

4 UK INSTITUTIONAL CLIENT MARKET

KEY FINDINGS

MARKET OVERVIEW

- » IA members manage £3.8 trillion for UK institutional clients in offices around the globe. Pension funds are the largest client type, with 63% of institutional AUM, followed by insurance companies at 25%.

PENSIONS

- » £2.4 trillion is managed for UK pension schemes by IA members, representing 63% of the market.
- » Automatic enrolment has been a success with over nine million people enrolled into pension schemes as a result. In order to ensure that this new generation of pension savers achieves good outcomes there will need to be:
 - More emphasis on the importance of the investment process in generating returns for DC default funds
 - Greater facilitation of efficient asset allocation in default investment strategies
 - Increased contributions and engagement

THIRD PARTY MARKET

- » Once in-house mandates are excluded from the institutional data, assets under management reduce to £3.1 trillion.
- » Pension funds are even more dominant in the third party market, accounting for 71% of third party assets.
- » Assets managed in liability-driven investment strategies broke through £1 trillion for the first time in 2017, with an estimated £1.1 trillion of institutional assets managed in LDI strategies.

MANDATE TYPES

- » Multi-asset, or 'balanced' mandates, now account for about a quarter of total mandates once LDI mandates are excluded. Single-asset mandates account for the remaining three quarters.
- » The breakdown of specialist mandates has been relatively unchanged from 2016. Global equity mandates increased to 50% (up from 45%) and specialist UK mandates dropped slightly to 23%.
- » Global bonds overtook sterling corporate bond mandates for the first time, increasing to 29% of all specialist mandates.
- » 66% of assets were managed actively. All institutional client types were more likely to be managed on an active than a passive basis.
- » Almost two thirds of third party institutional mandates were managed in segregated mandates (65%). The increase in segregated mandates observed over the last couple of years appears to have stabilised.



This Chapter examines more closely the shape of the UK institutional client market and reports on specific 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, as well as the developments in the pensions market and particularly the shift from DB to DC.

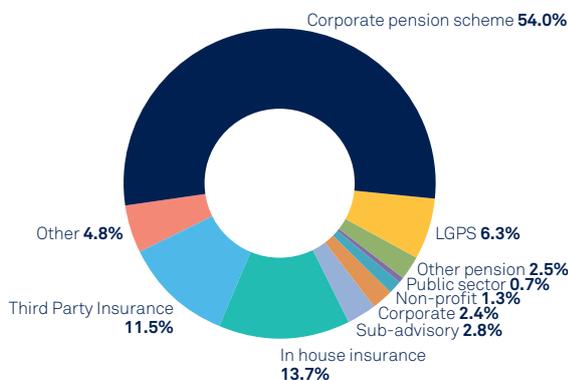
The analysis differs from that in Chapters 1 and 2 in two ways:

- It 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.
- It looks at the UK institutional client market regardless of asset management location (ie. the focus is on clients based in the UK rather than on assets managed in the UK). However, we estimate that an overwhelming majority of the assets are managed in the UK (approximately 93%).

CLIENT BREAKDOWN

IA members manage £3.8 trillion for UK institutional clients globally.³⁵ As Chart 26 indicates, pension funds and insurance companies (including in-house and third party management) account for the majority of UK institutional assets (88%)³⁶, with pension funds remaining the largest client type.

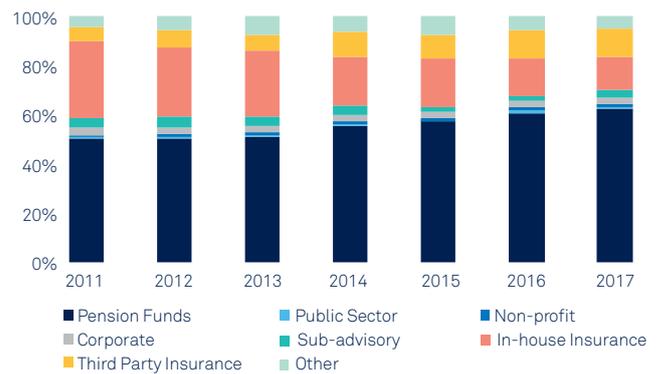
CHART 26: UK INSTITUTIONAL MARKET BY CLIENT TYPE



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.

DC pension assets operated via an intermediary platform through an insurance company are reflected in the IA's insurance assets. Consequently this shift in assets towards pension funds is even stronger than is implied in Chart 27.

CHART 27: UK INSTITUTIONAL MARKET BY CLIENT TYPE (2011-2017)



PENSION SCHEMES

In 2017, pension funds continued to account for the majority of the institutional client base (£2.4 trillion).

The IA divides pension scheme assets in three categories:

- Corporate pension funds, which at £2.1 trillion represented the majority of UK pension fund assets in 2017. This category includes a number of in-house Occupational Pensions Scheme (OPS) managers, which manage an estimated £170 billion in assets.
- The Local Government Pension Scheme (LGPS) which accounted for £240 billion of assets in 2017, indicating that IA members manage around 92% 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 £95 billion.

³⁵ Implied figure based on data collected on an estimated 84% of the institutional client base.

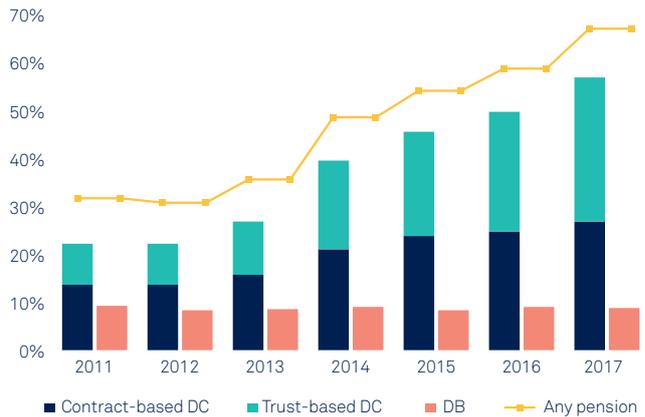
³⁶ The remaining 12% of assets is made up from mandates managed for corporations (outside of pension assets) sub advisory, not for profit mandates and public sector mandates. 'Other' client types generally refers to a variety of open-and closed-ended pooled vehicles, and investors from the more specialist areas of private equity, venture capital and property.

THE SHAPE OF THE UK PENSION MARKET

The IA estimates the size of the UK pension market to be £3 trillion at the end of December 2017.³⁸ This includes all assets in DB and DC pensions, as well as those assets in some form of drawdown arrangement, plus assets backing annuities.³⁹ Figure 11 provides an estimate of how these assets are broken down across the different scheme types.

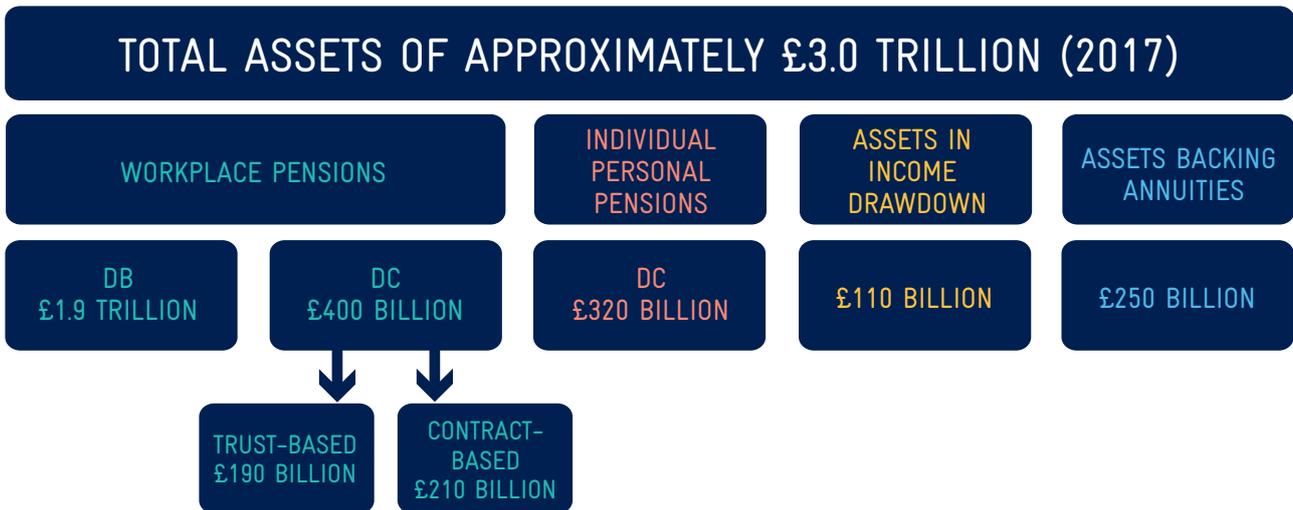
DB (funded) assets continue to make up the majority of the UK pension market, at £1.9 trillion in assets at the end of December 2017.³⁷ However, the number of savers into DC schemes now exceeds those actively saving into DB schemes. This shift is largely a result of the introduction of automatic enrolment. The majority of DB 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 stark (see Chart 28).

CHART 28: PENSION PARTICIPATION FOR PRIVATE SECTOR JOBS (2011-2017)



Source: ONS

FIGURE 11: OVERVIEW OF THE UK'S PENSION LANDSCAPE⁴⁰



³⁷ This figure is not directly comparable to the £2.1 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. Also IA DB figures include LDI data on the basis of liabilities hedged which is likely to be higher than asset value.

³⁸ Significant progress has been made in the last two years and the data below has been collected and inferred from a number of sources. External sources include ONS, Pensions Policy Institute, PPF and TPR. Nevertheless this data should still be considered indicative as not all data are updated with the same frequency or at the same date. Where possible estimates have been made to equalise the data at the end of 2016. Data on the DC market sourced from a number of sources at different dates. Numbers have been estimated so they are comparable at end December 2017 using returns on the IAs mixed investment 40-85% shares sector, a proxy for a typical DC default investment.

³⁹ 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%.

⁴⁰ Source: ONS, FCA, PPI, IA, DCLG

BOX 6: PUTTING INVESTMENT AT THE HEART OF DC PENSIONS

Since 2012 automatic enrolment has brought over nine million new people into pension saving. A combination of adequate contributions and long-term returns will now be needed to facilitate good retirement outcomes. The IA has proposed a number of key areas where there is scope for pension schemes and the investment industry to collaborate to improve member outcomes.⁴¹

MAKING INVESTMENT COUNT

- Investment should have the same priority in all forms of pension, whether DB, DC or Collective Defined Contribution (CDC).
- An emphasis on the investment process in DC scheme design, selection, governance and value assessment will facilitate better long-term member outcomes. At the heart of this are clear member objectives for the default arrangement.
- Transparency of investment costs for decision-makers in bundled workplace DC schemes should extend to separating the investment component from other costs. This will help to enhance the value assessment process for investment.
- Responsibility and sustainability in the investment process are increasingly important themes. The IA and the investment management industry are working to build on existing frameworks to support customers going forward.

FACILITATING EFFICIENT ASSET ALLOCATION

- In relying on diversified market returns, DC schemes are inherently no different to DB schemes (or any other institutional investors), either in their needs, or in the economic function of the capital that schemes put to work on behalf of savers.

- The question as to what are the barriers DC schemes face in relation to investing in illiquid assets has been widely asked in recent years. We conclude that a range of supply and demand side changes could facilitate a different approach to investment by DC schemes, making it more straightforward to access opportunities such as infrastructure.
- Demand side behaviour could be supported by further regulatory guidance on investment design for default arrangements. There is also scope to explore whether a new fund vehicle could better facilitate access to less liquid asset classes.

INCREASING CONTRIBUTIONS AND ENGAGEMENT

- The risk of inadequate contributions relative to anticipated outcome is high in the current DC environment. The IA supports automatic escalation to facilitate higher contribution rates.
- Inertia-based tools are not enough on their own. Real engagement is necessary, and could be facilitated by the further development of decision-making tools that draw on behavioural insights and harness technological innovation.
- Engagement also depends on confidence. One important element here will be clearer and consistent communication. This will require a combination of changes. Some are pension specific such as moving away from the term 'default'. Others relate more to the nature of investment management.

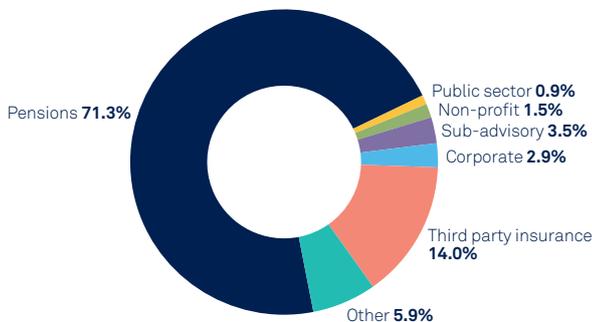
⁴¹ Putting Investment at the Heart of DC Pensions, IA position paper, 2018.

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 Two. The remainder of this chapter looks more closely at IA data from the institutional market that is available to third parties (excluding mandates managed in-house by insurance parent groups and occupational pension schemes).

Once in-house mandates are excluded from the institutional data, assets under management reduce to £3.1 trillion. Pension funds become even more dominant (see Chart 29), representing 71% of third party assets, with the remaining insurance assets representing only 14% of the market.

CHART 29: UK INSTITUTIONAL CLIENT MARKET BY CLIENT TYPE

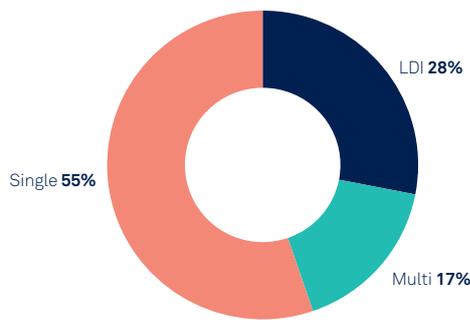


MANDATE BREAKDOWN

Chart 30 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 more than half of assets managed on this basis.
- Multi-asset, or ‘balanced’ mandates, which would cover a number of asset classes and regions. These account for 17% 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. They are therefore included on the basis of the notional value of liabilities hedged, rather than the value of physical assets held in the portfolio. An estimated £1.1 trillion is now being hedged in LDI mandates.

CHART 30: UK INSTITUTIONAL MANDATES INCLUDING LDI



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 31 indicates that the preference for specialist mandates remains high, with 76% of assets being invested in this way, although Chart 32 shows that this figure has gradually reduced in recent years.

24% of third party institutional assets are allocated to multi-asset mandates, up from 21% in 2016, which seems consistent with the use of multi-asset funds in DC default strategies and the increase of assets primarily due to automatic enrolment.⁴² Contribution rates in this space began to escalate in 2018. The extent to which employees will continue contributing higher rates or decide to opt out of their schemes possibly due to lack of affordability, will be a key determinant of whether this trend continues in coming years.⁴³

CHART 31: UK INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST

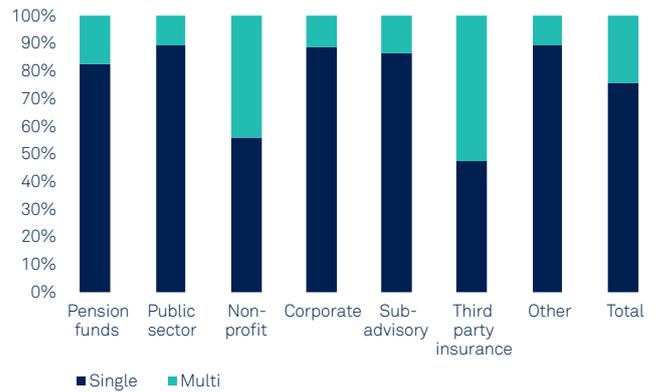


CHART 32: UK INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST (2011-2017)



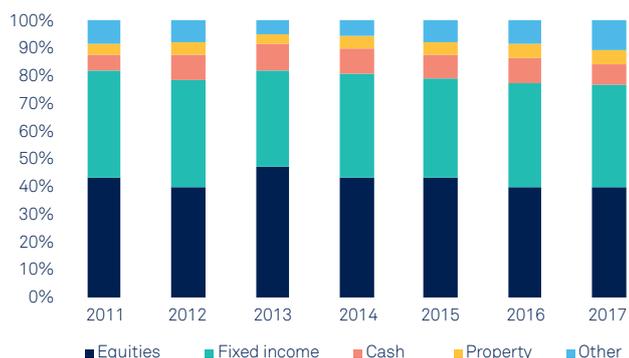
⁴² Excludes any assets managed in-house by occupational pension schemes or insurance companies

⁴³ Increases in minimum contribution rates for automatic enrolment pensions, TPR

INVESTMENT TRENDS WITHIN SPECIALIST MANDATES

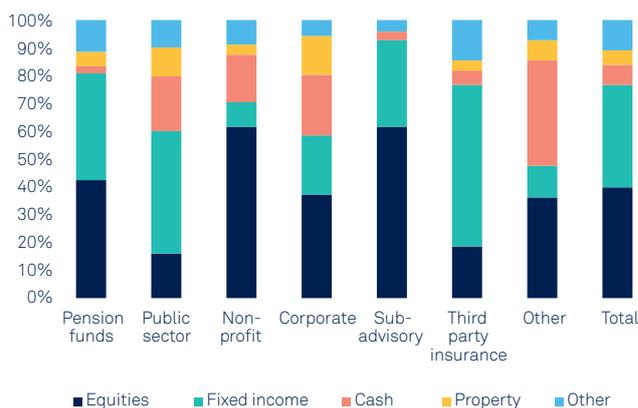
Equity remained the most popular type of specialist mandate with the proportion staying unchanged at 40%. There was generally little change apart from a decrease in the cash allocation and a corresponding increase in other assets. Chart 33 shows the progression since 2011 and there is no clear trend outside the increase in other assets particularly in the last five years, which is consistent with the growth of private assets.

CHART 33: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS (2011-2017)



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 34).

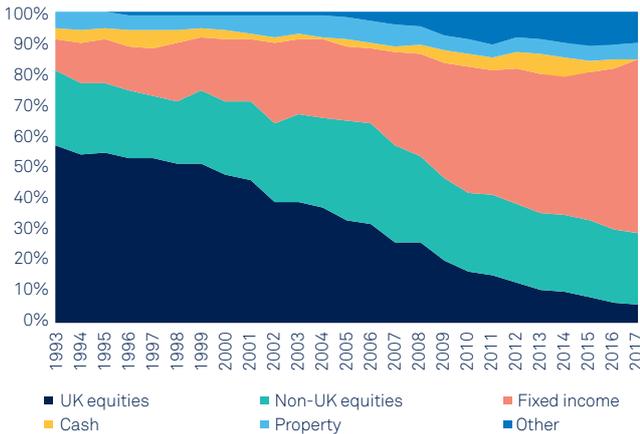
CHART 34: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS



As is evident from the increase in assets managed according to LDI strategies, many DB schemes are moving away from using traditional scheme-specific asset allocation benchmarks and are now closer to those that match their assets to their liabilities and manage their deficit volatility.

Chart 35 shows what this has meant for the change in asset allocation of DB pension scheme in the UK over the last 20 years. In the early 1990s, a typical DB scheme would have been heavily invested in equities (>80%), and particularly domestic equities, with a small allocation to fixed income assets and other asset types, notably property. The growing maturity of DB scheme membership has increased scheme appetite to hold assets that behave in a similar way to liabilities and led to the evolution of their investment strategies. So a typical DB scheme is now likely to hold a much smaller proportion in equities, which itself includes more overseas than domestic equities, and a considerably larger allocation in fixed income assets, and have a significant exposure to alternatives (10% compared to 1% in the mid-1990s).

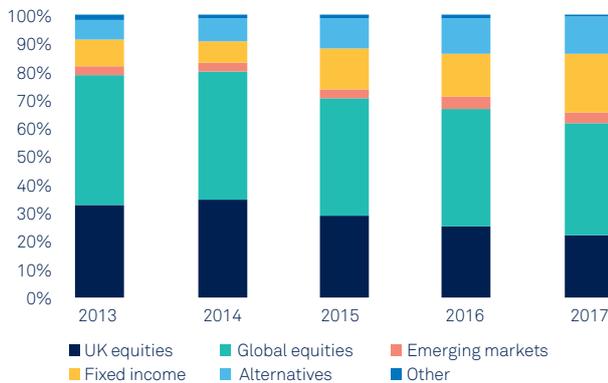
CHART 35: UK DB PENSION FUND ASSET ALLOCATION (1993-2017)



Source: UBS/PPF

In contrast to DB schemes, the asset allocation of DC schemes shows a much higher allocation to equities. Although the proportion allocated to equities, and particularly domestic equities, among DC schemes is also following a downward trend, it is still at approximately two thirds of assets (see Chart 36).

CHART 36: DC ASSET ALLOCATION, SELECTED FTSE 100 / FTSE 250 PENSION SCHEMES

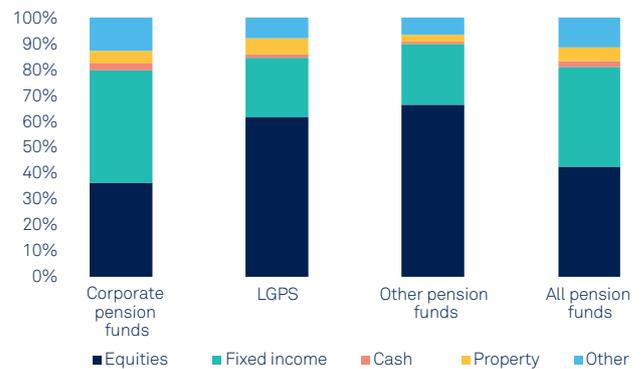


Source: FTSE Default DC Schemes Report 2017, Schroders

This in large part reflects the difference in demographic between the membership of DC and DB schemes. As occupational DB schemes are now almost entirely closed to new entrants and moving to being cashflow negative, DC schemes are likely to have a much higher proportion of younger members, with a far longer-term investment horizon than that of the more mature DB schemes. This means they are able to have an increased allocation to riskier asset classes rather than asset classes targeting either a regular income stream or an inflation protected return. Nevertheless, longer term as DC schemes mature, there is no reason why the DC market should not be characterised by the same degree of sophistication of discussion around the role of different asset classes and the investment process that characterises DB delivery.⁴⁴

Chart 37 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. This year's data is consistent with the findings of previous years, the key amongst these being that the LGPS has a higher allocation to equities than corporate pension schemes (62% vs 36%). As with DC schemes, the LGPS has a rather different membership makeup than other DB schemes. 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 37: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS AMONG UK PENSION FUNDS

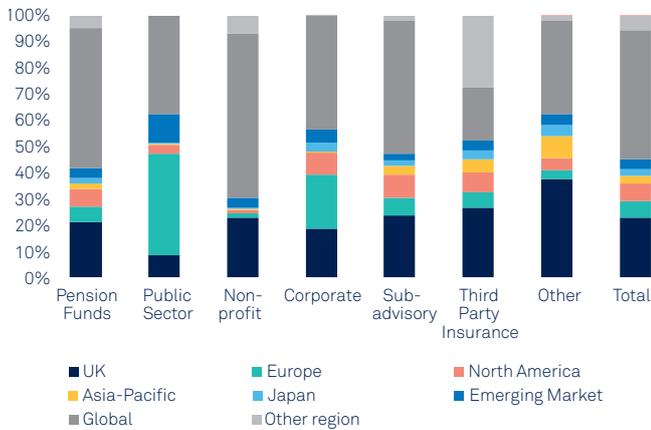


⁴⁴ Putting investment at the heart of DC pensions – IA position paper, June 2018

GEOGRAPHIC ALLOCATION

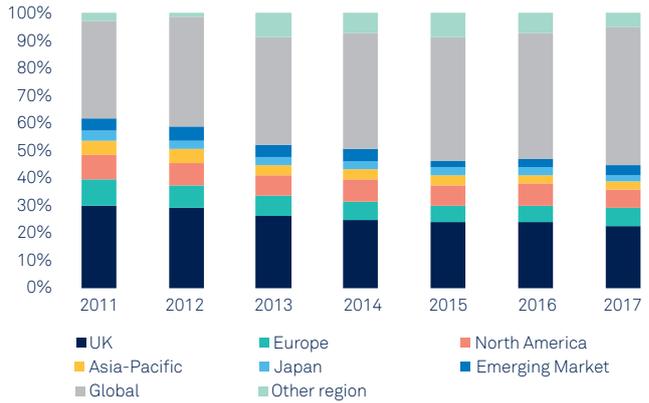
Chart 38 shows the breakdown of specialist mandates in 2017. There was very little change in the overall allocation from 2016.

CHART 38: GEOGRAPHICAL EQUITY ALLOCATION OF SPECIALIST MANDATES BY CLIENT TYPE



Overall the globalisation of investment in the institutional market remains a key theme as more than three quarters of specialist equity mandates apply to non-UK mandates. Chart 39 shows that global equity mandates increased to 50% of all specialist mandates at the end of 2017, while specialist UK mandates fell another percentage point ending the year at 23%.

CHART 39: GEOGRAPHICAL EQUITY ALLOCATION OF SPECIALIST MANDATES (2011-2017)



Looking at UK pension funds, once again it is evident that there are further significant differences between the LGPS and other schemes. 26% of LGPS specialist mandates managed by IA members at the end of 2017 were in UK equity mandates, a two percentage point increase from 2016 (see Chart 40).

This is in contrast to corporate pension funds which held only 20% in UK equity mandates. So the LGPS remains more focused on equities and within that, on domestic equities.

CHART 40: GEOGRAPHICAL EQUITY ALLOCATION OF SPECIALIST MANDATES AMONG UK PENSION FUNDS

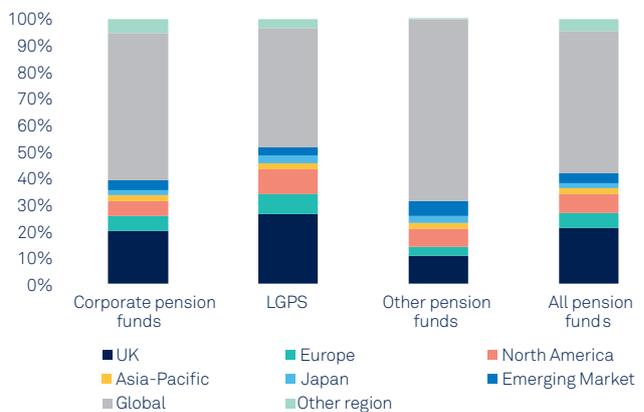


Chart 41 shows that within fixed income, global bonds are now the largest category of specialist mandate, at 29% (up from 21% in 2016). The amount allocated to government bonds (including index-linked) fell slightly, to 24%, but the big drop was in sterling corporate bonds, which fell from 27% to 21% year on year.

CHART 41: FIXED INCOME ALLOCATION OF SPECIALIST MANDATES BY CLIENT TYPE

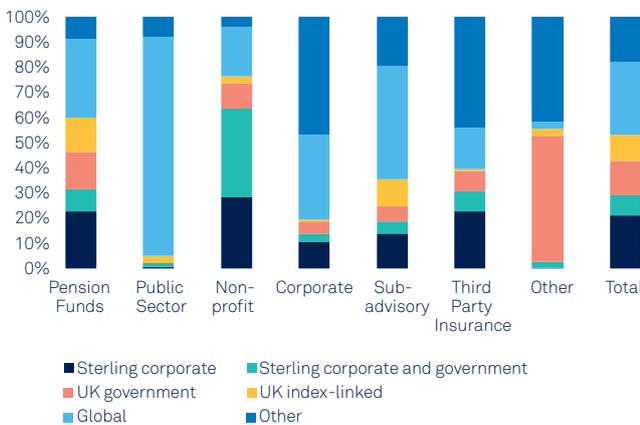
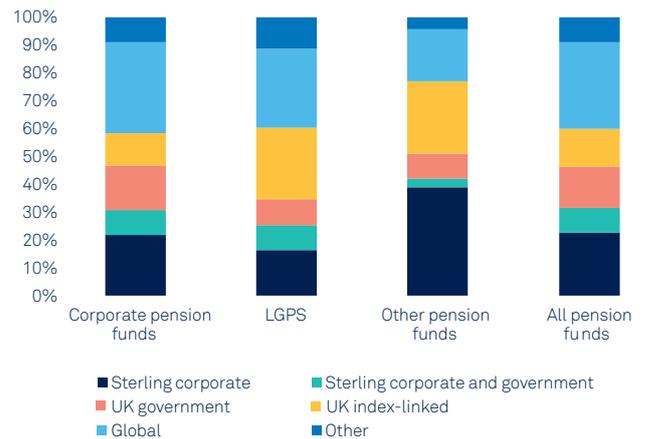


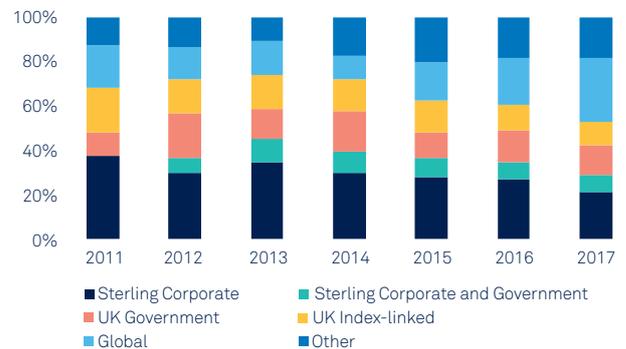
CHART 42: FIXED INCOME ALLOCATION OF SPECIALIST MANDATE TYPES AMONG PENSION FUNDS



Looking at the trend in fixed income allocation over the last five years, building on the increased allocation last year, global bonds overtook sterling corporates as the largest specialist mandate type for the first time in 2017, increasing to 29% of all specialist mandates.

Chart 41 also shows how fixed income allocation can differ by client type, and this difference is clear in the differences exhibited by different types of pension scheme. The LGPS has a significantly higher allocation to index-linked gilts and a much lower allocation to sterling corporate bond mandates than corporate pension schemes (see Chart 42).

CHART 43: SPECIALIST FIXED INCOME ALLOCATION (2011-2017)⁴⁵



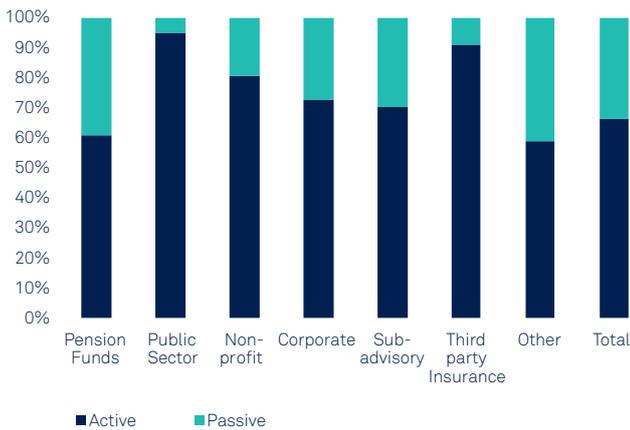
⁴⁵ £ Corporate and Government not separated out in 2011

ACTIVE VS PASSIVE

Just under two thirds of assets (66%) were managed by IA members on an active basis, up from five years ago (61%).

All institutional client types this year were more likely to be managed on an active rather than a passive basis (Chart 44). This may reflect changes in asset allocation, and particularly the increased allocation to other assets, rather than any conscious shift out of passive and into active.

CHART 44: ACTIVE AND PASSIVE THIRD PARTY MANDATES BY CLIENT TYPE (SAMPLE-ADJUSTED)

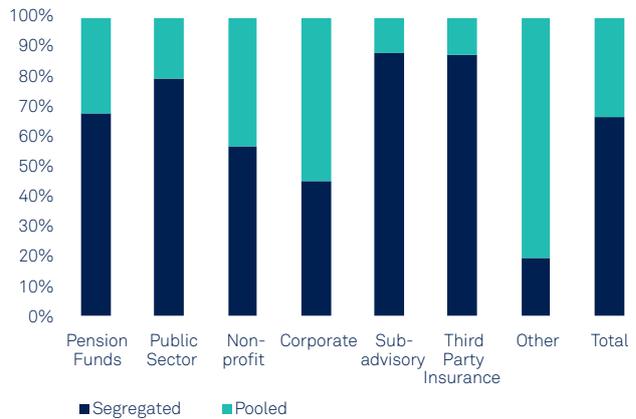


SEGREGATED VS POOLED

Chart 45 shows that segregated mandates represented approximately two thirds (65%) of assets managed for third party institutional mandates at the end of 2017. Almost all mandates managed for third party insurance and sub-advised mandates were managed on a segregated basis in contrast to corporate mandates.

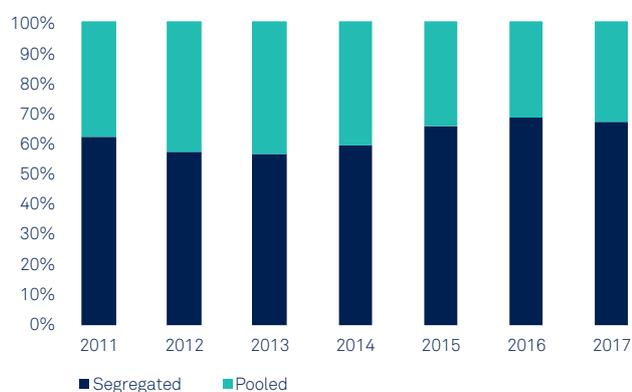
Other clients represent a wide variety of clients including family offices and private wealth firms and these assets are significantly more likely to be managed on a pooled basis.

CHART 45: SEGREGATED AND POOLED MANDATES BY INSTITUTIONAL TYPE



The increase in segregated mandates that was observed in the last four years may have reached a plateau as there was no further increase in 2017 (see Chart 46). However, it remains to be seen in the future whether the share of segregated mandates has stabilised at this level.

CHART 46: INSTITUTIONAL SEGREGATED AND POOLED MANDATES (2011-2017)



Corporate pension schemes use segregated mandates to a much greater extent than the LGPS funds and other pension schemes (see Chart 47), which may be partly related to scale. The pension schemes within the other category, which include pensions for smaller institutional clients such as charities, are more likely to use pooled management arrangements.

CHART 47: SEGREGATED AND POOLED MANDATES AMONG THIRD PARTY PENSION FUNDS

