EXECUTIVE SUMMARY

1. UK ASSET MANAGEMENT INDUSTRY: A GLOBAL CENTRE

- 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. £1.7 trillion was invested in the UK economy via equities and corporate bonds and in domestic commercial property and infrastructure projects.

- The UK remains the largest centre of asset management outside of the US. It is the largest centre of asset management in Europe, where it accounts for 35% of all assets under management. UK asset managers manage £3.1 trillion for overseas clients, which translates to earnings representing 6% of net services exports.

- Assets managed for European clients increased by almost 30% year-on-year, bolstered by extremely strong flows into EU UCITS funds in 2017.

2. CHANGING DYNAMICS IN ASSET MANAGEMENT IN THE UK

- The number of companies listed on public markets has reduced in the last decade, notably in the US and to a lesser extent in the UK and mainland Europe. At the same time, there has been increased interest in private markets as asset managers have expanded into real assets such as infrastructure and, more recently following the reduction in bank activity after the financial crisis, direct lending.

- The range of responsible and sustainable investment approaches has led to a varying picture of how much money is managed in these strategies. Dedicated ESG investment remains the domain of the larger pension schemes. Among retail investors, interest is more muted, with the proportion of investment into UK authorised funds categorised as 'ethical' standing at just 1.3% of funds under management. Nevertheless there is increased adoption of responsible and sustainable values into mainstream investment processes by asset management firms.

- Over the last decade there has been a shift in product demand towards more solutions-focused strategies (including liability-driven investment) and alternative asset classes (including infrastructure and direct lending). In the institutional market this shift has been fuelled by interest from defined benefit (DB) pension schemes and insurers in investments that offer ways to more closely match their liabilities and cash flow needs.

- Demand for passive investments has also been strong, driven by a desire for lower-cost solutions. The growth of passive investment via the ETF market has been particularly marked, with assets in UK-Listed ETFs increasing from £11 billion to £250 billion in the last ten years.

- Harnessing technological innovation is an increasing priority for the industry. Three key areas are:

  - improving the efficiency of back office systems such as transaction processing.

  - using big data to improve decision making and achieve better investment outcomes either by increasing the sophistication of factor-based quantitative strategies in the smart beta environment, or in informing the investment decision making of fund managers responsible for active strategies.

  - enhancing the investor experience and making investment easier than ever for the individual by facilitating access to funds through a variety of media.

- The distribution of retail funds in the UK remains heavily intermediated. Asset managers are increasingly considering how they can improve their connection with customers. A range of approaches are possible including vertical integration.

- The regulatory and policy environment continues to reflect a mixture of challenge and opportunity for the industry in the UK and globally. Questions about the role played by the asset management industry focus both on the customer delivery side, and the wider contribution to the economy. They fall into two categories:

  - How can the value of asset management to its customers be demonstrated, broadened and maximised.

  - How can the needs of the broader economy be met from asset management activity.

3. TRENDS IN CLIENT ASSETS AND ALLOCATION

- Almost four fifths of assets under management (79%) were managed on behalf of institutional investors. Pension schemes remained the largest client type although for the first time in more than five years pensions failed to increase as a proportion of total assets, remaining almost unchanged from 2016 at 44%.
- Demand for real assets such as infrastructure and real estate continued in 2017 and these asset classes are expected to be a key growth area in the coming year. This demand is driven by pension schemes and insurance companies looking to manage their liabilities and match cash flows.

4. UK INSTITUTIONAL CLIENT MARKET

- IA members managed £3.8 trillion for UK institutional clients in offices around the globe. Pension funds were the largest client type, with 63% of institutional total assets under management, followed by insurance companies at 25%. An estimated £1.1 trillion of this was managed in liability-driven investment strategies.
- Once in-house mandates were excluded from the institutional data, assets under management stood at £3.1 trillion. Pension funds were even more dominant in the third party market, with 71% of third party assets.
- Multi-asset, or 'balanced' mandates, now account for almost a quarter (24%) of total mandates once LDI mandates are excluded. Single-asset mandates accounted for the remaining 76%. The increase in multi-asset mandates may in part reflect the use of multi-asset strategies in defined contribution (DC) default funds.
- Within specialist mandates, global equity mandates increased to 50%, while UK mandates continued to fall, dropping by another percentage point to 23% of specialist equity mandates. For the first time sterling corporate mandates were not the largest category within specialist fixed income mandate. Global bonds was the largest category, at 29%.

5. RETAIL FUND MARKET

- UK investor funds under management in UK authorised and recognised funds grew to £1.2 trillion. £147 billion of this was held in funds domiciled overseas, suggesting UK investors are not shying away from overseas funds following the Brexit referendum, although UK equity funds remained out of favour in 2017.
- Net retail sales were £47.1 billion in 2017. This was partly a bounceback from weak 2016 sales, but may also reflect structural changes encouraging investment into UK funds.
- Outcome and Allocation funds were most popular with £13.8 billion of net retail sales. Fixed income funds also had a very strong year, with retail sales of £13.2 billion as the desire for income continued unabated.

6.OPERATIONAL AND STRUCTURAL ISSUES

- Operating profit fell from 30% to 28%. Despite rising revenue (£20.6 billon), costs rose more quickly, Profitability at individual firm level continued to vary widely.
- An estimated 38,000 people were employed directly by asset managers at the end of 2017 up by around 1% on the 2016 figure. Jobs in the asset management industry vary by location, with the largest proportion in London being employed in investment management and operations, while fund administration is of greater importance in Scotland. Staff in Compliance, Legal and Audit have grown most significantly over the past five years with the proportion of staff employed in these roles more than doubling in absolute terms.
- The UK asset management industry remains relatively unconcentrated. 43% of assets were managed by the top five firms and assets managed by the top ten firms increased by two percentage points to 58%. Merger and acquisition activity between traditional asset managers continued but managers also bought in expertise in private assets, technology and distribution.