

1 UK ASSET MANAGEMENT INDUSTRY: A GLOBAL CENTRE

KEY FINDINGS

THE SIZE OF THE ASSET MANAGEMENT INDUSTRY IN THE UK

- » Total assets managed in the UK by the IA's members increased by 11% during 2017, ending the year at a record £7.7 trillion. This represents around 85% of the wider asset management industry which reached an estimated £9.1 trillion at the end of 2017.
- » £615 billion is managed by IA members in Scotland. Almost a quarter of assets (23%) managed by UK-headquartered asset managers are represented by managers with their headquarters in Scotland.
- » The UK is the largest centre of asset management outside of the US. It is the largest centre of asset management in Europe, accounting for 35% of all assets under management.
- » Assets managed for European clients increased by almost 30% year-on-year, bolstered by extremely strong flows into EU UCITS funds in 2017.
- » 40% of the assets managed by UK asset managers are from overseas clients. £3.1 trillion is managed for investors from overseas, which translates to earnings representing 6% of net services exports.
- » £1.7 trillion is managed in the UK for overseas funds (up from a revised £1.3 trillion at the end of 2016). The vast majority of this (84%) is managed for funds domiciled in Ireland and Luxembourg.
- » £1.7 trillion is invested in the UK economy via traditional asset classes such as equities, corporate bonds and commercial property, and more recently via other assets such as infrastructure and direct lending.



ROLE OF ASSET MANAGEMENT

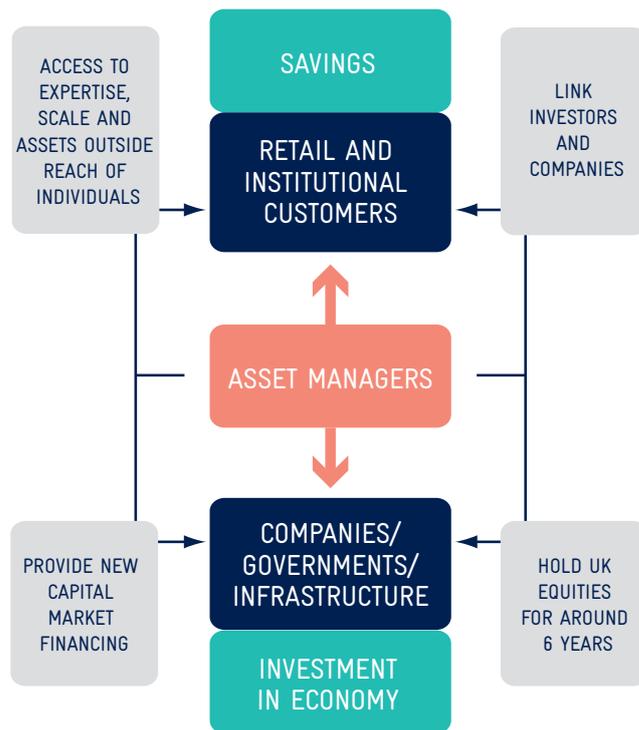
The UK asset management industry has a central role in the economy, channelling savings into investment (see Figure 1). As this report explores, the industry’s clients are both retail savers and institutions such as pension schemes and insurance companies, who act on behalf of millions of individuals, in the UK and all over the world.

The fundamental purpose of asset management is to deliver good outcomes to those clients. This includes providing expertise and achieving economies of scale that allow access to a wide range of assets that would normally be out of reach for individual investors. Using shares, bonds and other assets such as property, asset managers can deliver returns over many years while managing the risk appropriately. The sophistication of the services varies, with some clients, e.g. defined benefit (DB) pension schemes, facing increasingly complex challenges.

A second side of the industry’s role reflects the actual investment and here the purpose of asset managers is to ensure that capital markets work effectively for this investment to take place. In allocating capital, asset managers contribute to market efficiency and to correct price information. This facilitates both primary issuance when companies or governments are trying to raise money, and secondary trading of different instruments. Without this, capital markets cannot grow effectively and may even destabilise. Asset managers thus contribute to sustainable growth, benefiting both clients and non-clients.

Asset 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. And as long-term holders of investments, asset management firms also have an important responsibility to undertake stewardship activity over the companies they invest in. UK asset managers hold UK equities for approximately six years.¹

FIGURE 1: THE ROLE OF ASSET MANAGERS IN CHANNELLING SAVINGS TO INVESTMENTS



“IT’S NOT JUST ABOUT RETURN, IT’S ABOUT RESPONSIBLE DEPLOYMENT OF CAPITAL TO BUSINESS AND THEN MAKING SURE THOSE BUSINESSES ARE WELL MANAGED. THAT LEADS TO GROWTH, WHICH ALLOWS PEOPLE TO HAVE A BETTER RETIREMENT. OUR INDUSTRY FACILITATES THAT WHOLE PROCESS.”

¹ The contribution of asset management to the UK economy, July 2016, Oxera

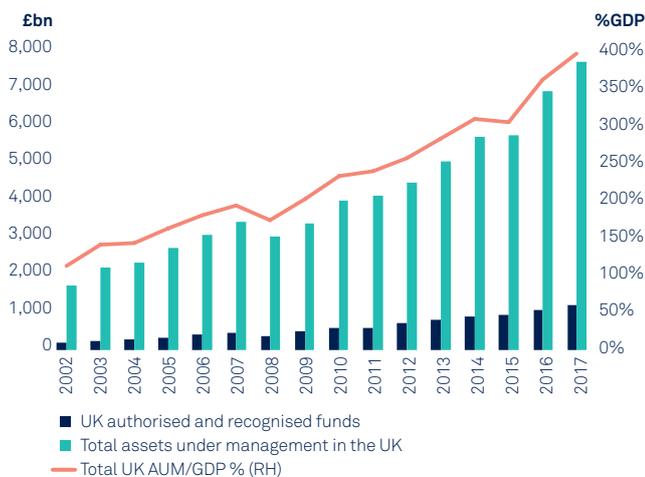
SIZE OF THE UK INDUSTRY

At the end of 2017, IA members, as outlined in Figure 2, managed £7.7 trillion in the UK, an 11% increase from the end of 2016 (see Chart 1).

This growth partly reflected strong asset performance, particularly in overseas equities as double-digit returns were seen in many markets during 2017.

At the same time, a combination of high inflows and strong market appreciation saw total assets held specifically in investment funds reach £1.2 trillion, up 15% year on year.²

CHART 1: TOTAL ASSETS UNDER MANAGEMENT IN THE UK (2002-2017)



Source: IA, ONS

The continued growth in assets under management was also reflected in the industry's size relative to that of the UK economy. At the end of 2017, the size of the industry had grown to four times the size of the UK's GDP, up by around 30 percentage points from last year.

By comparison, the latest data available for Europe excluding the UK indicated that the industry there has almost a 1:1 relation to GDP. This means that asset management is considerably more important to the UK economy than it is to the economies of other European countries.³

FIGURE 2: WHO ARE THE IA'S MEMBERS?

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

1 Large asset management firms (both UK and overseas-headquartered), which may be independent or part of wider financial services groups such as banks or insurance companies. They undertake a wide range of asset management activities across both retail and institutional markets and manage substantial amounts for overseas client in the UK. Such firms will typically be managing >£50 billion from the UK, but a number of international firms have a smaller UK footprint.

2 Small and medium-sized asset management firms, primarily focused on UK and/or European clients, which undertake a diverse range of activities, of which asset management is a constituent part.

3 Fund managers, whose business is based primarily on authorised investment funds.

4 Specialist boutiques and private client managers with a smaller asset and client base and, typically, a specific investment or client focus.

5 Occupational pension scheme (OPS) managers running in-house asset management services for a large scheme.

² Includes assets in both UK authorised and recognised funds, capturing overall UK investor holdings in funds. See Chapter 5.

³ IA analysis of EFAMA data.



SCALE OF WIDER INDUSTRY

IA members represent the majority of the UK asset 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

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 ASSET MANAGEMENT INDUSTRY



Source: ComPeer, Morningstar, Hedge Fund Intelligence/ EuroHedge, Investment Property Forum, IA estimates based on external data where necessary.

SCOTLAND AS A MAJOR CENTRE

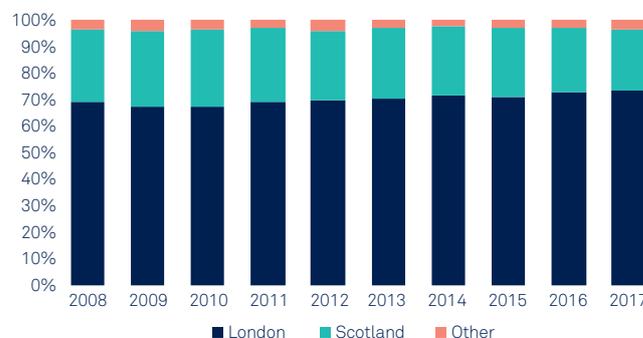
Although the City of London remains the leading centre of asset management activity in the UK, Scotland, and particularly Edinburgh, plays a key role nationally. Almost a quarter (23%) of the assets managed by UK-headquartered asset managers are represented by managers with headquarters in Scotland (see page 92).

Looking at this from a different perspective, assets managed in Scotland represented 8% of total assets managed by IA members at the end of 2017, accounting for £615 billion of total assets.

The fact that lower levels of assets are managed in Scotland than would be suggested by the location of firm headquarters is indicative of the fact that, whilst firms may have their headquarters in Scotland, many IA members headquartered in Scotland undertake asset management activity in other regions, most notably in London. This is reflected in the IA's data on location of staffing, which shows that London is more likely to be a location for portfolio manager jobs than other areas of the UK (see page 89).

Chart 2 shows that the regional split has remained relatively unchanged from a decade ago, with more than two thirds of UK-managed assets run by firms with a headquarters in London, although the relative importance of London does appear to show a gradual increase in recent years.

CHART 2: UK-MANAGED ASSETS BY UK REGIONAL HEADQUARTERS (2008-2017)



POSITION OF UK ASSET MANAGEMENT INDUSTRY IN EUROPE AND WORLDWIDE

The UK continues to dominate the asset management industry within Europe, although its market share fell slightly from 36% in 2015 to 35% in 2016 (see Figure 4).

In recent years, the UK has outweighed the next three largest European countries put together. This is still the case. Spain has appeared in the list of the top ten European countries for the first time, increasing its market share to 1%, making it the eighth largest centre of asset management in Europe.

In a global context, this puts the UK as the second largest asset management centre in the world after the United States, and ahead of Japan as third largest.

TABLE 1: GLOBAL ASSETS UNDER MANAGEMENT

	Assets under Management (local currency) ⁴	Assets under Management (£ equivalent)
US	\$35 trillion	£22.2 trillion
Europe	€23 trillion	£19.6 trillion
Japan	¥514 trillion	£3.4 trillion

FIGURE 4: ASSETS UNDER MANAGEMENT IN EUROPEAN COUNTRIES (DECEMBER 2016)



Country	Net assets (€bn)	Market share
1. UK	8,093	35%
2. France	3,971	17%
3. Germany	2,093	9%
4. Switzerland	1,646	7%
5. Netherlands	1,326	6%
6. Italy	1,229	5%
7. Denmark	386	2%
8. Spain	314	1%
9. Belgium	301	1%
10. Austria	132	1%
Other	3,360	15%
TOTAL	22,851	

Source: EFAMA

⁴ US estimate based on North America Data from Global Asset Management 2018, BCG, 2018. European data from Asset Management in Europe, 10th Annual Review, EFAMA (provisional at time of publication). Japanese data from Japan's Asset Management Business 2017/2018, NRI

OVERSEAS CLIENT MARKET

The UK maintained its position in 2017 as a pre-eminent centre for portfolio management on behalf of investors worldwide with £3.1 trillion, ie. 40%, of all assets in the UK being managed on behalf of overseas clients.

The largest client base remains the EEA, for which the UK industry manages approximately £1.7 trillion. Around £130 billion in assets is managed for clients in other parts of Europe, notably Switzerland (see Figure 5). Assets managed for European clients increased by almost 30% year-on-year, bolstered by extremely strong flows into EU UCITS funds in 2017.⁵

FIGURE 5: ASSETS MANAGED FOR OVERSEAS CLIENTS



IMPORTANCE TO UK SERVICE EXPORTS

Given the size of its overseas client base, the asset management industry makes a significant contribution to the UK's service exports. The value of export receipts has increased sevenfold on an inflation adjusted basis in the last 20 years. Chart 3 indicates that although there has been some volatility from year to year, export earnings represented an average of 6% of total net exports over the past ten years.

Chart 3 captures earnings by independent asset managers and is thus 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, the actual contribution of asset management overall to service exports is likely to be higher.

CHART 3: EXPORT EARNINGS OF FUND MANAGERS AND CONTRIBUTION TO SERVICES EXPORTS (1997-2016)



Source: ONS

⁵ European Quarterly Statistical Release, EFAMA Q1-Q4, 2017. Note there is a residual of overseas clients invested in pooled arrangements where the location of underlying client cannot be easily identified

SERVICES TO OVERSEAS FUNDS

In addition to the size of the overseas customer market, we capture a related but distinct data point relating to overseas-domiciled fund assets that are managed in the UK. These may be sold either to UK or overseas customers.

New data suggests that, at the end of 2017, £1.7 trillion was managed in the UK for overseas funds (up from a revised £1.3 trillion at the end of 2016). The vast majority of this (84%) was managed for funds domiciled in Ireland and Luxembourg.

The proportion of overseas funds managed for the various overseas domiciles has stabilised over the last three years, with around half (53%) managed for funds in Ireland and a third (31%) for funds domiciled in Luxembourg.

Although the split across overseas domiciles has remained broadly stable, the split between UK and overseas domiciles has changed in favour of overseas. Specifically, there has been a gradual increase in the proportion of assets managed by IA members for funds domiciled overseas in comparison to UK-domiciled funds (see Chart 4).

CHART 4: CHANGE IN PROPORTION OF ASSETS MANAGED FOR UK AND OVERSEAS FUNDS (2015-2017)



SAFEGUARDING THE GLOBAL POSITION OF THE INDUSTRY

The UK's place as a pre-eminent centre of asset management has been undisputed for a number of years but this is by no means guaranteed in the future. Brexit raises a range of challenges for the industry, from immediate regulatory questions such as fund passporting through to business operation issues, including maintaining access to talent and facilitating the seamless transfer of data.

Many UK managers already have fund ranges both in the UK and at least one member of the EU27, most commonly in either Ireland and/or Luxembourg. Consequently the changes they reported having made to date to their businesses in preparation for the UK leaving the EU were fairly specific and included:

- Ensuring the firm has a UCITS Management Company located within the remaining EU27 countries.
- Locating a MiFID regulated entity in one of the remaining EU27 countries.
- Creating limited jobs in the EU27 offices to enable them to continue to distribute funds more easily across Europe post Brexit.

Where jobs were reported being created outside of the UK the numbers are small – “in the tens not the hundreds” – confirming what members had reported to us in the last two years.

The concern most commonly shared was that asset managers around the globe are permitted to continue to delegate asset management activity to offices where the most relevant expertise is located, whether this is the UK, continental Europe, the US, the Far East or elsewhere.

The ability to delegate asset management to areas of expertise was widely stated as being fundamental to delivering a high quality service to investors all over the world. This will require Regulatory Cooperation Agreements to be put in place prior to the UK becoming a third country.

SUPPORTING THE UK ECONOMY

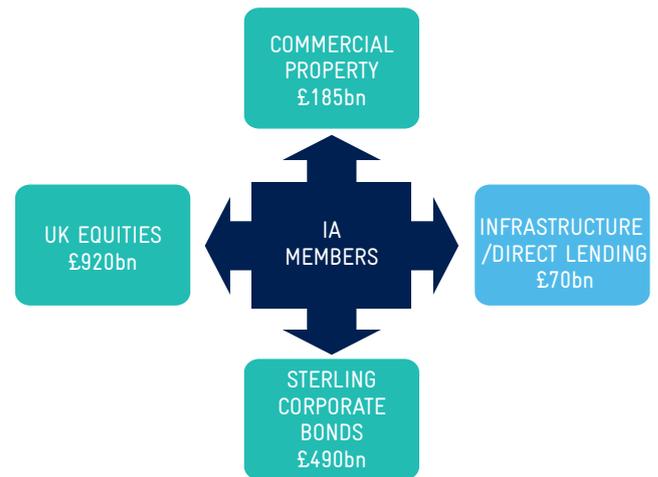
Through channelling savings to capital markets, the asset management industry is a key source of funding for the economy providing financing through different asset classes including equities and bonds as well as real assets such as property and infrastructure – see Figure 6.

In 2017, the industry had £920 billion invested in UK equities representing roughly one third of the UK market capitalisation. The exposure to UK equities as a proportion of holdings over the past twenty years has fallen significantly (see page 48 for further discussion). This has been driven both by two main factors. First, a sustained erosion in ‘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). Second, significant changes in institutional pension allocations which has seen a de-risking, reflecting both regulatory/accounting changes and maturing DB schemes.

Moreover, the UK’s asset 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 asset managers have purchased the majority of corporate bond issues in recent years, as companies have turned increasingly to the debt markets to raise capital.⁶

Importantly, investment is increasingly taking place via more diverse asset classes such as infrastructure and direct lending, which are especially attractive to DB pension schemes and insurers looking to match their liabilities and cash flow requirements. Infrastructure investment particularly has seen considerable growth as discussed in the next section.

FIGURE 6: IA MEMBER HOLDINGS IN UK ASSET CLASSES⁷



⁶ The contribution of asset management to the UK economy, July 2016, Oxera

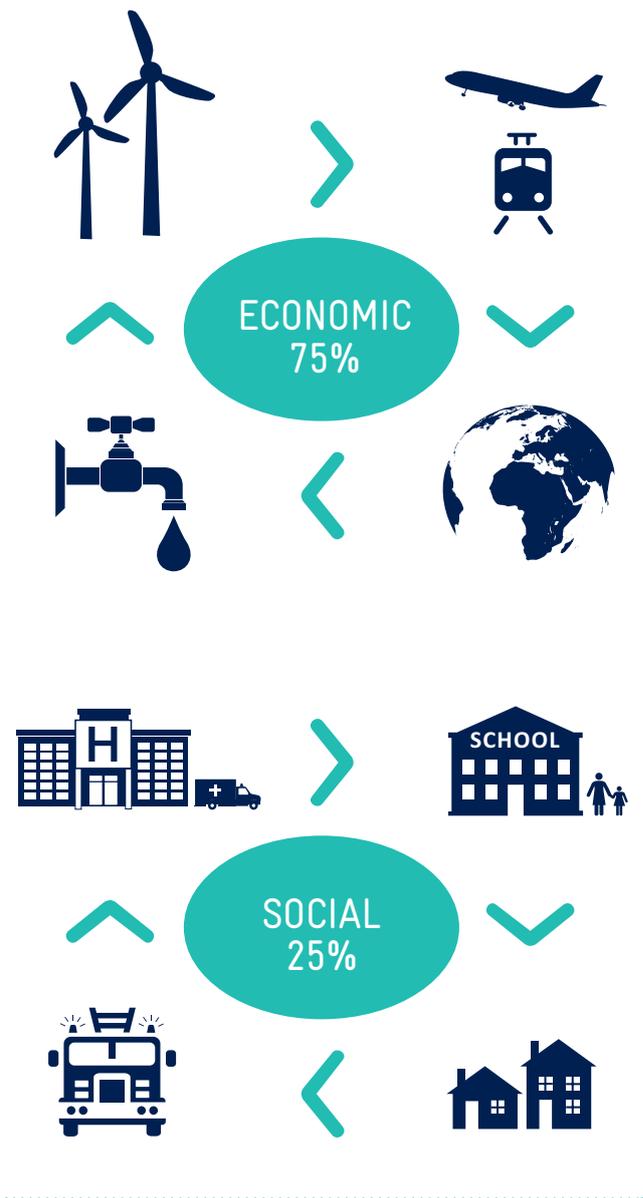
⁷ The majority of property investment is in commercial property, however a small amount may be allocated to residential accommodation. The majority of infrastructure investment is UK but some may be invested overseas.

INVESTMENT IN UK INFRASTRUCTURE

The amount of investment reported by UK asset managers into infrastructure remains low in absolute terms, but grew to £40 billion by the end of 2017, from £29 billion reported at the end of 2016.⁸ Although improvements in data reporting have partly contributed to this growth, increased investment is the central reason. On a like-for-like basis, assets increased by 24% year on year.

Similar to the findings in 2016, three quarters of the total invested by IA members at the end of 2017 (75%) was in economic infrastructure, which includes projects such as energy, transport, utilities and environmental. The remaining quarter was invested in projects which offer a social benefit, particularly social housing (see Box 1) and healthcare-related projects such as hospitals (see Figure 7).

FIGURE 7: INFRASTRUCTURE INVESTMENT BY IA MEMBERS



⁸ IA data captures the majority of investment by asset managers in the UK. Infrastructure investment is also facilitated by companies outside of the IA membership such as overseas asset managers and specialist infrastructure managers, which will not be captured in the IA's data.

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

“MUCH MORE COULD BE DONE AROUND INFRASTRUCTURE AND FUNDING, CAPITAL PARTNERSHIPS AND HOME BUILDING – PRODUCING CAPITAL PROJECTS THAT BENEFIT THE BROADER ECONOMY.”



The range of projects facilitated by IA members on behalf of their clients is extremely broad and Figure 8 provides a flavour of the projects that have been supported by UK asset managers in recent years.

FIGURE 8. SELECTION OF UK INFRASTRUCTURE INVESTMENT FACILITATED BY IA MEMBERS

