investors

Pyrford International

Rathbone Unit Trust Management

RBS Collective Investment Funds

Royal London Asset Management

Ruffer

Schroder Investment Management

Scottish Friendly Asset Managers

Sharefunds

Skagen

Standard Life Investments

State Street Global Advisors

T. Rowe Price International

Threadneedle Asset Management

TwentyFour Asset Management

UBS Global Asset Management

Vanguard Asset Management

Virgin Money Management Services

Wellington Management International

Appendix Six: Firms Interviewed

Aberdeen Asset Management

Allianz Global Investors

Ashmore Investment Management

AXA Investment Managers

Barclays Wealth and Investment Management

BlackRock Investment Management

F & C Asset Management

FIL Investments International

Henderson Global Investors

Insight Investment Management

Invesco Perpetual

Jupiter Asset Management

Legal & General Investment Management

M&G Investments

PIMCO Europe

Royal London Asset Management

Schroder Investment Management

Standard Life Investments

State Street Global Advisors

Threadneedle Asset Management

UBS Global Asset Management