Asset Management in the UK 2013–2014
The IMA Annual Survey

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Contents

Index of Charts, Tables and Figures

Charts

Tables

Figures

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 £4.3 trillion in this country (85% of total UK assets under management by the entire IMA membership base).

The IMA would like to express its gratitude to member firms who provided detailed questionnaire information.

The Survey is in five chapters:

1 **Industry Overview**

2 **Broader Trends**

3 **UK Institutional Client Market**

4 **UK Fund Market**

5 **Operational and Structural Issues**

There are also five appendices:

1 **Summary of assets under management in the UK**

2 **Summary of the UK institutional client market**

3 **Overview of key EU and UK regulatory developments affecting asset management**

4 **Category definitions**

5 **Survey respondents**

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 2013. For a more detailed explanation of the term please refer to Appendix 4.
- 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 therefore the response rate differs 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.
- Numbers in the charts and tables are presented in the clearest possible manner for the reader. At times this may mean that numbers do not add to 100%, or do not sum to the total presented, due to rounding issues.

Survey Foreword

Daniel Godfrey
Chief Executive

The IMA asset management survey is now in its twelfth year and the results for 2013 show that growth in assets under management in the UK continues to be strong. The UK remains Europe's largest centre for asset management and is second only to the US on the global stage. The investor base for UK assets is becoming ever broader, with the growing importance of overseas clients in recent years continuing into 2013.

Pension funds were the largest investor group again in 2013. De-risking among defined benefit schemes continues, with greater use of liability driven investment strategies and insurance buyouts. This de-risking now looks to be irreversible as corporate defined benefit schemes continue to close. However, despite the shift out of equities by defined benefit schemes, pension schemes overall remain relatively strong holders of equities, buoyed by higher equity allocations among local authority funds and defined contribution schemes.

At the same time, the changes announced in the Budget will radically alter the retirement income landscape, signalling recognition on the part of the Government that individuals should be allowed greater control over the way in which they access their accumulated savings in retirement. This too is a tremendous opportunity – and responsibility – for the asset management industry.

The reputation of the industry is likely to be shaped to a large extent by its response to these challenges in the coming years. Firms are under pressure on many fronts to demonstrate that they can serve savers and investors, as well as the broader economy, successfully and do so in a way that is both transparent and which puts the industry beyond suspicion that it does not always act in the best interests of clients.

I hope you enjoy reading the 2013 Survey; we welcome any thoughts or suggestions on the issues you would like us to consider in future editions.

Daniel Godfrey

Daniel Godfrey
Chief Executive

Executive Summary

- **UK assets managed by IMA member firms grew by 13%** during the year to reach £5.0 trillion at the end of 2013, with £2.0 trillion (40%) managed on behalf of overseas clients.

- There was strong **growth in UK authorised funds,** increasing 16% from £662 billion in 2012 to £770 billion in 2013 following strengthening investment since the credit crisis in 2008. There continues to be an ongoing hunt for yield as investors search for income, as well as growing interest in asset allocation and outcome-focused approaches.

- The trend over the past two decades points to **increasing globalisation of the client base** with a shift away from dependence on UK clients. The proportion of assets managed for UK headquartered firms has decreased from 57% to 45% in the last decade. Asset management's contribution to the UK's net export earnings has grown from under £300 million in the early 1990s to over £5 billion in 2012.

- The **UK is the leading centre for asset management in Europe** (35%) with more assets under management than the next two largest centres combined. Globally it remains second only to the US. Asset management continues to be concentrated in London, but 11% of all UK-managed assets are now managed in Scotland. The same trend is not seen in fund domicile, where the UK is the 5th largest centre in Europe with 11% of the market.

- **Pension funds remain the largest client type** (36%) followed by insurance companies (20%). The balance between retail (20%) and institutional assets (80%) has remained broadly stable since 2005.

- **Equities remain the largest asset class (46%), followed by fixed income 34%. 'Other' assets, including alternatives have increased** in recent years to around 11% of total assets under management. This growth is largely attributable to the increasing use of derivative-based strategies, such as currency overlay and liability driven investment (LDI).

- The significance of the **shift from defined benefit (DB) to defined contribution (DC)** is immense. To date more than four million additional savers are in a workplace pension scheme due to automatic enrolment, most in a DC scheme. Eventually the number of additional savers through automatic enrolment could reach 9 million. This shift will bring asset managers increasingly into the spotlight as will the 2014 Budget changes to the retirement income rules, giving people more freedom of access to their pension savings at retirement.

- **The de-risking undertaken by DB pension schemes** now looks to be irreversible with continued use of LDI strategies and insurance buyouts. However, in spite of this, pension schemes overall (DB & DC) remain relatively strong holders of equity (52%).

- **Governance will remain crucial,** particularly following the introduction of a charge cap of 0.75% for default funds used for automatic enrolment purposes from April 2015. This will be a source of major fee pressure on the industry but may not deliver value for money for the end investor. The high number of invstors remaining in a default fund will mean default design will be key to the success of automatic enrolment in the long term.

- Since the **introduction of the Retail Distribution Review (RDR)** in January 2013, strong retail sales have continued, with net retail sales in UK authorised funds of £20 billion in 2013 significantly higher than the £14 billion that came in throughout 2012. At the time of writing over 80% of flows were being directed into lower charging share classes, compared to 60% directed to the share class with the highest annual management charge prior to RDR.

- **The UK asset management industry remains highly competitive** with the top ten firms accounting for 50% of total assets (at June 2013). Within the investment fund industry specifically, the top ten firms represent around 46% of the total authorised funds under management. This percentage has remained fairly stable since the early 1990s but the make-up of the top ten firms has varied over time, with the top ten today representing only 33% of the market back in 1995.

Key Statistics

£5.0 trillion

[£4.5 trillion in 2012]

Total assets managed in the UK by IMA member firms as at December 2013

£770 billion

[£662 billion in 2012]

Managed in UK authorised funds (OEICs and unit trusts)

£2.0 trillion

[£1.8 trillion in 2012]

Assets managed in the UK on behalf of overseas clients

£775 billion

[£721 billion in 2012]

UK-managed funds domiciled overseas

30%

[unchanged from 2012]

UK domestic market capitalisation accounted for by IMA members' UK equity holdings

35%

[36% in 2011]

Total European assets under management managed in the UK as at December 2012 (latest available)

1 Industry Overview

Key Findings

Total assets under management

- As at December 2013, IMA members managed a total of £5.0 trillion assets in the UK, an increase of 13% year-on-year.
- UK authorised funds, which are the main delivery vehicle within the UK retail market, grew by 16% reaching £770 billion at the end of 2013.

Scottish industry

- As in previous years, asset management activity continued to be concentrated in London. However, 11% or nearly £560 billion of total assets were managed in Scotland.

UK in a comparative perspective

- The UK is the second largest asset management centre in the world after the US, which accounted for almost half of global assets under management as at the end of 2012.
- Within Europe, the UK retains its position as the largest asset management centre in the continent with a market share of 35% of total European assets at the end of 2012 (2011: 36%).

Client type

- Pension funds remain the largest institutional client type (36%) followed by insurance companies (20%).
- The overseas client base grew in absolute terms to £2.0 trillion but in relative terms remains at 40% of total UK assets under management in 2013.

Asset allocation

- Developed equity markets, notably Japan and the United States, saw extremely strong performance in 2013 whilst emerging markets recorded very poor annual returns.
- Headline aggregate asset allocation data do not allow detailed conclusions about client behaviour, but the change in allocation levels is consistent with market movements rather than significant reallocation.
- Equities rose to 46% of total assets under management (2012: 42%), whilst fixed income fell to 34% (2012: 37%). Growing use of alternative instruments and asset classes has also seen the 'other' category increase in recent years to 11% (although this figure remained unchanged from 2012).

Type of management

- The proportion of total UK-managed assets that are run on a passive basis remains almost unchanged year-on-year at 22%. However, our data does not capture the full exchange traded fund (ETF) market.
- Segregated mandates increased to 56% compared to 44% pooled. (2012: 52% vs 48%). This is closer to levels reported in earlier Surveys.

1 Industry Overview

The UK asset management industry serves a wide spectrum of institutional and retail clients from all over the world. This Survey focuses on the activities of the IMA membership base from a range of different perspectives, including a breakdown of activity by asset class, client and mandate type.

The IMA membership covers a broad range of firms and is detailed in Figure 1.

Figure 1: IMA member characteristics

The IMA membership includes both MiFID-regulated asset management firms and UCITS-regulated fund management firms. They manage assets from the UK on behalf of both domestic and overseas clients, and can be independent or part of a larger financial services group.

The membership can be broken down into five broad groups

1. **Large asset management firms** (both UK and overseas-headquartered), which may be independent or part of wider financial services groups such as banks or insurance companies. They undertake a wide range of asset management activities across both retail and institutional markets and manage substantial amounts of overseas client assets in the UK. Such firms will typically be managing >£50bn from the UK, but a number of international firms have a smaller UK footprint.
2. **Small and medium-sized asset management firms,** primarily focused on UK and/or European clients, which undertake a diverse range of activities, of which asset management is a constituent part.
3. **Fund managers,** whose business is based primarily on authorised investment funds.
4. **Specialist boutiques and private client managers** with a smaller asset and client base and, typically, a specific investment or client focus.
5. **Occupational pension scheme (OPS) managers** running in-house asset management services for a large scheme.

'UK assets under management'[1] in this report is used as an all-encompassing term to cover all forms of asset management activity. In broad terms, this activity splits out pooled vehicles (operating on behalf of multiple clients who pool their investment exposure in a fund), and segregated mandates (a bespoke arrangement between an individual client and an investment manager, governed by a specific agreement).

The pooled vehicles include:

- Authorised unit trusts
- Open-ended investment companies (OEICs)
- Unauthorised investment vehicles (eg. unauthorised unit trusts)
- Closed-ended investments (eg. investment trusts)
- Exchange-traded funds (ETFs)
- Life funds, operated by insurance companies

'UK authorised funds', in contrast, are used specifically for UK-domiciled authorised investment funds, which includes (authorised) Unit Trusts and OEICs. Collectively, these investments are referred to as the 'UK fund industry' and are analysed in detail in Chapter Four.

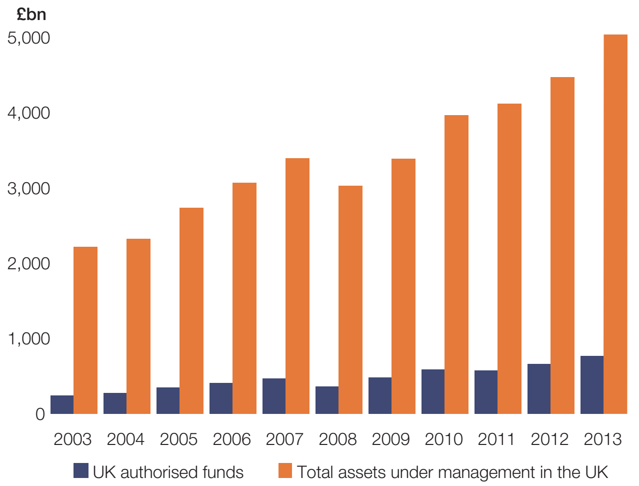
Total Assets under Management

IMA members together account for a total of £5.0 trillion in UK-managed assets at the end of 2013, an increase of 13% year-on-year (see Chart 1). The growth has been primarily driven by a combination of net flows and market movements. While there is always a degree of evolution in the IMA membership base, this has had little impact on the year-on-year change.[2] UK authorised funds, which are the main delivery vehicle within the UK retail market, grew by 16% to £770 billion at the end of 2013.

[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.

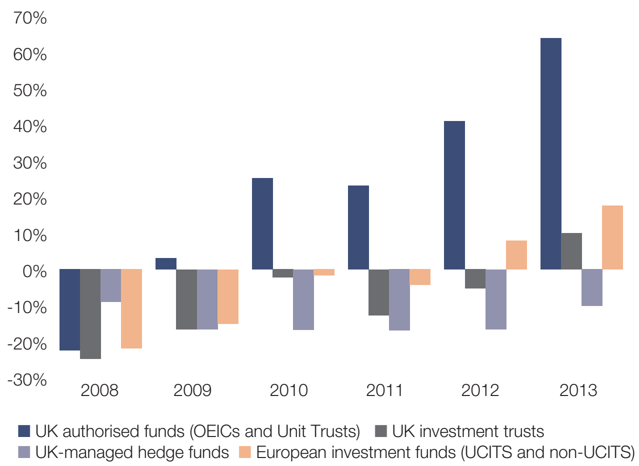
[2] We do not collect total managed asset data at a level of granularity that would allow us to distinguish between the impact of flows and market movements. Flow is driven by client decisions, and changes in business organisation (ie. decisions as to where the money is actually managed) by the many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

Chart 1: Total assets under management in the UK and in UK authorised funds (2003–2013)



In comparison to other parts of the UK industry and the international experience, the strength of growth in total authorised funds under management since the period preceding the global financial crisis finds little parallel (see Chart 2). A central driver in this growth has been strong inflows – reaching record levels in 2009 and 2010. The UK funds industry is explored in more detail in Chapter Four.

Chart 2: Cumulative percentage change since 2007 by fund range



Scottish Business

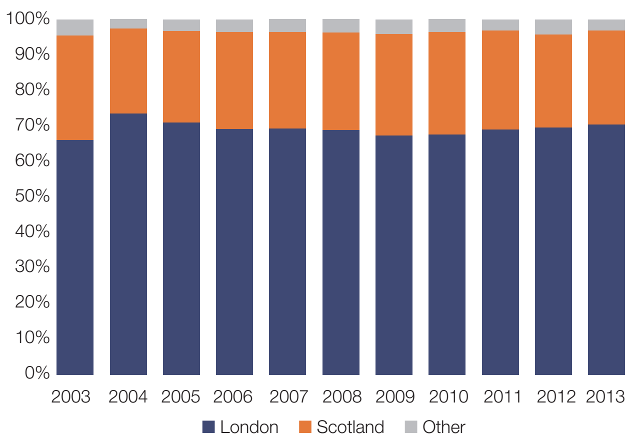
As in recent years, assets managed in Scotland represent a significant proportion of the total asset management industry in the UK, and our latest estimates place this at around 11%, or £560 billion. This represents little change in relative terms.

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 is just over a quarter (26% at June 2013) of the total managed by UK-headquartered firms (see Chart 3).

This higher figure, equating to £571 billion, 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.

Chart 3 also shows there has been little change in the relative market share of regional headquarters over the past decade, with the clear majority (65-75%) still represented by London-based groups.

Chart 3: UK-managed assets by UK regional headquarters (2003–2013)

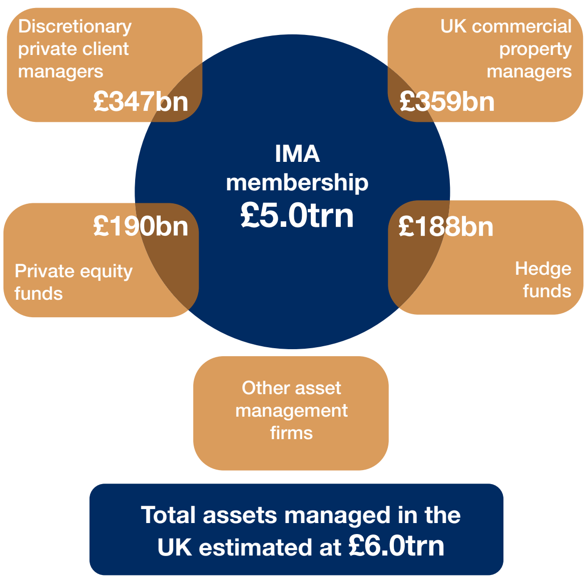


Wider Industry

While IMA members represent the majority of the UK asset management industry in asset terms, a significant number of firms contributing to the industry's activity lie outside the IMA membership. These firms typically sit within the following categories (see Figure 2):

- Hedge funds
- Private equity funds
- Commercial property management
- Discretionary private client management
- Firms who do not fall into the above categories, but are not IMA members[3]

Figure 2: Wider asset management industry



Source: ComPeer, HedgeFund Intelligence/EuroHedge, IPD, IMA estimates for private equity based on 2012 BVCA data

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 £250 billion in these areas:

- As at the end of 2013, our respondents managed nearly £40 billion in hedge funds which represents just over a fifth of the estimated UK total of £188 billion.[4] This proportion has fluctuated somewhat in recent years, but remains broadly stable. The majority of the hedge fund universe sits outside the IMA membership base, as is the case for the private equity universe. Our estimates suggest that private equity accounts for only 0.5% of overall assets managed by IMA members.
- IMA respondents account for just under a third of the value of UK investible commercial property (including directly held property). This is much lower than our previous estimates due to significant upward revision in the external estimates we use to size the wider investible market. A recent IPF study sizes the UK investible commercial market at £364 billion, alongside new IPD data (£359 billion). Similar to trends in UK equity market investment (see p.21), it estimates that overseas investors are now the biggest single ownership group.[5]
- IMA firms accounted for a quarter of UK discretionary private client assets, run within wealth management units.[6]

[3] This last group is more difficult to size as there is no consistent third party data available.
[4] Source: HedgeFund Intelligence/EuroHedge.
[5] Source: IPD and IPF: *The Size and Structure of the UK Property Market 2013: A Decade of Change.*
[6] Source: ComPeer.

UK in a Comparative Context

The UK is the second largest asset management centre in the world after the US, which accounted for almost half of global assets under management as at the end of 2013). This translates into £20.5 trillion ($34.0 trillion) in US assets under management, most of which are managed in the US.[7]

Within Europe, the UK retains its position as the largest asset management centre in the continent with a market share of 35% of total European assets at the end of 2012 (most recent data at the time of going to print), though this represents a slight fall, in relative terms, from 36% at the end of 2011.[8]

Figure 3 shows European country rankings at the end of 2012, indicating consistency amongst the big players, despite the unavoidable impact of exchange rate fluctuations. Swiss assets under management were estimated at £3.6 trillion (CHF 5.3 trillion),[9] although a significant proportion of these is likely to refer to advisory business.

Outside Europe and the US, the closest rival to the UK industry in terms of size is Japan with an estimated £2.8 trillion (¥399 trillion) in assets under management as at March 2013; this is up from £2.7 trillion (¥361 trillion) the year before.[10]

Figure 3: Assets under management in Europe (December 2012)

	Country	Net assets (€bn)	Market share
1	UK	5,449	35%
2	France	2,977	19%
3	Germany	1,618	10%
4	Italy	841	5%
5	Netherlands	469	3%
6	Belgium	225	1%
7	Other	3,857	26%

Source: EFAMA

[7] Source: *BCG, Global Asset Management 2014* (US assets under management figures based on the location of the client, not the location of the asset manager).

[8] Source: EFAMA.

[9] Source: Swiss Bankers Association.

[10] Source: Nomura Research Institute.

Client Type

The IMA splits out the £5.0 trillion managed from the UK by broad client group (combining retail and institutional). We provide greater granularity about UK institutional clients in Chapter Three and about UK retail funds in Chapter Four. As Chart 4 shows, the client group served from the UK includes domestic and overseas retail, institutional and private clients. The overall split between institutional and retail is 80/20, with pension funds the largest single client group.

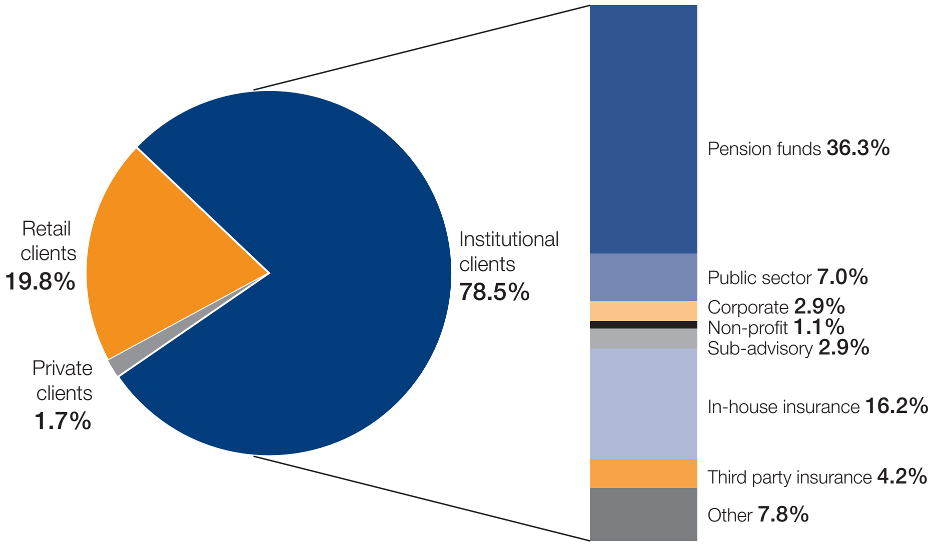
Institutional investors will be investing via segregated mandates and pooled vehicles, while retail clients are focused on pooled vehicles such as UCITS funds. The UK retail market remains highly intermediated by independent financial advisers (IFAs), in contrast to the bancassurance model that still dominates in continental Europe.

In reality, the asset management industry is serving tens of millions of individuals in the UK, both directly and indirectly, since beneficiaries of pension schemes or holders of investment-linked insurance products are all ultimately dependent upon its services. The delivery mechanisms look more classically institutional in these instances, since a trust-based pension scheme or an insurance company will be the owners of the assets and control the governance underpinning the delivery.

As we discuss further in Chapter Two, the distinction between retail and institutional is becoming increasingly blurred at a number of levels:

- Retail distribution is increasingly undertaken through platforms that are effectively a wholesale client of a fund management company whose range they carry on that platform. The direct client relationship lies with the platform (in conjunction with an IFA as relevant). The negotiating relationships between fund managers and their retail distributors therefore look more institutional. Under the Retail Distribution Review (RDR) (see p.29), which effectively unbundles fund manufacture, distribution and advice costs, this dynamic is likely to intensify.

Chart 4: Assets managed in the UK by client type



- The growth of defined contribution (DC) pensions coupled with the implementation of the UK's policy to automatically enrol all eligible employees into a workplace scheme, adds a further dimension. There is now an institutional delivery process for something that is in essence a personal account, whether provided under trust law or contract arrangements (see p.40). Overlaid with the greater freedom to access pension savings without having to take a specific income, pensions have a potentially much more retail set of characteristics, even if the majority of individuals saving in DC schemes still use default mechanisms (with trustee or other professional oversight) rather than active choice.

- Partly because of developments in the DC market, but partly also because institutional investors are broadening their opportunity set, the distinction between purely 'institutional' and 'retail' products has also diminished. Many pooled vehicles will have a wide range of investors, whether retail consumers (self-direct or advised) or 'traditional' institutional investors such as pension funds, insurance companies or endowments.

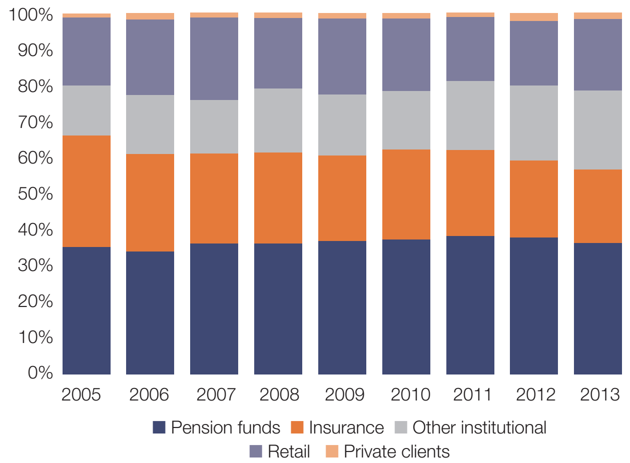
Looking at the historical data, Chart 5 shows the evolution of different client types, tracked on a consistent basis since 2005.[11] The evolution has to be interpreted with care since there are a number of reasons, some operational, why fluctuations occur year-on-year. For example, there have been occasions during this period where IMA firms have relocated parts of their business to the UK, and this will inevitably impact the reporting.

Nonetheless, a number of broad observations can be made about the progression over the last eight years:

- The overall institutional and retail split has remained reasonably stable, averaging 80/20, with fluctuations possibly reflecting the greater sensitivity of retail flows to market conditions.[12] The data points to a peak of 23% in retail in 2007, suggesting some retrenchment followed by stabilisation in the period afterwards. This may be influenced by the international nature of the client base covered in this part of the Survey. It is not consistent with UK retail market behaviour, which saw record sales through 2009-2010 and total funds under management significantly above the 2007 level by December 2013 (see p.52).

- More significantly, there is a sustained relative decline in the growth of insurance assets relative to pension funds within the institutional categories, with total insurance assets falling to just 20% of the total by the end of 2013 (from 31% in 2005).[13] Insurance assets have grown by only 2.4% a year on average since 2005, compared to 8.2% for pension funds. In-house insurance assets represented 16% of the total at the end of 2013. Primarily run for life insurance parent companies, the continuing decrease in insurance assets managed in-house supports the view of an industry moving away from the in-house model and towards less vertically integrated structures.

Chart 5: Assets managed in the UK by client type (2005–2013)



As in previous years, private client assets accounted for 1-2% 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. The overall size of UK-managed discretionary private client assets is about four times that, at £347 billion (see p.14).[14]

[11] Consistent comparison is not available before this period.

[12] 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).

[13] 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.

[14] Source: ComPeer.

Overseas clients

The relative proportion of the overseas client base remains at 40% of total UK assets under management in 2013. This is the same proportion as in 2012, and thus represents an increase only in absolute terms from £1.8 trillion to £2.0 trillion.

The breakdown of this figure between European and other overseas clients remains broadly unchanged, with 48% (£967 billion) managed on behalf of the former and 52% (£1,028 billion) on behalf of the latter.

As flagged over the years, asset managers based in the UK are tapping into a number of areas facilitated through international opportunity:

- Changing growth dynamics and global demographics are creating significant opportunities for the export of investment services. These opportunities are seen in different ways. Some are classically institutional, eg. sovereign wealth funds and other forms of government asset pool (eg. pension reserve funds). Others are more retail in nature as governments increasingly require individuals to make greater personal provision.

- In the funds market specifically, 'UCITS' (Undertakings for the Collective Investment of Transferable Securities) has been an extremely successful brand at both the European and global level. 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 opened up to third party offerings.

None of these trends are irreversible and could be threatened in a number of ways. For example:

- The emergence of rival centres and/or pan-regional products

- Fragmentation within the European market with rising barriers to entry in national markets

- Changes in the international regulation or tax environment affecting the openness of the international investment services market

On tax, the IMA's recent experience suggests that countries are increasing rates of withholding tax on cross border payments, and imposing obstacles for obtaining benefits granted under double tax treaties. This is particularly prevalent for investments through funds where tax administrations are questioning the entitlement to treaty benefits of funds and raising technical and administrative impediments, resulting in higher overseas withholding tax charges than those strictly required by law.

Increased withholding tax represents a barrier to cross border investment, the elimination of which is the main purpose of double tax treaties. These barriers are disproportionately affecting fund investment. The industry has called on the Government and the OECD to introduce simplified procedures for obtaining withholding tax benefits for fund investment through the previous work on the OECD's TRACE project and the implementation of FATCA standards of investor due diligence.

Overseas-domiciled funds with UK asset management

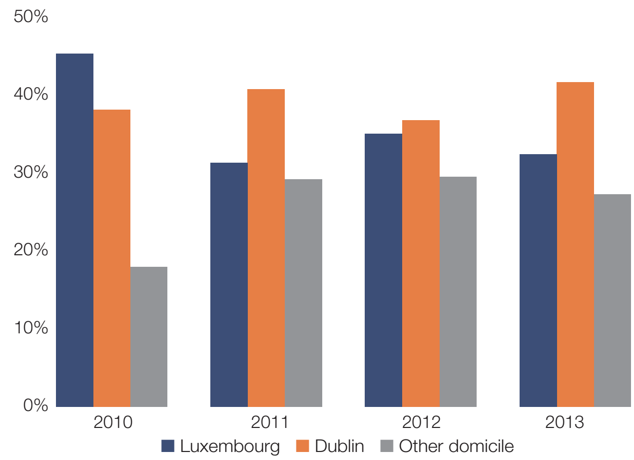
The UK's attractiveness as a location for asset management is also reflected in the scale of overseas-domiciled funds that continue to be managed from the UK. This increased by 7% from 2012 to £775 billion at the end of 2013. One of the largest single components in this area is institutional money market funds, with the remainder comprising a range of institutional and retail products, including hedge funds and ETFs.

For a number of years, the overseas-domiciled funds with assets managed from the UK have exceeded the domestic funds industry in asset terms. Given faster growth in the latter, this gap has now narrowed (see Chart 6). The significance of the evolution lies mainly in the robustness of the UK market. There are a range of reasons why the comparative growth of the overseas-domiciled fund component is slowing, not least the decline in euro-denominated institutional money market funds (see p.21). Operational changes also contribute to year-on-year variations in this metric.

Chart 6: UK authorised funds and overseas-domiciled funds managed from the UK (2010–2013)

The relative market share of overseas fund domiciles within the UK-managed asset base seems to have remained fairly consistent year-on-year, with Dublin (41%) and Luxembourg (32%) accounting for a large majority of activity (see Chart 7).

Chart 7: Location of overseas-domiciled funds (2010–2013)

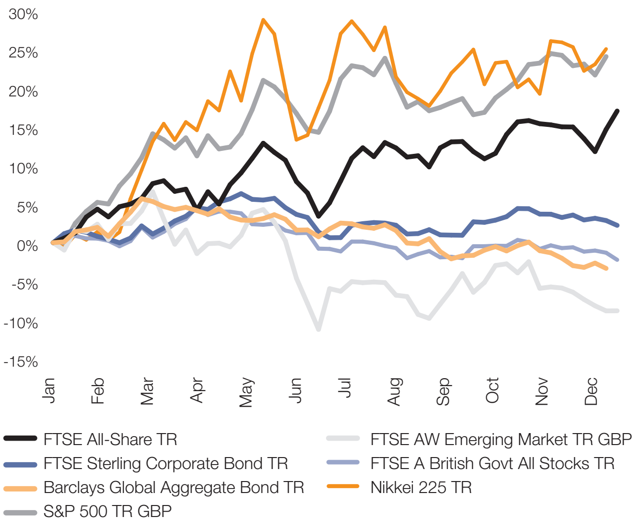


North America (and therein predominantly the US) is the most frequently mentioned fund domicile location aside from Dublin and Luxembourg. Other jurisdictions include the Channel Islands and Cayman Islands.

Asset Allocation

Equity and fixed income market performance during 2013, for both UK and international indices, is shown in Chart 8 (total return basis). Developed equity markets saw extremely strong performance, notably Japan and the United States. With the euro-zone stabilising, European equity performance was also robust. In contrast, emerging markets performed unevenly with far weaker returns overall than seen in the developed markets. Fixed income also fared poorly in total return terms, with gilts particularly hard hit.

Chart 8: Monthly performance of selected equity and bond indices (2013)



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

As we pointed out in our last two Surveys, the behaviour of markets globally is still heavily influenced by the consequences of exceptional measures undertaken by central banks, as well as the anticipated consequences of unwinding. While there was some sign of rising yields in 2013, interest rates remained unusually low compared to historical averages and further accommodative action was taken in the euro-zone by the European Central Bank (ECB). These consequences are particularly evident in the money market sector, which has encountered significant difficulties, potentially compounded by regulatory change.

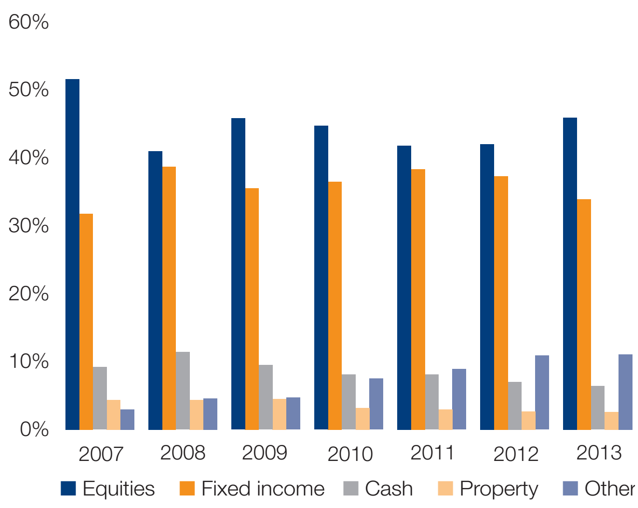
While our aggregate asset allocation data for UK-managed assets does not allow us to distinguish between market performance and flows, it is possible to identify the following features of the UK-managed asset base (see Chart 9):

- In relative terms, equities (46% of total assets, up from 42% a year earlier) have seen an increase broadly consistent with the impact of market movements rather than a major allocation shift. However, there are two factors likely to be contributing to this overall impact:
  - A structural shift in investor preferences, particularly Defined Benefit (DB) pension schemes looking to de-risk, that will not see a return to the levels of equity market investment seen in the 1990s and early 2000s.[15]
  - Within retail funds, where we have access to detailed flow analysis, there is some evidence of rotation, both into equities from other asset classes and from emerging markets towards developed market equities.
- Fixed income holdings show a fall from 37% to 34%, again broadly consistent with what we might expect from market movements.
- Property assets stood at 2.6% (2012: 2.7%). While a relatively small part of the overall asset base is managed by IMA members, a number of firms have very significant property businesses.
- Cash[16] continued to fall from a high of 11% in 2008 to 6.4% in 2013. This appears to be due both to a gradual shift away from the 'flight to safety' and to clients' increased concern about yield in money market funds.
- The past six years have seen the relative size of the 'other' category increase from 3% in 2007 to 11% at the end of 2013. Alternative assets such as private equity and commodities constitute part of this category, but the growth is largely attributable to the increasing use of derivatives to deliver strategies such as currency overlay and liability driven investment (LDI).

[15] Third party asset allocation analysis suggests there is some further sign of significant UK pension fund disinvestment from equities and into fixed income, but slower than in previous years. See State Street Analytics, *UK Pension Fund Annual Review*, 2013.

[16] Includes assets held in institutional money market funds (IMMFs), other money market funds and un-invested cash held in other forms.

Chart 9: Overall asset allocation of UK-managed assets (2007–2013)

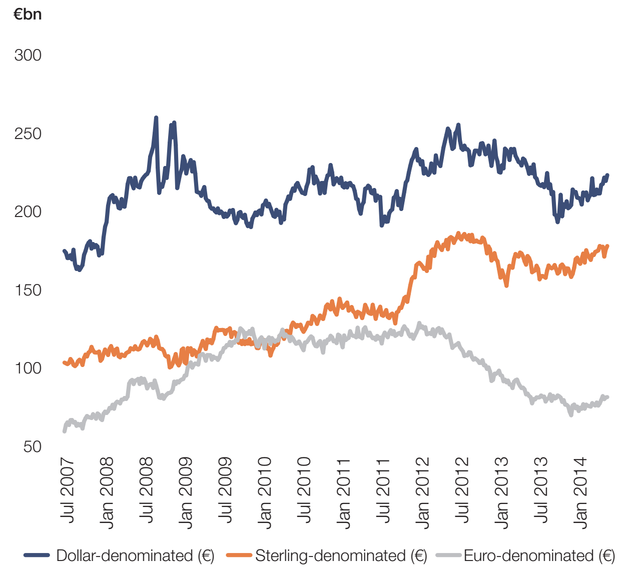


Looking in more detail at money market funds, data from the Institutional Money Market Funds Association (IMMFA) shows that assets under management for the constant NAV sector of the MMF industry continued to ease during 2013 (see Chart 10). Most noticeably this was in euro-denominated funds and was a consequence of the euro-zone interest rate environment.

Progress in the discussions regarding the change of the regulation of MMF, both in the EU and the US, has been slow. The US Securities and Exchange Commission (SEC) has released its new rules during July 2014, and a conclusion in Europe may follow towards the end of the year. However, implementation of the new rules is still some way away, with significant aspects of the UK changes not due until October 2016.

A balance is being sought between reducing the possibility of large-scale redemptions for money market funds and maintaining the utility of the product for investors (ease of operation, diversifier risk, same day settlement, cash and cash equivalent accounting treatment).

Chart 10: Institutional money market fund assets (Jul 2007–Jan 2014)



Source: IMMFA

Geographic equity split

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.[17]

Chart 11 shows the relative composition of equity holdings, and the change in the relative distribution between 2006 and 2013:

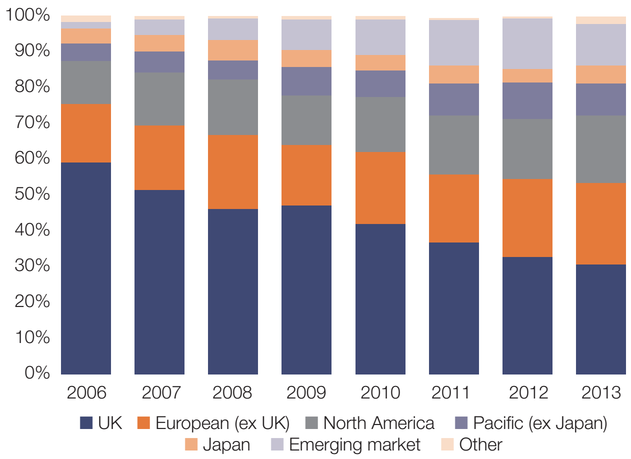
- The UK continued to see a decline in its proportion of total equity holdings. From a peak of 59% in 2006, the proportion at the end of 2013 was 31% (2012: 33%). This erosion of home bias is seen across investor groups and is also mirrored internationally, albeit at a very uneven rate. Looking at institutional behaviour, the trend is far less marked in the US pension funds than in their counterparts in Canada, Japan, Switzerland and the United Kingdom.[18]

[17] The IMA has flow data only for UK-domiciled investment funds. Institutional client flows are sourced from the ONS, *MQ5: Investment by Insurance Companies, Pension Funds and Trusts, Q4 2013.*

[18] For information on pension fund investment behaviour in international context, see Towers Watson, *Global Pensions Asset Study 2014*

- Emerging market equity holdings appeared to peak at the end of 2012, having increased more than six-fold to 14%. At the end of 2013 this proportion had fallen to 12%. IMA calculations suggest this reflects primarily the impact of relative market movements rather than re-allocation.
- Pacific (excluding Japan) equities more than doubled in relative terms between 2006 and 2012, accounting for 10% at the end of 2012, but fell to 9% in the most recent data at the end of 2013.
- Japanese equity holdings increased slightly to 5%, from 4% in 2012.
- European equities were almost static year-on-year (23% of total equity holdings at the end of 2013 from 22% in 2012).
- North American equity holdings increased again by the end of 2013, finishing the year on 19% of total equity holdings, from 17% in 2012 and only 12% in 2006.
- Other regions mostly consist of investments in Middle Eastern, African and Latin American equities, and these holdings increased above 1% for the first time since 2006.

Chart 11: UK-managed equities by region (2006–2013)



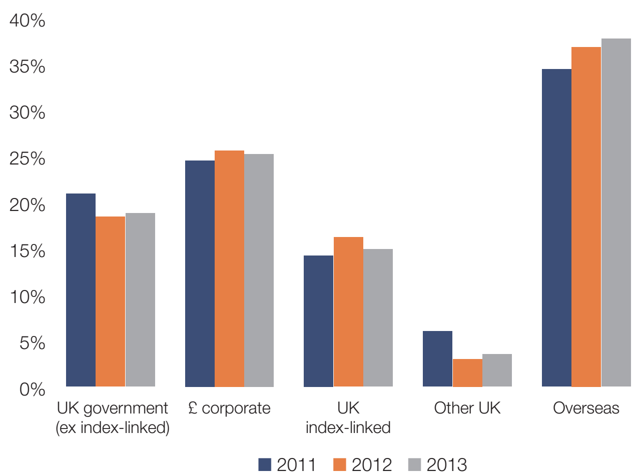
Fixed Income

Given the liabilities and long time horizon of many large UK institutional investors, fixed income holdings by IMA members are significant. For insurance companies, both UK government and £ corporate debt are at the heart of the annuity investment pool. DB pension schemes are also heavily invested in similar instruments. It is possible that changes to the provision of retirement income outlined in the 2014 Budget (removing the requirement to take an income of any kind) could have an impact on the appetite among both insurance and pension schemes for government and corporate fixed income instruments. However, it remains too early to anticipate whether this will be the case and how significant that impact might be.

UK index-linked investments declined slightly from 16% in 2012 to 15% in 2013, whilst the overseas bonds category ticked up to 38% (see Chart 12). UK gilts and £ corporate bonds remained almost unchanged from 2012.

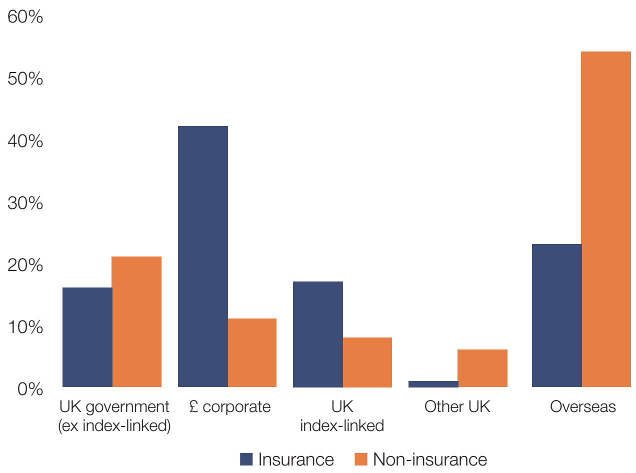
The globalisation of the investment process is evidenced by the year-on-year increases in overseas bond holdings as well as the change in equity exposures. We have seen similar flow data from the ONS which suggests strong net investment in overseas corporate and government securities.

Chart 12: Allocation of UK-managed fixed income by type and region (2011–2013)



The proportions shown for fixed income holdings, outlined in Chart 12 above, are based on an unadjusted sample. We can also look at how the composition is altered when we consider the firm type – those firms with an insurance parent and those without. This shows greater fixed income holdings among the insurance-owned groups and much heavier exposure to £ corporate bonds and index-linked gilts, as shown in Chart 13 below.

Chart 13: Fixed income ownership by parent group (insurance vs. non-insurance)



Adjustment for over-representation of insurance-owned asset managers in the Survey respondent sample would give a different split in fixed income (see Table 1), reducing the £ corporate bond, and increasing the overseas fixed income exposure.

Table 1: Headline vs. sample-adjusted fixed income ownership[19]

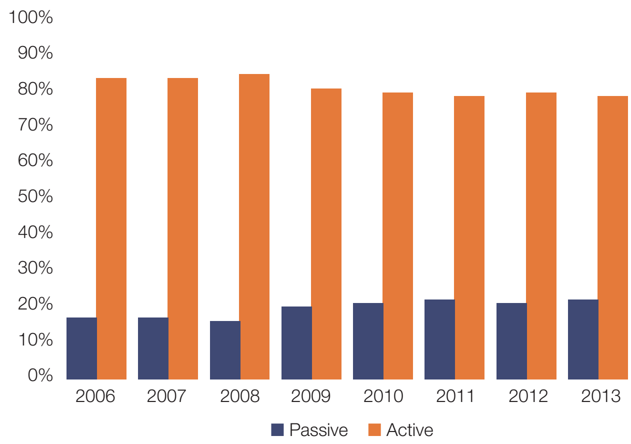
	Headline	Sample-adjusted
UK government (ex index-linked)	18.8%	19.1%
£ corporate	25.2%	23.1%
UK index-linked	14.9%	13.9%
Other UK	3.5%	3.8%
Overseas	37.7%	40.1%

Type of Management

Active and Passive

Chart 14 shows the extent to which passive management strategies are being used across the UK-managed asset base. Increasing gradually from 17% in 2006 to 21% in 2010, it remained broadly stable at 22% in 2013. Whilst we do not capture the full ETF market in our data, there is evidence from the UK institutional market that this stabilisation is reflected in occupational pension scheme allocations.[20] However, this may not fully reflect the longer term direction of travel, with significant drivers towards higher passive allocations (see p.31).

Chart 14: Active and passive assets as proportion of total UK assets under management (2006–2013)



Segregated mandates and pooled vehicles

In recent years, the balance between segregated and pooled assets has remained relatively stable, representing around 55% and 45% of total UK assets respectively. The figures from the end of 2012, which saw an increase in pooled assets to 48%, may have been something of an exception, since we have seen a return to more typical levels at the end of December 2013 (56% segregated, 44% pooled).

[19] 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.

[20] See State Street Global Analytics, *WM UK Pension Fund Annual Review 2013.*

2 Broader Trends

Key Findings

Growth and internationalisation

- The UK industry has become much more international over the past two decades. One long-term proxy for the increasingly international nature of asset management is its contribution to net export earnings, which have grown from under £300 million per year in the early 1990s to £5.3 billion in 2012.
- There is a growing proportion of overseas-headquartered firms and parent groups; overseas firms grew from 43% in 2003 to 55% by 2013, with the biggest change seen in North American firms (from 23% to 43% in the same period).
- At the same time, investment on behalf of clients has become far more international, with the erosion of home bias continuing both in the equity and fixed income markets.

Client and product evolution

- The UK industry has moved through a phase of intense specialisation (mid-1990s to mid-2000s) towards a greater focus on meeting specific client outcomes and/or solutions. This has been seen across UK markets: DB, DC and retail.
- Within the retail market, the RDR has been a key recent regulatory change. It has significant consequences across the value chain in areas such as cost, access to advice, the role of advisers in facilitating product selection and the position of platforms.
- Intermediation patterns have also been evolving in the institutional market, where investment consultants are a critical component in occupational pension scheme delivery and the divisions between the roles of manager and consultant are becoming increasingly blurred.
- Although scrutiny of the active manager's performance is not new, we are seeing intensifying pressure on more conventional active management as a result of a number of factors. Some factors relate to markets and patterns of competition whereas others arise from the political environment in the UK and Europe.

Regulatory and political scrutiny

- There are significant opportunities for the asset management industry internationally as a result of broader demographic and welfare trends and more recent constraints on government and bank financing.
- However, the political and regulatory environment has become steadily more challenging for asset managers, at national, EU and international level. Pressure is building in a number of areas, from transparency through to potential systemic significance.
- Regulation is likely to remain more intrusive and costs of compliance elevated, while the industry itself is also taking initiatives to improve operating practices and disclosure.

2 Broader Trends

This chapter brings together a number of data points from within this report, as well as insights from previous Surveys and external sources. It shows the extent to which the asset management industry has changed over the past two decades and outlines a range of current and future opportunities and challenges. We focus on five key industry themes in particular:

- Strong growth and increased internationalisation
- Recent moves away from specialisation towards outcome-focused strategies
- Changing patterns of intermediation
- Increasing commercial and wider pressure on active managers
- Sustained regulatory and political scrutiny in the post-2008 environment

The institutional chapter, which follows, picks up a sixth theme: the implications of the shift towards DC pensions and reform of the UK retirement income market.

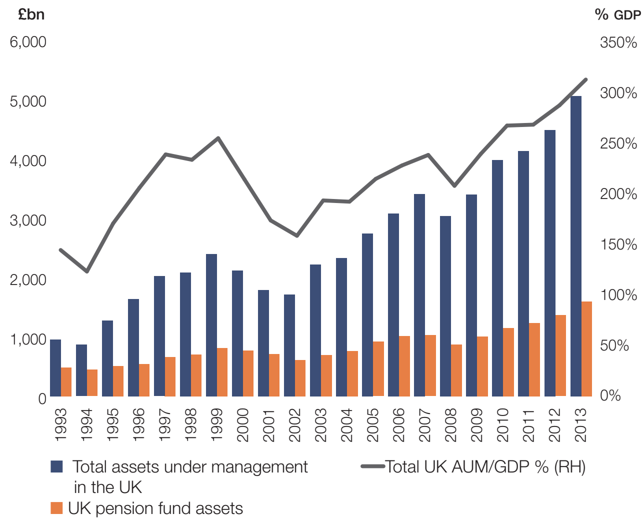
Putting all this together reinforces the messages of our last Survey relating to the future of the industry. In many respects, the actual – and anticipated – growth of the industry does suggest that we are entering an 'age of asset management'. A number of changes to the way in which firms serve clients are likely, not least to ensure that the industry operates with the full trust of clients, politicians and regulators.

Rapid Growth and Internationalisation

Chart 15 illustrates the evolution of total assets under management since 1993. This is the first time the IMA has published this data, based on asset management surveys from the former Fund Managers Association (FMA). Beside the significant growth of the industry over the last two decades (10% annual equivalent rate of growth), one particularly striking feature of Chart 15 is the changing relationship between the UK client base and the overall size of the industry. While domestic institutional clients (pension funds and insurers in particular) formed the core client group in the mid-1990s, the industry has broadened considerably in the past decade, including a significant level of activity on behalf of overseas as well as UK clients.

Measuring assets under management relative to domestic GDP also provides a useful metric of the scale of the industry. As Chart 15 shows, assets under management in the UK have increased from 144% of total GDP in 1993 to 313% of GDP in 2013.

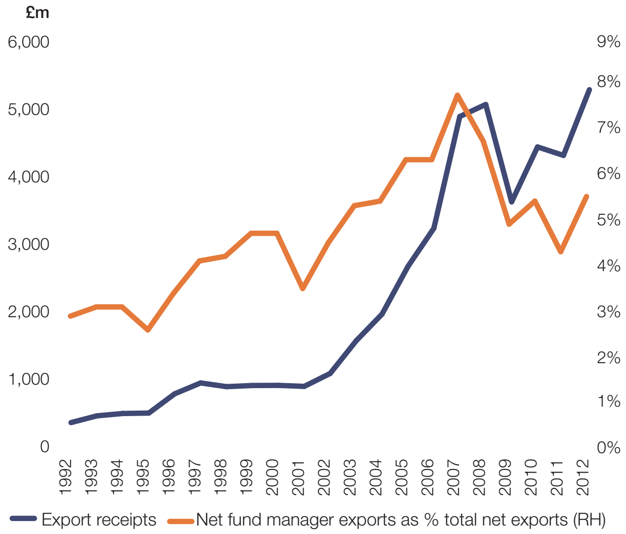
Chart 15: Total assets under management in the UK and UK pension fund assets (1993–2013)



Contribution to export earnings

The overseas client base accounted for 40% of total assets managed in the UK in 2013. External data suggests this has increased from around one quarter ten years ago. One long-term proxy for the increasingly international nature of asset management is its contribution to net export earnings, which had grown from under £300 million per year in the early 1990s to £5.3 billion in 2012 (equivalent to 5.5% of total net exports). Fund managers have accounted on average for 6% of annual services exports over the past decade. This is shown in more detail in Chart 16.

Chart 16: Export earnings of fund managers and contribution to services exports (1992–2012)



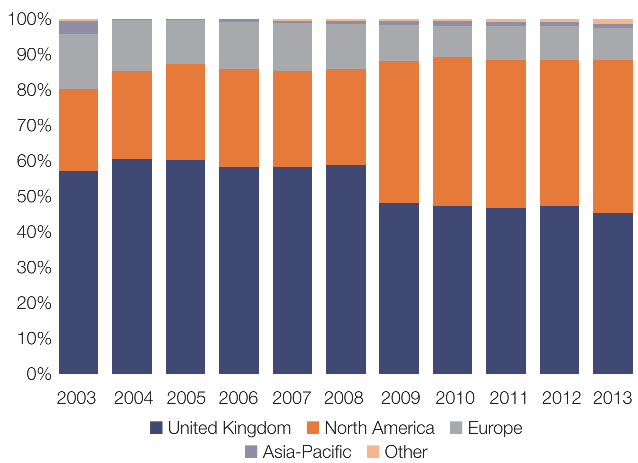
Source: ONS

Internationalisation of corporate structure

One other aspect of this internationalisation is the growing proportion of overseas-headquartered firms and parent groups (see Chart 17):

- Measured as a proportion of total assets managed in the UK, overseas firms grew from 43% in 2003 to 55% by 2013. In other words, UK-owned asset management firms now account for less than half of total assets managed from the UK.
- The biggest change is seen in North American firms (from 23% to 43% over the last 10 years). The amplitude largely reflects the merger between BlackRock and Barclays Global Investors (BGI) in 2009.
- European firms, on the other hand, have recorded a fall in market share since 2003. This relative decline was accentuated by the impact of the 2008 crisis on the European banking industry.
- Firms from Asia-Pacific and other regions have been growing in recent years, but given their relatively small size (1.1% and 1.3% of total UK assets under management respectively), they are increasing from a very low asset base.

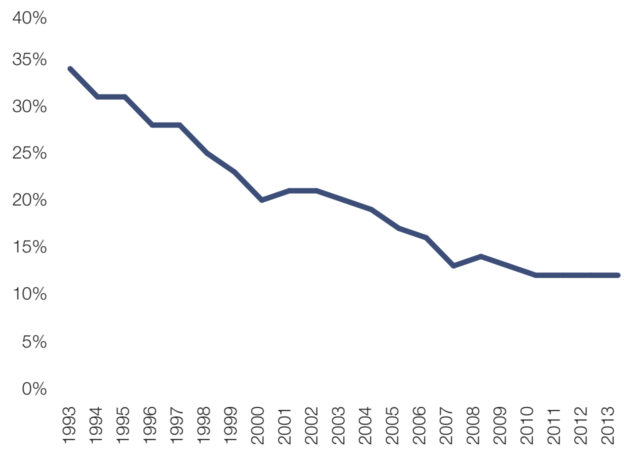
Chart 17: UK assets under management by region of parent group headquarters (2003–2013)



Investment in overseas markets

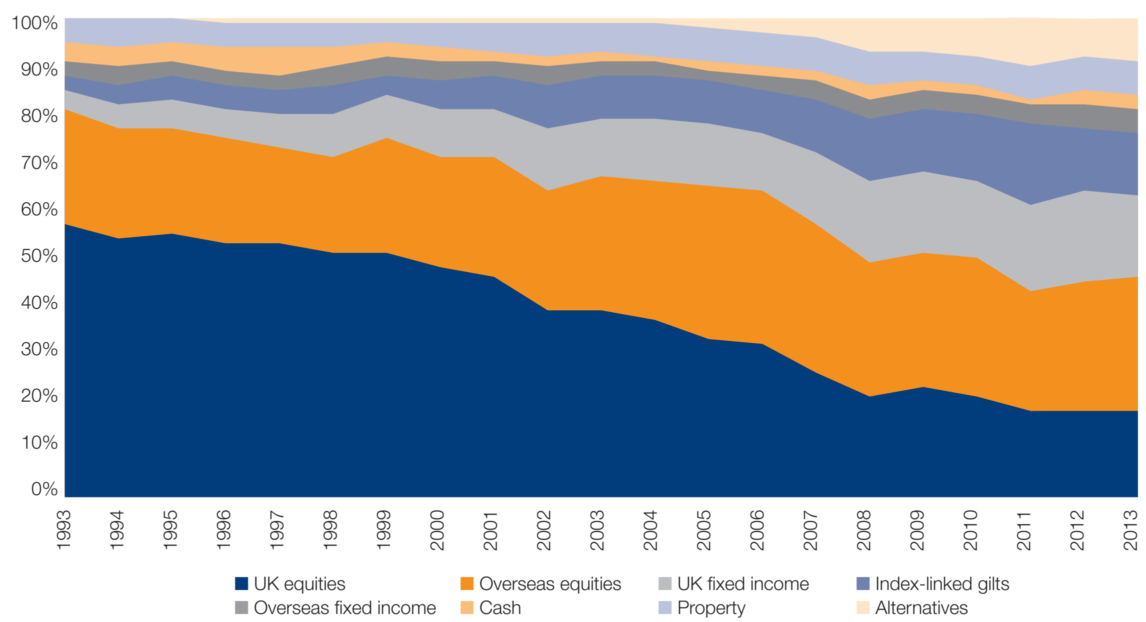
A further aspect of this internationalisation can be seen in the role of UK asset managers as investors in overseas markets. In Chapter One, we showed how both overseas equity and fixed income holdings have increased in recent years. External historical data show how significant this erosion of domestic bias has been, both for the overall UK equity market (see Chart 18), and for the asset allocation of large investor groups, notably pension funds and insurance companies (see Chart 19).[21]

Chart 18: Pension fund ownership of UK equities, measured as proportion of total domestic market capitalisation (1993–2013)



Source: IMA Calculations, based on data from London Stock Exchange and UBS Pension Fund Indicators 2014

Chart 19: Overall UK pension fund asset allocation (1993–2013)



Source: UBS Pension Fund Indicators

[21] The ONS (Office of National Statistics) data show that UK pension and insurance ownership has further declined to 4.7% and 6.2% of domestic market capitalisation respectively. However, the difficulties encountered in seeing through pooled nominee accounts may cause an under-estimate. Data from the PPF (Pension Protection Fund) suggests that UK corporate DB pension schemes may account for a larger proportion of domestic market capitalisation.

Measured as a proportion of domestic market capitalisation, UK equities managed by IMA members in the UK account for just 30% of the total. While longer term data is unavailable, this is consistent with the sharp falls in the holdings of UK institutions. However, within the investment funds industry specifically, industry growth has seen holdings of UK equities increase strongly in absolute terms, whilst declining as a proportion of total funds under management as the industry diversifies. UK funds owned about 6% of the UK market in 1993. We estimate that this has now reached 10% (see p.62).

There is also significant overseas portfolio management activity by UK asset management firms. 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. We estimate that UK-headquartered asset management firms managed £2.1 trillion in the UK, but a further £2.1 trillion worldwide.

Client and Product Evolution

Through the 1990s and into the 2000s, a number of significant changes have taken place in the way the industry serves its clients.

Specialisation and its limits

By the late 1990s a significant move towards specialisation (defined as a focus on investment component products such as global equity funds, rather than asset allocation or outcomes) was taking place within the asset management industry and continued into the 2000s. This was seen particularly through the transition away from the balanced mandate environment that had been a central feature of services provided to UK DB pension schemes.

Over the last five years, we have observed increasing signs of recognition by asset managers that the trend toward specialisation could be reversing in favour of solutions that are more tailored to specific client outcomes. This can be seen in a number of areas of the market, both institutional and retail:

- In the institutional market, there has been a strong take-up of LDI products by DB pension schemes. KPMG[22] estimates that the notional value of liabilities hedged rose by 17% to reach £517 billion at end December 2013 (£443 billion in 2012). On the DC side, the UK is also seeing a slow but accelerating emergence of outcome-focused asset management products, such as target date funds (TDFs).

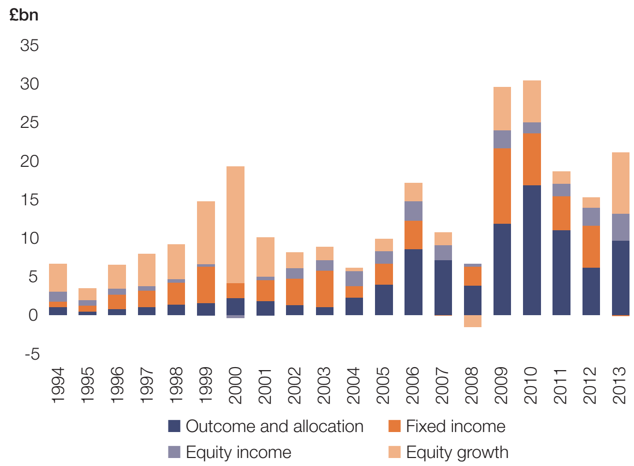
- In the retail market, the most obvious shift in this context has been towards targeted absolute return and, most recently, risk-targeted fund strategies. However, strong sales of asset allocation funds are seen in the retail market too (see Chart 20).

[22] Source: KPMG. *Navigating the UK LDI Market. 2014*

At the same time, both specialist and more tailored product sets are becoming more diversified. There has been increasing use of 'alternatives' and the definition of 'alternatives' has been broadened towards sources of return that can provide the kind of yield and inflation-hedging that many institutional investors are looking to access (see also p.46).

We discuss these issues in detail in Chapters Three and Four.

Chart 20: Retail investor preferences by fund type (1994–2013)



Source: IMA

Intermediation patterns

Over the past decade, distribution platforms have emerged as an important new form of intermediary, used by both advisers and direct investors to access a variety of products, including funds and wrappers such as ISAs and SIPPs. Funds may be available under a broad open architecture offering or, increasingly, a 'guided architecture' environment with a smaller range of funds.

At the same time, the way in which advisers build portfolios has evolved away from more traditional fund selection towards greater use of model portfolios which effectively outsource significant aspects of product design and manager selection.

The RDR is, of course, the key current driver of change in the distribution environment. The RDR has come into force in two stages, with adviser charging rules being effective from 31 December 2012 and platform payments rules from 6 April 2014. While the new regime is making the total cost of investment, measured by fund charges, much clearer, it has also created a more complicated environment for investors due to the greater range of share classes and the different charging structures of advisers and platforms. The process of migrating existing clients from pre-RDR to post-RDR share classes has added to this complexity.

UK fund managers identify a number of possible consequences of RDR:

- Greater transparency of cost within individual elements of the value chain is expected to result in increased adviser and client scrutiny of both fund management performance and charges. The combination of RDR, changes in adviser approaches to fund selection and greater availability of passive funds is widely expected to result in greater selection of the latter, with increased margin pressure on active managers. Despite pricing pressure on fund managers, there is limited evidence as yet of a reduction in the average total cost of ownership when all components (investment, distribution and advice) are included.

- While the quality of advice may be improving, access to it is considered to have become more difficult, particularly at the less affluent end of the market. Partly as a consequence of increasing visible costs of advice, RDR is expected to drive upwards non-advised sales, with investors using a variety of access points. Execution-only platforms are now a well-established feature of the retail landscape, but there are also signs of non-advised online distribution processes that offer a form of discretionary service in helping clients build portfolios. A broader regulatory issue that emerges here has been the blurred boundary between guidance and regulated advice, which has implications for both fund managers and distribution intermediaries.

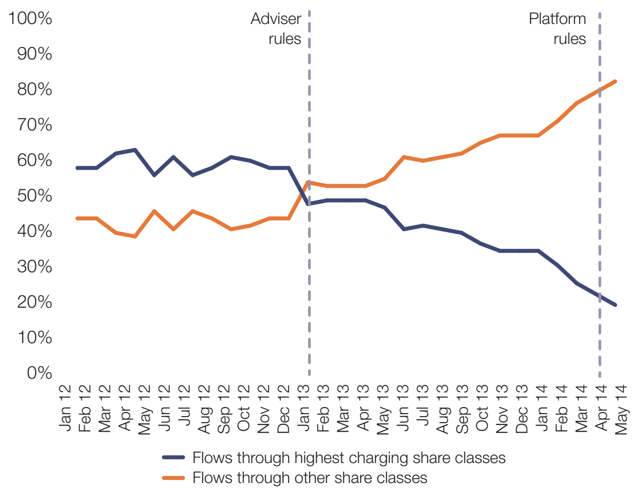
- Consolidation across the distribution chain is also expected, particularly in the range of platforms. If the trend of fund managers buying parts of the distribution network continues, there may also be a reduction in fund choice as non-integrated firms find it harder to get market access.

With respect to the evolution of the funds market in the face of these changes in the distribution market, one critical research finding to date is that concentration of flows is not happening in the way that all of these developments might lead us to expect (see more detailed discussion on p.76). On the contrary, at the gross retail sales level, there are signs of decreasing concentration (see Chart 21), indicating a highly competitive industry.

However, entirely as expected, there has been a noticeable change regarding into which share classes flows are being directed. The IMA collects data at the share class level and is able to quantify the proportion of flows going into particular share classes. Analysis has been performed over the period January 2012 to May 2014, and the results are presented in Chart 22.

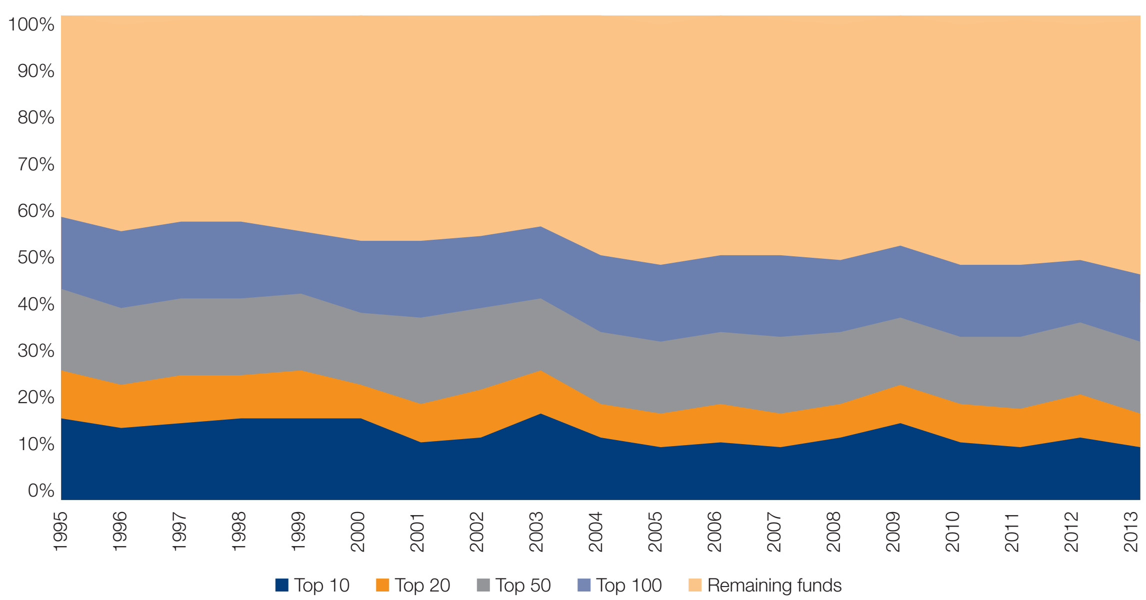
The data indicates that around 60% of all gross retail flows immediately prior to the introduction of RDR were directed into the share class with the highest annual management charge, for each of the funds in the IMA sectors. Though not always the case, the highest charging share class of a particular fund will often be the primary retail share class, where the majority of retail business was historically invested.

Chart 22: Gross retail sales at share class level (Jan 2012 to May 2014)



The introduction of the first stage of the RDR at the end of December 2012 saw a move towards the use of share classes that were not the highest charging. The adoption of lower charging share classes has gathered pace ever since. By the end of May 2014, which is our latest data at the time of writing, over 80% of flows were being directed into lower charging share classes as opposed to the highest.

Chart 21: Concentration of UK funds industry (gross retail flows into all funds, 1995–2013)



Intermediation patterns have also been evolving in the institutional market, where investment consultants are a critical component in occupational pension scheme delivery. Here, there has been an increasing blurring between the traditional roles of asset manager and consultant as a result of activity in the implemented consulting and fiduciary management marketplace. In terms of market sizing in this area, IMA Survey results have shown very low penetration of fiduciary management as measured in asset terms. A report by KPMG last year confirmed this, pointing to a market size of around £58 billion, albeit growing very quickly from a low base.[23]

Greater use of passive management

Ten years ago Huw Van Steenis published the well-known 'barbell' analysis which predicted a polarisation in the market between commoditised beta and high alpha products, with intensifying pressure on the middle ground of more conventional active management. Whilst the IMA data points to some stabilisation in the shift towards passive (see p.23), limitations of coverage suggest caution as to the implications of this data. A number of factors continue to increase the pressure on active managers:

- Conditions in equity markets have inclined some investors, particularly in the retail space, to wariness regarding risk and to greater focus on product cost.
- Retail distribution reforms and the changing structure of the advice market are also contributing to a greater focus onto costs, with implications for active managers (see p.29).
- The availability of indexing products has increased significantly, both in terms of the diversity of markets accessible and the techniques available (eg. 'smart' beta).
- Recent political interventions, notably a consultation regarding the future of Local Government Pension Scheme (LGPS) investment processes (see p.33).

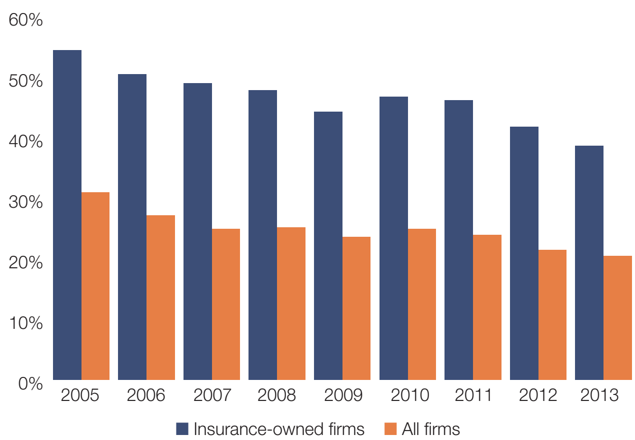
Evolution of insurance industry

Over the past two decades, there has been a structural shift in the insurance industry away from the traditional with-profits business towards investment-linked products, particularly for the pensions market. This has translated into little growth in the asset base underpinning life and other non-pensions business. Measured in nominal terms, ABI data shows this increasing from £260 billion in 1992 to just £330 billion twenty years later.

The IMA has tracked the shifts in insurance business since the inception of its Survey in 2002, when insurance (in-house and third party) accounted for almost a third of total assets under management in the UK. Over the intervening decade, this has fallen to some 20% with much faster growth in other client segments, notably pension schemes, changing the relative position of the major institutional client groups.

The decrease is also reflected across the sample of insurance-owned firms, which saw insurance client assets fall from 54% in 2005 to 39% at the end of 2013 (see Chart 23). 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 (including other insurers). This is part of a wider pattern within financial services which has resulted in a move away from the vertically-integrated business models that have been the norm in the past.

Chart 23: Insurance assets as proportion of total assets under management by firm type (2005–2013)



[23] *2013 KPMG UK Fiduciary Management Market Survey*, November 2013.

Two decades of industry evolution

1993

Total UK assets under management = **£955 billion**

Authorised funds industry (unit trusts) = **£95 billion**

UK occupational pension scheme assets = **£480 billion** (80% equities)

Active private sector DB scheme members = **c5 million**

- DB provision mainstay of workplace pension system and largest client group of asset management industry.
- UK pension schemes and insurers heavily invested in equities, especially UK stocks.
- Balanced mandates a key feature of third party institutional asset management.
- Insurance industry vertically integrated; emphasis on with-profits business.
- Retail funds industry direct and IFA intermediated.

2003

Total UK assets under management = **£2.2 trillion**

Authorised funds industry (unit trusts and OEICs) = **£242 billion**

UK occupational pension scheme assets = **£693 billion** (67% equities)

Active private sector DB scheme members = **c3.6 million**

- UK corporate DB schemes closing to new members, and starting to de-risk.
- Third party institutional asset management predominantly specialist and consultant intermediated.
- Market for passive investing growing.
- Insurance industry moving toward open architecture; unit-linked business rising.
- Retail fund platforms starting to emerge.
- Workplace DC in infancy.

2013

Total UK assets under management = **£5.0 trillion**

Authorised funds industry (unit trusts and OEICs) = **£770 billion**

UK occupational pension scheme assets = **£1.6 trillion** (46% equities)

Active private sector DB scheme members **<1.5 million**

Active DC scheme members **>4 million**

- UK corporate DB schemes mainly closed to new members and increasingly to future accrual. Still largest client group in asset terms.
- DB de-risking seen in asset allocation, extensive use of LDI strategies and buyout.
- Third party institutional asset management moving towards solutions and wider asset classes.
- Passive investing characterised by significantly increased reach and innovation.
- Insurance provision increasingly differentiated between investment and protection.
- Fund platforms at heart of retail distribution process.
- Automatic enrolment accelerating shift to DC.
- Combined effect of platforms and DC shift eroding institutional vs. retail distinction.

Political and Regulatory Environment

We have emphasised in our past two Surveys that the broader policy environment is one of potential opportunity for the industry. In particular, demographic shifts and the associated move towards greater responsibility for pension saving clearly create a different role for asset managers.

Policy attention is also shifting towards a different role in capital intermediation that the industry could play in the context of more capital-constrained banks and national governments. This is reflected in initiatives such as the European Long-Term Investment Funds (ELTIFs) regime. At the same time, there is an increasing focus on the question of 'long-termism' in terms of stewardship and engagement, with the Investor Forum established in the UK in the summer of 2014 to provide a new mechanism for institutional investors to engage collectively.[24]

However, while more active engagement in the routing of capital flows and the governance of the sources of return is an increasingly important public policy objective, there are countervailing political pressures on the industry:

- Post-2008, the political climate around financial services has focused increasingly on charges and remuneration. Attention was initially concentrated on the banking industry internationally, but asset managers are now also under the spotlight. One example of this was a proposal in 2013 from within the European Parliament to introduce bonus caps for UCITS managers as part of the UCITS V package. A more recent example is the UK Government's announcement that it is to introduce a charge cap of 0.75% for default strategies in pension schemes used for automatic enrolment. While pension delivery involves more than just investment management, the public debate about the charge cap has often involved discussion about whether active investment management has a place. This debate is linked in turn to the issue of transparency (see p.34).
- The UK Government has turned the spotlight onto the role of active managers in other ways, too. In Spring 2014, the Department for Communities and Local Government (DCLG) launched a consultation on the future of the LGPS investment processes which could see the reallocation of actively managed equity and fixed income mandates towards collective investment vehicles run on a passive basis.

Regulatory landscape

Regulators in the UK, EU and internationally are also scrutinising the role and operations of asset management firms more closely than ever. In this section we explore three themes that are particularly prominent at the current time:

- Market transparency (including market structure)
- Client-facing transparency
- Potential systemic significance – and the resolution and/or recovery – of non-bank, non-insurance entities, including collective funds but also central counterparties

The political dimension here is particularly significant. It has led not only to a number of prescriptive pieces of legislation but also to a much more sceptical attitude towards financial services as a whole. Regulation is likely to remain more intrusive and costs of compliance elevated, prompted by a desire to prevent a recurrence of the paralysis within the financial system six years ago. This has added to the complexity of transatlantic relations and, within the EU, has reduced the regulatory and supervisory room for manoeuvre of individual member states.

Appendix 3 outlines the full range of regulatory initiatives affecting the industry.

Market Transparency

The question of transparency covers a wide range of areas, from the functioning of markets through to client disclosure. One of the central objectives of MiFID I, which came into effect seven years ago, was to secure greater market transparency, while simultaneously seeking to create effective competition between trading venues and indeed types of venue.

[24] www.investorforum.org.uk

Why is market transparency such a critical issue for asset managers?

It is generally accepted that transparency has a cost to it. If market participants telegraph trading intentions to other market participants – eg. in relation to a large sell order – then those other participants will naturally tend to mark down the price at which they are willing to buy. As compared with a more discreet approach, that may ultimately cost the end-investor money. The larger the holding that needs to be sold, the bigger the impact is likely to be. Given that investment managers operate on a scale designed to reduce other costs (including the bid-offer spread), they will very often be transacting in a size which makes 'market-price impact' difficult or impossible to avoid.

Even 'post-trade' transparency (if that means reporting the transaction as soon as it is done) can have the same effect, because one typically relies on a market-maker to take on the price risk (reducing the search costs associated with finding a willing counterparty). Market-makers bridge a temporary gap between buyer and seller and consequently can only quote a price that is as good as their anticipated ability to find someone willing to take the other side to a transaction. But as soon as the initial transaction with the market maker is completed and signalled to other participants, that market maker is in exactly the same situation as an investor who had been obliged to telegraph their intentions.

The new MiFIR, in replacing MiFID I on matters of market structure, raises this issue at a time when market-maker inventories are generally dropping (because of pressures on them on the capital-adequacy front). The new legislation will require post-transaction price transparency to the rest of the market and restrict the use of the 'dark' liquidity pools that help end-users limit market impact. The crucial question will be how tightly these constraints operate. The new ceilings will clearly limit 'dark' trading, but could also create operational challenges. For post-trade transparency, even with exemptions for transactions that are 'large-in-scale', the industry is concerned that there will still most likely be a reduction in capacity, which is unlikely to be offset by a narrower bid-offer spread for transactions in smaller size.

As this Survey goes to press, the exact details of the regime remain in the balance. But, with the G20 countries committed to transparency, the concern of the asset management industry is that this transparency may come at a high cost to end customers.

One possible conclusion is that the new European legislation still offers increasingly commercialised exchanges a relatively privileged position. So, while restrictions on low latency forms of high-frequency trading are welcome to the industry, there are concerns that exchanges may exploit their central role by selling data, not least to high-frequency trading firms.

Meanwhile, the new MiFID package has delayed the creation of a meaningful and affordable 'consolidated tape' of European equity price information. Based on the last disseminated price for the shares in question, such a record is helpful to the nurturing of a Europe-wide equities market. It is true that the 'tape' could still work by taking data from only the biggest trading venues (leaving out information from venues with a minimal fraction of the European trading in a given share). But even that is generally regarded as a tall order logistically and financially. At least on the IT side there is now a way to provide the granularity that users need as to the type of transaction being reported, in the form of the 'MMT' (Market Model Typology) standard for labelling transactions according to their nature.

Otherwise, the impact of the updated regime for trading 'venues' is uncertain. But there is an increased focus on any form of 'match-making' function. Thus, 'internalised' crossing of buy and sell orders within a firm or group, without exposing those orders to the rest of the market, is likely to attract the same requirements and obligations as a more formalised venue, whether exchange, Multilateral Trading Facility or (in the derivatives world) 'organised trading facility' (OTF).

Client-facing transparency

From an industry client disclosure perspective, one of the core issues over the past twelve months has been the question of charge transparency and widespread accusations about 'hidden' charges and costs. The drivers of this are partly the same as those driving the focus on active managers, notably returns in many equity markets since the end of the dot.com crisis and the on-going fallout from the global financial crisis that began in 2007/08.

A key additional factor in the UK has been the beginning of the process of automatic enrolment into workplace pension schemes in 2012, which has seen over four million new pension savers. The combination of the shift of risk that DC entails (see discussion in Chapter 3) and the fact that many of the new scheme members have little previous direct exposure to investment have drawn the attention of policymakers and regulators to industry disclosure.

As we reported in the last Survey, asset managers clearly recognise the need for improved communication with clients and the industry is taking steps to work for significant change. One particular initiative taken by the IMA has been to seek better disclosure of charges and transactions for investment funds, with the development of a pounds and pence table showing charges and costs in the context of typical unit performance.

More activity will follow through 2014 and 2015 as government, regulators and industry move to a different reporting framework. The direction of travel here is also influenced by EU legislation, notably MiFID II and PRIPs. The combination of UK domestic drivers and European regulation is expected to result in far greater detail being provided on transaction costs incurred in delivering investment returns across the product environment.

Systemic significance

One of the consequences of the financial crisis has been more reflection by the regulators on the systemic significance within the global financial system.

The most directly relevant element of the focus on systemic significance has been the Financial Stability Board (FSB) and the International Committee of Securities Commissions (IOSCO) January 2014 consultation on a methodology for identifying global systemically important financial institutions (G-SIFIs) that are 'non-bank non-insurer (NBNI)', including collective funds. This consultation also underscores the extent to which global regulatory institutions, rather than national or regional entities, are driving the debate.

The FSB-IOSCO paper assumes that the distress or failure of a collective fund could be transmitted to other financial entities and markets and thereby, poses a threat to global financial stability and the economy more broadly. For the asset management industry, this raises a number of issues, not least that the consequences of a fund being designated systemic are not set out in the paper.

The industry has also felt that because of the fundamental difference in nature between funds and banks, the FSB-IOSCO methodology should only look at combinations of factors, notably leverage and counterparty risk, in determining possible impact on others in the system. It further argues that the highly regulated nature of collective funds ought to be taken into account by supervisors, as should existing reporting requirements and activity-specific market regulation. A likely area for regulatory interest is the way managers may be able to manage mass redemptions, using tools that could in theory slow down any market panic.

The FSB will report on progress to the G20 at its meeting in mid-November in Brisbane and a second round of consultation, following the January 2014 paper, is expected around the end of 2014. A place-holder has been left for future deliberations on segregated mandates, managers and what they refer to as 'families of funds'.

A less prominent but important dimension of the systemic risk debate has been the approach to rescuing clearing houses or central counterparties

(CCPs) if they get into difficulty, however remote that possibility may be in practice. The difficulty arises from the notion that a CCP that has got itself into such a situation could have the credibility to resume business, given the truly systemic importance of its credit-risk-management function. Many participants depend on CCPs, while the latter can realistically only ever be few in number, if not unique within their asset class, making it unlikely that any other entity can step in to replace them.

The asset management industry is concerned, in this context, that most of the burden for rescuing a discredited CCP could fall on institutional investors or funds that make use of central clearing (which they may have no choice but to do, unless they stop making use of derivatives to hedge or for efficient portfolio management purposes). There is an alternative, which is to require the CCP to make adequate plans for winding itself down, possibly supplemented by the CCP putting its own capital at risk, in greater amounts and earlier in the process of absorbing losses.

Finally, the regulators' focus in the area of systemic risk includes repurchase agreements and other collateralised trades. One can expect increasing regulatory scrutiny of and pressure on any form of 'securities-financing trade' and much tighter monitoring and limits on the use (and onward re-use) of collateral.

Overall Picture

In many respects, the asset management industry has weathered the global financial crisis robustly, and the rising asset base is a reflection of the central importance of the industry both to economic growth and to helping clients achieve their financial objectives. The UK asset management base, almost unparalleled in its breadth and depth, contributed positively to the balance of payments through strong overseas earnings.

The industry is also changing quickly, with the cycle of 'specialisation' that characterised the period between the mid 1990s and mid 2000s evolving towards a greater focus on delivering specific client objectives, whether in the retail, DB or DC markets. As we explore in more detail in the next chapter, the DC market will be in many ways the bellwether of the industry's ability to deliver, with the UK Budget 2014 unexpectedly opening the door to a major shift in the way in which retirement income products are used.

At the same time, a consistent refrain of this report in recent years has been the growing pressure on the industry to change the way in which it operates, communicates and accounts for its products. While the combination of ageing societies and constrained government and bank balance sheets creates an unprecedented opportunity for the industry, there is also growing expectation and impetus for such change. Furthermore, the 'age of asset management' is resulting in more profound questions about the systemic significance of the industry. We expect such themes to remain on the agenda for some time to come.

3 UK Institutional Client Market

Key Findings

Market overview

- IMA members managed a total of £2.6 trillion in UK institutional client assets around the world, an increase of 7% from 2012. Of the £2.6 trillion, £1.4 trillion (51%) is managed for the pensions market.
- With 32% of UK institutional client mandates, insurance continues to be the second largest client category with an estimated £846 billion.

Pensions market

- Corporate pension funds remain the largest pension fund category, accounting for £1.1 trillion of total UK institutional assets. IMA members also manage a number of assets for local government and other types of pension schemes including trade unions and not-for-profit organisations.
- While the DB asset base is known, the actual size of the DC asset base continues to be a source of on-going debate and is difficult to determine with accuracy.
- Some 4 million pension savers had been automatically enrolled by August 2014 and the process could eventually lead to 9 million more pension savers.
- The majority of asset managers remain providers of specialist segregated or pooled investment services. A small but growing group are currently offering more tailored investment-only services and a further minority offer DC investment platforms and/or bundled DC.
- While it is not yet clear precisely how both products and individual behaviour will evolve in response to the Budget announcement, the asset management industry expects to play a far greater role in providing retirement income.

Third party mandates

- IMA members managed £1.9 trillion of assets for third party institutional clients, thereby accounting for the large majority of the third party market.
- Specialist equity mandates account for 47% of the total in the third party institutional market, some way ahead of fixed income with 35% market share.
- Internationally, comparing asset allocation, UK pension funds are still relatively strong holders of equity, despite the heavy de-risking by corporate DB plans.
- Segregated mandates represent over one-half (56%) of third party institutional mandates.

Geographic allocation

- We are seeing an increasing shift towards globalisation of investment horizons with UK equity mandates representing only 26% of the total third party equity mandates in comparison to global equity mandates accounting for 39% at the end of 2013. This indicates the extent of the decline of ‘home bias’ in investment.
- The next largest regional categories were Europe (excluding UK) and North America equity mandates with 7.5% and 7.4% of total third party equity mandates, respectively.
- The LGPS is more UK focused than corporate pension funds, also leaning more heavily towards regional rather than global mandates.

3 UK Institutional Client Market

Market Overview

This chapter explores the state of the UK institutional client market. The analysis differs from that in Chapter One in two important ways:

- It focuses on the nature of mandates rather than on the underlying assets.
- It looks at the UK institutional client market regardless of management location (ie. the focus is on clients based in the UK rather than on assets managed in the UK). However, we believe that an overwhelming majority in asset terms (approximately 93%) continues to be managed in the UK.

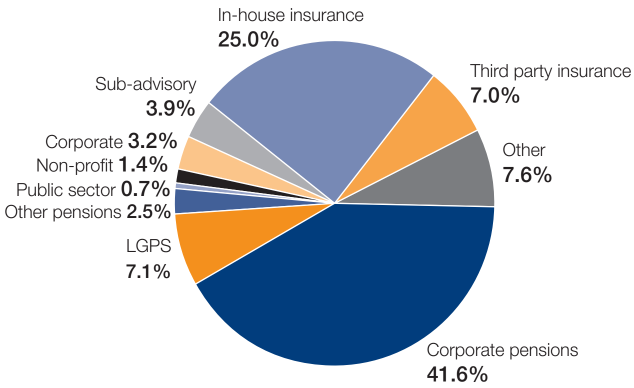
This is only the fourth year that we have collected data for this market and the dataset is still being refined. This year's responses suggest that, at the end of 2013, IMA members managed £2.6 trillion, an increase of 7% from 2012. In terms of client split, Chart 24 shows the breakdown of the UK institutional client market, including both in-house and third party mandates:

- Pension fund clients represent 51%, or an estimated £1.4 trillion of the UK institutional client market managed by IMA members.
- With 32% of UK institutional client mandates, insurance continues to be the second largest client category with an estimated £846 billion. Looking at its two main sub-categories, in-house insurance accounts for the vast majority (25% of total institutional with third party insurance accounting for 7%).

The UK institutional client space also includes a smaller proportion of other client types with little change evidenced year-on-year:

- Of these, the largest single category was 'Sub-advisory', amounting to 3.9% of mandates.
- Corporate (non-pension) client mandates represented 3.2% of the total.
- Non-profit and public sector client mandates accounted for 1.4% and 0.7%, respectively.
- 'Other institutional' client mandates came to 7.6%. This category consists mostly of various open- and closed-ended pooled vehicles and more niche clients from the private equity, venture capital and property spectrum.

Chart 24: UK institutional market by client type



Pensions

Pension fund clients of IMA members fall into three categories:

- Corporate pension funds – traditionally the largest pension fund category – account for £1.1 trillion or 42% of total UK institutional assets. This includes a number of OPS managers together estimated at around £127 billion.
- The LGPS accounts for 7.1% of total UK institutional assets.
- Some 2.5% is managed for other types of pension funds (mostly for trade unions and not-for-profit organisations), translating into an estimated £66 billion of UK institutional client mandates.

The corporate pension fund category includes both DB and DC assets, which largely represent trust-based schemes. We are unable to break out workplace DC and personal pension assets. The latter are mainly accounted for in the insurance client category.

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 DB and DC environments.

Over the past few years, the Survey has reflected a particular evolution with respect to a blurring of traditional roles in the DB pensions market. This is currently seen in the emergence of 'fiduciary' mandates where pension schemes outsource to third parties a wider range of decision-making activities. Despite the signs of strong activity in this space, the asset base subject to fiduciary mandates is estimated to remain very small, at £58 billion.[25]

While the DB asset base is known, the actual size of the DC asset base continues to be a source of on-going debate and is difficult to pin down with accuracy.[26] Our previous estimate of workplace DC accumulation phase assets was £286 billion in line with external data. However, there is rising uncertainty over the precise size of this market, with data from The Pensions Regulator pointing to a dramatically smaller asset base in the mainstream DC market. Until we can make more accurate estimates, we are not updating the figures published in previous editions of the Survey. We can estimate DB assets with a higher degree of certainty: corporate DB assets totalled some £1.1 trillion at the end of 2013, and the LGPS an estimated £210 billion.[27]

[25] *2013 KPMG UK Fiduciary Management Market Survey,* November 2013.

[26] The Pensions Regulator (TPR) data suggest that the trust-based DC environment continues to have a low asset base, with TPR suggesting £30 billion in its most recent report. ONS (Office of National Statistics) and independent consultant data has pointed to a much larger market size, with estimates in the £200-300bn range.

[27] Based on DCLG (Department for Communities and Local Government), PPF (Pension Protection Fund) data and other sources.

Towards DC: Outlook for UK Pensions Market

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.

Indeed, the area of greatest change over the last twelve months has been in the fast-growing workplace DC market, which had seen 4 million pension savers automatically enrolled by August 2014 and which the Government anticipates could eventually lead to 9 million more pension savers. So far the opt out rate has remained low at 8-9% and the Department for Work and Pensions predicts the final opt out rate will be lower than expected, at 15%. In asset terms, automatic enrolment will become much more significant as contributions rise to 8% within five years.

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

- The majority of specialist asset managers remain – for now – providers of segregated or pooled investment services to a variety of schemes and platforms.
- A small but growing 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).

Likely evolution

With the UK asset management industry having until recently been focused on specialist manufacturing capabilities in the context of significant intermediation (both in the retail and institutional markets), two immediate strategic issues arise:

- **Nature of product.** Whether to focus on manufacturing investment components (eg. passive or active asset classes) within strategies designed by others, or also to offer DC solutions that embed an overall investment strategy within a product.
- **Commercial terms of access.** Where distribution platforms may be operated by pension providers with in-house investment management capabilities, the nature of the competitive dynamics is clearly different to an investment-only platform.

The focus on default investment arrangements in the DC market, effectively concentrating inflows, means that these issues are particularly acute. At the same time, there is significant on-going change in the policy environment governing DC scheme behaviour, with three major developments in progress:

- Cap of 0.75% for charges borne by members in default arrangements.
- New governance arrangements for contract-based schemes, which will see the creation of independent governance committees (IGCs) overseeing schemes (as recommended by an Office of Fair Trading (OFT) market study in September 2013[28]).
- Reforms for the retirement income phase, which aim to remove any requirement to take any income (either annuity or drawdown) from April 2015, replace the regime put in place in April 2011. The previous regime abolished the effective compulsion to annuitise, but still required savers either to go into a 'capped drawdown' arrangement (limiting the level of withdrawal permitted each year) or 'flexible drawdown' (providing total freedom as long as a minimum annual income requirement of £20,000 was met).

[28] Source: OFT, *Defined contribution workplace pension market study,* September 2013

Figure 4: DC accumulation phase: retail or institutional?

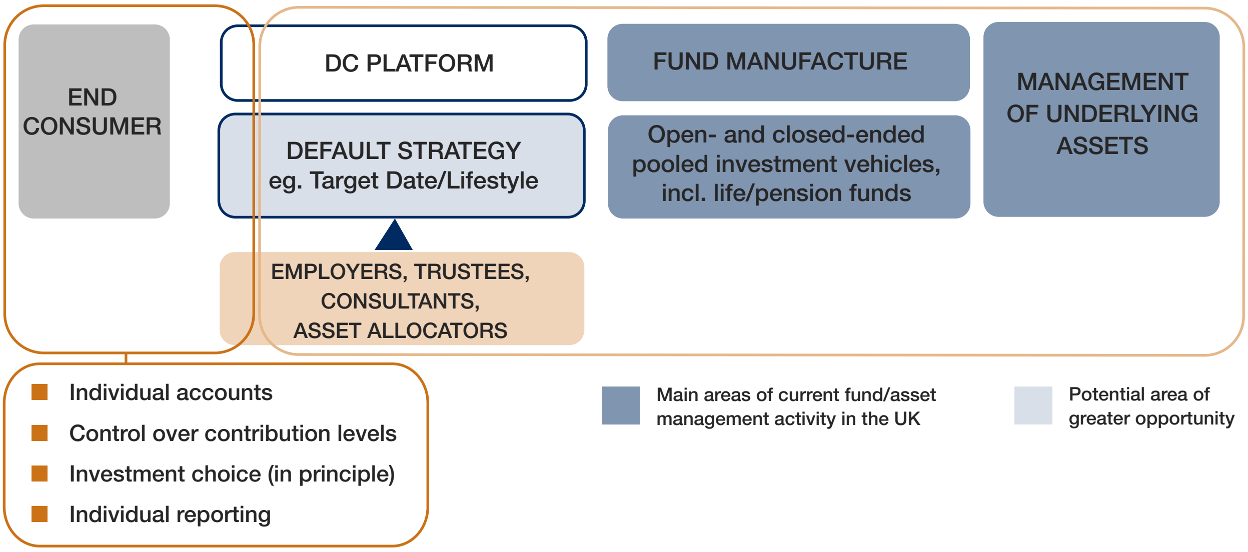


Figure 4 offers a stylised overview of the accumulation delivery chain from underlying portfolio management through to product distribution. In the light of the breadth of international evidence pointing to high take-ups of default strategies (aimed at individuals who do not make an active investment decision), the shape of this part of the market will be of critical importance.

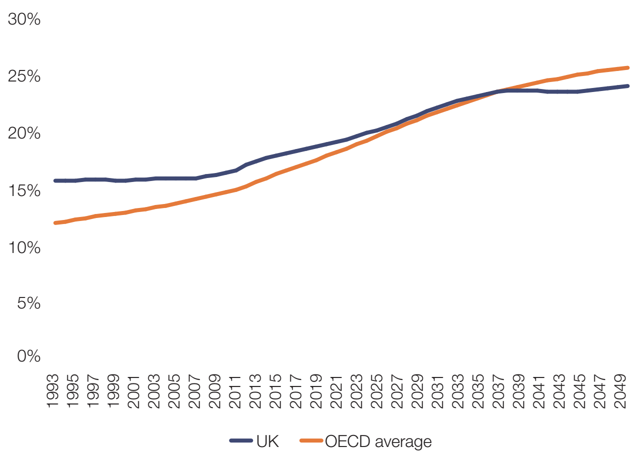
One key element that complicates both the politics and the regulation of DC is the blur between institutional and retail characteristics. While aspects of the delivery are strongly akin to the institutional decision-making that characterises DB (ie. involvement of trustee boards and for DC contract-based schemes, IGCs), the nature of the DC product looks very retail and many of those being automatically enrolled have little experience of investment.

This has arguably created a tension in the policy domain between a desire for greater control over the 'consumer experience' and the recognition that strengthening institutional governance is a critical element – the core recommendation of the OFT study. The outcome is in fact both retail style price controls and new governance safeguards, most notably the creation of IGCs for contract-based pension schemes.

3

Even before the 2014 Budget announcement, a number of factors had started driving the focus of asset managers on the retirement income phase. In part this was a result of unusually low interest rates, but the structural elements have been apparent for some time. OECD projections suggest that, by 2050, almost a quarter of the UK population will be over 65, with a marked acceleration in the pace of change expected in the next 15 years (see Chart 25).

Chart 25: Population aged 65 and over (UK vs. OECD average, 1993–2050)



Source: OECD

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 provisions for retirement. While it is not yet clear precisely how both products and individual behaviour will evolve in response to the Budget announcement, the asset management industry expects to play a far greater role in providing retirement income. The broad expectation is that greater use of drawdown will complement not replace annuitisation, but that annuitisation is likely to take place later and with greater innovation in the so-called 'third way' market between drawdown and full annuitisation.

Figure 5: Key characteristics of 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 product of great importance.
3. Governance frameworks to evolve significantly as IGCs created and greater government and regulatory focus on governance quality.
4. Default strategy charge cap to intensify margin pressure for investment managers.
5. 2014 Budget to change the shape of the retirement income phase, with greater use of non-annuity approaches, including drawdown.
6. Member behaviour and communication to remain a critical challenge, particularly in context of greater freedoms approaching, at and after retirement.

The major unknown element at the time the Survey went to press is exactly how individuals will be supported to make better choices. The UK Government is offering a guidance guarantee to allow all scheme members approaching retirement to access guidance, but wider questions still need to be resolved. These centre on the future shape of default strategies and the level of on-going guidance, and possibly regulated advice, that scheme members may need beyond the one-off guidance guarantee.

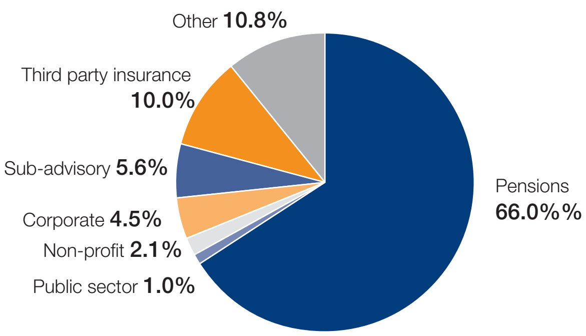
Third Party Institutional Market

Our UK institutional client analysis focuses mainly on the market that is available to third parties, therefore excluding mandates managed in-house by insurance parent groups and internally-managed occupational pension schemes. As at the end of 2013, this market (as measured by IMA member share) came to £1.9 trillion. While the wider market is difficult to size, we believe this represents 80-90% of the total.

As might be expected, the third party market looks considerably different in composition to the total UK institutional market (see Chart 26):

- Pension fund mandates predominate (two thirds of the total)
- Insurance client mandates accounted for only 10% of the third party market[29]
- The third largest area is sub-advisory business (5.6%)

Chart 26: Third party UK institutional client market by client type



The core part of the UK institutional market in asset terms – corporate DB pension schemes – has been characterised by a number of changes over the last decade. Principally, there is a trend towards de-risking that has seen an on-going reduction in holdings of riskier assets. Moreover, there is greater adoption of specific liability-matching strategies and exit in the form of buyout by insurance companies.

The LGPS has seen a different pattern of development. This is primarily because of different funding, regulatory and accounting pressures combined with a differing liability profile to corporate pension schemes as they continue to close to new members and future accrual. This has resulted in an investment portfolio that is still considerably more exposed to the equity market than corporate DB schemes, and the equity held by the LGPS is also somewhat less geographically diversified.

We reported in last year's Survey that asset managers believe that the de-risking patterns seen in the DB environment are permanent, rather than cyclical. While longer-term asset allocation patterns of UK pension schemes point towards a cyclical element in the pattern since the late 1990s, a combination of factors still suggest that the portfolio allocations of the 1980s and early 1990s are unlikely to return.

Mandate breakdown

Looking at the institutional client market by mandate, we use three categories:

- Single-asset (also called 'specialist') mandates, which focus predominantly on a specific investment universe, be it asset class-focused, regional-focused 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 in meeting liability structures, typically involving extensive hedging of risk

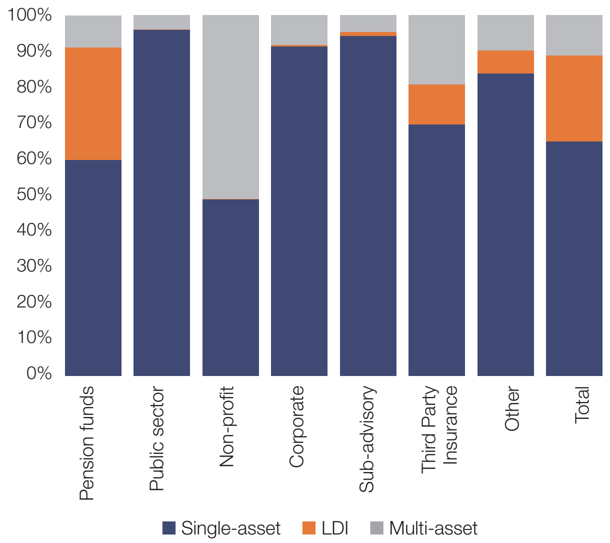
3

[29] 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.

As shown in Chart 27, single-asset mandates are by far the most widely used mandate type, accounting for 65% of third party institutional client mandates, which is slightly down from last year in relative terms. This compares with 11% (end-2012: 10%) for multi-asset and 24% (end-2012: 22%) in LDI mandates. Due to the nature of LDI mandates, they are used almost exclusively by pension funds and insurance clients.

In-house and third party LDI mandates represented a total of £360 billion at the end of 2013, an increase of 19% from end of 2012. However, collecting LDI data on an asset basis introduces inconsistencies of reporting, and a way to avoid this is to look at liabilities hedged. External estimates based on the total notional value of liabilities hedged by LDI strategies show an increase of 17% during 2013, from £443 billion to £517 billion, a faster growth than the 11% seen in 2012.[30]

Chart 27: UK third party institutional client mandates (including LDI)

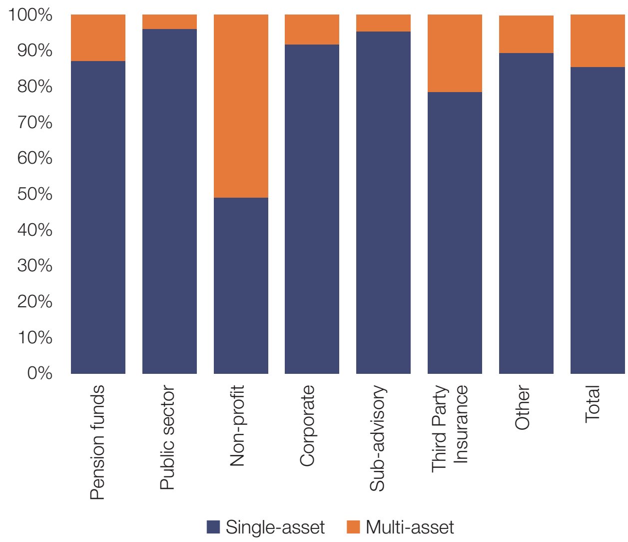


Given the challenges in quantifying LDI mandates in terms of assets under management, Chart 28 shows the balance between single and multi-asset excluding LDI. This increases the proportion of specialist mandates to 85%, compared to 87% in 2012.

Taken together with the growth of LDI, this provides further evidence to support a theme that has been developing over a number of years: the limits of specialisation. Nonetheless, the multi-asset universe in the institutional environment still remains very small compared to twenty years ago when balanced mandates were the predominant third party investment management delivery vehicle for investment services in the DB pensions market.

As we show in Chapter Four, there is also a significant move towards solution-based products in the retail market. However, given that products are being built upstream by asset allocators using specialist components, the IMA Survey management perspective will not capture the full extent of change in this area.

Chart 28: UK third party institutional client mandates: Multi-asset vs. single-asset



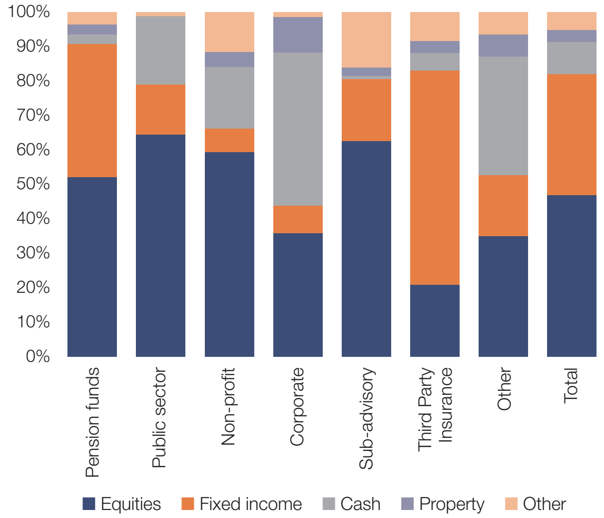
[30] See KPMG *2013 LDI Survey.*

Nature of specialist mandates

This year's headline findings suggest that specialist equity mandates account for 47% of the total in the third party institutional market, some way ahead of fixed income with 35% market share. Chart 29 shows the split of third party specialist mandates by client type (including in-house mandates in the breakdown increases the overall proportion of fixed income mandates to 41%, whilst equities fall to 40%).

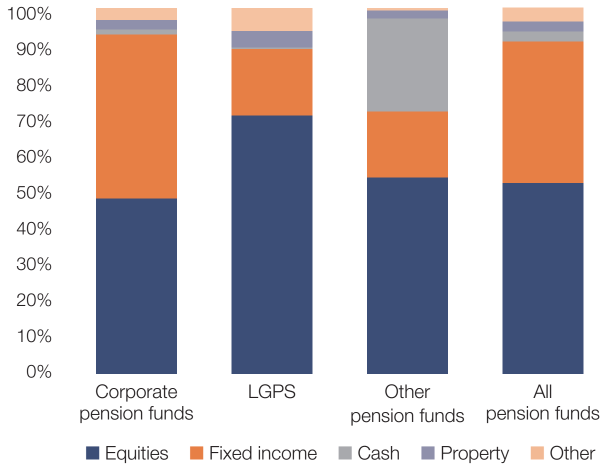
In terms of other asset classes, the corporate client category, in particular, reflects significant use of money market funds for cash management purposes, whilst the large proportion of cash in the 'other' client category is a result of firms being unable to identify precisely the client types within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

Chart 29: Specialist mandate breakdown by asset class



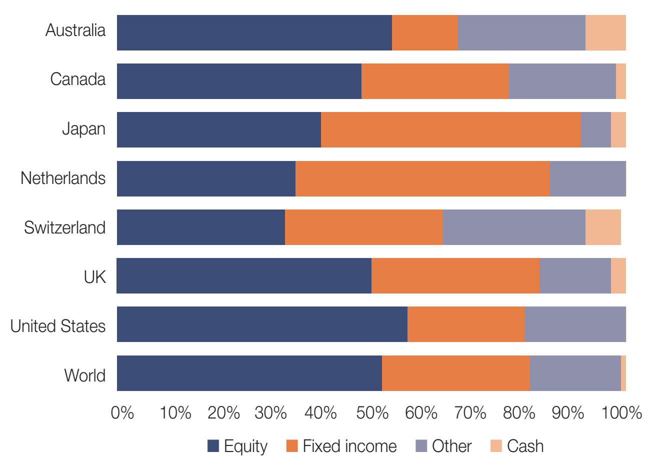
In Chart 30, we see different approaches to investment among pension funds, as reflected in the proportions of specialist fixed income mandates. Corporate pension funds continue to be the most heavily fixed income-focused (45%), while the LGPS and other pension funds are most heavily equity-focused (71% and 54%, respectively). This reflects different funding, regulatory and accounting procedures between the corporate and LGPS environments.

Chart 30: Specialist mandate breakdown by asset class among UK pension funds



An international comparison of pension fund asset allocation reveals that UK pension funds (combined DB and DC) are still relatively strong holders of equity, despite the heavy de-risking by corporate DB plans. There is an even higher equity focus present in the US and Australia (both more mature DC markets), but a more fixed income focus across continental Europe, particularly the Netherlands which is the other main European jurisdiction with a large corporate DB tradition (see Chart 31).

Chart 31: Pension fund asset allocation, selected countries (2013)



Source: Towers Watson Global Pension Assets Study 2014

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

While the Survey does not capture this in detail, there is growing evidence that the focus both on yield and on the need to hedge interest rate and inflation risk is inclining institutional clients towards ‘real assets’ and alternative asset classes as sources of return. This focus can also been seen in certain corporate actions recently undertaken by UK-based asset management firms eg. greater focus on energy and commodities.

This is also coinciding with a public policy focus that is looking to secure greater institutional (and retail) involvement in plugging gaps in capital transmission left by constrained bank lending and government borrowing. As we reported in last year’s Survey, the asset management industry expects to become more involved in this area, whilst recognising that a well-functioning banking system undertaking core functions such as maturity transformation is essential for the broader health of the financial system.

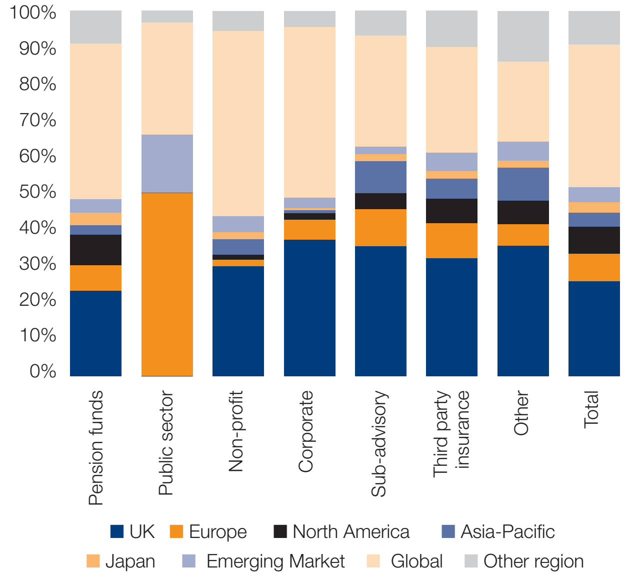
Geographic allocation

We have seen a substantial shift from the UK to a more global investment outlook in recent years, and this is further supported in this year’s figures on the relative size of third party equity mandates (see Chart 32). UK equity mandates represented 26% while global equity mandates accounted for 39% of the total at the end of 2013. The next largest regional categories were Europe (excluding UK) and North America equity mandates with 7.5% and 7.4% respectively.

Including in-house mandates would increase the proportion of UK equity mandates to 29%, and that of global mandates would increase to 37%. This is due to the higher proportion of specialist domestic equity mandates in the in-house insurance category, where they take up 63% of the total (see Appendix 2).

The figures above once again support the evidence of an eroding ‘home bias’ and increasing globalisation of investment horizons.

Chart 32: Geographical equity allocation of specialist mandates by client type



We can also take a closer look at the composition of different pension funds as these show interesting variations, primarily around the relative size of UK, global and other regional equity mandates (see Chart 33). This year’s responses suggest that local authorities remain more UK-focused than corporate pension funds, representing 26% and 23%, respectively. In addition, just as last year, they also appear more inclined to use regional rather than global mandates.

Chart 33: Geographical equity allocation of specialist mandates among UK pension funds

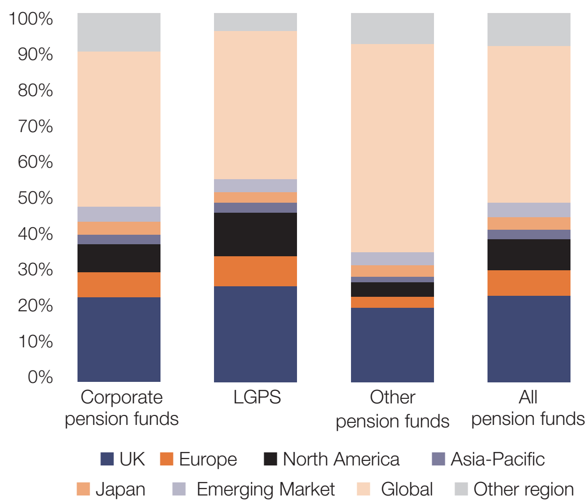
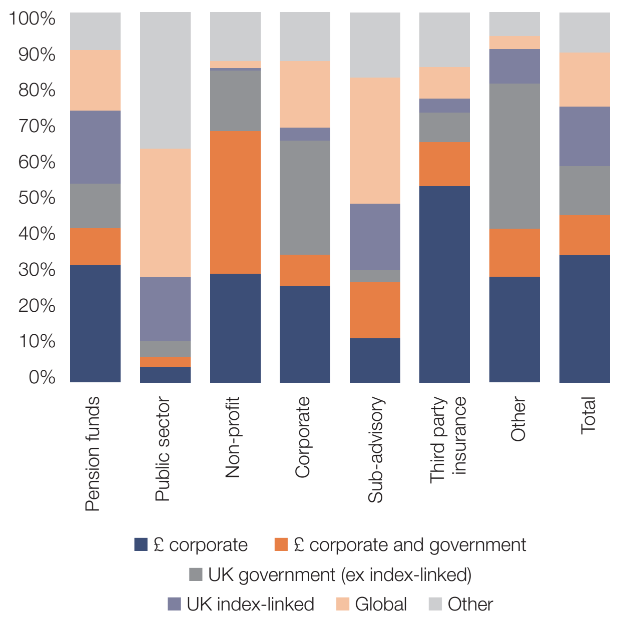


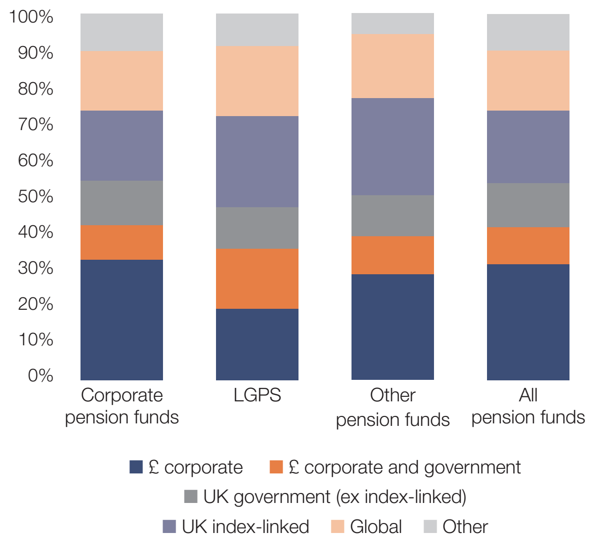
Chart 34 shows that fixed income mandates are largely dominated by a domestic focus with the £ corporate bond category the largest (34%), followed by index-linked gilts at 16% and 13% for gilt mandates. In contrast to equity mandates, global and other fixed income mandates represent a much lower proportion of the fixed income allocation, at 15% and 11%, respectively. A breakdown of fixed income mandate types across third party pension funds is shown in Chart 35.

Chart 34: Fixed income allocation of specialist mandates by client type



With the inclusion of in-house mandates in the breakdown, £ corporate bond mandates decrease to 32% and index-linked gilt mandates decrease to 15%. Meanwhile, gilt mandates increase to 15% and this is largely due to the relatively high proportion of gilt mandates within the in-house insurance category (21%).

Chart 35: Fixed income allocation of specialist mandate types among pension funds

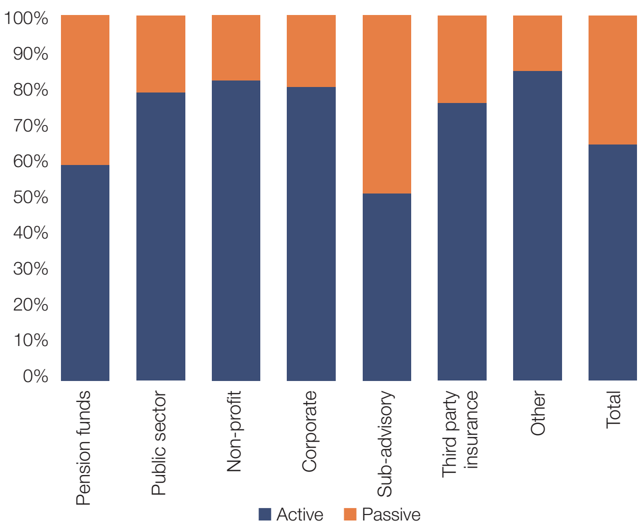


3

Active vs. passive

Given the on-going concentration of the passive market and the IMA Survey sample mix, this data is better interpreted on a sample-adjusted basis. This is in line with results presented in Chapter One on the overall balance between active and passive. Chart 36 shows the sample-adjusted figures. The overall proportion of third party assets managed on a passive basis was 35% and that of pension funds was 41% (this includes both DB and DC).[31]

Chart 36: Active and passive mandates by client type (sample adjusted)

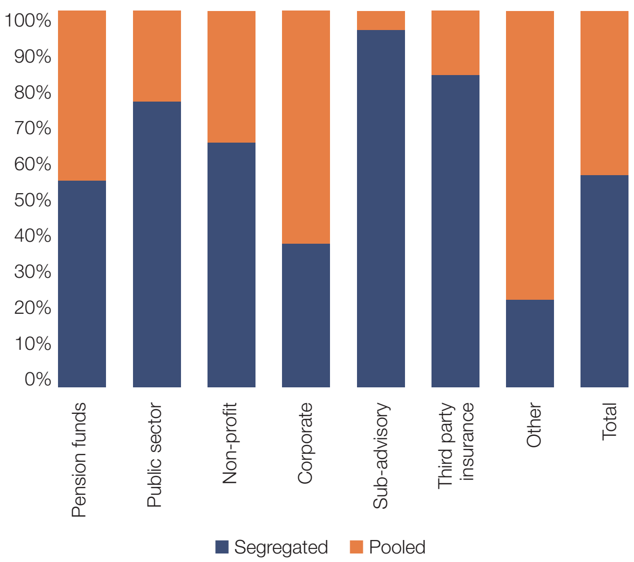


As noted in recent surveys, many believe that the trend towards decomposition of beta and alpha will continue. In the institutional market, the nature of the conversation about both alpha and beta is constantly evolving and becoming more sophisticated. Over the past twelve months, the potential role of 'smart beta' (or what some have described as 'scientific beta') has become a major focus. While we do not yet capture this aspect of the indexing market, we will do so in future editions of the Survey.

Segregated vs. pooled

Segregated mandates represent over one-half (56%) of third party institutional mandates. As shown in Chart 37, segregated mandates are most prevalent in the sub-advisory and third party insurance space (95% and 83%, respectively. The very high proportion of pooled assets assigned to 'other' clients is likely to reflect the difficulty firms experience in categorising the underlying client type in pooled vehicles.

Chart 37: Segregated and pooled mandates by institutional client type



[31] The IMA used to show this data in a headline basis, which would increase to 60%, the proportion of third party mandates managed on an active basis, broadly in line with the proportion at end-2012.

Once again, pension funds continue to have a large proportion of pooled assets. This is likely to be due in part to a greater use of indexing vehicles. However, as shown in Chart 38, both corporate (44%) and local authority funds (43%) have similar proportions in pooled vehicles. In Spring 2014, the UK Government launched a consultation on the future of LGPS investment processes which could see the reallocation of actively managed equity and fixed income mandates towards collective investment vehicles run on a passive basis.

Chart 38: Segregated and pooled mandates among third party pension funds

4 UK Fund Market

Key Findings

Total funds under management

- Total UK-domiciled investment funds in 2013 stood at £770 billion, up by 16% from a year earlier.
- Retail funds under management make up the majority of the industry funds under management and accounted for 67% of the total in 2013, a similar level to ten years ago (64%).
- Total investment funds managed in the UK (including both UK authorised and overseas funds whose assets are managed in the UK by IMA members) are estimated at £1.5 trillion.
- Market movements in 2013 accounted for an £86 billion increase in funds under management with net investor inflows amounting to a further £23 billion.

Determinants of flows

- Net retail sales were £20 billion in 2013, significantly higher than the previous year (£14 billion).
- This has taken place in the context of a positive macroeconomic environment with households investing 1.9% of their available income into funds compared to 1.3% in 2012.
- While funds have increasingly become an important method of saving for retail investors, precise drivers are difficult to determine. One clear element is the inverse relationship between bank and building society deposits post-2008 and retail fund flows.

Asset mix in investment funds

- Equity funds have increased their share of total funds under management to 55%, up from 52% in 2012, as a result of favourable markets and strong inflows.
- Fixed income fell to 15% of the total (from 18% a year earlier).
- Mixed asset funds stayed at a similar level to last year (14%) while property funds increased to 2.2% (up from 2.0% in 2012).
- Targeted absolute return funds rose to 4.4% in 2013, from 3.9% in 2012.

Product preferences

- Equity growth funds have experienced their highest net retail inflow since before the dot.com crisis. Equity funds focused on the UK, Europe and North America posted their strongest net retail sales for over a decade, and those focused on Japan recorded their highest annual inflow for eight years.
- There continues to be an ongoing hunt for yield as investors search for income, with a shift towards equity income as opposed to fixed income funds, which experienced a small outflow in 2013.
- Investors also continue to favour outcome and allocation investing, with mixed asset sectors being the best-selling after equity funds.

Appetite for equities

- 2013 saw global equity markets reacting positively to the aversion of the 'fiscal cliff' by the US Government and concerns about the European debt crisis faded during the year.
- Economic sentiment strengthened as 2013 progressed and so too did equity fund sales. Most significantly, net retail sales of equity funds grew in the second half of 2013 accounting for over £7 billion of the £11 billion total for the year.

Fixed income fund sales

- In the low interest rate environment following the financial crisis, many retail investors turned to fixed income funds, which generate income and are perceived to have lower risk than equities.
- However, in 2013, net retail sales of fixed income funds dropped significantly and the year actually finished with a small net outflow of £20 million.

Index tracking fund sales

- Net retail sales of tracker funds were very robust at £3.2 billion in 2013 compared to £1.8 billion in 2012. This annual figure is the highest since records began in 1992.
- Index-tracking funds represented 9.6% of industry total funds under management at the end of 2013, up from 6.1% in 2004.
- Our data does not include exchange traded funds (ETFs). At the end of 2013, ETFs with a primary London listing reached £94 billion, up from £81 billion at the end of 2012. These funds are utilised by a mixture of investor types.

UK industry and concentration

- The fund industry remains a highly competitive environment, with the top ten firms representing approximately 46% of total UK authorised funds under management; a similar level to the early 1990s.
- While the top ten firms' share of the fund market has changed little over the last seventeen years, the composition has changed significantly. Only five companies have remained in the top ten since 1995 and the top ten companies in 2013 only had 33% of the market between them in 1995.
- Despite expectations of consolidation, fund gross sales data does not point towards greater market concentration. Further analysis at asset class level, suggests a connection between level of concentration and number of products in the market.

UK fund management in context

- European investment funds under management increased to €9.8 trillion (£8.2 trillion) at the end of 2013, an 8.9% increase from 2012.
- Despite strong growth in the UK market, the UK continues to be the fifth largest fund domicile in Europe, representing 11% of the total European investment fund industry as at the end of 2013.

4 UK Fund Market

This part of the Survey covers UK-domiciled authorised Unit Trusts and Open-Ended Investment Companies (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 though often with portfolio management being 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 such as pension funds and insurance companies also invest in them for a variety of reasons; for example, to gain access to certain portfolio manager skills or to reflect investor preferences within unit-linked life products that offer access to third party funds. There have also been periodical restructurings of assets out of life products and into OEICs over recent years.

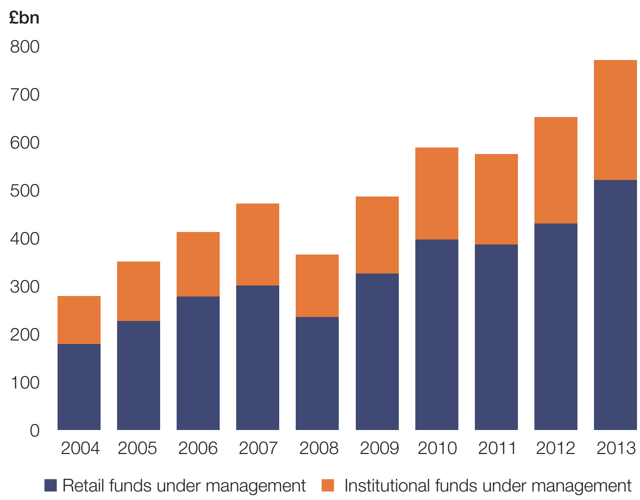
The analysis in this section is based mainly on IMA fund data, which is more detailed and has a longer history than the Survey. Most importantly, it captures funds under management and flows on a monthly basis. In 2013, the IMA collected this data for 2,508 funds.

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.

Total Funds under Management

At the end of 2013, total funds under management of UK-domiciled funds were £770 billion (see Chart 39), up by 16% from £662 billion in 2012. Despite the popularity of funds among institutional investors, retail funds under management made up the majority of the industry funds under management and accounted for 67% of the total in 2013, a similar level to ten years ago (64%).[32] UK investor holdings of overseas domiciled funds[33] totalled £64 billion at the end of 2013. Including all assets of overseas-domiciled funds managed in the UK (£775 billion), increases the total to £1.5 trillion.

Chart 39: Industry funds under management (2004–2013)



As we highlighted in Chapter One (see Chart 2), the UK funds industry has grown in nominal terms by 64% from pre-crisis levels at the end of 2007. This illustrates robust industry growth over recent years despite the variable market conditions that have prevailed since 2008, relative both to previous periods and to other parts of the asset management industry.

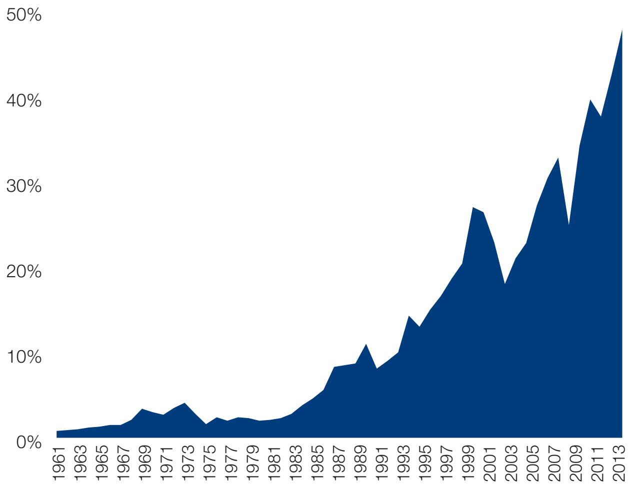
[32] In this context, 'retail funds under management' comprises assets held by retail funds. These are defined as funds with a minimum lump sum investment amount of up to £50,000 and with at least one-third of gross sales over the preceding three years being retail.

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

These growth figures translate into a compound annualised growth rate of 8.6% since 2007 in nominal terms and 5.3% when adjusted for inflation. The corresponding figure for the FTSE All-Share index was 5.3% nominal and 2.2% in real terms, including re-invested income.

Unit trusts have been around since the 1930s but the industry started to develop more rapidly in the early 1960s. The annualised growth rate of assets from 1960 to 2013 was 17% in nominal terms and 11% in real terms. Such expansion rates are clearly greater than those of the UK GDP rate (a useful comparator against which to measure industry growth), with fund industry growth rates particularly strong in the 1980s. At the end of 1960, funds under management equated to less than 1% of GDP (see Chart 40). By the end of 2013, this figure was over 47%.

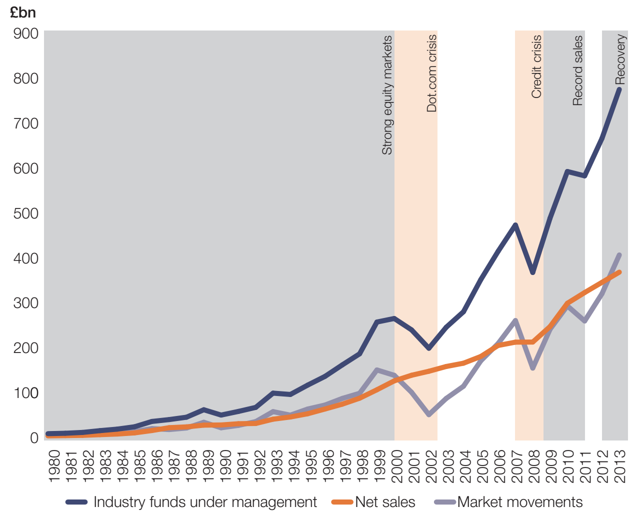
Chart 40: Funds under management as percentage of GDP (1960–2013)



Source: IMA, ONS

Chart 41 shows some of the main drivers of industry growth since 1980 and considers the effect of flows versus market performance. Market movements have had a significant impact on asset values year-on-year and positive annual net sales have provided a more consistent contribution to growth over the period.

Chart 41: Drivers of industry growth (1980–2013)



Industry growth reflects a number of factors since 1980, with the strength of net sales as a driver particularly evident over the last six years:

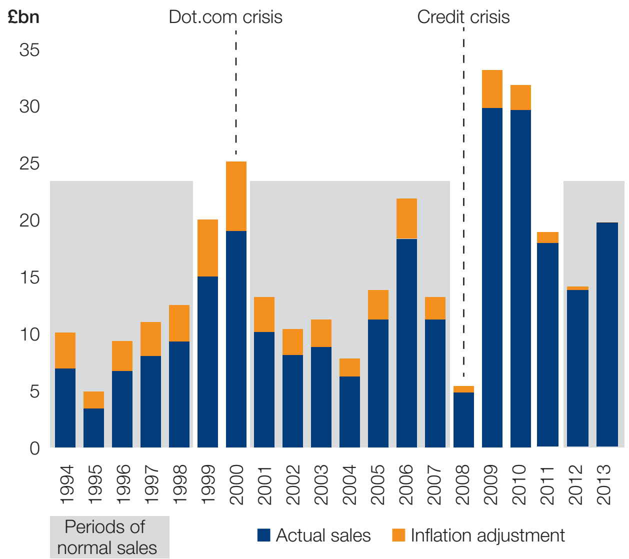
- Strong sales of equity funds during buoyant equity markets fuelled significant growth in the 1980s and 1990s.
- The industry got a boost in 2009-2011 as retail investors reacted to the first years of the global financial crisis and invested record amounts of money into funds.
- Expansion of the industry has been helped by periodical restructuring of insurance assets into OEICs in recent years. Since 2010, these flows have accounted for over £24 billion of net new money.
- Recovering equity markets towards the end of 2012 and throughout 2013 attracted robust flows and inflated asset values. In 2013, market movements accounted for an £86 billion increase in funds under management with net investor inflows amounting to a further £23 billion.

At £20 billion, net retail sales accounted for the overwhelming majority of this inflow, a significant increase from £14 billion in 2012 (see Chart 42). In recent Surveys we have highlighted a period of sustained high net retail sales from January 2009 to June 2011, when average monthly net retail sales were over £2.4 billion. As a result, the annual inflation adjusted average net retail inflow of the five years following the crisis reached £24 billion, significantly higher than the annual average in the five years prior to 2008 (£14 billion).

Since June 2011 we have observed monthly net retail sales returning to what might be considered more normal levels and whilst flows in 2013 did not meet the recent record highs, they were very strong at an average of £1.7 billion per month.

Chart 42 includes an adjustment for inflation to illustrate purchasing power in 2013 money values.

Chart 42: Net retail sales (1994–2013)

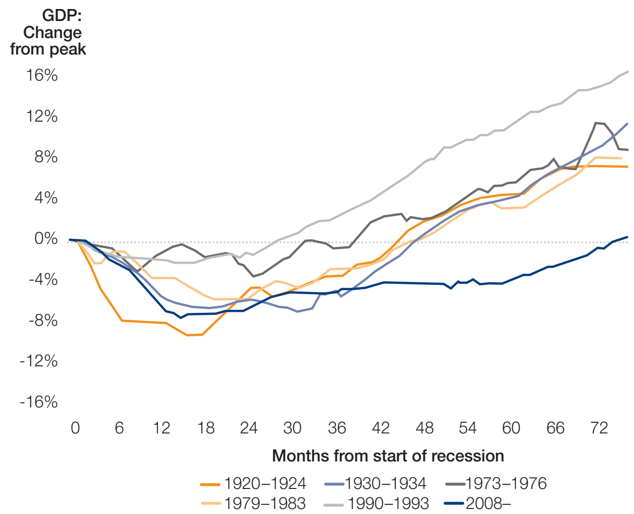


Source: IMA, ONS

Determinants of flows

The UK economy strengthened in 2013 with GDP growing by 1.7% from 2012. Chart 43 shows that this improvement in the economy is particularly significant; the recession that started in 2008 has been one of deepest on record with GDP finally recovering to pre-crisis levels during the second quarter of 2014.

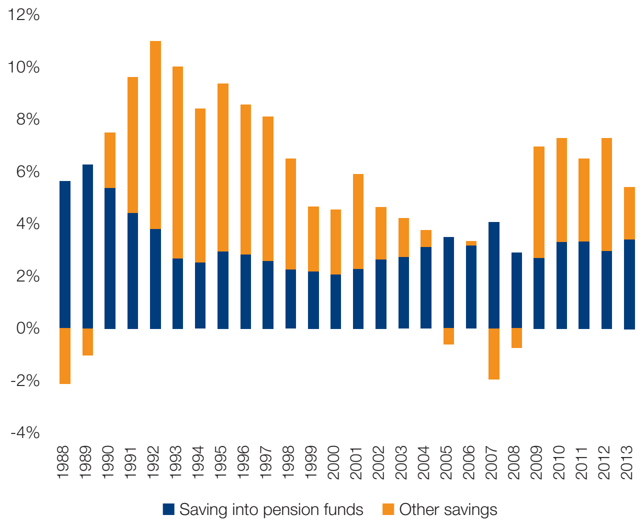
Chart 43: The profile of UK recession and recovery



Source: NIESR (National Institute of Economic and Social Research)

There were significant changes in the savings habits of UK households, as shown in Chart 44; savings rates were lower in 2013 (5.1%) than in 2012 (7.3%), possibly indicating that households felt confident enough about their financial future to forgo saving and spend more of their income. In contrast, savings rates from 2009 to 2012 were relatively high with an annual average of 7.1%. The cycle over the last five years echoes the behaviour seen in the recession of the early 1990s.

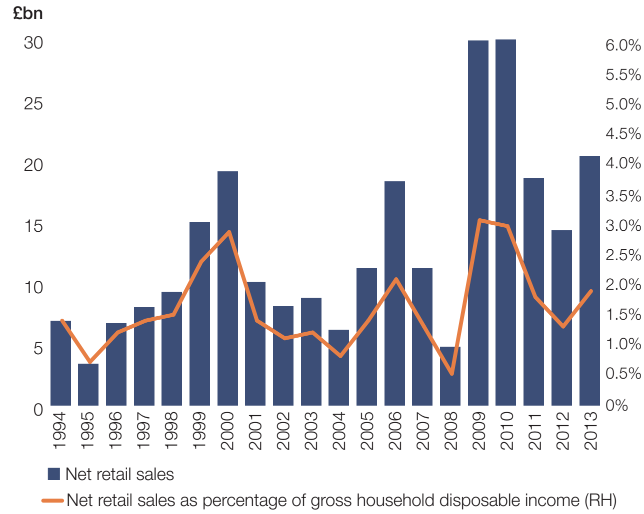
Chart 44: Household savings as a percentage of household's resources (1988–2013)



Source: ONS

While aggregate savings rates have dropped back, Chart 45 shows that in 2013, households invested 1.9% of their disposable income into funds compared to 1.3% the previous year, which suggests that the industry is benefiting from improved overall sentiment among investors. The latest figure reinforces a trend of increased fund investment as a proportion of income since the crisis in 2008. The annual average from 2009 to 2013 was 2.2% compared to 1.5% from 1994 to 2007.

Chart 45: Household saving into funds as a percentage of disposable income (1994–2013)



Source: IMA, ONS

Chart 46 shows the increasing significance of retail funds under management as a proportion of households' total gross financial assets, growing to £520 billion at the end of 2013 (2012: £429 billion). This suggests further that funds are becoming more important as a method of saving for retail investors.

Chart 46: Retail funds under management as a percentage of total financial assets (2004–2013)

Source: IMA, ONS

4

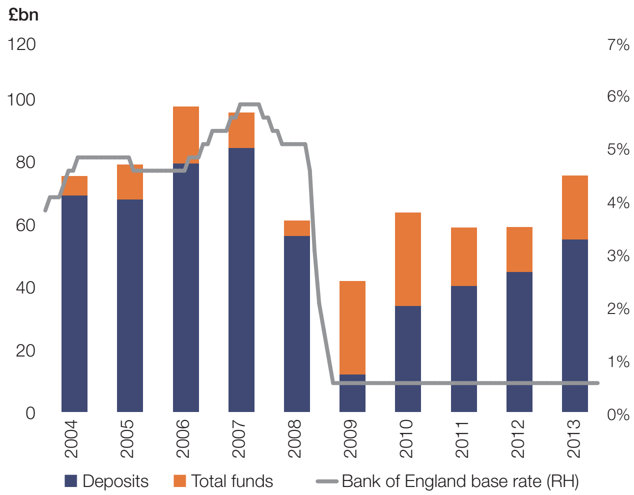
It is difficult to provide firm conclusions about what is driving the savings behaviour observed above because available data aggregates the decisions of a wide variety of investors. However, following the onset of the financial crisis one can observe an inverse relationship between net retail flows into banks and building societies and into UK authorised funds.

Chart 47 shows this relationship since 2004 and indicates that the financial crisis in 2008 had a significant impact on the savings habits of retail investors. Growth in net bank and building society deposits fell sharply, and appeared to be directly correlated with the declining base rate.[34] At the same time, from January 2009 to June 2011, the funds industry experienced its highest monthly net retail inflows on record. In previous Surveys, three broad explanations have been offered for this:

- Retail investors turned to funds for income, as interest rates on bank accounts fell in line with the base rate.
- A finite period of reallocation of assets from deposit accounts and into investment funds occurred, because these cash assets were generating a low return.
- A lack of trust in banks in the immediate aftermath of the crisis deterred investors from deposit accounts in bank and building societies.

The most recent year shows net acquisitions of bank deposits further recovering from the decline initiated by the financial crisis though still down on pre-crisis levels. At the same time fund sales were strong despite the fall in the savings rate as less was invested in life and pension funds and other investment products. The data also suggest that investment funds play an increasingly important role in the savings habits of retail investors. Compared to the five years before 2008, the five years to end 2013 have seen noticeably higher flows. The period following the crisis may have highlighted the benefits of investment funds to 'new' consumers, who had not previously considered them as a saving vehicle.

Chart 47: Net acquisition of currency and deposits by UK households and net retail sales of UK authorised funds (2004–2013)



Source: IMA, ONS

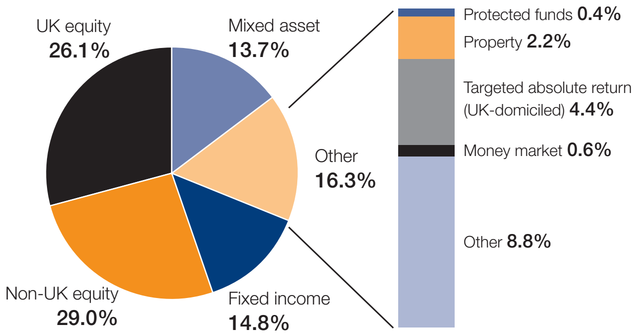
[34] The net deposit data include interest payments. Therefore, all things being equal, such a sharp fall in interest rates would exercise a downward influence.

Asset mix

The overall asset mix of UK funds as at the end of December 2013 is shown in Chart 48. In detail:

- Equity funds represented 55% of total funds under management at the end of 2013, up from 52% in 2012. This increase was due to favourable markets and strong inflows.
- Funds under management of fixed income funds fell to 15% of the total, down from 18% a year earlier. This reflected a combination of low sales of fixed income funds and poor returns on assets within these funds.
- Mixed asset funds made up 14% of the market, the same as the year before.
- Strong growth in the UK property sector helped property funds increase their market share to 2.2% (up from 2.0% in 2012). These funds peaked in 2006 when they represented 3.0% of the total.
- Targeted absolute return funds continued to increase in significance, up from 3.9% in 2012 to 4.4% of total funds under management[35].
- Retail money market funds (as distinct from the very large institutional money market fund business managed out of the UK) continued to account for a very small proportion of funds under management at 0.6%.

Chart 48: Funds under management by fund/asset type



Product preferences

Table 2 shows net retail sales of the main fund categories since 2011. We break out the UK fund universe by asset class and fund type, reflecting IMA sector classifications.[36]

Table 2: Net retail sales by fund type (2011–2013)

Fund type	Net retail sales (£m)		
	2011	**2012**	**2013**
Equity	3,203	3,675	11,401
of which tracker	1,275	1,203	2,484
Mixed Asset	5,876	2,847	4,551
Targeted Absolute Return	933	862	2,210
Property	564	423	1,545
Money Markets	151	-52	-103
Fixed Income	4,486	5,601	-20
of which tracker	685	345	23
Others	3,346	916	814
All funds	**18,559**	**14,272**	**20,398**
of which funds of funds	**5,476**	**3,530**	**3,884**

Note: Numbers may not add up due to rounding

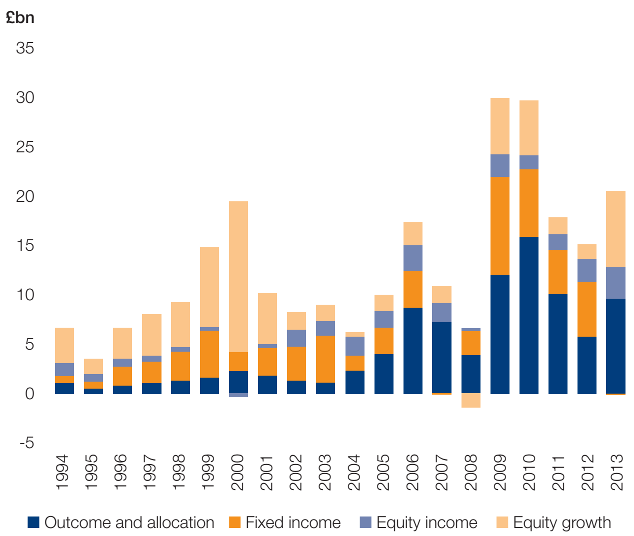
4

[35] This refers to the proportion of total funds under management made up by UK domiciled targeted absolute return funds. These funds reside in the Targeted Absolute Return sector, which contains both UK and offshore domiciled funds.

[36] In this context, the Targeted Absolute Return sector is the renamed Absolute Return sector.

To put this into a broader context, Chart 49 shows how investors' fund choices have developed over the last 20 years as market conditions evolved. 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. However, 2013 saw a dramatic increase in flows back into equity growth funds. While equity income funds built on their popularity in recent years, fixed income funds suffered because of shifting investor preferences throughout 2013.

Chart 49: Net retail sales by different investment objective (1994–2013)



Looking at these patterns in detail:

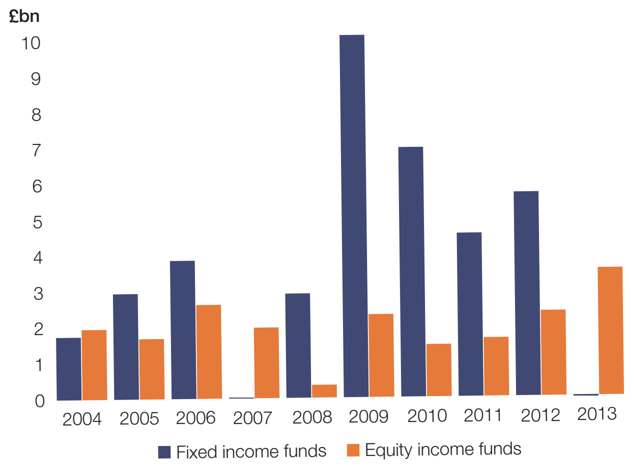
- **Resurgence of developed market equity funds.** In 2013, equity growth funds experienced their highest net retail inflow since before the dot.com crisis. This marks the end of a sustained period in which sales of equity growth funds were dwarfed by other fund types. In particular, equity sectors that focus on developed markets sold well. Funds focused on the UK, Europe and North America posted their strongest net retail sales in over a decade and those focused on Japan recorded their highest annual inflow for eight years.

- **Ongoing hunt for yield.** 2013 saw a continuing search for income among investors, albeit with a shift towards equities. As highlighted in previous Surveys, returns on bank and building society accounts remain at historically low levels and investors are continuing to use investment funds as a means to generate income. This trend has been prevalent since the crisis of 2008 and income generating funds, particularly fixed income funds, have been very popular since then. A very noticeable difference between flows in 2013 and previous years is that fixed income funds suffered a net outflow for the first time since records began. This highlights one of the major trends in 2013: the shifting of investor preferences away from fixed income and towards equities, which will be discussed in more detail in the following sections. Chart 50 shows flows into fixed income and equity income funds since 2008.

- **Outcome-oriented investing.** The post dot.com equity market, coupled with the dislocation after 2008 has led some investors to funds where managers focus more on outcomes, both in terms of targeted absolute return and, to a lesser extent, capital protection. For example, targeted absolute return funds now represent 4.4% of industry funds under management, having seen their highest annual net retail inflow in 2013 since the sector was launched in 2008 (<1% of total funds under management). The latest data suggests that these funds form part of a wider investment portfolio and are viewed as a complementary product rather than just a fall-back in times of market uncertainty.

- **Asset allocation funds.** Whilst over half of industry flows went into equity funds in 2013, asset allocation funds also attracted strong flows. This represents a continuation of their popularity in recent years as investors have attempted to deal with the uncertainty created by volatile markets. 'Asset allocation' in this context describes funds where asset managers can exercise greater discretion over the type of assets the fund invests in. These include two types of fund; those categorised under the Mixed Asset sector 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 in recent years and reached over £12 billion in 2010 though falling back somewhat more recently (see p.62).

Chart 50: Net retail sales of fixed income funds and equity income funds (2004–2013)



Source: IMA, Morningstar

2013 Fund Sales

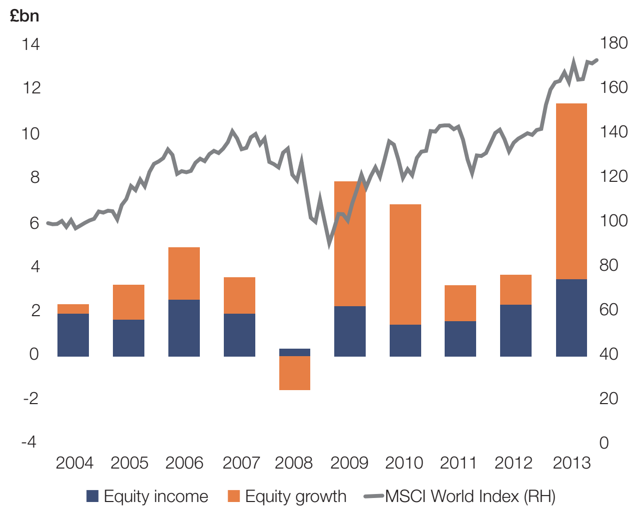
This section explores the trends outlined in the previous section across different asset and fund types in more detail, looking also at funds of funds and ISAs.

Increasing appetite for equities

Developed equity markets performed well in 2013 and this provided the backdrop for some of the strongest equity fund sales on record, particularly in the second half of the year.

Chart 51 shows annual equity net retail sales over the last ten years and 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. Global equity markets reacted positively to the aversion of the 'fiscal cliff' by the US Government at the start of 2013 and concerns about the European debt crisis faded throughout the year. These factors along with improving economic conditions in both the US and Europe meant equity fund sales started to gather momentum in the second half of 2012 and this carried on through 2013.

Chart 51: Net retail sales of equity funds vs MSCI World Index (2004–2013)



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

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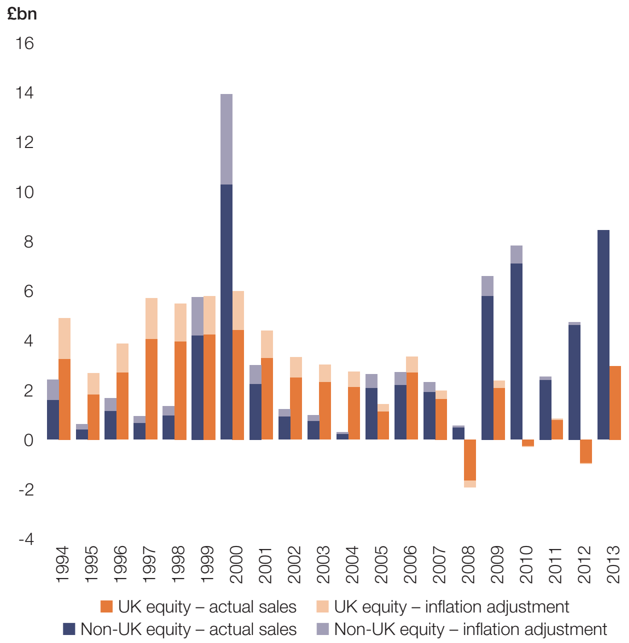
Chart 52 shows that, for the seventh year in a row, non-UK equity funds outsold UK equity funds. Globally focused funds had another strong year of net retail sales but in contrast to 2012, UK equity funds also sold extremely well in 2013. Chart 52 includes an adjustment for inflation to illustrate purchasing power in 2013 real money values.

Chart 52: Net retail sales of UK and non-UK equity funds (1994–2013)



Source: IMA, ONS

Positive economic data emanating from the UK appears to have reignited interest in the domestic equity market. The FTSE 100 increased by 14% in 2013, and there was GDP growth of 1.7% which was significantly higher than generally forecast. Economic sentiment strengthened as 2013 progressed and so too did equity fund sales. Net retail sales of equity funds in the second half of 2013 accounted for over £7 billion of the £11 billion total for the year.

Chart 53 looks further at the regional focus of equity funds and highlights investor preferences shifting back towards developed markets:

- Funds focused on the UK, Europe and North America posted their strongest net retail sales in over a decade with £3.0 billion, £2.0 billion and £1.1 billion respectively. The latest flows were particularly significant for European equity funds following persistent outflows from 2004 to 2012.
- Japan, which has had volatile flows over recent years, recorded its highest annual inflow in eight years with £663 million. This more than offsets last year's outflow of £32 million.
- Global (containing a diverse range of funds that do not fall into the other regional categories) recorded inflows of £4.0 billion, down slightly from £4.1 billion in 2012.
- Equity funds focused on Asia were hampered by variable macro-economic conditions in some emerging markets and experienced only a modest increase in sales of £45 million compared to 2012. They took a total of £744 million in 2013.

Chart 53: Net retail sales of equity funds by regional focus (2004–2013)

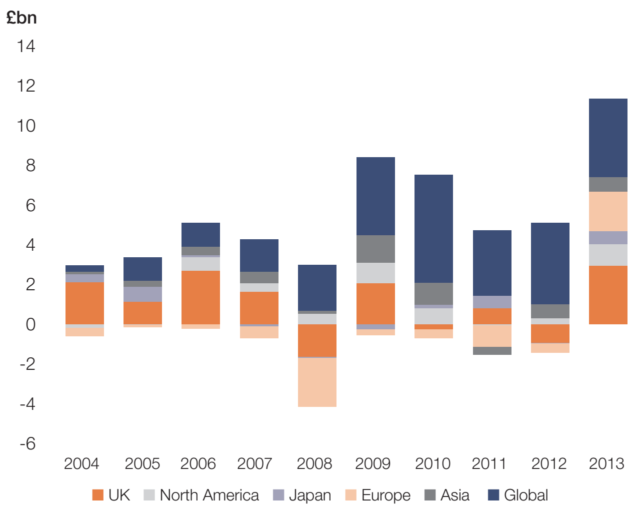


Table 3 shows that the best-selling equity sector in 2013 was Global Equity Income with net retail inflows of £1.8 billion up from £1.3 billion in 2012, when it was the second best-selling equity sector. The Global sector increased by £872 million year-on-year to £1.2 billion in 2013. This was despite many of the funds from the Global sector being re-classified to the Global Equity Income sector when it was launched in 2012.

The best-selling equity sector in 2012 was Global Emerging Markets and, although 2013 sales were strong, they fell by almost half compared to 2012, leaving it in sixth position. Emerging economies had a difficult year in 2013, with talk of tapering of the US quantitative easing programme causing turmoil in many developing economies. Some emerging countries have benefited from money being pumped into the economy by the US Government, which flowed into developing markets as global investors sought returns in flat domestic equity and fixed income markets.

Although sales of global equity sectors were very strong in 2013, they were in line with annual flows since the crisis. The most notable difference in 2013 compared to recent years was the resurgence of developed market equity funds. UK Equity Income recorded nearly double the net retail sales of 2012, which meant it was the second best-selling equity sector in 2013. With dividends relatively stable, the steady income stream from equity income funds can be beneficial in times of market volatility. The popularity of the equity income sectors may also reflect the 'hunt for yield' in the context of low interest rates, elaborated on earlier in this chapter.

Table 3: Net retail sales and funds under management among equity sectors (2012–2013)

Sector	**Net retail sales (£m)**		**Funds under management (£m)**
	2012	**2013**	**2013**
Global Equity Income	1,348	1,752	10,038
UK Equity Income	989	1,745	71,600
Global	372	1,244	70,502
Europe Excluding UK	-628	1,242	39,005
UK Smaller Companies	82	1,014	11,565
Global Emerging Markets	1,651	889	18,082
North America	380	883	30,909
European Smaller Companies	278	800	4,665
Asia Pacific Excluding Japan	965	784	26,368
Japan	-41	636	10,208
UK All Companies	-2,015	207	139,063
North American Smaller Companies	-67	199	1,660
Asia Pacific Including Japan	-8	56	1,882
Specialist	695	50	27,938
Japanese Smaller Companies	8	27	261
Technology and Telecommunications	50	22	919
Europe Including UK	-128	-54	2,137
China/Greater China	-258	-96	1,697
TOTAL	**3,675**	**11,401**	**468,499**

Note: Numbers may not add up due to rounding.

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In addition to UK Equity Income, there are two other sectors that are considered as purely UK focused: UK Smaller Companies and UK All Companies. UK Smaller Companies reinforced the strong investor appetite for domestic equity with an increase of over £900 million compared to 2012. The sector totalled £1.0 billion in net retail inflows by the end of 2013.

The UK All Companies sector recorded its worst year on record in 2012 with over £2.0 billion of outflows. It rebounded this year with a modest inflow of £207 million. Index tracking funds made up about 32% of this sector at the end of 2013 in terms of assets, and for the third consecutive year there was a divergence between active and passive funds. The latter took in £690 million in net retail sales which offset an outflow from active funds of £535 million.

In general, equity funds with a European focus performed well in 2013 in terms of flows. The Europe Excluding UK sector rebounded from a £628 million outflow in 2012, to accrue sales of £1.2 billion by the end of 2013. European Smaller Companies took in net flows of £800 million compared to £278 million the year before. One exception to the positive trend was the Europe Including UK sector, which posted an outflow of £54 million.

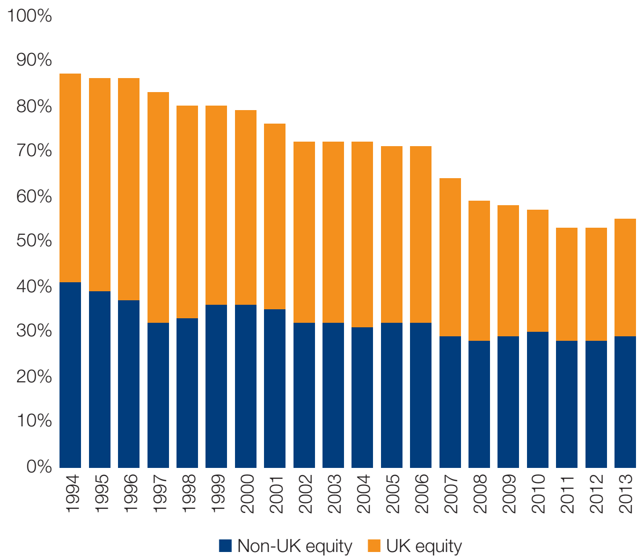
Despite the recent increase in the market share of equity funds, they still represent a much smaller proportion of the market than they did 20 years ago. Chart 54 shows the decrease in the proportion of equity funds from 87% in 1994 to 55% at the end of 2013. This reflects the fact that the funds industry has significantly expanded and now serves a much wider variety of investor needs rather than a decline in investor appetite for equity fund investments.

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 fourth consecutive year. Despite this long term decline, the proportion of total equity represented by UK focused funds has remained constant over the last four years at 47%.

It is important to emphasise that these are relative and not absolute changes. The fund market in 1994 totalled only £92 billion in assets, compared to £770 billion at the end of 2013. In real terms, total equity fund holdings are therefore still much higher now than in 1994, 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 1994; this has risen steadily to around 9% at the end of 2013. 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 54: Proportion of industry funds under management represented by equity funds (1994–2013)



Mixed asset funds

Mixed assets funds were the second best-selling fund type after equity funds and they too appeared to benefit as the demand for fixed income funds dropped away in 2013. Mixed asset funds allow the manager greater discretion over asset allocation, and they occur in two main areas of the IMA universe.

The majority of mixed asset funds are classified to the mixed asset sectors but additionally, over 61% of funds in the Unclassified Sector (45% by total assets) are categorised by Morningstar as 'asset allocation funds'.

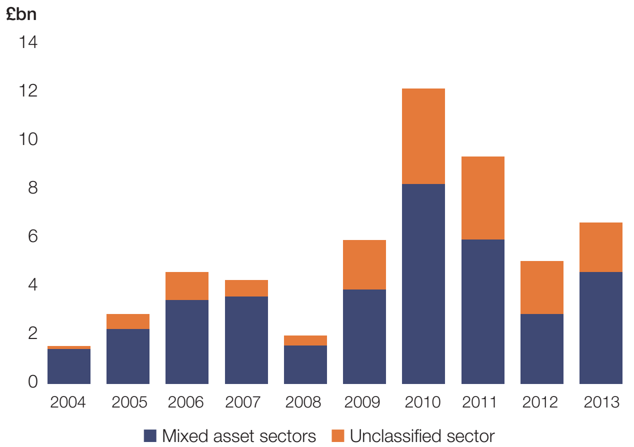
Often, the latter are risk-targeted funds that aim to maximise investment returns to retail investors within the risk constraints matched to investors' risk profiles.

The net retail sales of mixed asset sectors and asset allocation funds in the Unclassified sector have been combined in Chart 55:

- Funds in the mixed asset sectors recorded net retail sales of £4.6 billion in 2013 compared to £2.8 billion in 2012.
- Asset allocation funds in the Unclassified sector received a further £2.0 billion to bring the total to £6.6 billion in 2013, significantly higher than the 2012 total (£5.0 billion).

Mixed asset funds were particularly popular following the crisis in 2008, and benefited heavily from record inflows that occurred in 2009, 2010 and the first half of 2011.

Chart 55: Net retail sales of asset allocation funds (2004–2013)



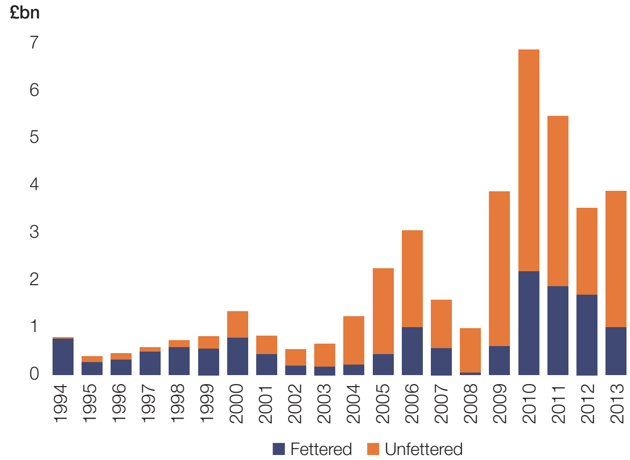
Source: IMA, Morningstar Direct

Most funds of funds invest across different asset categories and are therefore classified to the mixed asset sectors. This means there is often a strong overlap between funds of funds and the mixed asset sectors. At the end of 2013 funds of funds represented 39% of mixed asset funds. Conversely, mixed asset funds accounted for 51% of the total funds under management among funds of funds.

Including those outside the mixed asset sectors, funds of funds have been increasing in significance over the last ten years. Overall funds under management of funds of funds have increased from 5.5% of industry funds under management in 2004 to 11% in 2013. Other notable data include:

- Funds under management of funds of funds increased to a record £88 billion at the end of 2013, an increase of 20% from the end of 2012.
- Net retail investment into funds of funds totalled £3.9 billion in 2013 compared to £3.5 billion in 2012.

Chart 56: Net retail sales of fettered and unfettered funds of funds (1994–2013)



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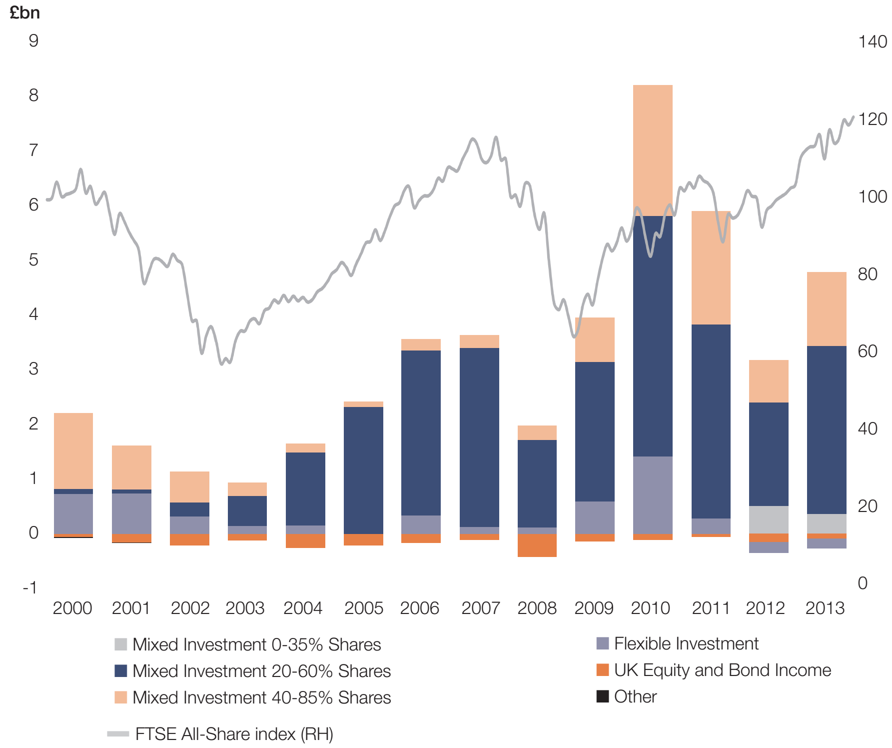
In terms of net retail sales, Chart 56 shows that funds of funds have played a major part in the strong sales of funds overall during the last five years. Unfettered funds of funds (ie. those predominantly investing in funds run by managers outside the group, rather than internal funds) have been the most popular over the ten years to the end of 2013. The most recent annual data reinforce this with less than a quarter of net retail sales into fettered funds of funds. Only four years in the last 20 have reported a lower proportion than this.

In terms of funds under management, fettered funds of funds now represent half of the total holdings in funds of funds. This figure has fallen steadily from 10 years ago when it was 55%.

Chart 57 shows the progress in net retail sales of mixed asset funds since 2000. They recorded strong sales over the last ten years and the latest annual net retail sales figure of £4.6 billion is well above the annual average of the previous ten years (£3.4 billion).

Considering mixed asset funds at a more granular level provides additional information about the preferences of retail investors, although we are unable to do this with asset allocation funds within the Unclassified sector. Looking across the mixed asset fund universe, the Mixed asset 20-60% shares sector sold particularly well in 2013 and finished the year as the best-selling sector overall in terms of net retail sales. This was the sixth time the sector was the best selling in the last ten years.

Chart 57: Net retail sales of mixed asset funds vs FTSE All-Share index (2000–2013)



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

Looking over a longer period, Chart 57 reveals three distinct periods of flows:

- Up until 2003, retail investors in mixed asset funds favoured the Mixed Investment 40-85% Shares sector and the Flexible Investment sector, which allow managers to hold a higher proportion of equities than other mixed asset sectors. This would suggest a higher risk tolerance until the market bottomed out after the dot.com crisis, with popularity diminishing thereafter.
- With risk aversion appearing to increase, the majority of mixed asset investors plumped for the Mixed Investment 20-60% Shares sector (cap of 60% on equity exposure) between 2003 and 2008, even as equity markets were rising strongly.
- Since 2008, Mixed Investment 20-60% Shares continued to sell well, but there was an accompanying resurgence in the Mixed Investment 40-85% Shares sector. Historically low interest rates may have driven investors who wanted a higher level of return but were not prepared to invest solely in equities into this market.

Table 4 shows the full breakdown of net retail sales of the mixed asset sectors over the last two years:

- The best selling Mixed Investment 20-60% Shares sector took in net retail flows of £3.1 billion in 2013 and accounted for the majority of the flows into all mixed asset funds (£4.6 billion).
- Second highest selling was the Mixed Investment 40-85% Shares sector, which saw inflows of £1.4 billion, almost doubling rom £778 million the previous year.
- The Mixed Investment 0-35% Shares sector took £366 million, slightly lower than in its debut year of 2012.
- Two mixed asset sectors experienced net outflows. Flexible Investment lost £180 million, which was similar to the outflow from this sector last year. UK Equity and Bond Income reported its fourteenth year of net outflows.

Table 4: Net retail sales of mixed asset funds by sector (2012–2013)

Sector	Net retail sales (£m)		Funds under management (£m)
	2012	2013	2013
Mixed Investment 20-60% Shares	1,896	3,093	42,543
Mixed Investment 40-85% Shares	778	1,357	48,356
Mixed Investment 0-35% Shares	519	366	4,751
UK Equity and Bond Income	-152	-85	2,832
Flexible Investment	-194	-180	17,950
Total	**2,847**	**4,551**	**116,432**

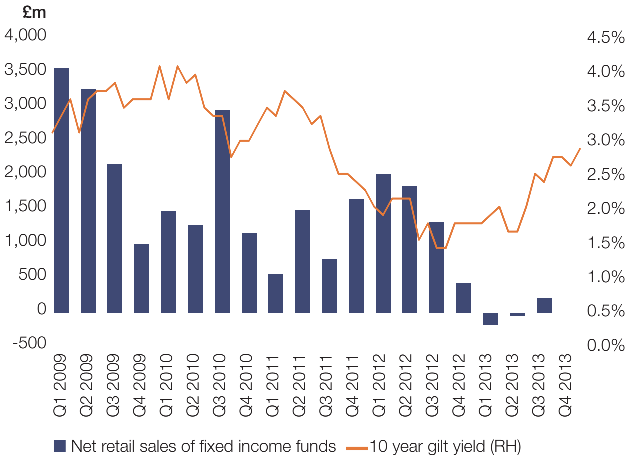
Fixed income funds

In the low interest rate environment following the financial crisis, many retail investors turned to fixed income funds, which generate income and have a lower perceived risk than equities. This 'flight to quality' meant demand for fixed income products increased dramatically following 2008 and enabled borrowers to issue bonds with increasingly low yields without denting demand. This was further exacerbated by quantitative easing programmes in developed economies, which have been propping up high prices in the bond market.

With limited upside offered by fixed income investment it may not be surprising that when equity markets started to recover and investors became more confident in them, flows into equities would increase at the expense of flows into fixed income products. This is certainly what the data suggests. Fixed income funds sold well after the crisis of 2008; from 1992 (when the IMA started collecting sector level data) to 2012, net retail flows into fixed income funds totalled £63 billion, over 40% of which was gathered from 2009 to 2012.

In 2013, however, net retail sales of fixed income funds dropped significantly and the year actually finished with a small net outflow of £20 million. This is in stark contrast to 2012, when fixed income funds were the best-selling fund type with £5.6 billion of net retail inflows. Chart 58 shows that flows lost momentum towards the end of 2012 and this continued throughout 2013. The chart also illustrates fluctuating yields over the period.

Chart 58: Ten year gilt yield vs. fixed income sales (2009–2013)



Source: IMA, Lipper IM

Chart 59 shows annual net retail sales of fixed income from 1994 to 2013 and includes a sector breakdown from 2008 onwards.

Chart 59: Net retail sales of fixed income funds (1994–2013)

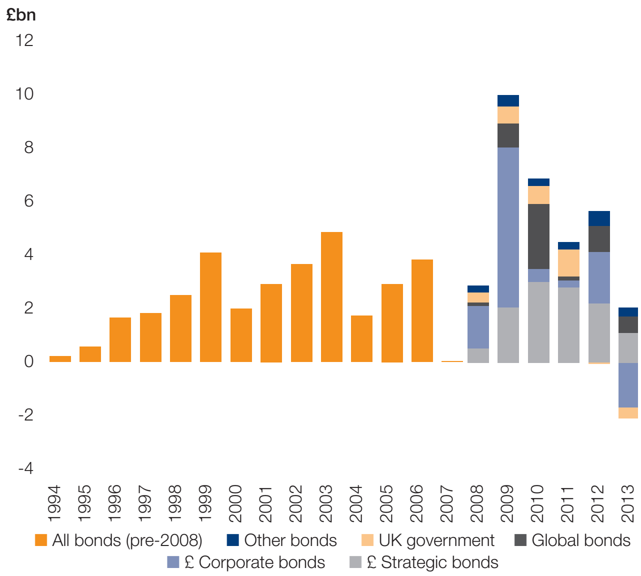


Chart 59 shows the extent of the move to fixed income funds, which were the best-selling fund type in 2009, with exceptionally strong flows into the £ Corporate Bond sector. Sales peaked that year, despite robust sales between 2010 and 2012 which also saw an evolution in investor behaviour reflected in higher sales in the Global and £ Strategic Bond sectors (funds in this sector may hold a range of different bonds, with no limit on levels of exposure).

In terms of 2013 net retail sales, the following pattern could be observed:

- The best-selling fixed income sector was once again £ Strategic Bond with a total of £1.1 billion, down from £2.2 billion in 2012. This made it only the ninth best-selling sector in terms of overall net retail sales whereas it was the top selling sector last year.
- The Global Bonds sector was the second best-selling fixed income sector in 2013 and it attracted net retail flows of £603 million, down from £966 million the previous year.
- Following strong net retail inflows of £1.9 billion in 2012, the £ Corporate Bond sector experienced an outflow of similar magnitude in 2013 (£1.7 billion). 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 1994.
- UK government bonds, which include the UK Gilts and UK Index Linked Gilts sectors, suffered an outflow of £392 million compared to an outflow of £41 million last year.

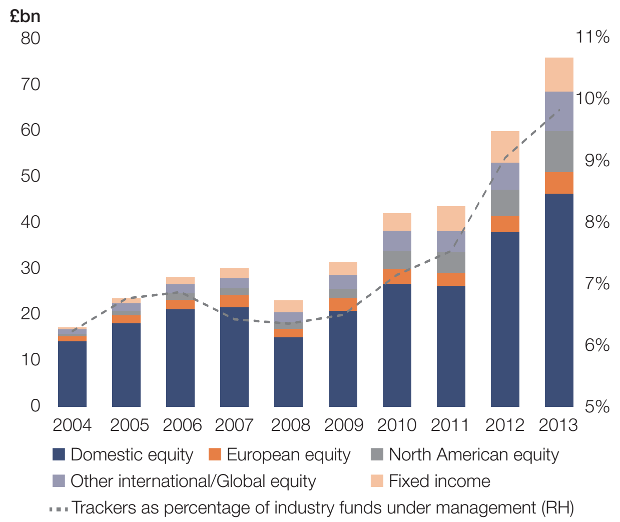
Index tracking funds

The IMA collects data only on UK authorised index tracking funds, and is unable to analyse the wider ETF market, which has become a very significant part of the indexing universe. By the end of the year, ETFs with a primary London listing reached £94 billion, up from £81 billion at the end of 2012.[37] 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.

Index-tracking authorised funds benefited from favourable market conditions during 2013 and they reached their highest level of funds under management on record. Net retail sales of tracker funds were very robust at £3.2 billion in 2013 compared to £1.8 billion in 2012. This annual figure is the highest since records began in 1992.

Chart 60 shows that funds under management of domestic equity trackers increased by 22% to £46 billion at the end of 2013. Over the same period, global equity trackers increased by 47% to £8.6 billion. Fixed income trackers increased to £7.3 billion (2012: £6.8 billion). Overall, index-tracking funds represented 10% of industry total funds under management at the end of 2013, up from 6.1% in 2004.

Chart 60: Funds under management of tracker funds by index investment type (2004–2013)

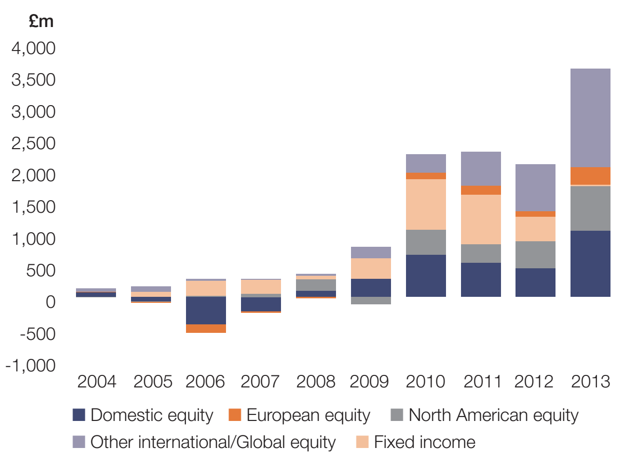


[37] Source: Blackrock Investment Institute, Bloomberg.

Chart 61 shows net retail sales of tracker funds broken down by the type of index that they track. At £3.3 billion, the largest proportion of the flows continues to go into equity trackers whilst fixed income trackers experienced their lowest sales since 2004. In more detail:

- Flows into trackers echoed what was seen in the wider market; developed equity trackers saw a dramatic increase in net retail flows year-on-year.
- UK equity trackers attracted retail flow of £919 million in 2013, over double the £402 million that came in during 2012.
- North American equity trackers also performed well with inflows of £626 million, up from £373 million the previous year.
- Flows into European equity trackers have been volatile since 2004, but 2013 saw a relatively strong inflow of £245 million.
- Global equity trackers reported strong net inflows (£1.4 billion in 2013 compared to £651 million in 2012). This year-on-year increase demonstrates the growing popularity of tracker funds. Whilst sales of global equity funds overall were strong in 2013, they remained in line with flows during 2012.
- Fixed income trackers had a disappointing year with net retail inflows of only £23 million.

Chart 61: Net retail sales of tracker funds by index investment type (2004–2013)



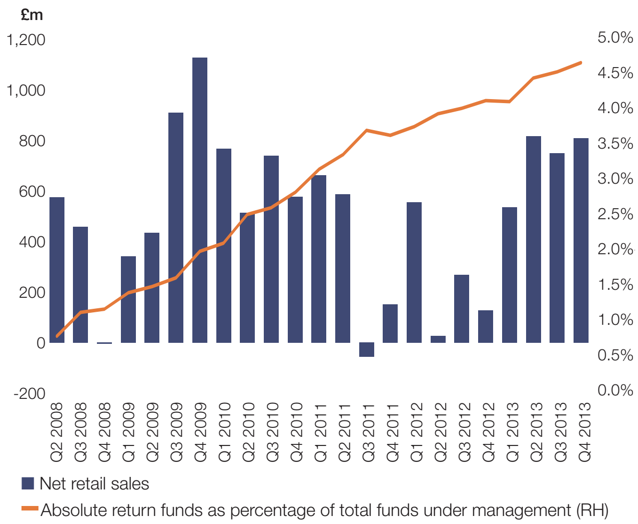
Targeted absolute return in the mainstream?

A designated IMA sector for UK- and overseas-domiciled targeted absolute return funds was created in April 2008. Taking overseas- as well as UK-domiciled assets into account, targeted absolute return funds increased their share of industry funds under management in 2013, and by the end of the year represented 4.5% (2012: 4.0%). Net retail sales among these types of funds were strong throughout the year, particularly after Q1 (see Chart 62). Total net retail sales for the sector were £2.9 billion compared to £976 million the previous year. Funds under management increased to £41 billion, a 33% increase from the end of 2012.

While we remain in a low interest rate environment, investor demand for return-based or outcome-oriented products may continue. Renewed vigour in the equity market does not seem to have dampened investor appetite for targeted absolute return funds, which intuitively may appeal to investors in times of market volatility. Flows data from 2013 actually suggest the opposite, with sales of targeted absolute return funds apparently complemented by strong equity markets, rather than these funds being substituted for other products.

Since the launch of the Absolute Return sector in 2008 (renamed Targeted Absolute Return in June 2013), it has remained unclear whether their popularity was cyclical or part of a wider structural evolution within the industry. The relationship between targeted absolute return funds and other products will become clearer in the coming years. However, we have reported in recent years that many within the asset management industry believe the shift is structural.

Chart 62: Quarterly net retail sales of targeted absolute return funds vs targeted absolute return funds under management as percentage of total funds under management (2008–2013)



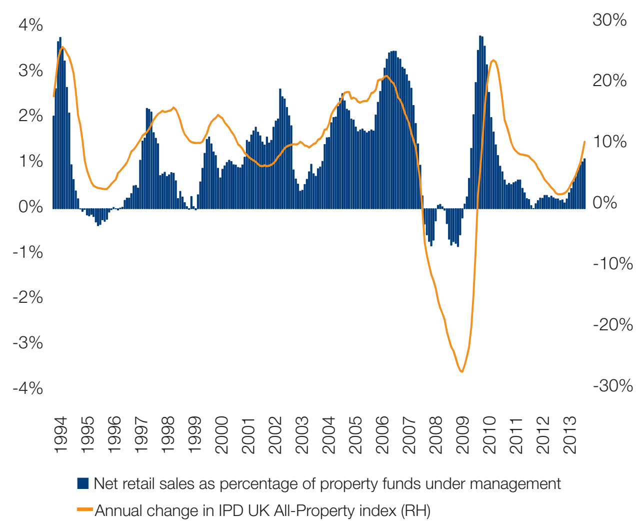
Source: IMA, Morningstar Direct

Property funds

There was a resurgence in the UK property market in 2013 with the IPD UK All Property Index posting an 11% year-on-year increase in December calculated on total return basis. Net retail sales of property funds followed suit and totalled £1.5 billion by the end of the year. This was the highest inflow since 2010.

As Chart 63 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 had been falling steadily until a dramatic reversal in January 2013.

Chart 63: Net retail sales of property funds vs IPD UK All Property Index (1994–2013)[38]



Source: IMA, Lipper IM

[38] 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.

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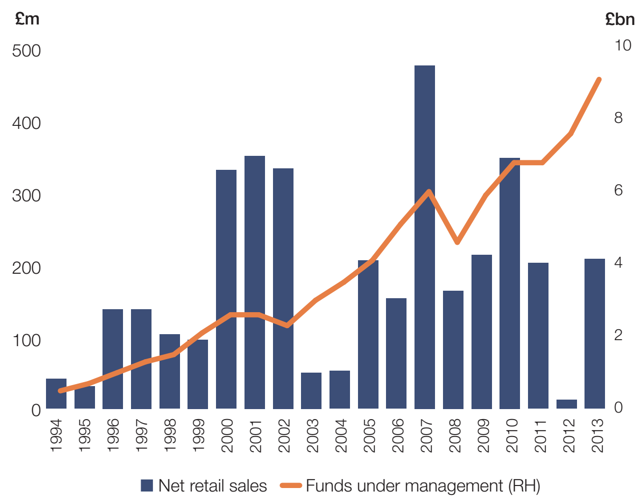
Ethical funds

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 funds investing with a Socially Responsible Investment (SRI) or an Environmental, Social and Corporate Governance (ESG) focus.

Chart 64 shows the progression of ethical funds under management and net retail sales from 1993 to 2012. After a poor year in 2012, net retail sales of ethical funds rebounded to £207 million which is in line with the annual average of the ten years prior to 2013.

Funds under management of ethical funds stood at £9 billion at the end of 2013, a 20% increase on the end-2012 figure. The majority of ethical funds are concentrated in the UK All Companies and Global Equity sectors, which between them account for 56% of the total. Positive market conditions benefited both of these sectors and buoyed the ethical funds within.

Chart 64: Ethical funds under management vs. net retail sales (1994–2013)

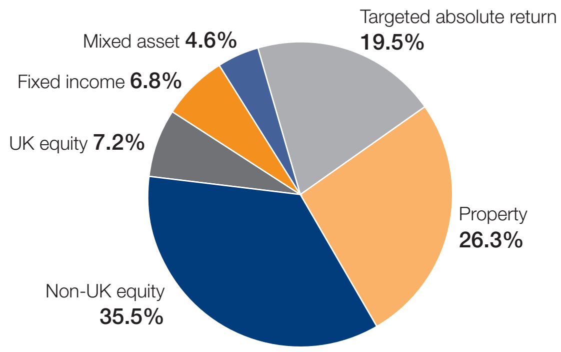


Newly launched funds

In 2013 the IMA classified 97 newly-launched funds, which between them reported £866 million of net retail sales throughout the year. Chart 65 shows how these net retail sales were distributed over various categories:

- Non-UK equity funds represented the largest proportion of net inflows at 35.5%. Sales of newly launched UK focused equity funds represented a further 7.2%.
- The second highest share of inflows was into property funds (26.3%).
- UK-domiciled targeted absolute return funds accounted for 19.5% of the total.
- Fixed income and Mixed asset funds represented 6.8% and 4.6% of the total respectively.

Chart 65: Net retail sales of newly launched funds by fund/asset type

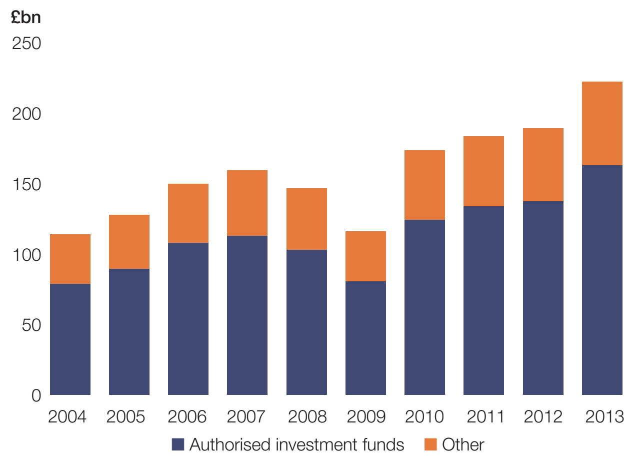


Individual Savings Accounts (ISAs)

A substantial proportion of retail investment is held within stocks and shares ISAs. Fund holdings represent around three-quarters of this, with the remainder accounted for by direct holdings of securities. At the end of the 2012/13 tax year, HMRC data show that investors owned funds (see Chart 66) valued at £163 billion out of a total investment of £222 billion in stocks and shares ISAs.

As a proportion of industry funds under management, ISAs have been falling from 31% in March 2004 to 23% at the end of March 2013, though ISA assets in funds have increased in absolute terms as shown in Chart 66.

Chart 66: Funds under management in ISAs (tax year ending April 2004–April 2013)

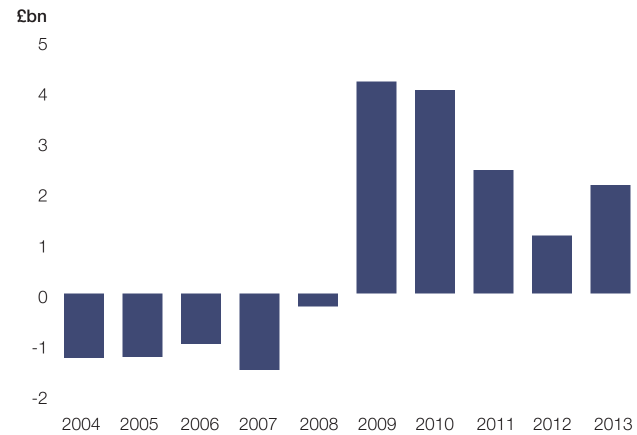


Source: HMRC

IMA sales figures in Chart 67 show the progression since 2003/04 among ISAs provided by fund managers and five larger fund platforms. It should be noted that as ISA distribution evolves, an increasing number of providers are wrapping the ISA products. This is typically small fund platforms and wealth managers from whom the IMA does not collect data. As a result, IMA data covered 75% of the stocks and shares ISA market in funds at the end of the 2012/13 tax year, compared to 92% at the end of the 2007/08 tax year. We can observe the following trends from the data we collect:

- Net sales of funds within ISA wrappers fell sharply after the dot.com crisis 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.
- ISA net sales turned positive in the period of high industry sales following the crisis. This continued into the 2012/13 tax year, with the most recent annual total increasing in line with industry flows.

Chart 67: Net ISA sales (tax year ending April 2004–2013)[39]



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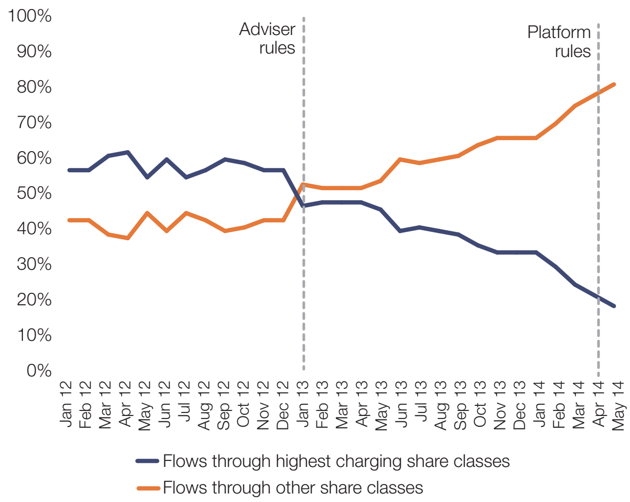
[39] For the purposes of this chart, the tax year is defined as 1st April to 31st March.

Distribution Dynamics and their Implications

January 2013 saw the introduction of the RDR and our data suggests that, at an aggregate level, flow rates have not been negatively affected by this. There has, in fact, been a dramatic increase in flows year-on-year, with net retail sales of £20 billion in 2013 significantly higher than the £14 billion that came in throughout 2012.

By considering flows by individual share class, however, we can observe a change in the direction of flows in terms of charging level. The IMA collects data by share class, which means we are able quantify the proportion of flows going into particular share classes and, more importantly, the charging levels associated with those share classes. We analysed over 2,500 funds on this basis and the results are presented in Chart 68.

Chart 68: Gross retail sales at share class level (Jan 2012 to May 2014)



Source: IMA, Lipper IM, Morningstar Direct

The data indicates that around 60% of all gross retail flows prior to the introduction of RDR were directed into the share class with the highest annual management charge in the various funds. Though not always the case, the highest charging share class of a particular fund will often be the primary retail share class, or the share class that the majority of retail business was historically directed to.

The introduction of the first stage of the RDR in January 2013 saw a move towards lower charging share classes which, in some cases, will be the post-RDR share classes. The adoption of lower charging share classes has gathered pace and at the end of May 2014, our latest data at time of writing, over 80% of flows were being directed into lower charging share classes as opposed to the highest.

Though it is useful to observe the effect of RDR on flows in this way, Chart 68 does not show us anything unexpected. We are seeing a move away from the higher charging share classes in funds since the introduction of RDR, which seems like an obvious consequence of introducing lower charging retail share classes into the market.

Major Distribution Channels

In terms of distribution at the fund level, fund platforms continued to gain market share in terms of gross retail fund sales, accounting for 49% of the total in 2013 (up from 45% in 2012 and up 37% from when we started collecting data in 2010).[40] This reinforces the increasing dominance of platforms as the chosen distribution channel for funds.

Total net retail sales through fund platforms were £16.2 billion, which was £4.8 billion higher than 2012. This represented 80% of total net retail sales in 2013, the same as the year before.

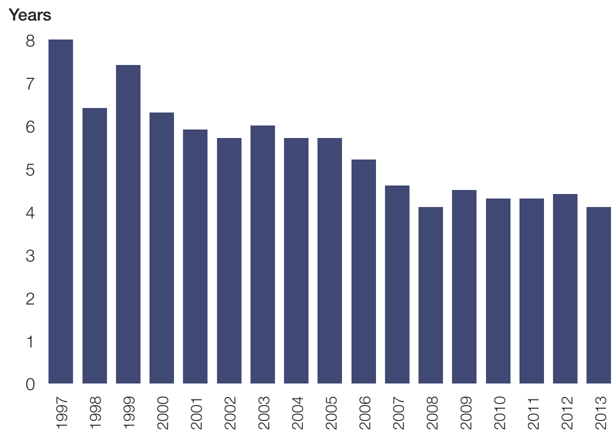
The increasing popularity of platforms as a distribution channel is also supported by the data we collect directly from five fund platform operators.[41] These platforms account for three-quarters of the platform market in terms of total transactions. By the end of 2013, they had fund holdings of £164 billion, up 24% on the year before (2012: £132 billion).

The latest funds under management figure supports the increasing popularity of platforms seen in the sales figures. They increased their market share as the overall industry grew by 16% in the same period.

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 (26%) and sales of ISA-wrapped products accounting for 25%. Our figures indicate that these five fund platforms held around 43% of the total ISA-wrapped funds in March 2013, up from 32% five 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 of the reasons why fund managers have been experiencing greater flow volatility. Nonetheless, the average time for which investors hold funds has stabilised in recent years after falling sharply between 1997 and 2007 (see Chart 69). We calculate the average holding period for retail investors as the inverse of the average redemption rate for retail funds.

Chart 69: Average holding periods of retail investors (1997–2013)



Holding periods were relatively unaffected by the most 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.

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[40] 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.

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

UK Industry Concentration and Structure

By the end of 2013, we collected data on 104 fund operators, ie. companies operating funds but not necessarily performing the investment function. This reflects a steady decline from the 118 companies observed eight years ago, which is mainly a result of merger activity around the mid-market level.

The UK fund management industry remains a highly competitive environment, with the top ten firms representing approximately 46% of the total UK authorised funds under management in 2013, a similar level to the early 1990s. Chart 70 shows the top ten fund operators by total retail and institutional funds under management, while Chart 71 shows the top ten firms in terms of retail funds under management.[42]

Chart 70: Top ten UK fund operators by total funds under management

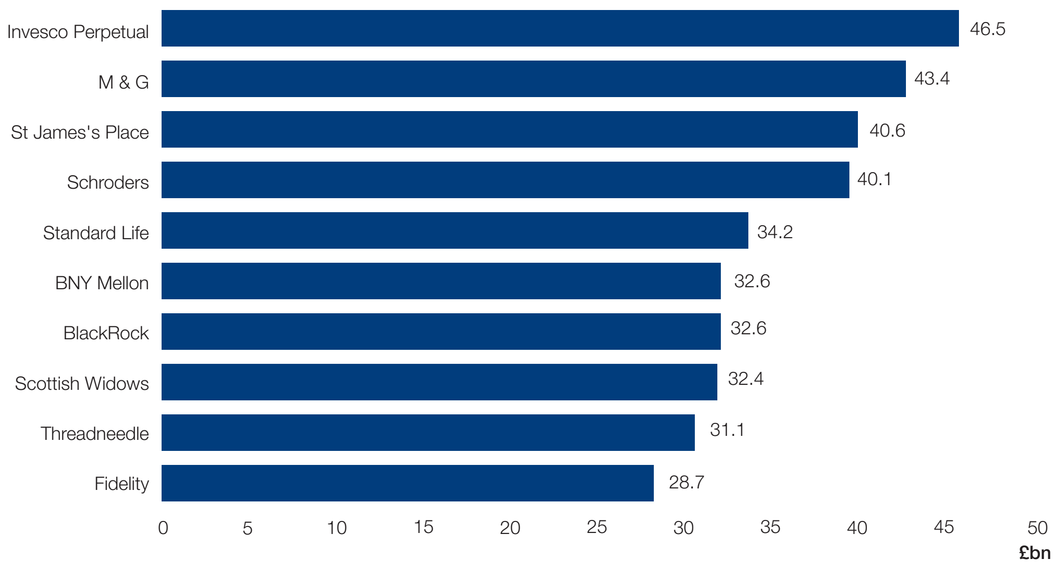
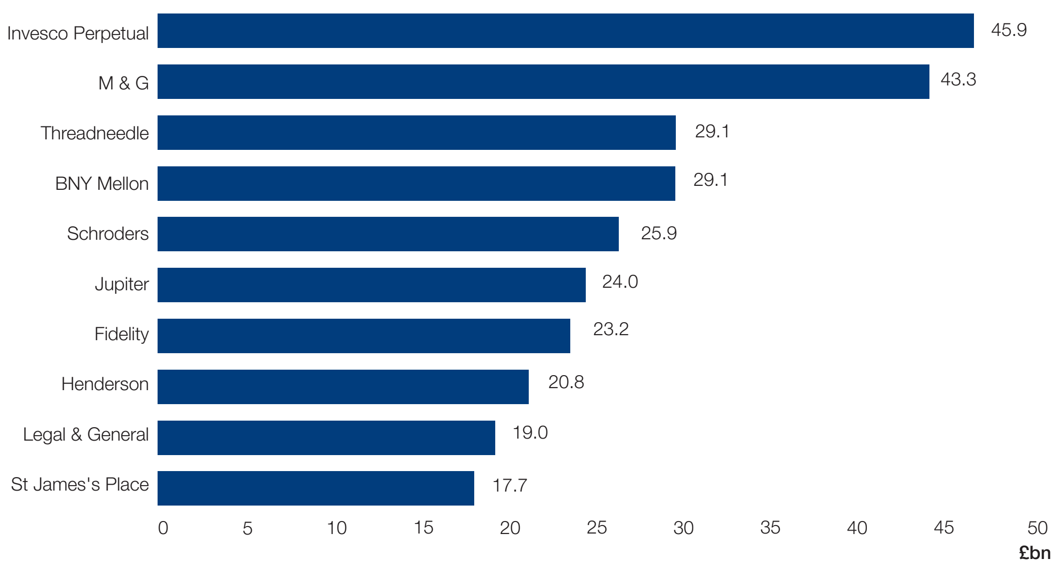


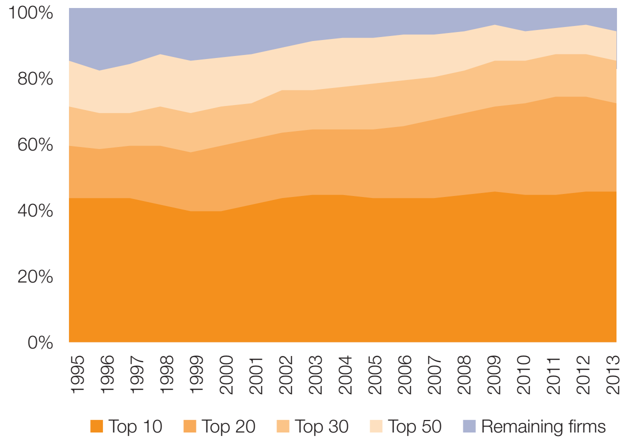
Chart 71: Top ten UK fund operators by retail funds under management



[42] In this context, retail funds 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.

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 72), the composition has changed significantly. Only five companies have remained in the top ten since 1995. The top ten companies in 2013 between them only had 33% of the market in 1995.

Chart 72: Combined market shares of top firms by funds under management (1995–2013)



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 27% between 1995 and 2013. 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 2013. However, the market share of companies outside the top 30 declined substantially, from 29% in 1995 to 14% in 2013.

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 mild concentration and a value of over 1,800 indicates high concentration. The reading at the end of 2013 for the UK fund industry was 308 and it was the same in 2012.

In measuring concentration at the manager level, we have used market shares of funds under management rather than sales. 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 73 shows the net retail sales of the 104 fund operators from whom we collected data in 2013, with positive net retail sales reported by 69 operators. This highlights an important point; whilst industry net sales were positive, only 65% of fund operators actually took money in. These operators reported net retail inflows of £30 billion, offset by outflows of £9.1 billion. This situation marks an improvement on 2012, however, when only 56 out of 106 of reporting managers took in positive net sales amid disappointing market conditions. Total net retail flows were significantly lower in 2012 and more firms suffered as a result.

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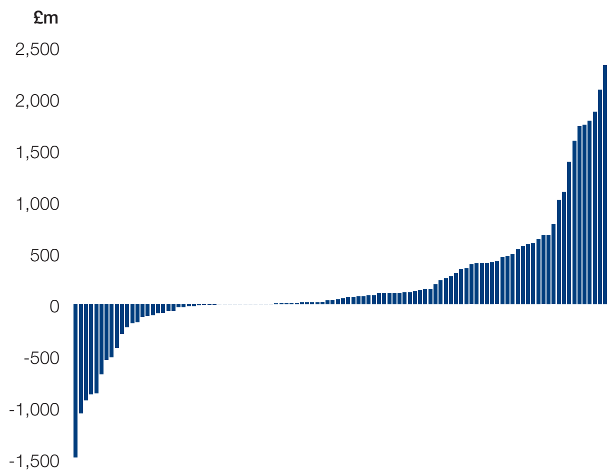
Chart 73: Fund operator net retail sales



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.

One can also look at whether flows into individual funds have become more concentrated in recent years. Chart 74 shows the shares of the top 10, 20, 50 and 100 funds in terms of funds under management and Chart 75 does this in terms of gross retail sales:

- As noted earlier, the IMA collected data on 2,508 funds in 2013. Just ten of these funds accounted for 11% of funds under management, with the top 100 funds taking 41%, which was in line with the figures over most of the last 15 years.
- Fund sales are generally more concentrated than funds under management and, whilst sales are susceptible to intermittently large in or outflows, gross retail sales have generally become less concentrated over the 19 year period shown. The top ten funds took 17% of the gross retail sales in 1995 compared to 11% in 2013, whilst the top 20 funds' share of sales fell from 26% to 18% in the same period. Funds that were ranked from 51 to 100 in terms of sales maintained their share of the market at around 15%.

Chart 74: Combined market share of top funds by funds under management (1995–2013)

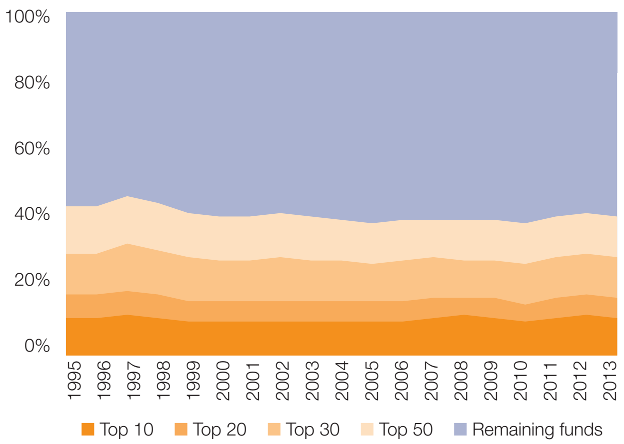
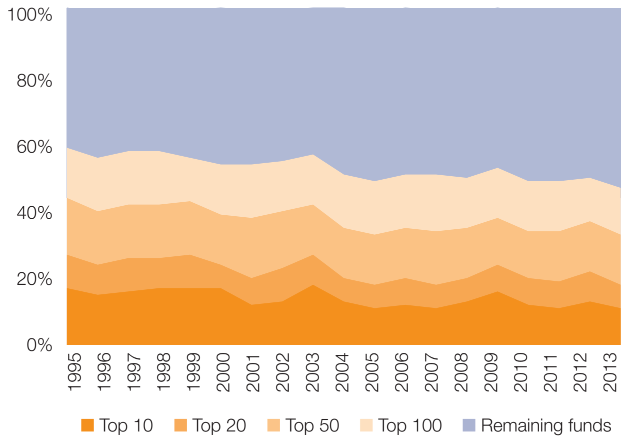


Chart 75: Combined market share of top funds by gross retail sales (1995–2013)



Concentration at asset class level

Considering flows at the asset category and fund type level reveals additional detail about how concentration has changed since 1995. In this section, we look more closely at the equity, fixed income and mixed asset sectors.

As previously stated, the industry was very much equity orientated back in 1995, with equity funds representing 87% of the market in terms of assets. By this time the industry had benefited from strong flows and the robust equity markets of the 1980s and early 1990s, so many equity funds were well established by that point. Chart 76 shows that concentration of flows into equity funds has remained relatively constant since this period. The top ten equity funds represented 18% of total gross retail sales in 2013, compared to 21% in 1995.

It appears that this relatively constant level of concentration is related to the number of products in the market. Chart 76 shows that the number of equity funds reporting data to the IMA remained relatively constant over the period at around 1,200 funds.

Chart 76: Combined market share of top equity funds by gross retail sales (1995–2013)

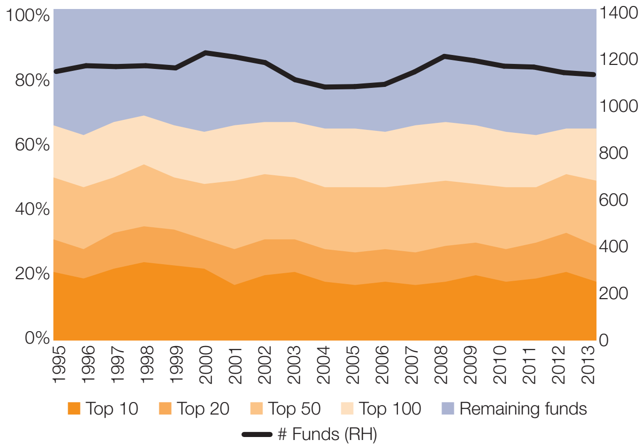
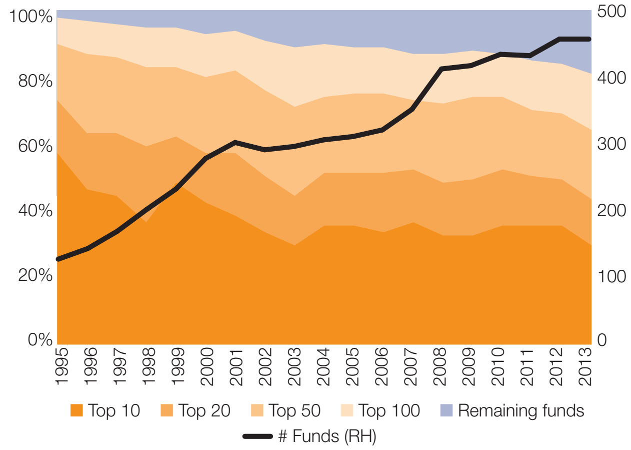
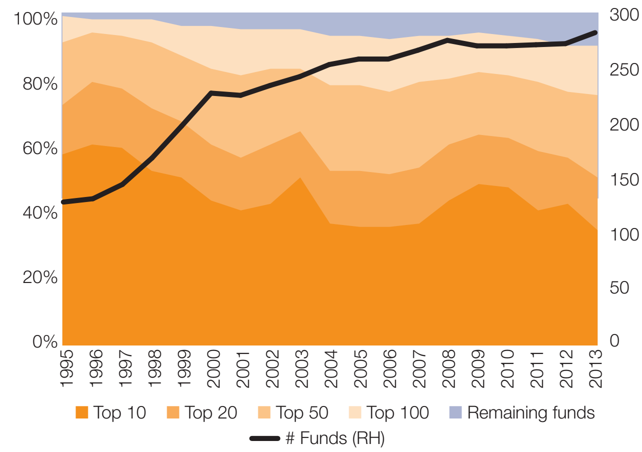


Chart 78: Combined market share of top mixed asset funds by gross retail sales (1995–2013)



In contrast to equity funds, the number and significance of fixed income and mixed asset funds has increased considerably since 1995. In particular, both of these fund types sold well in the aftermath of the dot.com crisis and the credit crisis. Chart 77 and Chart 78 show how the concentration of flows into these fund types has developed over time.

Chart 77: Combined market share of top fixed income funds by gross retail sales (1995–2013)



As more fixed income and mixed asset products became available, concentration fell:

- Historic data shows that 126 fixed income funds reported data to us at the end of 1995 and the top ten of these were attracting 58% of the flows. In 2013, 280 fixed income funds reported funds under management data and the top ten were attracting only 35% of the flows. Concentration did increase outside of the top 20; funds ranked from 21 to 50 in terms of gross retail sales accounted for 19% of flows in 1995 and 25% of flows in 2013.

- The story was similar for mixed asset funds; of the 124 mixed asset funds that reported data in 1995, the top ten attracted 58% of gross retail flows. By the end of 2013, 456 mixed asset funds reported data and the top ten attracted 30% of the flows. Concentration of flows into funds ranked 21 to 50 increased from 17% to 21% over the period.

It is difficult to reach firm conclusions about what factors drive retail investors to direct their money into a finite number of funds. It would make sense, however, that as the number of available funds increased, more competition would dilute total flows as funds vie for business.

Another way to consider the distribution of fund assets is to compare mean and median fund size. We have already shown that the industry is not concentrated, but Table 5 shows that the distribution of fund sizes is highly skewed. At the end of 2013, the average fund size was £339 million but one half of all funds managed less than £90 million.

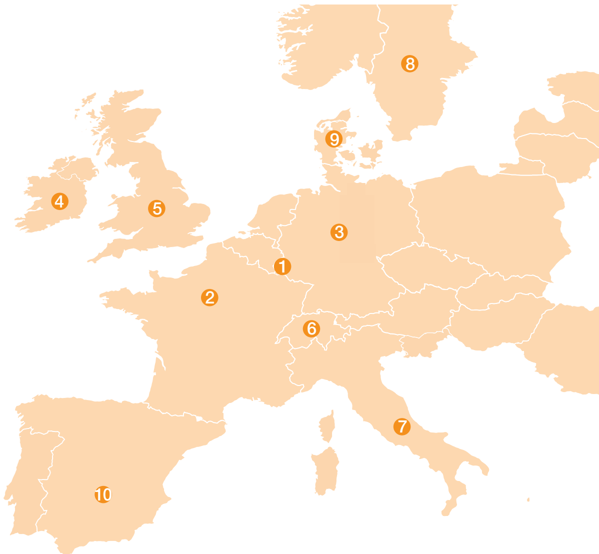
Table 5: Mean and median fund sizes (2004–2013)

Year	No. of funds	Mean (£m)	Median (£m)
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	2,457	260.3	69.4
2011	2,477	255.8	66.3
2012	2,516	289.3	72.9
2013	2,508	338.9	89.5

UK Fund Management in Context

European investment funds under management increased to €9.8 trillion (£8.2 trillion) at the end of 2013, an 8.9% increase on a year earlier. UCITS accounted for 70% of the total and, when considered in isolation, increased 9.3% from the end of 2013 to €6.9 trillion (£5.6 trillion). Since 2007, net assets of European investment funds (including UK) have grown by 22%, which compares to 64% growth on the UK authorised funds industry. These figures translate into an annualised growth rate of 3.4% for European funds and 8.6% for UK funds.

Figure 6: European investment funds by country of domicile (December 2013)



	Country	Net assets (€bn)	Market share
1	Luxembourg	2,615	26.7%
2	France	1,525	15.6%
3	Germany	1,404	14.3%
4	Ireland	1,344	13.7%
5	United Kingdom	1,121	11.4%
6	Switzerland	357	3.6%
7	Italy	209	2.1%
8	Sweden	200	2.0%
9	Denmark	186	1.9%
10	Spain	185	1.9%
	Other	642	6.6%

Source: EFAMA

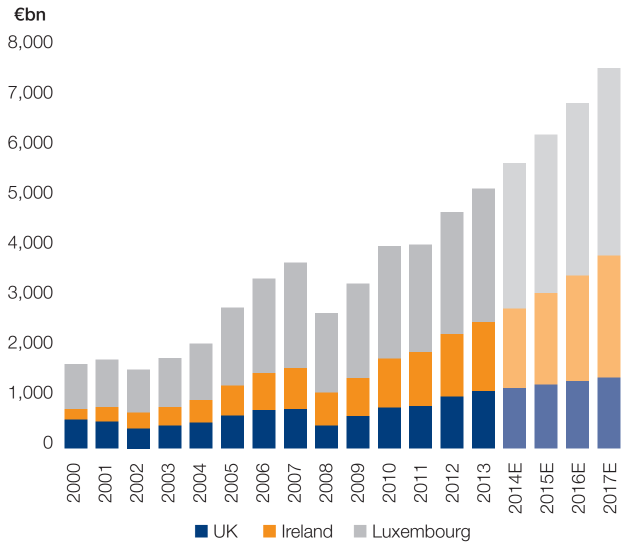
Despite strong growth in the domestic market, the UK continues to be the fifth largest fund domicile in Europe, representing 11% of the total European investment fund industry as at end-2013 (see Figure 6). Including the £775 billion in overseas-domiciled funds whose assets are managed in the UK (see p.19), the total for UK-managed investment funds would increase to £1.5 trillion.

The UK's market share is broadly the same as in 2012 and, in fact, the relative market share of the top five European fund domiciles has remained virtually unchanged over the past four years. As in previous years, Luxembourg has an undisputed first place within the European investment fund industry, followed by France, Germany and Ireland; altogether, these four domiciles account for nearly three-quarters of European funds under management.

Of these four countries, Luxembourg and Ireland stand out as extremely attractive fund domiciles for overseas promoters and, over the past decade, they have grown considerably in the value and number of funds domiciled. As shown in Chart 79, the UK has gradually been overshadowed by Luxembourg and, in recent years, Ireland as a fund domicile. Annual average growth rates of fund assets within these domiciles have been 9% and 15%, respectively, since 2000. In comparison, over the same period, the equivalent annual average growth rate for the UK was only 5%. The growth in Luxembourg and Ireland has been largely driven by successful marketing strategies and favourable regulatory and corporate environments. At this rate of growth, funds domiciled in Ireland and Luxembourg would, by 2017, increase to an estimated total of €6.0 trillion compared with €1.4 trillion for the UK.

In March 2013 the UK Government announced an innovative Investment Management Strategy, designed in part to improve the UK's attractiveness as a fund domicile and to promote it more actively overseas as a global investment management centre.

Chart 79: Fund assets by domicile, UK, Ireland, Luxembourg (2000-2013, projected to 2017)



Source: IMA, EFAMA

By converting the above chart into percentages, we are able to see historical developments in the relative market share of the three domiciles (Chart 80) as a proportion of their combined total funds under management. This shows that, while Luxembourg has maintained a stable 50-55% market share, that of the UK has gradually eroded from 34% in 2000 to just 22% in 2013, while Ireland's has increased from 13% to 26% over the same period. Once again, assuming that these growth rates are sustained going forwards, by 2017, Ireland's share would increase to just over one-third while the UK's proportion would decrease to 18%.

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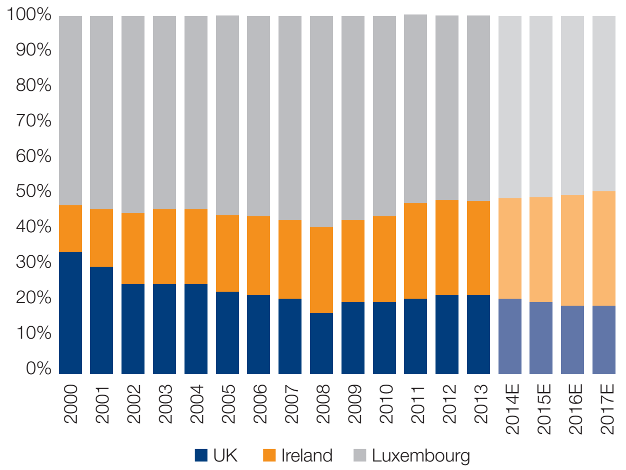
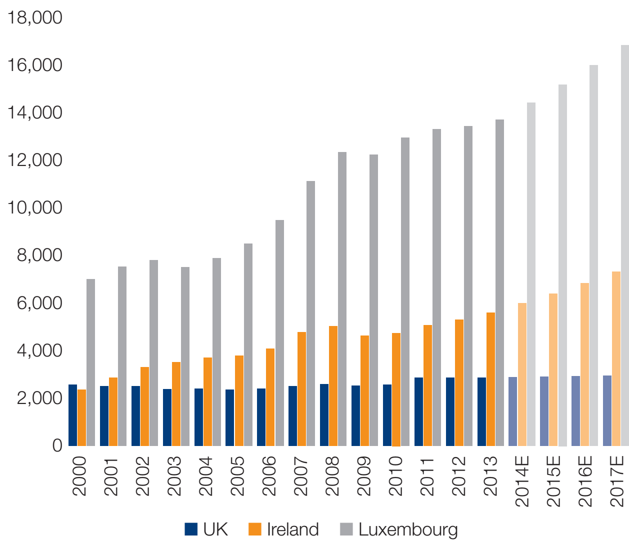
Chart 80: Proportion of fund assets by domicile, UK, Ireland, Luxembourg (2000–2013, projected to 2017)



Source: IMA, EFAMA

Another way to compare the three locations is by the number of funds within each domicile, as shown in Chart 81. This also illustrates the strong growth experienced in Luxembourg and Ireland. In terms of actual fund numbers, the UK has increased by only 0.8%, while Irish funds have increased by 6.9% and Luxembourg by 5.3%.

Chart 81: Total number of funds by domicile, Ireland, Luxembourg, UK (2000–2013, projected to 2017)



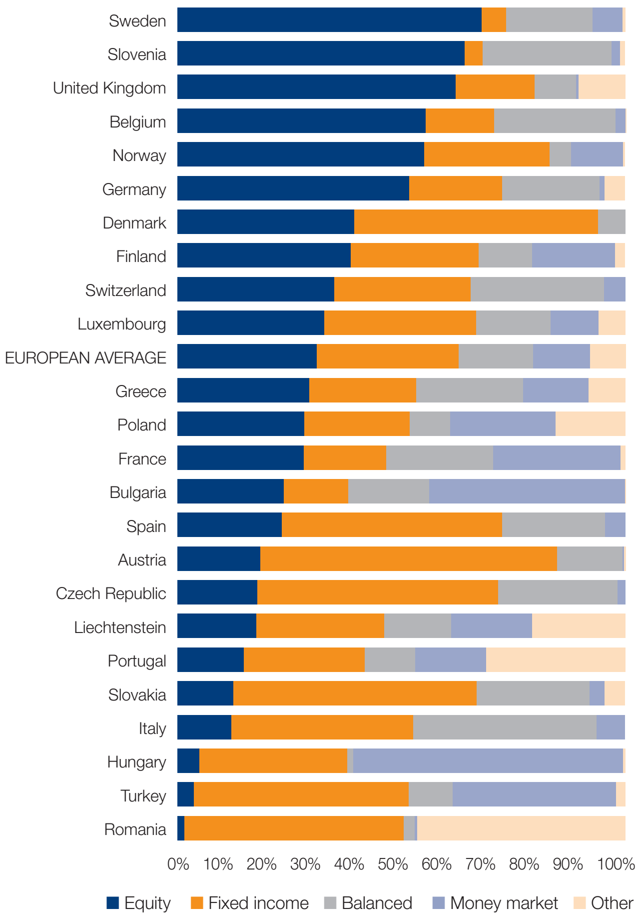
Source: IMA, EFAMA

Considering UK funds in the wider European context reveals some interesting contrasts.

Chart 82 shows the breakdown of funds under management in the major asset categories by fund domicile. As compared to the rest of Europe, equities continue to be popular in 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 62% 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.

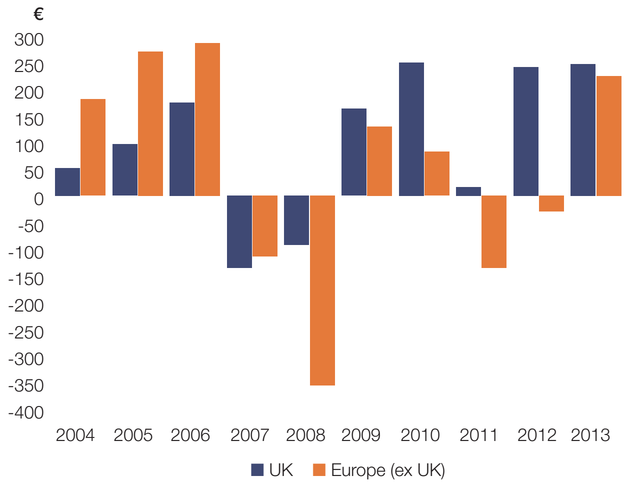
Chart 82: Breakdown of funds under management by fund domicile



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 83 which shows net sales of UCITS equity funds per capita in the UK and in Europe over the last 11 years.

Chart 83: Net sales of equity funds per capita, UK and Europe (ex UK) (2004–2013)



Source: IMA, EFAMA, Eurostat

Both UK and other European investors began to sell equity funds during 2007. The following year, European investors sold equity funds worth €356 (£297) per capita compared with €92 (£77) 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.

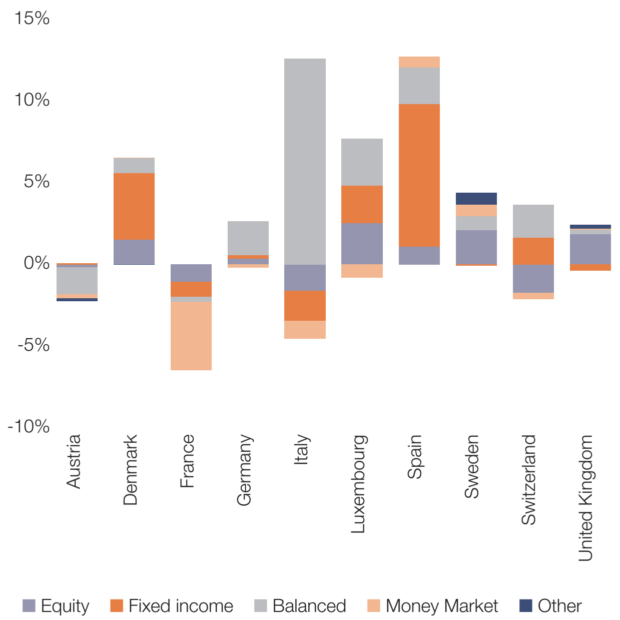
While UK and other European investors returned to net investment in equity funds in 2009 and 2010, UK investors showed greater confidence by adding to their equity fund holdings at a higher rate. Both 2011 and 2012 saw a reversal of this on the part of European investors. However, rallying markets throughout 2013 attracted European equity investors back and, per capita, they invested almost as much as UK investors throughout the year. UK investors bought equity funds worth €247 (£206) per capita compared to the rest of Europe's €225 (£189).

In terms of overall sales, European UCITS experienced net inflows of €229 billion (£191 billion) during 2013, which was higher than the inflow of €196 billion in 2012. Balanced funds and equity funds echoed trends in the UK and both reported strong inflows. They took in €114 billion (£95 billion) and €99 billion (£83 billion) respectively. In contrast to the UK, fixed income also had strong inflows in Europe of €70 billion (£58 billion).

Only one asset class had an outflow; money market lost €84 billion (£70 billion), marking the fifth consecutive year of outflows.

Chart 84 displays net sales of UCITS by asset class for the top ten countries (ranked by the size of their total funds under management), expressed as a percentage of average UCITS assets during 2013.

Chart 84: Net sales of UCITS by asset class as percentage of total UCITS funds under management, selected countries



Source: EFAMA

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 14% 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 but domiciled elsewhere (see p.21).

5 Operational and Structural Issues

Key Findings

Market overview

- Average industry net revenue (including all activity – in-house and third party) increased to 31 basis points (bps) (from a revised 29bps in 2012). This represents 17% growth year-on-year on the absolute revenue value. As a proportion of assets it remains below the pre-crisis level of 32bps (2007).
- Total operating costs have grown by 14% in absolute terms. As a proportion of average assets, this equates to 20bps, almost unchanged from 2012.
- The gross operating margin rose to 34% in 2013, from a revised 32% in 2012.
- Industry contribution in GDP terms rose to 0.8%, continuing the gradual increase over recent years, driven primarily by faster revenue than GDP growth.

Performance-based fees

- The use of performance-based fees decreased to 80% across our respondent base (down from 81% in 2012).
- The share of assets under management subject to performance-fees stood at 13%, accounting for a comparatively small proportion of total assets, as seen in previous years.
- A smaller proportion of respondents than last year stated they use performance-based fees in their retail product range (40%).
- The majority of respondents (83%) stated that they did not think performance fees have increased in prevalence over 2013.

Employment

- Total industry headcount increased by 3.4% to an estimated 31,800 indicating a steady industry growth in the post-crisis years. This is attributed to industry recovery and a more stringent regulatory environment, which has boosted growth across many staff sectors as firms face up to the challenges of greater operational complexity and regulatory compliance requirements.
- Scottish headcount represented around 15% of the total.
- Core functions such as investment management, research and dealing continue to represent the single largest division, with 28% of the headcount (2012: 27%).
- Contrary to previous years, 2013 saw a fall in the proportion of respondents who outsource some part of their business (72%).

Industry concentration

- Overall, the industry remains comparatively unconcentrated. The proportion of assets represented by the top five remained at 35% of the total UK asset base, whilst the top 10 fell slightly to 50%.

Changing ownership

- Over the past decade we saw a surge in the share of assets under management in the UK accounted for by autonomous asset managers, rising from 15% in 2003 to 37% in 2010. This level has remained broadly unchanged thereafter.
- There has also been a gradual but strong growth in the market share of ownership among large diversified financial corporations (notably custodian banks), rising from 7% in 2003 to 15% in 2013.
- Recent M&A activity suggests a complex pattern, with a mixture of trends: the growth of autonomous managers is continuing, amid acquisitions by banks and insurance companies.

Boutiques

- The boutique end of the IMA membership base has been particularly strong, compared to the industry as a whole, with asset growth of 25% in 2013 (compared to 13% for the industry as a whole).

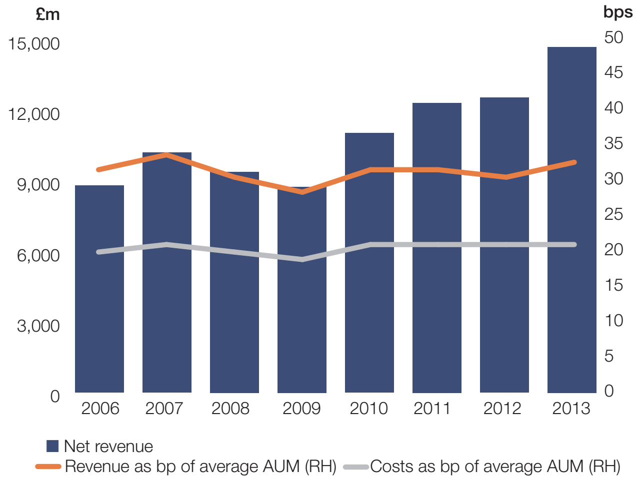
5 Operational and Structural Issues

Revenue and Costs

Total average industry revenue (covering both in-house and third party business) is illustrated in both absolute and relative terms in Chart 85, together with costs:

- Total average industry revenue (net of commission) rose to £15 billion over this period, up from £13 billion in 2012. This represents growth of 17% on a like-for-like basis.
- As a proportion of average assets under management, this accounts for 31bps – up from the revised 29bps in 2012, but lower than the 32bps at the start of the financial crisis in 2007.
- Total operating costs amounted to £9.7 billion (2012: £8.5 billion) which, on a matched basis, is an increase of 14%. As a proportion of average assets under management, the total cost figure accounts for 20bps, almost unchanged from 2012.
- The above data suggest an industry operating margin of 34%, up from a revised 32% in 2012, but below the 37% seen in 2007.[43]

Chart 85: Industry net revenue vs. revenue and costs as percentage of average assets under management (2006–2013)

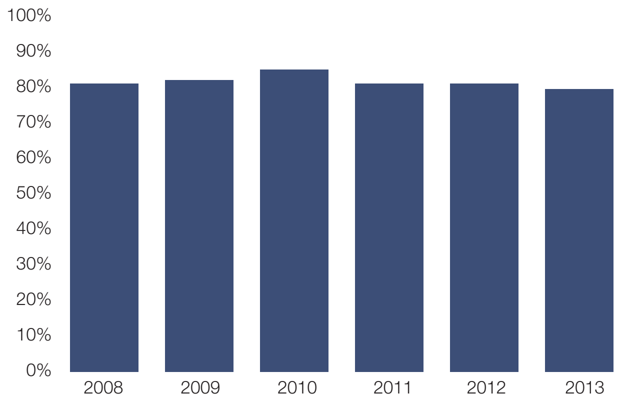


Measuring industry contribution in GDP terms, we estimate that it rose to 0.8% of GDP in 2013 (2012: 0.7%).[44] This continues the gradual increase seen over recent years, driven primarily by faster revenue than GDP growth.

Performance-based Fees

Performance-based fees were used by 80% of respondents. These types of fees continue to account for a comparatively small proportion of total assets. Firms that use performance-based fees do so on average for 20% (2012: 22%) of their assets, suggesting that a total of only 13% (2012: 17%) of industry assets are subject to performance-based fees.

Chart 86: Proportion of respondents using performance-based fees



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

[44] GDP contribution is measured on the basis of a value-added calculation derived from net revenue, adjusting for pass-through into the supply chain to avoid double counting.

Table 6: Proportion of assets under management subject to performance-based fees

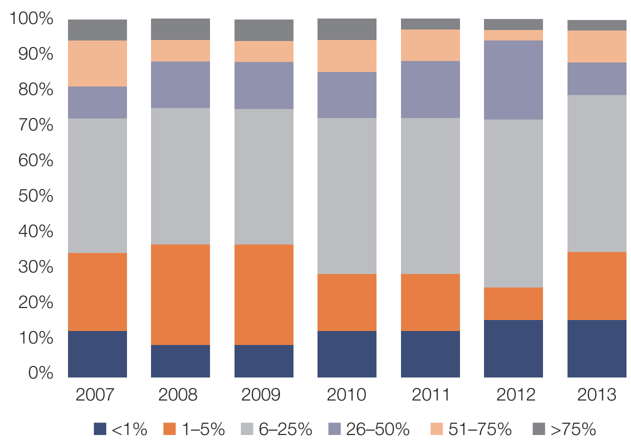
Proportion of assets under management subject to performance-based fees	Percentage of respondents	Total UK assets under management (£bn)	Assets under management subject to performance-based fees (£bn)
0%	20%	224	0
1-5%	24%	1,103	31
6-10%	15%	981	66
11-25%	15%	823	119
26-50%	10%	513	173
>50%	8%	149	93
Total using performance-based fees	**80%**	**3,794**	**483**
Performance-based fee assets under management as percentage of total			**12.7%**

Note: Proportions have been rounded to the nearest whole number for each respondent. 7% of respondents using performance-based fees did not report the proportion of assets relating to them.

Table 6 shows the proportion of assets subject to performance-based fees, and the significant variation between firms is clearly evident. While one-fifth of respondents do not charge performance-based fees at all, around a quarter only use these types of fees on up to 5% of their assets.

Looking at this distribution historically (see Chart 87), one can see that, on a like-for-like basis, performance-based fees are being increasingly used on smaller proportions of assets under management when taken at individual company level and, in fact, this shift has been sustained in the most recent year's data.

Chart 87: Proportion of companies using performance-based fees split by percentage of assets to which such fees apply (2007–2013)



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. A smaller proportion compared with last year – 40% as opposed to 44% in 2012 – also use performance-based fees in their retail product range.

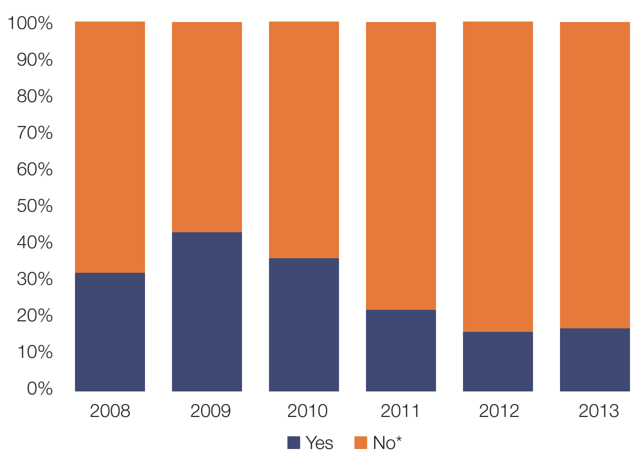
Table 7: Views on the prevalence of performance-based fees

Has the use of performance-based fees in your product range become more prevalent over the past year?	Percentage of respondents	Total UK assets under management	Percentage of assets under management subject to performance-based fees	Assets under management subject to performance-based fees (£bn)
Yes	17%	329	12%	41
No	43%	1,403	12%	167
Same	40%	2,103	11%	226
TOTAL	**100%**	**3,834**		**433**

We also asked respondents whether they thought performance-based fees increased in prevalence over 2013. The overwhelming majority (83%) said that they did not, or that they had remained the same (Table 7), which is broadly similar to the proportion reported in 2012.

Indeed, a look at the historical responses in Chart 88 points to a growing consensus that performance-based fees are becoming less prevalent across the industry; a fact that is supported by the trend towards smaller proportions of assets being subject to these types of fees.

Chart 88: Increase in prevalence of performance-based fees (2008-2013)

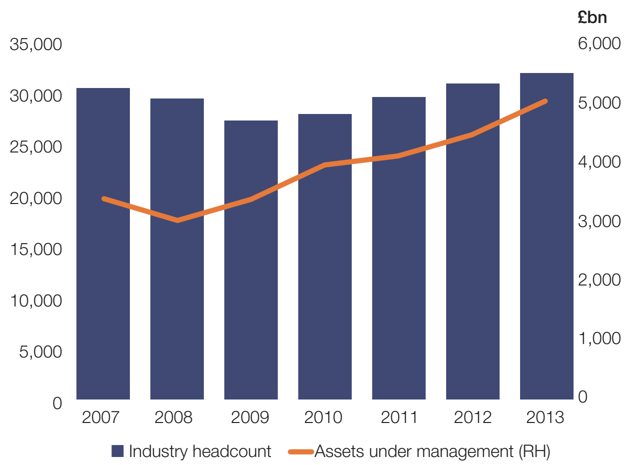


* Since 2011, includes those who answered 'Same'

Employment

Direct industry headcount increased by 3.4% on a matched basis to a total of 31,800, as the industry continues to steadily expand in line with the asset growth post-crisis. Historical data of both the headcount and assets under management is depicted in Chart 89, which shows a continuation of the recovery after the significant retrenchment in 2008 and 2009.

Chart 89: Industry headcount estimate vs. UK assets under management (2007–2013)



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Scottish headcount represented around 15% of the total, unchanged from a year earlier. 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.

The factors behind the headcount growth in 2013 are not solely down to industry recovery. There is also evidence to suggest that the regulatory environment, on a national, regional and global level, has boosted growth across many staff sectors as firms face up to the challenges of greater operational complexity and regulatory compliance requirements.

A breakdown by staff segment as a proportion of the total headcount is given in Table 8, and this shows that core functions such as investment management, research and dealing continue to represent the single largest division, with 28% share of the headcount (2012: 27%). Business development and client services account for the second largest staff segment (20%), closely followed by operations and fund administration (18%) – both categories exactly in line with their proportions in 2012.

Meanwhile, IT services fell slightly by one percentage point to 12% and compliance, legal and audit remained almost static at 7%. This latter category also includes 'risk', which was included for the first time last year, and this sub-category, as a proportion of compliance, legal and audit, increased to 31% from the 26% recorded in 2012.

The 'other sector' is 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 2013, this category represented 6.0% of the total headcount – an increase of one percentage point on last year's total.

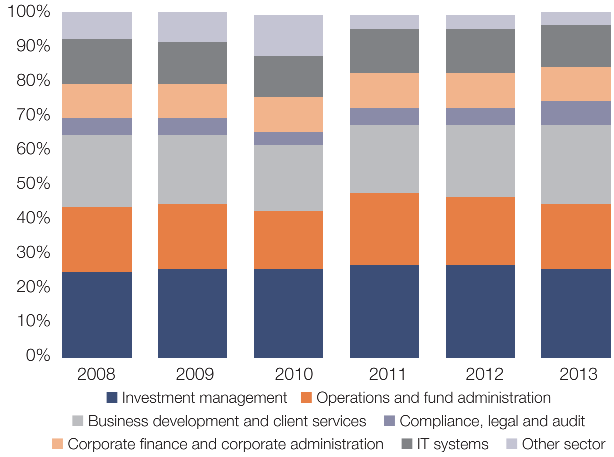
Table 8: Distribution of staff by activity (direct employment)

Activity	Percentage of total headcount
Investment management *of which:*	**28%**
Investment management (asset allocation and stock selection)	68%
Research, analysis	25%
Dealing	7%
Operations and fund administration *of which:*	**18%**
Investment transaction processing, settlement, asset servicing	33%
Investment accounting, performance measurement, client reporting	39%
Other fund administration (incl. CIS transfer agency, ISA administration etc.)	29%
Business development and client services *of which:*	**20%**
Marketing, sales, business development	70%
Client services	30%
Compliance, legal and audit *of which:*	**7%**
Compliance	40%
Risk	31%
Legal	22%
Internal audit	7%
Corporate finance and corporate administration *of which:*	**10%**
Corporate finance	44%
HR, training	22%
Other corporate administration	33%
IT systems	**12%**
Other sector	**6%**

We can see the historical evolution of the distribution of employment by staff segment in Chart 90. The largest increase, on a matched basis, has been in the Compliance, Legal and Audit function, which has registered an increase of 48% since 2008. However, the vast majority of this increase is attributable to the last 12 months alone, since the 2013 total has gone up by 40% relative to that reported in 2012. This is not altogether surprising given the incorporation of the 'risk' function in this category within the IMA questionnaire, which will likely have accentuated the growth due to the huge emphasis on this across a number of business areas.

Business Development and Client Services recorded the second largest increase over the past five years, increasing as it did by 8% from the figure reported in 2008. Investment Management grew by 4% and Corporate Finance and Corporate Administration grew by 5%. Operations and Fund Administration and IT Systems actually shrunk in relative terms compared with their respective share of the total six years ago.

Chart 90: Direct employment by staff segment (2008–2013)



An estimation of total industry headcount is difficult due to a large proportion of firms taking advantage of outsourcing. At the end of 2013, 72% of our respondents outsourced some part of their business, a proportion that has been growing slightly over recent years but has seen a fall in the most recent period (see Table 9). It is too soon to draw any conclusions regarding the latest set of figures.

Table 9: Proportion of respondents outsourcing part of their activity (2007–2013)

	2007	2008	2009	2010	2011	2012	2013
Proportion of firms outsourcing part of their activity	74%	74%	75%	76%	78%	79%	72%

5

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 half of our respondents and most of them do so entirely. While the majority of firms seem to outsource these functions within the UK, a small number of respondents delegate them to companies based in Ireland.

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

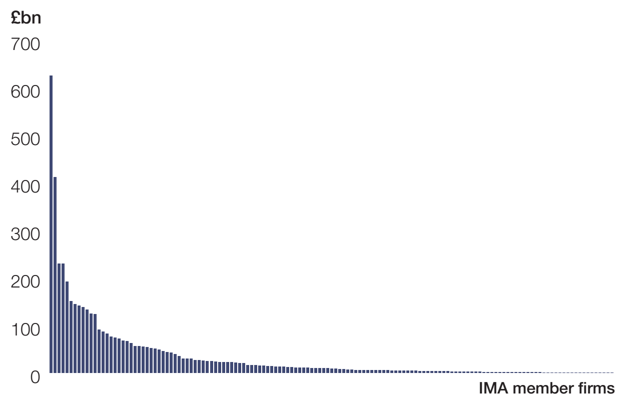
As noted in previous years, outsourcing does not seem to depend on firm size and is typically undertaken by specialist third party administrators or other asset management firms offering such services.

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 competitive industry (see Chart 91).

With average assets under management of £34 billion as at June 2013 (June 2012: £29 billion), the median stood at £9.2 billion (June 2012: £6.6 billion).

Chart 91: Firm ranking by UK assets under management (June 2013)



In Table 10, we can see the composition of IMA member firms based on the size of their assets under management. The breakdown remains broadly similar to that of 2012, but the largest year-on-year difference was registered for firms of less than £1 billion in assets, decreasing to 18 as at June 2013 (June 2012: 23).

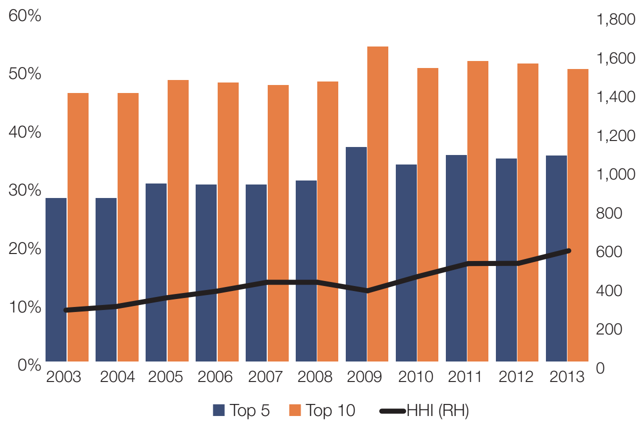
Table 10: Assets managed in the UK by IMA firm size[45]

Assets under management	No. of firms (Jun 2013)	Survey respondents (Dec 2013)
>£100 billion	12	13
£50-100 billion	15	12
£25-50 billion	13	9
£15-25 billion	14	8
£1-15 billion	69	22
<£1 billion	18	2
TOTAL	**141**	**66**

The level of industry concentration as measured by the HHI stood at 420, broadly similar to the revised figure of 418 in 2012 (see Chart 92).

With regards to the market share of the largest firms, the top five remained at 35% of the total UK asset base, whilst the share of assets of the top 10 largest firms fell slightly to 50% (2012: 35% and 51%, respectively).

Chart 92: Market share of largest firms by UK assets under management vs. HHI (June 2003–2013)



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

Chart 93: Top ten firms by UK and global assets under management (December 2013)

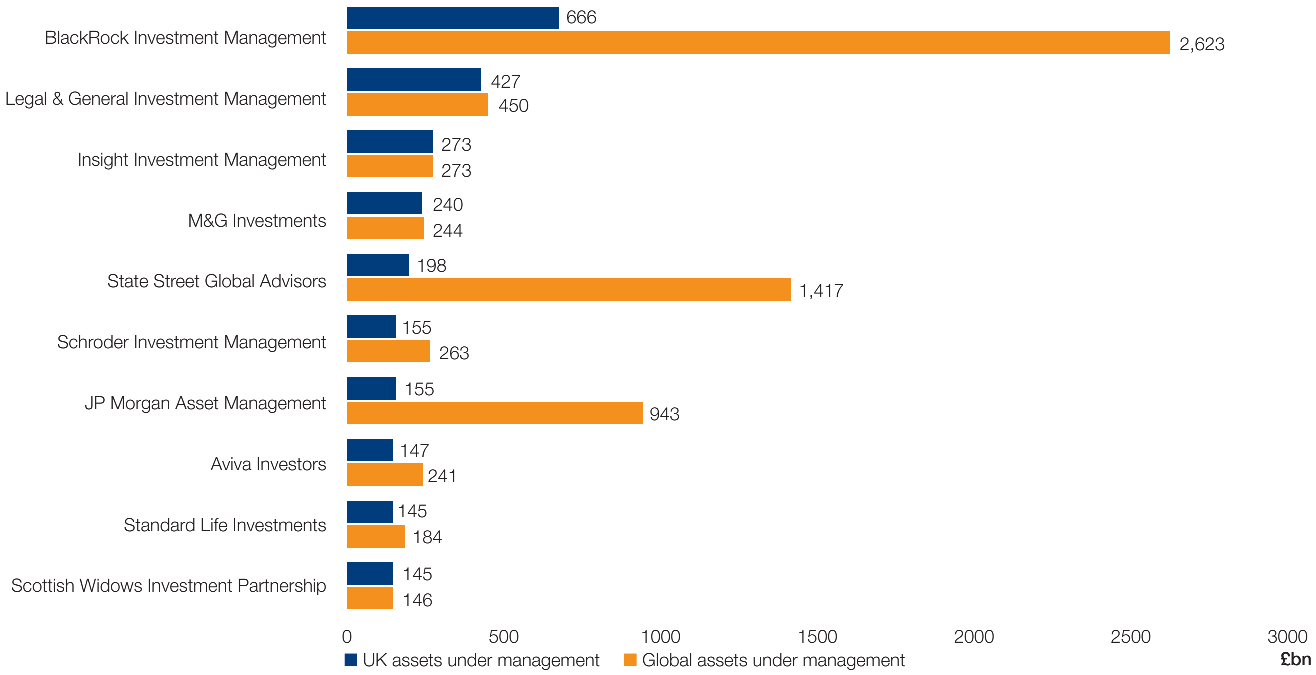


Chart 93 lists the ten largest firms, as measured by UK assets under management.[46] The top ten firms demonstrate a wide range of characteristics. Some are independent and others are bank- or insurance-owned. Some are UK headquartered with a limited global footprint whilst others combine a global reach with their UK presence.

In addition, several of the top ten are leading players in the indexing market, but others are primarily active managers.

Boutiques

Compared with previous years, the growth of the boutique end of the IMA membership has, been particularly strong (25%), compared to the industry as a whole (13%). This counters last year's finding, which suggested a more challenging commercial and operating environment for smaller players, which is now also increasingly coupled with growing regulatory burdens.

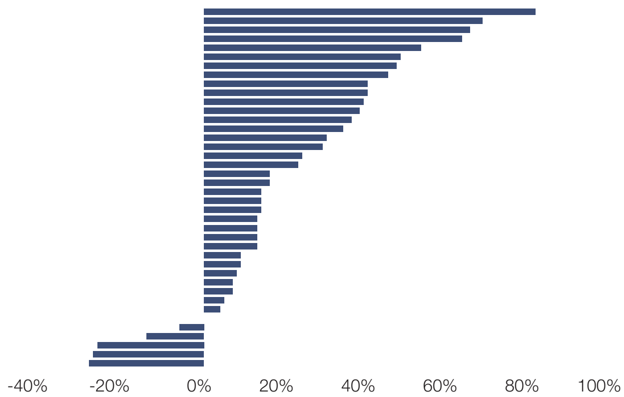
We broadly define boutique firms as having the following characteristics:

- UK assets under management of less than £5 billion
- Independent ownership
- A degree of specialisation
- Self-definition

[46] Comparison is complicated in this area by differing calculation methodologies. The IMA publishes this ranking table on the basis of headline data supplied by members in response to its Survey questionnaire.

The IMA membership base included 40 such firms as at June 2013. As shown in Chart 94, performance varied considerably between firms, with the top performing firm growing its assets by over 80% year-on-year but the worst experiencing declines of around 30%.

Chart 94: Percentage change in UK-managed assets across boutique IMA members (2012–2013)

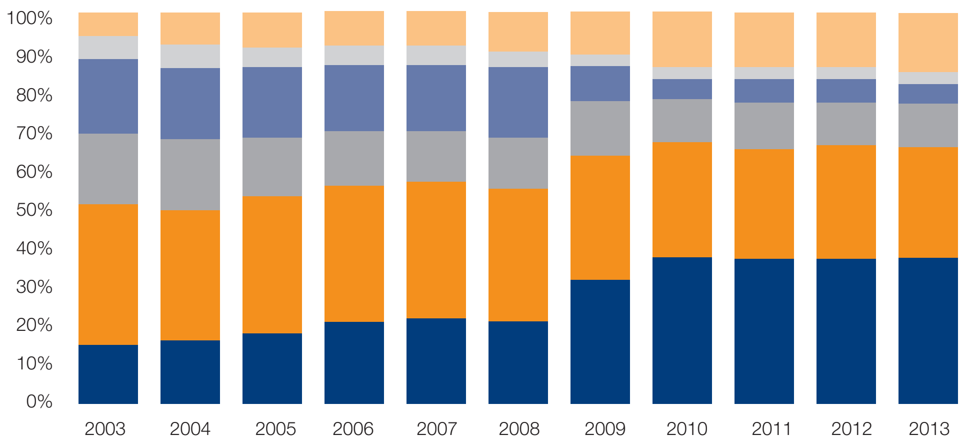


Changing Ownership

We continue to track the market share of UK assets under management by the type of parent group (see Chart 95).

The past decade has seen significant growth among autonomous asset managers, up from 15% in 2003 to 37% in 2010, and has been broadly unchanged since then (2013: 37%). Insurance companies and banking groups (both investment and retail) have shrunk from 36% and 37% to 28% and 17%, respectively since 2003.

Chart 95: Breakdown of UK assets under management by parent type (2003–2013)



	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Asset / Fund manager	15%	16%	18%	21%	22%	21%	32%	37%	37%	37%	37%
Insurance company	36%	33%	35%	35%	35%	34%	32%	29%	28%	29%	28%
Investment bank	18%	18%	15%	14%	13%	13%	14%	11%	12%	11%	11%
Retail bank	19%	18%	18%	17%	17%	18%	9%	5%	6%	6%	5%
Pension fund manager	6%	6%	5%	5%	5%	4%	3%	3%	3%	3%	3%
Other (incl. custodian banks)	6%	8%	9%	9%	9%	10%	11%	14%	14%	14%	15%

What we now see emerging is a far more independent asset management industry, less characterised than it has been in the past by large in-house investment management companies owned by banks and insurance companies. The drivers of this have been both structural and responses to particular circumstances, ie:

- The structural shift relates to the changing nature of the asset management industry, which is now much more clearly defined as a discipline in its own right as opposed to a part of another financial services product set (for example, the shift to unit-linked policies in the insurance industry partly reflects this).
- The experience of the global financial crisis led to some significant divestment of asset management arms by banks, both as a result of immediate capital needs and broader strategic refocusing.

The 2013 data does not include the Aberdeen acquisition of Scottish Widows Investment Partnership (SWIP), which completed in Spring 2014. While this would increase the share of independent asset managers further, this is not a one-way direction of travel (eg. the Bank of Montreal and F&C deal). Equally, there are signs of consolidation within the insurance-owned space, for example the deal between Royal London and the Cooperative.

A notable parallel development over the past ten years has been the gradual but strong growth in the share of ownership among large diversified financial corporations, notably custodian banks, that we categorise in 'other' (increasing from 6% in 2003 to 15% in 2013).

The M&A activity of the last 12-18 months underscores other significant aspects of UK asset management activity:

- On-going internationalisation, both with respect to manufacturing and distribution capability
- 'Bolting on' of specific capabilities rather than pursuing new capability through internal growth
- Diversification of capability beyond traditional asset classes
- Consolidation within the wealth management part of the wider asset management industry

Table 11: Notable M&A deals in the UK asset management sector (2009–July 2014)

Year	Acquirer	Purchase
2013-14	Aberdeen	Artio Global Investors
		Scottish Widows Investment Partnership
	Aviva	Solar portfolio from Ecovision Renewable Energy
	Barings	SEI Asset Korea (SEIAK)
	BlackRock	Credit Suisse ETF Business
	Bank of Montreal	F&C
	Henderson	H3 Global Advisers
		Northern Pines Capital (50%)
		90 West (33%)
	Liontrust	North Investment Partners
	Miton	PSigma
	PSigma	Axa Framlington private client business
	Royal London	Co-Operative (Insurance and asset management businesses)
	Schroders	Cazenove Capital Management
		STW Fixed Income
	Standard Life Wealth	Private client division of Newton
2012	Brooks Macdonald	Spearpoint
	Bridgepoint & Quilter	Quilter (MBO)
	Broadstone	UBS Wealth corporatepension arm
	Franklin Templeton	K2 Advisors
	Goldman Sachs	Dwight
	Insight	Pareto
	Legg Mason	Fouchier Partners
	Liontrust	Walker Crips
	Natixis	McDonnell
	Punter Southall	PSigma
	Rathbone	Taylor Young
2011	BT Investment Management	JO Hambro
	Close Investment Management	Cavanagh Wealth Management
	Close	Allenbridge Group
	Cyrun Finance	SVM Asset Management
	Franklin Templeton	Rensburg
	Henderson	Gartmore
	Investec	Evolution
	Liontrust	Occam
	Principal	Origin (74%)
	Punter Southall	Brewin Dolphin's corporate pensions arm
	Royal London	Royal Liver
	SGBP Hambros	Barings (private client arm)
	Threadneedle	Liverpool Victoria
	Williams de Broe	BNP Paribas' private client business

Year	Acquirer	Purchase
2010	Aberdeen	RBS multi-manager and alternatives business
	Alpha Real Capital	Close Brothers property fund management business
	AMG	Artemis
	Aviva Investors	River Road
	Close	Chartwell Group
	F&C	Thames River Capital
	Investec	Rensburg Sheppards
	Man Group	GLG Partners
	Marlborough	SunLife Financial of Canada's funds
	Schroders	RWC Partners (49%)
	State Street	Bank of Ireland
2009	BlackRock	BGI
	BNP Paribas	Fortis
	BNY Mellon	Insight
	Henderson	New Star
	Ignis	Axial
	Invesco	Morgan Stanley retail fund business
	Marlborough	Apollo
	Neuberger Berman Group	Management buyout of Lehman asset management business
	Rathbone	Lloyds' RBS PMS client portfolio and two private client portfolios
	Sumitomo Trust	Nikko

APPENDICES

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

	TOTAL
Assets under management in the UK (£m)	**5,041,853**
Segregated or pooled (%)	
Directly invested on a segregated basis	**56.2%**
Managed on a pooled basis	**43.8%**
Active or passive (%)	
Actively managed	**77.7%**
Passively managed	**22.3%**
Asset allocation (%)	
Equities *of which:*	**45.9%**
UK	30.6%
Europe (ex UK)	22.8%
North America	18.9%
Pacific (ex Japan)	8.9%
Japan	5.0%
Emerging market	11.6%
Other	2.1%
Fixed income[2] *of which:*	**33.9%**
UK government (ex index-linked)	18.8%
£ corporate	25.2%
UK index-linked	14.9%
Other UK	3.5%
Overseas	37.7%
Cash/Money market	**6.4%**
Property	**2.6%**
Other	**11.1%**

[1] This includes all assets under management by IMA member firms in this country, regardless of where clients or funds are domiciled. Caution should be used in undertaking direct year-on-year comparisons with previous surveys. 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 over-state the value of these securities held.

INSTITUTIONAL								ALL INSTITUTIONAL	RETAIL	PRIVATE CLIENT
Pension fund	Public sector	Corporate	Non-profit	Sub-advisory	In-house insurance	Third party insurance	Other institutional			
1,831,841	353,501	145,169	57,914	146,796	816,188	212,350	394,423	3,958,183	998,626	85,044
36.3%	7.0%	2.9%	1.1%	2.9%	16.2%	4.2%	7.8%	78.5%	19.8%	1.7%

Appendices

Appendix Two: Summary of the UK Institutional client market[1 2]

	TOTAL
Total UK institutional client market (£m)	**2,644,944**
Segregated or pooled Institutional Assets (%)	
Assets directly invested on a segregated basis	61.0%
Managed on a pooled basis	39.0%
Active or passive (%)	
Actively managed	74.5%
Passively managed	25.5%
Multi-asset, LDI or specialist (%)	
Multi-asset	**12.6%**
LDI	**19.2%**
Single-asset (specialist) *of which:*	**68.2%**
Equities *of which:*	**40.3%**
UK	28.6%
European ex UK	7.7%
North America	8.1%
Asia-Pacific	3.9%
Japan	2.8%
Emerging market	4.0%
Global	36.5%
Other	8.5%
Fixed income *of which:*	**41.1%**
£ corporate	32.1%
£ corporate and government	13.7%
UK government (ex index-linked)	15.4%
UK index-linked	14.8%
Global	12.1%
Other	11.9%
Cash/Money market	**9.1%**
Property	**4.9%**
Other	**4.5%**

[1] This includes UK institutional client mandates, regardless of where assets are managed.

[2] Third party institutional business is defined here as total UK institutional business minus in-house insurance and in-house managed OPS assets. We do not have additional granularity.

Pension funds			Public sector	Corporate	Non-profit	Sub-advisory	In-house insurance	Third party insurance	Other institutional
Corporate	Local government	Other							
1,099,869	187,931	65,611	19,437	84,070	38,328	103,976	660,846	185,174	199,701
41.6%	7.1%	2.5%	0.7%	3.2%	1.4%	3.9%	25.0%	7.0%	7.6%
57.2%	56.9%	18.7%	75.9%	38.1%	65.0%	94.9%	79.1%	82.9%	23.3%
42.8%	43.1%	81.3%	24.1%	61.9%	35.0%	5.1%	20.9%	17.1%	76.7%
62.9%	63.0%	62.6%	79.0%	80.4%	82.2%	51.3%	96.9%	76.1%	84.9%
37.1%	37.0%	37.4%	21.0%	19.6%	17.8%	48.7%	3.1%	23.9%	15.1%
8.8%	**6.9%**	**10.2%**	**4.0%**	**8.3%**	**50.9%**	**4.6%**	**19.5%**	**19.2%**	**9.7%**
32.9%	**20.6%**	**10.9%**	**0.0%**	**0.4%**	**0.0%**	**1.1%**	**2.7%**	**11.1%**	**6.3%**
58.3%	**72.5%**	**78.9%**	**96.0%**	**91.3%**	**49.1%**	**94.3%**	**77.8%**	**69.7%**	**83.9%**
46.0%	**70.3%**	**53.6%**	**64.5%**	**35.7%**	**59.2%**	**62.5%**	**21.1%**	**20.9%**	**35.0%**
22.6%	26.0%	20.1%	0.0%	37.3%	30.0%	35.6%	62.8%	32.2%	35.7%
7.3%	8.0%	3.1%	50.1%	5.6%	1.8%	10.0%	6.5%	9.7%	5.9%
8.1%	11.9%	3.8%	0.0%	1.7%	1.4%	4.4%	13.0%	6.6%	6.4%
2.7%	2.7%	1.5%	0.0%	0.8%	4.3%	8.9%	5.3%	5.6%	9.1%
3.6%	2.9%	3.2%	0.0%	0.6%	1.8%	1.8%	1.1%	2.0%	1.8%
4.1%	3.5%	3.4%	15.9%	2.8%	4.4%	2.1%	2.5%	5.0%	5.3%
41.5%	40.1%	56.4%	30.7%	46.7%	50.7%	30.4%	7.1%	29.0%	21.8%
10.1%	4.9%	8.5%	3.3%	4.5%	5.6%	6.8%	1.6%	9.9%	13.9%
45.3%	**18.1%**	**18.0%**	**14.5%**	**7.8%**	**6.8%**	**18.0%**	**59.9%**	**62.2%**	**17.6%**
31.9%	19.5%	28.8%	4.2%	26.0%	29.4%	11.9%	26.7%	53.0%	28.5%
9.1%	16.3%	10.5%	2.7%	8.5%	38.5%	15.1%	24.4%	11.9%	13.0%
13.2%	11.3%	11.1%	4.3%	30.8%	16.3%	3.3%	20.6%	7.9%	39.2%
21.0%	24.9%	26.5%	17.2%	3.5%	0.7%	18.0%	6.1%	3.8%	9.3%
15.2%	19.1%	17.5%	34.7%	18.0%	1.8%	34.0%	5.4%	8.6%	3.5%
9.6%	8.9%	5.6%	36.9%	13.2%	13.3%	17.6%	16.9%	14.7%	6.6%
1.4%	**0.4%**	**25.4%**	**19.7%**	**44.3%**	**17.8%**	**0.9%**	**9.9%**	**5.0%**	**34.6%**
3.3%	**4.8%**	**2.2%**	**0.0%**	**10.4%**	**4.6%**	**2.4%**	**8.0%**	**3.6%**	**6.3%**
4.0%	**6.4%**	**0.8%**	**1.3%**	**1.8%**	**11.6%**	**16.2%**	**1.1%**	**8.4%**	**6.6%**

Appendices

Appendix Three:
Overview of Key EU and UK Regulatory Developments Affecting Asset Management

Regulators	
Transition from the FSA into the FCA and the PRA	■ Following consultation, discussion and lobbying in 2012, the split was completed on 1 April 2013. ■ The PRA has responsibility for prudential regulation of systemically important firms (mainly banks and insurers) while the FCA regulates markets and conduct. ■ Most IMA firms are regulated solely by the FCA, although some are part of PRA regulatory groups.
Regulatory focus on asset management sector	■ As set out by Martin Wheatley (Chief Executive of the FCA) in September 2012, the FCA's continued focus areas for the asset management sector are charging, competition, and understanding customers. The review of how dealing commission is used to pay for research has been a major theme, alongside guidance on the use of inducements.
ESMA	■ ESMA, and European Supervisory Authorities (ESAs) in general, are growing in resources, responsibilities and workload as part adopting a more direct role in regulation. ■ November 2012, the UK launched a legal case against the discretionary powers of ESMA under the Meroni principle. The judgment on the case was published on 22 January 2014 and the UK lost.

Capital markets and investments	
CSDR	■ After negotiation in 2013, the CSDR is expected to become law in 2014 for implementation in 2015. ■ For the most part it seeks to harmonise the regulation and supervision of Central Securities Depositaries in Europe. ■ Significantly, it will also harmonise securities settlement practices, in particular: ◆ The maximum settlement cycle (at T+2) for trades executed on-exchange; and ◆ Settlement discipline regimes, both to encourage timely settlement and to address settlement failures.
EMIR	■ After substantial consultation in 2012, many rules came into force in March and September 2013, principally imposing mandatory risk mitigation obligations in relation to uncleared OTC derivatives contracts. ■ During 2014 will be obligations to report all derivatives contracts (exchange-traded and OTC) to a registered trade repository, followed in 2015 by the mandatory central clearing of certain OTC contracts and bilateral margin requirements for those that are not cleared.

Capital markets and investments *(continued)*	
MiFID II	■ Negotiated through 2013, and now to go live on 2 January 2017, this package will amend the 2004 MiFID I, implementing numerous changes to the regulation of financial services firms and markets. ■ Consumer protection: ◆ Independent advisors and portfolio managers are not allowed to retain any third party payments any more. ◆ Investors will receive at least annually information on the aggregated cost of their investment. ◆ When issuing or manufacturing financial products the issuer will have to define a target market for each product. ◆ National supervisors or ESMA will be able to ban or suspend financial activity. ■ All commodity derivatives that do not qualify as hedges for commercial activities will be subject to position limits. Derivatives related to electricity and gas supply are exempted, provided that they are exclusively physically settled, are traded in the new organised trading facilities, and are held up to maturity by end-users. Oil- and coal-related derivatives are not exempted but benefit from a temporary exemption from EMIR CCP clearing and bilateral risk management provisions. ■ High frequency trading: ◆ A tick size regime will be introduced for trading venues. The details of the tick size regime will be developed by ESMA ◆ Trades which were executed by algorithmic trading will have to be marked as such and be disclosed to the market participants. ◆ Trading venues will have to take the order to trade ratio into account in their fees. Traders placing a large number in orders just to cancel them within a short period and who therefore have a high order to trade ratio will have to pay higher fees in the future. ■ All derivatives that are required, under EMIR, to be cleared through a CCP will now also be subject to the obligation to trade them on a MiFID trading venue as a limitation on OTC transactions. ■ Implementation is foreseen for 2017.
MAD II	■ Issued by the Commission in October 2011, the proposals replace the 2003 MAD with a Regulation and a Directive. ■ Lobbying targeted numerous issues including the nature of inside information, Chinese walls and exemptions/'safe harbours' from the abuse regime and obtained improved near final text by the end of 2013. ■ The Commission sent a mandate to ESMA for advice on delegated acts in October 2013. ESMA issued a Discussion Paper in November 2013 to which IMA responded. ■ ESMA issued two consultation papers in July 2014 on technical advice to the Commission for its delegated advice and draft technical standards. ■ The MAD II package will be implemented on 2 January 2017 in line with MiFID II.

Capital markets and investments *(continued)*	
LIBOR	■ Following the Wheatley Review, IOSCO consultation and work by ESMA in 2012, there is a continued move to regulating indices and their use. ■ The British Bankers' Association (BBA) transferred responsibility for LIBOR in 2013, with regulatory oversight given to the FCA. ■ FCA now regulating LIBOR as a significant benchmark.
Solvency II	■ Implementation on 1 January 2016, with lots of preparatory work by asset managers during 2013. SII imposes capital requirements, as well as quantitative and qualitative requirements for risk management and governance, and market disclosure on insurance companies. ■ It has implications for asset managers in terms of disclosure requirements (line-by-line security), service-level agreements and NDAs (possible IP issues), as well as possible implications for asset allocation should capital charges be considered too high by insurance clients for a particular asset class.

Funds and distribution	
PRIIPs	■ The Council of Ministers and European Parliament discussed during 2013 and agreed in April 2014 a regulation to improve market transparency for retail investors across Europe through the establishment of a Key Information Document (KID) for packaged retail and insurance-based investment products (PRIIPs). ■ The UCITS Key Investor Information Document (KIID) will remain for authorised funds for at least five years after the regulation comes into force.
UCITS V	■ UCITS V, which covers management company remuneration policy, depositary requirements and provisions relating to regulatory sanctions, was deleted (in April 2013) and agreed by the Council of Ministers and the European Parliament. The next step is publication in the EU Official Journal. Member States will then have 18 months to transpose UCITS V into national law and regulation.
RDR	■ Following on from the adviser charging rules, which have been in force since 31 December 2012, new FCA rules covering payments to platform service providers came into force from 6 April 2014. ■ These new rules contain a general prohibition on payments from product providers to platform service providers and on the payment of cash rebates to consumers through platforms. ■ The prohibition applies to both advised and non-advised business. ■ Certain specified charges can still be paid for by product providers. ■ Although the payment of cash rebates to consumers through platforms is banned, consumers can still be paid rebates in the form of extra units. ■ Following a thematic review of payments from product providers to advisory firms, the FCA issued
NMPIs	■ New rules governing the promotion of unregulated collective investment schemes and close substitutes (together non-mainstream pooled investments – NMPIs) came into force from 1 January 2014. ■ The new rules change the financial promotion rules to limit the type of customer to whom these products can be promoted, removing the possibility of promoting certain categories of product to retail clients altogether.

Funds and distribution *(continued)*	
AIFMD	■ The Directive and related Regulation must be implemented by Member States by July 2013. ■ 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 NURS, QIS, unauthorised unit trusts (UUTs), 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 AIF 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. ■ In November 2013, ESMA issued its guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD. ESMA also issued its opinion on the collection of information for the effective monitoring of systemic risk under Article 24(5), first sub-paragraph, of the AIFMD and related IT technical guidance and templates.
Venture Capital Funds and Social Entrepreneurship Funds	■ These two new EU fund regimes were implemented in 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. ■ To use the EuSEF label for a fund, the manager will have to demonstrate that a high percentage of investments in the fund (70% of the capital received from investors) is invested in undertakings whose primary objective is to achieve measurable, positive social impacts. ■ To use the EuVECA label for a fund the manager will have to demonstrate that a high percentage of investments in the fund (70% of the capital received from investors) is invested in small and medium sized enterprises. If the funds comply with the above 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.
European Long-Term Investment Funds (ELTIFs)	■ In July 2013 the Commission issued legislative proposals for a subset of AIF 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. ■ Trilogues will start once the new European Parliament is in place and once the Council has voted on its position.

Funds and distribution *(continued)*	
Money Market Funds	■ Commission proposals for Money Market Funds issued in September 2013. ■ The proposed Regulation requires: ◆ Certain levels of daily/weekly liquidity in order for the MMF to be able to satisfy investor redemptions; ◆ Clear labelling on whether the fund is a short-term MMF or a standard one; ◆ A capital cushion (the 3% buffer) for constant NAV funds that can be activated to support stable redemptions in times of decreasing value of the MMFs' investment assets; ◆ Customer profiling policies to help anticipate large redemptions; ◆ Some internal credit risk assessment by the MMF manager to avoid overreliance on external ratings.

Firm regulation	
CRD IV	■ The new Capital Requirements Package transposes Basel III into European law. It consists of a directive and a regulation. The directive came into force in July 2013, the regulation in June 2013. ■ Institutions are required to implement the new rules from 01/01/2014 with full implementation on 01/01/2019. ■ It affects all firms already under the scope of CRD III. The national regulators do have discretion to apply the existing CRD III rules on some MiFID firms. The FCA allows some current BIPRU firms who cannot hold client money, and who do not carry out MiFID regulated activity which goes beyond portfolio management and the execution of orders on behalf of clients, to be subject to the CRD III rules. ■ Member states are required to introduce a harmonised sanctions regime. ■ The package requires all managers to carry more base capital, sets a new, narrower definition of what qualifies as capital for some managers, and introduces additional obligations to build up capital buffers. ■ Firms are obliged to comply with new liquidity rules and to provide at any time a stock of high-quality liquid assets to meet liquidity outflows. The liquidity coverage ratio will be implemented gradually till 2018. ■ New rules on remuneration and bonus caps were introduced. ■ Pension fund deficits will have 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 were 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.

Firm regulation *(continued)*	
CASS	■ Final rules published in June 2014 for implementation on three dates: 1 July 2014, 1 December 2014 and 1 June 2015. ■ The CASS rules were amended to incorporate the new ISA changes from July 2014 – transfers between S&S and Cash ISAs and their treatment of client money therein. ■ There will be a further CASS consultation at end of 2014 to consider recommendations from the SAR Final Review commissioned by HMT.
EU Benchmark Regulation	■ The Commission issued their proposal for a regulation on indices used as benchmarks. ■ This will catch those who contribute to, administer and use indices as benchmarks. ■ Even portfolio managers who, at the request of clients, produce blended or bespoke benchmarks would be caught. ■ Access to non-EU indices may be greatly restricted.
Fourth Money Laundering Directive	■ In February 2013 the European Commission issued proposal for a fourth Money Laundering Directive (4MLD). The text is essentially an updated version of 3MLD, amended to incorporate the revised FATF standards. Key changes include: ◆ New emphasis on the risk-based approach ◆ Removal of concept of 'equivalence' ◆ Extension to cover Domestic PEPs, and PEPs in international bodies ◆ Introduction of concept of 'risk factors', both regarding SDD and EDD ◆ New requirement for corporates and trustees to hold details of their beneficial owners

International issues	
FATCA	■ Following publication of a model intergovernmental agreement (IGA) in July 2012, FATCA is in force since January 2013. ■ It impacts funds, their operators, asset managers, platforms and distributors, who 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.

Appendix Four: Category Definitions

£ corporate debt

Exposure to Sterling-denominated debt, irrespective of whether it is issued by UK or overseas companies.

Corporate clients

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'.

Funds of funds

Funds whose investment objective is fulfilled by investing in other funds rather than investing directly into assets such as cash, bonds, shares or property. Often more widely referred to as 'multi-manager products'.

In-house insurance clients

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

Investment funds

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, and hedge funds) but it does not include life or insurance funds.

Liability driven investment (LDI)

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

Multi-asset mandate

Also called 'balanced', these types of mandate invest across a range of asset classes and geographies without a specific focus on a particular universe.

Non-profit clients

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

'Other' clients

Assets managed on behalf of 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 bonds

Includes overseas government bonds as well as debt denominated in overseas currencies.

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 clients

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 an intermediary platform, particularly a life company structure wrapping the funds, the assets are reflected in 'Insurance'.

Public sector clients

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 clients

Comprises 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 several clients whose contributions are pooled. It also includes assets in segregated portfolios that are held indirectly via pooled vehicles managed by the respondent.

Retail

Includes investment into unit trusts, open-ended investment companies (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. This would also include 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', these types of mandate are 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).

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 clients

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 funds 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.

UK fund market

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

UK institutional client market

Covers mandates or investment in pooled funds by UK institutional clients. We analyse this market on the basis of client domicile, not domicile of funds invested in or location of asset manager. This is in contrast to the analysis of UK assets under management, which covers assets managed in the UK regardless of domicile of funds or clients for whom firms manage money.

Appendix Five: Survey Respondents

Aberdeen Asset Management

Aberforth Partners

Aerion Fund Management

Alliance Trust Investments

AllianceBernstein

Aviva Investors

AXA Investment Managers

Baillie Gifford & Co

Barings Asset Management

BlackRock Investment Management

Brewin Dolphin

Brooks Macdonald Asset Management

Canada Life Asset Management

CCLA Investment Management

CIS Unit Managers

Edinburgh Partners

Family Investment Management

FIL Investment Services

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

Lindsell Train

Liontrust Fund Partners

M & G Securities

Martin Currie Unit Trusts

McInroy & Wood

Morgan Stanley Investment Management

Natixis Global Asset Management

Newton Investment Management

Nomura Asset Management

Northern Trust Global Investments

Odey Asset Management

Old Mutual Fund Managers

Pictet Asset Management

PIMCO

Pioneer Global Investment

Premier Portfolio Managers

Principal Global Investors

Rathbone Unit Trust Management

RBS Collective Investment Funds

Record Currency Management

Royal London Asset Management

Ruffer

Santander Asset Management

Sarasin & Partners LLP

Schroder Investment Management

Scottish Widows Investment Partnership

Sharefunds

Skagen

SMT Fund Services (UK)

Standard Life Investments

State Street Global Advisors UK

T Rowe Price International

Threadneedle Asset Management

UBS Global Asset Management Funds

Vanguard Investments

Virgin Money Management Services

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