

THE  
INVESTMENT  
ASSOCIATION

# INVESTMENT MANAGEMENT IN THE UK 2018-2019

The Investment Association Annual Survey

September 2019



## CONTENT ENQUIRIES

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# ABOUT THE SURVEY

**THE SURVEY CAPTURES INVESTMENT MANAGEMENT UNDERTAKEN BY MEMBERS OF THE INVESTMENT ASSOCIATION (IA) ON BEHALF OF DOMESTIC AND OVERSEAS CLIENTS. UNLESS OTHERWISE SPECIFIED, ALL REFERENCES TO 'UK ASSETS UNDER MANAGEMENT' REFER TO ASSETS, WHEREVER DOMICILED, WHERE THE DAY-TO-DAY MANAGEMENT IS UNDERTAKEN BY INDIVIDUALS BASED IN THE UK. THE ASSET VALUE IS STATED AS AT DECEMBER 2018.**

## **THE FINDINGS ARE BASED ON:**

- Questionnaire responses from 66 IA member firms, who between them manage £6.0 trillion in the UK (78% of total UK assets under management by the entire IA membership base).
- Other data provided to the IA by member firms.
- Data provided by third party organisations where specified.
- Publicly available information from external sources where relevant.
- Interviews and roundtable discussions with senior personnel from 14 IA member firms.

**THE IA WOULD LIKE TO EXPRESS ITS GRATITUDE TO MEMBER FIRMS WHO PROVIDED DETAILED QUESTIONNAIRE INFORMATION AND TO THOSE WHO TOOK PART IN THE INTERVIEWS AND ROUNDTABLES.**

## **THE SURVEY IS IN SIX CHAPTERS:**

1. UK Investment Management Industry: A Global Centre
2. Wider Regulatory, Policy and Operational Environment
3. Trends in Client Assets and Allocation
4. UK Institutional Client Market
5. UK Retail Funds Market
6. Operational and Structural Issues

## **THERE ARE ALSO SEVEN APPENDICES:**

1. Summary of assets under management in the UK
2. Summary of data from the UK institutional market
3. Major UK and EU regulatory developments affecting investment management
4. Notable M&A deals in the UK investment management sector (2009-July 2018)
5. Definitions
6. Survey respondents
7. Interview and roundtable participants

## **A NUMBER OF GENERAL POINTS SHOULD BE NOTED:**

- 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.



IA MEMBERS HOLD  
**ONE THIRD**  
OF UK PLC

MANAGE  
**37%**  
OF ALL ASSETS  
MANAGED IN  
EUROPE

**£1.2**  
TRILLION  
MANAGED FOR  
UK FUNDS

**£3.1**  
TRILLION  
MANAGED FOR  
OVERSEAS  
CLIENTS

**£1.8**  
TRILLION  
MANAGED FOR  
OVERSEAS FUNDS

**SECOND  
LARGEST**  
INVESTMENT  
MANAGEMENT CENTRE  
AFTER THE US

**£7.7 TRN**  
MANAGED BY IA  
MEMBERS IN  
THE UK



# SURVEY FOREWORD



**THE LAST YEAR HAS SEEN THE UK INVESTMENT MANAGEMENT INDUSTRY REMAIN IN ROBUST HEALTH, DESPITE SIGNIFICANT MARKET AND POLITICAL UNCERTAINTIES. ASSETS UNDER MANAGEMENT WERE UNCHANGED AT £7.7TRN AS OUR ROLE IN SERVING SAVERS AND THE WIDER ECONOMY, BOTH DOMESTICALLY AND INTERNATIONALLY, CONTINUES TO BROADEN AND DEEPEN.**

Our industry is world leading. The UK is the second largest investment management centre globally after the US, and perhaps the most international when measured in terms of customer base and range of activities.

The £7.7 trillion looked after by UK investment managers is more than the next three largest centres in Europe (France, Germany and Switzerland) combined.

Almost two fifths of the assets we manage here in the UK are for international clients, contributing to export earnings, tax revenue and helping to support 115,000 jobs across the sector.

This achievement tops a decade of growth, and assets under management in the UK have more than doubled since the financial crisis.

We have the opportunity to develop even further and I would highlight four themes in particular that are covered in this year's edition of the Investment Management Survey.

First, in terms of international competitiveness, the UK's success as a financial services cluster needs to be reinforced and reinvented as the world around us changes, and of course as we exit the EU. We highlight in particular the importance of the collaboration between fintech and investment management firms in giving a new energy and impetus to our financial services expertise. This in turn depends on wider factors, such as the UK's attractiveness to international talent but also its ability to nurture and develop domestic talent.

Second, our investment horizons are rapidly changing. There is a growing emphasis on responsible and sustainable investment, and on expanding our activity beyond public markets to support wider sources of company and infrastructure funding. Getting these areas right will help ensure better outcomes for UK customers and the domestic economy, but also bolster our position to compete globally, particularly as sustainability becomes an ever more urgent theme for policymakers, regulators and all stakeholders.

Third, ensuring good retirement outcomes for millions of citizens who are living longer, but not necessarily saving enough, is a central societal challenge. With investment risk both during working life and into retirement increasingly borne directly by individual savers, investment returns will be ever more scrutinised. And understandably so. Our member firms are working closely with pension schemes and others in the delivery chain to ensure the 'investment engine' delivers successfully, and our Report contains a number of insights from firms about the direction of travel in this critical area.

The fourth theme underpins everything that we do. We are going through one of the most significant periods of change in how we deliver better for our customers, with an unprecedented focus on competitiveness, transparency of products and services, and stronger internal governance. This in turn links to the wider question of culture and ensuring that the industry mindset evolves in line with its growing responsibilities and public scrutiny. It also includes the critical area of ensuring greater diversity and inclusion.

Our Report shows an industry energised and ready for this new environment, but also realistic about the challenges ahead. I am pleased to say the same is true for the Investment Association, which is engaged significantly in all of these areas, whether through our fintech accelerator, our Investment20/20 programme to widen industry participation or our involvement in the Cost Transparency Initiative. We have also set out the broader strategic delivery agenda for the industry in our 2025 Vision paper\*, published earlier in the summer. The paper picks up a number of themes covered in the Survey, outlining specific actions to ensure we can deliver successfully in the UK and overseas.

I hope you find the Survey a useful set of insights into the ever more important role of investment management today.



**Chris Cummings**  
CEO



\*<https://www.theia.org/sites/default/files/2019-06/PolicyPaper-June2019.pdf>

# EXECUTIVE SUMMARY

## UK INVESTMENT MANAGEMENT INDUSTRY: A GLOBAL CENTRE

- » Against a backdrop of volatile markets, total assets managed in the UK by the IA's members were relatively resilient in 2018, ending the year unchanged at £7.7 trillion. This represents around 85% of the wider UK investment management industry which was also unchanged at an estimated £9.1 trillion in 2018.
- » The UK remains one of the largest centres of investment management in the world. It is second only to the US and is the largest centre of investment management in Europe, where it is responsible for 37% of total assets under management.
- » Overseas clients account for 40% of total assets managed in the UK. Beyond immediate preparations for Brexit, the industry is looking ahead to identify how the UK can maintain its global competitive edge. Co-location of investment managers and fintech firms is seen as a significant new dimension for UK financial services city clusters.
- » The Survey identifies a range of challenges ahead to ensure future success, notably continued access to international talent, and maintaining access to overseas markets in a potentially more protectionist world with associated regulatory divergence.

## WIDER REGULATORY, POLICY AND OPERATIONAL ENVIRONMENT

- » A confluence of factors, including a rapidly widening customer base and the ongoing consequences of the Global Financial Crisis, is resulting in the investment management industry being increasingly in the public spotlight. A very broad set of domestic regulatory and policy interventions are underway.
- » A unifying theme is the delivery of customer value, and an associated emphasis on alignment of interest, transparency and oversight. This in turn links to a focus on broader culture. The industry is also the subject of rising expectations regarding its role in the domestic economy, particularly as a steward and allocator of capital.

- » The responsible investment agenda is being strongly embraced by the industry. This year, we found 26% of total assets under management subject to a responsible investment approach. A key challenge is how to communicate different approaches to customers in a clear and consistent manner.
- » A further significant evolution is the growing importance of private markets. On the supply side, market-based finance has been more widely used since the Global Financial Crisis and there has also been a decline in the proportion of listed companies. In a persistently low interest rate environment, demand for alternative assets has been strong, particularly in the institutional market.
- » Across the investment management and capital markets landscape, technological change is accelerating and will be a fundamental driver of industry transformation, leading to greater efficiency and reducing costs.

## TRENDS IN CLIENT ASSETS AND ALLOCATION

- » Institutional clients remain the largest client group accounting for 80% of assets under management. Pension schemes (45% of total assets) continue to be the largest institutional client type.
- » Equities as a proportion of total assets fell from 40% to 36%, possibly reflecting the poor performance in global markets in the last quarter of 2018. Within equities, the UK allocation remained unchanged at 30%, but down from 46% ten years ago.
- » The fixed income allocation to overseas bonds increased by 7% to 49% in 2018, up from 34% in 2011 when data was first collected.
- » Despite reduced allocations to UK assets as a proportion of total assets, IA members remain significantly invested in the UK economy holding £1.6 trillion in UK equities, corporate bonds, commercial property and, increasingly in recent years, in infrastructure and direct lending.
- » Across the £7.7trn total assets under management, some three quarters (74%) of assets remain managed on an active basis, down from 84% a decade ago.

## UK INSTITUTIONAL CLIENT MARKET

- » IA members manage £4.0 trillion for UK institutional clients in offices around the globe. This represents an increase of £180 billion from 2017, with the majority of the increase estimated to come from net inflows.
- » Third party assets account for about 85% (£3.4trn) of the total, slightly increased from 2017. Pension funds remain the largest client type, accounting for 71% of third party assets.
- » Multi-asset mandates account for just under a quarter (24%) of mandates in total asset terms once LDI mandates are excluded. Assets managed in liability-driven investment strategies reached an estimated £1.2 trillion in 2018, up from £1.1 trillion in 2017.
- » Within specialist third party mandates, equities account for 35% (down from 40% in 2017). Fixed income increased two percentage points to 39% to become the most popular type of specialist mandate.

## UK RETAIL FUNDS MARKET

- » The UK retail funds market has grown significantly over 10 years and is more focussed on meeting investor demand for investment solutions and outcome-oriented funds.
- » Investor demand for outcome-oriented and mixed asset funds is a long-term trend, suggesting a permanent shift in investor expectations and increasing the role of retail fund managers as asset allocators.
- » Following extremely strong growth in 2017, net retail sales were relatively weak during 2018, particularly in the second half of the year. Although this volatility is making the outlook for flows unclear, average five year retail inflows since 2008 remain significantly higher than in the period preceding the global financial crisis.

- » The proportion of UK investor funds under management in passive index-tracking funds has grown gradually to 16% in 2018. Although slow, the pace of growth has accelerated since 2013 when the retail distribution review was implemented.
- » FUM in funds pursuing dedicated 'responsible investment approaches' was £69 billion, equivalent to 6% of UK investor FUM. Net sales to these funds reached £1.08 billion in 2018.

## OPERATIONAL AND STRUCTURAL ISSUES

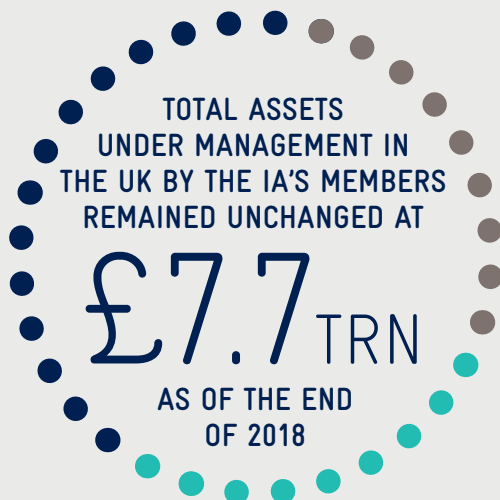
- » Total average industry revenue after commission stood at £21 billion in 2018. This equates to 27bps of total assets (28bps in 2017). Consistent with findings in recent years, costs increased at a higher rate than revenue during 2018. As a consequence profitability stood at 29% (from 30%)
- » The UK investment management industry directly employed almost 40,000 people at the end of 2018, up 4% on the 2017 figure. Around 115,000 jobs are supported by the UK investment management industry, either directly or indirectly.
- » The UK investment management industry remains relatively unconcentrated. Assets managed by the top five and the top ten firms stood at 42% and 57% of total assets respectively. Both were one percentage point lower than 2017.
- » The proportion of assets managed by independent investment managers now stands at 44%, more than double the level in 2008 (21%). This is in large part a reflection of high levels of M&A activity seen in the industry over that period.

# 1 UK INVESTMENT MANAGEMENT INDUSTRY: A GLOBAL CENTRE

## KEY FINDINGS

### SIZE OF THE UK INDUSTRY

- » In a year of high volatility within global markets, total assets under management in the UK by the IA's members remained unchanged at £7.7 trillion as of the end of 2018.
- » One quarter of firms with UK headquarters are based in Scotland with 7% of total assets (£530 billion) managed in Scotland. This represents an £85 billion decrease from 2017.
- » The wider investment management industry (including hedge funds, private equity, commercial property and discretionary wealth managers) is estimated to manage £9.1 trillion from the UK, again unchanged from 2017.



### UK INVESTMENT MANAGEMENT IN A EUROPEAN AND GLOBAL CONTEXT

- » The UK is one of the largest and broadest investment management centres in the world, second only to the US which has a significantly larger domestic market. It is larger than the top three European centres combined with a European market share of 37% of total assets under management.
- » The UK investment management industry serves a global client base with 40% of UK managed assets from overseas clients, this is unchanged from 2017. European clients account for almost 60% of this despite strong growth in North American client assets.
- » The UK investment management industry has a strong competitive edge in its unrivalled global focus, the ability to adapt and innovate in response to changing demand and in the city clusters and their proximity to other industries.
- » Beyond immediate preparations for Brexit, the industry is looking ahead to how the UK can maintain its global competitive edge in the longer term. The co-location of investment managers and fintech firms is seen as a particularly important new dimension of the financial services cluster.
- » There are also a number of challenges ahead to ensure future success, notably continued access to international talent, and maintaining access to overseas markets in a potentially more protectionist world with associated regulatory divergence.



This Chapter looks at the growth of the UK as a pre-eminent global investment management centre and considers the importance of the industry, both to the UK economy and to investors around the globe.

### FIGURE 1: WHO ARE THE IA'S MEMBERS?

Full members of the IA can be broken down into five broad groups.

**1 Large investment 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 investment management activities across both retail and institutional markets and manage substantial amounts for overseas clients in the UK. Such firms will typically be managing >£100 billion from the UK, but a number of international firms have a smaller UK footprint.

**2 Small and medium-sized investment management firms**, primarily focused on UK and/or European clients, which undertake a diverse range of activities, of which investment 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 investment management services for a large scheme.

Alongside these firms, the IA works with affiliate organisations from the wider financial and professional service sectors covering all aspects of the investment management ecosystem and value chain.

Financial Technology firms are proving increasingly important to business operations (see pages 36-37) and since launching the FinTech innovation hub and accelerator in October 2018, the IA now interacts with over 100 buy-side focused Fintech members.

## ROLE OF INVESTMENT MANAGEMENT

The investment management industry has a central role in the economy channelling savings into investments, and it is these two sides that define the industry's purpose – see Figure 2.

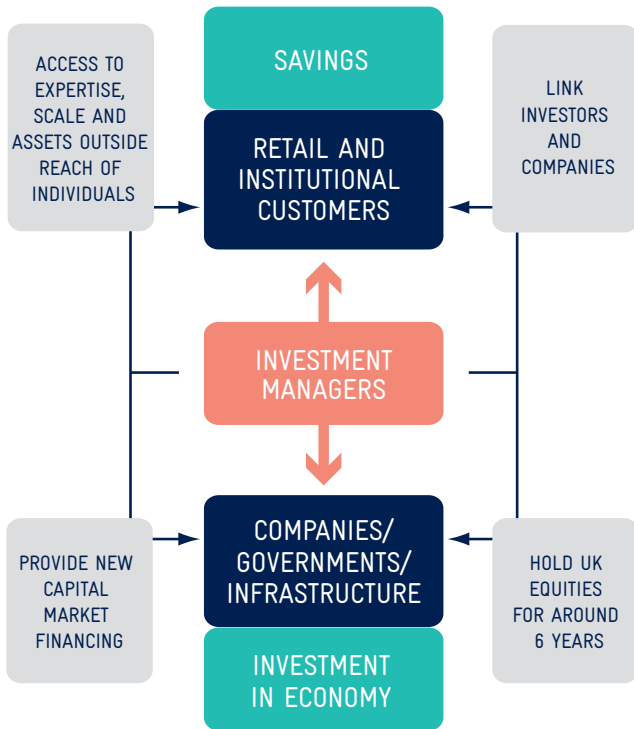
The primary purpose of investment managers is to deliver good outcomes to their clients, whether these are individual savers or institutions such as pension schemes. This includes providing wider expertise in areas such as risk management, achieving economies of scale, and giving access to a wide range of assets that would normally be out of reach for individual investors. The ultimate goal is to provide customers with a basket of shares, bonds and other assets such as property, which can deliver returns over many years without exposing them to undue risk.

The second side of the industry's role reflects the actual investment, ensuring that capital markets work effectively for this investment to take place. In doing so, investment manager activity contributes to efficient markets which price information correctly and allow buyers and sellers to transact. This facilitates both primary issuance when companies or governments are trying to raise money, and secondary trading of different instruments. Without efficient markets, market economies cannot grow effectively or may even destabilise. Investment managers thus contribute to sustainable growth in the economy, benefiting both clients and wider society.

Investment managers are not unique in this as other financial institutions and individuals contribute to capital market efficiency, but the industry has historically been at the heart of long-term capital allocation, whether through shares, bonds or other assets. As long term holders of investments, UK investment managers hold UK equities for approximately six years.<sup>1</sup> The industry therefore also has an important responsibility to undertake stewardship activity over the companies they invest in to protect the value for their clients. As we discuss in Chapter 2, this increasingly extends to broader issues such as environmental sustainability and executive remuneration.

<sup>1</sup> The contribution of asset management to the UK economy, July 2016, Oxera

**FIGURE 2: THE ROLE OF INVESTMENT MANAGERS IN CHANNELLING SAVINGS TO INVESTMENTS**



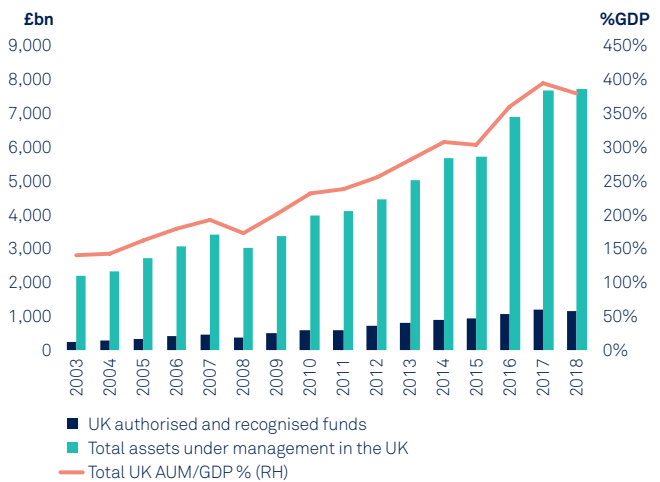
## SIZE OF THE UK INDUSTRY

At the end of 2018, IA members managed £7.7 trillion of client money in the UK, almost unchanged from the end of 2017 (see Chart 1).

Although unchanged year on year, the assets under management figures needs to be viewed against a backdrop of high levels of volatility in global markets in 2018. Equity markets around the world suffered sharp falls in sterling terms. Global bonds fared better, and global aggregate bond returns were positive on the year, but overall 2018 was a challenging year in which to generate returns for investors (see “Review of global markets in 2018” overleaf for more detail).

Funds under management for UK investors in investment funds fell slightly to £1,150 billion at the end of 2018, representing 15% of overall assets under management.<sup>2</sup> Since 2003 the growth in funds under management has outpaced the growth in total assets under management with cumulative annual growth rates (CAGR) of 10.3% and 8.1% respectively.

**CHART 1: TOTAL ASSETS UNDER MANAGEMENT IN THE UK AND IN UK FUNDS (2003-2018)**



Source: IA, ONS

<sup>2</sup> Includes assets in both UK authorised and recognised funds.



As the industry's assets under management stalled in 2018, the UK economy continued to grow. Therefore by the end of 2018, the size of the industry relative to GDP had fallen slightly but remains almost four times the size of the UK's economy.

By comparison, the latest data available for Europe excluding the UK indicated that outside of the UK the average size of an investment management industry in Europe is just over the size of local GDP. This means that investment management is considerably more important to the UK economy than it is to the economies of other European countries.<sup>3</sup>

## REVIEW OF GLOBAL MARKETS IN 2018

Returns in 2018 were dominated by market volatility in the final quarter. Until that point, the year had seen largely positive returns in global equity markets, reflecting ongoing economic confidence. This was especially true of the US, where the economy continued to strengthen buoyed by tax cuts. Economic growth in Europe on the other hand showed signs of weakening, causing concern because of the ECB's limited ability to stimulate growth in an already low interest rate environment. Many countries within Europe experienced difficulties, particularly Italy, which struggled to agree a budget with the wider EU. Protests in France and growing political pressure on the German government helped add to the volatility and, in the UK, the ongoing and long-term uncertainty over Brexit had a persistent negative impact on investor sentiment. In Japan, in spite of substantial monetary stimulus and good export growth, the economy slowed and continued to lag the growth of other countries.

Table 1 looks at the 2018 total return of selected indices. Towards the end of the year there was a marked increase in volatility as concerns heightened about a US/China trade war and rising global interest rates. Equity markets fell sharply around the world as a result. UK and Europe ex-UK equities were the worst performers in Sterling terms, ending the year with near double-digit negative returns. Equity markets further afield performed slightly better but this reflected Sterling weakening versus the US and Asian currencies during 2018, rather than higher underlying returns in those markets.

Global bonds fared better but returns were variable and driven by country specific factors. In the UK, inflation, expected increases in interest rates and Sterling weakness on the back of further Brexit uncertainty led to bond yields fluctuating substantially throughout the year. Ultimately bond returns, both UK and overseas, were edged into positive territory at the very end of the year on the back of the volatility in equity markets. Waning optimism over international economic growth led investors back to the relative safety of fixed income markets.

Outside of the two main asset classes, the UK commercial property market continued to post positive returns in 2018, boosted largely by income levels in excess of 5%.

**TABLE 1: SELECTED BOND AND EQUITY MARKET RETURNS IN 2018 (£ TERMS)**

UK equity	-9.5%
Emerging Market equity	-7.6%
Japan equity	-2.2%
US equity	1.6%
Global bonds	4.9%
UK Gilts	0.5%
UK Corporates	2.2%

Source: Lipper

<sup>3</sup> IA analysis of EFAMA data.

## SCOTLAND AS A MAJOR CENTRE

One quarter (25%) of the assets managed by UK-headquartered investment managers are represented by managers with headquarters in Scotland.

Although the City of London remains the leading centre of investment management activity in the UK, Scotland, and particularly Edinburgh, plays a key role nationally.

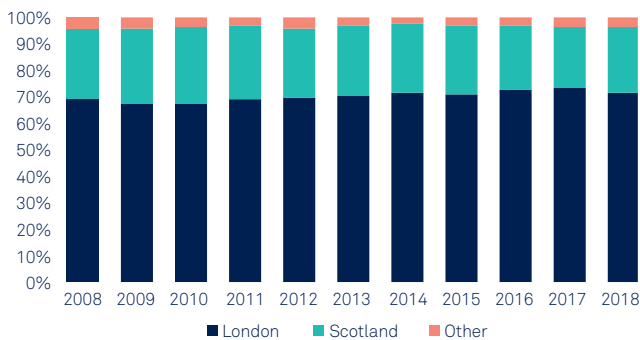
Looking at this from a different perspective, assets managed in Scotland represented 7% of total assets managed by IA members at the end of 2018, accounting for £530 billion of total assets, a fall of £85 billion on 2017.

The fact that lower levels of assets are managed in Scotland than would be suggested by the location of firm headquarters is a consequence of the fact that many IA members headquartered in Scotland undertake investment management activity in other regions, primarily London.

This is consistent with the data collected on staffing levels, which clearly shows that London is more likely to be a location for portfolio manager jobs than other areas of the UK (see p89 – staffing table).

Chart 2 shows that the regional split has remained relatively unchanged from a decade ago, with more than two thirds of assets managed by firms with UK-headquarters run by firms with a headquarters in London.

**CHART 2: REGIONAL HEADQUARTERS OF ASSETS MANAGED BY UK HEADQUARTERED FIRMS (JUNE 2008-2018)**



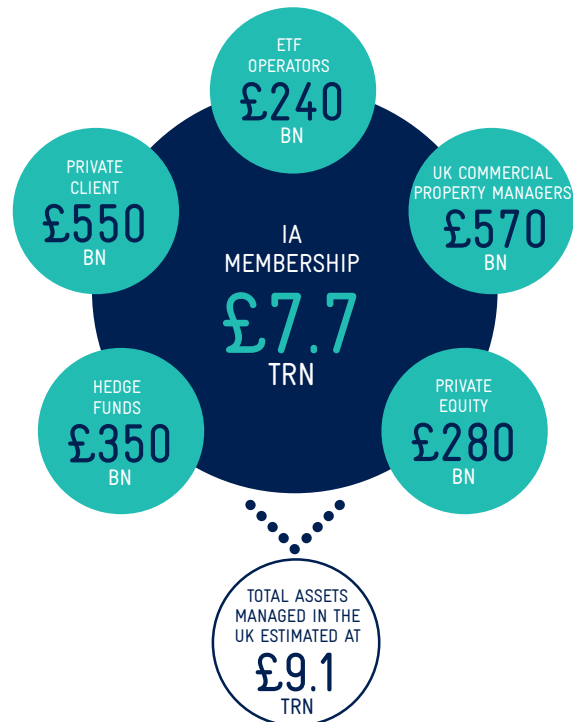
## SCALE OF WIDER INDUSTRY

IA members represent the majority of the UK investment management industry in asset terms (85%). Firms not covered in detail in this report can be broadly split into the following categories:

- Hedge funds
- Private equity funds
- Commercial property management
- Discretionary private client management
- A small number of dedicated ETF operators
- Firms who are not members of the IA for reasons not noted above<sup>4</sup>

Figure 3 provides estimates to show how these wider parts of the industry contribute to total assets under management in the UK.

**FIGURE 3: WIDER INVESTMENT MANAGEMENT INDUSTRY**



Source: ComPeer, Morningstar<sup>5</sup>, Hedge Fund Intelligence/ EuroHedge, Investment Property Forum, IA estimate based on private equity return data.

<sup>4</sup> This last group is more difficult to size as there is no consistent third party data available.

<sup>5</sup> ETF data based on ETF funds listed in the UK.

## UK INVESTMENT MANAGEMENT IN A EUROPEAN AND GLOBAL CONTEXT

The UK continues to dominate the investment management industry within Europe, with market share increasing from 35% in 2016 to 37% in 2017 (see Figure 4). This market share has remained fairly stable since 2011.

In recent years, the UK's share of the European market has been higher than the next three largest European countries put together. This is still the case. Finland has appeared in the table for the first time, increasing its market share to 1% in 2017, making it the tenth largest centre of investment management in Europe.

Table 2 shows that looking globally, this puts the UK as the second largest investment management centre in the world after the United States, and ahead of Japan as third largest.

**TABLE 2: GLOBAL ASSETS UNDER MANAGEMENT**

	Assets under management (local currency)	Assets under management (£ equivalent)
US	\$33 trillion <sup>6</sup>	£26.1trillion
Europe	€24 trillion <sup>7</sup>	£21.6trillion
Japan	¥618 trillion <sup>8</sup>	£4.4 trillion

**FIGURE 4: ASSETS UNDER MANAGEMENT IN EUROPEAN COUNTRIES (DECEMBER 2017)**



Country	Net assets (€bn)	Market share
1. UK	8,670	37%
2. France	4,142	17%
3. Germany	2,161	9%
4. Switzerland	1,887	8%
5. Italy	1,294	5%
6. Netherlands	844	4%
7. Denmark	425	2%
8. Spain	409	2%
9. Belgium	332	1%
10. Finland	223	1%
Other	3,363	14%
<b>TOTAL</b>	<b>23,750</b>	

Source: EFAMA

<sup>6</sup> Estimate based on North America data. Global Asset Management 2019, BCG, 2019.

<sup>7</sup> Asset Management in Europe, 11th Annual Review, EFAMA.

<sup>8</sup> Japan's Asset Management Business 2018/2019, NRI.

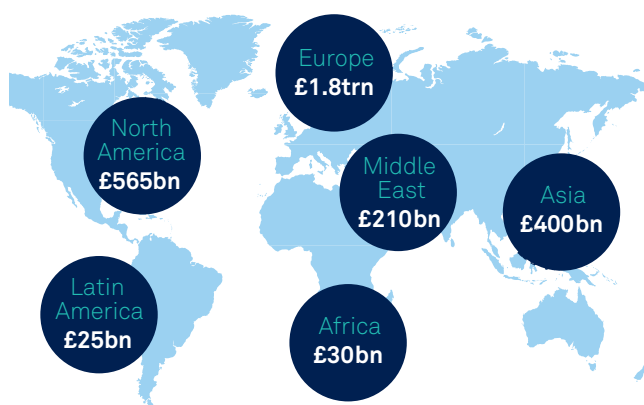
## OVERSEAS CLIENT MARKET

The UK remains one of the world’s prominent centres for portfolio management on behalf of investors around the world. £3.1 trillion, i.e. 40%, of all assets in the UK, is being managed on behalf of overseas clients, this is unchanged from 2017.

The largest client base remains the European Economic Area (EEA), for which the UK industry manages approximately £1.7 trillion. A further £135 billion is managed for clients in other parts of Europe. Much of this represents assets managed by clients in Switzerland. This takes the total European share of overseas assets to 59% (see Figure 5).

Overseas assets managed on behalf of North American clients saw the biggest relative increase at 11% from £510 billion in 2017 to £565 billion in 2018.

**FIGURE 5: ASSETS MANAGED FOR OVERSEAS CLIENTS**



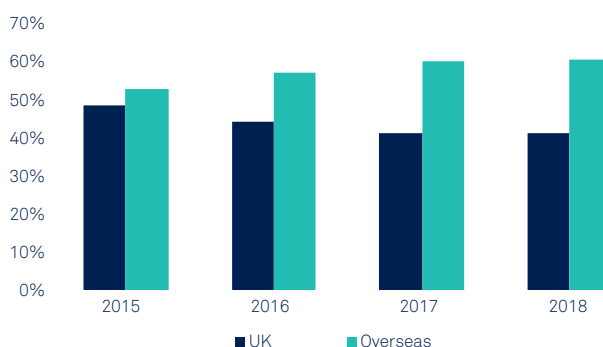
## SERVICES TO OVERSEAS FUNDS

A significant proportion of UK-managed assets are managed for overseas-domiciled funds.<sup>9</sup> These may be sold either to UK clients or to clients located around the world. For example, UK institutional investors represent a significant proportion of the assets invested in institutional money market funds located in Ireland and Luxembourg. A mixture of UK, European and overseas investors will be found in many funds domiciled in these jurisdictions.

Survey data suggests that, at the end of 2018, £1.8 trillion was managed in the UK for overseas funds (a small increase on 2017). This represents 40% of UK managed funds and has remained unchanged on 2017 following two years of decline (see Chart 3).

As has been evident in recent years, the overwhelming majority of this (79%) was managed for funds domiciled in Ireland and Luxembourg, although IA members manage assets for funds domiciled across all continents.

**CHART 3: CHANGE IN PROPORTION OF ASSETS MANAGED FOR UK AND OVERSEAS FUNDS (2015-2018)**

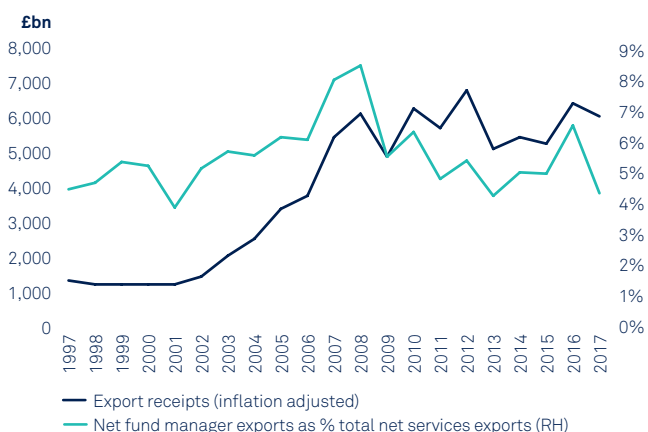


<sup>9</sup> This is a related but distinct data point from the AUM estimate for overseas customers.

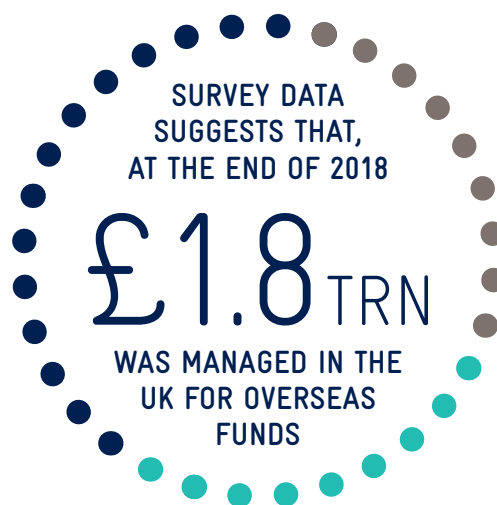
## IMPORTANCE TO UK SERVICE EXPORTS

Given the size of its overseas client base, the investment management industry makes a significant contribution to the UK’s service exports through overseas earnings. The value of export receipts has increased sevenfold on an inflation-adjusted basis in the last 20 years. Chart 4 indicates that export earnings represented an average of 6% of total net exports over the past ten years. However there has been some year on year volatility in this figure, with more recent figures tending towards the lower end, at 4.3%<sup>10</sup>

**CHART 4: EXPORT EARNINGS OF FUND MANAGERS AND CONTRIBUTION TO SERVICES EXPORTS (1997-2017)**



Source: ONS



<sup>10</sup> The data in Chart 4 captures earnings by independent investment managers but is likely to understate earnings from asset managers that are part of a wider financial services group such as an investment bank or insurer. As such, this estimate is conservative and the actual contribution of investment management overall to service exports is likely to be higher.

## FUTURE ROLE OF THE UK AS AN INVESTMENT MANAGEMENT CENTRE

The UK investment management industry is a leading centre of excellence and one of the most international in the world. Our data shows considerable growth in the international reach of the industry over the last decade:

- 40% of assets are managed on behalf of overseas customers up from 31% in 2008.
- 70% of UK-managed equities are invested overseas compared to 54% a decade ago.
- 57% of assets are managed in the UK by a firm with a parent headquartered overseas, increasing from 40% in 2008.

Looking ahead, clearly Brexit is an imminent, highly significant issue for the investment management industry. Preparations for a range of scenarios, including a hard Brexit, have been taking place for some time. One of the key priorities is the need to ensure business continuity, particularly in the context of a global business model that depends upon delegated portfolio management to deliver for customers internationally.

Beyond the specific terms of a Brexit deal (or the circumstances where there is none), there are wider considerations about the longer-term opportunities and challenges for UK investment management on the global stage.

**FIGURE 6: FOUR MEASURES OF A GLOBAL INDUSTRY**



In this year's Survey, we spoke specifically to a range of firms to capture their outlook. A number of themes emerged from the discussion and are outlined in the following section.

## MAINTAINING UK COMPETITIVE ADVANTAGE

Looking ahead, three key features emerge as important to help ensure the UK maintains its critical edge:

### 1. The UK FS cluster and the role of fintech

In the view of Survey participants, the ongoing benefit of city clusters, especially London and Edinburgh, should not be underestimated. Proximity to other market participants, particularly investment banks in the traditional 'buy-side sell-side model', has been a key feature. Also important has been the availability – and development in parallel – of critical professional services, including legal, audit and wider business support.

**“THE IMPORTANCE OF THE CLUSTER OF THE CITY OF LONDON IS NOT JUST ABOUT INVESTMENT MANAGEMENT OR ADMINISTRATION BUT BUILDING A FULL SERVICE FINANCIAL SERVICES COMMUNITY WITH ALL THE THINGS WE KNOW AND VALUE: LAWYERS, ACCOUNTANTS, PROFESSIONAL SERVICES: THE WHOLE CLUSTER IS INCREDIBLY DIFFICULT TO REPLICATE. YOU CAN COPY BITS IN OTHER JURISDICTIONS BUT YOU CAN'T REPLICATE THE WHOLE THING.”**



A new form of co-location is identified as absolutely critical to ongoing development and innovation: this is the co-location of investment management firms and fintech, helping to re-define how the industry – and policymakers – think in future about what constitute the key components of centres of excellence. In this regard, the UK is seen extremely positively by the investment management industry, subject to factors such as wider openness and attraction to talent.

**“THE PHYSICAL JUXTAPOSITION BETWEEN THE TECH AND THE MONEY IS CRITICAL. THEY'RE IN SHOREDITCH, WE'RE IN BANK - YOU CAN GET THERE IN 10 MINS. IN THE US, THERE IS A REAL SENSE THAT ONE IS ON THE WEST COAST, ONE IS ON THE EAST COAST. WE'VE GOT EVERYTHING TOGETHER IN SUCH CLOSE PROXIMITY. WE WERE APPROACHED BY AN AI DATA SCIENCE BUSINESS WHICH HAS SPUN OUT OF A LEADING LONDON UNIVERSITY. THAT PHYSICAL JUXTAPOSITION IS VERY POWERFUL.”**



The impact of technological change will clearly be felt throughout the investment management value chain, from capital markets and trading systems through to distribution. Several participants in the Survey could see how some of the potential changes in middle and back office use of technology could help to boost the UK as a fund domicile, through the re-defining of the administrative services associated with a successful domicile.

**“THE PLUMBING IS GOING TO CHANGE THROUGH TECHNOLOGY. THE ASSET SERVICING BUSINESS IS INCREDIBLY IMPORTANT, AND THERE ARE THINGS WE CAN DO TO FOSTER THAT. IF THE BACK OFFICE AND THE TRANSFER AGENTS MOVE TO BLOCKCHAIN, OPERATIONAL RISK WILL REDUCE AND HENCE SO WILL THE CAPITAL DEMANDS. THAT MAY CREATE OPPORTUNITY FOR THE UK.”**



**2. Keeping a global focus**

There remains a strong sense that the UK is distinguished in its breadth of financial services and investment management expertise, and its ability to be outward looking and to operate with a global view. This is particularly important for firms looking to service their global operations from within the UK and has implications for both businesses and policymakers in terms of global positioning.

“THE UK HAS TRADITIONALLY HAD A GLOBAL PERSPECTIVE. IT DOESN'T JUST THINK ABOUT THE DOMESTIC MARKET. THIS ALLOWS THE UK TO PLAY A REALLY IMPORTANT ROLE BUT IT DOES REQUIRE US TO ENSURE THAT WE ARE ENGAGED FROM A POLICY PERSPECTIVE ACTIVELY IN GLOBAL DISCUSSIONS.”

In terms of how the UK-based investment management industry can be most effective globally, a number of participants in the Survey identified a further dimension: exporting the accumulated weight of experience, skills and mindset, alongside specific products and services. This could help to reinforce UK influence internationally, thereby hopefully bolstering commercial success on the back of potential alignment between the UK and other jurisdictions. Like many features of the competitiveness debate, this has always been true, but may become even more important as the UK seeks to define itself more broadly in a post-Brexit environment.

“YOU SET YOURSELF UP AS A THOUGHT LEADER IN THE SENSE THAT YOU HAVE GLOBAL LEADERSHIP IN ASSET MANAGEMENT IF YOU CAN BUILD OUT THAT EXPERTISE IN DIFFERENT COUNTRIES. IT REINFORCES THE CENTRAL POINT OF THE UK BEING A LEADER FROM AN ASSET MANAGEMENT PERSPECTIVE THAT IS APPLYING ON A WORLD STAGE.”

“IN ESSENCE WHAT WE'RE ACTUALLY DOING IS HELPING TO CREATE OVERSEAS MARKETS WHICH WILL BE OF MORE INTEREST TO US IN 5-10 YEARS' TIME BECAUSE THERE WILL BE NATURAL CONSUMERS OF MUTUAL FUNDS IN VOLUME WHICH ARE GLOBAL. WE'RE CREATING A NEW MARKET PLACE.”

**3. Ability to respond to changing demands**

Firms identify a strong ability in UK financial services, including investment management, to respond effectively to changing customer needs and markets. One example has been developing Liability Driven Investment (LDI) approaches for the defined benefit (DB) pensions market, which can in turn be exported as part of the industry's global offer.

“THE ABILITY TO BUILD PRODUCTS IN RESPONSE TO A SPECIFIC DEMAND FROM ANOTHER JURISDICTION AND TO ADAPT IN THAT WAY IS A KEY STRENGTH.”

There is also a challenge here in ensuring that broader UK approaches to long-term savings and pensions can be adapted, as appropriate, to other jurisdictions. While the underlying investment management processes were likely to be comparable internationally, retirement systems (particularly the shape of Defined Contribution provision) vary considerably. Firms see a need to ensure a flexibility of philosophy and approach to ensure that adaptability and innovation, alongside a specific set of products and services, are part of the UK investment management export offer.

“WE'RE DEVELOPING AN APPROACH TO RETIREMENT SAVINGS IN THE UK THAT IS VERY FOCUSED ON INDIVIDUAL DC PROVISION. THE THING TO BE THINKING QUITE HARD ABOUT IS HOW THESE POLICY ISSUES, WHICH ARE UNIVERSAL, ARE GOING TO EVOLVE DIFFERENTLY ACROSS JURISDICTIONS AND POSITION OUR INDUSTRY ACCORDINGLY.”



## PRECONDITIONS FOR GROWTH

At the same time, firms identify several concerns about challenges ahead that have the potential to limit future industry growth:

### 1. Access to talent

The depth of talent in the UK is cited as a significant driver behind firms' decisions to choose the UK as their European or global base. Firms emphasise the importance of continuing to attract the best people in a post-Brexit environment. This links to the broader issue of maintaining UK attractiveness as a jurisdiction in which to do business – factors such as the tax and legal system, transport, housing and education infrastructure.

“WE’RE GETTING THE BEST TALENT AND YOU EXPORT AGAIN AND IT BECOMES THAT VIRTUOUS CIRCLE. OUR GLOBAL CHIEF EXECUTIVE KEEPS COMING BACK TO UK POLITICIANS AND POLICYMAKERS SAYING: ‘DO NOT UNDERESTIMATE HOW MUCH TALENT SITS IN LONDON BECAUSE IT POPULATES OUR BUSINESS GLOBALLY. IT IS CRITICAL FOR LONDON’S SUCCESS TO CONTINUE TO GET THE BEST TALENT.’”



“ONE OF THE IMPORTANT QUESTIONS TO BE ANSWERED IS, CAN THE UK STILL BE A MAGNET FOR PORTFOLIO MANAGEMENT EXPERTISE, AND CAN IT CONTINUE TO ATTRACT TALENT? FROM THAT PERSPECTIVE, I STILL THINK THAT BARRIERS ARE INCREASING.”



On talent specifically, the view is still broadly positive, but with some caution about direction of travel. At the same time, the industry also recognises the importance of developing home-grown talent, reflected in a range of initiatives, including Investment20/20. A critical point is that the two tracks should be complementary and mutually reinforcing, particularly as UK employees have an opportunity to develop and take skills sets to other international markets (see Point 2 above).

WE NEED TO MAKE SURE THAT WE CAN ATTRACT THAT GENERATION IN OTHERWISE WE’LL BE SEEN AS STUFFY AND OLD FASHIONED. WE NEED A MODERN, THRIVING, DIVERSE EMPLOYEE BASE.



WE USE OUR INTERNSHIP PROGRAMME TO DRIVE OUR INCLUSION AGENDA, SO WE’RE NOT ONLY FOCUSED ON TRYING TO BRING YOUNG TALENT IN BUT DO IT IN A WAY THAT ENCOURAGES DIVERSITY AND DIFFERENT VIEWPOINTS. WE NEED TO MAKE THIS AN ATTRACTIVE PLACE TO WORK SO WE CAN ATTRACT AND RETAIN TALENT. THIS IS THE CRITICAL MASS AS THE HUB FOR ASSET MANAGEMENT.



## 2. Ensuring overseas market access

The second concern is about the ability to enter new markets. Many developing economies such as China are focussing on building domestic markets and expertise, which requires firms to have a much more significant local presence, potentially limiting the opportunity for portfolio management to be delegated back to UK companies.

Survey respondents flagged barriers rising both to cross-border fund distribution on a global level and potentially to portfolio management. Some of this relates to wider patterns in international economic relations: while UCITS has been a great global success in exporting a European fund standard, there are signs of limits in a broader environment in which protectionism is more evident, both at national and regional level. The last twelve months in particular have seen a ratcheting up of global trade tensions.

“WHERE I DO THINK THIS REGIONALISATION IS A THREAT TO THE UK, IS THAT WE’VE BEEN ABLE TO EXPORT OUR INVESTMENT MANAGEMENT EXPERTISE QUITE FREELY INTO ASIA FROM A PASSPORTING POINT OF VIEW. THAT PASSPORTING WILL GET HARDER AS LOCAL REGIMES FAVOUR NURTURING THEIR DOMESTIC INDUSTRIES. YOU CAN STILL THINK GLOBALLY, BUT YOU HAVE TO BE SENSITIVE TO LOCALISATION. ON BALANCE, WE SHOULD STILL SEE OPPORTUNITIES OPEN UP RATHER THAN CONTRACT.”

## 3. Ability to navigate a complex regulatory landscape

Market access can also be considerably constrained by regulation. This is seen in two ways: directly in terms of demands placed upon firms in specific jurisdictions; and more indirectly in regulatory divergence which can increase complexity and cost for firms looking to operate efficiently as a cross-border level.

“WE’RE IN A DIFFERENT ENVIRONMENT WHERE THE ABILITY TO ENTER A MARKET IN A LIGHT TOUCH WAY IS MUCH MORE CHALLENGING NOW. WHETHER IT’S TO PROTECT CONSUMERS OR SHOW COMMITMENT TO THAT JURISDICTION, TO MAKE THE REGULATOR COMFORTABLE YOU ACTUALLY NEED TO HAVE FULL SERVICE RISK AND CONTROL FUNCTIONS THERE.”

“ONE OF THE THINGS WE ARE INCREASINGLY WORRIED ABOUT FROM A GLOBAL PERSPECTIVE IS THERE IS ALWAYS THIS PUSH AND PULL BETWEEN HOW CLOSE REGULATION IS AND HOW FAR APART IT GOES. AT THE MOMENT WE’RE AT A PHASE WHERE REGULATION POLICY IS LOOKED AT FROM A REGIONAL OR NATIONAL LEVEL AND WE SEE INCREASING LEVELS OF DIVERGENCE AND THEREFORE INCREASING LEVELS OF COMPLEXITY COMING IN TO RUNNING A BUSINESS. THIS FUNDAMENTALLY DRIVES UP COST AND MEANS INVESTING IS MORE EXPENSIVE IN A PERIOD WHEN WE’RE TRYING TO ENCOURAGE PEOPLE TO SAVE FOR THEIR LONG TERM FUTURES.”

# 2 WIDER POLICY, REGULATORY AND OPERATIONAL ENVIRONMENT

## KEY FINDINGS

### PERIOD OF UNPRECEDENTED CHANGE

- » A range of factors, including a rapidly widening customer base and the ongoing consequences of the Global Financial Crisis, are seeing the investment management industry increasingly in the public spotlight and a very broad range of domestic regulatory and policy interventions.
- » A unifying theme is the delivery of customer value, and an associated emphasis on alignment of interest, transparency and oversight. This in turn links to a focus on broader culture. The industry is also the subject of rising expectations in the domestic economy, particularly as a steward and allocator of capital.

### A FOCUS ON VALUE IN AN EVOLVING LANDSCAPE

- » The UK funds industry is going through a major period of change during 2019, with the first edition of fund value assessments and a number of other changes to enhance governance and transparency.
- » The shift towards more solutions-focused strategies, including outcome and allocation funds in the retail market, is highlighting a broadening of the value debate beyond a more traditional approach based on active out-performance in a given asset class.

### RESPONSIBLE INVESTMENT

- » The responsible and sustainable investment agenda is increasingly being embraced by the industry. A key challenge is how to communicate different approaches to customers in a clear and consistent manner.
- » With the definitional landscape continually evolving, the data collected in the Survey this year will be a baseline moving forward. This year using GSIA definitions we found 26% of total AUM subject to a responsible/sustainable approach.

### GREATER ROLE OF PRIVATE MARKETS

- » Both supply and demand factors are leading to a significant focus on private markets by investment managers. On the supply side, market-based finance has been more widely used since the Global Financial Crisis and there are also signs of a decline in the proportion of listed companies. In the continuing low interest rate environment, the demand for alternative assets has been strong, particularly in the institutional market.

### FURTHER TECHNOLOGICAL ADVANCES

- » Technological change is accelerating across the value chain and will be a fundamental driver of industry transformation, leading to greater efficiency and reducing costs. It also raises wider issues for the industry in terms of talent recruitment and diversity.



This Chapter explores a number of important external drivers of change in the UK industry, resulting from a range of factors, particularly regulatory, policy and technological developments. At a regulatory and policy level, one distinguishing feature in recent years has been the extent of the domestic agenda and the changing role of the investment management industry within that. However, many of the themes identified have a significant international resonance.

## A PERIOD OF UNPRECEDENTED CHANGE

The UK industry is experiencing an unprecedented series of regulatory and policy interventions, reflecting a range of factors, most notably:

- The changing importance of the industry in serving the domestic market, particularly in a growing retail market and a more individualised retirement savings environment.
- Ongoing consideration of the role and structure of the financial services industry in the aftermath of the Global Financial Crisis of 2008.
- Accelerating and deepening concerns about the financial risks posed by climate change.

In Figure 7, we show at a high level how this plays out thematically:

- A primary issue is how the industry delivers value to its customers, across retail, institutional and private wealth markets. This is expressed in a number of ways, with three specific themes that fall under broader culture:
  - Alignment of interest between providers and customers, particularly in the area of fees.
  - Transparency of delivery, covering both costs and product objectives.
  - Internal governance processes at product and wider firm level.
- That definition of value extends to the external oversight associated with corporate governance and wider questions of environmental sustainability, where expectations are rising significantly among customers and policymakers.
- From a broader macro-economic perspective, there is an increasing focus on how investment managers deploy capital across the economy and the implications of that activity in the context of the stability of the global financial system.

**FIGURE 7: KEY POLICY AND REGULATORY THEMES**



Value also links to a critical operational and resilience issue: how firms are deploying technology to improve efficiency, lower costs of delivery and ensure cyber resilience. Technology in turn is shaping up to transform all aspects of the investment management delivery chain.

## A FOCUS ON VALUE IN AN EVOLVING LANDSCAPE

In the UK, the defining feature of 2018/19 will be the implementation of a range of regulation stemming primarily from the Asset Management Market Study,<sup>11</sup> but also drawing in work on conduct and culture:

- Firms are preparing for the implementation of new value assessment processes, which will take effect from 30 September, the same time as requirements for independent non-executive directors (or equivalent) on fund management company bodies. These value assessments arise from a desire by UK regulators to place more responsibility directly on fund manufacturers for driving competition on price across the UK fund market.
- The value assessment requirements are linked to the implementation of the Senior Management and Certification Regime (SM&CR) from December 2019. Undertaking the value assessment will be a prescribed responsibility under SM&CR.
- Firms are also implementing extensive changes in the area of transparency and clarity of communication. These affect two areas in particular. First, the transaction costs incurred in the capital markets, with a significant new framework for institutional reporting under the Cost Transparency Initiative. Second, investment fund objectives, use of benchmarks and performance reporting.

A consistent theme in the IA Investment Management Survey, and in other reports, has been the convergence between retail and institutional markets as traditional differentiators have been eroded. This can be seen both at product level and in terms of customer type in the context of the growing pre-eminence of DC pension schemes. Firms also increasingly point to a convergence in terms of levels of governance, transparency and fee competition, and see this direction of travel intensifying in the context of recent regulatory change.

**“THE FIRST THING THAT COMES TO MIND IS THE EVER INCREASING SIMILARITY BETWEEN WHAT THE END CUSTOMER CAN GET, WHETHER AN INDIVIDUAL OR INSTITUTION. THE HIGH QUALITY INVESTMENT MANAGEMENT AND ALL THE TRANSPARENCY THAT COMES WITH INSTITUTIONAL INVESTING IS NOW AVAILABLE TO RETAIL CLIENTS.”**



**“FROM WHERE I SIT THERE IS HUGE COMPETITION IN THE ASSET MANAGEMENT SECTOR. EVERY SINGLE BIT OF RETAIL BUSINESS WE GET IS SECURED THROUGH HAND TO HAND FIGHTING. THERE IS COMPETITION FOR EVERYTHING THAT WE DO FROM BIG PLAYERS, SMALL PLAYERS, CHEAP PLAYERS, EXPENSIVE PLAYERS.”**



<sup>11</sup> The Final Report of the FCA Asset Management Market Study was published in June 2017, with implementation of remedies now almost complete. The FCA has also published the Final Report from its Platform Market Study (March 2019) and the CMA released the final report from its investment consultants market investigation in December 2018. All have ramifications for the UK asset management industry.

## DEFINING VALUE IN THE NEW WORLD

The changing regulatory requirements will also intensify an environment in which cost is becoming ever more important in the context of an ongoing split in the market between a widening range of low cost indexing products and active funds with demonstrable capabilities, whether within or across asset classes.

As we note in our analysis of the UK retail fund market, the last ten years have seen a clear trend towards more outcome-focused funds (e.g. multi-asset funds, volatility-constrained, targeted absolute return) which many in the industry see as a long-term structural shift, albeit with a cyclical dimension given the low interest rate environment. This is also taking place in the context of changing patterns of competition for asset allocation services, with investment advisers increasingly outsourcing this activity together with fund selection.

For the funds industry as a whole, value therefore is being defined far more broadly than outperformance in a given asset class vs. an indexing alternative, which has often tended to be the perception of active management.

### Investment management increasingly defined through the lens of allocation and outcome

#### *A view from investment managers*

“ACTIVE EQUITY MANAGERS NEED TO THINK VERY CAREFULLY ABOUT WHAT IS THE VALUE THAT THEY’RE BRINGING. THERE’S NO POINT IN DOING INDEX PLUS BECAUSE YOU CAN GET THAT VERY CHEAPLY FROM BETA. ASSET ALLOCATION IS ALSO REALLY IMPORTANT AND DRIVES LONG TERM RETURNS BEYOND THE SINGLE INDIVIDUAL STOCK FUNDS THAT ACTUALLY BEAT A BENCHMARK...WE HAVEN’T YET FOUND A COMPUTER THAT CAN DO ASSET ALLOCATION WELL, YOU STILL NEED THAT HUMAN ASSET ALLOCATION SKILL SET.”



“THE VALUE AS AN ACTIVE MANAGER HAS BEEN MOVING TOWARDS THE OUTCOME BEING DELIVERED IN TERMS OF INCOME AND RISK. THAT IS A CONTINUING TREND OF WHAT YOU’RE SEEKING TO DO IN TERMS OF THE PORTFOLIO MANAGEMENT...THE MOVE TO DESCRIBING THE OUTCOME YOU’RE SEEKING TO ACHIEVE AND BEING HELD TO ACCOUNT FOR HOW YOU DELIVER AGAINST THAT IS RIGHT IN TERMS OF THE CHANGING WAY IN WHICH ACTIVE VALUE IS BEING DELIVERED.”



#### *A view from a wealth manager*

“WHETHER YOU’RE A MULTI-ASSET FUND MANAGER OR A DISCRETIONARY WEALTH MANAGER SUCH AS OURSELVES, YOU HAVE THE OPTION OF CHOOSING BETWEEN ACTIVE AND PASSIVE INVESTMENTS. THE KEY IS TO PROVE VALUE AND TO BE ABLE TO DEMONSTRATE VALUE TO END CONSUMERS. WE DO USE ACTIVE FUNDS BUT WE USE THEM SELECTIVELY WHERE WE THINK WE CAN ACTUALLY DEMONSTRATE SOME ALPHA OVER AND ABOVE A PASSIVE SOLUTION. THE THING WE FIND IS OUR DIFFERENTIATOR IS THE INVESTMENT OF TIME AND MONEY INTO OUR ASSET ALLOCATION PROCESS. ROUGHLY 80% OF THE CONTRIBUTION TO OUTPERFORMANCE OF THE BENCHMARK COMES FROM THE ASSET ALLOCATION RATHER FROM YOUR ASSET SELECTION.”



## RESPONSIBLE INVESTMENT

A key trend in terms of the evolving product set, as well as the underlying investment process is the growth of responsible investment. This builds on environmental and social themes as well as on more traditional stewardship activities such as corporate governance oversight and engagement.

“ESG HAS BECOME MUCH MORE HANDS ON THAN THE APPROACH 5-10 YEARS AGO. IT IS MUCH MORE ABOUT LOOKING AT THE IMPACT THAT BUSINESSES HAVE ON THE ENVIRONMENT ALONGSIDE HOW THEY ARE GOVERNED, HOW THEY ARE MANAGED AND HOW THEY PAY THEIR EXECUTIVES. OUR APPROACH IS CHANGING MASSIVELY.”



“IN THE EARLY DAYS OF ESG IT WAS FIRST CHAT ABOUT IT, THEN HIRE SOMEBODY WHO UNDERSTOOD THE CONCEPT.... NOW IT'S ABOUT EMBEDDING THE PROCESS THROUGHOUT THE ORGANISATION.”



Four factors are now deepening the debate and can be expected to do so further:

- **The scale of concern about environmental change** and its implications, probably the most potent theme at an international level.
- **A growing expectation that private finance should support projects aiming at positive social impact.**
- **Stronger expectations of what the investment management industry can achieve in key areas of corporate oversight and holding companies to account.** These include executive pay, improving board and company diversity, audit quality and long-term investment, as well as broader behaviours that may negatively impact corporate and wider economic sustainability. Recent corporate governance scandals in the UK have turned the spotlight on the responsibilities exercised by, or on behalf of, institutional investors.

- The question of corporate oversight in turn raise **questions about ‘stakeholder voice’ and the extent to which mechanisms are developed to ensure that corporate decision-making is not just focussed on shareholder value** but more representative of the wider society, including employees, suppliers and customers. In the UK this theme has featured in policy discussion on both the right and left of the political spectrum.

Together these strands are often brought together under the label of Environmental, Social and Governance (ESG) issues. Multiple initiatives at national, regional and global level are exploring new frameworks for monitoring and development. These involve government, regulators, industry and wider stakeholders, and are increasingly affecting both customer behaviour and industry delivery.

There is an ongoing debate about the boundaries between areas where government or wider society may be responsible for defining norms and what should be left to the investment management industry. This is likely to remain a grey area, with some firms taking a stronger position than others in areas such as investing in tobacco.

“THE VAST MAJORITY OF PEOPLE IN ASSET MANAGEMENT WANT TO DELIVER GOOD OUTCOMES AND HAVE AN IMPACT. AT THE SAME TIME, FUND MANAGERS ARE RELUCTANT TO BECOME POLITICIANS OR TAKE MORE POSITIONS BECAUSE THAT'S NOT OUR JOB. THOSE THINGS ARE CHOICES FOR SOCIETY AND CUSTOMERS AND INEVITABLY, WILL ALIGN IN THE LONG RUN - GOOD BUSINESS DELIVERS GOOD OUTCOMES FOR CUSTOMERS, DELIVERS GOOD IMPACT FOR SOCIETY AND DELIVERS GOOD THINGS FOR THE PLANET. OTHERWISE NO ONE GETS A GOOD OUTCOME.”





## WIDE-RANGING DEVELOPMENTS

In the UK, the Government set up an independent Advisory Group chaired by Elizabeth Corley, which published a report in 2017 on “Growing a Culture of Social Impact Investing in the UK”. In 2018, the Prime Minister commissioned an industry taskforce to progress the recommendations of this report.<sup>12</sup>

The IA is pursuing its own proactive work and has been engaging in extensive consultation on industry-agreed definitions and potential product labelling options.

**“A CRITICISM OF ALL OF US IN THE INDUSTRY IS THAT WE DON’T NECESSARILY EXPLAIN THINGS VERY EASILY TO PEOPLE. THE NEXT WAVE OF MILLENNIALS AND INVESTORS WOULD LIKE TO SEE A REALLY TRANSPARENT, CLEAR AND UNDERSTANDABLE SET OF DEFINITIONS.”**



All of this work is taking place against a fast-moving backdrop, building on existing initiatives such as the UN Principles for Responsible Investment (UNPRI). Recent developments include:

- The European Commission’s Sustainable Finance Package, including an EU Taxonomy and Ecolabel, building on the final report of the High-Level Expert Group on Sustainable Finance.<sup>13</sup>
- A global focus on the private sector’s role in delivery of the UN Sustainable Development Goals.
- British Standards Institute (BSI) work on Sustainable Finance.
- The Financial Conduct Authority (FCA) Discussion Paper on Climate Change and Green Finance.<sup>14</sup>
- A growing debate on the role and responsibilities of UK pension schemes. Following Law Commission reports in 2014 and 2017, the Department for Work and Pensions (DWP) subsequently introduced

regulations clarifying and strengthening trustee investment duties in this area.<sup>15</sup> The FCA is currently consulting on similar requirements for Independent Governance Committees (IGCs) in respect of the insurance-based pension schemes they scrutinise.<sup>16</sup>

The inconsistency in the definitions of the various approaches to responsible investment and interpretation of those definitions, means that data collection is particularly challenging. In this year’s Survey the IA has collected data on the basis of the Global Sustainable Investment Alliance (GSIA) definitions (see Table 3). These categories will be updated in future iterations of the Survey following publication of the IA’s framework on common approaches to responsible investment, but provide a good base for initial analysis.

Chart 5 shows that taking segregated mandates and pooled vehicles together, 26% of total assets are managed according to some form of responsible investment criteria. The data also suggests that almost all of those assets which are invested responsibly are integrating ESG in their investment processes. The overlap in the figures suggests some firms are integrating ESG in combination with other approaches. Given the direction of travel in regulation, it is likely that ESG integration will be systematically embedded into investment processes across firms within the next few years.

Looking at the dedicated responsible investment approaches (negative screening; positive screening; norms-based screening; sustainability themed investing and impact investing) we find:

- Negative screening is the most commonly used approach with £735 billion (10%) of assets excluding investment in certain companies or sectors.
- Positively screened, sustainable and impact approaches are all much less widely used, each with less than 1% of total assets under management. In the impact space this figure stands at 0.3% of total assets, representing £23.2 billion.

It is difficult to estimate total investment in dedicated responsible investment approaches as it is likely that there will be significant overlap in some of the reported totals.

<sup>12</sup> <https://www.gov.uk/government/publications/growing-a-culture-of-social-impact-investing-in-the-uk>

<sup>13</sup> [https://ec.europa.eu/info/publications/180131-sustainable-finance-report\\_en](https://ec.europa.eu/info/publications/180131-sustainable-finance-report_en)

<sup>14</sup> <https://www.fca.org.uk/publications/discussion-papers/dp18-8-climate-change-and-green-finance>

<sup>15</sup> In 2014, the Law Commission issued a report, Fiduciary Responsibilities of Investment Intermediaries, which clarifies expectations that pension trustees should take into account the financially material aspects of sustainability, and also set out circumstances in which non-financial factors could be relevant. It was followed by a Law Commission report of 2017, which clarified how far pension funds may or should consider issues of social impact when making investment decisions.

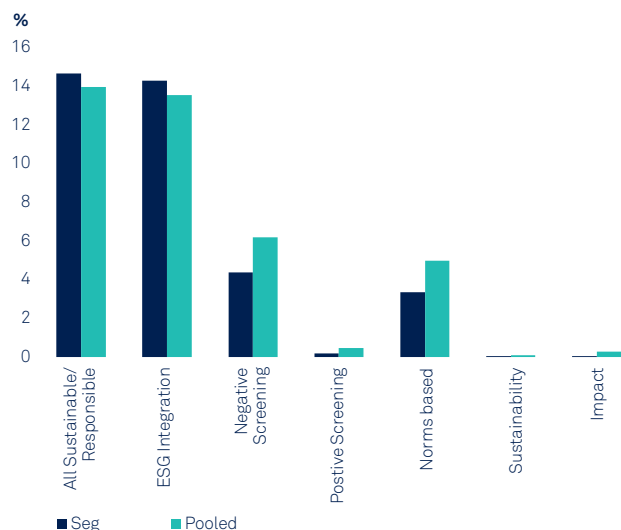
<sup>16</sup> CP19/15 Independent Governance Committees: extension of remit



**TABLE 3: GLOBAL SUSTAINABLE INVESTMENT ALLIANCE (GSIA) DEFINITIONS**

Category	Definitions
Integration of ESG factors	The systematic and explicit inclusion by investment managers of environmental social, and governance factors into traditional financial analysis.
Negative/exclusionary screening	The exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria.
Positive/best-in-class screening	Investments in sectors, companies, or projects selected for positive ESG performance relative to industry peers.
Norms-based screening	Screening of investments against minimum standards of business practice based on international norms.
Sustainability-themed investing	Investment in themes or assets specifically related to sustainability (for example clean energy, green technology, or sustainable agriculture).
Impact/community investing	Targeted investments, typically made in private markets, aimed at solving social or environmental problems, and including community investing, where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to businesses with a clear social or environmental purpose.

**CHART 5: PROPORTION OF ASSETS UNDER MANAGEMENT BY GSIA CATEGORY**



- The FCA has led a discussion on what effective stewardship looks like, the minimum expectations of firms that invest for clients, the standards which the UK should aspire to and the role of the regulator.

**“WE’VE RECOGNISED THE CORRELATION BETWEEN STRONG CORPORATE GOVERNANCE AND REDUCING SOME OF THE RISK. OVER TIME, IT PROVIDES BETTER, LOW VOLATILITY RETURNS. WE’VE BEEN BUILDING THAT MORE INTO OUR INVESTMENT PROCESS OVER THE LAST 5-10 YEARS BUT NOW WE’RE DOING A LOT MORE DOCUMENTING OF IT BECAUSE OF THE REGULATORY ENVIRONMENT AND SOCIETAL EXPECTATIONS.”**



On the UK stewardship side, there is policy and regulatory activity at multiple levels:

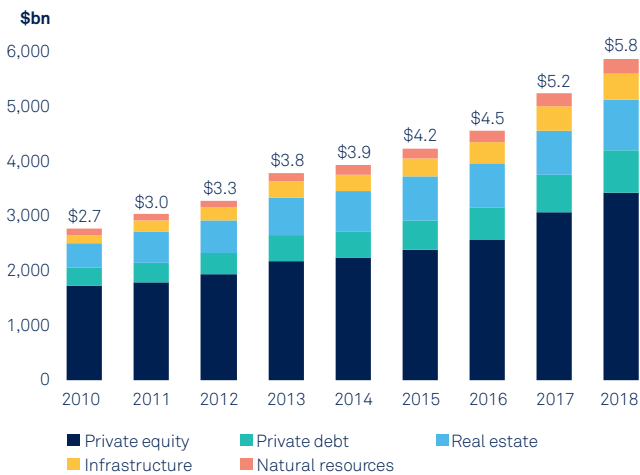
- The Government has set out its expectations of companies and institutional investors in its Corporate Governance Reform package.
- The Financial Reporting Council (FRC) has been consulting on a new Stewardship Code to encourage active stewardship by asset managers and asset owners.

Underpinning this is a fundamental question as to the role of regulation of stewardship, which has also been a longstanding debate at EU level, with the Shareholder Rights Directive II being implemented through 2019. Internationally, stewardship codes are now in place in dozens of countries, reflecting the growing importance of this area of investment management activity.

## GREATER ROLE OF PRIVATE MARKETS

The last ten years have seen a significant growth in private markets. A combination of capital-constrained banks and governments has seen a growing role for market-based finance in many areas of economic and social infrastructure, such as housing. As Chart 6 shows, total private markets have more than doubled since 2010, with growth in infrastructure particularly strong and expected to continue.

**CHART 6: ACCELERATING GROWTH IN PRIVATE MARKETS (2010-2018)**

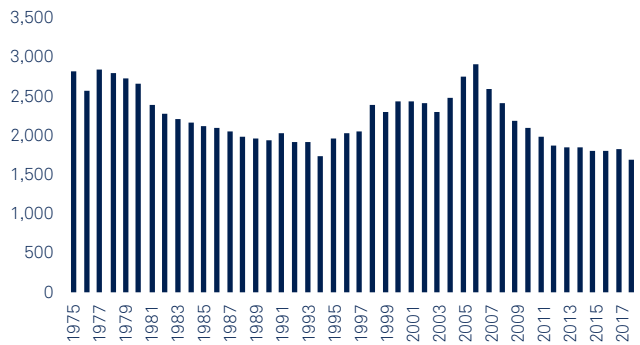


Source: Preqin

It has also coincided with greater activity from corporates who are finding public markets less attractive. This phenomenon is most evident in the US, but can also be seen in the UK as Chart 7 illustrates, with a falling number of publicly listed UK companies. Again, there is a cyclical dimension, with low interest rates making debt an attractive way of raising capital for companies, but there are also structural features, notably the increased burden of registration; and more demanding corporate governance and transparency regulations. These may act as a longer-term dampener.

“IN OUR VIEW, THE AREA THAT IS MOST INTERESTING FOR INVESTORS GOING FORWARD IS THE PRIVATE MARKET. THE UK ECONOMY IS NOT THE 2,500 LISTED COMPANIES, THE UK ECONOMY IS THE 4 MILLION COMPANIES. THEY ARE REALLY INTERESTING BUSINESSES AND SOMEONE’S GOT TO WORK OUT A WAY OF GAINING ACCESS TO THE RETURNS IN THE WIDER ECONOMY RATHER THAN JUST THE QUOTED ECONOMY. FIRST, IT’S A MUCH BIGGER POOL. SECOND, REGULATION AND POLITICAL PRESSURE IS GOING TO LEAD TO A REDUCTION IN THE NUMBER OF QUOTED COMPANIES.”

**CHART 7: NUMBER OF UK LISTED COMPANIES OVER FOUR DECADES (1975-2018)**



Source: World Bank / IA estimates

On the demand side, the drivers have been fairly clear. Pension schemes and other institutional customers are looking for more diversified sources of return and income, reflected in greater interest in alternative strategies and asset classes. Some of this is cyclical, particularly in the context of low interest rates post-2008 and a hunt for yield which has been a key feature of investor behaviour over the past decade.

“WE’RE ON THE BACK OF ALMOST A DECADE OF ULTRA-LOW INTEREST RATES AND QUANTITATIVE EASING WHICH MEANS THE YIELDS ON CONVENTIONAL FIXED INCOME ASSETS ARE LOW. NO ONE WANTS TO ADD THE COMPLEXITY OF ALTERNATIVES FOR THE SAKE OF IT, BUT PEOPLE ARE BEING FORCED TO LOOK AT MORE COMPLEX NICHE AREAS AS A RESULT OF LOW INTEREST RATES.

THIS CYCLE IS CLEARLY DIFFERENT. WHEN YOU COMBINE QUANTITATIVE EASING AND YOU HAVE A SITUATION LIKE Q4 LAST YEAR WHERE CENTRAL BANKS WERE PERCEIVED AS STEPPING AWAY FROM MARKETS, THE CORRELATION BETWEEN BONDS AND EQUITIES BECOMES QUITE HIGH. THAT IS WHY PEOPLE ARE LOOKING AT ALTERNATIVE ASSETS.”



The growth in private markets is raising important questions about how fund investors, including those investing through DC pensions, are able to access such returns effectively.

“THE CHALLENGE FOR INDIVIDUAL INVESTORS IS HOW THEY ARE GOING TO INVEST IN PRODUCTS THAT USE THE FULL INVESTMENT TOOLBOX. BECAUSE THEY CAN’T ACCESS NON-TRADITIONAL ASSETS, WE’RE ACTUALLY HARMING THE VERY INVESTORS WE ARE TRYING TO PROTECT BY NOT GIVING THEM A FULL RANGE OF STRATEGIES TO MEET THEIR LONG TERM OBJECTIVES.”



As this survey is published, the public debate about these issues is intensifying, with a range of concerns about ‘liquidity mis-match’, whereby expectations of daily trading for investment funds may not reflect the liquidity of the underlying assets themselves. The most obvious examples of this are the challenges in open-ended funds that invest directly into asset such as

property which are slow to buy and sell. However, the debate rapidly becomes more complicated given the different degrees of liquidity which may exist across different asset classes and over time, depending on market conditions.

A range of options exist to address these issues, including using open-ended funds with longer redemptions periods or closed-ended funds where the price will provide an adjustment mechanism in the event of investors seeking to sell quickly. The Investment Association has put forward plans for a new kind of fund, a Long-Term Asset Fund which could provide customers with a different way to access less liquid or illiquid assets.

Whichever route is ultimately chosen, the industry recognises the need for clear communication and investor education to help customers understand the nature of the investment process.

“IF YOU THINK WIDER IN TERMS OF INNOVATION, GOVERNANCE, SMALL COMPANY FORMATION, SCALE UP AND ALL THOSE KIND OF AREAS THEN IT IS CLEARLY A GOOD THING FOR THE ASSET MANAGEMENT INDUSTRY TO BE CONTINUALLY PUSHING INTO THAT SPACE. BUT YOU’VE GOT TO MAKE SURE YOU’RE REALLY CAREFUL ABOUT THE TRANSPARENCY OF RISK AND REWARD FROM A CLIENT’S PERSPECTIVE.”



“THE ABILITY TO INVEST IN LESS LIQUID ASSETS IN ITSELF WOULD BE A GOOD THING BUT THERE NEEDS TO BE THE EDUCATION THAT THE INVESTMENT IS OVER A DIFFERENT TIMELINE. THE BEHAVIOUR WE OBSERVE AROUND SHORT TERM PERFORMANCE DRIVING FLOWS COULD MEAN THE CLIENT WOULD COME OUT AT THE WRONG MOMENT.”



## FURTHER TECHNOLOGICAL ADVANCE

Firms we interviewed for this and other recent Surveys emphasise the strategic importance of technological innovation, which will transform every aspect of the industry, from investment decisions to client experience. It is already evident in a number of areas, facilitating new products such as ETFs, new distribution processes (e.g. robo-advice) and dramatic changes in the speed and process of trading in capital markets. The consensus is that transformational change lies ahead as the industry undergoes a revolution in technology, which will affect front, middle and back offices, as well as the advice and distribution landscape.

Looking to the longer term, the full impact of this is difficult to predict beyond the scale of change. Over the short to medium term, key areas to watch will include:

- **Increased internalisation** as more firms internalise resources and decrease offshore headcount to retain IP and support cross functional initiatives.
- **Role redeployment** through a shift of resources to value-add functions and oversight activities, meaning automation – and potential outsourcing - of commoditised activities.
- **Evolving skill set** with investment managers increasing tech talent to take advantage of Artificial Intelligence (AI) data analytics and Robotic and Automation technologies with the potential to transform business operations (discussed in more detail below).

“THE MOST IMPORTANT THING IS HOW TECHNOLOGY CAN IMPROVE THE ACCESSIBILITY AND ANALYSIS OF THE DATA THAT WE’VE ALREADY GOT... WE NEED TO UNDERSTAND MORE ABOUT OUR CUSTOMERS SO WE CAN GET BETTER AT BUILDING THE RIGHT PRODUCTS AND SOLUTIONS.”

There is also a link here to wider issues of culture and diversity within the industry as it seeks to attract those with different backgrounds and skillsets in the context of both technological change and the wider shift toward sustainable and responsible investment outlined in the previous section.

“ASSET MANAGEMENT IS NO LONGER JUST ABOUT RUNNING THE MONEY AND TALKING TO INVESTORS. IT REQUIRES HUGE INVESTMENT IN TECHNOLOGY AND A DIFFERENT WAY OF THINKING, INCLUDING MAKING THE WORLD A BETTER PLACE. YOU’RE GOING TO NEED DIFFERENT SKILL SETS AND DIFFERENT TYPES OF PEOPLE THAT WE NEVER THOUGHT OF HIRING BEFORE.”



## CHANGE THROUGHOUT THE VALUE CHAIN

These trends are being driven by the increasing adoption and implementation of new technologies throughout the value chain expressed as:

- Acceleration of operational modernisation and robotic process automation (RPA), ensuring substantial efficiency gains within and between different functions of the middle and back office.
- Increasing use of AI and data analytics across functions from funds marketing and distribution to portfolio decision-making and risk analysis.
- The further emergence of AI assisting key decision processes, including asset allocation, security selection, portfolio construction and trading. From a technology perspective, trading is already a major focus for firms to ensure the most efficient trade execution in a fast-evolving environment.
- Changing patterns of distribution, which may see a further blurring between the role of investment manager and advisor/distributor.
- Increasing cloud migration with the growing prevalence of third party applications as firms re-optimize internal architectures for cloud readiness and evaluation of vendor security maturity.
- A shift to digital platforms leveraging distributed ledger technologies and broad Application Programme Interface (API) architecture, both internally and with external clients along with integration of third party platforms to provide best of breed client experiences.

## WIDER RANGE OF ISSUES FOR INDUSTRY

The ways in which investment management firms respond will vary, both between and within different categories of managers. Key questions will include:

- The balance between outsourcing vs. internal system development.
- The balance between manufacturing and distribution in the long-term savings and pensions markets, likely leading in turn to a greater role for robo-advice.
- AI ethics and accountability and its impact on resource reallocation.
- The shape of the client acquisition and retention experience.

Clearly, the extent of this digital transformation will require the implementation of new governance oversight control processes and compliance frameworks, as well as enhanced operational and cyber resilience in the context of a rapidly evolving and borderless threat environment. Ultimately, management buy-in and firms' appetite for moving from legacy applications to the scaling-up of data driven AI and RPA solutions will determine the pace of digital adoption and transformation.

# 3 TRENDS IN CLIENT ASSETS AND ALLOCATION

## KEY FINDINGS

### CLIENT TYPE

- » Institutional clients remain the largest client group accounting for four fifths of assets under management (80%).
- » Pension schemes continue to be the largest institutional client type with 45% of total assets in 2018, increasing total assets by £135 billion in a year when the absolute value of retail and other institutional assets were down.
- » Consistent with previous findings, 56% of assets were managed on a segregated basis and 44% on a pooled basis.

### ASSET ALLOCATION

- » Allocation to equities fell from 40% to 36%, possibly reflecting the poor performance in global equity markets in the last quarter of 2018. Both fixed income and 'other' assets increased their share by 1.8% as a result, increasing to 33% and 23% respectively. All other asset classes remained largely unchanged from 2017.
- » Within equities the UK allocation remained unchanged at 30% compared to 47% ten years ago. The fixed income allocation to overseas bonds increased by 7% in 2018 to 49%, up from 34% in 2011 when data was first collected.

### GROWTH OF INDEXING MARKET

- » Three quarters (74%) of assets remain managed on an active basis, down from 84% a decade ago.
- » UK listed ETFs reached £240 billion in 2017, a 21-fold increase in value from £11 billion at the end of 2008.

### INVESTMENT IN THE UK ECONOMY

- » Despite reduced allocations to UK assets as a proportion of total assets, IA members remain significantly invested in the UK economy holding £1.6 trillion in UK equities, corporate bonds, commercial property and, increasingly in recent years, in infrastructure and direct lending.
- » Three quarters of infrastructure investments are in economic infrastructure with the remaining quarter invested in social infrastructure, such as public schools or hospitals.



This Chapter looks across the entire UK-managed asset base of IA members and documents how these assets are split between different client groups, how they are allocated across asset classes and geographies, and what proportions are actively or passively managed. The distinctions are not always entirely clear, for example the line between retail and institutional is becoming increasingly blurred in the context of the growth in DC pensions. The institutional and retail markets are covered separately and in more detail in Chapters 4 and 5 respectively.<sup>17</sup>

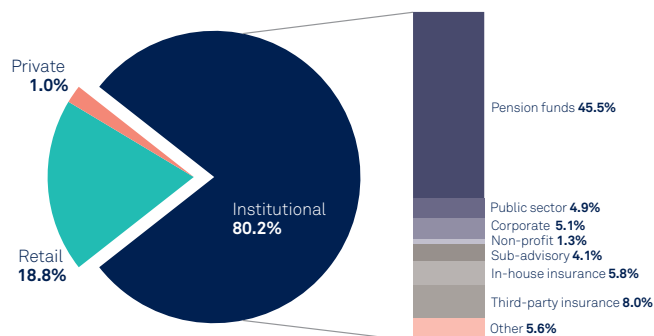
## CLIENT TYPES

IA members manage assets on behalf of a range of different clients which can be broadly split into retail and institutional. The client breakdown in 2018 has remained fairly consistent with what we reported last year.

As Chart 8 shows, four-fifths (80%) of IA members' assets were managed on behalf of institutional clients in 2018, a marginal increase on the previous year. Once again pension funds dominate the client breakdown and are approaching half of all assets under management (45%). In a year where the absolute values of both retail and insurance assets were lower than the previous year, pension fund assets increased by £135 billion to £3.5 trillion.

The biggest year on year changes are in the insurance assets. In-house insurance has decreased from 8.3% in 2017 to 5.8% while third party insurance has increased from 6.7% to 8.0%. This decline in in-house insurance assets is a long term trend (see Chart 25) but has accelerated over the last year due to merger and acquisition activity. When we combine the insurance assets we still see an 8.5% reduction in their absolute value in 2018.

**CHART 8: ASSETS MANAGED IN THE UK BY CLIENT TYPE 2018**



The distinction between the different client types is becoming more challenging giving the blurring of line between different client types (see “Blurring of client types” overleaf for more detail).

<sup>17</sup> Chapter 4 relates to money managed for UK institutional investors by IA members globally. It does not reflect money managed in the UK for all institutional clients.

## BLURRING OF CLIENT TYPES

### Insurance vs Pension

The definition of pension funds in the IA's data includes all schemes, both defined benefit (DB) and defined contribution (DC) where the scheme has a direct relationship with the investment manager, notably DB schemes and some of the larger DC schemes, including master trusts. However, the direction of travel in the pension provision market, with the ever-increasing importance of DC schemes, is making the distinction between the different client types more challenging.

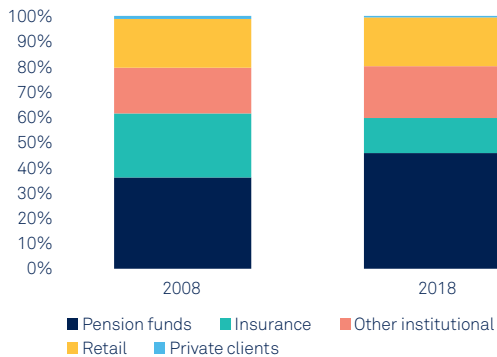
### Retail vs Institutional

DC is something of a hybrid between retail and institutional. Pension savers in DC schemes receive an income in retirement that is based on the value of the pension pot they have accrued during their working life. Unlike a DB scheme, where their pension is based on their salary and is ultimately guaranteed by an employer, the value of a DC pension is determined by the contributions an individual makes to their plan and the return on assets they achieve on the investment strategies they select. The ultimate investment risk lies with the individual rather than the employer, and in this regard DC pensions are more akin to retail investments than institutional, albeit they will appear in the IAs data either as Pension fund or Insurance assets.

## LONGER-TERM EVOLUTION OF CLIENT BASE

Looking at the long term trend in client types, we see the 80/20 split between institutional and retail clients observed in 2018 has seen little change over the last decade (Chart 9). More significantly, the underlying institutional client types have seen considerable change. The proportion of total assets from insurance clients is close to half the levels observed in 2008, driven by the decline in in-house insurance. The majority of the lost market share has been absorbed by pension funds which have increased their share by a quarter in the last decade from 36% in 2008 to 45% in 2018. Other institutional assets, particularly public sector and corporate client assets have absorbed the rest.

**CHART 9: ASSETS MANAGED IN THE UK BY CLIENT TYPE (2008-2018)**

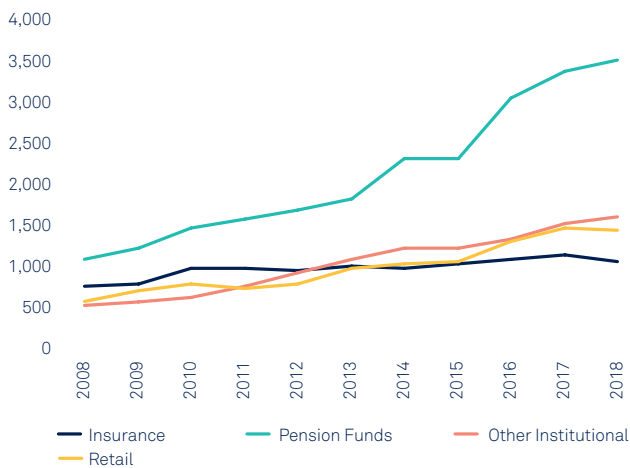




As we will see in Chapter 4, liability driven investment (LDI) by DB pension schemes looking to manage the run off of their liabilities is a likely driver behind the growth of pension assets. To a lesser extent it will also reflect the increased pension participation resulting from automatic enrolment, much of which has been invested into master trust arrangements.

Chart 10 shows the growth of assets by client type in billions and shows the scale of pension assets relative to other client categories. The almost ten percentage point increase in pension funds' share of total assets seen in Chart 9 is equivalent to a threefold increase in assets from £1.1 trillion in 2008 to £3.5 trillion in 2018. Until 2013 growth in pension assets was in line, or slightly behind growth in retail and other institutional assets. Since 2013 pension assets have outpaced the growth in retail by a factor of two, almost doubling their assets in a period when retail and other institutional assets grew by 50%.

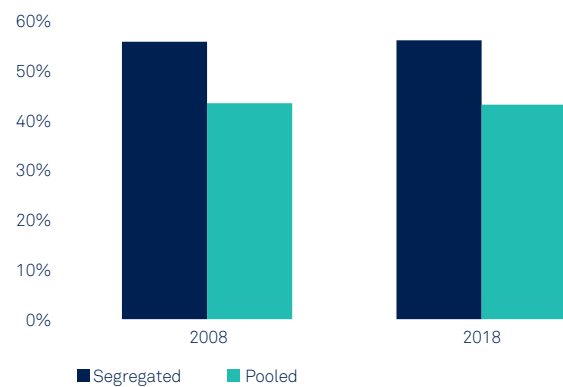
**CHART 10: ASSETS MANAGED IN THE UK BY CLIENT TYPE, £BN (2008-2018)**



## SEGREGATED VS. POOLED

Despite the rise of ETFs alongside more established indexing vehicles such as investment funds and life funds, segregated mandates remain heavily used in the traditional institutional market. The ratio of segregated to pooled assets in 2018 is equal to the ratio reported in 2008, with almost no fluctuation in between (Chart 11). In 2018, 56% of assets were managed on a segregated basis and 44% on a pooled basis.

**CHART 11: SEGREGATED VS. POOLED INVESTMENT (2008-2018)**



## ASSET ALLOCATION

As we discussed in Chapter 1, global equity markets' performance was severely hit in the last quarter of 2018 and although our data does not allow us to distinguish between market performance and flows, we can reasonably conclude that the changes in asset allocation are at least partly due to the market volatility observed in 2018. The most significant changes in asset allocation were seen in equity and 'Other' assets. Allocation to equities decreased from 40% in 2017 to 36% in 2018. Fixed income and 'other' asset classes with both increased as a proportion of total assets by 1.8% to 33% and 23% respectively.

Chart 12 illustrates the structural shift in asset allocation over the last decade. Equity and fixed income remain the two largest asset classes, but allocations outside traditional asset classes have increased significantly. The 'other' category has itself evolved from a focus on commodities, infrastructure and private equity to include LDI and solutions strategies where firms may be using derivatives extensively. It will also include some products where it is not possible to break down the allocation precisely. In 2018, 23% of assets were identified in this broad category, higher than the 21% observed in 2016 and 2017.

**CHART 12: OVERALL ASSET ALLOCATION OF UK-MANAGED ASSETS (2008-2018)**

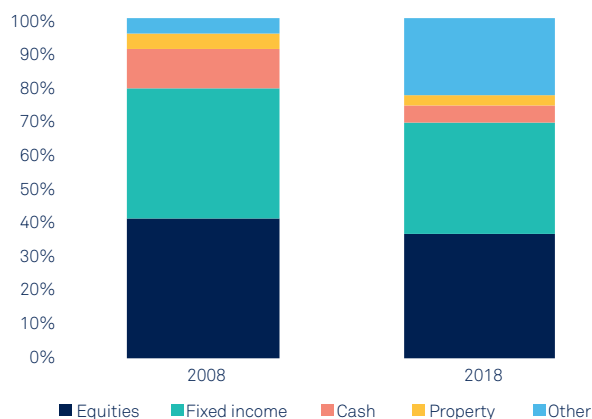
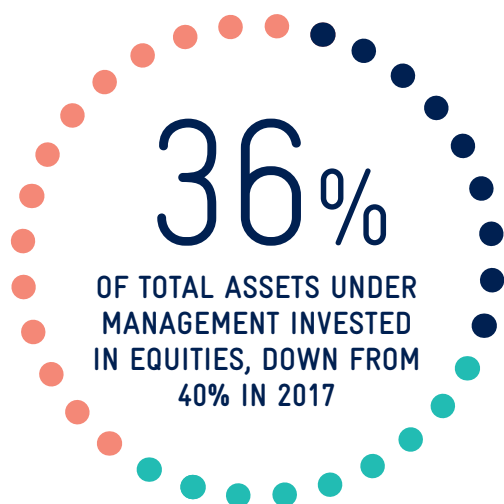


Table 4 shows that almost all members invest in equities with the vast majority also investing in fixed income and cash. The number of firms investing in property and alternative assets is significantly lower.

**TABLE 4: PROPORTION OF IA MEMBERS INVESTING BY ASSET CLASS**

	Percentage of firms
Equities	96%
Fixed income	85%
Cash	71%
Property	44%
Other	58%



## DETAILED ASSET ALLOCATION

Beyond the shifts between asset classes, the IA also monitors the trends within equity and fixed income allocations according to type of exposure and this section considers these changes in more detail.

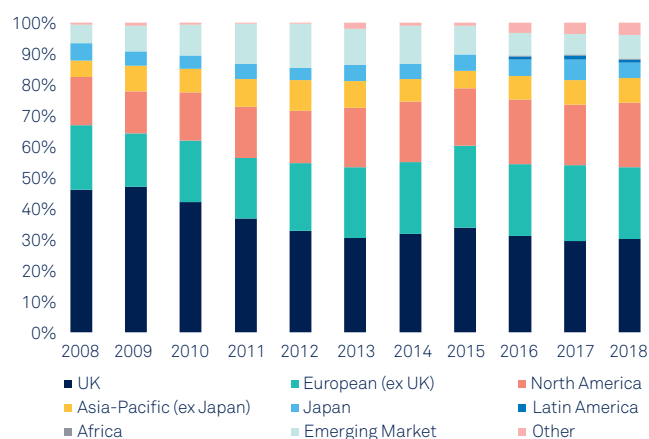
### EQUITY BY REGION

Despite the market turbulence discussed in Chapter 1, there were no significant year on year changes in regional equity allocation. Within the last year allocation to UK equities remained unchanged. There was a slight decrease in allocations to Europe ex-UK to 23% as well as a slight increase in the allocation to North America from 19% in 2017 to 21%.

The long term trend in regional equity has been the decreasing allocation to UK equity relative to overseas equity (Chart 13). In 2018, this figure remained unchanged from last year standing at 30% compared to 46% a decade ago. Allocations to UK equity have fluctuated around, but not yet breached, the 30% mark for a number of years suggesting a base level of home bias. North America and European regions have absorbed the majority of this reduced allocation. This decline in UK equity allocation is driven by trends in both the institutional and retail market (see page 63 and page 69). We discuss overall investment in the UK economy in the final section of this chapter.

Emerging market equities' share of total equity allocation grew consistently in the immediate aftermath of the financial crisis but have been falling year on year since 2012. This trend appears to have reversed slightly in 2018 where allocation increased from 6% last year to 7%.

**CHART 13: UK-MANAGED EQUITIES BY REGION (2008-2018)**



### FIXED INCOME BY REGION

While regional allocations in the equity markets have remained largely unchanged in the last few years, the bond market has seen considerable increases in overseas allocation from 42% in 2017 to 49% in 2018 (Chart 14). Half of this loss in UK market share in 2018 comes from the reduced allocation to UK government bonds (non-index linked) from 20% to 16%.

Growth in allocation to overseas bonds has coincided with the UK's decision to exit the European Union, increasing by two-fifths since 2015 from 36% to 49%. The uncertainty around Brexit has meant that firms are looking to reduce their exposure to the UK market. It is also a reflection of pension scheme derisking leading to more much money chasing a limited supply of UK bonds with greater investment opportunities in overseas markets.

Sterling corporate bonds have been the biggest losers since the referendum, with allocations decreasing year on year from 26% in 2015 to 18% in 2018.

**CHART 14: ALLOCATION OF UK-MANAGED FIXED INCOME BY TYPE AND REGION (2011-2018)**

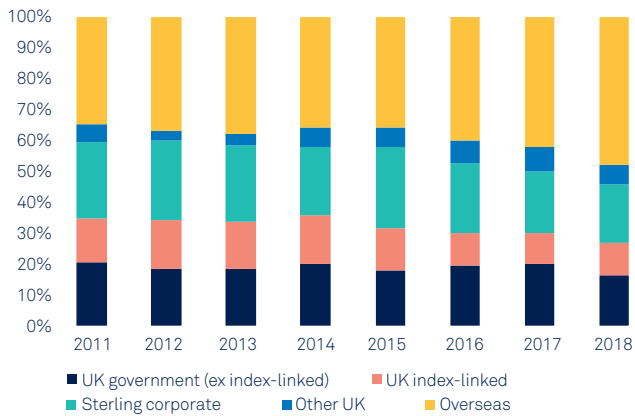
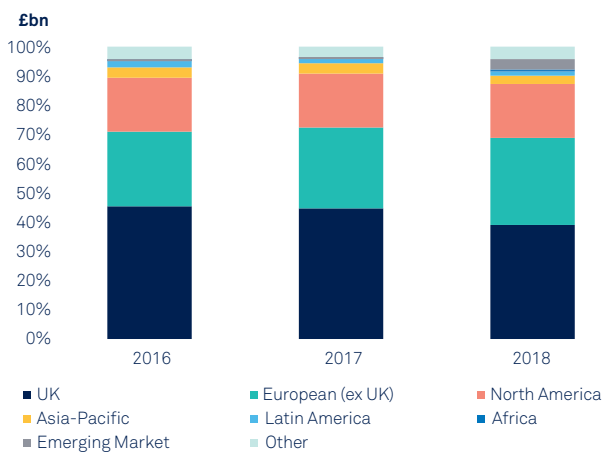


Chart 15 shows that as a proportion of total corporate bond assets, allocation to UK corporate bonds fell in 2018 from 45% to 39%, mirroring what we observed in Chart 14.

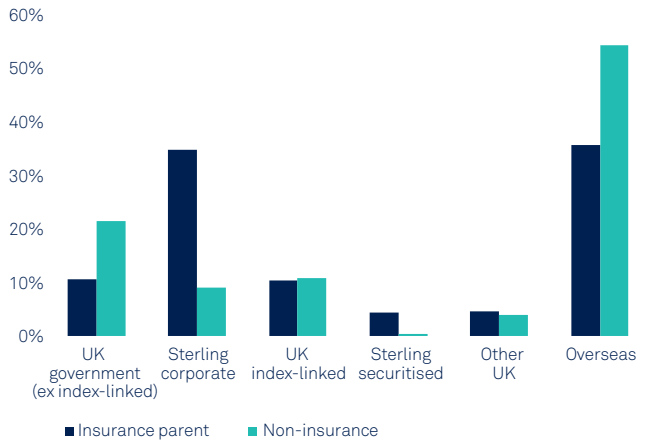
**CHART 15: CORPORATE BOND ALLOCATION BY COUNTRY OF ISSUER (2016-2018)**



**FIXED INCOME BY CLIENT TYPE**

Fixed income allocations differ depending on the category of the underlying client. Insurance companies, for example, have very specific requirements, partly driven by the nature of their product set (ie. annuities, protection such as life insurance) and partly driven by prudential regulation. If we look at how the allocation is altered depending on whether the investment manager has an insurance parent or not (see Chart 16) that difference becomes very clear. Insurance-owned groups have a much higher exposure to sterling corporate securities and, to a lesser extent, to index-linked gilts.

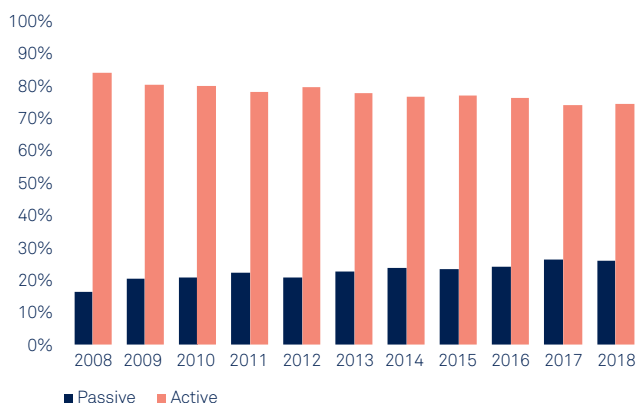
**CHART 16: FIXED INCOME OWNERSHIP BY PARENT GROUP (INSURANCE VS. NON-INSURANCE)**



## GROWTH OF INDEXING MARKET

Chart 17 shows the extent to which UK managed assets are actively managed versus passively (index or 'index plus') managed and how this has evolved over the last decade. The growth in passive assets has increased from 16% in 2008 to 26% in 2018. This growth has been very gradual over the last decade.

**CHART 17: ACTIVE AND PASSIVE AS PROPORTION OF TOTAL UK ASSETS UNDER MANAGEMENT (2008-2018)**



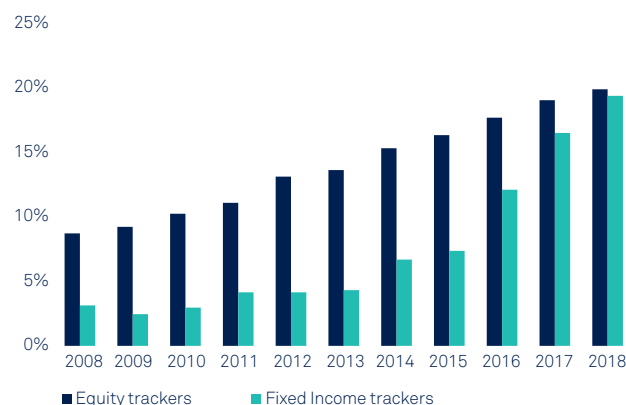
The trend in active and passive reflects two key factors

- Increasing demand for active and passive strategies within each asset class.
- Increasing allocation to strategies such as multi-asset or outcome focused that, by nature, involve more active management.

The IA began to collect the split between active and passive for equity and fixed income assets in 2017. In 2017 we reported that over half of equity assets were managed passively, in 2018 this fell to just over two fifths (42%). This is likely a reflection of the performance of major equity indices in Q4 of last year. The proportion of passive in fixed income also fell slightly from 34% in 2017 to 31%.

In the retail market, data from the IA's monthly fund statistics shows the proportion of funds under management in tracker funds was slightly lower at 15% by the end of 2018, more than double what it was in 2008. At an asset class level, in both equity and fixed income about 20% of fund assets sit in tracker funds (Chart 18). Fixed income in particular has seen remarkable growth in tracker fund assets, increasing by more than six times the proportion of assets reported in 2008.

**CHART 18: TRACKER FUNDS AS A PROPORTION OF FUNDS UNDER MANAGEMENT BY ASSET CLASS (2008-2018)**



ETF data is not currently included in IA monthly fund statistics, therefore we may not be capturing all retail investment activity. In 2018 we launched a consultation on the inclusion of ETFs in IA sectors, which should be captured in future iterations of the Survey.

## THE ETF MARKET

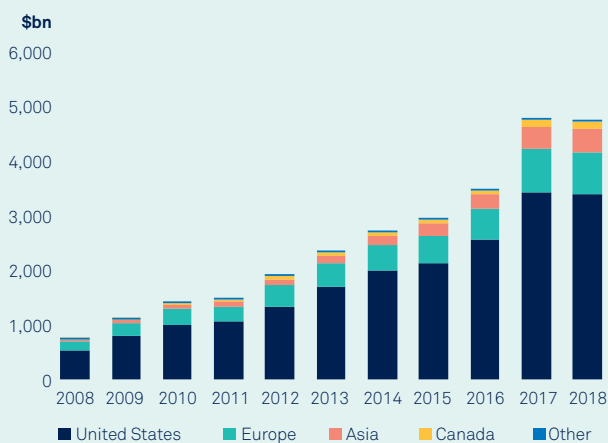
An ETF is an open-ended pooled investment vehicle with shares that, like a ‘traditional’ fund, will offer investors access to a portfolio of stocks, bonds, and other assets, most commonly aiming to track an index. Unlike a fund, it can be bought or sold throughout the day on a stock exchange which is why ETFs are effectively a hybrid of a tradeable stock and an index-tracking fund.

Over the last decade global ETFs have grown significantly from \$746 billion in 2008 to \$4.7 trillion. This is equivalent to a CAGR of 18% per annum. This global growth has far outpaced the CAGR in both UK AUM and FUM which grew 9% and 11% per annum respectively over the same period.

Chart 19 shows how assets in United States domiciled ETFs dwarfs all other jurisdictions with almost three quarters of total assets (\$3.4 trillion), European-domiciled ETFs stood at \$766 billion and Asian domiciled ETFs had assets under management of \$441 billion. Ireland is the second largest country of domicile behind the United States with \$427 billion held in ETFs.

As noted throughout the report, 2018 was a volatile year for global markets. Although the 0.5% fall is miniscule, it marks the end of a 10-year trend of year on year growth.

**CHART 19: ETF ASSETS UNDER MANAGEMENT BY REGION OF DOMICILE**



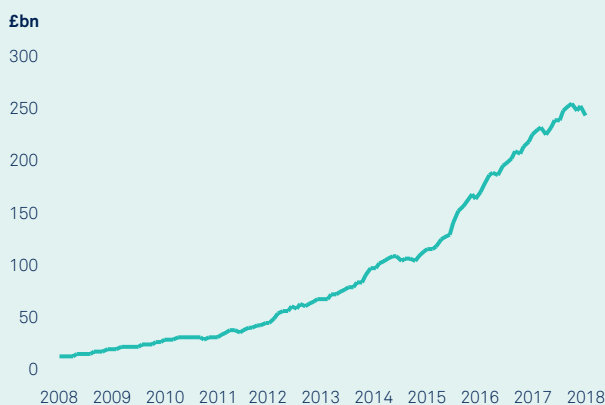
Source: Morningstar

## ETFs IN THE UK

We cannot isolate the UK market for ETFs by domicile or by investor location in the same way we do for UK authorised and recognised funds. There is just one ETF domiciled in the UK. An ETF’s domicile is not entirely relevant as it can be bought and sold from around the world making it impossible to know the location of the investor.

We use listing location as a proxy for UK managed ETFs on the basis that most of these assets are managed in the UK by IA members, who also report that almost all assets they manage in ETFs are managed on a passive basis. There are about 1,000 ETFs listed on UK exchanges with assets totalling £240 billion at the end of 2018, UK-listed ETFs have seen a 21x increase in value from £11 billion at the end of 2008 (see Chart 20).

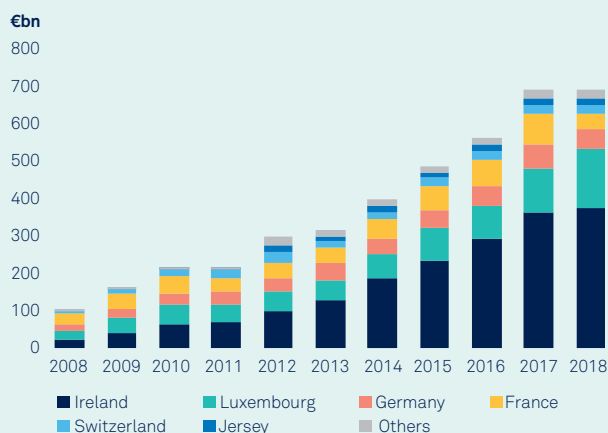
**CHART 20: ASSETS MANAGED IN UK LISTED ETFs (2008-2017)**



Source: Morningstar

The US ETF market is so large, it can mask some of the strong growth we see in other domiciles. Chart 21 focuses on the long-term trend in European domiciled ETFs which largely mirrors the growth we observed in the global market. As discussed, Ireland is the second largest global domicile for ETFs and dominates in the European market with 54% share (€375 billion) more than double its share of the market a decade ago.

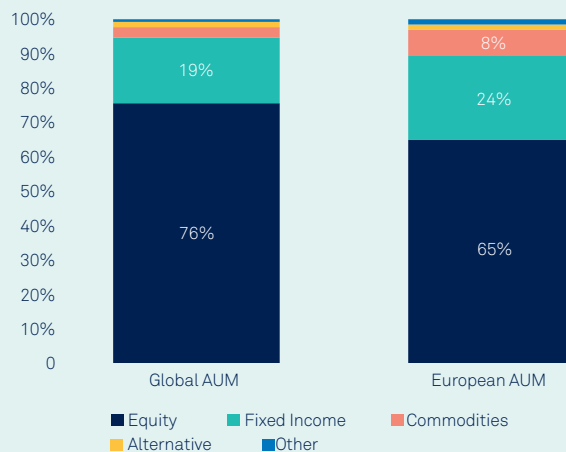
**CHART 21: EUROPEAN ETF ASSETS UNDER MANAGEMENT BY COUNTRY OF DOMICILE**



Source: Morningstar

Asset allocations have remained fairly consistent over the last decade with equities commanding the largest allocation both globally and in Europe. European domiciled ETFs have a lower proportion of equity ETFs and a higher proportion of fixed income and commodity ETFs relative to global allocations (Chart 22).

**CHART 22: PROPORTION OF TOTAL ETF ASSETS UNDER MANAGEMENT BY ASSET CLASS, 2018**



Source: Morningstar

## INVESTMENT IN THE UK ECONOMY

By channelling savings to capital markets, the investment management industry is a key source of funding for the UK economy, providing financing through a wide range of asset classes. Historically equities, fixed income and property dominated the activity of investment managers in the UK, but increasing use of private markets, including infrastructure, private equity and direct lending reflect the broadening expertise to be found in the UK's investment management industry – see Figure 8.

At the end of 2018, changes in asset allocation shown earlier in Chart 13 meant that the industry had £850 billion invested in UK equities representing 35% of the UK's market capitalisation. The exposure to UK equities as a proportion of holdings over the past twenty years has fallen significantly. This has been driven both by two main factors:

- Erosion of 'home bias', mirrored in other countries, whereby institutional and retail customers are

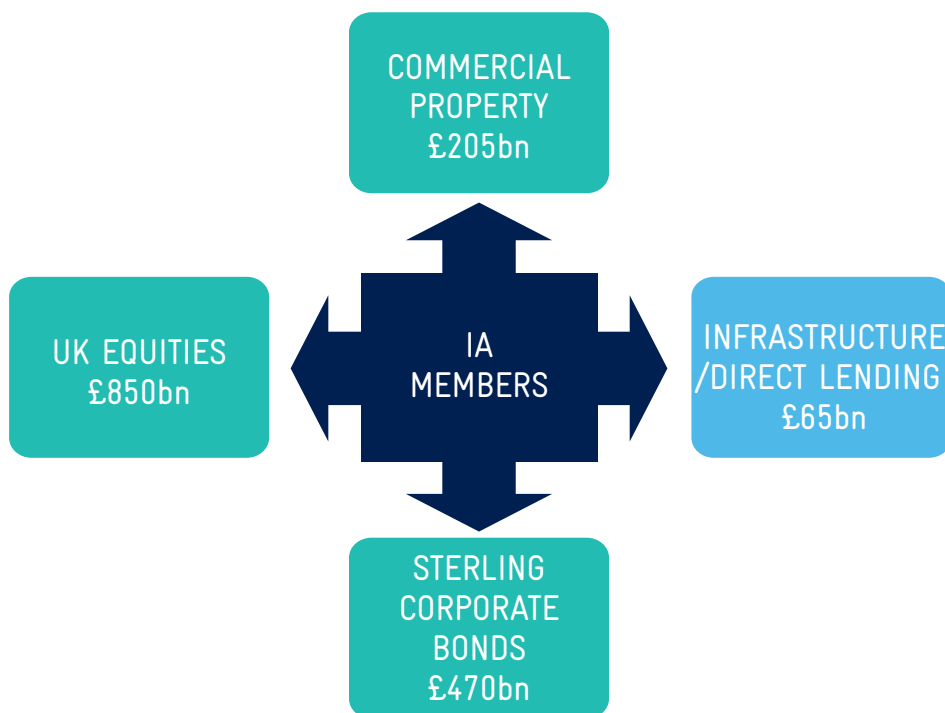
accessing a more international basket of shares (see page 63 and page 68).

- Significant changes in institutional pension allocations which has seen a de-risking, reflecting both regulatory/accounting changes and maturing DB schemes.

The UK's investment management industry continues to play a primary role in corporate debt financing having almost half a trillion invested in sterling corporate bonds. Independent research suggests that investment managers have accounted for purchasing the majority of corporate bond issues in recent years, as companies have turned increasingly to the debt markets to raise capital.<sup>18</sup>

Investment is occurring via more diverse asset classes such as infrastructure and direct lending, which are especially attractive to defined benefit pension schemes and insurers looking for liability driven and cash flow driven investment.

**FIGURE 8: IA MEMBER HOLDINGS IN UK ASSET CLASSES<sup>19</sup>**



<sup>18</sup> The contribution of asset management to the UK economy, July 2016, Oxera

<sup>19</sup> The majority of property investment is in commercial property, however a small amount may be allocated to residential accommodation, notably student housing. The majority of infrastructure investment is UK but some may be invested overseas.

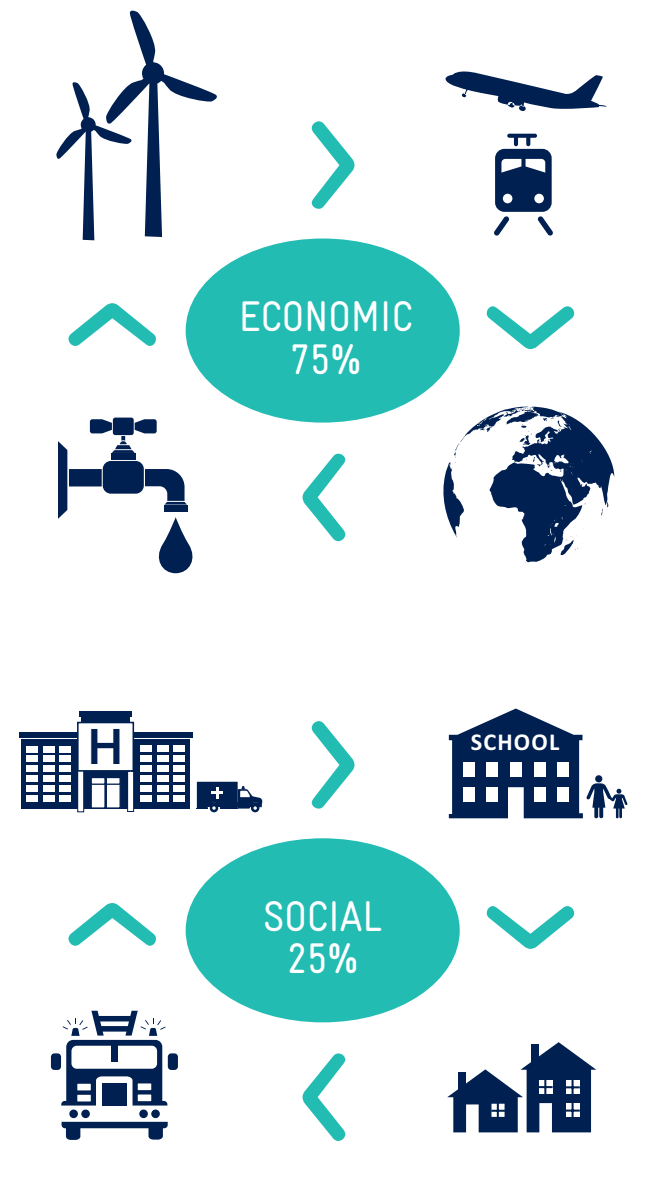
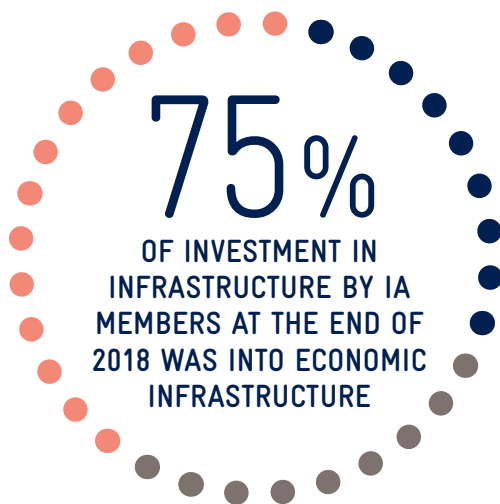


## INVESTMENT IN UK INFRASTRUCTURE

Total assets reported by UK investment managers into infrastructure was £35 billion in 2018, broadly in line with what was reported last year.

Similar to 2017, most investment in infrastructure by IA members at the end of 2018 (75%) was into economic infrastructure. This includes a variety of projects such as energy generation and metering, transport, utilities and environmental schemes such as flood protection. The remaining quarter was invested in projects which offer a social benefit, particularly social housing and healthcare-related projects such as the construction of hospitals (see Figure 9).

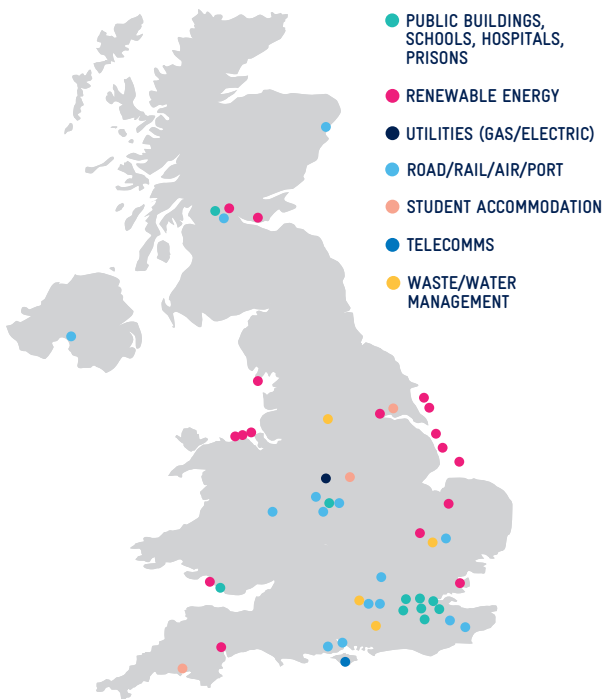
**FIGURE 9: INFRASTRUCTURE INVESTMENT BY IA MEMBERS**



The majority of this investment is estimated to be in UK infrastructure projects. Most UK investment managers will also consider investing in overseas projects that can meet the strict criteria required by their institutional clients.

The range of projects facilitated by IA members on behalf of their clients is extremely broad and Figure 10 provides a flavour of the projects that have been supported by UK investment managers in recent years. Green energy projects are particularly important, with investment in offshore wind farms.

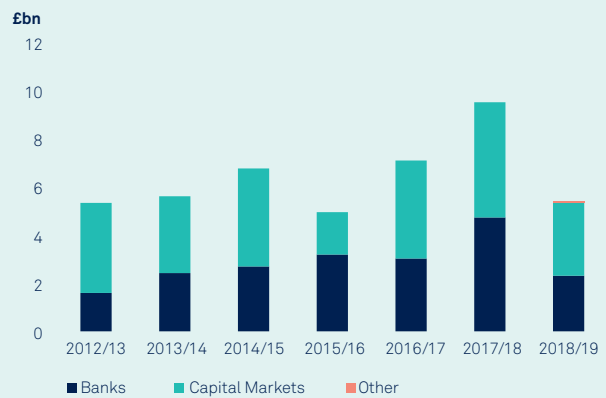
**FIGURE 10: SELECTION OF UK INFRASTRUCTURE INVESTMENT FACILITATED BY IA MEMBERS**



## FINANCING SOCIAL HOUSING IN THE UK

The funding of social housing has undergone a number of step changes over the last 40 years. In the early 1980s housing associations were funded by the Housing Corporation, which provided grant funding. During the 1980s high street lenders entered the market financing housing that would provide them with what was effectively a government guaranteed rental stream, backed by housing benefits. As long-term finance from high-street lenders has become harder to come by housing groups have looked towards the capital markets for funding, via the bond market and private placements.

**CHART 23: NEW HOUSING ASSOCIATION FINANCING BY BANKS AND CAPITAL MARKETS<sup>20</sup>**



Source: Homes and Communities Agency

<sup>20</sup> Quarterly survey of private registered providers, Homes and Communities Agency.

# 4 UK INSTITUTIONAL CLIENT MARKET

## KEY FINDINGS

### MARKET OVERVIEW

- » IA members manage £4.0 trillion for UK institutional clients in offices around the globe. Pension funds are the largest client type, with 65% of institutional assets under management, followed by insurance companies at 22%.
- » This represents an increase of £180 billion from 2017. Data provided by IA members suggests that the majority of this resulted from net inflows from institutional clients during the year, with the remainder coming from asset appreciation.

### THIRD PARTY MARKET

- » Once in-house mandates are excluded from the institutional data, assets under management reduce to £3.4 trillion, up from £3.1 trillion in 2017.
- » Pension funds are even more dominant in the third party market, accounting for 71% of third party assets.

### EVOLUTION OF PENSIONS MARKET

- » £2.6 trillion is managed for UK pension schemes by IA members, with corporate pension schemes representing the greatest proportion of assets, at £2.3 trillion.
- » Assets managed in liability-driven investment strategies reached an estimated £1.2 trillion in 2018, up from £1.1 trillion in 2017.

### MANDATE TYPES

- » Multi-asset mandates, account for about a quarter of total mandates once LDI mandates are excluded (unchanged from 2018).
- » In the breakdown of specialist mandates, equities fell by five percentage points to 35%. Fixed income increased two percentage points to 39% to become the most popular type of specialist mandate.
- » Global bonds remained the largest category of fixed income mandates increasing to 38%, up from 29% in 2017.
- » Over two thirds (69%) of assets were managed actively. All institutional client types were more likely to be managed on an active than a passive basis, but passive is much more widespread in the institutional than retail market.
- » Almost two thirds of third party institutional mandates were managed in segregated mandates (66%), again almost unchanged from 2017.



This Chapter looks more closely at the shape of the UK institutional client market. It differs from previous chapters as it covers all assets irrespective of whether they are managed in the UK or in offices overseas (however, we estimate that more than 90% of the assets are managed in the UK).

The analysis in this Chapter also focuses on the nature of a mandate rather than on the underlying assets. So a global equity mandate will appear as such, rather than being broken down into the underlying constituent countries.

This Chapter covers aspects including the different client types and their relative importance, the size of the third party mandate market and the long-term trends in mandate types. It also looks at developments in the DC pensions market around consolidation, investing in illiquid assets, and delivering retirement income.

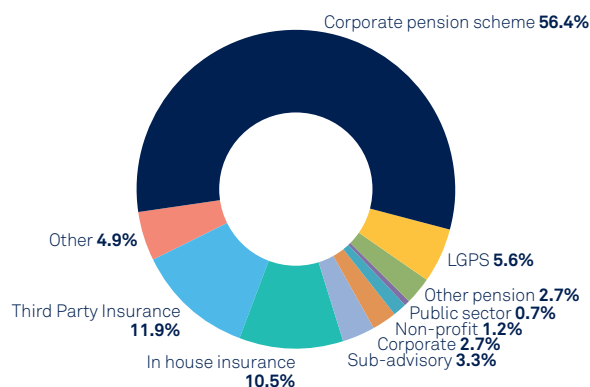
## MARKET OVERVIEW

IA members manage £4.0 trillion<sup>21</sup> for UK institutional clients globally. This represents an increase of £180 billion from 2017. Data provided by IA members suggests that around £100 billion of this resulted from net inflows from institutional clients during the year, with the remainder coming from the change in value of the underlying assets.

## CLIENT BREAKDOWN

Chart 24 indicates pension funds and insurance companies (including in-house and third party management) account for the majority of UK institutional assets (87%)<sup>22</sup>, with pension funds remaining the largest client type.

CHART 24: UK INSTITUTIONAL MARKET BY CLIENT TYPE



<sup>21</sup> Implied figure based on data collected on an estimated 84% of the institutional client base.

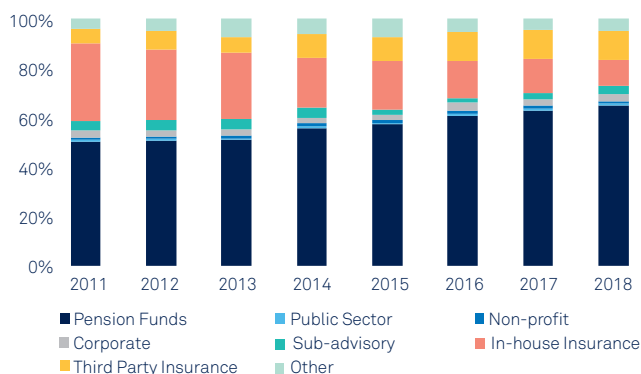
<sup>22</sup> The remaining 12% of assets is made up from mandates managed for corporations (outside of pension assets) sub advisory, not for profit mandates and public sector mandates. Just over half of this (7%) is managed for 'other' client types, which generally refers to a variety of open- and closed-ended pooled vehicles, and investors from the more specialist areas of private equity, venture capital and property.

Since the IA began monitoring the breakdown of the institutional client base in the UK, there has been a marked increase in the proportion of assets managed for pension funds and a decrease in insurance assets, most notably in-house insurance.

Chart 25 shows two notable long term trends in the UK institutional client base: the growth of pension fund assets and the decline in in-house insurance assets. The decline in in-house insurance assets accelerated in 2018 due to merger and acquisition activity.

It should be noted that DC pension assets operated via an intermediary platform through an insurance company are reflected in the IA's insurance assets. Consequently pension assets are actually under-represented in Chart 25 and the shift in assets towards pension funds is even stronger than is implied.

**CHART 25: UK INSTITUTIONAL MARKET BY CLIENT TYPE (2011-2018)**



## EVOLUTION OF PENSION MARKET

IA pension fund data includes DB and DC schemes where the investment manager has a relationship with the pension fund rather than it being distributed via a wrapped product through an insurance company. In 2018, pension funds continued to account for almost two thirds of the institutional client base (£2.6 trillion).

The IA divides pension scheme assets in three categories:

- Corporate pension funds, which at £2.3 trillion represented the majority of UK pension fund assets in 2018. This category includes a number of in-house Occupational Pensions Scheme (OPS) managers, which we estimate manage around £155 billion in assets.
- The Local Government Pension Scheme (LGPS) which accounted for £220 billion of assets in 2018, indicating that IA members manage around 90% of LGPS assets.
- Assets managed for pension schemes that do not fit into either of these categories, such as those run for not-for-profit organisations, representing £110 billion.

Corporate pensions are still dominated by DB schemes, which accounted for around £2.0 trillion in corporate pension assets at the end of December 2018<sup>23</sup>.

<sup>23</sup> Includes assets in the PPF 7800 index plus an estimate of assets in crown guaranteed schemes. This figure does not directly relate to the £1.8 trillion managed for corporate pensions by IA members as some DB assets will be managed by non-IA members and some DC pension assets will be directly managed by IA members.

## SIZING THE MARKET

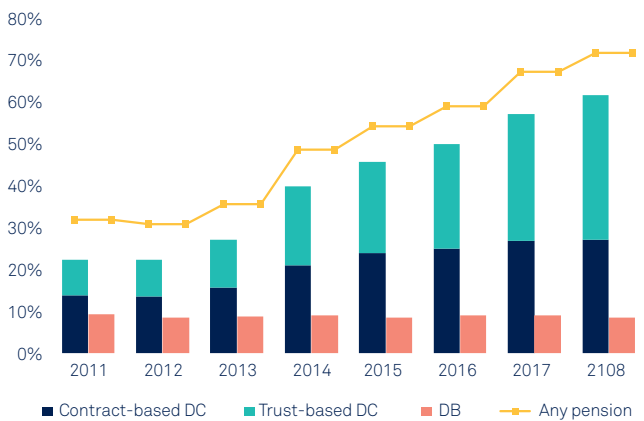
The IA estimates the size of the UK pension market to be £3 trillion at the end of December 2018. This includes all assets in DB and DC pensions, as well as those assets in some form of drawdown arrangement, plus assets backing annuities.<sup>24</sup> Figure 11 provides an estimate of how these assets are broken down across the different scheme types.

DB (funded) assets continue to make up the majority of the UK pension market. However, the policy of automatic enrolment introduced in 2012 has had a major impact on pension saving in the UK. The number of savers into DC schemes now exceeds those actively saving into DB schemes. The majority of defined benefit schemes that remain open to new members are linked to jobs in the public sector. Therefore when only private sector pension saving is taken into account the shift from DB to DC is even more evident (see Chart 30).

In April 2018 the minimum employee contribution under automatic enrolment increased from 1% of qualifying pay to 3%. So far there is no indication that the phased increase in contributions is having an adverse effect on participation rates. However, in April 2019 there was a further increase in employee

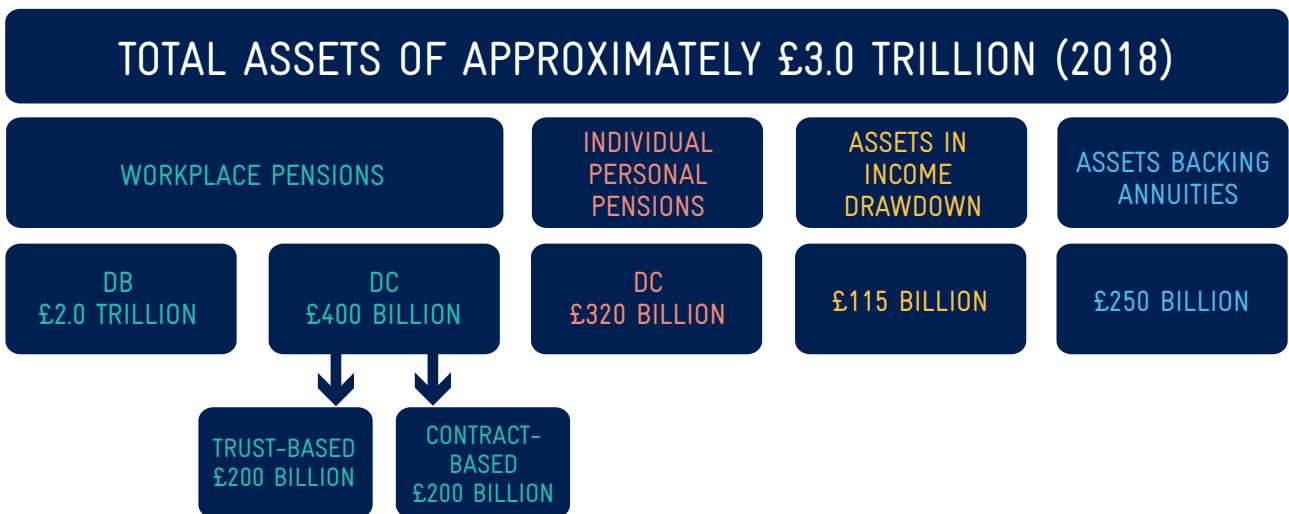
contribution rate from 3% to 5%. The ultimate success of automatic enrolment will depend on whether participation rates remain at the high levels they have reached as contributions increase.

**CHART 26: PENSION PARTICIPATION FOR PRIVATE SECTOR JOBS**



Source: ONS

**FIGURE 11: OVERVIEW OF THE UK'S PENSION LANDSCAPE<sup>25</sup>**



<sup>24</sup> The assets of DB schemes are reported in figure 11. The liabilities attributed to these schemes would result in higher figures as funding levels currently average around 85%.

<sup>25</sup> Source: ONS, FCA, PPI, IA, DCLG. Due to changes in regulatory reporting, some data has not been updated since 2015. Estimates are provided on a best efforts basis until alternative sources are found.

## CURRENT AND FUTURE TRENDS IN DC PENSION PROVISION

The UK pensions market – like many around the world – has seen significant change in the past 20 years, with the shift from Defined Benefit (DB) to Defined Contribution (DC) schemes. This has been reinforced by Automatic Enrolment since 2012 (see Chart 26), and the introduction in 2015 of the pension freedoms, which ended what was a de facto requirement to annuitise DC pension savings.

While the DB system continues to form an important part of the UK market, with its own developments and innovation, the DC market is now starting to develop along its own distinct lines. We asked a number of firms specifically about what they see as the key emerging themes and their implications for investment managers and customers.

### 1. CONSOLIDATION AND COMMERCIALISATION OF DC PENSION PROVISION

The workplace DC pension market is increasingly characterised by commercial pension providers – master trusts and contract-based schemes – to whom employers outsource provision, including responsibility for critical areas such as default investment strategy design. This is in marked contrast to the DB model, characterised by employers running their own trust-based schemes, although even here opportunities for consolidation are starting to emerge.

**“IT LOOKS LIKE A PRETTY POWERFUL TREND AT THE MOMENT. YOU SEE THAT SOME OF THE NAMES THAT HAVE GONE TO MASTER TRUSTS WERE VERY MUCH VIABLE TO RUN AS [INDIVIDUAL TRUSTS] IF THEY WANTED TO, BUT THEY DIDN'T WANT TO.”**

With the contract-based market already made up of a relatively small number of providers, further consolidation is expected in the trust-based market too.

**“ON THE CONSOLIDATION THEME, WE'RE MOVING FROM A DC MARKET OF 2000-ODD SINGLE EMPLOYER TRUSTS TO ABOUT 100 SINGLE-EMPLOYER TRUSTS AND 20-30 MASTER TRUSTS IN 5-10 YEARS.”**

This tendency towards consolidation is being given additional momentum by regulation: a master trust authorisation framework, which will restrict the number of these schemes in future, is already in place and the Government has recently consulted on proposals to require trustees of small DC schemes to actively consider on a triennial basis whether their members may be better served by transferring into a scheme with significantly more scale.

The impact of this increased consolidation and commercialisation is changing the dynamic of how the investment management industry operates in the DC market. Although firms recognised the importance of strong competition on fees, there is an emphasis on the need to broaden the debate further on value.

**“FEES ARE ALWAYS GOING TO BE FRONT AND CENTRE BUT CONSOLIDATION CHANGES THE DYNAMIC OF HOW WE AS AN INVESTMENT MANAGEMENT INDUSTRY OPERATE. LARGER MANDATES, MASSIVE COMPETITION, LOWER FEES.”**

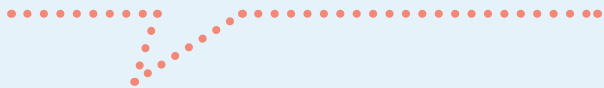
**“AT THE MOMENT, THE FOCUS IS ON PRICE AND IT SHOULD BE MORE ON VALUE, SO WHAT ARE YOU GETTING FOR THAT MONEY, PARTICULARLY WHEN YOU START TALKING ABOUT THE ROLE OF ILLIQUID INVESTMENTS”**

It is also seen as likely that the current policymaker focus on price in the accumulation phase will extend more significantly into the retirement phase. For the moment, the emphasis is more on how to ensure that investment pathways are available for what can be a challenging set of decisions (see point 3 below).

## 2. EVOLUTION OF INVESTMENT PROCESS

A corollary of this consolidation is that the reduced number of pension schemes may be more sophisticated customers of investment management services. While increased size does not automatically mean better governance, larger pension schemes frequently have in-house investment expertise which is deployed in helping schemes develop more sophisticated and diversified portfolios.

**“WHETHER YOU’RE IN 5,000 OR 10,000 MEMBER-SCHEMES OR MEGA-CAP SCHEMES, YOU’VE GOT SIZE AND SCALE TO BE ABLE TO DELIVER SOPHISTICATION.”**

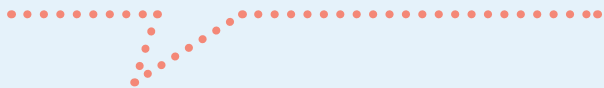


In that regard, the National Employment Savings Trust (NEST), along with a small number of large single-employer trust schemes are very visibly focused on DC investment strategy design. These schemes have the potential to act as ‘bellweathers’ for the market, with their investment approaches influencing other schemes in future.

Two areas in particular stand out:

- An increasing emphasis on private market investment.
- The growing importance of responsible and sustainable investment, often based on Environment, Social and Governance (ESG) factors.

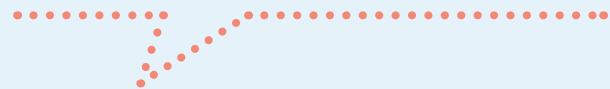
**“ALL THE SOPHISTICATED SCHEMES, PARTICULARLY MASTER TRUSTS, WILL BE LOOKING AT SUSTAINABLE INVESTING MORE AND MORE AND SOME WILL BE LOOKING AT ILLIQUIDS AND ALTERNATIVES BECAUSE THEY HAVE THE SCALE TO DO IT AND IT MAKES INVESTMENT SENSE.”**



While the benefits of allocating a small portion of the default to illiquids are increasingly appreciated in the market, in practice such allocations have not been significant in UK DC pensions to date. This is due to a combination of demand-side factors and operational challenges that the industry is working to solve.

Incorporation of sustainable investing and ESG integration into DC portfolios has been a major theme in this market, partly driven by regulation on pension schemes that intensifies the focus on sustainable investment, partly also reflecting increasing concern about the reality of how financially material ESG is becoming as climate change concerns accelerate. Further development and discussion that results in a consistent understanding across the investment industry, pension schemes and their members of what is meant by sustainable investment will help to move the debate forward. The Investment Association has been doing extensive work on definitions and labelling, looking to help establish a more common approach, and will publish the results of its work in Autumn 2019.

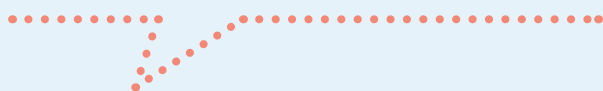
**“IT REALLY IS ABOUT THE DEFINITIONS AND CLARITY AROUND THE SUSTAINABLE INVESTMENT PIECE. THE GOOD THING ABOUT SUSTAINABLE INVESTING IS THAT IT IS HERE TO STAY, BUT WE’VE GOT A LONG JOURNEY ON WHAT IT MEANS.”**



The DC investment market will be further aided in its development as better information on the performance of default strategies becomes available. Most default strategies are multi-fund constructions with individual investment managers acting as component part suppliers. While performance of these components is the responsibility of the underlying investment manager, accountability for the construction and on-going performance of the default strategy rests with pension schemes and their advisers.



**“INVESTMENT RETURNS ARE A DOMINANT FEATURE OF GOOD OUTCOMES, BUT STILL NO-ONE IS REALLY MEASURING THEM PROPERLY [IN DC]. WE KNOW WHAT EACH INDIVIDUAL FUND IS RETURNING, BUT YOU DON'T OFTEN GET THE RETURN OF THE DEFAULT STRATEGY. IT IS SOMEWHAT DRIVEN BY STRUCTURE IN THAT YOU HAVEN'T GOT A DEFAULT FUND, YOU'VE GOT A DEFAULT STRATEGY ON A LIFE INSURANCE COMPANY'S PLATFORM. THE MECHANISM FOR CALCULATING PERFORMANCE [OF THE STRATEGY] CAN BE DONE, BUT IT'S NOT BUILT INTO THE SYSTEM.”**



Increasing availability of performance information of default strategies by age cohorts, reflecting age-related dynamic asset allocation in DC, will in future be used to compare scheme strategies against the peer group of other defaults with similar risk or asset profiles, thus creating a more value-driven conversation about DC investment.

### 3. DELIVERING RETIREMENT INCOME

There is widespread recognition among investment management firms of the challenges facing individual savers when they approach retirement. While the new world of Pension Freedoms offers the opportunity for providing access to the right approach at the right time, ensuring the decision-making mechanisms and product sets are available will be a longer-term development process for all players involved in pension scheme delivery.

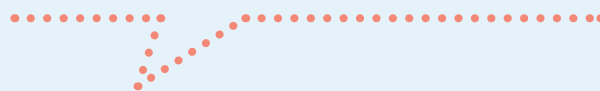
#### ***Direction of travel in workplace DC***

For workplace DC schemes, the adjustment to the pension freedoms has up until now been about ensuring default strategy asset allocations are aligned with member preferences for accessing DC pensions. Beyond this there has been little development of in-scheme retirement solutions. This reflects several factors, including employer attitudes to responsibility in this area and the relative immaturity of the UK DC market in terms of

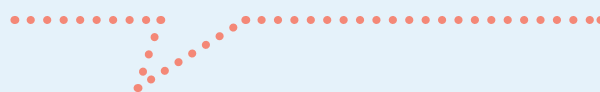
scale and number of members retiring with only DC provision. Current practice involves schemes seeking to arrange decumulation options with an external provider. This is particularly true of single employer trust schemes.

Master trusts have the potential to change this by offering in-scheme solutions that take their members 'to and through' retirement. Master trusts will have a commercial incentive to retain assets through retirement and the knowledge of their members' needs required to design appropriate retirement income strategies. In the contract-based market, regulation will increasingly nudge non-advised customers towards the FCA's proposed 'investment pathways'.

**“OUR CONSUMER RESEARCH SHOWS THAT PEOPLE COMING UP TO RETIREMENT DON'T WANT TO SHOP AROUND, THEY WANT TO CONVERT THEIR POT TO INCOME, AND IF THEY ARE GIVEN A STRAIGHT-FORWARD PATH TO DO THAT THEN THEY'LL GO FOR IT.”**



**“IN FUTURE IT WOULD BE GREAT IF THE MASTER TRUSTS CAN PROVIDE A 'TO AND THROUGH' SOLUTION FOR INCOME DRAWDOWN SO PEOPLE CAN REMAIN INVESTED IN THE SAME STRATEGIES.”**



For investment managers, this non-advised mass market may look increasingly like the accumulation stage: investment strategies designed by pension providers and their advisers, with investment managers being component suppliers for these strategies. Assets could be concentrated in investment pathways and master trust in-house strategies with a smaller number of larger mandates, and strong competitive and pricing pressure.

**Areas of potential innovation**

At the same time, firms do see significant opportunities, particularly in the advised market or for those savers that are more self-directed. To the extent that retirement income (decumulation) is about a combination of asset allocation and income generation, investment managers have the capability to do both. This links to broader patterns of competition - and innovation - within the wider investment and wealth management industry over the provision control of asset allocation services.

“AS AN INDUSTRY WE ARE ASSET ALLOCATORS, PARTICULARLY FOR MULTI-ASSET PRODUCTS. AN INDIVIDUAL HAS ALL THESE DIFFERENT LEVERS TO PULL WHETHER IT IS SAVINGS, INVESTMENTS, PENSIONS, MORTGAGES. MAYBE WE SHOULD BE INNOVATING MORE AROUND HOW WE CAN HELP INDIVIDUALS ALLOCATE THROUGHOUT THEIR LIVES ACROSS ASSET CLASSES.”

The industry is also starting to think more about regulatory barriers to innovation at the investment fund level. The UK Fund Regime Working Group, established under the auspices of the HMT Asset Management Taskforce, published its final report in summer 2019, which included proposals in this area. One potential way forward is to look again at how capital and income are treated within funds to allow for strategies that aim to target more specific retirement needs involving how savers draw on their capital to generate an income. This was reflected in a number of comments made by interviewees for this year’s Survey.

“THERE NEEDS TO BE MORE FLEXIBILITY GIVEN THE DEMOGRAPHICS OF THE COUNTRY. AN EVER GROWING PERCENTAGE OF THE POPULATION ARE IN DECUMULATION AND THE FUND STRUCTURES DON’T NECESSARILY ALLOW FOR THE DISTRIBUTION OF CAPITAL FROM FUNDS. WE WOULD WELCOME AN IMPROVED STRUCTURE. AT THE MOMENT YOU HAVE TO SELL A PORTION OF THEIR INVESTMENTS TO CREATE INCOME.”

**Access to advice**

A critical theme, especially in the context of the current reviews of the Retail Distribution Review (RDR) and the Financial Advice Market Review (FAMR) is to get the broader advice market right in terms of accessibility. Participants in the Survey strongly emphasised the importance of this point, particularly given the significance – and potential complexity - of the decisions and the consequences in later life of not getting them right.

“THE KEY THING, ESPECIALLY IN TRANSITIONING FROM ACCUMULATION TO DECUMULATION, IS THE ADVICE PIECE. HOW CAN WE MAKE SURE CLIENTS GET THE RIGHT ADVICE AND THEY KNOW WHAT TO DO? IN ACCUMULATION YOU PAY IN MONEY AND ARGUABLY THE MOST IMPORTANT THING IS SIMPLY THAT YOU GET A GOOD RETURN IN THE END. BUT IF YOU’RE NOT GOING TO ANNUITISE OR HAVE THE GUARANTEES, THEN WHAT HAPPENS FROM THAT MOMENT YOU RETIRE? THERE ARE SO MANY FACTORS AND SO MANY DIFFERENT STRATEGIES TO CONSIDER.”

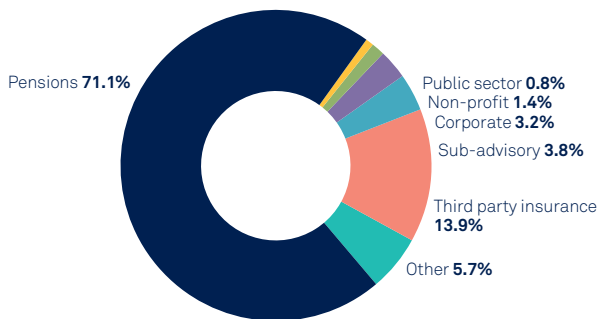
“RDR HAS CREATED A LEVEL OF PROFESSIONALISM IN THE ADVICE INDUSTRY THAT WASN’T THERE BEFORE. WHAT IS MISSING IS HOW DOES ADVICE BECOME MORE ACCESSIBLE? THROUGH RDR AND OTHER REGULATION, ACCESS TO ADVICE HAS BECOME MORE DIFFICULT IN SOME WAYS. YOU COULD ARGUE THAT THOSE WHO ARE GETTING IT ARE GETTING A HIGHER QUALITY OFFERING. HOWEVER, THE ABILITY TO GET GOOD BASIC ADVICE AT A BASIC COST IS NOT THERE.”

## TRENDS IN THE THIRD PARTY INSTITUTIONAL MARKET

Full details of the asset allocation and investment strategy for the entire institutional market are available in Appendix 2. The remainder of this chapter looks more closely at IA data from the institutional market that is available to third parties, that is, excluding mandates managed in-house by insurance parent groups and occupational pension schemes, as at the end of 2018.

Once in-house mandates are excluded from the institutional data, assets under management reduce to £3.4 trillion. Pension funds become even more dominant (see Chart 34), representing almost three quarters (71%) of third party assets, with the remaining insurance assets representing 14% of the market.

**CHART 27: THIRD PARTY UK INSTITUTIONAL CLIENT MARKET BY CLIENT TYPE**

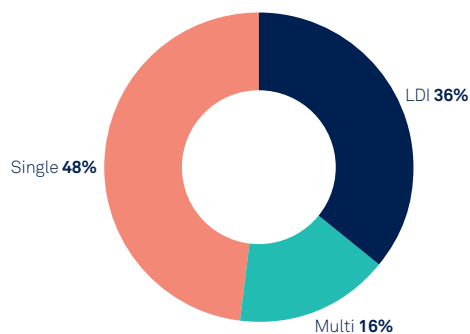


## MANDATE BREAKDOWN

Chart 28 breaks the institutional market down into three categories of mandate:

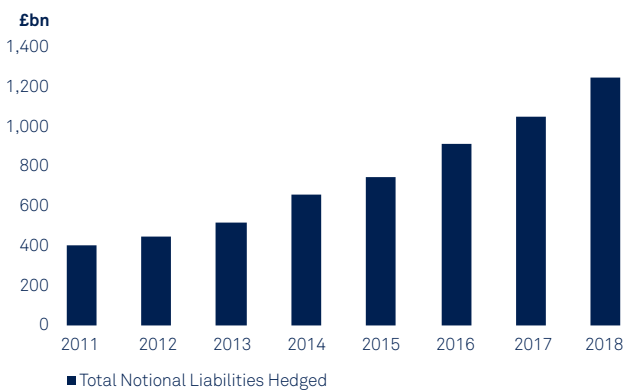
- Single-asset, or ‘specialist’ mandates, which focus on a specific asset class or geographical region. Specialist mandates remain the most popular form of investment among institutional investors, with just under half of all institutional assets (48%) managed on this basis.
- Multi-asset, or ‘balanced’ mandates, which would cover a number of asset classes and regions. These account for 16% of total mandates. Stripping out the LDI mandates below, the balance between specialist and multi-asset is 76% single asset versus 24% multi-asset.
- LDI mandates, which are specifically designed to help clients meet future liabilities. These mandates frequently make greater use of derivative instruments and are therefore included on the basis of the notional value of liabilities hedged, rather than the value of physical assets held in the portfolio. Just under a third of institutional assets are now managed in this way. An estimated £1.2 trillion is now being hedged in LDI mandates.

**CHART 28: UK THIRD PARTY INSTITUTIONAL CLIENT MANDATES INCLUDING LDI**



LDI has seen a three-fold increase in assets since 2011 increasing from £400 billion to £1,200 billion in 2018. This is double the growth rate in single mandate assets and also higher than the growth rate in multi-asset assets over the same period.

**CHART 29: NOTIONAL VALUE OF LDI (2011-2018)**

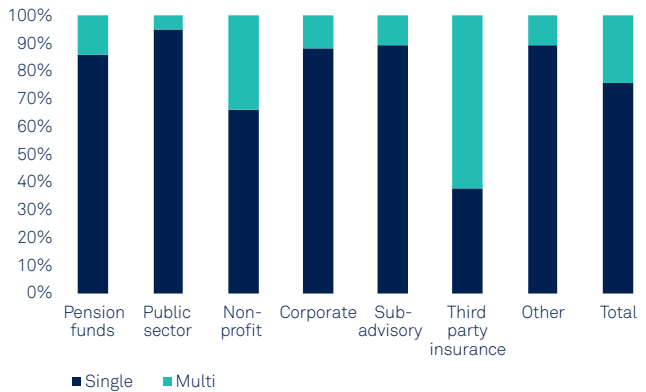


Source: KPMG LDI Survey, IA

Although DB pension schemes remain a significant proportion of the institutional market, the fact that they have very specific requirements means that their LDI allocations can mask trends that might otherwise be observed in the market. For that reason we exclude the value of LDI mandates from the asset allocation analysis on pages 60 to 65 and focus purely on whether clients are favouring multi-asset or specialist solutions other than explicit liability management.

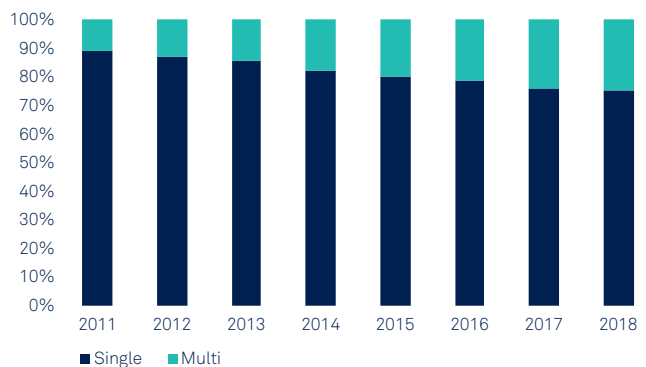
Chart 30 indicates that the preference for specialist mandates remains high, although there is significant variation depending on the type of client. Multi asset mandates are most likely to be utilised by third party insurance (possibly default pension arrangements) and non-profit organisations. The largest client type, pension funds, remains heavily dependent on single asset specialist mandates.

**CHART 30: UK THIRD PARTY INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST**



The trend towards multi asset in recent years seen in Chart 31 may partly be driven by the increased use of multi-asset mandates in DC default arrangements, as private sector pension participation continued to increase in 2018 despite contribution levels beginning to rise (see Chart 26).

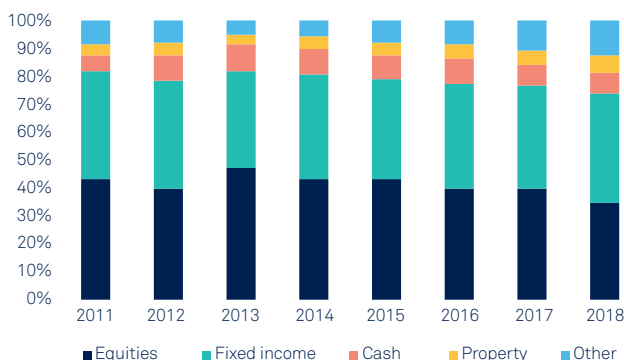
**CHART 31: UK THIRD PARTY INSTITUTIONAL CLIENT MANDATES: MULTI ASSET VS. SPECIALIST (2011-2018)**



## INVESTMENT TRENDS WITHIN SPECIALIST MANDATES

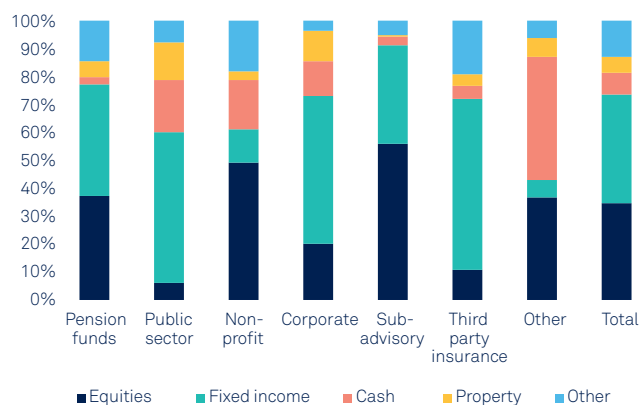
Fixed income overtook equity to become the most popular type of specialist mandate in 2018 with proportion of assets increasing two percentage points to 39%. Reflecting what we saw in Chapter 3, allocations to equity were most severely hit by market volatility falling from 40% of total assets in 2017 to 35% of assets in 2018. Allocations to 'other' assets (13%) saw a two percentage points increase on 2017. Chart 32 shows the progression since 2011 and the most significant development is the growth of 'other' mandates types, which have more than doubled since 2013, consistent with the growth of private assets.

**CHART 32: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS (2011-2018)**



Different types of institutional client have very distinct requirements and the headline split between single asset classes masks a wide variation in the type of mandate required by each client type. Insurance companies for example have particularly high allocations to fixed income mandates. Pension funds also have higher than average fixed income allocations, led by particularly high allocations among corporate pension schemes (see Chart 33).

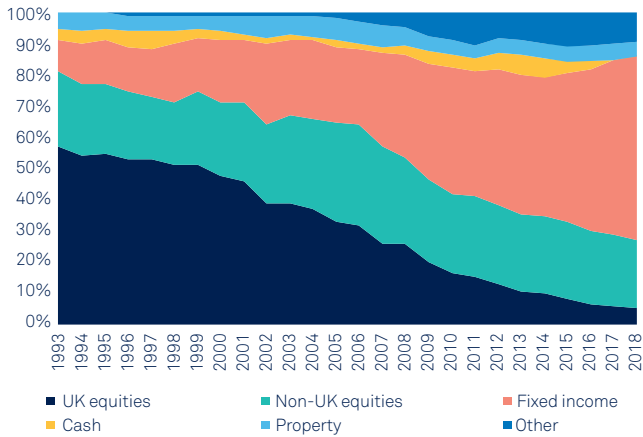
**CHART 33: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS**



The shift in asset allocation of DB schemes as they move away from using traditional scheme-specific asset allocation benchmarks to strategies which more closely match their assets to their liabilities and manage their deficit volatility is well documented and has been a theme of this Survey for a number of years.

A typical DB scheme is now likely to hold a much smaller proportion of equities (around a quarter) which itself includes more overseas than domestic equities, a considerably larger allocation in fixed income assets (almost 60%) and have a significant exposure to alternatives (10% compared to almost nothing in the mid-1990s).

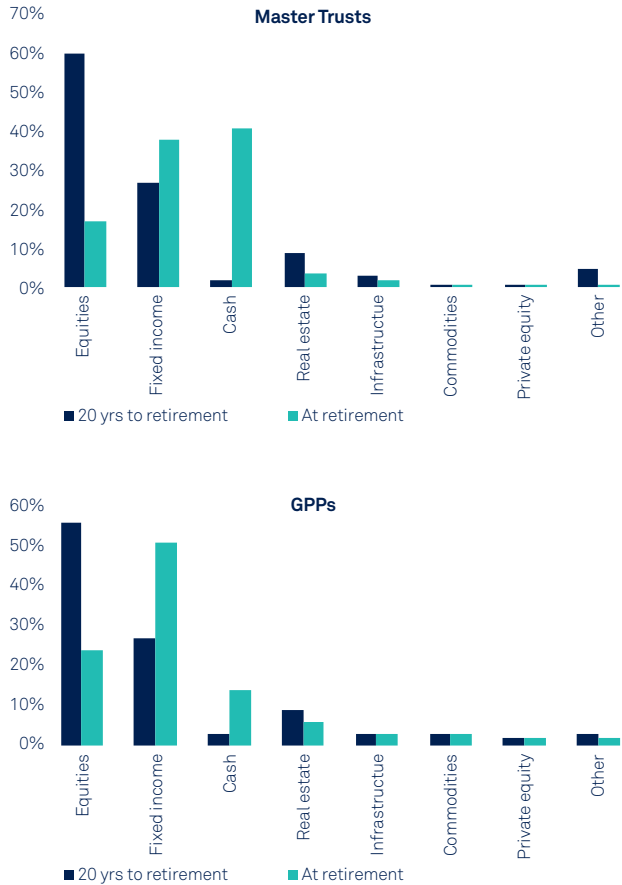
**CHART 34: UK DB PENSION FUND ASSET ALLOCATION (1993-2018)**



Source: UBS, PPF/TPR Purple Book

In contrast to DB schemes, the asset allocation of DC schemes shows a much higher allocation to equities although there is a significant change in asset allocation between accumulation phase and at retirement. Default strategies will typically reduce their allocation to equities and increase the allocation to fixed income and cash in order to reduce investment risk and volatility for the pension saver approaching retirement.

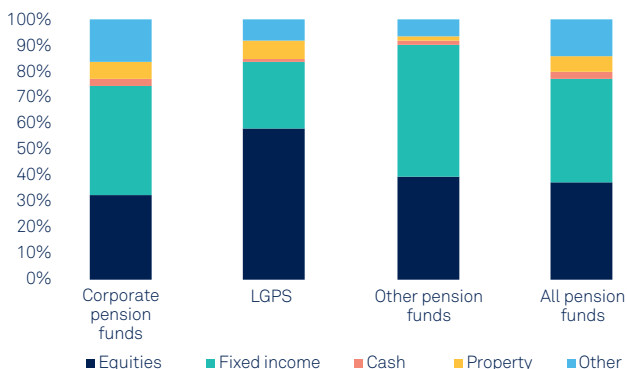
**CHART 35: DC ASSET ALLOCATION, 20 YEARS PRIOR TO RETIREMENT AND AT RETIREMENT**



Source: PPI Future Book 2018

Chart 36 shows the change in asset allocation of pension schemes in aggregate. There is a wide variation depending on the type of pension scheme in question. As in previous years LGPS have a higher allocation to equities than corporate pension schemes, though both have fallen since 2017 (58% vs 33%). As with DC schemes, LGPS have a rather different membership makeup than other DB schemes. As a DB scheme that remains open to new members, scheme membership is comparatively less mature than closed corporate DB schemes and the LGPS funds function within a different regulatory framework to corporate schemes and are thus subject to less pressure to implement de-risking investment strategies. Consequently, they can maintain a higher allocation to return-seeking strategies.

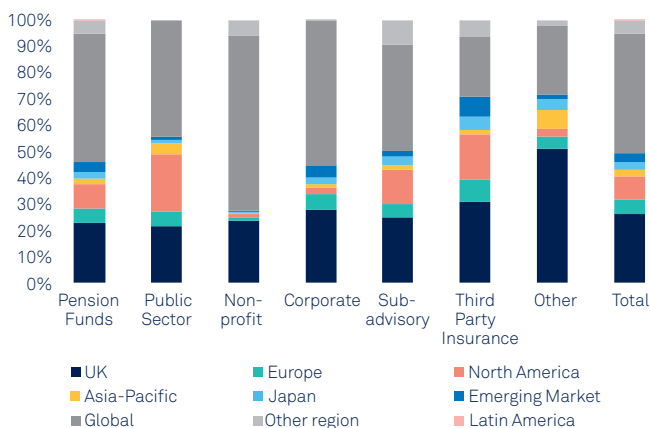
**CHART 36: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS AMONG UK PENSION FUNDS**



**GEOGRAPHIC ALLOCATION**

Chart 37 shows the breakdown of specialist mandates in 2018. Global mandates remain the dominant region geographically, continuing the theme of diversification seen in data in recent years.

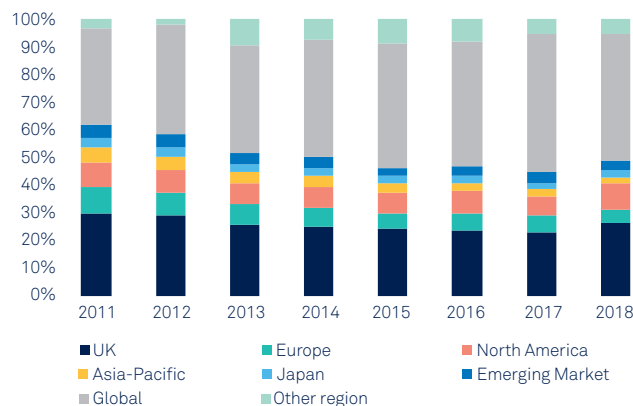
**CHART 37: GEOGRAPHICAL EQUITY ALLOCATION OF SPECIALIST MANDATES BY CLIENT TYPE**



Almost three quarters of specialist equity mandates apply to non-UK mandates. Chart 38 shows that 2018 saw something of a shift back towards UK mandates increasing over three percentage points to 26%—the highest level since 2012. This may be another reflection of a ‘base level’ of home bias, preventing the allocation to UK mandates continuing to fall among UK

institutional clients. Allocations to North America also saw a notable increase to 9%, up from 7% in 2017.

**CHART 38: GEOGRAPHICAL EQUITY ALLOCATION OF SPECIALIST MANDATES (2011-2018)**



Looking at UK pension funds, once again it is evident that there are further significant differences between the LGPS and other schemes. 25% of LGPS specialist mandates managed by IA members at the end of 2018 were UK equity mandates, down one percentage point from 2017 (see Chart 39).

Corporate pension funds held slightly less in UK equity mandates (23%). The LGPS remains more focused on equities and within that, on domestic equities.

**CHART 39: GEOGRAPHICAL EQUITY ALLOCATION OF SPECIALIST MANDATES AMONG UK PENSION FUNDS**

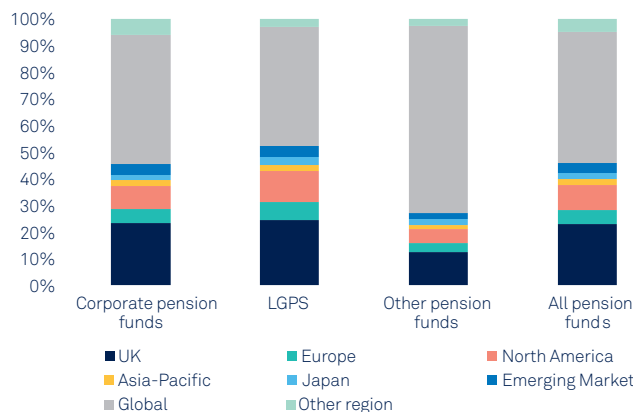
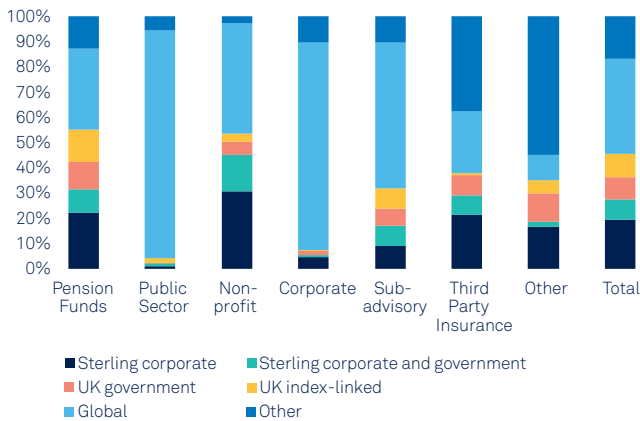


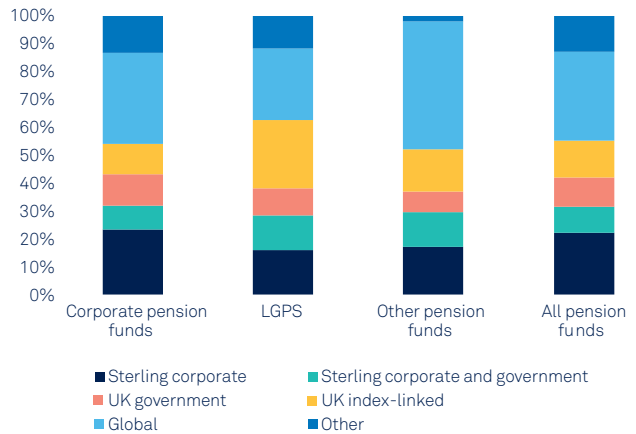
Chart 40 shows that there is significant variation in allocation amongst different client groups. Pension funds have the largest allocations to UK government bonds (24%), more than double the insurance allocation (9%). Global bonds are most widely used for corporate and public sector clients making up over half of total specialist fixed income allocation.

**CHART 40: SPECIALIST FIXED INCOME ALLOCATION BY CLIENT TYPE**



Pension schemes continued to exhibit significant disparity in their fixed income allocations, notably the LGPS continues to have a significantly higher allocation to index-linked gilts than average and a lower allocation to sterling corporate bond mandates than corporate pension schemes (see Chart 41).

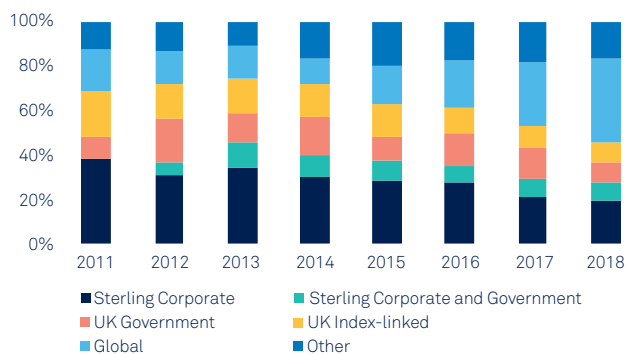
**CHART 41: FIXED INCOME ALLOCATION OF SPECIALIST MANDATE TYPES AMONG PENSION FUNDS**



Looking at the long-term trend in specialist fixed income allocation, global bonds overtook sterling corporates as the largest specialist mandate type for the first time in 2017 with the gap in allocations widening in 2018 (Chart 42). Sterling corporate bonds are now half the level recorded in 2011 while global bonds allocations have doubled in the same period.

The allocation to overseas bonds has notably increased in 2018 from 29% of specialist fixed income assets to 38%. The allocation to UK government bonds fell again from 24% last year to 18% in 2018. Sterling corporate bond allocations were also down two percentage points at 19%.

**CHART 42: SPECIALIST FIXED INCOME ALLOCATION (2011-2018)<sup>26</sup>**



<sup>26</sup> £ Corporate and Government were not separated out in 2011

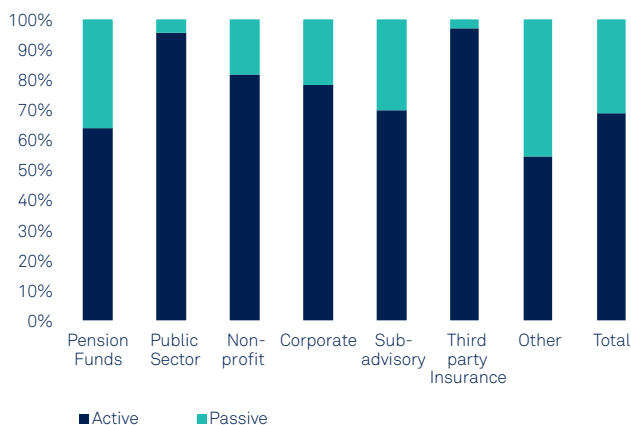


### ACTIVE VS PASSIVE

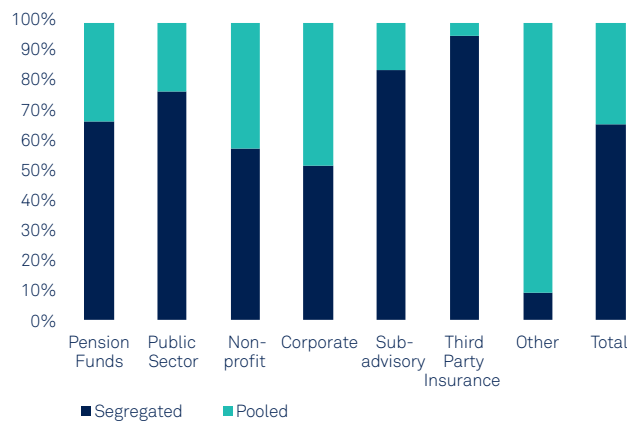
Over two thirds of assets (69%) were managed by IA members on an active basis, up from 65% in 2017.

All institutional client types this year were more likely to be managed on an active rather than a passive basis (Chart 43).

**CHART 43: ACTIVE AND PASSIVE THIRD PARTY MANDATES BY CLIENT TYPE (SAMPLE-ADJUSTED)**



**CHART 44: SEGREGATED AND POOLED MANDATES BY INSTITUTIONAL CLIENT TYPE**



The proportion of mandates managed on a segregated basis has increased slightly from around 62% when the IA began to collect this data in 2011. However, the proportion has been relatively stable since 2015, with little year on year variation.

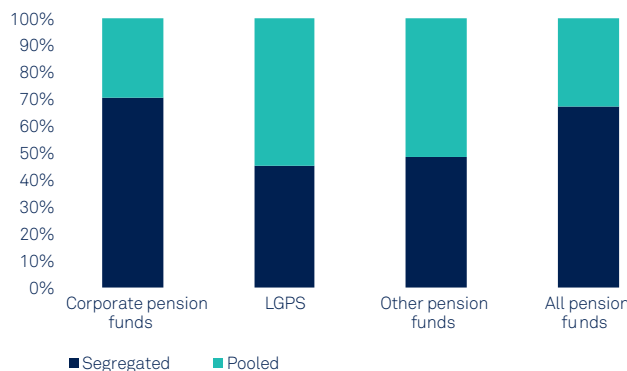
Among pension schemes corporate pension funds are significantly more likely to be managed on a segregated basis (70%) compared with LGPS (45%).

### SEGREGATED VS POOLED

Chart 44 shows that segregated mandates represented approximately two thirds (66%) of assets managed for third party institutional mandates at the end of 2018. Once again in 2018 almost all mandates managed for third party insurance and sub-advised mandates were managed on a segregated basis.

Other clients are almost all managed on a pooled basis. These include a wide variety of clients including family offices and private wealth firms which are significantly more likely to opt for pooled arrangements for managing their assets.

**CHART 45: SEGREGATED AND POOLED MANDATES AMONG THIRD PARTY PENSION FUNDS**



# 5 UK RETAIL FUNDS MARKET

## KEY FINDINGS

### EVOLUTION OF UK FUNDS UNDER MANAGEMENT

- » The UK retail funds market has grown significantly over the last 10 years and is more focussed on meeting investor demand for investment solutions and outcome-oriented funds.
- » In 2018, total UK investor FUM reached £1.15 trillion, a slight decrease of 6.6% year on year and the first since 2011.
- » Investor demand for outcome-oriented and mixed asset funds is a long-term trend, suggesting a permanent shift in investor expectations and an increasing emphasis on the role of retail fund managers as asset allocators.

### RETAIL SALES TRENDS

- » Following extremely strong growth in 2017, net retail sales were relatively weak during 2018, particularly in the second half of the year. Although this volatility is making the outlook for sales unclear, average five year inflows since 2008 remain significantly higher than in the period preceding the global financial crisis.
- » Recent outflows from funds in the outcome-oriented Targeted Absolute Return sector, one of the best-selling sectors over 10 years, suggest that investor preference is shifting in the near-term to volatility managed strategies.
- » In contrast, mixed asset funds have not seen the levels of sales volatility experienced by funds in other asset classes. Mixed asset sectors have not had a year of negative sales since 2002.
- » Outflows from UK equity funds have been notable since the Brexit referendum in 2016. Retail outflows over this period of £11 billion represent 4.6% of the average UK investor funds under management.

### ACTIVE VS. TRACKER SALES TRENDS

- » The proportion of UK investor funds under management in passive index-tracking funds has grown gradually to 16% in 2018. Although slow, the pace of growth has accelerated since 2013 when the retail distribution review was implemented.
- » Net flows to tracker funds were one-third of total net sales between 2013 and 2018, a significant increase on the previous five years.
- » Sales to index tracking funds outstripped sales to active funds in 2018 and notably garnered positive inflows in UK equity sectors whereas active funds suffered outflows.

### RESPONSIBLE FUNDS

- » FUM in funds pursuing dedicated 'responsible investment approaches' was £69 billion, equivalent to 6% of UK investor FUM. Net sales to these funds reached £1.08 billion in 2018.

### TRENDS IN RETAIL FUND DISTRIBUTION

- » In 2018, UK fund platforms remain the largest distribution channel for UK retail investors by gross and net sales. 45% of gross retail sales are flowing through UK fund platforms.
- » UK fund platforms received the highest proportion of net retail sales (£12.6 billion) but sales were 47% lower than in 2017.

This chapter looks specifically at funds under management (FUM) for UK investors, with a particular focus on trends in the UK retail fund market. The data and analysis draw heavily on IA sectors to explain long-term trends in patterns of demand and total FUM.

There are 37 IA sectors, as outlined in Figure 12 overleaf. The IA sectors help investors to:

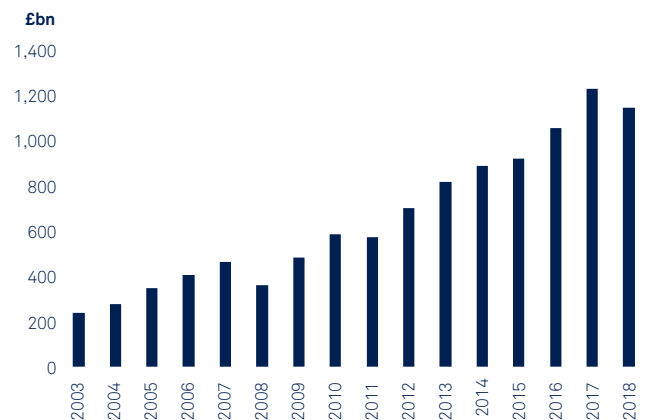
- Find certain types of fund based on their investment goals e.g. growth, income.
- Narrow down the fund universe and navigate investments by type of asset e.g. fixed income, equity.
- Perhaps compare performance or charges within the sector peer group.

Each sector has a clear definition setting out the criteria that funds in that sector must fulfil. The funds can broadly be split into funds targeting 'capital growth' and 'income' as shown by the classification schematic. Where we refer in the chapter to Mixed Assets, we are referencing a range of funds, with different risk characteristics as grouped into the Mixed Investment sectors.

## EVOLUTION OF UK INVESTOR FUNDS UNDER MANAGEMENT

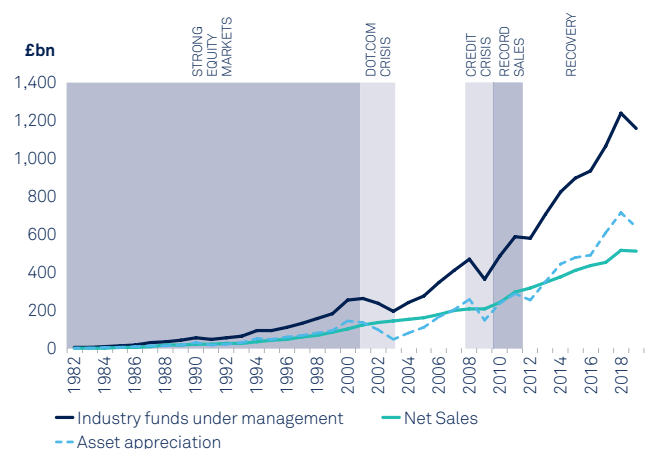
In 2018, total UK investor funds under management (FUM) were £1.15 trillion, a decrease of £81.3 billion or 6.6% year on year. This was the first annual drop since 2011, but as Chart 46 shows, UK investor FUM has grown significantly over the last 15 years from £242 billion in 2003 and has remained greater than £1 trillion for the last three years.<sup>27</sup>

**CHART 46: TOTAL INDUSTRY FUNDS UNDER MANAGEMENT (2003-2018)**



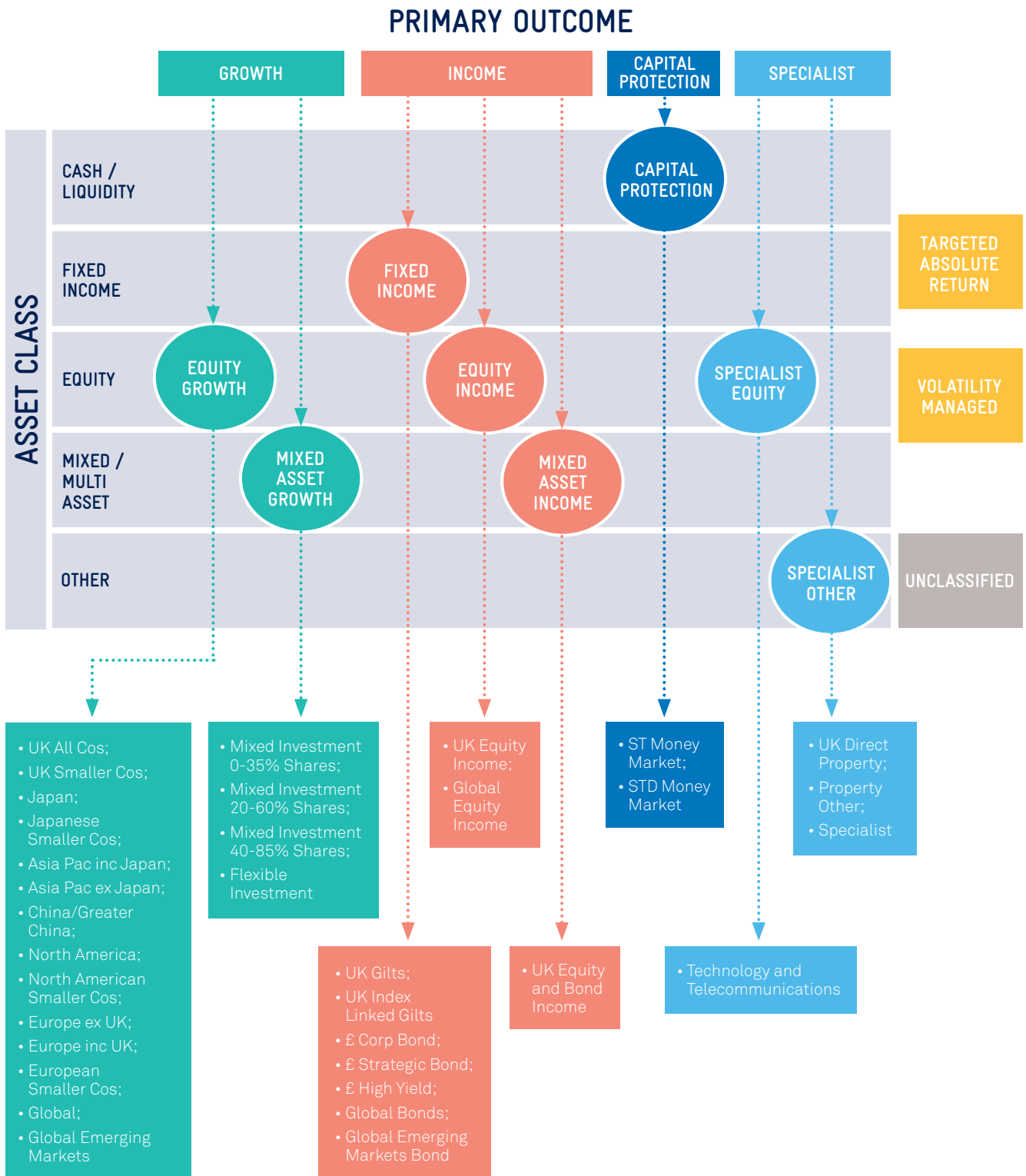
As Chart 47 illustrates, 2018's dip in FUM is largely attributable to asset values shrinking amidst challenging market conditions in the second half of the year, rather than as a result of net outflows. Turbulent markets reflected a range of events including the Sino-US trade dispute, US Federal Reserve rate hikes and various geo-political tensions.

**CHART 47: DRIVERS OF INDUSTRY GROWTH (1980-2018)**



<sup>27</sup> Chart 46 shows retail and institutional funds under management for UK investors in UK domiciled and overseas domiciled funds but from 2012 does not include overseas investors in UK domiciled funds. Prior to 2012 the data represents all investors in UK domiciled funds. Data on overseas investors in UK domiciled funds is shown in Chart 49.

**FIGURE 12: IA SECTOR CLASSIFICATION SCHEMATIC**



## THE SHIFTING PROFILE OF UK INVESTOR FUM

UK investors' home bias to investing in UK equities has eroded significantly over the last 15 years. Chart 48 shows that in 2003, UK equities represented the highest proportion of total FUM. By 2018, FUM in overseas equities is double that of UK equities.

- The decline in **UK equities** as a proportion of FUM is notable. In 2003, UK equity FUM stood at 40%, this dropped to 17% in 2018. The Brexit referendum has undoubtedly accelerated this decline: between year-end 2015 and end 2016 FUM decreased by 4 percentage points from 24% to 20%.
- FUM in **overseas equities** has risen slightly from 33% in 2003 to 35% in 2018. It has the highest share of UK investor FUM in 2018.
- Growth in **mixed asset** FUM has been more gradual than the steady stream of net sales to this asset class would suggest. FUM in mixed asset funds has moved from 11% in 2003 to 16% in 2018.

CHART 48: FUM BY ASSET CLASS (2003-2018)

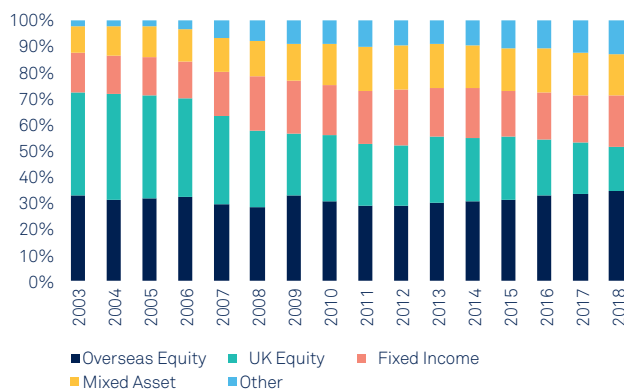


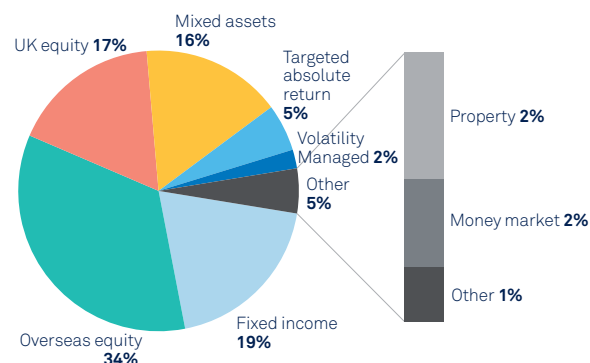
Chart 49 offers more detail on the profile of funds that fall into the 'Other' asset class in Chart 48. FUM in 'Other' has been steadily increasing, so it is helpful to provide greater detail on its contents.

Chart 49 splits out the percentage of total FUM in Targeted Absolute Return (TAR) funds (5%) and

in volatility managed funds (2%). Funds in these sectors offer investors a specific outcome: TAR funds' objective is to deliver a positive return irrespective of market conditions. Volatility managed funds seek to ensure that the volatility of returns are kept within set parameters. Money market funds, where the objective is to protect investors' capital, are also included as outcome-oriented funds.

FUM in outcome-oriented funds and mixed asset sectors, where there is typically a diverse allocation across different types of asset, is one quarter of total FUM in 2018.<sup>28</sup>

CHART 49: UK INVESTOR FUM BY ASSET/FUND SECTOR



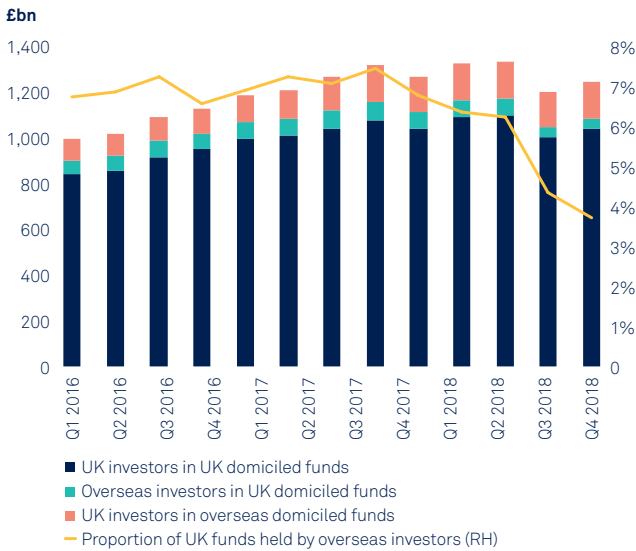
## OVERSEAS INVESTORS IN UK DOMICILED FUNDS

Overseas investors in UK domiciled funds are an important facet of the UK funds landscape but Brexit is driving down the proportion of UK domiciled funds held by these investors. So far, the most significant factor in this decline appears to have been operational decisions made by firms to ensure business continuity post-Brexit. Chart 50 shows funds under management in UK domiciled funds and the profile of investors in those funds since Q1 2016, just before the Brexit referendum. £1.04 trillion was managed in UK domiciled funds in 2018, of which £46 billion or 4% was managed on behalf of overseas investors.<sup>29</sup> This compares with 7% just before the referendum.

<sup>28</sup> The IA classes funds in the following sectors as pursuing an outcome or allocation strategy: Mixed Investment 0-35% Shares; Mixed Investment 20-60% Shares; Mixed Investment 40-85% Shares; Money Market; Targeted Absolute Return; Volatility Managed.

<sup>29</sup> This chart differs from the £1.15tn cited at the beginning of the chapter because it incorporates overseas investors in UK domiciled funds but removes overseas domiciled funds invested in by UK investors.

**CHART 50: UK DOMICILED FUNDS BY INVESTOR PROFILE (2016-2018)**



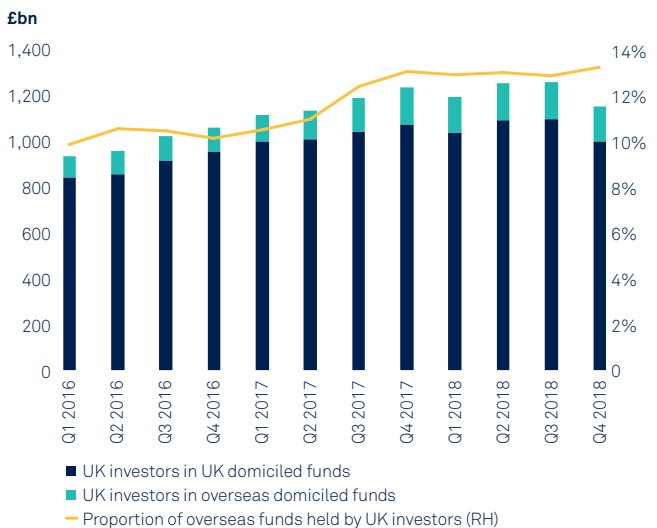
- UK investor FUM (retail and institutional) in overseas funds represents £150 billion invested in 1,754 funds.<sup>30</sup> As a point of comparison, UK investor FUM in UK domiciled funds is £1.0 trillion invested in 2,797 funds. It appears that UK investors are using overseas domiciled funds for a smaller proportion of their portfolios.
- Gross retail sales are more indicative of investor demand because they do not account for redemptions. Chart 49 suggests that retail investors' appetite for investing in overseas domiciled funds has not shifted dramatically post-referendum. The percentage of gross retail sales from UK investors into overseas domiciled funds has risen from 16% at the end of 2016 to 22% in 2018.
- Net retail sales from UK investors to overseas domiciled funds in 2018 were £1.07 billion, 14% of total net retail sales. Since 2013, net retail sales to overseas domiciled funds have consistently been circa £1 billion. 2017 is the exception: net retail sales to overseas domiciled funds rose to £17.8 billion or 37% of total net retail sales. If and when material changes to passporting rights occur, we would expect to see this pattern of flows alter.

The steep drop observed between Q3 and Q4 2018 in Chart 50 was largely precipitated by operational decisions made by firms to transfer assets in non-sterling share classes to funds domiciled in the European Union. It is more difficult to quantify the impact of negative overseas investor sentiment or to predict future trends.

**UK INVESTORS IN OVERSEAS DOMICILED FUNDS**

UK investors have not been deterred from investing in overseas domiciled funds since the Brexit referendum, IA data suggest. UK investor FUM in overseas domiciled funds has gradually increased from 10% at the beginning of 2016 to 13% at the end of 2018. In 2018, UK investors appear to have adopted a 'wait and see' attitude to concerns expressed in some quarters that Brexit could affect passporting rights and impede access to funds domiciled overseas.

**CHART 51: UK INVESTOR FUM IN OVERSEAS DOMICILED FUNDS (2016-2018)**



<sup>30</sup> IA FUM data does not account for ETFs or international money market funds, which are mainly domiciled overseas. UK investor FUM in overseas domiciled funds is therefore higher than £0.15tn. IMMFA data show that €296.7bn was invested in international money market funds by UK investors as at December 2017. It is difficult to assess UK investor FUM in ETFs. London Stock Exchange (LSE) data indicates that 40% of European trading turnover for ETFs goes through the exchange and 1100 ETFs are traded on the LSE, but the LSE is an international trading venue and not a reliable indicator of UK investor flows or FUM.

## SALES TRENDS

Over the last 10 years, net retail sales have been volatile, particularly in the equity asset class. This makes it difficult to determine a long-term trend and it is unclear whether this volatility will continue when a new market cycle begins.

As Chart 52 shows, the shockwaves of global events are felt by the UK retail funds market and can negatively affect net retail sales. Most recently, the global financial crisis caused net retail sales to halve between 2007 and 2008 and UK retail flows were not immune to the effects of the dot.com bubble bursting in the early 2000s (see Chart 47).

In 2016 the Brexit referendum significantly depressed net retail sales, which decreased by circa £10 billion from net sales of £16.9 billion in 2015 to £7.0 billion in 2016.

But five year average net sales remain significantly higher than pre-2008 levels and the negative impact of major events on net retail sales over the last 10 years has been short-lived.

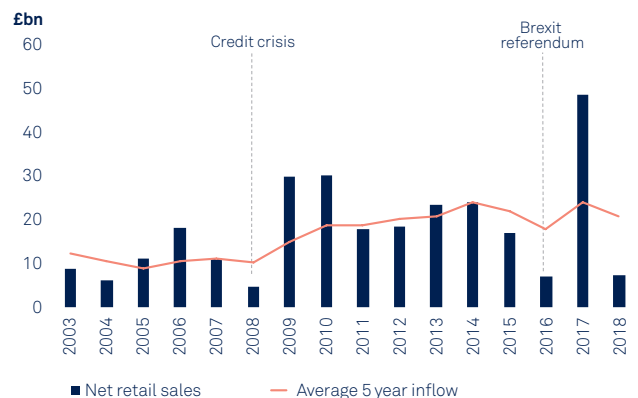
In 2017, UK net retail sales rebounded from the Brexit-dominated negative sentiment in 2016 to record levels of £48 billion. In 2009, the data tells a similar story with then-record flows of £29.8 billion following net flows of £4.8 billion in 2008.

The impetus behind the scale of the 2017 surge remains hard to explain. 2017 was also an exceptional year for net sales to European<sup>31</sup> investment funds at €984 billion compared with €258 billion in 2018, which suggests that across Europe, investors were attracted by a benign economic climate in 2017 and that supra-national forces were a determinant of flows. The global economy

in 2017 has been described as a goldilocks economy: 'not too hot, not too cold, but just right.' Economic growth was stable, staving off recessionary forces and inflation remained in check. This meant that shares performed well and it was an attractive environment for investors to place more assets into funds.

Domestic circumstances also played a role: sales were further augmented by defined benefit pension transfers into funds in personal pensions, defined contribution pensions or self-invested personal pensions. The DB transfer market was unlocked by the introduction of the pension freedoms in April 2015 and reached a peak in 2017<sup>32</sup> when transfer values were high, inflated by low gilt yields and a Bank of England base rate of 0.25%<sup>33</sup>. Between 1 April 2017 and 31 March 2018 the total value of DB transfers was approximately £14.3 billion.<sup>34</sup>

**CHART 52: NET RETAIL SALES (2003-2018)**



<sup>31</sup> EFAMA Fact Book 2019.

<sup>32</sup> ONS data show £37 billion in pension transfers in 2017 compared with £13 billion in 2016; a significant proportion of this total is likely to represent transfers out of defined benefit schemes and into funds in SIPPs, personal pensions and defined contribution pensions.

<sup>33</sup> The Bank of England raised the base rate to 0.5% at the end of October 2017 and while the rate rise may have had little immediate impact on transfer values, the expectation of further rate rises, which did take place in 2018, will have affected the cash equivalent transfer value.

<sup>34</sup> This data comes from The Pensions Regulator's response to a Freedom of Information request and represents 72,700 transfers out of DB schemes. TPR estimates the actual figure to be in the region of 100,000.



## THE PATTERN OF NET RETAIL SALES IN 2018

In 2018, net retail sales dropped to £7.2 billion, a sharp fall of 85% compared with 2017. Sales to funds that track an index were a significant factor in driving a positive net flows total in 2018 as active funds saw outflows.

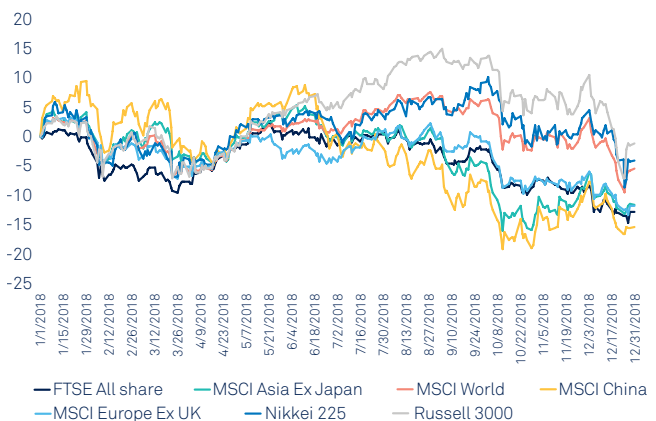
Chart 53 shows the increase in equity market volatility in Q4 and a sharp deterioration in capital returns in December 2018 across most major equity indices. Concerns over slowing economic growth and global trade tensions introduced a climate of uncertainty. Bond yields also declined and the ECB signalled the end of quantitative easing in the Eurozone. These factors played a part in creating a tougher environment for fixed income managers.

Unfavourable macro-economic conditions are likely to have had some impact on the shape of flows at the end of 2018 but while the retail fund market flow data does respond to changes in the political and economic environment, the scale of change is often limited.

A tougher regulatory stance on DB transfer advice following a series of mis-selling scandals and a rise in professional indemnity premiums for advisers offering this type of advice, helped to dampen the flow of pension transfer assets in 2018.



**CHART 53: PERFORMANCE OF MAJOR EQUITY INDICES (CAPITAL RETURN BASIS)**



Source: Lipper data as of Dec. 31. 2018

The pattern of sales in 2018 supports the long-term trend to sales volatility. Net retail sales started well in Q1 at £6.8 billion. Outflows were largely concentrated in the last quarter of the year but affected most asset classes. The notable exception is the mixed asset class: inflows to mixed asset funds were consistent quarter-on-quarter.

Chart 54 shows net retail sales by asset class over 2018<sup>35</sup>.

- Equity funds net inflows reached £1.0 billion but net retail sales fluctuated across the year. Only four months in 2018 saw positive net sales but from May onwards, apart from the brief respite in September<sup>36</sup>, net sales were negative.
- Fixed income fund flows were negative for the year at -£2.0 billion. Net sales ebbed and flowed before the large outflows in Q4 turned annual net sales negative.
- Net sales to mixed asset funds were £7.9 billion and bucked the trend to outflows in Q4 achieving positive sales each month.

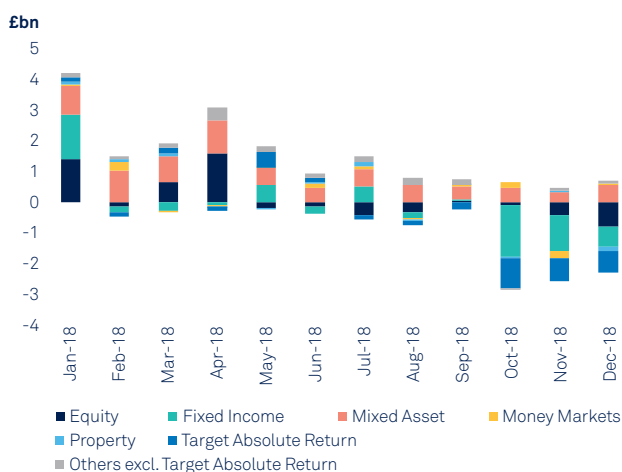
<sup>35</sup> As one of the largest components of Other, targeted absolute return has been broken out in Chart 54. Alongside targeted absolute return, the Other asset class includes the following IA sectors: Specialist; Unallocated; Unclassified and Volatility Managed.

<sup>36</sup> Net sales to Fixed income and Property were also positive in September, as were sales to Other if targeted absolute return fund sales are excluded from the data.



- Sales to funds in the ‘Other’ asset class were mixed: the Targeted Absolute Return sector, which sits in ‘Other’, saw net outflows of -£2.2 billion. Sales to funds in the Volatility Managed sector were far more consistent, achieving positive sales each month in 2018 to reach sales of £1.7 billion for the year.

**CHART 54: NET RETAIL SALES BY ASSET CLASS 2018**



It is important to emphasise not just the direction of fund flow in Q4, but the scale. The fixed income outflows of Q4 2018 amounted to only 0.3% of total FUM. Analysis of regional equities show that UK equity funds remain extremely out of favour following the referendum. However, cumulative outflows of £593m in Q4 represent only 0.05% of total FUM.

**ARE SHORTENING INVESTOR HOLDING PERIODS PROMOTING SALES VOLATILITY?**

The shortening of average retail investor holding periods could be a factor in promoting more volatile net sales over the past 10 years.

From an average holding period of six years in 2003, IA calculations based on patterns of flow show that funds are now being held by retail investors for just over three years (see Chart 55). Two drivers of this may be the increasing dominance of investment platforms and the widespread adoption of centralised investment propositions by financial advisers.

- The ascent of direct and adviser investment platforms in the retail market, where assets can be switched between funds at the click of a button, means that it is now far easier to change fund selection. Although it remains challenging to move money between platforms, work is underway to address this.<sup>37</sup>
- Centralised investment propositions (CIPs) are now widely used by advisers following the Retail Distribution Review<sup>38</sup>. CIPs are designed to meet the needs of different client segments and improve the consistency of investment advice offered to clients. They are typically offered as a range of risk-rated model portfolios and are re-balanced quarterly. Advisers and their investment committees use track records as an important indicator of performance when selecting funds, many requiring at least a three year track record to effectively assess fund performance. It may be no coincidence that average holding periods align with this minimum 3 year term.

**CHART 55: RETAIL INVESTOR AVERAGE HOLDING PERIODS (2003-2018)**



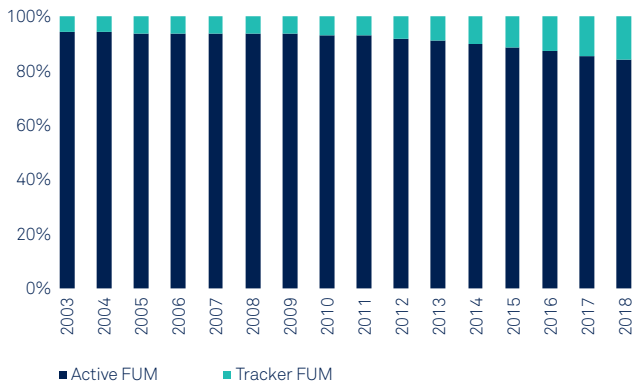
<sup>37</sup> The FCA outlines its concerns that ‘consumers and advisers who want to switch platforms find it difficult to do so because of time, complexity and the cost of switching platforms’ but welcomes the progress being made by STAR, a not-for-profit joint industry venture to improve transfer times in the Investment Platforms Market Study, Final Report, MS17/1.3 March 2019.  
<sup>38</sup> The FCA set out its expectations for advice firms on CIPs in its 2012 report: Assessing suitability: replacement business and centralised investment propositions.

### LONG-TERM TRENDS: ACTIVE V. PASSIVE<sup>39</sup>

The increasing use of index-tracking funds by UK retail investors has been much commented upon. The data presented in Chart 56 show that FUM in index trackers has been increasing as a percentage of total UK investor FUM but that this increase has been extremely gradual over the last 15 years.

Tracker fund FUM growth starts to accelerate following the introduction of the RDR in 2013. Chart 56 suggests that the removal of commission and the commission-bias has been an important factor in the growth of trackers as a proportion of FUM.

**CHART 56: ACTIVE FUNDS AND TRACKER FUNDS AS A PROPORTION OF TOTAL FUNDS UNDER MANAGEMENT (2003-2018)**



In 2018, as Chart 57 illustrates, net retail sales to trackers were £9.0 billion whereas net retail sales to active funds were -£1.7 billion (outflows were concentrated in Q3 and Q4 as explained in the section on page 72).

Between 2013 and 2018, cumulative net sales to tracker funds were £43.7 billion. In the period between 2008 and 2013, they were just £9.2 billion (sales to active funds over this period were £92 billion). The implementation of the RDR has removed the barrier of commission, resulting in higher net retail sales to trackers.

**CHART 57: NET RETAIL SALES TO ACTIVE AND INDEX TRACKING FUNDS (2008-2018)**

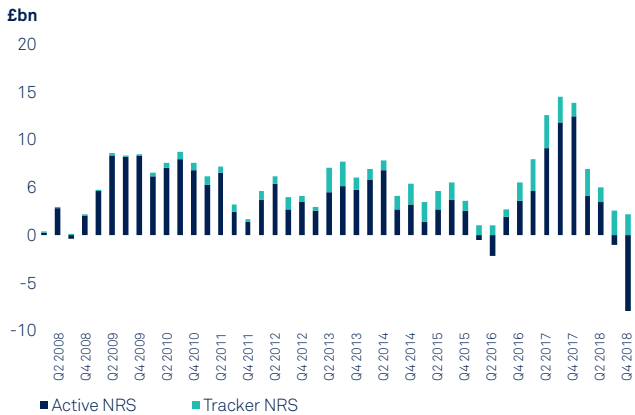
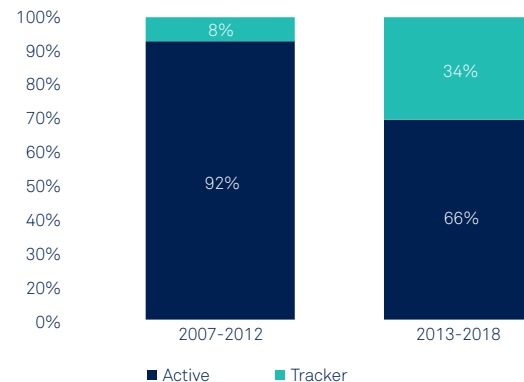


Chart 58 shows that the proportion of net flows to tracker funds was one-third of total net sales between 2013 and 2018, whereas sales to tracker funds only accounted for 8% of total net retail sales in the five years preceding the RDR.

**CHART 58: NET RETAIL SALES BY TRACKER FUND AND ACTIVE FUND PRE- AND POST-2013**



<sup>39</sup> The passive universe of funds encompasses Exchange Traded Funds (ETFs) (although ETFs can be active) but IA data does not include the FUM or sales of ETFs.

Looking at the share of net sales to tracker funds by asset class, trackers have been a more popular way of gaining exposure to UK equities than actively managed funds since the referendum.

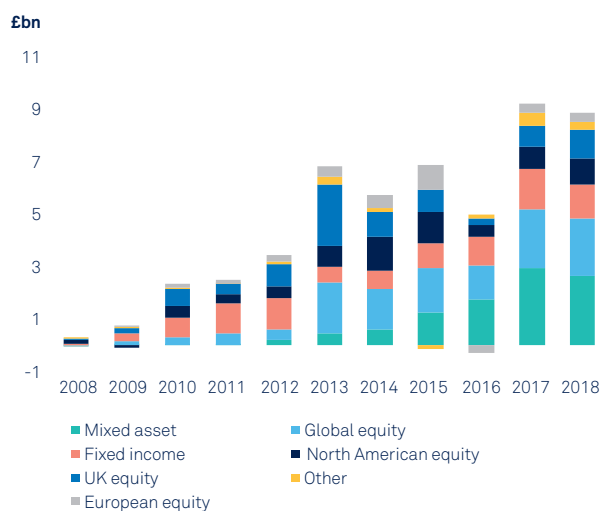
Chart 59 shows that trackers have bucked the trend to UK equity outflows, attracting positive flows into UK equities since 2016. Sales to trackers of UK equity indices were £7.3 billion over the period 2016 to 2018.

Comparing sales to active funds and tracker funds in the UK All Companies sectors between 2016 and 2018 gives further colour to the difference in fortune between UK equity trackers and active funds.

- Cumulative sales to active funds in the UK All Companies sector between 2016 and 2018, were -£12.8 billion. Every quarter between Q1 2016 and Q4 2018 has seen negative net retail sales.
- Sales to tracker funds in the UK All Companies sector were not immune to the negative impact of the referendum: three of the 12 quarters between 2016 and 2018 saw negative net sales. But trackers did substantially better over the period with net retail sales of £1.9 billion.

Trackers have been a more popular way of gaining exposure to UK equities than actively managed funds since the referendum.

**CHART 59: NET RETAIL SALES OF TRACKER FUNDS BY INDEX INVESTMENT TYPE (2008-2018)**



The advent, in 2018, of ex-post and ex-ante costs and charges disclosure to investors under the MiFID II regulation may prove another fillip for low-cost passives and tracker funds. Investors have been used to seeing charges expressed as a percentage of their invested assets. This is arguably a less tangible way of expressing fees than outlining them in pounds and pence. Now that retail investors are seeing advice, platform and fund fees in monetary terms, it could increase fee sensitivity. Tracker funds are an obvious means of reducing the total cost of ownership for investors and this could drive further increases in sales.

## INVESTMENT FUNDS AND THE RISE OF RESPONSIBLE INVESTING

As we note in Chapter Two of this report, the rise of responsible investment as well as a focus on dedicated responsible investment approaches at the fund level has intensified over the course of 2018 and is a powerful catalyst for evolution in the investment environment. Responsible investment is very broad in scope and specific funds' characteristics range from social impact investing to negative screening for shares that could be deemed "unethical", for example tobacco or arms manufacturers. There is also a wide array of terms used to describe fund objectives including "ESG" and "ethical".

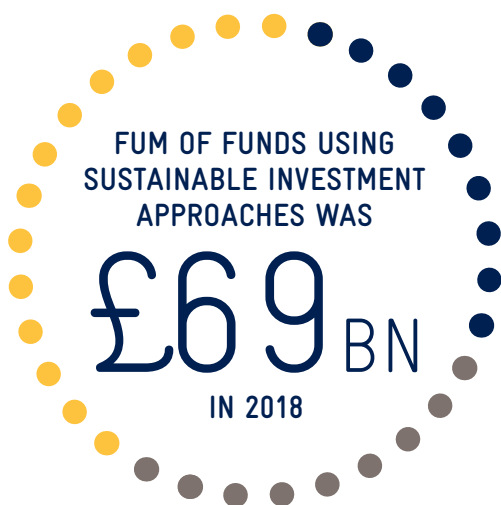
The IA has collected data using the Global Sustainable Investment Alliance (GSIA) definitions outlined in Table 5 overleaf. Investment management firms that have applied ESG integration to investment processes and are pursuing corporate engagement and shareholder action strategies can be described as taking a responsible approach to investing but many go further at the fund-level and adopt a variety of very specific sustainability-related investment approaches in their objectives.

The broad range of terms for responsible investment approaches means that there are classification and data collection challenges as well as issues around the consistency of interpretation. It can also be hard to determine if responsible investment characteristics apply at a fund level or at the firm level. The IA is working to ameliorate these issues by creating an industry-agreed responsible investment framework with an accompanying glossary of definitions, and will report further on this later in 2019.

**Total funds under management and retail sales**

Using GSIA definitions, we present our investment fund data in two ways:

1. There is a universe of funds that can be said to pursue dedicated responsible investment approaches at fund level: negative screening; positive screening; norms-based screening; sustainability themed investing and impact/community investing. Many of these funds are overtly marketed as “sustainable” or “ESG” funds with names that reflect these attributes and objectives. The FUM of funds that are pursuing sustainable investment approaches was £69 billion or 6% of total FUM in 2018. Net retail sales in 2018 were £1.08 billion.<sup>40</sup>
2. The wider universe of funds is referred to as “responsible investment”. This includes not only dedicated responsible investment approaches at a fund-level but also incorporates funds sold by investment managers that have adopted ESG integration and/or corporate engagement at a firm-level applying them across their fund ranges. Using this wider definition, the latest data show that total FUM in funds managed with reference to responsible and sustainable criteria reached £103 billion at the end of 2018. This represents 9% of total UK investor FUM. On this basis, net retail sales are slightly negative (£-0.53 billion).



**TABLE 5: GLOBAL SUSTAINABLE INVESTMENT ALLIANCE (GSIA) DEFINITIONS**

Category	Definitions
Integration of ESG factors	The systematic and explicit inclusion by investment managers of environmental, social, and governance factors into traditional financial analysis.
Corporate engagement and shareholder action	The use of shareholder power to influence corporate behaviour, including through direct corporate engagement (i.e. communicating with senior management and/or boards of companies), filing or co-filing shareholder proposals, and proxy voting that is guided by comprehensive ESG guidelines.
Negative/exclusionary screening	The exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria.
Positive/best-in-class screening	Investments in sectors, companies, or projects selected for positive ESG performance relative to industry peers.
Norms-based screening	Screening of investments against minimum standards of business practice based on international norms.
Sustainability-themed investing	Investment in themes or assets specifically related to sustainability (for example clean energy, green technology, or sustainable agriculture).
Impact/community investing	Targeted investments, typically made in private markets, aimed at solving social or environmental problems, and including community investing, where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to businesses with a clear social or environmental purpose.

<sup>40</sup> Compared to previous years, the IA has changed its approach to the collection and reporting of both fund-level and wider assets under management data on responsible investments to improve its accuracy. This means that year-on-year comparison between the funds under management data and retail sales data is not possible.

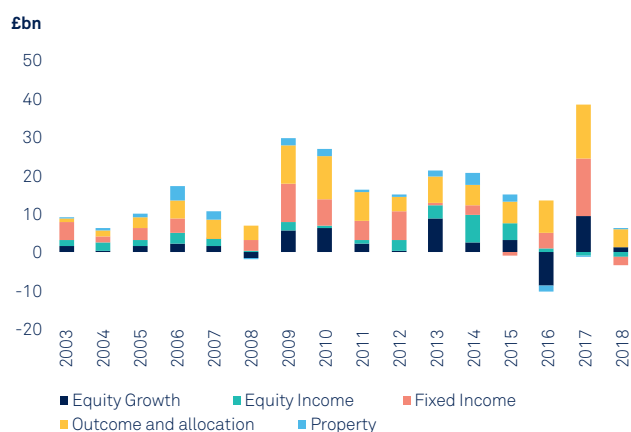
## SALES BY INVESTOR OBJECTIVE

To understand how retail investor motivation has shifted over time, Chart 60 analyses sales data by grouping funds by the investor's objective. Investors typically look to grow their capital, protect their capital or to deliver an income from their investments. They may also be seeking a particular outcome, for example to achieve positive returns irrespective of market conditions or to smooth the volatility of returns. The chart illustrates the rise and fall of sales to these types of funds.

Chart 60 shows net retail sales by investors' principal objectives between 2003 and 2018.

- Investor preference for funds that offer a specific outcome or diversified allocation has increased post-2008. As Table 6 shows, cumulative sales to these funds since 2008 are £81 billion outstripping sales to fixed income, equity growth and equity income. Over five years, the pattern of sales remains the same: sales to outcome and allocations funds were just over twice as high as sales to fixed income funds.
- Sales to fixed income, equity income and equity growth funds have been less consistent. Whilst net outflows are relatively rare, in periods of economic or political instability in 2008 and 2016, equity growth funds saw net outflows.
- Outflows were seen in fixed income in 2015, amid a climate of volatile bond yields for developed market bonds, and in 2018, as bond yields declined. This may be more a reflection that investors dislike uncertainty than that they are highly responsive to the vagaries of the price or yield of corporate and government debt.

**CHART 60: NET RETAIL SALES BY INVESTOR OBJECTIVE (2003-2018)**



**TABLE 6: CUMULATIVE SALES TO FUNDS BY INVESTOR OBJECTIVE**

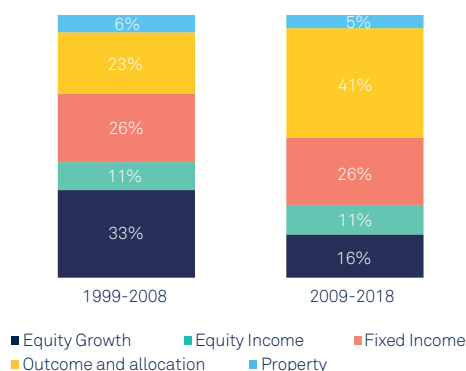
	Cumulative sales Last five years (£bn)	Cumulative sales Last ten years (£bn)
Outcome & allocation	44.6	81.0
Fixed income	19.2	51.2
Equity growth	16.0	29.0
Equity income	14.3	21.2
Property	4.9	9.0

There is compelling evidence that investor demand for outcome and allocation funds is a structural change: over the last 10 years investors have increasingly opted for funds that act as investment solutions where the allocation of assets is done within the fund rather than at the portfolio level.

The shift away from equity growth funds to outcome and allocation funds after 2008 is outlined in Chart 61:

- **Equity growth funds** made up the highest percentage (33%) of cumulative net sales between 1999 and 2008 but in the following ten years, this percentage roughly halved to 16%.
- Sales to **outcome and allocation** funds between 2009 and 2018 were £77.3 billion or 41% of the total net retail sales, the highest share of net sales over the period. Between 1999 and 2008 this percentage was 23%, less significant than sales to equity growth and fixed income funds (26%).
- In **fixed income, equity income** and **property** there has been little change in the proportion of sales between 1999 to 2008 and 2009 to 2018.

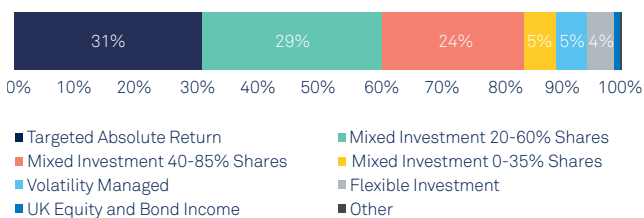
**CHART 61: NET RETAIL SALES BY INVESTOR OBJECTIVE PRE-2008 AND POST-2008**



The balance of sales within outcome and allocation funds is illustrated in Chart 62.

- 68% of net sales went to the combined mixed asset sectors, this represents £46.3 billion. Mixed asset funds have not had a negative quarter of net sales since 2002.
- Targeted Absolute Return and Mixed Investment 20-60% shares attracted roughly one third of flows each over the ten year period.

**CHART 62: NET RETAIL SALES TO OUTCOME AND ALLOCATION FUNDS BY SECTOR (2009-2018)**

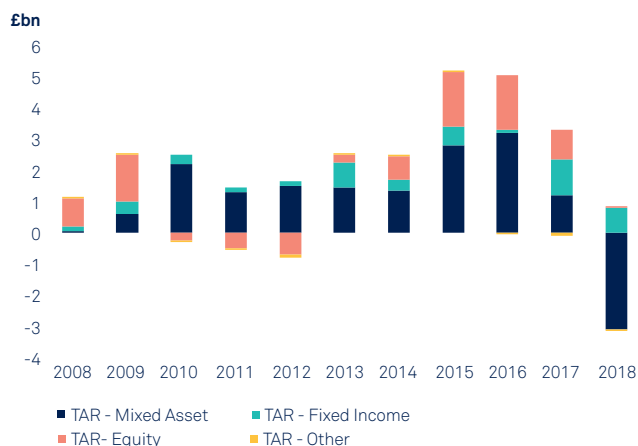
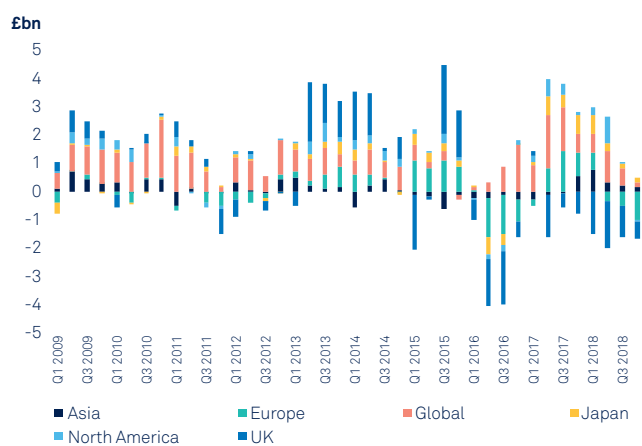


This chart does not convey the recent downwards trajectory of sales to Targeted Absolute Return funds. This sector experienced -£2.2 billion outflows in 2018 (See Chart 63). Outflows were concentrated in the second half of 2018: Targeted Absolute Return funds had positive annual net sales for the rest of this ten year period.

However, looking in more detail at Chart 63, the pattern of net sales by fund profile looks more mixed than one of outflows across the board.

- Outflows in 2018 were very concentrated among TAR funds with a **mixed asset** profile. Outflows from these funds were £3.1 billion in 2018 compared with inflows of £1.2 billion in 2017.
- Sales to TAR **fixed income** funds were positive, and the second highest in the last 10 years, at £0.8 billion against a backdrop of challenging market conditions for fixed income managers in the second half of the year.
- TAR **equity** funds had three consecutive years of outflows between 2010 and 2012 but have achieved net inflows from 2013 onwards. Net retail sales in 2018 were £0.08 billion but were considerably weaker than sales of £1.7 billion in 2016 and of £0.9 billion in 2017.

The outflows from mixed asset TAR funds run contrary to the more general trend of positive sales to mixed asset funds.

**CHART 63: NET RETAIL SALES TO TARGETED ABSOLUTE RETURN FUNDS BY ASSET CATEGORY (2008-2018)**

**CHART 64: EQUITY FUNDS, NET RETAIL SALES BY REGION (2009-2018)**


## REGIONAL EQUITY FUND SALES OVER 10 YEARS

The picture for sales to equity funds remains mixed. Global equity funds have consistently attracted strong retail inflows. There has only been one quarter of negative sales to global equity funds between 2008 and 2018 in Q4 2015. Global equity funds have high levels of geographic diversification: investors have found this diversified exposure consistently attractive. Funds invested in narrower geographic regions have seen more volatility of sales, affected by the health of these regional or national economies and the stability of their political systems.

In the case of UK equities, we can see the immediate impact of the referendum. Net sales to UK equities have been weak and net outflows have been rising since 2016 when the UK voted to exit the EU. Net retail outflows from UK equities between 2016 and 2018 total £12.4 billion: the five year cumulative sales picture in Table 7 masks the extent of outflows since the referendum.

**TABLE 7: CUMULATIVE SALES TO EQUITY FUNDS BY REGION OVER FIVE AND 10 YEARS**

	Cumulative sales Last five years (£bn)	Cumulative sales Last ten years (£bn)
Global	17.2	35.8
North America	5.3	8.0
Japan	5.0	5.6
Europe	4.5	-0.4
Asia	0.3	3.2
UK	-1.9	-2.3



## FIXED INCOME – A 10 YEAR REVIEW

In the last 10 years, investors have been attracted to fixed income funds with a diverse allocation of fixed interest securities and with global exposure. Sales to sterling strategic bonds and global bonds have been consistent over five and 10 year periods and strategic bonds is the highest selling fixed income sector over five and 10 years (see Chart 65 and Table 8)<sup>41</sup>.

Net sales to sterling corporate bonds have been highly volatile over the last five years. Assets have washed in and out of funds in the corporate bond sector: three of the past five years have seen net outflows and the pattern of flows each quarter has been lumpy.

Performance appears to be less of a driver of flows in fixed income than investor confidence. The strategic bond sector and corporate bonds have had similar performance on a total return basis over five years<sup>42</sup>, but strategic bonds draw from across the universe of fixed interest securities and managers are relatively unconstrained in what they can invest in. This means that strategic bond funds are typically more diversified than corporate bonds where fund managers have tighter parameters. The data throughout this chapter shows that investors are attracted by diversification and that they are less content to make allocation decisions themselves.

**CHART 65: FIXED INCOME, NET RETAIL SALES BY SECTOR (2008-2018)**

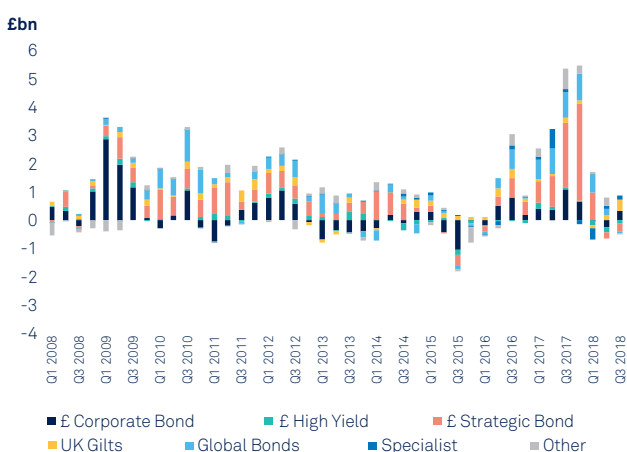


Table 4 shows the breakdown of net retail sales into fund of funds by distribution channel.

**TABLE 8: CUMULATIVE SALES TO FIXED INCOME FUNDS BY SECTOR (2008-2018)**

	Cumulative net retail sales Last five years (£bn)	Cumulative net retail sales Last ten years (£bn)
£ Strategic Bonds	11.9	22.6
Global bonds (inc. GEMB)	5.1	11.4
UK Gilts (inc. index-linked)	2.4	5.4
£ Corporate Bond	-0.5	9.9
£ High Yield	-0.6	1.3
Specialist	0.9	0.9
Other	1.9	1.2

<sup>41</sup> Gilts and index linked gilts have been grouped in Table 8 and Chart 65. Global bonds and Global emerging market bonds have also been grouped together as GEMB became a sector in Q1 2014: cumulative sales to GEMB between Q1 2014 and Q4 2018 are £0.34 billion.

<sup>42</sup> Morningstar data show that on an annualised total return basis over 5 years to year-end 2018, the IA £ Corporate bond sector returned 4.79% and the IA £ Strategic bond sector returned 3.62%.

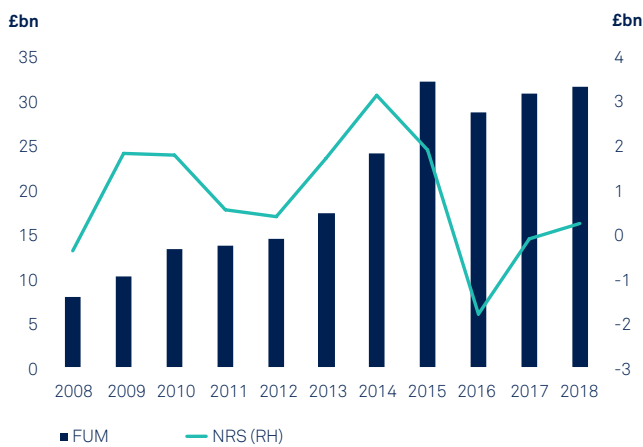


## PROPERTY

FUM in property funds reached £31.4 billion in 2018, growing by 2% year on year since 2017 (see Chart 66). Net retail sales in 2018 were £0.25 billion, a stronger result than the outflows of -£0.13 billion in 2017 and -£1.8 billion in 2016, when a number of direct property funds were suspended in order to meet investor redemption requests.

Cumulative net retail sales since 2013 total £4.9 billion and net retail sales since 2008 are £9.1 billion. Property fund sales grew steadily between 2013 and 2015 before the 2016 outflows.

**CHART 66: PROPERTY, FUM AND NET RETAIL SALES (2008-2018)**



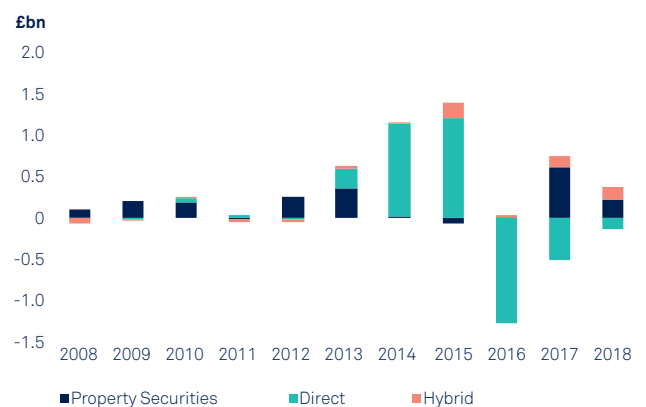
Property funds can be broken into three categories:

- Direct funds that invest directly in commercial buildings
- Indirect funds that invest in property related securities
- Hybrid funds that invest in a mixture of property related securities and physical buildings.

Funds that invest directly in property are more illiquid than their indirect and hybrid counterparts.

Property fund sales rebounded somewhat in 2018 but the underlying data, shown in Chart 67, suggest that investors prefer more liquid funds. Funds that invest directly in UK commercial property continued to see outflows, albeit smaller outflows than in 2016 and 2017. Sales to indirect (£0.22 billion) and hybrid funds (£0.16 billion) were positive while direct property funds suffered outflows of -£0.14 billion.<sup>43</sup>

**CHART 67: NET RETAIL SALES BY TYPE OF PROPERTY FUND (2008-2018)**



<sup>43</sup> In 2018, the IA asked all property fund managers to categorise their funds as: property securities; indirect, direct and hybrid. The data in Chart 67 does not include funds in unclassified or unallocated sectors so does not equate to total 2018 net retail sales to property funds.

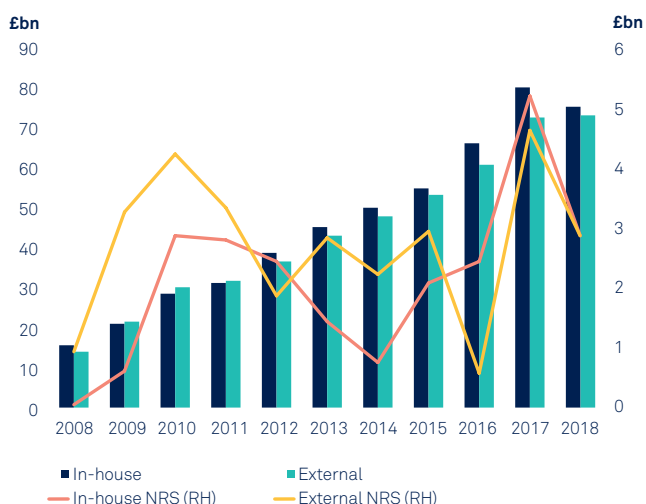
## FUND OF FUNDS SALES & FUM

Net sales to fund of funds that are managed in-house<sup>44</sup> were £2.9 billion in 2018 and sales to external<sup>45</sup> fund of funds were also £2.9 billion. Funds under management in 2018, as shown by Chart 68, remain evenly split:

- FUM in in-house fund of funds was £75.0 billion, a decrease of 7% year on year.
- FUM in external fund of funds was £73.0 billion, FUM is unchanged between 2017 and 2018.
- Cumulative net sales to external fund of funds were £29.8 billion between 2008 and 2018, compared with £23.6 billion to in-house, indicating that investors prefer a whole of market approach.
- The picture for in-house fund of funds sales between 2013 to 2018 was £14.8 billion. Sales to externally managed fund of funds reached £16.0 billion.

Overall, the data suggest a slight investor preference for funds of funds that invest in external managers.

**CHART 68: FUND OF FUNDS, FUM AND NET RETAIL SALES (2008-2018)**

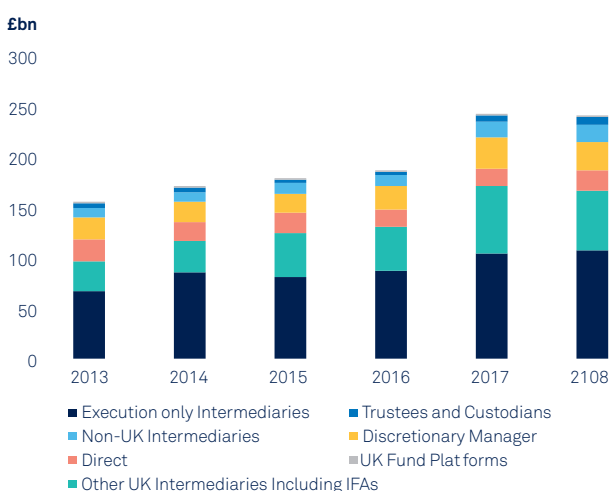


## UK FUND DISTRIBUTION

In 2018, UK fund platforms<sup>46</sup> remain the largest distribution channel for UK retail investors by gross sales. 45% of gross retail sales are flowing through UK fund platforms (see Chart 69).

- Gross retail sales through UK fund platforms reached £108 billion in 2018, a 2% increase year on year.
- The 'other intermediary including IFA's channel saw a 9% decrease in gross sales between 2017 and 2018. It is likely that some of these sales are being re-directed through platforms. IFAs are placing more business on platform on behalf of their clients: platforms make it easy for advisers to deduct fees through the platform and to manage and report on client portfolios.
- Gross sales through execution-only intermediaries rose by 25% year on year, the highest increase of any channel. This suggests that non-advised investors still had some appetite to invest new money in 2018, although gross sales through execution only-intermediaries represent only 1% of total gross sales.

**CHART 69: GROSS RETAIL SALES BY DISTRIBUTION CHANNEL (2013-2018)**



<sup>44</sup> Fund of funds can be constrained to invest only in in-house managers from the same firm, this type of fund of fund has been termed in-house in the commentary

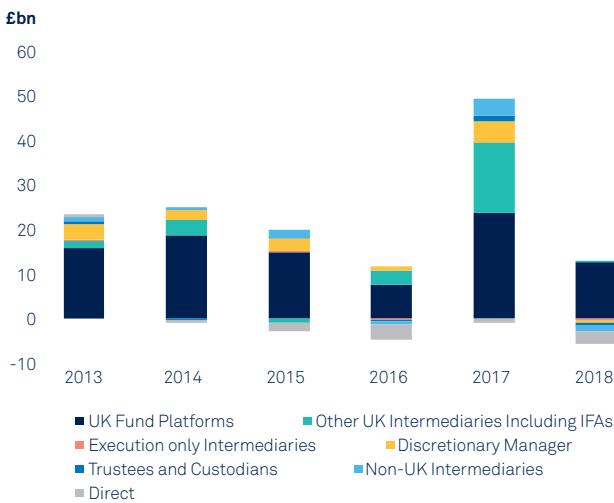
<sup>45</sup> Many fund of fund managers are free to select funds from the whole market. These funds are called external or externally managed in the commentary.

<sup>46</sup> UK fund platforms covers fund companies' transactions (reported by fund companies) with the following: Ascentric; AEGON (Cofunds); Avalon (Embark); Aviva Wrap; Fidelity FundsNetwork; FNZ (platforms powered by); Hargreaves Lansdown; James Hay Wrap; Novia; Nucleus; Old Mutual Wealth (including Selestia, Skandia Multifunds and Skandia Life); Parmenion; Standard Life Savings; Transact; Wealthtime.

The net retail sales data in Chart 70 shows how redemptions have affected sales through UK distribution channels.

- UK fund platforms received the highest proportion of net retail sales (£12.6 billion) but sales were 47% lower than in 2017.
- ‘Other UK intermediaries including IFAs’ also attracted positive net sales in 2018 but sales dropped by 99% between 2017 and 2018.
- All other channels experienced net outflows. Outflows from the non-UK intermediary channel were the second highest, totalling £1.2 billion. This indicates the negative influence of Brexit on this channel, which also saw net outflows in 2016, the only other year of outflows since 2012.

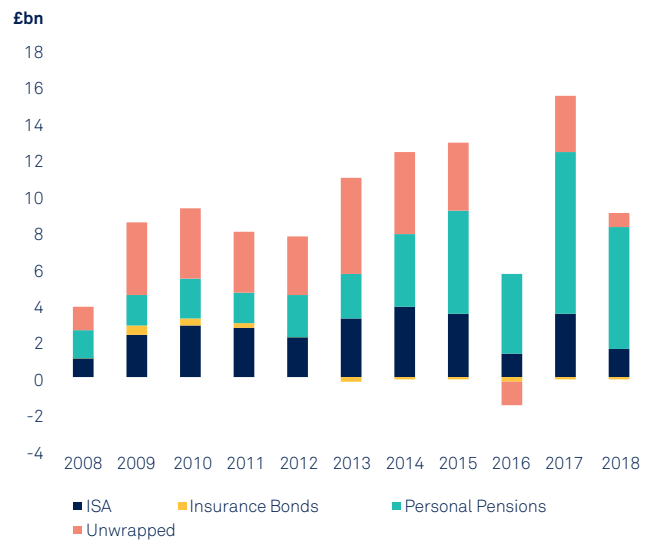
**CHART 70: NET RETAIL SALES BY DISTRIBUTION CHANNEL (2013-2018)**



**WRAPPERS USED BY RETAIL INVESTORS IN THE UK**

Since the pension freedoms were introduced in April 2015, net sales to pension wrappers have been steadily increasing and in 2018 net sales to pension tax wrappers were again the highest (see Chart 71). There has been a steady shift away from sales to unwrapped funds, which account for funds in the general investment account on platforms. The increase in the annual tax free allowance for ISAs to £20,000 in 2017-2018 means that sales may be shifting from unwrapped (9% of sales in 2018) to ISAs (17% of sales in 2018).

**CHART 71: NET RETAIL SALES TO TAX WRAPPERS THROUGH UK FUND PLATFORMS (2008-2018)**



## THE UK MARKET IN THE CONTEXT OF EUROPE

The UK is the fifth largest European domicile with €1.5 trillion in equivalent UK domiciled funds and a market share of 10%.

**TABLE 9: ASSETS DOMICILED IN EUROPEAN UCITS AND ALTERNATIVE INVESTMENT FUNDS (AIFS) IN 2018**

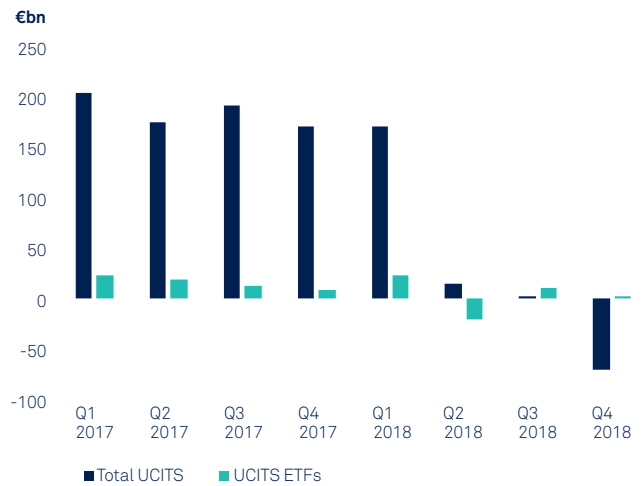
	Net assets (€bn)	Market share (%)
1. Luxembourg	4,065	27%
2. Ireland	2,421	16%
3. Germany	2,037	13%
4. France	1,813	12%
5. United Kingdom	1,493	10%
6. Netherlands	828	5%
7. Switzerland	532	4%
8. Sweden	333	2%
9. Italy	302	2%
10. Spain	286	2%
Rest of Europe	1040	7%
<b>TOTAL</b>	<b>15,150</b>	<b>100%</b>

Source: EFAMA

The pattern of net sales to UCITS funds in Europe mirrors that of the UK (see Chart 72) with large outflows of €70.5 billion over Q4 2018. Sales to UCITS ETFs were just positive for that quarter at €2.8 billion but still weak.

- Total net sales to UCITS funds in 2018 were €118.4 billion compared with €739.7 billion in 2017.
- UCITS ETFs attracted net sales of €18.1 billion in 2018: in 2017 net sales had reached €64.5 billion.

**CHART 72: EUROPEAN NET SALES OF UCITS FUNDS (2017-2018)**



Source: EFAMA

Chart 73 shows that assets in UK domiciled UCITS and AIFs have dropped back slightly in 2018 to 2016 levels. This contrasts with the growth in assets in the two largest European fund domiciles, Luxembourg and Ireland. As noted earlier, some investment firms have made the operational decision to move non-sterling share classes away from UK domiciled funds into European domiciles, which will have had some impact on the 2018 figures.

**CHART 73: ASSETS IN UCITS AND AIFS BY DOMICILE**



Source: EFAMA

# 6 OPERATIONAL AND STRUCTURAL ISSUES

## KEY FINDINGS

### REVENUE AND COSTS

- » Total average industry revenue after commission stood at £21 billion in 2018, a 2% increase in nominal terms. This equates to 27 basis points (bps), from 28bps in 2017.
- » Total operating costs in 2018 increased 4% to £15 billion. In basis point this is almost unchanged from last year at 19bps.
- » Consistent with findings in recent years, costs increased at a higher rate than revenue during 2018. As a consequence profitability stood at 29%, down one percentage point on 2017.

### INDUSTRY EMPLOYMENT

- » Around 115,000 jobs are supported by the UK investment management industry, either directly or indirectly.
- » The UK investment management industry directly employed an estimated 40,000 people at the end of 2018, up 4% on the 2017 figure.
- » Jobs in the investment management industry vary by location, with the largest proportion in London being employed in investment management and operations and fund administration being of greater importance in Scotland.

### INDUSTRY CONCENTRATION

- » The UK investment management industry remains relatively unconcentrated. Assets managed by the top five and the top ten firms stood at 42% and 57% of total assets respectively. Both were one percentage point lower than 2017.
- » The industry continues to comprise a small number of very large firms but a long tail of medium- and small-sized organisations. The median figure for assets managed by IA member firms was similar to 2017, at £12 billion, compared to a mean figure of £52 billion.

### INVESTMENT MANAGER OWNERSHIP

- » Over the past decade the proportion of assets managed by firms owned by a parent headquartered in the US has increased from 27% to 44%.
- » The proportion of assets managed by independent investment managers now stands at 44%, more than double the level in 2008 (21%). This is in large part a reflection of high levels of M&A activity seen in the industry over that period.

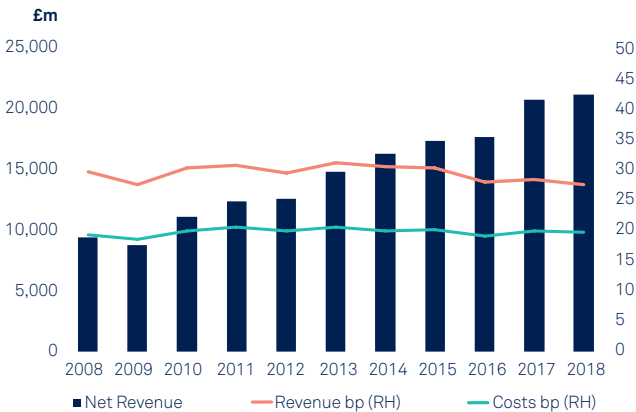
This Chapter focuses on investment managers as firms. It covers three broad themes: industry revenue and profitability, employment and broader corporate issues, including changing patterns of ownership and industry concentration levels.

## REVENUE AND COSTS

Chart 74 reports aggregate revenue and cost figures for the industry, covering both in-house and third party business.

- Total average industry revenue after commission stood at £21 billion in 2018, an increase of 2% on the 2017 figure. This represented 27bps of total assets, down 1bp.<sup>47</sup>
- Total operating costs in 2018 rose by 4% to £15 billion. In basis point terms this was almost unchanged from 2017, representing 19bps of total average assets under management.<sup>48</sup>
- Consistent with findings in recent years, costs increased at a higher rate than revenue during 2018. As a consequence, profitability fell to 29%, down from 30% in 2017.
- Viewed over a longer time horizon, average profitability has declined from 35% in 2008.

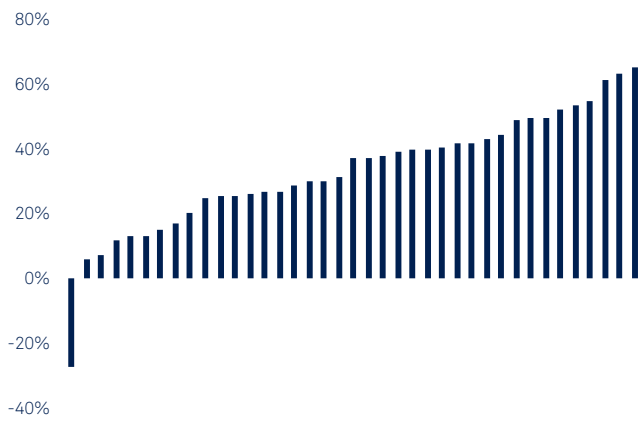
**CHART 74: INDUSTRY NET REVENUE VS. REVENUE AND COSTS AS A PERCENTAGE OF AVERAGE ASSETS UNDER MANAGEMENT (2008-2018)<sup>48</sup>**



The average profitability figure is a useful measure for monitoring year on year changes in the overall industry. However, investment managers operate in a very diverse environment and profitability varies significantly by individual firm. Chart 75 shows the distribution of profitability of respondent firms in 2018.

Profitability ranged from -28% to 66%, with almost one quarter of firms having profit margins of 20% or lower and one quarter above 46%.

**CHART 75: DISTRIBUTION OF INVESTMENT MANAGER PROFITABILITY**



Performance-based fees remain a relatively small part of the industry’s fee generation. In 2018 around 9% of assets under management were subject to performance-based fees.

<sup>47</sup> Calculated as net revenue less costs divided by net revenue.

<sup>48</sup> Average assets under management are calculated using AUM figures at the beginning and end of each year, reflecting the practice that charges are billed throughout the calendar year.

## EMPLOYMENT IN THE INVESTMENT MANAGEMENT INDUSTRY

The IA has been monitoring direct employment numbers in the investment management industry since 2006. In recent years this has been extended to estimate employment in supporting industries such as custodian banks, transfer agents and wealth managers. For the first time this year data also includes those employed in a broader range of the IA's affiliate members, notably legal firms providing services to the investment management industry.

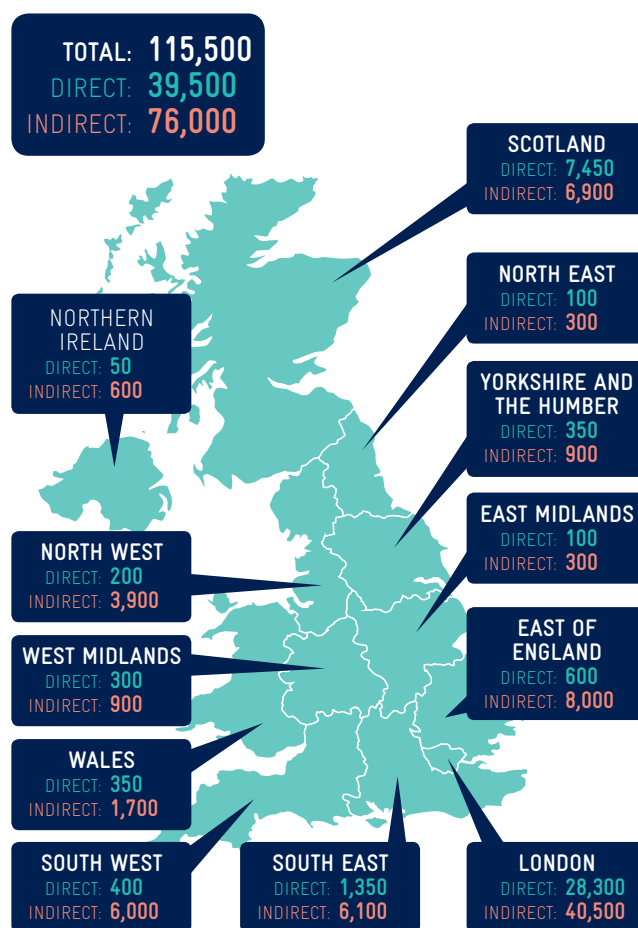
The IA estimates that UK investment management industry supports just over 115,000 jobs in the UK. 40,000 are employed directly by investment management firms. 76,000 are employed in IA affiliate members and in fund and wider administration services, and securities and commodities dealing activities<sup>49</sup>. Given that we have included a broader range of affiliate employment in the indirect category this year, no year on year comparison of total employment can be made.<sup>50</sup>

The bulk of this resource is concentrated in London and South East England, with a broader regional footprint, particularly seen in a strong Scottish industry. Figure 13 shows this in more detail. Specifically, IA members have offices across the UK. Locations include: Bristol, Birmingham, Bournemouth, Cardiff, Chester, Chelmsford, Guildford, Harrogate, Henley, Leeds, Manchester, Norwich, Oxford, Peterborough, Southampton, Swindon and York. In addition a number of firms have offices in other parts of the British Isles, notably the Channel Islands.

Not yet included in the above data, an increasing number of people are employed in Fintech companies providing services to the investment management industry. In October 2018 the IA launched Velocity ([www.iavelocity.com](http://www.iavelocity.com)), a FinTech Innovation Hub and Accelerator for investment management and capital markets. With an Advisory Panel consisting of 25 industry practitioners and experts Velocity has been created to accelerate the identification and adoption

of new emergent technology across the sector. Over 110 firms are now active within the Velocity ecosystem, operating in over 35 countries and technology-related jobs are likely to become increasingly important in the coming years.

**FIGURE 13: DIRECT AND INDIRECT EMPLOYMENT IN INVESTMENT MANAGEMENT IN THE UK**



Source: IA estimates from information provided by members and publicly sourced information. All regional numbers have been rounded to the nearest 50 and therefore may not add to exact total

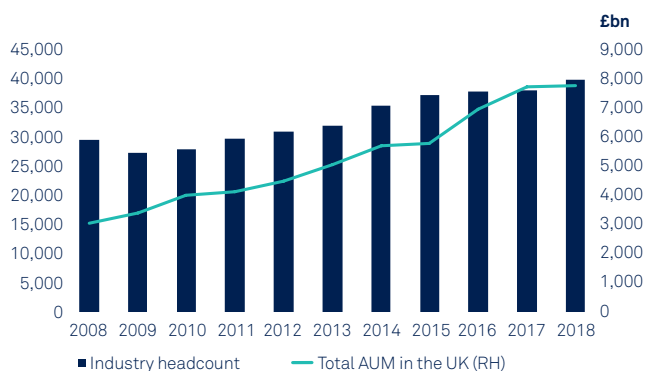
<sup>49</sup> It is difficult to identify jobs associated with investment management among firms that have a remit that extends wider than their investment management support, such as consultants, lawyers and accountants. In addition, a substantial number of roles in areas such as IT are outsourced to third party organisations and cannot be discretely measured. The figures provided below should therefore be viewed as a conservative estimate of those employed in investment management related roles.

<sup>50</sup> Our figures do not include the estimated 26,000 financial advisers in the UK, who provide a distribution point for a wider variety of financial services alongside funds and/or discretionary wealth management (e.g. insurance).

## DIRECT EMPLOYMENT

An estimated 40,000 are directly employed by investment managers in the UK. This figure has increased by 4% since the end of 2017.

**CHART 76: INDUSTRY HEADCOUNT ESTIMATE VS. UK ASSETS UNDER MANAGEMENT (2008-2018)**



The investment management industry involves significant levels of outsourcing, notably in IT. These figures are likely to understate the numbers working to directly support investment management activity.

## DISTRIBUTION OF STAFF BY ACTIVITY

Table 10 provides more detail on the number of employees directly employed by investment managers in the UK by function. The breakdown of staff activity was similar to 2017. The proportion of staff in Operations and Business Development fell slightly and those employed in Corporate Finance increased.

**TABLE 10: DISTRIBUTION OF STAFF BY ACTIVITY (DIRECT EMPLOYMENT)**

Activity	Percentage of total headcount
<b>Investment Management of which</b>	<b>26%</b>
Investment management (asset allocation and stock selection)	63%
Research, analysis	30%
Dealing	7%
<b>Operations and Fund Administration of which</b>	<b>17%</b>
Investment transaction processing, settlement, asset servicing	36%
Investment accounting, performance measurement, client reporting	39%
Other fund administration (incl. CIS transfer agency, ISA administration etc.)	25%
<b>Business Development and Client Services of which</b>	<b>20%</b>
Marketing, sales, business development	68%
Client services	32%
<b>Compliance, Legal and Audit of which</b>	<b>8%</b>
Compliance	37%
Risk	36%
Legal	22%
Internal audit	6%
<b>Corporate Finance and Corporate Administration of which</b>	<b>13%</b>
Corporate finance	37%
HR, training	23%
Other corporate administration	40%
<b>IT Systems</b>	<b>12%</b>
<b>Other Sector</b>	<b>4%</b>



Over the longer term some trends in staffing levels do emerge. Over the last five years, Chart 77 shows the following changes:

- The proportion of people employed in investment management has fluctuated slightly year on year but stands at 26%, down from 28% in 2013.
- Operations and fund administration roles have also fallen slightly over the same period (from 18% to 17%).
- The levels of staffing in Compliance, Legal and Audit and in Corporate Finance and Administration have seen increases of two and three percentage points respectively.

**CHART 77: DIRECT EMPLOYMENT BY STAFF SEGMENT (2013-2018)**

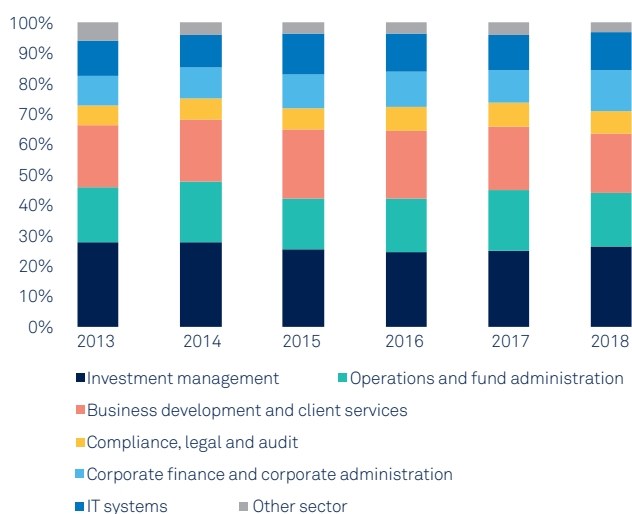


Table 11 shows that the type of activity undertaken in different locations differs widely:

- London is the main centre of investment management activity and business development.
- Operations activities and finance are more important outside of London. There is a marked contrast with Scotland in this regard, also seen in IT roles.

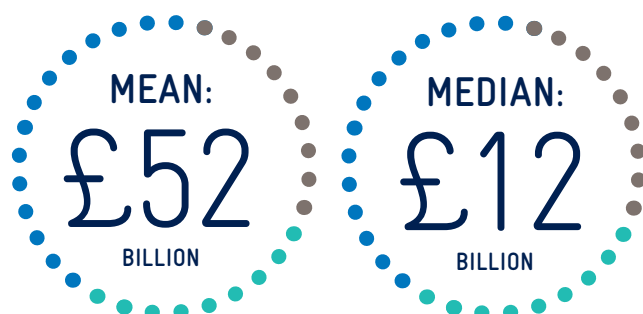
**TABLE 11: DISTRIBUTION OF INVESTMENT MANAGEMENT JOBS BY REGION**

	London	Scotland	Elsewhere in the UK
<b>Investment Management of which</b>	<b>28%</b>	<b>18%</b>	<b>30%</b>
Investment management (asset allocation and stock selection)	64%	57%	65%
Research, analysis	30%	35%	27%
Dealing	7%	8%	8%
<b>Operations and Fund Administration of which</b>	<b>14%</b>	<b>26%</b>	<b>24%</b>
Investment transaction processing, settlement, asset servicing	43%	28%	16%
Investment accounting, performance measurement, client reporting	37%	53%	27%
Other fund administration (incl. CIS transfer agency, ISA administration etc.)	19%	19%	57%
<b>Business Development and Client Services of which</b>	<b>21%</b>	<b>15%</b>	<b>17%</b>
Marketing, sales, business development	72%	46%	81%
Client services	28%	54%	19%
<b>Compliance, Legal and Audit of which</b>	<b>8%</b>	<b>6%</b>	<b>8%</b>
Compliance	35%	43%	35%
Risk	37%	31%	35%
Legal	22%	20%	25%
Internal audit	6%	6%	5%
<b>Corporate Finance and Corporate Administration of which</b>	<b>13%</b>	<b>15%</b>	<b>10%</b>
Corporate finance	35%	38%	52%
HR, training	24%	26%	12%
Other corporate administration	41%	36%	36%
<b>IT Systems</b>	<b>12%</b>	<b>17%</b>	<b>9%</b>
<b>Other</b>	<b>4%</b>	<b>3%</b>	<b>1%</b>

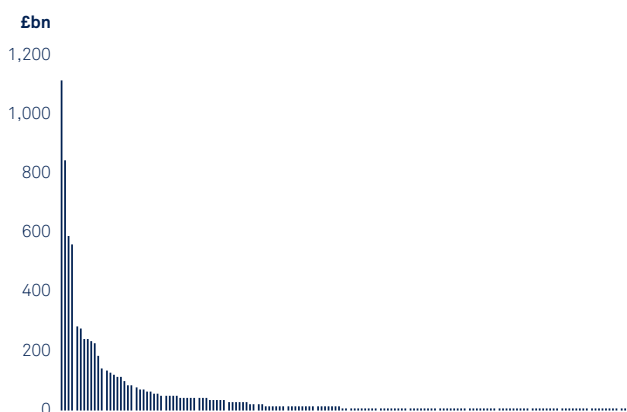
## INDUSTRY CONCENTRATION

Chart 78 illustrates that the investment management industry in the UK continues to comprise a small number of very large firms but a long tail of medium- and small-sized organisations. This is evidenced by the difference between the mean value of assets under management by an IA member firm and the median. The median value of assets under management stands at £12 billion of assets but the mean value is much higher because of the relatively small number of members with large volumes of assets under management.

### AVERAGE ASSETS UNDER MANAGEMENT AT JUNE 2018



**CHART 78: IA MEMBER FIRMS RANKED BY UK ASSETS UNDER MANAGEMENT (JUNE 2018)**



Looking at how the distribution of assets under management has changed over time there has been a steady increase in the number of the largest firms with more than £100 billion under management (see Table 12). This is consistent with level of merger and acquisition activity that has been seen in the industry in recent times (see Appendix 4).

2018 saw a decrease in the proportion of firms with less than £1 billion under management. However, at the same time there was a larger increase in firms with between £1 billion and £15 billion and £25-50 billion under management, indicating there is still significant competition and demand for smaller firms, which might be more likely to offer specialist investment services.

**TABLE 12: ASSETS MANAGED IN THE UK BY IA MEMBERS BY FIRM SIZE**

AUM	Members (June 2013)	Members (June 2014)	No. of firms (June 2015)	No. of firms (June 2016)	No. of firms (June 2017)	No. of firms (June 2018)
>£100bn	9%	8%	10%	11%	12%	12%
£50-100bn	11%	10%	10%	9%	9%	8%
£25-50bn	9%	10%	10%	11%	10%	14%
£15-25bn	10%	10%	10%	8%	10%	8%
£1-15bn	49%	48%	50%	51%	47%	49%
<£1bn	13%	15%	11%	10%	13%	10%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

The UK investment management industry remains relatively unconcentrated. The five largest firms represented 42% of assets, down one percentage point from 2017. The ten largest firms represent 57% of industry assets. A figure of less than 1,000 on the Herfindahl-Hirschmann Index, a standard measure of competition, represents low concentration. The value for the investment management industry stands at just 500 (see Chart 79).

**CHART 79: MARKET SHARE OF LARGEST FIRMS BY UK ASSETS UNDER MANAGEMENT VS. HHI (JUNE 2008-2018)**

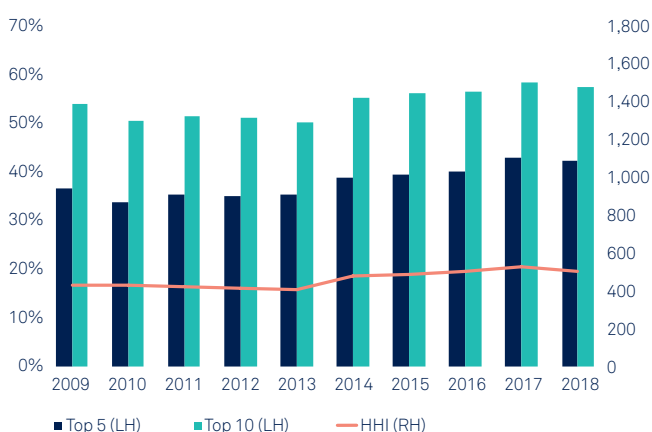
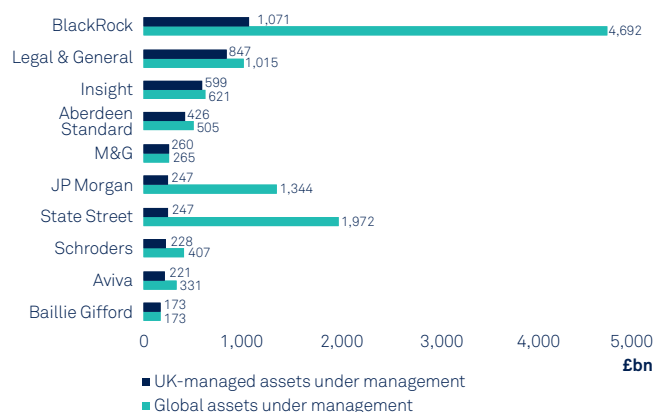


Chart 80 shows the ten largest firms in the UK, measured by UK assets under management supplied to the IA in response to the Survey questionnaire.<sup>51</sup> The top ten includes a mix of active and passive managers. There is also a wide variety of group types in the top ten, including independent investment managers, as well as managers that are part of a larger insurance group, or bank. Unsurprisingly, with institutional clients representing 80% of assets under management the assets of the top ten managers are dominated by institutional assets.

As the difference between UK and global assets shows, a number of the largest investment managers are primarily UK focused, whereas others have a much wider global footprint.

**CHART 80: TOP TEN FIRMS BY UK-MANAGED AND GLOBAL ASSETS UNDER MANAGEMENT**<sup>52</sup>



## BOUTIQUES

The IA membership contains a number of boutique managers. The definition of a boutique firm is not based purely on the size of the firm. There are four broad criteria:

- Being independently owned
- Managing assets of less than £5.5 billion<sup>53</sup>
- Providing a degree of investment specialisation
- Self definition

According to these criteria the number of boutiques within the IA membership increased from 22 in 2017 to 25 in 2018.

<sup>51</sup> Based on headline data supplied to the IA in response to the Survey questionnaire.

<sup>52</sup> Assets under management figures may reflect the value of wider economic exposure managed for clients in addition to securities within segregated or pooled portfolios.

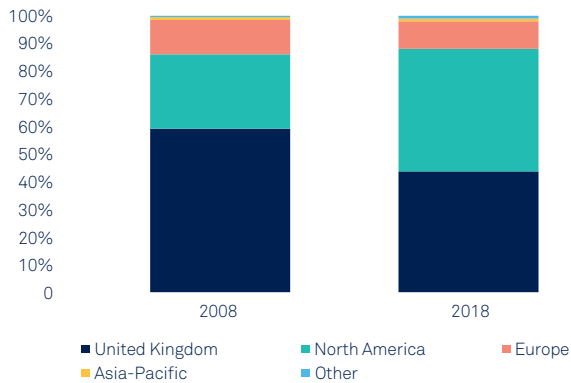
<sup>53</sup> Our original definition in 2013 used £5 billion in assets under management. We have increased this threshold in line with overall asset growth.

## INVESTMENT MANAGER OWNERSHIP

Over the past decade the biggest shift in ownership of UK investment managers has been the large increase in the proportion of assets managed in the UK by organisations with a headquarters in the US. This proportion has increased from 27% in 2008 to 44% in 2018. However, much of the shift occurred early in the decade and the proportion of US owned firms has remained relatively stable in the past five years.

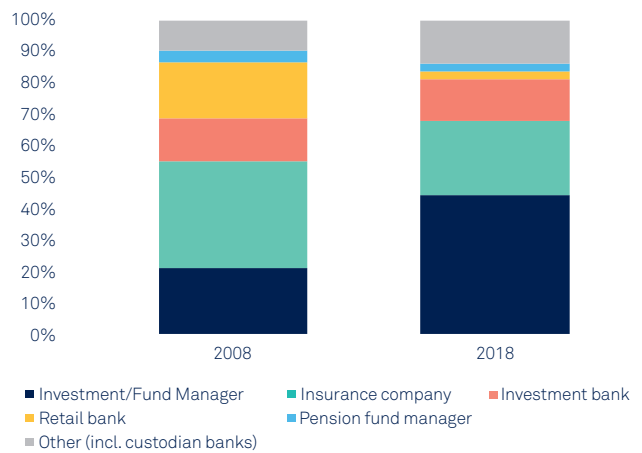
- UK-owned investment managers now account for 43% of assets managed in the UK, down from 59% in 2008.
- Assets managed by European-owned firms remain at a relatively low proportion of total assets managed in the UK at around 10%. This is down from 13% in 2008.

**CHART 81: ASSETS UNDER MANAGEMENT BY REGION OF PARENT GROUP HEADQUARTERS – TEN YEAR COMPARISON**



Over the same period, there has been a fundamental shift in the ownership of investment management companies. Chart 82 illustrates the proportion of assets managed by independent investment managers now stands at 44%, more than double the level in 2008 (21%). This is in large part a reflection of high levels of M&A activity seen in the industry (see Appendix 4). Retail banks are now the smallest parent group, representing just 2% of assets.

**CHART 82: BREAKDOWN OF UK ASSETS UNDER MANAGEMENT BY PARENT TYPE – TEN YEAR COMPARISON**



# APPENDICES

# APPENDIX 1

## SUMMARY OF ASSETS UNDER MANAGEMENT IN THE UK<sup>1</sup>

	TOTAL
<b>Assets under management in the UK (£m)</b>	<b>7,721,510</b>
<b>Segregated or pooled (%)</b>	
Directly invested on a segregated basis	56.1%
Managed on a pooled basis	43.9%
<b>Active or passive (%)</b>	
Actively managed	74.1%
Passively managed	25.9%
<b>Asset allocation (%)</b>	
<b>Equities of which:</b>	<b>36.2%</b>
UK	30.3%
Europe (ex UK)	23.1%
North America	20.9%
Pacific (ex Japan)	7.7%
Japan	5.2%
Latin America	0.9%
Africa	0.4%
Emerging market	7.4%
Other	4.1%
<b>Fixed Income of which:<sup>2</sup></b>	<b>33.4%</b>
UK Government (ex index-linked)	16.3%
Sterling corporate	18.2%
UK index-linked	10.2%
Other UK	5.9%
Overseas	49.3%
<b>Cash/Money market</b>	<b>5.2%</b>
<b>Property</b>	<b>2.7%</b>
<b>Other</b>	<b>22.5%</b>

<sup>1</sup> This includes all assets under management in this country, regardless of where clients or funds are domiciled.

INSTITUTIONAL								ALL INSTITUTIONAL	RETAIL	PRIVATE CLIENT
Pension funds	Public sector	Corporate	Non-profit	Sub- advisory	In-house insurance	Third party insurance	Other institu- tional			
3,510,761	378,755	392,556	98,664	313,872	448,612	618,852	432,123	6,194,195	1,449,658	77,413
45.5%	4.9%	5.1%	1.3%	4.1%	5.8%	8.0%	5.6%	80.2%	18.8%	1.0%

## APPENDIX 2

# SUMMARY OF DATA FROM THE UK INSTITUTIONAL CLIENT MARKET<sup>2</sup>

	TOTAL
<b>Total Institutional Market (£m)</b>	<b>4,006,739</b>
<b>Segregated or pooled institutional assets (%)</b>	
Assets directly invested on a segregated basis	66.1%
Assets managed on a pooled basis	33.9%
<b>Active or passive (%)</b>	
Actively managed	72.1%
Passively managed	27.9%
<b>Multi-asset, LDI or Specialist (%)</b>	
<b>Multi-asset</b>	<b>15.0%</b>
<b>LDI (notional)</b>	<b>32.0%</b>
<b>Single-asset / specialist of which:</b>	<b>53.0%</b>
<b>Equities of which:</b>	
UK	31.5%
European (ex UK)	6.3%
North American	8.1%
Asia Pacific	2.5%
Japan	2.5%
Latin America	0.0%
Africa	0.0%
Emerging Market	3.2%
Global	41.2%
Other	4.7%
<b>Fixed Income of which:</b>	
Sterling Corporate	18.1%
Sterling Corporate and Government	7.0%
UK Government	9.6%
UK Index-linked	8.6%
Global	38.2%
Other	18.6%
<b>Cash/Money Market</b>	<b>7.1%</b>
<b>Property</b>	<b>7.2%</b>
<b>Other</b>	<b>9.2%</b>

<sup>2</sup> This includes UK institutional client mandates, regardless of where assets are managed in the world.



	Pension funds			Public sector	Corporate	Non-profit	Sub-advisory	In-house insurance	Third party insurance	Other institutional
	Corporate	Local government	Other							
	2,261,381	223,962	110,026	26,445	108,788	47,422	131,804	421,245	478,500	197,166
	56.4%	5.6%	2.7%	0.7%	2.7%	1.2%	3.3%	10.5%	11.9%	4.9%
	70.4%	44.9%	48.4%	76.9%	52.2%	57.5%	84.1%	55.1%	95.5%	9.4%
	29.6%	55.1%	51.6%	23.1%	47.8%	42.5%	15.9%	44.9%	4.5%	90.6%
	64.7%	67.0%	47.4%	95.4%	78.3%	81.9%	69.7%	97.9%	96.9%	54.7%
	35.3%	33.0%	52.6%	4.6%	21.7%	18.1%	30.3%	2.1%	3.1%	45.3%
	<b>6.5%</b>	<b>10.3%</b>	<b>13.8%</b>	<b>3.7%</b>	<b>12.1%</b>	<b>33.4%</b>	<b>10.5%</b>	<b>10.1%</b>	<b>61.4%</b>	<b>9.8%</b>
	<b>55.3%</b>	<b>8.1%</b>	<b>26.2%</b>	<b>26.6%</b>	<b>0.0%</b>	<b>1.6%</b>	<b>0.5%</b>	<b>0.1%</b>	<b>1.3%</b>	<b>11.1%</b>
	<b>38.2%</b>	<b>81.6%</b>	<b>60.0%</b>	<b>69.7%</b>	<b>87.8%</b>	<b>65.0%</b>	<b>89.0%</b>	<b>89.9%</b>	<b>37.3%</b>	<b>79.2%</b>
	<b>32.6%</b>	<b>58.2%</b>	<b>39.3%</b>	<b>5.9%</b>	<b>20.1%</b>	<b>49.2%</b>	<b>56.1%</b>	<b>24.4%</b>	<b>10.7%</b>	<b>36.5%</b>
	23.3%	24.5%	12.5%	21.5%	28.1%	23.5%	24.8%	62.5%	30.7%	50.9%
	5.2%	6.6%	3.5%	5.6%	5.6%	1.3%	5.2%	12.2%	8.6%	4.9%
	8.7%	11.7%	4.9%	22.0%	2.8%	1.4%	13.0%	3.3%	17.2%	2.9%
	2.3%	2.4%	1.7%	4.2%	1.2%	0.2%	2.0%	1.7%	1.5%	7.1%
	2.0%	3.0%	2.4%	1.0%	2.5%	0.5%	3.0%	1.5%	5.3%	4.2%
	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.2%	0.0%	0.0%
	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	3.8%	4.0%	2.1%	1.4%	4.4%	0.7%	2.3%	1.3%	7.8%	1.8%
	48.5%	44.9%	70.4%	44.2%	55.2%	66.4%	40.7%	15.5%	22.4%	25.8%
	6.2%	3.0%	2.5%	0.0%	0.1%	6.0%	9.1%	1.9%	6.5%	2.3%
	<b>41.9%</b>	<b>25.6%</b>	<b>50.8%</b>	<b>54.2%</b>	<b>52.9%</b>	<b>11.9%</b>	<b>35.3%</b>	<b>57.0%</b>	<b>61.5%</b>	<b>6.2%</b>
	23.5%	16.1%	17.3%	1.0%	4.8%	30.6%	9.2%	12.2%	21.5%	16.5%
	8.7%	12.6%	12.3%	1.2%	0.8%	14.3%	7.6%	2.8%	7.5%	2.0%
	11.0%	9.4%	7.5%	0.0%	1.7%	5.4%	7.2%	11.8%	8.1%	11.3%
	11.2%	24.6%	15.3%	2.2%	0.2%	3.0%	7.8%	5.7%	0.9%	5.1%
	32.3%	25.6%	45.5%	90.2%	82.2%	43.7%	57.6%	41.0%	24.4%	10.1%
	13.4%	11.8%	2.1%	5.4%	10.4%	3.0%	10.6%	26.4%	37.6%	55.0%
	<b>2.7%</b>	<b>1.1%</b>	<b>1.7%</b>	<b>18.7%</b>	<b>12.6%</b>	<b>17.6%</b>	<b>2.8%</b>	<b>4.6%</b>	<b>4.7%</b>	<b>44.4%</b>
	<b>6.3%</b>	<b>7.1%</b>	<b>1.6%</b>	<b>13.3%</b>	<b>10.7%</b>	<b>3.4%</b>	<b>0.3%</b>	<b>13.4%</b>	<b>3.9%</b>	<b>6.5%</b>
	<b>16.5%</b>	<b>8.0%</b>	<b>6.6%</b>	<b>7.9%</b>	<b>3.6%</b>	<b>17.9%</b>	<b>5.4%</b>	<b>0.5%</b>	<b>19.2%</b>	<b>6.4%</b>

## APPENDIX 3

# MAJOR UK AND EU REGULATORY DEVELOPMENTS AFFECTING INVESTMENT MANAGEMENT

### CAPITAL MARKETS AND INVESTMENT

#### CSDR

- The Central Securities Depositories Regulation was adopted in September 2014. It seeks to harmonise the regulation and supervision of Central Securities Depositories in Europe and harmonise securities settlement practices..
- The initial measure was to impose a maximum settlement cycle of T+2 for trades executed on-exchange in Europe. This was adopted by most markets in October 2014, ahead of the mandated change in January 2015.
- CSDR also will impose a more harmonised settlement discipline regime, including mandatory buy-ins where trades do not complete with a short period after the intended settlement date and the imposition of financial penalties on those that cause settlement delays.
- The technical standards for the settlement discipline regime were adopted by the European Commission in May 2018 and, absent objections from the European Parliament and Council, will apply from Q3 2020.

#### MiFID II

- Implemented on 3 January 2018, MiFID II/MIFIR provides the framework of EU legislation for investment intermediaries providing services to clients in relation to shares, bonds, units in collective investment schemes, derivatives and the trading of financial instruments. At a high level the Directive sets out Europe-wide conduct of business (COB) and organisational requirements for investment firms; authorisation requirements; regulatory reporting; transparency obligations; and rules on admission of instruments to trading. The European authorities are now analysing the impact and effectiveness of MiFID II. Firms should expect an update to MiFID II in due course. This will be heavily influenced by the final Brexit outcome.
- In the UK, as a general approach, the FCA has tended to extend the implementation of MiFID II requirements to Alternative Investment Funds (AIFs) and Undertakings for Collective Investment in Transferable Securities (UCITS), including on research, best execution and clock synchronisation.
- **Client Reporting**  
Firms have implemented the new obligations. While the first monthly and quarterly reports have been sent to clients, firms have also sent out the first annual reports. There is considerably more detail set out in MiFID II, and there is less flexibility in terms of differentiating between professional and retail clients.
- **Best Execution**  
MiFID II requires firms to publish extensive information on where they execute trades and details of the quality of execution achieved. This represents a significant data gathering exercise, including obtaining information published by venues which must then be analysed and considered by investment managers. Firms have published their first two sets of these reports, and should be providing full granularity and detail in all future returns. The FCA is reviewing the implementation of these new rules, particularly as to the utility of the disclosures.
- **Post-trade transparency and transacting reporting**
  - The revised regimes were implemented with fewer problem than most had expected
  - Some issues remain and further regulatory guidance is anticipated, but for the most part firms have been able to meet their obligations as they understand them currently

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- **Research**

MiFID II has had a profound and lasting impact on the market for research. The majority of investment managers are now paying for research from their own balance sheet. It is likely that these requirements will stay in the UK as the FCA remains committed to the underlying principles embodied in the rules. Globally however there are questions about how the fundamental structure of the research market should operate, particularly in the US and the EU27.

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- **Transparency**

MiFID II brings enhanced transparency requirements in both the equities and fixed income world. In addition it provides a Europe-wide standard definition of spot FX v financial instruments.

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- **Trading Obligations**

The Trading Obligation for equities and derivatives has attained a much greater importance with the crystallising of Brexit. Whilst the proposed EU27 wording had been finessed, for example for Switzerland, it remains a significant issue. Any UK Trading Obligation is likely to have a material impact on firms trading obligations. In the absence or reciprocal equivalence between the EU and the UK, post-Brexit the Trading Obligation could present a significant obstacle to achieving best execution for clients and fragment liquidity in the long term.

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- **Product Governance**

- The MiFID II rules are two dimensional. They aim at product development and oversight on the one hand, and closer oversight of distribution of financial instruments to ensure robust investor protection throughout the supply chain on the other.
  - Firms are required to have in place robust product governance procedures. The product governance rules oblige manufacturers to maintain, operate and review a process for the approval of each product. Additionally, firms must review their products and choice of distribution channels regularly. However, for this to be possible, distributors must share some level of sales data with the manufacturers.
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**SFTR**

- The Securities Financing Transactions Regulation has applied since January 2016 and already imposes pre-sale and periodic disclosure requirements but will also impose a trade reporting regime.
  - It will also impose obligations to report details of in-scope transactions to authorised trade repositories - these will apply to EU fund, insurer, and pension scheme clients of investment managers from October 2020.
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## FUNDS AND DISTRIBUTION

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**Packaged Retail and Insurance-based Investment Products (PRIIPs)**

- PRIIPs Regulation came into force in January 2018 and aims to increase the transparency and comparability of investment products through the issue of a standardised short form disclosure document - the PRIIPs Key Information Document (KID). The KID is intended to help retail investors to understand and compare the key features, risk, rewards and costs of a wide range of different products. It is a free-of-charge document that must be shared with the investor prior to the conclusion of any transaction.
  - UCITS, and AIFs where national regulators have extended the UCITS KII requirements (as the FCA has on a voluntary basis for NURS), are exempt from the PRIIPs Regulation until December 2021.
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- A review of the presentation of the main sections and the detailed methodologies used for performance scenarios and transaction costs is underway and a formal consultation about the way forward is expected in the Autumn 2019.

#### **AIFMD**

- ESMA has been working on identifying third countries which should be deemed to be sufficiently equivalent that the AIFMD passporting regime should be extended to them. In 2016 they submitted advice to the Commission regarding twelve third countries, however the Commission has yet to publish its proposals. This process has proven politically contentious, which may be further impacted by the Brexit negotiations.
- The Commission has commenced its review on AIFMD and has commissioned an external report on the effectiveness of the AIFMD implementation from KPMG. The report was published in January 2019.

#### **Venture Capital Funds and Social Entrepreneurship Funds**

- On 14 July 2016, the Commission published a proposal to amend the EuVECA and EuSEF regulations intended to improve the take up of these funds. This followed a public consultation issued in September 2015.
- The Commission proposes changes to the EuVECA and EuSEF regulations to extend the range of managers eligible to market and manage EuVECA and EuSEF funds, increase the range of companies that EuVECA funds can invest in, and make cross-border registration and marketing of these funds easier and cheaper.
- The proposed changes to the EuVECA and EuSEF regulations have recently been agreed by the Council and the European Parliament following the trilogue process.
- The amended Regulations were published in February 2019.

#### **Money Market Funds**

- The Regulation came into effect in July 2018, and following the end of the transition period all existing MMFs are now required to be authorised under the Regulation.
- The Regulation, provides for Variable Net Asset Value (VNAV) MMFs, Low Volatility Net Asset Value (LVNAV) MMFs and Public Debt Constant Net Asset Value (CNAV) MMFs.
- The Regulation also includes transparency requirements to ensure all MMF investors are aware of risks that may result in MMFs being revalued, restrictions on eligible assets, diversification and concentration limits, prohibitions on external support (eg. from a parent bank), requirements on MMFs to calculate their NAV on a daily basis and requirements for LVNAV and CNAV MMFs to have liquidity fees and redemption gates available for use in stressed periods.
- ESMA issued its final guidelines on stress testing scenarios and regulatory reporting for MMFs in July 2019. Managers of MMFs will be required to provide their first reports to regulators, including the results of stress tests, for Q1 2020.

#### **Illiquid Assets in Open Ended Funds**

- In February 2017, the FCA published a Discussion Paper: Illiquid assets and open-ended investment funds (DP 17/1). It focused on the challenges which open-ended funds, with frequent dealing obligations investing in illiquid assets, can pose to managers and investors. The DP recognised that there are good reasons to gain exposure to illiquid assets and that fund vehicles are a good way of providing access to such investments. In that context, the FCA therefore wanted to explore how regulation should deal with the challenge that there may be a mismatch between investors' expectations of how liquid their fund is and the fund manager's ability to meet those expectations. The FCA will draw on responses received together with its supervisory work to decide whether or not it needs to propose any changes to its rules and guidance.'

- In October 2018, the FCA published a follow-up Consultation Paper: Illiquid assets and open-ended funds and feedback to DP 17/1 (CP 18/27). The Consultation contained several proposals relating to the labelling of funds that substantially hold illiquid assets, the mandatory suspension of funds that hold a significant amount of assets that are difficult to value and other proposals surrounding liquidity in funds. The Policy Statement is expected to be published by the end of June 2019.

### **Pan-European Personal Pension (PEPP)**

- In June 2017 the European Commission released a draft regulation for the introduction of a Pan European Personal Pension (PEPP) product across the EU. Following two years of negotiations between the Commission, Parliament and Council, a final version of the regulation was agreed and entered into force in August 2019.
- The PEPP is a voluntary personal pension scheme that will offer consumers a new option to save for retirement. It could be offered by a broad range of providers including insurance companies, banks, occupational pension funds, certain investment firms and investment managers.
- The final regulation covers areas such as product authorisation, design, investment rules, distribution, provision of advice and disclosure.
- Following the adoption of the regulation, the European Insurance & Occupational Pensions Authority (EIOPA) has begun work on the detailed technical standards in the above areas that will underpin the regulation and will be required in order for providers to manufacture the PEPP. Although future timing is uncertain, these could be finalised by 2021, allowing the PEPP to be manufactured thereafter.

### **DC workplace pensions**

- In common with other clients of the investment management industry, the pensions sector has seen an increasing focus on sustainable and responsible investment and the role of ESG integration in investment strategies. From October 1 2019, trust-based DC pension schemes will be required by regulation to set out in their Statement of Investment Principles (SIP):
  - How they take account of financially material considerations, including (but not limited to) those arising from Environmental, Social and Governance considerations, including climate change;
  - Their policies in relation to the stewardship of investments, including engagement with investee firms and the exercise of the voting rights associated with the investment;
- In addition, schemes will, in relation to their default strategies, prepare or update their default strategy to set out how they take account of financially material considerations, including (but not limited to) those arising from ESG risks, including climate change.
- From 1 October 2020 trustees will be required to produce an implementation statement setting out how they acted on the principles they set out in their SIP.
- There has also been significant interest in seeing DC schemes increase their exposure to illiquid assets, with two relevant consultations taking place this year (the results of which are not yet known at the time of writing):
  - Proposed changes to the 'permitted links' rules for unit-linked life funds, heavily used in the UK pensions market, to expand the categories of permitted investments to cover a wider range of illiquid assets;
  - A proposed reporting requirement on trust-based DC schemes in relation to their allocation to illiquid assets.

## Retirement Outcomes Review

- Following the final report of the Retirement Outcomes Review in June 2018, which considered the evolution of the retirement income market for non-advised customers in the wake of the 2015 pension freedoms, the FCA has consulted on a series of measures designed to address the problems it found in this market. The most salient of these for investment managers concern the following areas:
  - Providers will be required to offer non-advised customers ready-made ‘investment pathways’ that reflect four standard objectives relating to the options customers have for accessing their pension.
  - New consumers accessing drawdown will have to make an active choice to be in cash. The FCA expect firms to have a strategy for dealing with consumers who have already been defaulted into cash, and who are unlikely to be best served by this investment strategy.
  - Although precise timelines have not been specified at the time of writing, it is expected that these requirements will apply from late 2020.
  - It is likely that for non-advised customers, the proposals will concentrate fund flows into the investment pathways, which like workplace pension default strategies, are expected to be strategies composed of a number of ‘building-block’ funds.
  - The FCA has chosen not to implement a charge cap on investment pathways at this stage, but may do so in future if it considers that there are “problems” with the level and structure of charges.
  - The FCA also consulted on extending the remit of Independent Governance Committees to cover ‘value for money’ assessments for investment pathways.

## FIRM REGULATION

### FCA Market Study

FCA has progressed remedies to the findings of the Asset Management Market Study in the following areas:

- **Enhanced consumer protection**
  - **A new fund governance regime.** New requirements are being introduced for authorised fund managers to assess and report on value delivered using criteria that among others include performance, quality of service, level of charges, and economies of scale. Authorised fund managers will also be required to appoint independent directors to their fund boards. These requirements come into force on 30 September 2019.
  - **Box management.** Firms are no longer allowed to retain risk-free box profits.
  - **Legacy share classes.** New guidance was introduced to facilitate mandatory conversions by making the process less onerous. Namely, investors will now need to be given a simple, one-off notification with at least 60 days’ notice, which will not require a response.
- **Driving competitive pressure on investment managers**
  - **Standardised disclosure of costs and charges to institutional investors.** The Cost Transparency Initiative (CTI) launched a new cost transparency framework in May 2019, built on the recommendations of the Institutional Disclosure Working Group (IDWG). The new framework is expected to be used for reporting to pension schemes in 2020.

- **Clarity and usefulness of investment objectives.** The FCA convened and chaired the Fund Objectives Working Group (FOWG) to discuss how greater clarity of language could be developed in the expression of investment objectives, policy and strategy in fund products. The findings led to the publication of the Policy Statement PS19/4 in February 2019. The Policy includes guidance on disclosure of fund objectives and final rules on the use and disclosure of benchmarks in fund documentation. The deadline for implementation was 7 August 2019. In March 2019, ESMA published an update to the UCITS Q&A on the use and disclosure of benchmarks in fund documentation.

- **Improving the effectiveness of intermediaries**

- **Investment Platform Market Study (IPMS).** The IPMS was launched in July 2017 as a separate market study, aiming to address the effectiveness of intermediaries in the retail space. The interim report was published on 16 July 2018. The final report, published on 14 March 2019 concluded that the market works well in many respects but not when it comes to a number of specific areas, notably: shopping around and switching between platforms; clarity of language in model portfolios; investors holding large amounts of cash on platforms; and 'orphan clients' that pay for an ongoing advice service but no longer receive advice. An accompanying consultation paper (CP 19/12: Consultation on Investment Platforms Market Study Remedies) contained proposals on requiring platforms to offer in specie transfers to other platforms and a discussion around the cap or abolition of exit fees.

- **CMA Investigation into Investment Consultant and Fiduciary Management Services.** This investigation looked to address the effectiveness of intermediaries in the institutional space. The CMA published its Final Report in December 2018. Findings included a weak demand side, with trustees relying heavily on investment consultants but having limited ability to assess their services, relatively low levels of concentration in both investment consultancy and fiduciary management, although the latter was at risk of greater concentration in future, barriers to expansion restricting new consultants developing their business and vertically integrated models creating conflicts of interest. The CMA proposed a number of supply and demand side remedies aimed at putting more information on costs and performance into the hands of trustees, as well as bringing more dynamism into the fiduciary management (FM) market through mandatory tendering for FM services covering mandates of 20% or more of a scheme's assets. There was also an overarching remedy to recommend to government that the scope of the FCA's regulatory perimeter be extended to include relevant services provided by investment consultancy and fiduciary management. The remedies were implemented by Order published in June 2019 and will mostly be in force by the end of the year. FCA, DWP, HMT and The Pensions Regulator have confirmed that these remedies will be incorporated into the relevant sectoral regulation in due course.

## EU Benchmark Regulation

- The FCA implementation of the Benchmark Regulation has resulted in them removing their regime for regulating the eight UK based benchmarks that had been deemed to be significant. While most users of benchmarks have completed any necessary changes, the deadline for firms complying with the obligations has been extended to the end of 2021. This is key for firms' ability to continue to use third country benchmarks, and identify alternatives to use from 2022, where these will no longer be available.
- The FCA is also taking necessary steps to develop its own benchmark register for use post-Brexit. Firms will need to ensure that the providers of all benchmarks that they use are registered with the FCA by the end of the two-year transitional period.



### **Fifth Money Laundering Directive**

- The Level One text has been finalised. The Directive, which amends and extends the Fourth Money Laundering Directive, is scheduled to apply from 10 January 2020.
- Implementing regulations are awaited.
- The HMT has consulted on revisions to the Money Laundering Regulation, but they will need to be amended and implemented.
- The JMLSG Guidance will need to be consulted on, the final version will depend on any changes to the HMT Regulation following consultation.

### **Senior Managers & Certification Regime (SMCR)**

- Since March 2016, Banks, Building Societies and Credit Unions in the UK have been subject to the SM&CR. Following the global financial crisis, the regime was brought in as an attempt to heighten personal rather than corporate responsibility. Solo-regulated firms will be subject to the regime from 9 December 2019.
- In 2017, the FCA proposed rules for the extension of this “accountability regime” to virtually all other authorised persons, replacing the existing Approved Persons regime (“APER”). Individuals will be assigned Senior Management functions (“SMF”) and undertake Prescribed Responsibilities (“PR”).
- In July 2019, the FCA released a summary of their final rules and guidance on SM&CR for solo-regulated firms. Policy statement PS19/7, outlining the final rules for establishing the Directory, and final guidance FG19/2 on Statements of Responsibilities and Responsibilities Maps were also published to provide additional, practical information on key areas of the regime.
- The key new requirements for investment management firms, being implemented on 9 December 2019 include:
  - Senior Managers Regime replacing the Significant Influence Function, with senior managers individually responsible and accountable for every area of a firm’s activities, and approved by FCA.
  - Certification Regime that applies to employees who could pose a risk of significant harm to the firm or any of its customers approved internally by Firms.
  - Set of conduct rules that apply to almost all other staff.



## APPENDIX 4

## NOTABLE M&amp;A DEALS IN THE UK INVESTMENT MANAGEMENT SECTOR (2009-JUNE 2019)

## 2018-2019

ACQUIRER	PURCHASE
Alliance Bernstein	Autonomous Research
Amundi	Mirae Global Investments Taiwan Anatec
BlackRock	eFront
Brewin Dolphin	Investecs Wealth Management Business in Ireland Mathiesen Consulting
Candriam	Tristan Capital Partners (strategic partnership)
Federated Investors	Hermes Investment Management (majority stake)
Franklin Templeton	Benefit Street Partners Edinburgh Partners
FundRock	SEB Fund Services Luxembourg
Goldman Sachs	Aptitude Investment Management Rocaton Investment Advisors S&Ps Model Portfolio business
Hargreaves Lansdown	£765m stake of retail ISA assets from JPM Chase
Impax Asset Management	Pax World Management LLC
Invesco	Oppenheimer Funds Intelliflo
Jupiter	Merger of retail and wealth management sales teams
Lyxor ETF	Commerzbank ETF Arm
Man GLG	Bond Fund from Sanlam
Mitsubishi UFG Trust and Banking	First State Investments
Muzinich	Springrowth SGR
Natixis	MV Credit
Nomura Asset Management	8 Securities (majority stake)
Pimco	Gurtin Municipal Bond Management
Quilter	Charles Derby
Quilter	Lighthouse
Rathbones	Speirs and Jeffery
Sanlam	Thesis Asset Management
Schroders	Thirdrock
Seven Investment Management	TCAM
SJP	Harvest Financial Services

2017

ACQUIRER	PURCHASE
Amundi Group	Pioneer Investments
BlackRock	Cachematrix Holdings First Reserve Energy Infrastructure Funds Scalable Capital (minority stake)
BNP Paribas Asset Management	Gambit Financial Solutions (majority stake)
Brewin Dolphin	Duncan Lawrie Asset Management
Canada Life Group (UK)	Retirement Advantage
Close Brothers	Adrian Smith and Partners
Crux Asset Management	Oriel Global and European funds from City Financial
FundRock	Fund Partners
LGIM	Canvas
Link Group	Capita Asset Services
Lovell Minnick Partners/ Existing Management Team	BNY Mellon Investment Management (CentreSquare Investment Management Real Asset Boutique)
Natixis Global Asset Management	Investors Mutual Ltd
Nikko Asset Management	ARK Investment Management (minority stake)
Principal Global Investors	Internos Global Investors
RWC	Pensato Capital
Sandaire	Joint venture with Delancey
Schroders	Adveq Holdings AG Alonquin
SJP	HJP Independent Financial Advisers
Standard Life Investments	Aberdeen Asset Management (merger)
Stonehage Fleming	OmniArte
Swiss Re	LGIM with profits business
TA Associates	Old Mutual Global Investors (single strategy funds)
Thesis Asset Management	Cambridge Fund Managers

## 2016

ACQUIRER	PURCHASE
Aberdeen	Arden Asset Management, Parmenion Capital,
Aegon	Cofunds
AJ Bell	IndeXx Markets Ltd, Allium Capital
Alliance Bernstein	Ramius Alternative Solutions
Allianz	Rogge Global Partners
Amundi	Kleinwort Benson Investors
Columbia Threadneedle	Emerging Global Advisors
Courtiers	JRH Asset Management
Franklin Templeton	AlphaParity
Henderson Global Investors	Janus
Legal and General Investment Management	Aegon annuity portfolio
Legg Mason	EnTrust Capital, Clarion Partners, Financial Guard
Liontrust	Alliance Trust Investment
Momentum	London and Capital adviser business
Standard Life	AXA portfolio services
State Street Global Advisors	GE Asset Management
Stonehage Fleming	FF&P Wealth Planning

## 2015

ACQUIRER	PURCHASE
Aviva	Friends Life
BNY Mellon	Cutwater Asset Management
Henderson	90 West (increased holding to 100%) Perennial Fixed Interest Partners/Perennial Growth Management
Broadstone	Blythwood
Brooks Macdonald	Levitas Investment Management Services Ltd
Legal and General Investment Management	Aerion
GAM	Singletery Mansley Asset Management
Maitland	Phoenix Fund Services
Stonehage	Fleming Family
Threadneedle	Columbia (merger)
Vontobel	TwentyFour

## 2014

ACQUIRER	PURCHASE
Aberdeen	Scottish Widows Investment Partnership
Bank of Montreal	F&C
Broadstone	Blythwood
Brooks Macdonald	Levitas Investment Management Services Ltd
Family Investments	Engage Mutual
GAM	Singletery Mansley Asset Management
Legg Mason	Martin Currie
Octopus	MedicX
Rathbones	Jupiter Asset Management Limited's private client and charity investment management business
River and Mercantile	P-Solve (merger)
Standard Life	Ignis Asset Management
Thomas Miller	Broadstone Wealth Management

## 2013

ACQUIRER	PURCHASE
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
Mitton	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

ACQUIRER	PURCHASE
Brooks Macdonald	Spearpoint
Bridgepoint & Quilter	Quilter (MBO)
Broadstone	UBS Wealth's corporate pension 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

ACQUIRER	PURCHASE
BT	JO Hambro
Close	Cavanagh Wealth Management
Close	Allenbridge Group
Cyrus Finance	SVM Asset Management
Franklin Templeton	Rensburg
Henderson	Gartmore
Investec	Evolution
Liontrust	Occam
Principal	Origin
Punter Southall	Brewin Dolphin's corporate pension arm
Royal London	Royal Liver
SGBP Hambros	Barings' private client business
Threadneedle	Liverpool Victoria
Williams de Broe	BNP Paribas' private client business

## 2010

ACQUIRER	PURCHASE
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

ACQUIRER	PURCHASE
BlackRock	BGI
BNP Paribas	Fortis
BNY Mellon	Insight
Henderson	New Star
Ignis	Axial
Invesco	Morgan Stanley's 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

## APPENDIX 5

# DEFINITIONS

### CORPORATE CLIENTS

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

### ESG INTEGRATION

The systematic and explicit inclusion by investment managers of environmental social, and governance factors into traditional financial analysis.

### FUND 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. These may also be referred to as 'multi-manager products'.

### IMPACT-DRIVEN INVESTMENT

This approach seeks to enhance value by proactively screening for businesses that are seeking to work for the benefit of all their stakeholders, not just shareholders or owners.

### IN-HOUSE INSURANCE CLIENTS

Refers to assets that insurance-owned investment 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

Include 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'.

### POOLED

Comprises investment vehicles operated by a manager for several clients whose contributions are pooled. More specifically, as used throughout this survey, the term includes: authorised unit trusts, open-ended investment companies (OEICs), unauthorised investment vehicles (eg. unauthorised unit trusts), close-ended investments (eg. investment trusts), exchange-traded funds (ETFs), life funds, operated by insurance companies.

### 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

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

## 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'.

## RESPONSIBLE INVESTMENT

An approach where the investor avoids investing in businesses that are harming people or the planet, such as oil, tobacco, or weapons production.

## 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).

## STERLING CORPORATE DEBT

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

## 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 manager products).

## SUSTAINABILITY-THEMED INVESTING

Investment in themes or assets specifically related to sustainability (for example clean energy, green technology, or sustainable agriculture).

## 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 individuals based in the UK. This includes assets managed by the firm in the UK whether for UK or overseas clients contracted with the firm. It also includes assets delegated to the firm's UK-based investment managers by either third party investment managers or overseas offices of the company or group. With respect to fund of funds and manager of manager products, the figure only includes 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. The term 'UK funds' used throughout the survey applies specifically to UK authorised and recognised investment funds, which include (authorised) Unit Trusts and OEICs. These investments are collectively referred to as the 'funds industry' and are analysed in detail in Chapter 5.

## 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 investment 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 6

# SURVEY RESPONDENTS

Aberdeen Standard Investments	M & G Investments Ltd
Aberforth Partners LLP	Man Fund Management (UK) Ltd
AllianceBernstein	Martin Currie Fund Management
Allianz Global Investors	McInroy & Wood
Artemis Fund Managers Ltd	Merian Global Investors
Aviva Investors	Morgan Stanley Investment Management Ltd
AXA Investment Managers UK Ltd	Odey Asset Management LLP
Baillie Gifford & Co Ltd	PIMCO Europe Ltd
Baring Asset Management Ltd	Premier Portfolio Managers Ltd
BlackRock Investment Management (UK) Ltd	Pyrford International plc
Bluebay Asset Management	Rathbone Unit Trust Management
Brewin Dolphin	RBS CIF
Brooks Macdonald Asset Management	Royal London Asset Management Ltd
Candriam Investors Group	Ruffer LLP
CCLA Investment Management	Santander Asset Management UK
Columbia Threadneedle Investments	Sarasin & Partners LLP
Courtiers Asset Management Ltd	Scottish Friendly Asset Managers Ltd
Edinburgh Partners Ltd	Schroder Investment Management Ltd
Evenlode Investment Management	Skagen AS
FIL Investment Management Ltd	Slater Investments Ltd
Franklin Templeton Investment Management Ltd	Smith & Williamson Fund Administration Ltd
Guinness Asset Management Ltd	State Street Global Advisors UK
Hermes Fund Managers	T. Rowe Price International Ltd
HSBC Global Asset Management (UK) Ltd	Tesco Pension Investment
Host Capital	Troy Asset Management Ltd
Insight Investment Management (Global) Ltd	TwentyFour Asset Management
Invesco Perpetual	UBS Global Asset Management (UK) Ltd
Investec Asset Management Ltd	Vanguard Asset Management Ltd
Janus Henderson Investors	Virgin Money Unit Trust Managers Ltd
JO Hambro Capital Management Group	Way Fund Managers
J P Morgan Asset Management	Wellington Management International
Lazard Asset Management	Zurich Investment Services (UK) Ltd
Legal & General Investment Management	
Lindsell Train	

## APPENDIX 7

# INTERVIEW AND ROUNDTABLE PARTICIPANTS

BlackRock Investment Management (UK) Ltd

Bluebay Asset Management LLP

Brooks Macdonald Asset Management

Fidelity Investment International

HSBC Global Asset Management (UK) Ltd

Independent Franchise Partners LLP

J.P. Morgan Asset Management

Legal & General Investment Management

M & G Investments Ltd

Natixis Investment Managers

Premier Portfolio Managers Ltd

State Street Global Advisors Ltd

St James's Place

Vanguard Asset Management Ltd

# NOTES



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