

# Asset Management in the UK 2015-2016

The Investment Association  
Annual Survey

THE  
INVESTMENT  
ASSOCIATION

September 2016



## CONTENT ENQUIRIES

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# ABOUT THE SURVEY

## THE SURVEY CAPTURES ASSET MANAGEMENT UNDERTAKEN BY MEMBERS OF THE INVESTMENT ASSOCIATION (IA) ON BEHALF OF DOMESTIC AND OVERSEAS CLIENTS FROM THE FOLLOWING PERSPECTIVES:

- Assets managed in the UK on behalf of institutional and retail clients, irrespective of the country in which the underlying client is located (Chapters 1 and 2).
- Assets managed for UK institutional clients by member firms, irrespective of the country in which the asset management activity is undertaken (Chapter 3).
- UK domiciled authorised Unit Trusts and Open Ended Investment Companies (Chapter 4).

### IT IS BASED ON:

- Questionnaire responses from 77 IA member firms, who between them manage £4.9 trillion in this country (85% 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 with senior personnel from 22 IA member firms (Appendix 7).

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.

### THE SURVEY IS IN FIVE CHAPTERS:

- 1 A Domestic, European and Global Industry
- 2 Key Characteristics of UK Asset Management
- 3 UK Institutional Client Market
- 4 UK Fund Market
- 5 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 Client Market
- 3 Major UK and EU Regulatory Developments Affecting Asset Management
- 4 Notable M&A deals in the UK Asset Management sector (2009-July 2016)
- 5 Definitions
- 6 Survey Respondents
- 7 Firms Interviewed

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

- A change in the financial reporting of overlay assets has impacted the total AUM figure for 2014 (revised to £5,690 billion). In order to enable meaningful comparison with last year's data, 2014 figures have been adjusted where possible. Adjusted figures are referred to as revised throughout this report.
- 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 2015. For a more detailed explanation of the term please refer to Appendix 5.
- 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.

# SURVEY FOREWORD



**WELCOME TO THE FOURTEENTH EDITION OF THE INVESTMENT ASSOCIATION'S ASSET MANAGEMENT SURVEY, THE DEFINITIVE OVERVIEW OF THE UK INVESTMENT SECTOR. WITH £5.7 TRILLION UNDER MANAGEMENT BY IA MEMBERS, AND A WIDER ASSET BASE OF AROUND £6.9 TRILLION, THE UK CONTINUES TO THRIVE AS A CENTRE OF EXCELLENCE. IT IS THE LARGEST ASSET MANAGEMENT CENTRE IN EUROPE BY A SIGNIFICANT MARGIN AND SECOND IN THE WORLD AFTER THE UNITED STATES.**

At the same time, a key part of that strength is of course provided by a very significant domestic client base, underpinned over many decades by funded pension provision. The industry is highly international in terms of the clients it serves, the assets in which it invests and the firms which operate here. Some 40% of the £5.7 trillion managed here is for clients based overseas, including £1.2 trillion for European clients outside of the UK. This overseas business helps the industry to develop and innovate from these shores. Importantly, it also makes a considerable positive contribution to services exports, and to the balance of payments.

The impact of the UK's historic vote to leave the EU on 23 June 2016 will not be known for some time, but the UK's future as a centre of excellence will undoubtedly depend on its ability to respond positively to the challenges it will face in the next few years. For its part, the asset management industry will need to work hard to help ensure a commercial and regulatory environment which allows firms to continue to deliver for clients in the UK, in the rest of Europe and around the world.

Part of that work requires wider recognition as to why the industry matters to the UK economy. This is more than just about taxes paid and employment provided, important as these are. Ultimately, investment management is about providing capital to allow the economy to grow and then helping to distribute the fruits of those returns in a way that meets the needs of millions of savers across the country.

The Survey, and other research work undertaken by the IA this year, provides evidence of the further evolution of the industry in both regards. The Survey documents in particular how investment managers are engaging more directly than ever with the needs of millions of end investors, both in the retail and institutional markets. Last year was marked by continued evidence of a shift towards multi-asset portfolios, income and other products that are more outcome-oriented than would have been the case a decade ago.

The industry will also undoubtedly come under continued scrutiny on both transparency and value. As we publish this year's survey, we await the interim findings of the FCA's market study on whether competition is working effectively in our industry. The focus on providing ever better value is likely to help shape our industry as politicians and regulators recognise that asset managers are playing an ever more important and visible role in funding the economy and delivering services to savers.

Andrew Haldane has declared that we have entered an 'Age of Asset Management' and I think that many of the findings in this Survey underline why this is the case. I hope you enjoy reading the report, and any suggestions you have to make it even more informative and helpful are, as ever, extremely welcome.

**Chris Cummings**  
Chief Executive

# EXECUTIVE SUMMARY



## UK REMAINS LEADING GLOBAL CENTRE

- The UK is the second largest centre of asset management globally, smaller only than the US. It is the largest centre of asset management in Europe by a significant margin, managing 37% of total assets managed in Europe – more than France, Germany and Italy together.
- Assets under management reached £5.7 trillion by the end of 2015, representing growth of 8% per annum over the last decade and bringing the size of the industry to over 320% of UK GDP, compared to a European average of 114%.
- The UK asset management industry has a global reach. £2.2 trillion is managed in the UK for overseas clients, £1.2 trillion of which is managed for European (ex-UK) clients. £310 billion is managed for clients based in the US and the remaining £660 billion is managed for clients in locations spanning the rest of the globe.
- Asset management contributes 6% to net service exports in the UK. Asset managers also contribute directly to UK economic growth via efficient allocation of capital, and stewardship and engagement activity with individual companies.
- The UK's decision to leave the European Union is a source of major regulatory and political uncertainty for the asset management industry, which is highly international but simultaneously highly integrated within the EU. The future of the UK as a centre of excellence for asset management will depend on its ability to adapt to the new world.



## CLIENT GROUPS CONTINUE MOVE TOWARDS SOLUTIONS

- Eighty percent of assets continue to be managed for institutional clients. Pensions remain the largest client type at 40% but the proportion of assets managed for insurance companies stabilised in 2015 at 18% after falling consistently over the last decade.
- At asset level, allocations outside the mainstream asset classes continued to increase, reaching 19% by the end of 2015. More than half of assets in this category are now represented by 'solutions-based' strategies as both institutional and retail investors diversify more widely and focus more on investment outcomes.
- Institutional investors are shifting away from specialist portfolios back to multi-asset mandates. By the end of 2015 institutional assets managed in multi-asset mandates had increased to 23%. This is likely to reflect, at least in part, the greater use of multi-asset strategies in defined contribution (DC) default funds, as pension assets continue to shift from defined benefit (DB) to DC. The shift to DC in turn continues to blur the definitional boundary between retail and institutional business.
- The drift towards passive persisted into 2015, with total assets managed on an indexed basis rising by one percentage point to 23% by the end of the year. There was no change in assets managed in strategies which fall between active and passive, such as smart beta (3%). However, IA data excludes much of the ETF market, where smart beta strategies are prevalent.

## UK RETAIL MARKET RESILIENT AMID DEMAND SHIFT

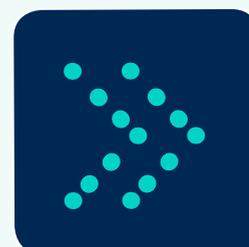
- Authorised funds reached another new high, with funds under management increasing to £872 billion by the end of 2015, up from £835 billion in 2014. Net retail sales fell to £18 billion from £22 billion in 2014, potentially indicating a return to levels more typical of the pre-crisis period.
- Retail allocations to equity funds remained stable into 2015. However, equity allocations have fallen from 87% twenty years ago, to 54% in 2015. This fall has primarily been driven by a reduction in UK equity allocations as the non-UK share has remained steady and retail investors have gradually diversified their investments into other asset classes.
- The demand for outcome-focused funds continued in 2015, with £8 billion of net retail flows into these funds. Among equity funds, investors continued to favour equity income over growth funds. Equity income funds received positive net flows of £5.6 billion during the year.
- The UK funds industry maintained its low concentration level in 2015 with the top ten firms' share of the market holding at 47%. Although the proportion of the market held by the top ten firms has remained relatively stable over the last 20 years, the composition of the top ten firms has changed significantly.

## INDUSTRY STRUCTURE

- An estimated 92,000 were employed in roles either in or linked to asset management in 2015. 37,000 of those were directly employed by asset management firms, with the industry outsourcing many middle and back office activities.
- The concentration of the UK asset management industry as a whole remains low. Assets managed by the top five firms was unchanged from 2014 at 39%. Assets managed by the top ten firms in 2015 increased one percentage point to 56%.
- The industry in the future is likely to favour larger firms with strong brands offering a full suite of services, alongside small targeted managers with unique product offerings.

## TECHNOLOGICAL CHANGE AND CYBERSECURITY A MAJOR PREOCCUPATION

- Ongoing developments in technology offer huge opportunities for asset managers increasingly keen to communicate directly with underlying investors. However, the security of client data has been identified as a key risk to both reputation and trust, and asset managers are committing substantial resources to protect themselves against cyber attacks.
- Despite improvements in digital technology, the 'direct to consumer' proposition, including robo-advice is still primarily an option for those asset managers that form part of a vertically integrated offering. For others, external distribution channels will remain key.



# KEY STATISTICS

£ 5.7 TRILLION

[£5.7 TRILLION (REVISED)  
IN 2014]

TOTAL ASSETS MANAGED IN THE UK BY THE IA'S MEMBERS  
AS AT DECEMBER 2015

£ 872 BILLION

[£835 BILLION IN 2014]

MANAGED IN UK AUTHORISED FUNDS (OEICS AND  
UNIT TRUSTS)

£ 2.2 TRILLION

[£2.2 TRILLION IN 2014]

ASSETS MANAGED IN THE UK ON BEHALF OF  
OVERSEAS CLIENTS

£ 1 TRILLION

[£895 BILLION IN 2014]

UK-MANAGED FUNDS DOMICILED OFFSHORE

31 PER CENT

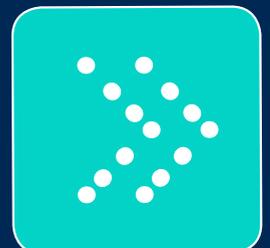
[32 PER CENT IN 2014]

UK DOMESTIC MARKET CAPITALISATION ACCOUNTED  
FOR BY THE IA'S MEMBERS' UK EQUITY HOLDINGS

37 PER CENT  
IN 2014  
(PROVISIONAL)

[37 PER CENT IN 2013]

TOTAL EUROPEAN ASSETS UNDER MANAGEMENT  
MANAGED IN THE UK AS AT DECEMBER 2014 (LATEST  
AVAILABLE).



# 1 A DOMESTIC, EUROPEAN AND GLOBAL INDUSTRY

## KEY FINDINGS

### THE SIZE OF THE ASSET MANAGEMENT INDUSTRY IN THE UK

- Total assets under management by IA members were almost unchanged year-on-year at £5.7 trillion.<sup>1</sup>
- Assets under management in the wider industry reached around £6.9 trillion.
- Assets managed in UK authorised funds increased by 4%, to £872 billion.
- 10% of assets under management in the UK were managed in Scotland (£548 billion).

### A TRULY GLOBAL INDUSTRY

- Some 40% of assets managed in the UK by IA members are managed for overseas clients.
- The majority, £1.2 trillion, is managed for clients in Europe, £310 billion is managed for US clients with the remainder spread around the rest of the world.
- The UK is the largest asset management centre in Europe and second only to the US on a global stage.
- Overseas-owned asset managers accounted for 58% of assets managed in the UK in 2015, up from 40% a decade ago.

### ASSET MANAGEMENT IN THE CONTEXT OF BREXIT

- The vote for the UK to leave the EU will have ramifications for the industry in terms of its commercial contribution and the regulatory environment.
- While the impact will take time to work through, firms identified a range of risks, particularly focused on EU market access.
- Asset management exports have represented on average 6% of net service exports over the past decade.

### WIDER CONTRIBUTION TO THE UK ECONOMY

- The industry is playing a vital role in helping to promote long-term business investment and drive sustainable returns via the Productivity Action Plan.
- Asset managers are increasingly involved in market-based financing activity, helping to fill the role partially vacated by the banks after the 2008 crisis.
- Over 90,000 people work in asset management in the UK, taking majority outsourcing activities into account. Almost 37,000 are employed directly by asset managers.



<sup>1</sup> 2014 figure revised to £5.7 trillion due to a change in accounting of overlay assets

# 1 A DOMESTIC, EUROPEAN AND GLOBAL INDUSTRY

## THE SIZE OF THE ASSET MANAGEMENT INDUSTRY IN THE UK

At the end of 2015, IA members managed £5.7 trillion of client money in the UK, slightly higher than last year (£5.7 trillion revised). This represents a sharp slowdown in the strong growth of industry assets witnessed since 2007 but is consistent with a slowdown in asset growth globally.<sup>2</sup> Funds under management in UK authorised funds increased by 4% in 2015 to reach £872 billion at the end of December 2015. This represents 15% of overall assets under management, a proportion that has remained largely unchanged since 2009.

**CHART 1: TOTAL ASSETS UNDER MANAGEMENT IN THE UK AND IN UK AUTHORISED FUNDS (2006-2015)<sup>3</sup>**



Chart 1 shows funds and assets under management over the last ten years, with the compound growth rate shown in Table 1.

**TABLE 1: ANNUALISED GROWTH RATE OF TOTAL ASSETS AND ASSETS MANAGED IN AUTHORISED FUNDS (2005-2015)**

9.6%	▶ FUNDS
7.7%	▶ TOTAL ASSETS

Chart 2 demonstrates assets under management relative to UK GDP. Over the past 20 years, the proportion has increased from 170% of GDP to 320%. However, this has showed signs of slowing since 2014 following a strong rise during 2009-2013 as markets rebounded in the context of low domestic growth.

The GDP data provides a useful measure of the change in scale of UK asset management as well as being useful in a comparative context, highlighting the fact that asset management is considerably more important to the UK economy than it is to the economies of other European countries. In mainland Europe the average proportion of GDP represented by asset management is 114%.<sup>4</sup>

Chart 2 also shows the growth in assets under management relative to UK pension scheme assets, traditionally the largest client group for the UK industry. From around 40% of total assets in 1995, pension assets now represent less than a third, (31%), reflecting in part the rise in the international activity of the UK, as well as the increasing significance of other domestic client groups. Total funds under management, a barometer of the UK retail market, have increased from 15% of GDP to 49% over the same period.

**CHART 2: TOTAL ASSETS UNDER MANAGEMENT IN THE UK AND UK PENSION ASSETS (1995-2015)**



<sup>2</sup> We do not collect data to allow us to distinguish between the impact of flows and market movements. Flows are driven by both client decisions and organisational change, eg. changes in where money is actually managed

<sup>3</sup> 2014 figure adjusted to £5,690 billion due to a change in financial reporting of overlay assets

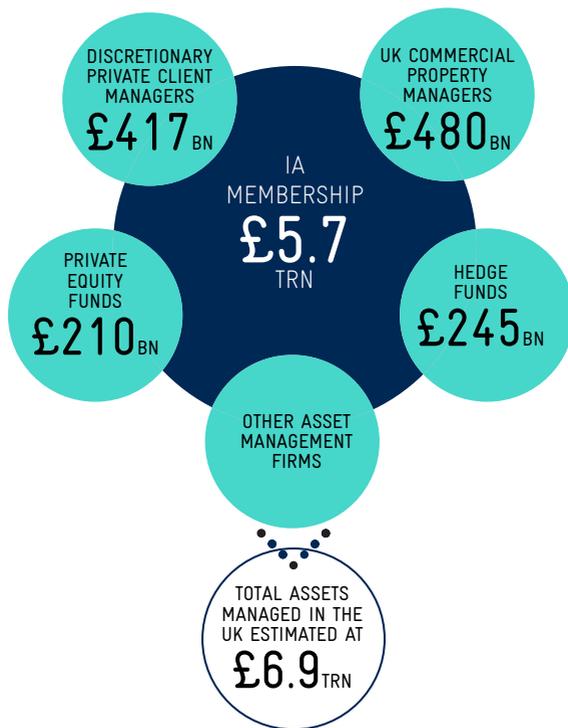
<sup>4</sup> Asset Management in Europe, EFAMA, 2015

## WIDER INDUSTRY

While the IA's members represent the majority of the UK asset management industry in asset terms (83%), a significant number of firms contributing to the industry's activity lie outside the IA membership and are not covered in detail in this report. These can be broadly categorised into the following groups (see Figure 1):

- Hedge funds.
- Private equity funds.
- Commercial property management.
- Discretionary private client management.
- Firms who are not members of the IA for reasons not noted above.<sup>5</sup>

**FIGURE 1: WIDER ASSET MANAGEMENT INDUSTRY**



Source: ComPeer, Hedge Fund Intelligence/EuroHedge, Investment Property Forum, Investment Association estimate based on private equity return data.

The overlap between IA members and the wider market is hard to measure for some asset classes but the latest data available indicated that IA members managed around 12% of assets in hedge funds in the UK, 23% of private client funds and 15% of private equity.

<sup>5</sup> This last group is more difficult to size as there is no consistent third party data available.

## SCOTLAND

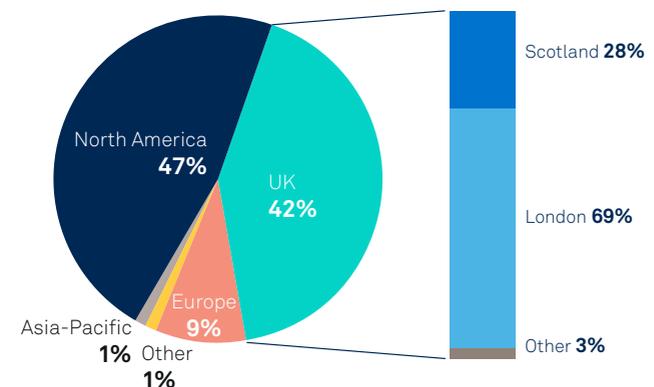
A number of asset managers have either headquarters or offices in Scotland. Assets managed in Scotland represented 10% of total assets managed by IA members at the end of 2015, accounting for £548 billion of total assets.

The picture of assets managed by firms with headquarters based in Scotland was rather different, with more than one quarter of assets managed by IA members headquartered in the UK being managed by companies with a headquarters in Scotland (28%).

Overall this equates to around 12% of assets, greater than assets actually managed in Scotland, as a number of asset managers headquartered in Scotland have substantial asset management capability located outside of Scotland, most notably in London.

There has been some year-on-year fluctuation in this figure but the regional split is relatively unchanged from a decade ago, with more than two thirds of UK-headquartered firms still located in London.

**CHART 3: UK-MANAGED ASSETS BY REGION OF PARENT GROUP HEADQUARTERS**



## A TRULY GLOBAL INDUSTRY

Today UK asset managers manage assets for a wide variety of clients from all over the globe. Members of the IA represent a range of firms with varying levels of global reach, including:

- Asset managers located in the UK but part of a wider group offering a truly global reach. These members are likely to provide a full suite of investment services to clients around the world.
- Asset managers with a domestic focus, where the majority of their assets are managed for clients located in the UK, both institutional and retail.
- Fund management firms, focusing on mutual funds, predominantly aimed at retail investors. These firms often have a strong focus on the domestic market in the UK but may also operate fund ranges which can be marketed to a wider global client base.
- Boutique firms which will often specialise in a particular investment style or strategy, for example those specialising in currency management, emerging market equity, fixed income or specialist multi-asset strategies. Typically these firms will manage £5.5 billion or less in assets on either a segregated or pooled basis. Many will market their investment services to an international client base.

## OVERSEAS CLIENTS

Thirty-eight percent of assets managed in the UK at the end of December 2015 were managed on behalf of overseas clients (almost unchanged from last year). In sterling terms this equates to £2.2 trillion.

**FIGURE 2: OVERSEAS CLIENTS**



As Figure 2 shows, around 14% (£310 billion) of overseas assets were managed for clients based in the US and a third of assets (£660 billion) were managed for clients outside of the US and Europe. The most significant investors in the 'other overseas' category were located in the Middle East but the global reach of the UK asset management sector extends throughout Latin America, Australia, Africa and Asia.

However, Europe (ex UK) represented the largest portion of the overseas-client market at 55% (£1.2 trillion).

## GLOBAL POSITIONING

The UK also continues to dominate the asset management industry within Europe (see Figure 3), with its market share increasing from 35% in 2012 to 37% in 2013 (latest available data). Provisional data for the end of 2014 indicates no significant change in the proportion of assets managed in the UK at the end of 2014.<sup>6</sup>

<sup>6</sup> EFAMA

**FIGURE 3: ASSETS UNDER MANAGEMENT IN EUROPEAN COUNTRIES (DECEMBER 2013)**

Country	Net assets (€bn)	Market share
UK	6,101	37%
France	3,258	20%
Germany	1,613	10%
Italy	881	5%
Netherlands	469	3%
Belgium	229	1%
Austria	85	1%
Other	3,820	23%
<b>TOTAL</b>	<b>16,456</b>	

Source: EFAMA

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:

- The US remains the largest centre of asset management by far, accounting for £24.5 trillion equivalent of the total £48.5 trillion global assets under management.<sup>7</sup>
- At the end of March 2016 assets managed by asset management companies in Japan were estimated to be £2.7 trillion, 475 trillion yen.<sup>8</sup> This is a large increase from 415 trillion yen last year but is an even bigger increase in sterling terms due to the decline in sterling versus the yen during 2015 of just under 4%.

**TABLE 2: GLOBAL ASSETS UNDER MANAGEMENT**

	Assets under Management (local currency)	Assets under Management (£ equivalent)
US	\$36.1 trillion	£24.5 trillion
Europe	€ 19 trillion <sup>9</sup>	£15.2 trillion
Japan	¥475 trillion	£2.7 trillion

This success as a pre-eminent portfolio management centre is less apparent in fund domicile terms, where the UK ranks fifth in Europe, with a domestically-domiciled investment funds industry that is primarily focused on the domestic market (see page 74).

While fund exports during 2015 were estimated at £28 billion,<sup>10</sup> the largest export is portfolio management services, which include significant delegation from EU-domiciled funds, particularly those domiciled in Dublin and Luxembourg. We estimate that around £800 billion is managed from the UK for these two fund centres. Just under one third of this is sterling and euro-denominated money market funds.

<sup>7</sup> BCG Perspectives: Global Asset Management 2016: Doubling Down on Data

<sup>8</sup> Nomura Research Institute. Japan's Asset Management Business 2015/2016

<sup>9</sup> Asset Management in Europe, 8th Annual Review, EFAMA (estimated figure)

<sup>10</sup> Fund exports reflect gross sales of UK authorised funds overseas

## INTERNATIONAL OWNERSHIP

The internationalisation of the UK industry can also be seen in the corporate structures of firms managing assets from this country. Over recent years the UK has increasingly benefited from managing assets for organisations headquartered overseas, especially those in the US. Chart 4 shows:

- UK-owned asset managers now account for 42% of assets managed in the UK, down from 60% ten years ago.
- The proportion of assets managed in the UK for US-owned asset managers has increased to 47% from 28% a decade ago.
- Assets managed on behalf of European-owned firms have fallen. However, the level has remained largely stable since 2010, following the initial disruption caused by the financial crisis which resulted in a number of European bank-owned asset management firms experiencing restructure and/or sale. At the end of 2015, 9% of assets managed in the UK were managed by European-headquartered firms (ex UK).
- Firms from Asia-Pacific and other regions remain unchanged at 1% of assets each.

**CHART 4: ASSETS UNDER MANAGEMENT BY REGION OF PARENT GROUP HEADQUARTERS (2006-2015)**



## ASSET MANAGEMENT IN THE CONTEXT OF BREXIT

On 23 June 2016 the UK voted to leave the European Union, creating uncertainty about the future of the UK outside of the EU.



But what is the UK's departure likely to mean to asset managers based in the UK?

## EU MARKET ACCESS

As a member of the EU the UK is entitled to carry on permitted activities in any European Economic Area (EEA) state by either establishing a presence in that country or by providing cross-border services. There is also significant delegation of portfolio management to UK-based firms.

We outlined in the previous section that there is £1.2 trillion of assets managed from the UK for European clients, with desks in the UK managing money for a variety of funds and institutions. Those same desks will also be providing services to domestic and international clients – eg. European equity portfolios.

This raises a number of key questions for the future:

- To what extent will it remain straightforward to serve European funds and clients from the UK? What, if any elements, will need to relocate within the EU?
- Will there be any disruption to wider client services from the UK, for example if a firm should decide to move a significant portfolio management capability which serves both European and other international clients?

“THE MOST DIRECT IMPACT [OF THE REFERENDUM] IS THAT IT RAISES QUESTIONS ABOUT OUR ABILITY TO WORK FOR CLIENTS IN EUROPE. PEOPLE WILL ASSUME THAT THE CURRENT LEGISLATION AND REGULATORY FRAMEWORK LASTS FOR A WHILE BUT THEY HAVE NO IDEA HOW IT WILL CHANGE - HOW IT WILL GET RENEGOTIATED.”

Whether the UK retains its position as a centre of excellence for asset management could be partly determined by whether overseas clients, particularly those located in mainland Europe, exhibit a preference post Brexit to repatriate their asset management activity within the EU.

There is no knowing what the impact of remaining UK-headquartered will be on winning and retaining business post Brexit but some members that we interviewed this year raised the prospect that it could complicate their activities to be UK-headquartered during the transition period and potentially beyond.

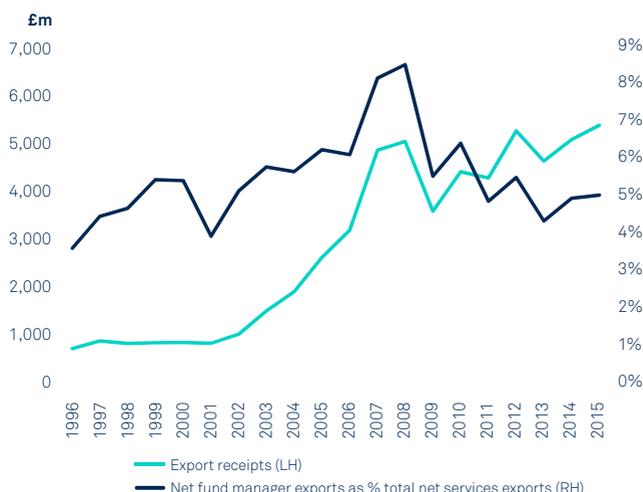
Clearly there may be wider ramifications on jobs associated with changing EU market access in the asset management industry. This is discussed in greater detail on page 23.

## EXPORT ACTIVITY

It has been suggested that the impact on the financial services sector following Brexit is likely to be greater than that on the economy as a whole and that the knock-on effects of this could have ramifications for the UK’s position as a global financial centre.<sup>11</sup> Clearly it will be some time before any judgement can be made.

Asset managers make a significant contribution to the UK’s service exports and have represented an average of 6% of total net exports over the past ten years. As Chart 5 indicates, there has been significant volatility in this figure in recent years, albeit the last two years have shown signs of stability in asset management exports.

CHART 5: EXPORT EARNINGS OF FUND MANAGERS AND CONTRIBUTION TO SERVICES EXPORTS (1996-2015)



Source: ONS



<sup>11</sup> Leaving the EU: Implications for the UK financial services sector, PWC, April 2016

Some of those we interviewed this year felt that more needed to be done to promote the asset management industry to attract clients from abroad. At the end of 2015, £2.2 trillion of assets managed in the UK were managed on behalf of overseas clients, almost unchanged from the figure in 2014. With Brexit looming, there is likely to be additional impetus to ensure that the global attractiveness of UK industry, both manufacturing and services, is to the fore. Given the comparative specialisation that UK financial services offers, including UK asset management, many firms are keen to ensure that the industry and Government continue to work together through the Investment Management Strategy.

### UK Government Investment Management Strategy

The Government is working closely with the industry to anticipate new trends and emerging challenges, so that it can simplify and develop regulatory and tax rules to support investment managers.

Specifically, the government has committed to:

- simplify and streamline taxes in the sector.
- create a more responsive regulatory environment.
- improve our marketing here and overseas to promote the UK as an international investment management centre.

“THERE’S A VERY, VERY STRONG MESSAGE FROM GOVERNMENT TO SAY LET’S EXPORT THE UK ASSET MANAGEMENT INDUSTRY MORE FULLY AND WE SHOULD FIND WAYS TO ACTIVELY DO THAT – TRADE DELEGATIONS TO CHINA, AMERICA, ETC..”

### REGULATORY ENVIRONMENT

A key determinant both of access for UK firms and future client preferences will be the extent to which a regulatory environment is created in which asset management firms operating from the UK are in the best possible position to deliver successfully for their clients, whether retail or institutional.

“WE DON’T REMOVE OURSELVES FROM BEING UNDER THE EUROPEAN REGULATOR UNLESS WE STOP SERVICING THE MARKET SO WE’RE BEHOLDEN TO BOTH THE UK AND EU REGULATORY AGENDAS.”

UK firms and regulators will henceforth be part of a third country, should the UK formally exit the EU and sit outside the EEA as well, which will almost inevitably result in a much diminished formal and informal voice. The danger here is clearly one of becoming a ‘regulation taker’ rather than a ‘regulation maker’. Equally, there may be consequences for the regulatory direction of travel in the EU itself, which has historically been heavily influenced by the FCA and its predecessors. Furthermore, at operational level, there may be major - and costly- changes to implement.

“REGARDLESS OF WHETHER IT MAKES A FUNDAMENTAL DIFFERENCE OR NOT, IT’S STILL GOING TO BE HUGEY EXPENSIVE AND THE LAST THING WE NEED IS ANOTHER ROUND OF REGULATORY CHANGE...”



The long-term direction of domestic regulation is also now more uncertain. While it may be expected that there will need to be ongoing convergence to allow UK firms to access the single market, this will depend on the outcome of the negotiations. Historic experience has shown that UK regulators have often taken different positions in key areas; for example, the Retail Distribution Review happened to a different timetable and is much more wide reaching than changes to inducement rules being implemented through MiFID II.

However, particularly post-2008, the increasing emergence of a global regulatory framework at G20 level is likely to ensure that UK and European regulation remains within a coordinated agenda.

## THE ROLE OF ASSET MANAGERS IN THE DOMESTIC ECONOMY

The asset management sector also has a more direct role in contributing to the UK’s economic prosperity. It achieves this as a major allocator of capital, funding corporate, government and other forms of investment activity.<sup>12</sup>

### PRODUCTIVITY ACTION PLAN

In March 2016 the IA launched a Productivity Action Plan which considered the existing barriers to long-term investment and how the industry can play a vital role in helping businesses to drive sustainable returns. The five principal objectives of the action plan are:

- **Enhance company reporting for efficient capital allocation** – through investment and analytical expertise the industry will identify and finance those companies contributing productive growth in the economy.
- **Enhance investor stewardship and engagement** – the investment industry will engage with companies to help them achieve sustainable value creation over the long term and support investments in improved productivity.
- **Simplify behavioural incentives and the investment chain** – the industry will work to ensure that the agreed incentives and governance of the investment chain ensure a clear alignment with clients’ long term investment objectives.
- **Develop efficient and diverse capital markets** – as key capital market participants, the investment industry has a key role in the development of asset classes and the efficient functioning of capital markets.
- **Overcome tax and regulatory impediments to the provision of long term finance** – the investment industry should contribute to the debate on tax and regulatory impediments to investment so as to ensure the right long-term outcomes for clients.

When we discussed the ways in which asset managers can contribute to UK productivity more widely with members, they identified two main areas:

- The efficient allocation of capital by active management to companies as they develop.

<sup>12</sup> The contribution of asset management to the UK economy, Oxera, 2016

- The role of asset managers in stewardship and engagement, with the potential to develop that dialogue further, thereby encouraging individual companies to invest in research and development activity to improve productivity in the future.

“AS A STRONGLY ACTIVE MANAGER, WE ARE VERY EFFECTIVE AT ALLOCATING CAPITAL. FIRSTLY, WE ADD ALPHA FOR OUR CLIENTS BECAUSE WE PUT CAPITAL IN PLACES WHERE IT’S MORE PRODUCTIVE THAN IT WOULD OTHERWISE BE. THE SECOND THING IS ABOUT SUPPORTING NEW DEVELOPMENTS – NEW CORPORATE ENTITIES. BY DOING OUR JOBS AS ACTIVE MANAGERS WELL OVER THE LONG TERM, THAT ABSOLUTELY DOES CONTRIBUTE TO UK PRODUCTIVITY AND GROWTH.

WE ALSO HAVE A GOOD REPUTATION OF BEING AN ACTIVE SHAREHOLDER. WE HAVE PRETTY BIG POSITIONS IN BIG FUNDS AND IF WE’RE SEEING THINGS GOING IN THE WRONG DIRECTION, WE WILL BE VOCAL. WE’LL USE OUR PRESENCE IN A VERY BIG WAY TO MAKE SURE THAT SHAREHOLDERS’ INTERESTS ARE BEING LOOKED AFTER.”

“YOU WANT CAPITAL BEING DEPLOYED AS EFFICIENTLY AS POSSIBLE. THE BEST INVESTMENTS GET THE MONEY, THE BEST EQUITIES GET THE MONEY. THE FASTEST GROWING INDUSTRIES GET THE RESOURCES THEY NEED TO GROW. THAT’S GOING TO LEAD TO A FASTER GROWING ECONOMY.”

One further element identified in interviews was the critical role played by asset managers, not just in supporting economic growth through the allocation of capital, but in providing returns to savers. Such returns can then enhance purchasing power over time, thus creating confidence and a virtuous cycle to support growth.

“IF IN THE NEXT TEN YEARS OUR INDUSTRY HELPS TO PROVIDE PEOPLE WITH AN INCOME THAT THEY WOULDN’T OTHERWISE HAVE HAD, OR GIVES THEM OPTIONS TO ADJUST THEIR INCOME VERSUS SPENDING, THEN THAT SHOULD HAVE A POSITIVE IMPACT [ON THE ECONOMY].”

However, a number of firms were cautious about what they could achieve as asset managers and cautious about calibrating expectations accordingly. In their view, productivity was a particular responsibility at firm and organisational level. While asset managers had broad responsibilities as stewards of capital, ultimately firms and Government (in areas such as education and training) would likely make a more significant direct contribution.

## THE ROLE OF ASSET MANAGERS IN MARKET-BASED FINANCING IN THE UK

Following the financial crisis there was a major reduction in bank lending in the UK. This position has improved in recent years but there has been a change in the nature of the market as a result of the bank activity decreasing after 2008, and some borrowers have increasingly looked to capital markets as an alternative source of financing.

We spoke to members this year about the role that asset managers could play, if any, in the realm of market-based financing and, if they had a role to play, how investments could be structured to facilitate investment. Views on this were mixed.

A number of members we spoke to were already established participants in infrastructure investing. A range of strategies may be used to offer access to infrastructure investment in an appropriate way depending on the specific client needs; including:

- Infrastructure debt, whereby money is lent to finance an infrastructure deal without any direct ownership occurring.
- Closed-end funds, similar to private equity vehicles, which take an equity stake in the underlying project and have a finite subscription period and typically have lives of ten years or more.
- Open-end funds, which take an equity stake in the underlying project, but these are seldom offered due the liquidity requirements associated with open-end funds.<sup>13</sup>

Several members that had an insurance company as their parent organisation told us that co-investing alongside institutional clients had proved an extremely popular approach.

“MANY OF THE INVESTMENT CAPABILITIES IN THE DIRECT LENDING AREA GREW OUT OF INVESTING FOR OUR INSURANCE PARENT COMPANY. THAT WAS WHERE IT STARTED BUT AS TIME HAS PASSED THE FLOWS ARE MORE OFTEN THIRD PARTY INTEREST. IT IS A POWERFUL MESSAGE TO BE ABLE TO SAY COME AND INVEST IN A STRATEGY ALONG WITH OUR PARENT ORGANISATION, AS YOU’RE COMING ACROSS AS AN INVESTOR TALKING TO ANOTHER INVESTOR RATHER THAN BEING AN ASSET GATHERER.”



Clients were keen to invest alongside a major institutional balance sheet as it tended to give them additional confidence in the robustness of the risk assessment process. It was also attractive to both customers and those looking for finance as they had the assurance that capital existed to back the project if necessary. Consequently, an asset manager with the backing of a parent balance sheet was thought to be more likely to be approached regarding financing opportunities than an independent asset manager looking to operate in this space.

<sup>13</sup> Infrastructure: Worth a closer look? SEI, 2014

“YOU HAVE TO DEMONSTRATE YOU HAVE SECURED FUNDING AND, IF YOU HAVE A SHARED INTEREST THROUGH SOME SORT OF INVESTMENT VEHICLE, YOU NEED TO HOLD THAT TOGETHER. I DON'T THINK IT'S AN IMPOSSIBLE HURDLE WITHOUT HAVING THE BALANCE SHEET [TO CO-INVEST], BUT THE CLEARER AND SIMPLER YOUR MESSAGE ABOUT AVAILABILITY OF CASH, AND CLARITY OF PURPOSE, THE BETTER IT IS – THAT'S HOW I WOULD PUT IT.”

However, the lack of backing from a parent company balance sheet was not seen as an insurmountable barrier to entry for independent asset managers, and indeed some of the independent managers we spoke to are well-established players in this area.

There is also increasing competition appearing in the form of the banks that had previously withdrawn from lending following the crisis, but are now slowly returning to the market. Asset managers are consequently having to compete with banks, which have greater experience and are able to syndicate deals with a proven track record.

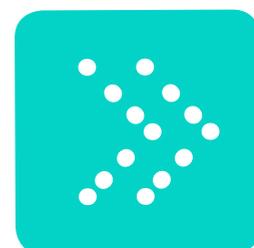
The OECD has identified a number of barriers to infrastructure investing, primarily:

- The opportunity set, including regulatory instability, market fragmentation, lack of clarity and the perceived risk of projects among pension schemes.
- Difficulties facing investors in the form of investor capability, including lack of investment expertise, the misalignment of interests between infrastructure funds and investors and regulatory barriers.
- Issues pertaining to the conditions for infrastructure investing such as the lack of transparency and the shortage of data on performance of infrastructure projects.<sup>14</sup>

“SO IF I THINK OF THE HOLISTIC FRAMEWORK FOR THE BETTER MARKET-BASED FINANCE OF INFRASTRUCTURE, WHICH IS A GLOBAL THEME, I THINK THERE NEEDS TO BE BETTER TRANSPARENCY, DEEP SOURCES OF PROJECT DATA, BETTER TIMELINES – ALL THE SORT OF THING THAT WE ARE USED TO IN UCITS.”

One specific barrier often cited is the lack of supply of available deals in the market. This was not seen as a particular problem by the members we interviewed, although finding a deal with the precise characteristics to make it suitable for private capital to commit to was considered a challenge. Institutional clients are often looking for a mix of low volatility and uncorrelated return, but also better liquidity than is often associated with infrastructure investment. This alignment of interest and expectation was therefore seen as the biggest challenge to participating in this space.

Another, perhaps more often overlooked, barrier that was raised during this year's interviews was the additional personnel that were required to arrange financing deals. Those asset managers that were well-established in this market told us they had boosted personnel in a number of areas including vehicle structuring and tax. Investment had also been required in IT as systems often needed to be adapted to cope with the different characteristics of new asset classes.



<sup>14</sup> Pension fund investment in infrastructure, a survey, OECD, 2011

Those interviewed felt that it would be difficult to build teams with this expertise from zero and this was likely to be another deterrent to new entrants in this area.

“I SUSPECT WE HAD AN EARLY MOVER ADVANTAGE OF GETTING THE RIGHT TEAMS IN AND THE EXPERTISE. NOW IT WOULD BE QUITE DIFFICULT TO BUILD THOSE TEAMS AND, AT THE SAME TIME, IN SOME OF THOSE AREAS THE YIELDS ARE NOT QUITE WHAT THEY WERE A YEAR OR TWO AGO.”

Some of those interviewed, who felt they did not have the expertise to facilitate infrastructure investment, nevertheless mentioned that they were active in the area of residential property. They believed this brought together more traditional asset management expertise with the need for residential housing in the UK and was consistent with the type of investment activity that had been taking place globally, most notably in the US, for some time.

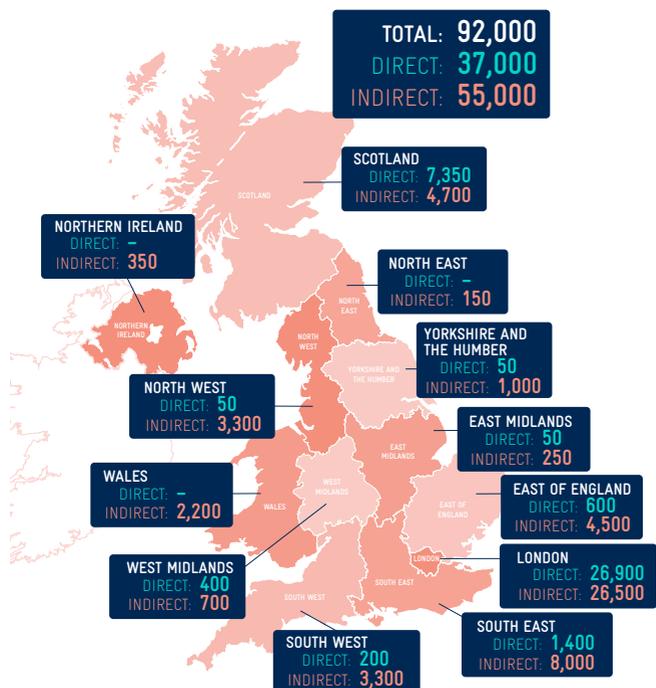
A number of members felt very strongly that asset managers had no new role to play in this area but that the industry had historically always helped to finance projects via the purchase of government debt. Others were concerned that increased asset manager involvement in market-based financing could lead to a proliferation of bank-like regulations and thus even further scrutiny on the asset management industry, which could place burdens on all asset managers, not only those engaged in financing activity.

## STAFF WORKING IN AND FOR THE ASSET MANAGEMENT INDUSTRY

The IA estimates that the number of people directly employed in the asset management industry in the UK increased by 5% in 2015 from 35,100 to 37,000 showing the industry continued to grow, albeit at a slower rate (see page 78). However, we believe that more than ninety thousand people are employed in activities related either directly or indirectly to asset management including fund and wider administration and securities and commodities dealing activities.

Due to the difficulty in obtaining staffing data by job type, especially for organisations that have a wide financial service remit, it is clear that the figures for indirect employment in Figure 4 are should be treated as a conservative estimate of the actual numbers employed in asset-management related activity. These figures also exclude personnel working for legal firms or investment consultants in roles linked to asset management.

**FIGURE 4: DIRECT AND INDIRECT EMPLOYMENT ACROSS 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.



Although London and Scotland remain the key centres for the UK asset management industry, Figure 4 shows that the asset management industry supports a significant number of jobs in all regions of the United Kingdom.

Respondents this year told us they had offices in many locations outside of London and Scotland, including Bristol, Norwich, Peterborough, Leeds, York, Bournemouth, Cardiff, Oxford and Chester.

At this stage it is impossible to ascertain the exact impact of a UK exit from the EU on staffing numbers in, or related to, asset management. However, firms interviewed this year noted that the long-term impact of Brexit would need to be judged in terms of future location of new capacity in Europe as much as potential relocation of existing personnel.

“AS YOU WANDER AROUND OUR BUILDING, A LOT OF OUR STAR EMPLOYEES COME FROM ACROSS EUROPE. WHETHER THEY WANT TO STAY OR WOULD BE ABLE TO STAY IS AN ELEMENT, NOT JUST FOR OUR BUSINESS BUT FOR OUR OUTSOURCED SUPPLIERS.”



# 2 KEY CHARACTERISTICS OF UK ASSET MANAGEMENT

## KEY FINDINGS

### CLIENT TYPE

- Institutional clients continue to account for the majority (80%) of total assets under management in the UK.
- The largest client group remains (UK and overseas) pension funds, accounting for 40% of total assets.
- 18% of assets were managed on behalf of insurance at the end of 2015, both in-house and third party.
- The blurring between retail and institutional investors, exacerbated by growth in the DC market, continued into 2015.

### ASSET ALLOCATION

- Equity allocations fell by one percentage point year on year to 39%. Allocations to UK equity rose to 33% of total equity, cementing indications from last year that the decline in UK equity holdings had finally halted.
- The allocation to fixed income also fell by one percentage point to 33% as clients increasingly look outside traditional fixed income for reliable sources of income.
- Allocation to other assets increased to 19%, more than half of that being in solutions-oriented products rather than true alternatives.
- Property and cash holdings remained stable at 3% and 6% respectively.

### INVESTMENT APPROACHES

- Interest in 'liquid alternative' investments continued to increase as investors look to manage volatility. For the first time in 2015 growing interest was reported among retail investors.
- While ESG strategies remain a small part of the overall market, there are signs of an increase in demand in this area, particularly from younger savers.

### ACTIVE AND PASSIVE

- Active mandates still represent the overwhelming majority of assets. Almost three quarters of assets were actively managed at the end of 2015 (74%). Three percent of assets were managed using strategies classified as neither active nor passive.

## 2 KEY CHARACTERISTICS OF UK ASSET MANAGEMENT

The UK asset management industry serves a wide variety of institutional and retail clients from all over the world. This Survey focuses on the activities of members of the IA, encompassing MiFID-regulated asset management firms and UCITS-regulated fund management firms.

### FIGURE 5: WHO ARE THE IA'S MEMBERS?

The membership can be broken down into five broad groups.

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

The term 'UK assets under management'<sup>15</sup> covers all forms of asset management activity, broadly split into pooled vehicles (run on behalf of multiple clients who pool their investment exposure in a fund), and segregated mandates (bespoke portfolios managed on behalf of an individual client by an investment manager, governed by a specific agreement).

Pooled vehicles include:

- 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

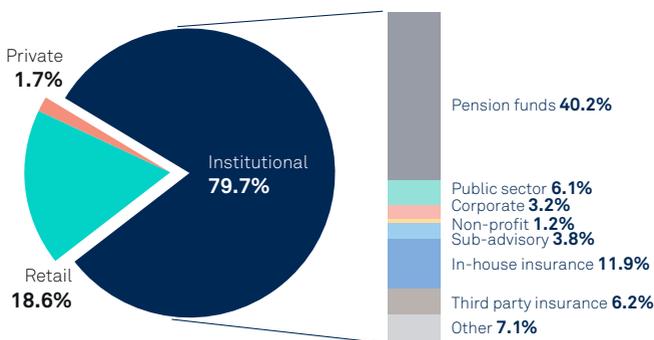
The term 'UK authorised funds', in contrast, applies specifically to UK-domiciled authorised investment funds, which include (authorised) Unit Trusts and OEICs. These investments are collectively referred to as the 'funds industry' and are analysed in detail in Chapter 4.

<sup>15</sup> Defined as assets where the day-to-day management is undertaken by managers within the firm and based in the UK. For a more detailed definition please refer to Appendix 5.

## CLIENT TYPE

Chart 6 shows the split of the £5.7 trillion managed from the UK by client type. This chart reflects assets managed in the UK for both institutional and retail clients and will include assets from clients based overseas as well as those in the UK.

**CHART 6: ASSETS MANAGED IN THE UK BY CLIENT TYPE**



The vast majority of assets managed in the UK are managed for institutional clients (80%). In line with data from previous years the ratio of institutional assets to assets invested directly by retail clients was almost unchanged at 4:1.

The pension fund category, which includes both defined benefit (DB) schemes and defined contribution (DC) schemes, continued to be the largest institutional client type (40%).

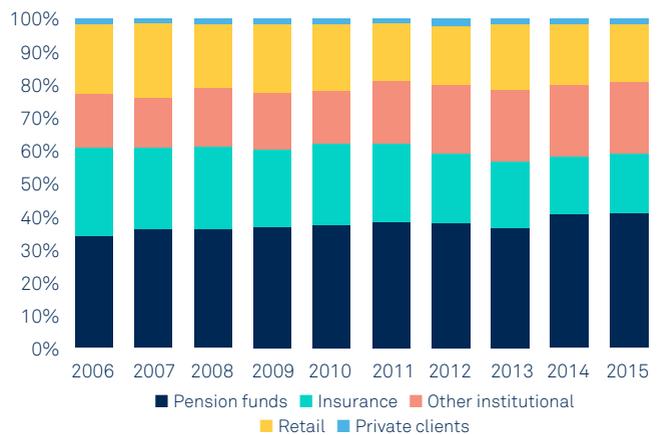
DC pension assets that are operated via life companies wrapping funds are not included in this figure but are reflected in assets managed on behalf of insurance companies. This will include assets managed for personal pension and GPPs. Therefore, the blurring of the designation between pension and insurance assets, and indeed retail and institutional assets more broadly, that has been a theme of recent surveys, continues to be significant in 2015.

Further details on the DC pension market, including an estimate of its size, and its growing importance to retirement saving in the UK are included in Chapter 3.

Insurance assets represented 18% of the client base at the end of 2015, halting the continuing decline in market share that has been a feature of at least the last decade. However, it is too soon to see whether this is indicative of any stabilisation in market share or is just a year-on-year fluctuation.

Chart 7 shows the change in the institutional client base over the last decade, and the sustained decline in insurance assets relative to pension funds and other institutional clients, more clearly. However, it is important to remember that this chart is based on market proportion rather than absolute assets. Due to the strength of growth exhibited by the asset management sector in the last decade, the absolute value of insurance assets has still increased over the period. They have, nevertheless, reduced in proportion due to the relatively stronger growth seen in pension assets.

**CHART 7: ASSETS MANAGED IN THE UK BY CLIENT TYPE (2006-2015)**



While there is some annual variation the proportion in this chart representing ‘other’ client types has been largely consistent in recent years. 7% of assets were managed for ‘other’ client types compared to 8% in 2014. This category is primarily populated by different types of pooled vehicles where it is not possible for respondents to identify the underlying client type.

The private client figures included in this chart only relates to the portion of the private client market where members of the IA provide dedicated private client investment services. As can be seen from Figure 1 the actual private client market is significantly larger than this. IA members are estimated to manage around one quarter of the private client market.

Investments by retail investors continue to account for around one fifth of assets at a headline level but as we have reported in recent years this does not tell the entire story. The blurring between retail and institutional continues, with the number of people investing via DC pension schemes increasing dramatically as a result of automatic enrolment (see page 38). Many of these investors may well be first time investors with little experience of the asset management industry.

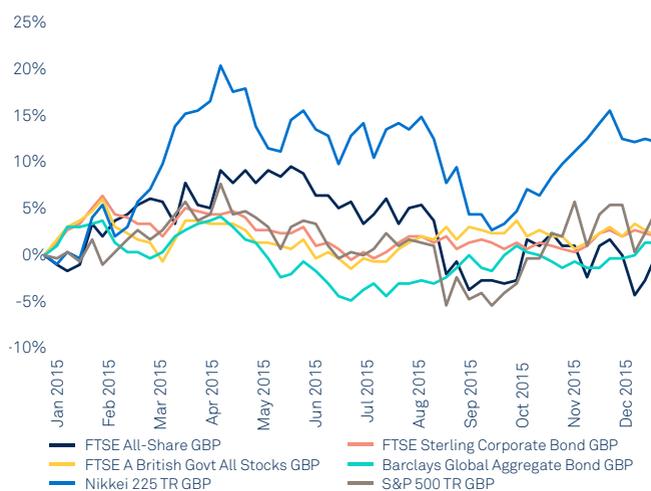
Many DC pension members, in particular those in contract-based arrangements will be included in Chart 7 under the insurance client category as their pensions are administered or distributed by insurance companies. However, the investment risk from these assets is being carried by the individual investor, rather than an employer or other institution, and could reasonably be considered to be ‘retail’ investment.

## ASSET ALLOCATION

Chart 8 shows the returns of a selection of major asset classes in sterling terms. Equity markets generally posted positive returns during 2015, with Japanese equities being the strongest performer.

Fixed income returns were generally flat or slightly negative as low yields continued to limit the potential for positive performance.

**CHART 8: CUMULATIVE PERFORMANCE OF SELECTED EQUITY AND BOND INDICES (2015)<sup>16</sup>**



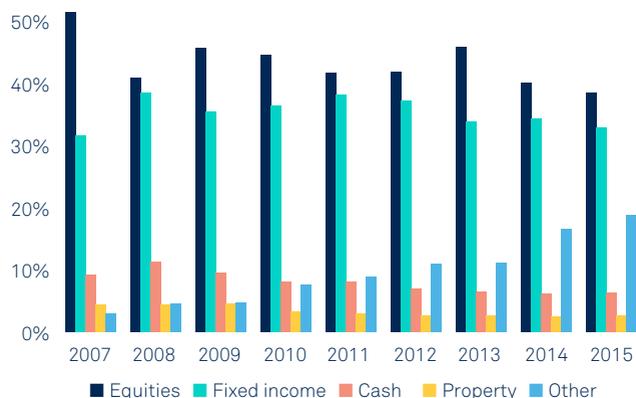
Source: Morningstar

<sup>16</sup> In local currency terms based on weekly data from Morningstar, 29 December 2014 until 26 December 2015.

The change in asset allocation since 2007 can be seen in Chart 9.

- Equity holdings continued to fall from a revised 40% in 2014 to 39% in 2015. This is a lower allocation than would be expected based on market movements, implying there was a continuing shift out of equities, predominantly in favour of alternative assets.<sup>17</sup>
- Fixed income fell slightly from a revised 34% in 2014 to 33% in 2015. This suggests there was a marginal shift of allocation out of fixed income, again, most likely in favour of ‘other’ assets.
- Property allocations were almost unchanged at 3%. Cash allocations also remained unchanged from the end of 2014, at 6%.
- The allocation to other assets increased from a revised 17% in 2014 to 19% at the end of 2015. We estimate a significant proportion of this category, well in excess of 50%, is now represented by solutions-based investments rather than more traditional alternative assets.

**CHART 9: OVERALL ASSET ALLOCATION OF UK-MANAGED ASSETS (2007-2015)**



## ALTERNATIVE INVESTMENTS

In general, the IA's membership comprises firms that invest primarily in mainstream asset classes of equity, fixed income and cash (Table 3). Nevertheless, approaching half invest in alternative asset classes and/or offer products that use derivatives.

**TABLE 3: PROPORTION OF IA MEMBERS INVESTING BY ASSET CLASS**

	Percentage of firms
Equities	96%
Fixed income	88%
Cash	70%
Property	46%
Other	45%

The move into ‘Other’ assets continued in 2015, with the allocation increasing by two percentage points from a revised 17% in 2014 to 19% in 2015. Due to the broad range of investments categorised as ‘Other’ it is difficult to judge how much of this shift comes from market movements and how much from flows. This category includes commodities, private equity and infrastructure, as well as solution-focused investments that use derivative instruments.

However, this increase in allocation is consistent with the trend we have observed in recent years for investors broadening their investment horizons in their search for return and volatility control.

<sup>17</sup> In calculating implied asset allocation the IA assumes all assets are held on an unhedged basis. These figures should therefore be seen as indicative only.



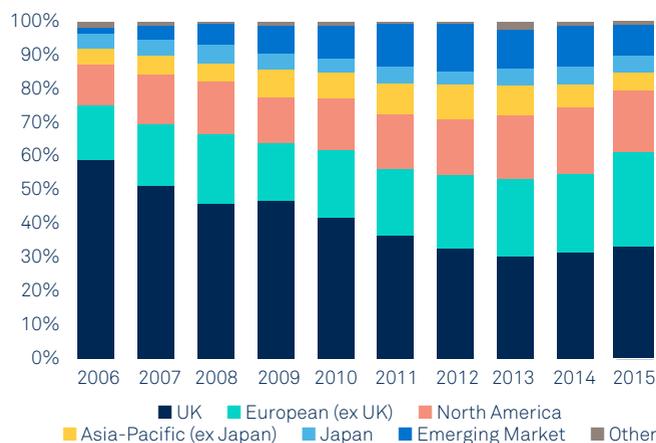
## GEOGRAPHIC EQUITY SPLIT

At a more granular level, the IA monitors the geographical breakdown of members' equity and fixed income allocations.

Chart 10 shows the change on a regional basis of equity allocations over the past ten years. Notably, there has been a slight increase in the allocation to UK equities over the past two years, to 33% of total equity holdings at the end of 2015. This increase gives further credence to suggestions from last year's data that the falling UK equity allocation had reached a floor of 31% in 2013.

- The Europe ex-UK allocation increased from 23% to 28%, seemingly at the expense of emerging markets and Pacific ex-Japan.
- The allocation to North American equities fell from 20% to 18%.
- There was a further drop in allocation to Pacific ex-Japan from 7% in 2014 to 5% in 2015.
- The allocation to Japan was largely unchanged at 5%, but emerging market allocations fell from 12% to 9%.

**CHART 10: UK-MANAGED EQUITIES BY REGION (2006-2015)**



## FIXED INCOME

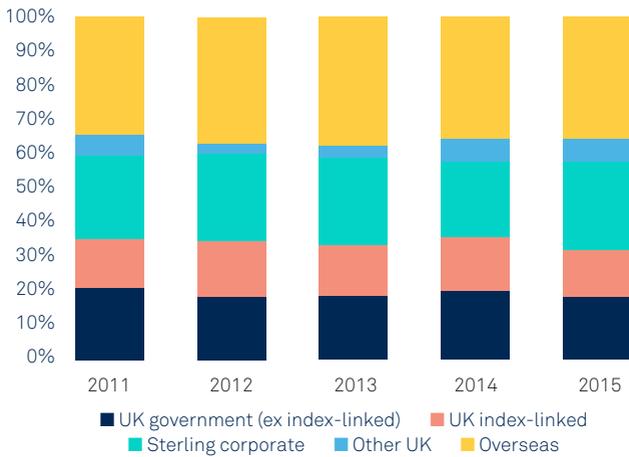
Demand for income was still strong in 2015. However, it is becoming increasingly clear that clients are looking outside of traditional fixed income securities towards other asset classes that can provide them with a reliable source of income.

Nonetheless, there is still a role for traditional fixed income among pension schemes looking to reduce risk and match their long term liabilities and from insurance companies, who remain heavily reliant on government and sterling corporate debt to fund their annuity pools.

Chart 11 shows the allocation to traditional fixed income in 2015 shifted out of government bonds towards corporates:

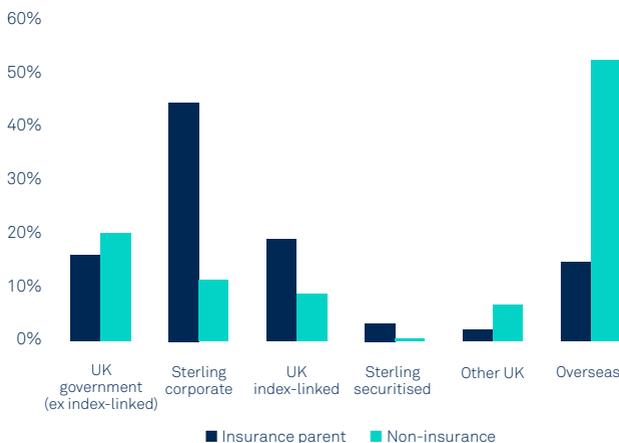
- The allocation to UK government debt fell by four percentage points in 2015 to 32%. Within government bonds, the allocation to both conventional gilts and index-linked bond allocations fell by two percentage points to 18% and 13% respectively.
- The allocation to UK corporate bonds increased to 26%, bringing it back to levels seen two years ago, after a fall to 22% last year.
- The allocation to 'other UK' securities remained relatively stable at 6%. We do not collect specific detail on the assets held within this category but it is likely to include both asset-backed and mortgage-backed securities.
- The overseas bond allocation remained unchanged at 36%.

**CHART 11: ALLOCATION OF UK-MANAGED FIXED INCOME BY TYPE AND REGION (2011-2015)**



Fixed income allocations differ depending on the category of the underlying client. Insurance companies, for example, have requirements unlike other types of institutional investor. If we look at how the allocation alters depending on whether the asset manager has an insurance parent or not (Chart 12), 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 12: FIXED INCOME OWNERSHIP BY PARENT GROUP (INSURANCE VS. NON-INSURANCE)**



The respondent sample to the IA's survey data tends to over-represent insurance-owned asset managers. Therefore we have adjusted the allocation to be more representative of the market as a whole. This shows, not surprisingly, that the allocation to sterling corporate and index-linked holdings drops slightly and the allocation to overseas bonds increases.

**TABLE 4: HEADLINE VS. SAMPLE-ADJUSTED FIXED INCOME OWNERSHIP**

	Headline	Sample-adjusted
UK government (excl. Index-linked)	18.3%	18.8%
UK index-linked	13.4%	12.3%
Sterling corporate	26.3%	22.6%
£ Securitised	1.8%	1.4%
Other UK	4.6%	5.2%
Overseas Bond	35.5%	39.7%

## LIQUID ALTERNATIVES

In the persisting low yield environment investors are inevitably being attracted to structures that have a different risk profile than they might have been in the past.

Another way members told us this year that investors are looking to reduce their volatility is increasingly to invest in liquid alternatives. Liquid alternatives are typically mutual funds or ETFs which seek to replicate some of the strategies implemented by hedge funds, but are subject to stricter regulations applying to UCITS funds in Europe covering liquidity, diversification, and leverage.

### Liquid Alternatives

Liquid alternatives typically exhibit modest to low correlation with traditional stock and bond investments. Indeed, many of the strategies employed in liquid alternative funds seek to generate positive returns by employing market neutral investment strategies either on a multi-asset basis or single market basis e.g. long/short equity, long/short multi-asset. However, liquid alternative strategies can also be employed to meet a wider range of investment requirements such as increased diversification by employing strategies based on alternative assets or currency, as well as inflation protection or income stabilisation.

This increase in liquid alternative strategies coincides with a shift away from investment in hedge funds. More hedge funds closed in 2015 than in any year since the 2008 crisis as subdued performance combined with volatile markets led to redemptions from poorer performing funds. Globally the value of assets in hedge funds fell below the \$3 trillion mark in January 2016 for the first time since 2014. Hedge funds returned an average of 1.99% globally, their smallest gain since at least 1998.<sup>18</sup>

Liquid alternatives have traditionally been the domain of institutional investors. However, a number of members this year reported growing interest in liquid alternatives among retail investors. This raises the question of suitability. The term “liquid” refers to the vehicle but not the underlying investment (which may or may not be liquid) so firms we spoke to thought it likely that liquid alternatives would only be offered via the channel of regulated advice.

“I SHOULD ADD THAT THERE IS GROWING DEMAND FOR ‘CHANGE MY BETA PROFILE’ WHERE YOU’RE NOT NECESSARILY THERE TO GENERATE A RETURN THAT’S SUBSTANTIALLY DIFFERENT TO THE INDEX BUT YOU’RE THERE TO REDUCE VOLATILITY AND THERE IS INCREASING DEMAND FOR THAT IN RETAIL.”

## ESG

Last year we reported the potential for a younger generation of DC savers wanting their pension savings to take more account of the ESG requirements in their default funds. A similar sentiment was repeated during our interviews this year, with members perceiving an increase in awareness of the issue, more generally among younger age cohorts. Where previously DC trustees might have included one ESG option in a list of funds for scheme members to choose from, there was a sense they are becoming open to more options, and that the process of inclusion was becoming less of a ‘tick-box’ exercise. However, because of the level of intermediation in the market, the growth of ESG in DC investment was expected to be highly dependent on the degree to which it is championed by investment consultants as well as driven by the attitudes of individual investors.

“I THINK THE MARKET IS DEFINITELY CHANGING THERE. THE CYNICS WOULD SAY IT’S 3% OF THE MARKET AND IT’S BEEN THERE FOREVER, BUT I DETECT A BROADENING OF THE MOOD. A YOUNGER GENERATION DC SET OF SAVERS, DEFINITELY WANT TO ENGAGE IN THAT MORE. NOT NECESSARILY DOING GOOD BUT AWARENESS.”

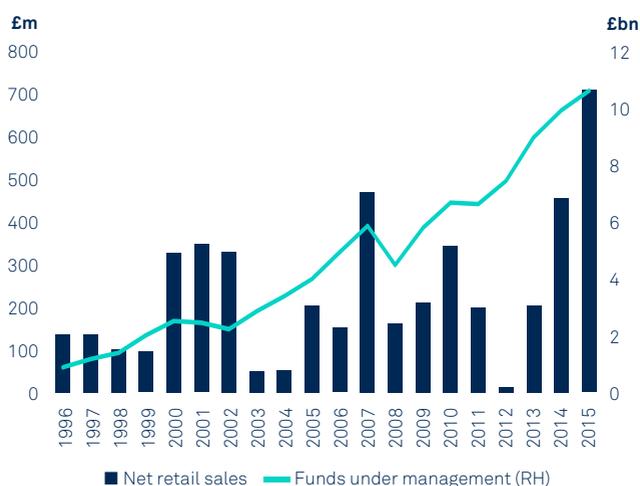
<sup>18</sup> Hedge Fund Intelligence

A number of members have raised the concern that the ESG landscape still suffers from a lack of clear definition and asset managers find it difficult to compare themselves to a relevant peer group because of the wide variation in ESG criteria.

“THE OTHER THING WE’VE SEEN DEMAND FOR IS ESG REQUIREMENTS ... THE PROBLEM IS THERE IS STILL NO UNIFORM VIEW OF ESG SO IT’S HARD TO RESPOND WITH AN APPROPRIATE PRODUCT...”

Some members observed that flows into ESG funds had tended to be more robust in times when flows into other funds fall. This seems to be borne out by the IA’s fund data. Chart 13 shows that net retail sales of ethical funds were £715 million in 2015, the highest on record in a year when overall net retail sales fell to £18 billion.

**CHART 13: ESG FUNDS UNDER MANAGEMENT VS. NET RETAIL SALES (1996-2015)**



On the institutional side the focus on ESG continues to be from Northern European clients, particularly pension funds. We asked members to report on how the level of UK institutional assets managed for clients that have imposed environmental, social and governance (ESG) requirements had changed since the end of 2014 (see page 46). One third of respondents reported that the level of business managed for clients that had imposed environmental, social and governance (ESG) requirements had increased in the last year.

When implementing ESG requirements, the emphasis now seems to be more about broader corporate behaviour than specific negative screening, with investors scoring ESG against fundamental values.

**ACTIVE AND PASSIVE**

Chart 14 illustrates the evolution of active and passive management over the past ten years. The proportion of assets being managed using passive strategies has continued to increase year on year since 2006.



**CHART 14: ACTIVE AND PASSIVE AS PROPORTION OF TOTAL UK ASSETS UNDER MANAGEMENT (2006-2015)**



The active vs passive debate has continued against a backdrop of ongoing scrutiny of industry fees. In the active space members reported increasing 'smart beta', index funds and ETFs among all client segments. However, the quantitative data we collected this year did not show any significant increase on the previous year. Only 3% of assets were reported as being managed in smart beta type strategies, so it remains to be seen whether this is a real shift, or if the main growth will be in pure passive strategies.

Chart 14 assumes that smart beta strategies have been included under 'passive' in the years prior to 2014 as we cannot be sure of the historical breakdown. Therefore some caution must be applied when comparing the results pre and post 2015.

“THE PURE BETA SPACE IS OBVIOUSLY BEING PRICED DOWN TO NOTHING SO EVERYONE'S MOVING INTO SMART BETA SPACE. I THINK WHAT YOU'RE SEEING IS PEOPLE MOVING THEIR QUANT CAPABILITIES INTO FACTOR INVESTING.”



Although no significant increase is evident in the IA's data from 2015, as mentioned above many assets are in smart beta ETFs, which are largely not included in the IA's data. We asked members this year whether they were managing ETF funds from the UK and 11% reported they were. This is little changed from the time the question was previously asked in 2012, so there is no evidence of a dramatic take-off in ETF management among IA members as yet. However, this is clearly an area in which asset managers are suggesting their presence is likely to increase.

Overall ETF/ETP products with a primary listing in the UK increased to £150 billion equivalent, up around 25% from 2014.<sup>19</sup>

<sup>19</sup> ETFGI

# 3 UK INSTITUTIONAL CLIENT MARKET

## KEY FINDINGS

### MARKET OVERVIEW

- IA members managed £3.3 trillion for institutional clients, up from a revised £3.1 trillion in 2014.
- Pension funds accounted for substantially more than half of all institutional assets, £1.9 trillion (57%)
- Insurance assets represented 29% of institutional mandates, equivalent to £960 billion.

### THIRD PARTY MARKET

- An estimated £2.5 trillion was managed for third party mandates, up from a revised £2.3 trillion in 2014. This excludes in-house insurance assets.
- Pension funds account for more than two thirds of third party assets (£1.7 trillion)

### PENSIONS

- Use of LDI strategies by DB pension schemes continues to increase. LDI mandates increased by £80 billion since the end of 2014 to £741 billion.
- Pension funds ownership of UK equities appears to have bottomed out at 11% in 2014, increasing to 12% by the end of 2015.

### THIRD PARTY MANDATE TYPES

- The use of multi-asset mandates continued to rise among institutional clients (23%) reflecting a clear shift away from specialist, single-asset mandates.
- The proportion of specialist mandates allocated to equity mandates remained unchanged year-on-year at 43%.
- The allocation to specialist UK equity mandates fell from 25% in 2014 to 24% at the end of 2015, but overall institutional holdings in UK equities may be bottoming out.
- Sterling corporate mandates remained the largest category of specialist fixed income mandates, making up 28% of specialist fixed income.
- Just over two thirds of mandates were managed on an active basis (68%).
- 66% of mandates were segregated at the end of 2015.

# 3 UK INSTITUTIONAL CLIENT MARKET

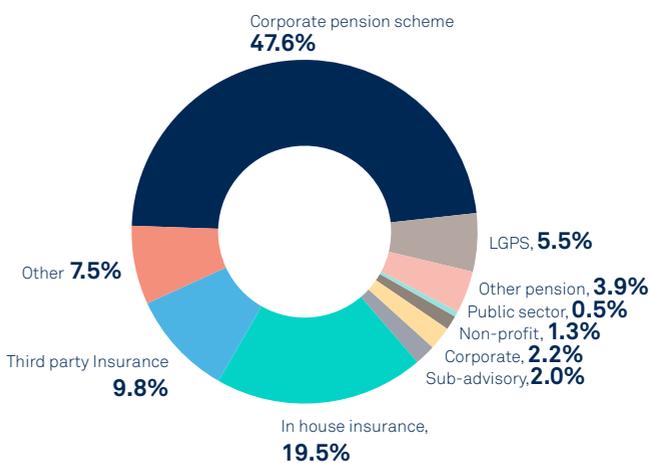
This chapter examines the shape of the UK institutional client market. The analysis differs from that in Chapter 1 in two ways:

- 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 believe that an overwhelming majority of the assets are managed in the UK (approximately 93%).

The data suggest that IA members manage £3.3 trillion for UK institutional clients globally.<sup>20</sup> This figure has increased from an £3.1 trillion (revised) in 2014.

Chart 15 illustrates the breakdown of institutional asset by client type. Pension funds and insurance companies (including in-house and third party management) account for the overwhelming majority of UK institutional assets (86%).

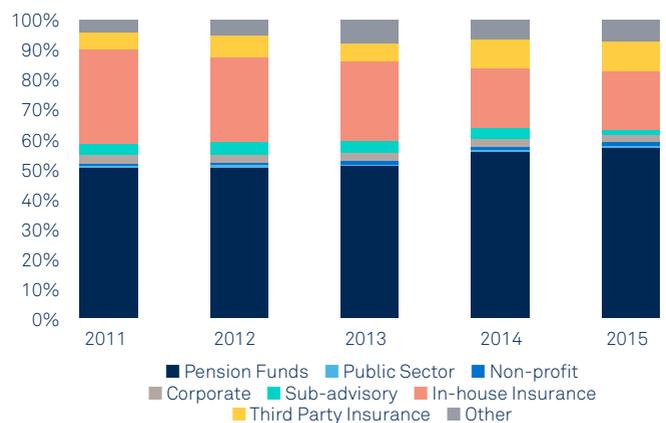
**CHART 15: UK INSTITUTIONAL MARKET BY CLIENT TYPE**



The remaining 14% of assets constitute mandates managed for corporations (outside of pension assets) sub-advisory, not for profit mandates and public sector mandates. Just over half of this (8%) 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.

Looking at the trend in this breakdown over the longer term highlights the steady reduction in insurance assets, most markedly in-house insurance. At the same time there has been a small increase in pension fund assets and an increase in other types of institutional client.

**CHART 16: UK INSTITUTIONAL MARKET BY CLIENT TYPE (2011-2015)**



## PENSION SCHEMES

IA pension fund data includes DB and DC schemes where the asset manager has a relationship with the fund rather than it being distributed via a wrapped product through an insurance company. In 2015 pension funds continued to account for more than half of the institutional client base (£1.9 trillion).

DC pension assets that are operated via an intermediary platform through an insurance company are reflected in the IA's insurance assets. Insurance mandates accounted for 29% of institutional business, down marginally from 2014.

The IA divides pension scheme assets in three categories;

<sup>20</sup> Implied figure based on data collected on an estimated 85% of institutional client base

- Corporate pension funds, which represent the majority of assets. In 2015 Corporate funds (both DB and DC) represented around £1.6 trillion of the £1.9 trillion total pension assets. This category includes a number of in-house Occupational Pensions Scheme (OPS) managers, which we estimate manage around £115 billion in assets.
- The Local Government Pension Scheme (LGPS) which accounted for £180 billion of assets in 2015.
- Assets managed for pensions schemes that do not fit into either of these categories, such as those run for not-for-profit organisations, representing £130 billion.

UK pension scheme assets are still dominated by funded DB schemes, which held £1.5 trillion in assets at the end of December 2015.<sup>21</sup> These schemes are almost entirely closed to new entrants, only 13% of corporate DB schemes were still open in March 2015 and almost a third had closed to future accrual for all members.<sup>22</sup> As these schemes continue to mature the pressure on schemes to de-risk their investment holdings becomes stronger.

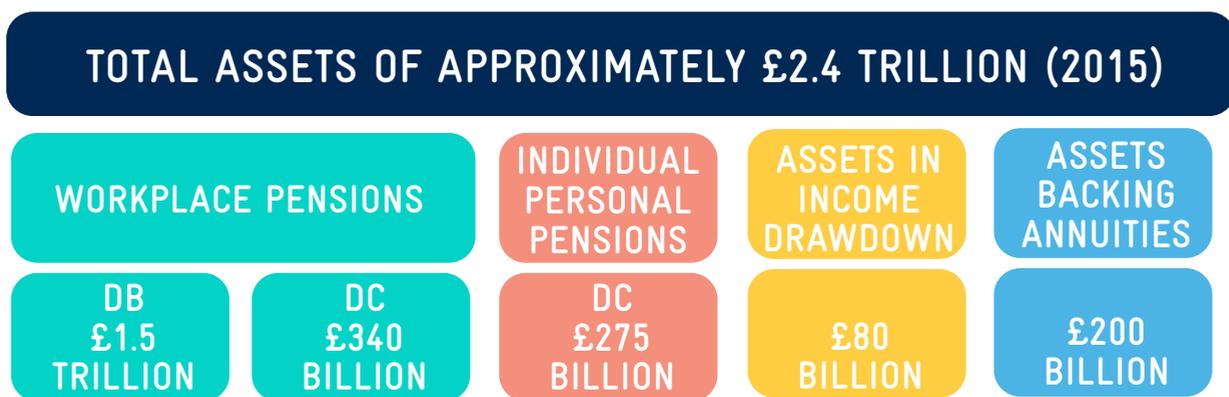
## OVERVIEW OF THE UK PENSION MARKET

In recent years we have refrained from including an overview of the UK pension landscape from this survey due to the lack of information about the DC market in the UK. The data below has been collected from a number of sources including the ONS, PPI, FCA and PPF. Due to the disparate nature of the data collected the table below should be considered indicative only.

We estimate the size of the UK pension market to be £2.4 trillion at the end of December 2015. This figure includes all assets in DB and DC pensions, as well as those assets in some form of drawdown or assets backing annuities.

3

FIGURE 6: OVERVIEW OF THE UK PENSIONS LANDSCAPE<sup>23</sup>



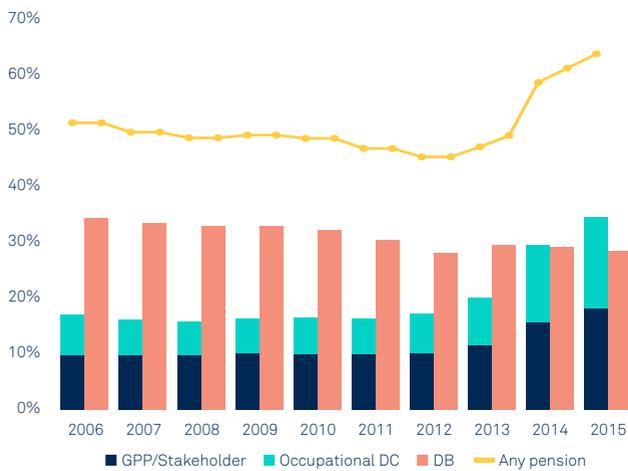
<sup>21</sup> This figure does not directly relate to the £1.6 trillion managed for corporate pensions by IA members as some DB asset will be managed by non-IA members and some DC pension assets will be directly managed by IA members.

<sup>22</sup> The Purple Book, TPR/PPF

<sup>23</sup> Data on the DC market sourced from a number of sources at different dates. Numbers have been adjusted to be comparable at end December 2015 using returns on the IA's mixed investment 40-85% shares sector, a proxy for a typical DC default investment.

DB (funded) assets continue to make up the majority of the UK pension market. However, due to the continuing closure of private sector DB schemes, we know that the number of savers into DC schemes now far exceeds those actively saving into all DB schemes. This shift is clearly visible in Chart 17.<sup>24</sup>

**CHART 17: MEMBERSHIP OF UK PENSION SCHEMES (2006-2015)**



Source: ONS

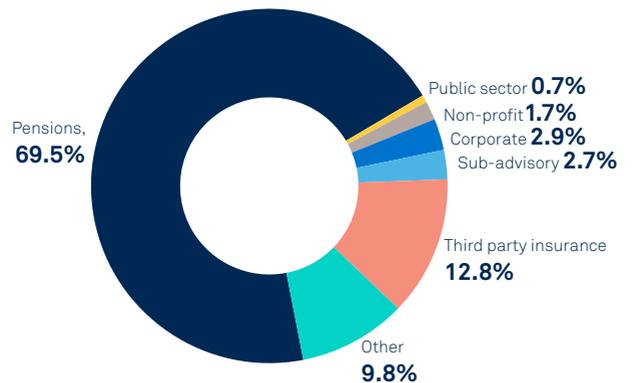
This is largely a reflection of the success of automatic enrolment. By the end of 2015 almost six million individuals had been automatically enrolled into a pension scheme, the vast majority into DC schemes.<sup>25</sup>

## 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 the IA's data from the institutional market that is available to third parties, therefore excluding mandates managed in-house by insurance parent groups and internally-managed occupational pension schemes, as at the end of 2015.

Once in-house insurance mandates are excluded from the institutional data, pension funds become even more dominant (Chart 18), representing more than two thirds of third party assets, with the remaining insurance assets representing only 13% of the market.

**CHART 18: THIRD PARTY UK INSTITUTIONAL CLIENT MARKET BY CLIENT TYPE**

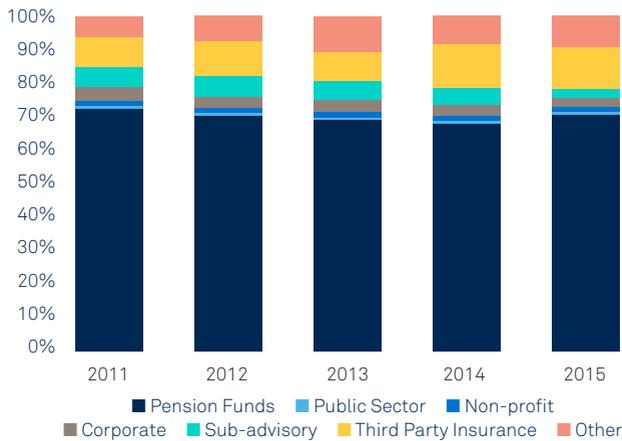


Looking at the longer term trend, the increase in pension scheme assets in the market overall is not replicated in the third party data (Chart 19). It was clear from Chart 16 that in-house insurance assets have declined significantly. This means that each year since 2011 an ever-smaller proportion of the market has been excluded when calculating the total value of the third-party market. Consequently the level of pension fund assets remains relatively stable when expressed as a proportion of the overall market.

<sup>24</sup> ASHE pension tables, ONS, 2016. Includes DB members in unfunded public sector schemes

<sup>25</sup> TPR Declarations of Compliance 2016

**CHART 19: UK INSTITUTIONAL CLIENT MARKET BY CLIENT TYPE**



The volume of assets managed in liability driven investment strategies continued to increase in 2015 finishing the year at £741 billion under management, up 13% from last year.<sup>26</sup>

Our data suggest that, measured on the basis of notional assets under management, 55% of assets were managed in specialist mandates at the end of December 2015, 17% in multi-asset mandates and 28% in LDI.

**CHART 20: UK INSTITUTIONAL CLIENT MANDATES INCLUDING LDI**



**MANDATE BREAKDOWN**

The following section breaks the institutional market down into three categories of mandate:

- Single-asset, or ‘specialist’ mandates, which might focus on a specific asset class or geographical region.
- Multi-asset, or ‘balanced’ mandates, which would cover a number of asset classes and regions.
- LDI mandates, which are specifically designed to help clients meet future liabilities. These mandates frequently make greater use of derivative instruments and are included in this chart on the basis of the notional value of liabilities hedged, rather than the value of physical assets held in the portfolio.

Chart 20 shows that specialist mandates remain the most popular form of investment among institutional investors, with more than half of assets being managed on this basis for third parties. This is slightly up from 2014 but in line with the level two years ago.

“BASIC LDI IS STILL POPULAR, THAT’S NOT CHANGING. BUT THERE’S A TREND AROUND MORE ACTIVE MANAGEMENT OF LIABILITY”



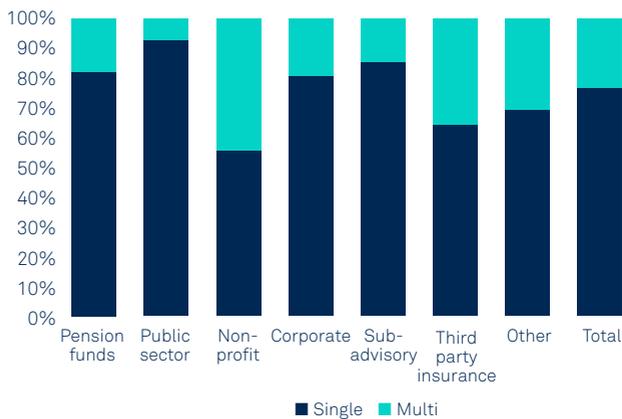
However, the majority of institutional client types make little or no use of LDI strategies, which are largely employed by DB pension funds to manage the run off of their liabilities.

If we exclude the value of LDI mandates and focus purely on whether clients are favouring multi-asset

<sup>26</sup> Powering ahead. The Current UK LDI Market, KPMG, June 2016

or single-asset specialist solutions outside of explicit liability management, Chart 21 signifies that the preference for specialist mandates remains, with 77% of assets being invested in this way.

**CHART 21: UK INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST**

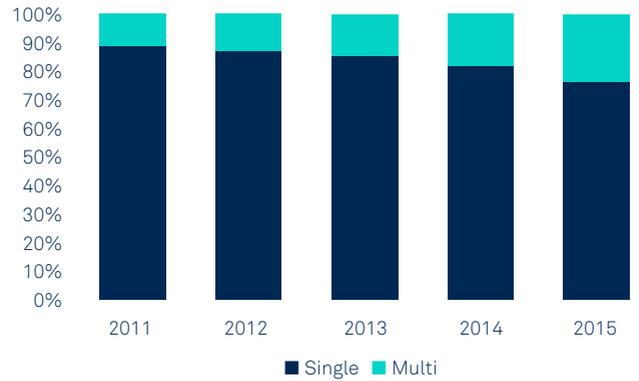


**NATURE OF SPECIALIST MANDATES**

We have suggested in recent reports that specialisation may be reaching its limits and clients are beginning to once again favour multi-asset mandates. This now seems to be clear, with managers taking on more responsibility for monitoring overall investment objectives rather than managing one asset class versus a specified benchmark. Although multi-asset mandates started from a relatively low base, Chart 22 illustrates that their proportion has more than doubled in the last five years from 11% to 23%.

This is likely to reflect the increase in the number of people saving into DC schemes, combined with the fact that default fund strategies are highly likely to be multi-asset strategies aimed at providing savers with good outcomes in retirement, while managing investment volatility along the way.

**CHART 22: UK INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST (2011-2015)**



Specialist equity mandates accounted for 43% of all specialist mandates in 2015 with fixed income mandates representing 36% (Chart 23). However, this headline figure hides a wide variation in the type of mandate awarded by different client types.

Pension funds and insurance companies have particularly high allocations to specialist fixed income mandates (45% and 51% respectively). This is illustrated in Chart 23, which also shows a high allocation to fixed income among corporate clients in 2015. However, this figure can be volatile as corporate client assets represent only 3% of the total and results can be skewed by a small number of mandates changing year-on-year.

Not for profit organisations and corporate entities showed high allocations to cash again in 2015, although again this number is based on a much lower asset value than the findings for pension funds and insurance assets.

The 'other' category predominantly represents mutual funds for which it is not possible to accurately identify the underlying client split.

**CHART 23: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS**

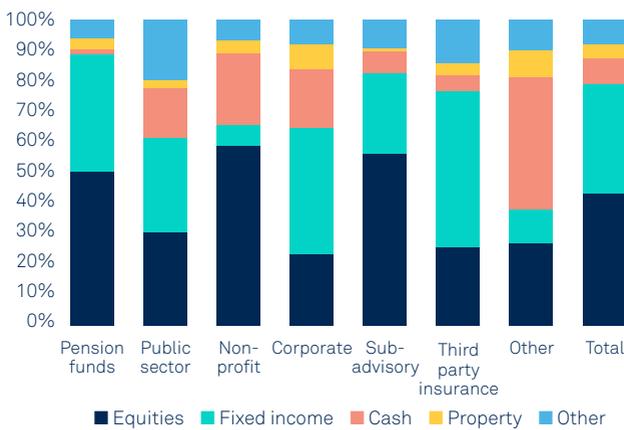
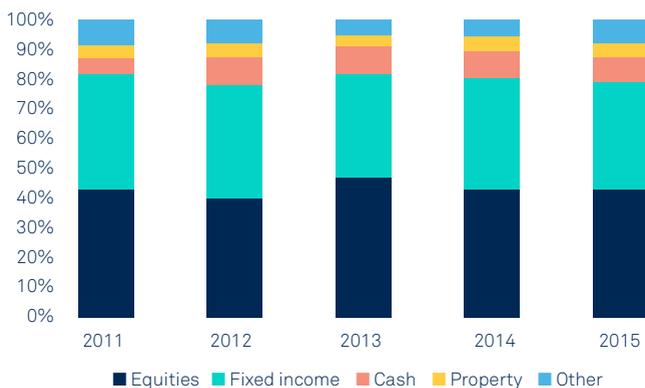


Chart 24 suggests that no clear trend is emerging among specialist mandates, although there are some signs of the allocation to equity mandates increasing in 2013, reflecting some return of risk appetite during that year as equity markets rose on the back of fiscal stimulus. The specialist equity allocation then drops off by the end of 2015 at the same time as volatility returned to global markets.

**CHART 24: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS (2011-2015)**

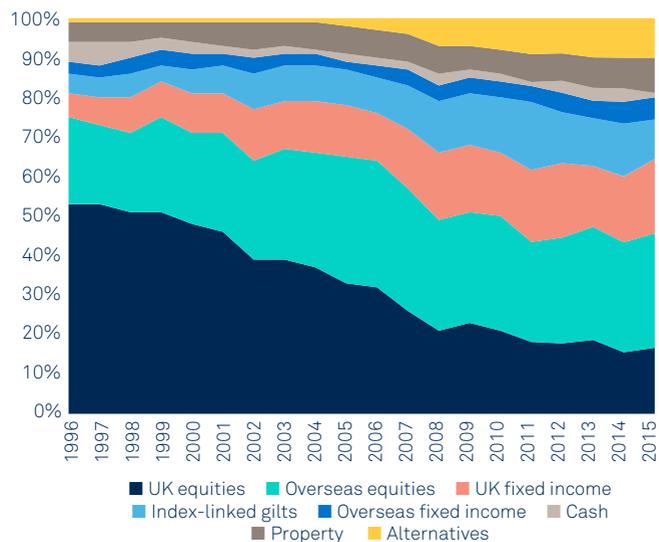


Unsurprisingly corporate pension funds and third party insurance continue to be most heavily invested in specialist bond mandates. Many of these pension schemes will be DB schemes that are closed to new members or future accrual and have a maturing membership reliant on a regular income stream.

These schemes are likely to be shifting their equity allocations into assets which are able to offer a better match to their liabilities as they focus on de-risking as their scheme matures. For this reason the allocation to alternative assets also continued to increase. Pension schemes may also allocate to alternative assets seeking an element of return in order to eliminate deficits or manage deficit volatility.

Chart 25 shows how the asset allocation of a typical DB pension scheme in the UK has changed over the last 20 years. In the early nineties the scheme would likely have been heavily invested in equities (more than 80%), with a small allocation to fixed income assets and other asset types, notably property.

**CHART 25: OVERALL UK PENSION FUND ASSET ALLOCATION (1996-2015)**



Source: UBS Pension Fund Indicators

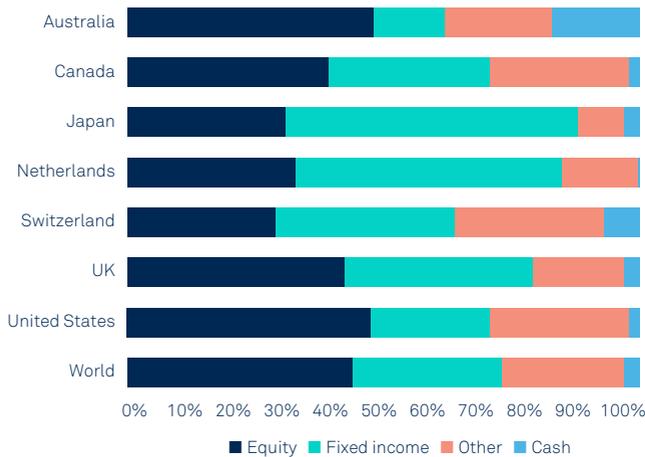


As we have observed in our own data, the growing appetite to hold assets that behave in a similar way to liabilities has led schemes to a re-assessment of investment strategies. The shift out of equities into fixed income is well established and has been going on since the early nineties. However, many DB schemes are moving from using traditional scheme-specific asset allocation benchmarks to those that more closely match their liabilities and manage their deficit volatility.

In line with the findings from IA data, Chart 25 shows that the allocation of pension schemes to UK equities may have reached a low in the last two years.

In spite of the aggressive de-risking being undertaken by DB schemes, on a global comparison UK pensions continue to be relatively high allocators to equities, as seen in Chart 26. This is partly a reflection of the tradition in the UK for DB schemes to allocate high levels to equities and the growth of DC in the UK, where higher allocations to equities are common during the growth phase.

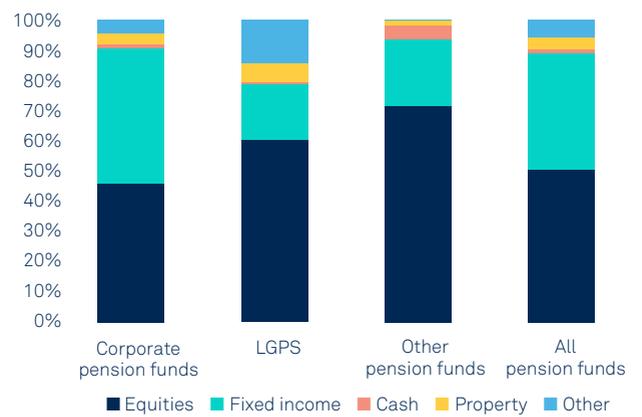
**CHART 26: PENSION FUND ASSET ALLOCATION, SELECTED COUNTRIES (2015)**



Source: Willis Towers Watson

This year's data is consistent with the findings of previous years, and Chart 27 shows that the LGPS has a higher allocation to equities than corporate pension schemes (61% vs 46%). Scheme membership of the LGPS is comparatively less mature than closed corporate DB schemes and the LGPS funds function within a different regulatory framework to corporate schemes and therefore experience less pressure to implement de-risking investment strategies.

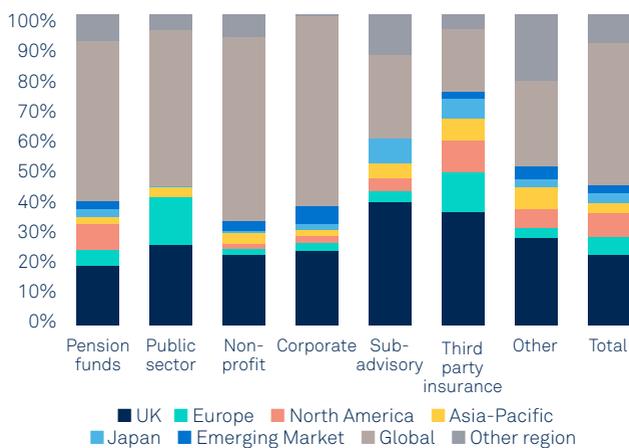
**CHART 27: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS AMONG UK PENSION FUNDS**



## GEOGRAPHIC ALLOCATION

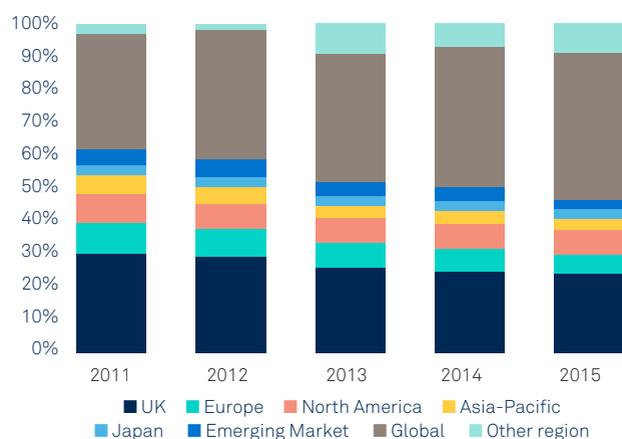
Chart 28 shows that 2015 saw a small drop in specialist UK equity mandates, making up 24% of all specialist third party equity mandates (down from 25% in 2014).

**CHART 28: GEOGRAPHICAL EQUITY ALLOCATION OF SPECIALIST MANDATES BY CLIENT TYPE**



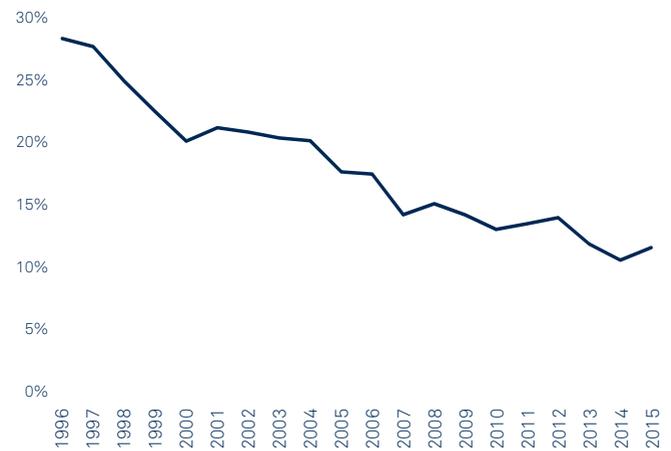
Looking at data from the past five years (Chart 29) we can see that the level of specialist UK equity mandates has reduced significantly from 30% in 2011 to 24% today, although the fall has slowed in the last two years. The globalisation of investment remains a key theme as more than three quarters of specialist equity mandates apply to non-UK mandates. Global equity mandates represented 46% of all specialist mandates, up from 42% in 2014 and 35% five years ago.

**CHART 29: GEOGRAPHICAL EQUITY ALLOCATION OF SPECIALIST MANDATES (2011-2015)**



The decrease in specialist UK equity mandates is consistent with the trend seen in the ownership of UK equities by pension funds from other data sources. Chart 30 shows that the movement of institutional clients out of domestic equities into overseas assets over the last 20 years is very clear, standing at 12% in 2015, albeit there are signs that the 11% seen in 2014 may mark the low.

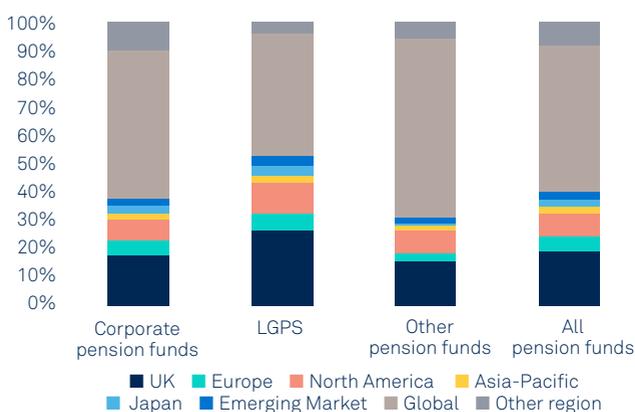
**CHART 30: PENSION FUND OWNERSHIP OF UK EQUITIES (1996-2015)**



Source: IA calculations based on data from LSE, and UBS Pension Fund Indicators

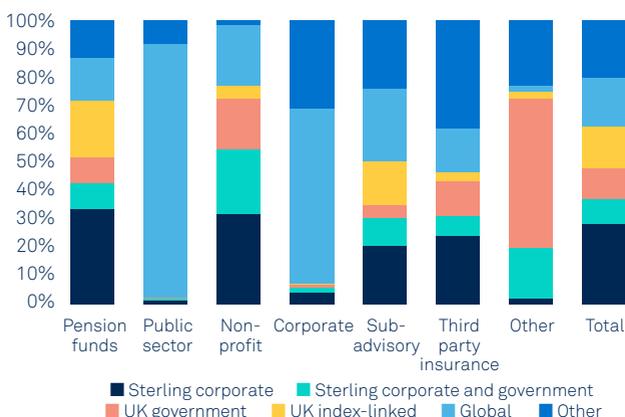
Looking at UK pension funds, once again it is evident that there are further significant differences between the LGPS and other schemes. 27% of LGPS specialist mandates managed by IA members at the end of 2015 were in UK equity mandates. This is in contrast to corporate pension funds which held only 19% in UK equity mandates. So the LGPS remains not only more equity centric but also more UK-centric than other types of scheme.

**CHART 31: GEOGRAPHICAL EQUITY ALLOCATION OF SPECIALIST MANDATES AMONG UK PENSION FUNDS**



Turning to Chart 32 shows that within fixed income sterling corporate mandates remained the largest category of specialist fixed income mandates (28%). The amount allocated to index-linked gilt mandates fell one percentage point to 14% and the allocation to conventional gilt mandates fell to 11%, (closer to the 13% level seen in 2013).

**CHART 32: SPECIALIST FIXED INCOME ALLOCATION BY CLIENT TYPE**



Looking at the trend in fixed income allocation over the last five years the repeated popularity of sterling corporate bonds is clear (Chart 33). This is consistent with investors looking for the additional yield offered by these securities at a time when yields on government bonds have been at historic lows. There are also indications of a trend to allocate more to other fixed income assets. We do not currently collect data on which securities are included here but this category will include mandates of mortgage-backed and asset-backed securities.

**CHART 33: SPECIALIST FIXED INCOME ALLOCATION (2011-2015)<sup>27</sup>**

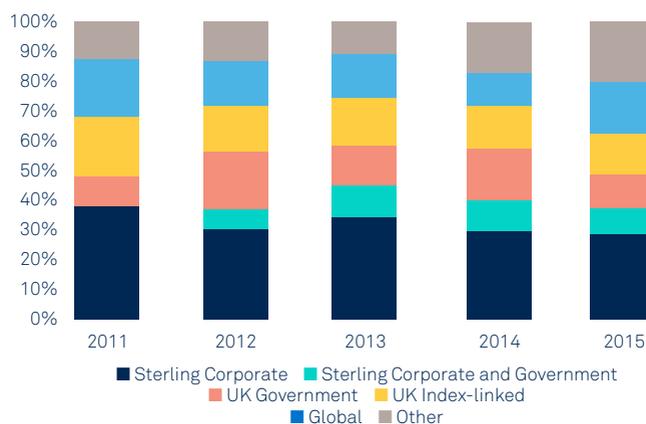
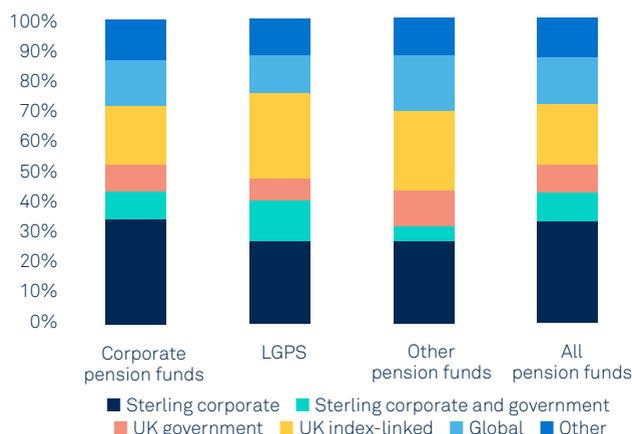


Chart 34 illustrates that among pension schemes there are once again substantial differences:

- Corporate pension funds tended to have higher allocation to sterling corporate bond mandates than average (35%).
- Index-linked mandates were once again most common in the LGPS (28%).

<sup>27</sup> £ Corporate and Government not separated out in 2011

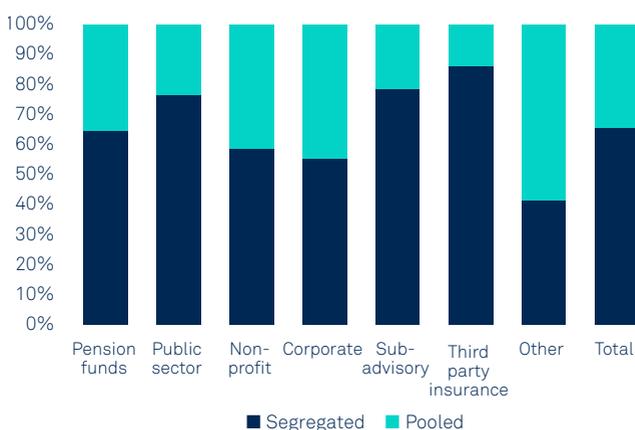
**CHART 34: FIXED INCOME ALLOCATION OF SPECIALIST MANDATE TYPES AMONG PENSION FUNDS**



**SEGREGATED VS POOLED**

Chart 36 shows that segregated mandates represented almost two thirds (66%) of assets managed for third party institutional mandates at the end of 2015. Almost all mandates managed for third party insurance, public sector and sub-advised mandates were managed on a segregated basis with corporate and ‘other’ assets most likely to be managed on a pooled basis.

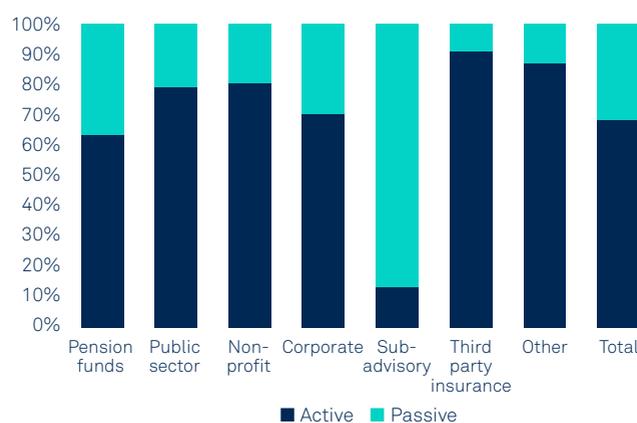
**CHART 36: SEGREGATED AND POOLED MANDATES BY INSTITUTIONAL CLIENT TYPE**



**ACTIVE VS PASSIVE**

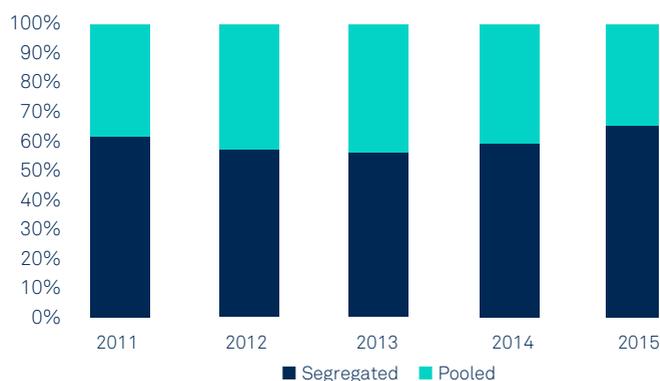
Just over two thirds of assets (68%) were managed by IA members on an active basis. In line with findings in previous years, only sub-advisory mandates were more likely to be managed on a passive rather than active basis (Chart 35).

**CHART 35: ACTIVE AND PASSIVE MANDATES BY CLIENT TYPE (SAMPLE-ADJUSTED)**



There is no clear trend in the past five years, although the proportion of assets managed in segregated mandates has increased since 2013.

**CHART 37: INSTITUTIONAL SEGREGATED AND POOLED THIRD PARTY MANDATES (2011-2015)**



Pension funds are more likely to be managed on a segregated basis with 65% of assets being managed in segregated mandates. However, a significant proportion of pension assets were allocated to pooled vehicles in 2015, particularly those in the ‘other pension fund’ category.

Corporate and LGPS funds are far more likely than other types of pension to be managed on a segregated basis (Chart 38). This may be related to the size of mandate awarded. Other pension schemes includes assets that do not fit into either of the other categories, such as portfolios managed on behalf of not for profit institutions. This may include more relatively small mandates than the very large corporate and local government funds.

### Changes to the LGPS

In the Summer Budget 2015, the Government asked funds in the LGPS to come forward with proposals on how they could use pooled investments to reduce their costs, but maintain fund performance. By July 2016 eight proposals for pools had been submitted. Key features of these pools are:

- A range of multi-asset pools (MAPS) for groups of funds with a like-minded approach to investment. Funds remain responsible for their own investment strategy, asset allocation decisions and whether they will use an active or passive approach.
- A focus on improving LGPS funds’ ability to invest in infrastructure.
- A mix of in-house and external management to provide greater choice, but with the potential to extend in-house management in the future.<sup>28</sup>

The Government is also consulting on new investment regulations for the LGPS. These will replace the current regulations and are aimed at facilitating pooled investing.

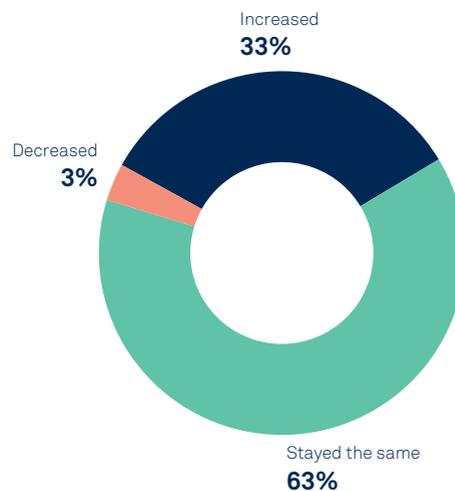
**CHART 38: SEGREGATED AND POOLED MANDATES AMONG THIRD PARTY PENSION FUNDS**



### ESG

In Chapter 2, we reported that firms were detecting a change in the requirement for assets managed on an ESG basis. When we asked members whether the level of institutional business they were managing subject to ESG requirements had changed in the last year one third said the level had increased. Chart 39 shows that only a tiny proportion (3%) reported the level of business subject to ESG requirements had fallen.

**CHART 39: CHANGE IN ESG REQUIREMENTS FROM INSTITUTIONAL CLIENTS DURING 2015**



<sup>28</sup> Findings of Project POOL. Joint Working Group of Local Authorities, January 2016

# 4 UK FUND MARKET

## KEY FINDINGS

### TOTAL FUNDS UNDER MANAGEMENT

- The value of UK domiciled funds stood at £872 billion at the end of 2015, up 4% on 2014. Since the global financial crisis in 2008 UK domiciled funds under management have increased by 140%.
- The value of assets managed in the UK on behalf of overseas-domiciled funds rose to £1 trillion in 2015, bringing the total value of investment funds managed in the UK to £1.9 trillion.
- Funds under management for retail investors stood at 65% of all funds under management, the same level as 2014 (revised).

### ASSET MIX IN INVESTMENT FUNDS

- Over the long term investors have shifted away from equity funds and diversified their portfolios into a broad range of asset classes.
- Equity funds made up 54% of total assets, unchanged from 2014, reinforcing a halt in the decrease in equity allocations over the last decade.
- Fixed income funds made up 14% of all assets, down slightly from 15% in 2014.
- The allocation to absolute return funds continued to grow, from 4.7% in 2014 to 5.8% by the end of 2015.
- Property remained a popular asset class, increasing its share of the fund market from 2.6% to 3%.

### RETAIL FLOWS INTO AUTHORISED FUNDS

- Net retail flows into authorised funds in 2015 were £17.6 billion, a significant drop from the £21.6 billion seen in 2014.
- The average five year flow level has fallen in the past two years, standing at £19 billion in 2015. This may reflect a move back towards levels seen before the 2008 crisis.

### PRODUCT PREFERENCES

- Product preferences continued to reflect both cyclical and structural factors as investors favoured investment solutions, income and property.
- There were strong flows of £8 billion into outcome and allocation funds, which have now seen positive monthly inflows in each month since January 2009.
- Investors favoured equity income funds over both equity growth and fixed income. UK and global equity income funds received a total of £5.7 billion in net retail sales.
- UK All Companies funds saw the biggest outflows again in 2015, with £2.2 billion moving out in 2015, although this represented just 1% of total funds under management for this sector.

## PASSIVE INVESTMENT STRATEGIES

- The portion of the fund market managed in index tracking funds increased by one percentage point to 12% in 2015, mirroring the shift among UK-managed assets more widely.
- Passive strategies were largely focused on equity funds, although net retail sales of fixed income trackers increased 135% from 2014, with interest centred on the UK fixed income sectors.

## FUND DISTRIBUTION

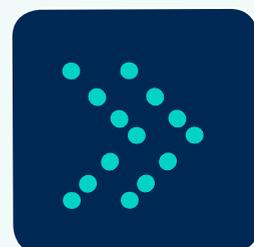
- For the first time since the IA started collecting data, platforms' share of gross sales fell to 52% in 2015, down from 55% in 2014.
- Fund of funds increased to £110 billion under management in 2015 and now represent 13% of the total fund management industry in the UK.

## INDUSTRY CONCENTRATION

- The concentration of the funds industry remained low in 2015. Although the proportion of the market held by the top ten firms has remained relatively stable over the last 20 years, the composition of the top ten firms has changed significantly.
- The UK funds industry is dominated by equity funds, with 1,194 equity funds in IA sectors, compared to 292 fixed income funds and 525 mixed asset funds.

## INTERNATIONAL CONTEXT

- The UK funds industry remains the fifth largest in Europe in terms of domicile, lower than the UK's number two position as a centre for investment management.



## 4 UK FUND MARKET

This chapter of the survey covers UK-domiciled authorised unit trusts and Open Ended Investment Companies (OEICs).

A growing part of the fund market is represented by funds domiciled overseas, albeit the portfolio management frequently takes place in the UK. There are also some UK-domiciled funds that are sold into overseas markets.

The main investors in UK unit trusts and OEICs are retail investors (65%), although institutional investors such as pension funds and insurance companies are able to invest in them and may do so for a variety of reasons, for example:

- To gain access to specific portfolio manager skills.
- To reflect investor preferences within unit-linked life products that offer access to third party funds. There has also been periodical restructuring of assets out of life products and into OEICs in recent years.

The analysis in this section is based primarily on the IA's funds data, which is more detailed and has a longer history than the data collected annually as part of the annual survey. This data captures holdings and flows for individual funds on a monthly basis. In 2015, the IA collected this data for a total of 2,717 funds domiciled in the UK.

IA figures on retail investment include sales through fund platforms, other intermediaries such as wealth managers, stockbrokers, tied agents and IFAs, as well as direct sales.

As we reflected earlier in this survey, sales to investors through insurance companies, whether as investment bonds or as part of pension arrangements (including workplace and personal pensions) are classified as institutional insurance assets.

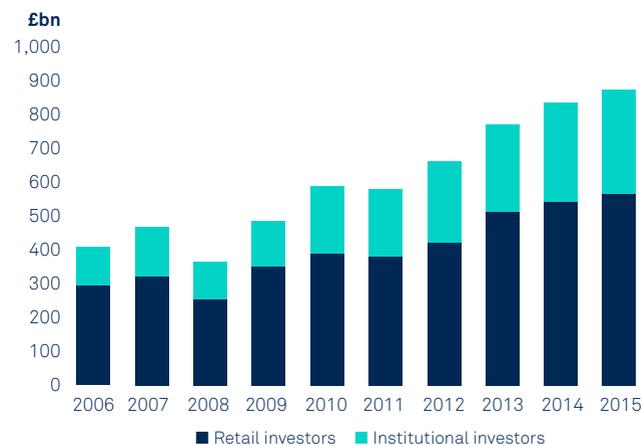
### TOTAL FUNDS UNDER MANAGEMENT

As at the end of 2015, UK domiciled funds under management were £872 billion, an increase of £37 billion, or 4.4% from 2014. Funds under management of UK investors in overseas-domiciled funds were £89 billion at the end of 2015, up from £77 billion in 2014, a 15% increase year-on-year.

Fund managers in the UK are also responsible for managing £1 trillion of assets for overseas domiciled funds. This brings the total funds under management for the UK to £1.9 trillion in investment funds, up from £1.7 trillion in 2014.

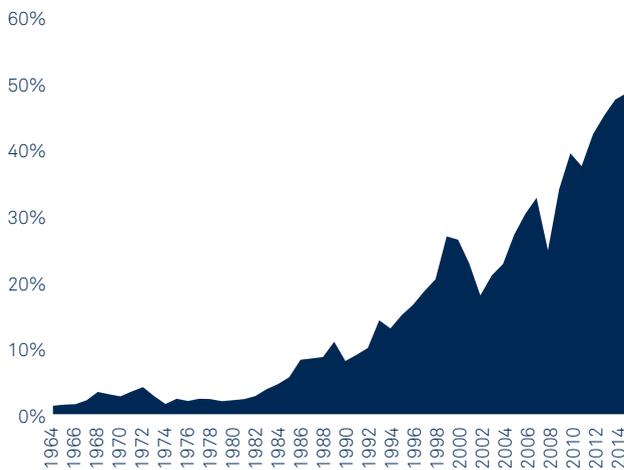
Since the global financial crisis of 2008, UK domiciled funds under management have grown from £363 billion to £872 billion, an increase of 140%.

**CHART 40: INDUSTRY FUNDS UNDER MANAGEMENT (2006-2015)**



Measuring industry funds under management as a proportion of UK GDP shows how the industry has grown relative to the UK economy. Fifty years ago the fund industry was equivalent to less than 1% of UK GDP. Chart 41 shows how this relationship has developed over time for the UK fund industry to be equivalent to 49% of GDP at the end of 2015.

**CHART 41: FUNDS UNDER MANAGEMENT AS PERCENTAGE OF GDP (1964-2015)**



Source, IA, ONS

Chart 42 tracks the growth of industry funds under management and isolates the two contributing growth factors - sales and asset value (return on investment) on a cumulative basis:

- From 1980-2000, sales growth, measured by net sales, and asset appreciation through investment growth, are highly correlated.
- During the dot.com crisis (2000-2002), there was a negative correlation as asset appreciation turned negative, but sales growth remained positive.
- In the following years until the financial crisis of 2008, correlation between sales growth and return on assets was again low as asset appreciation grew at a much faster pace than net sales.
- The pattern post-2008 financial crisis is more complicated, but characterised by strong sales amid considerable market volatility.

Over the past 35 years therefore, industry funds under management have been driven both by strong new monthly inflows and by investment returns. As we explore later in the chapter, there is some question as to whether the record inflows seen in 2009-2010 will be sustained into the longer term and whether the apparent 'new normal' of retail sales indicated in recent years will return to levels more similar to those seen before the 2008 crisis.

**CHART 42: DRIVERS OF INDUSTRY GROWTH (1980-2015)**

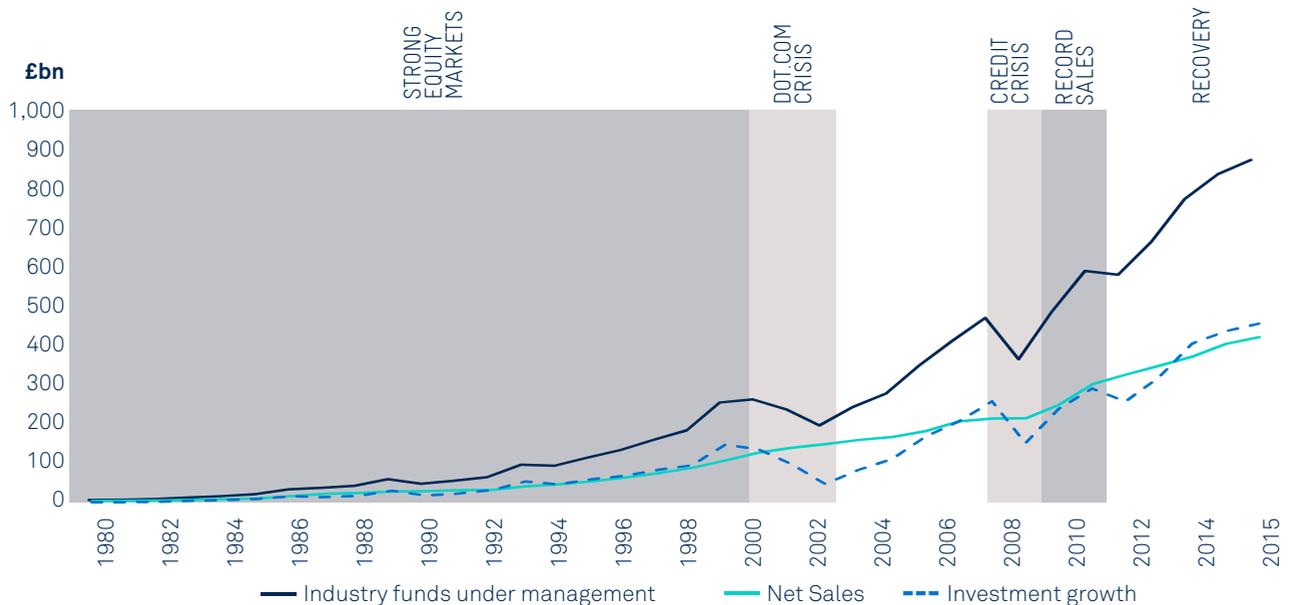
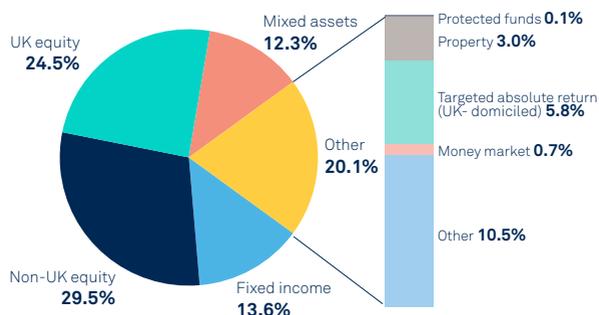


Chart 43 shows the overall asset mix within the UK fund universe, which is little changed from last year:

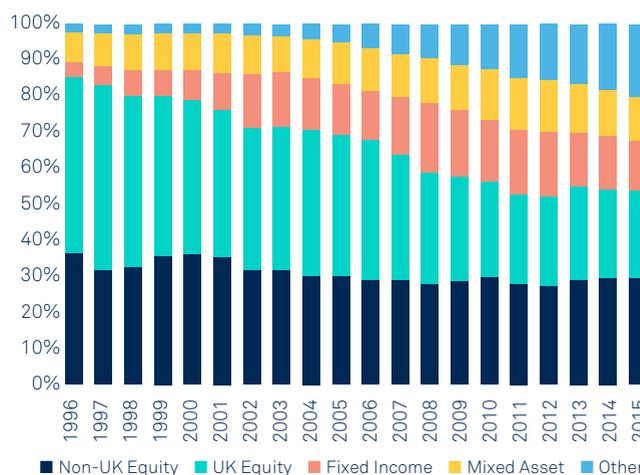
**CHART 43: FUNDS UNDER MANAGEMENT BY FUND/ASSET TYPE**



- Equity funds remained the largest asset class accounting for 54% of the total (unchanged from 2014).
- Fixed Income funds made up 14% of UK funds under management (15% in 2014).
- Mixed Asset funds accounted for 12% (broadly unchanged).
- Property remained a popular asset class with retail investors in 2015 and, along with strong investment returns, allowed property to increase its market share moderately (to 3.0% from 2.6%). This is equivalent to 2006 when the Property sector's market share peaked.
- Targeted Absolute Return funds continued to grow in significance (5.8% from 4.7% in 2014).
- The 'Other' fund category also increased, up to 10.5% from 9.8% in 2014, partly reflecting the introduction of volatility managed ranges.
- Money market funds remain a small part of the UK fund market.<sup>29</sup>

Longer term change is far more marked. Chart 44 shows how equity fund dominance has steadily fallen over the past twenty years as new products in other asset classes have attracted investor money. Investors have diversified their portfolios into other asset classes and benefited from outsourcing asset allocation decisions to professional investors through mixed-asset products. The growth in fixed income funds under management is attributable not only to high sales, but also strong capital growth due to falling bond yields.

**CHART 44: CHANGE IN FUNDS UNDER MANAGEMENT BY ASSET CLASS (1996-2015)**



The fall in the dominance of equities as an asset class is seemingly due to investors switching from UK equities into other asset classes. The non-UK share has remained relatively steady at around 30%, whilst UK equity has fallen from a peak of 51% in 1997 to 24.5% in 2015.

<sup>29</sup> IA data represents retail money market funds and does not represent the very large institutional money market fund industry managed from the UK.

## RETAIL FUND SALES

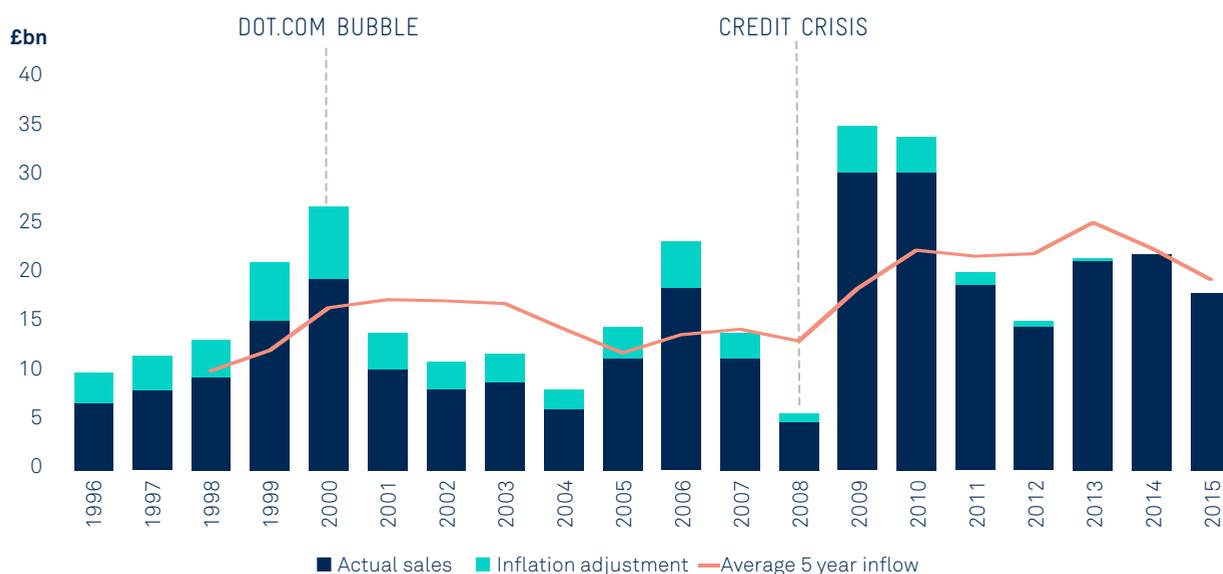
**TABLE 5: NET RETAIL SALES BY FUND TYPE (2012-2015)**

Fund type	2012 £m	2013 £m	2014 £m	2015 £m
Equity	3,659	11,468	8,666	8,353
<i>of which tracker</i>	1,215	2,686	3,782	3,438
Mixed Asset	2,829	4,641	4,022	2,543
Targeted Absolute Return	866	2,208	2,118	4,039
Property	442	1,519	3,805	2,748
Money Markets	-52	-92	63	591
Fixed Income	5,656	-58	1,451	-519
<i>of which tracker</i>	345	31	293	689
Others	988	1,224	1,467	-166
Property	535	391	1,530	3,822
<b>All funds</b>	<b>14,389</b>	<b>20,909</b>	<b>21,591</b>	<b>17,590</b>
<i>of which fund of funds</i>	3,938	3,852	3,133	3,721

Net retail sales were £17.6 billion in 2015, an 18% decrease on 2014's net retail sales figure of £21.6 billion. Retail sales increased post-crisis as investors moved to investment funds as an alternative source of return to savings accounts paying very unattractive levels of interest. However, Chart 45 shows retail sales have fallen in the last two years, possibly suggesting a return to pre-crisis levels and an end to what had looked like being a 'new normal' level for flows above the £20 billion mark in recent years.



**CHART 45: NET RETAIL SALES (1996-2015)<sup>30</sup>**



Source: IA, ONS

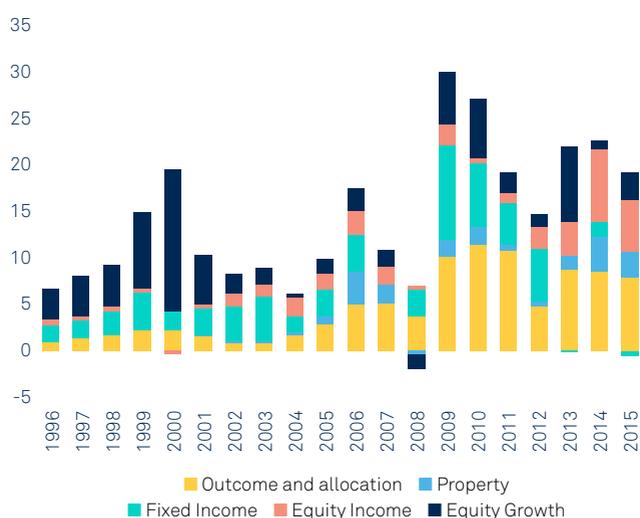
<sup>30</sup> Includes an adjustment for inflation to illustrate the historical purchasing power of money.

## CYCLICAL AND STRUCTURAL SHIFTS IN PRODUCT DEMAND

The structural and cyclical trends that we highlighted in 2014 have continued into 2015. As Chart 46 illustrates, inflows are characterised by three key themes:

- **Strong flows into outcome and allocation funds**, (£8 billion), notably mixed-asset and absolute return. Since 2008, outcome and allocation funds have drawn 41% of total net retail sales, the largest share. These funds have proven to be very popular with regular savers, receiving positive monthly inflows every month since January 2009.
- **Strong flows into income**, with a recent focus on equity income in contrast to the emphasis on fixed income in the immediate aftermath of the 2008 financial crisis.
- **Weak flows into equity growth**, continuing a pattern that dates back not to 2008, but to the end of the dot com bubble eight years previously.

**CHART 46: NET RETAIL SALES BY DIFFERENT INVESTMENT OBJECTIVE (1996-2015)<sup>31</sup>**



## ALLOCATION (MIXED ASSET)

Demand for mixed-asset funds is driven by a number of factors, including:

- **Market conditions** post-2008 and to some extent post-2000, which have resulted in an emphasis on increased diversification. For many investors, this emphasis has also been accompanied by a more explicit focus on volatility management and/or capital protection.
- **Changes in the distribution landscape**, which have made 'embedded advice' on asset allocation more attractive for certain kinds of investors post-RDR.
- **Policy evolution**, which is seeing an accelerating shift both to DC pensions and greater freedom in retirement income choice.
- **Low interest rate environment**, which has led to greater interest and innovation in multi-asset income funds.

Mixed-asset funds have been incredibly popular with retail investors since the 2008 financial crisis. Funds under management of mixed-asset products have increased by 140% from £49.7 billion at the end of 2008 to £119.5 billion at the end of 2015. Net retail sales have been consistently positive with no outflows in a single month over the same period.

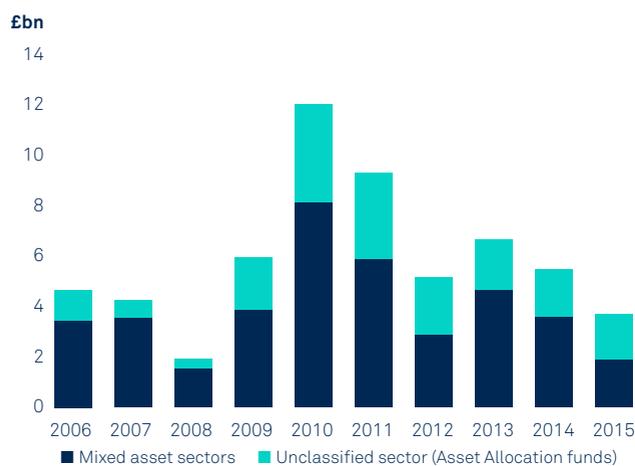
<sup>31</sup> Outcome and allocation category contains sales from the following sectors: Money Market, Flexible Investment, Mixed Investment, Targeted Absolute Return, Personal Pensions, Index Bear Funds and UK Equity and Bond Income.

Chart 47 shows net retail sales of mixed-asset funds, including both the Mixed Asset sectors and asset allocation funds currently in the Unclassified sector.<sup>32</sup> The Mixed Asset sectors are comprised as follows:

- Mixed Investment 0-35% Shares
- Mixed Investment 20-60% Shares
- Mixed Investment 40-85% Shares
- Flexible Investment
- UK Equity and Bond Income.

Annual net retail sales of mixed-asset funds have lessened since a peak in 2010, but remain positive for the product group as a whole. Including both the Mixed Asset sectors and those mixed-asset funds lying in the unclassified sector, there were, £4.4 billion net inflows in 2015, an 18% decrease from £5.3 billion in 2014, in line with broader patterns of retail sales.

**CHART 47: NET RETAIL SALES OF ASSET ALLOCATION FUNDS (2006–2015)**



Source: IA, Morningstar Direct

The two dominant Mixed Asset sectors were those with relatively high equity allocations; 40-85% shares and 20-60% shares. At the end of 2015 the Mixed Investment 40-85% Shares sector had £53.0 billion in funds under management, up from £50.2 billion in 2014. The Mixed Investment 20-60% Shares sector had £42.2 billion in funds under management in 2015, an increase of 4% from the £40.5 billion in the sector in 2014.

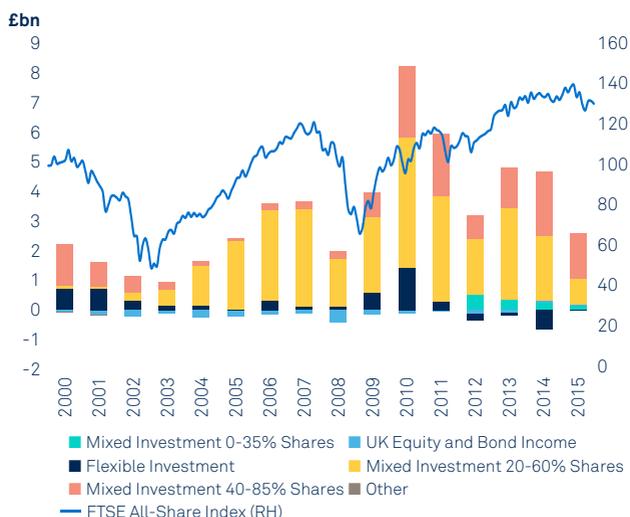
**TABLE 6: NET RETAIL SALES OF MIXED-ASSET FUNDS BY SECTOR (2014–2015)**

	2014	2015	2015
	Net retail sales £m	Net retail sales £m	Funds under management £m
Flexible Investment	-653	-28	17,790
Mixed Investment 0-35% Shares	277	138	5,012
Mixed Investment 20-60% Shares	2,158	854	42,170
Mixed Investment 40-85% Shares	2,177	1,521	53,028
UK Equity and Bond Income	63	59	2,417
<b>Total</b>	<b>4,022</b>	<b>2,544</b>	<b>120,417</b>

<sup>32</sup> Asset allocation funds in the Unclassified sector include volatility managed ranges which had no dedicated sector in 2015.

Chart 48 illustrates that the Mixed Investment 40-85% Shares sector was the best selling in 2015 with £1.5 billion in net retail sales, making it the best-selling sector in the asset class. This is the second year in a row it has been the most popular amongst retail investors. However, in each of the ten years prior to 2014 the Mixed Investment 20-60% Shares sector was the best-selling. One reason for this may be that as investors who would normally favour equities have become more cautious, they have taken some risk off and directed their investments toward mixed-asset funds, but preferred funds with a higher equity allocation.

**CHART 48: NET RETAIL SALES OF MIXED-ASSET FUNDS VS FTSE ALL-SHARE INDEX (2000-2015)**



The growing popularity of mixed-asset solutions has impacted on the patterns of competition in asset allocation. Mixed-asset funds can be provided directly by fund managers. These have long been a feature of the retail market, but are currently enjoying a strong resurgence. They are also seen in the DC pensions market, with products such as Target Date Funds which offer a mixed-asset strategy designed to deliver across the accumulation phase of a retirement income savings plan.

At the same time, asset allocation services are provided by a variety of retail and institutional advisers, consultants and other forms of gatekeeper, who work with clients to build a relevant portfolio to meet their needs. Patterns of competition between these different players are often complex and are intensifying. A fund management house may be simultaneously marketing its own multi-asset capabilities, while its component funds are being used by others to build client portfolios.

## TARGETED ABSOLUTE RETURN

“IT’S NOT JUST RETURN BUT HOW YOU GET THERE. IN MULTI ASSET WE’VE SET UP FOUR FUNDS BASED ON DIFFERENT VOLATILITY PROFILES FOR THE PENSION FREEDOMS – YOU CHOOSE YOUR VOLATILITY PROFILE.”

A significant feature of this more outcome-oriented environment is a lower tolerance for equity-like volatility among retail clients, often accompanied by a desire for some form of capital protection. This has led to a significant shift in demand towards absolute return strategies. This may be a cyclical shift, which will move again in changed market conditions, or it may be part of the structural shift as investors increasingly seek outcome-oriented products with lower levels of volatility. The industry view has been increasingly that it is mostly structural, with some elements of cyclical behaviour.



“THERE HAS BEEN MORE EXTREME VOLATILITY IN MARKETS THIS YEAR AND THAT’S FEEDING THIS ABSOLUTE RETURN TREND. I THINK IT’S A LONG TERM TREND WITH AN EXTRA STRONG WIND BEHIND IT AT THE MOMENT.”

### Mixed asset or absolute return?

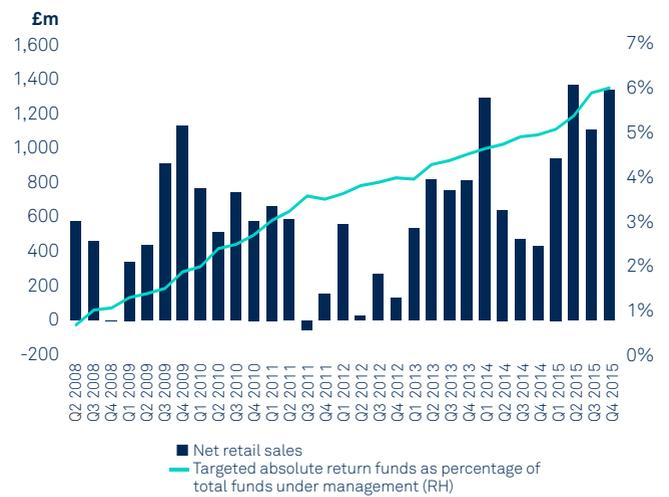
Mixed-asset and absolute return strategies can both aim to achieve a positive return. However, mixed-asset strategies will normally aim to achieve positive returns over the long term and will be more likely to tolerate periods of negative return throughout the investment period.

Absolute return strategies, which may or may not be mixed-asset, aim to achieve a positive return over a specified period irrespective of market conditions of the underlying asset class. They are designed to have a lower correlation with traditional market returns, which should mean that absolute return strategies offer investors a degree of protection to the client when other investments are producing negative returns. They do not, however, offer any capital guarantee.

The targeted absolute return sector was launched in 2008. Although all funds aim to make a positive return in all market conditions, they do not aim to make the same target return and they use very different investment strategies to achieve it. Managing an absolute return strategy has more challenges than a traditional benchmark-focused fund. Whereas a traditional fund can make a loss in absolute terms, but still outperform its benchmark, absolute return funds are designed, and expected to make positive returns in all market conditions over a certain time period. The sector has not always achieved this, and in the difficult market conditions of 2011 and 2012 many funds produced a negative return.

Chart 49 shows that in 2015, Targeted Absolute Return funds had net retail sales of £4.7 billion, their strongest year since the introduction of the sector.<sup>33</sup>

**CHART 49: QUARTERLY NET RETAIL SALES OF TARGETED ABSOLUTE RETURN FUNDS VS TARGETED ABSOLUTE RETURN FUNDS UNDER MANAGEMENT AS PERCENTAGE OF TOTAL FUNDS UNDER MANAGEMENT (2008-2015)**



“I SEE THE EVOLUTION BEING MORE ABOUT ABSOLUTE RETURN BECAUSE IT’S MUCH MORE ATTUNED TO WHAT INVESTORS ARE LOOKING FOR. IT’S TAKING DIVERSIFYING VOLATILITY A STEP FURTHER – WHY NOT HAVE NO VOLATILITY, AND IF YOU’RE AN INDIVIDUAL RETIRING AT 60 FOCUSING ON THE ABSOLUTE RETURN YOU CAN EXPECT FROM YOUR PORTFOLIO, IT’S A BETTER WAY OF THINKING ABOUT IT THAN JUST HAVING MULTI-ASSET INCOME.”

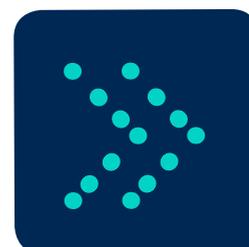
<sup>33</sup> The data in this section reflects UK and overseas domiciled funds. With the introduction of UCITS III came the ability to launch absolute return products across Europe. For this reason many of our members chose to domicile their funds overseas.

## INCOME

The search for yield and income remained a key priority for investors during 2015 according to those members we interviewed, and this was not expected to change in the foreseeable future given expectations of a continuation of the low interest rate environment. The key developments in the retail market identified by survey participants were increased demand for multi-asset income, global equity income and monthly income-paying products.

One key shift in the 'hunt for yield' pattern seen since 2008 has been the move towards equity income and away from fixed income (Chart 50). Sales of fixed income funds initially boomed in 2009 as monetary policy depleted cash savings rates and investors looked to bonds for low risk returns on their savings. Fixed income flows outstripped equities in the following years until 2013, when the US taper tantrum reverberated through global bond markets. Following sustained quantitative easing and other monetary policy operations put into action by various central banks, 2013 saw a spike in equity growth sales (Chart 46), however equity income has been the driver of equity sales in recent years.

**CHART 50: NET RETAIL SALES OF FIXED INCOME FUNDS AND EQUITY INCOME FUNDS (2006-2015)**



## SALES ANALYSIS BY ASSET CLASS

### EQUITY FUNDS

Equity funds overall experienced the strongest sales in 2015 of any asset class, a continuation of a three year trend in which Equity Income funds have been the greatest recipient of investor money, attracting £16.9 billion. Over the same period Equity Growth funds have still seen positive flows, £11.6 billion.

In absolute terms, equity sales fell slightly from 2014 with 12 out of 18 sectors recording lower year-on-year sales. The two equity income sectors, UK and Global, received £5.7 billion in net retail sales in 2015:

- UK Equity Income retained its crown as top selling sector with £4.3 billion (down from £6.3 billion in 2014).
- Global Equity Income attracted £1.3 billion in net retail sales and was more resilient year-on-year (down just £169 million from 2014).

The second best-selling equity sector was Europe ex-UK which brought in £3.5 billion in 2015 (from £702 million in 2014) as investors appeared to grow more confident in Europe's recovery. The smaller Europe Including UK sector was also positive in 2015 with £34 million in net retail sales.

The UK All Companies sector was once again the worst selling IA sector in absolute terms, but as it is by far the largest sector with £164 billion in funds management in relative terms the outflow was only 1% of total funds under management. With investors moving toward income from growth strategies, this pattern is not surprising.

**TABLE 7: NET RETAIL SALES AND FUNDS UNDER MANAGEMENT AMONG EQUITY SECTORS (2014–2015)**

	2014	2015	2015
	Net retail sales £m	Net retail sales £m	Funds under management £m
UK Equity Income	6,306	4,337	61,049
Europe Excluding UK	702	3,473	50,270
Global Equity Income	1,483	1,313	14,479
Japan	442	1,071	15,371
European Smaller Companies	-516	970	5,734
Global	1,476	921	78,467
Specialist	10	104	38,639
Europe Including UK	35	34	2,168
Japanese Smaller Companies	12	-3	366
Asia Pacific Including Japan	-50	-14	1,844
Technology and Telecommunications	61	-69	950
North American Smaller Companies	-198	-98	1,512
Global Emerging Markets	211	-99	13,294
China/Greater China	5	-264	1,562
North America	-125	-265	37,788
UK Smaller Companies	9	-303	12,629
Asia Pacific Excluding Japan	97	-588	24,370
UK All Companies	-1,292	-2,166	163,774
<b>Total</b>	<b>8,666</b>	<b>8,353</b>	<b>524,266</b>

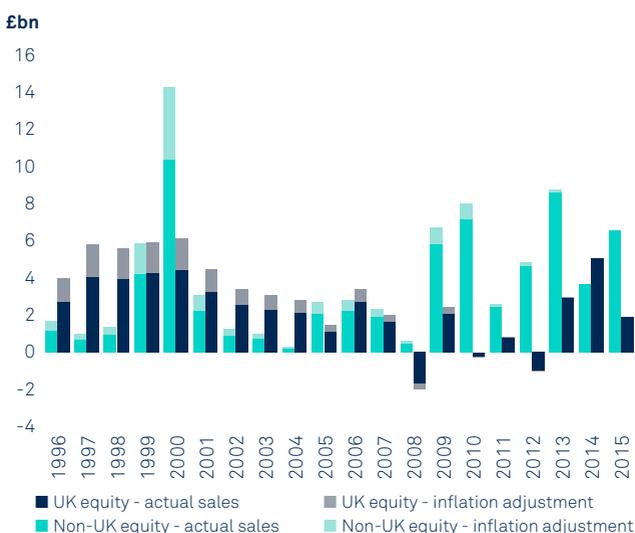
**Note:** Numbers may not add up due to rounding

### REGIONAL EQUITY SALES

In 2014, UK equity funds sold more than non-UK equity funds for the first time in seven years (Chart 51). This was not the start of a new trend however, as non-UK equity funds outsold UK funds by a factor of 3.5 in 2015.

Nevertheless, UK funds were still net beneficiaries with sales of £1.9 billion received from retail investors.

**CHART 51: NET RETAIL SALES OF UK AND NON-UK EQUITY FUNDS (1996-2015)**



- Japanese equity funds boomed in 2015, recording the highest net retail sales figure since the IA began collecting data. It was a bumpy ride for investors as President Shinzo Abe's continued corporate reforms led to Japanese markets hitting a 15-year high mid-year, before the global commodities rout wiped out the year to date return in September. Markets did however end the year in positive territory.
- Asia saw the biggest outflows as the effects of China's economic slowdown was felt across the region, with stock markets struggling all year. Asian net retail sales were the largest regional outflow within the IA data set.

**CHART 52: NET RETAIL SALES OF EQUITY FUNDS BY REGIONAL FOCUS (2006-2015)**

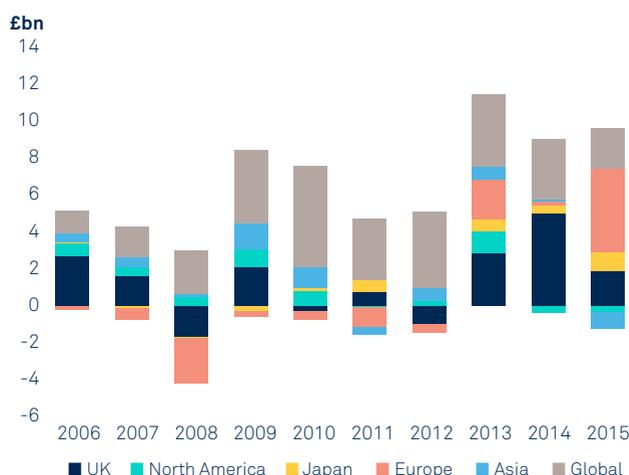


Chart 52 breaks down equity sales in more detail by region over the past ten years, while Table 8 provides the data for 2014-15:

- European-focused equity funds had their strongest year on record in 2015. Investors saw opportunities in Europe's recovery as the ECB loosened monetary policy further with the introduction of negative deposit rates and further quantitative easing.
- Global equity was the second best-selling region. However, Global Emerging Markets funds were punished by investor concern of a US rate rise and saw a modest outflow.

**TABLE 8: NET RETAIL SALES OF EQUITY FUNDS BY REGION (2014-2015)**

	2014 £m	2015 £m
Asia	53	-867
Europe	221	4,478
Global	3,240	2,170
Japan	454	1,068
North America	-323	-364
United Kingdom	5,022	1,868
<b>Total</b>	<b>8,666</b>	<b>8,353</b>

## FIXED INCOME

Fixed income funds saw an outflow of £519 million in 2015 (compared to £1.5 billion inflow in 2014). Investors were concerned about a possible rate rise in the UK, which never materialised, and the long awaited US rate rise which we saw in December 2015. In hindsight, concern about the effect of a rate rise was worse than the actual event; investors sold out of the riskier fixed income sectors, Emerging Market Bonds and £ High Yield, in expectation of rising yields and defaults.

With bond yields near, or at, historical lows some retail investors did not see the benefit of holding fixed income (Chart 53). However, with little other option in a risk-off environment, some investors still sought the safety of government bonds.

**CHART 53: TEN YEAR GILT YIELD VS. FIXED INCOME SALES (2010-2015)**



Source: IA, Lipper IM

Despite a general upward trend in bond yields over the year, UK Gilts was the best-selling sector in 2015 as investors looked for safe havens through difficult market conditions (Table 9). The sector received £412 million in net retail sales, up from £192 million in 2014. Global bonds had net retail sales of £144 million, following an outflow of £333 million in 2014.

**TABLE 9: NET RETAIL SALES OF FIXED INCOME FUNDS BY SECTOR (2014-2015)**

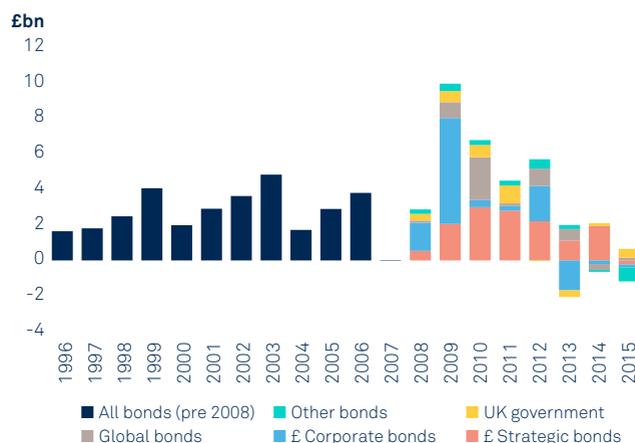
	2014	2015	2015
	Net retail sales £m	Net retail sales £m	Funds under management £m
Global Emerging Markets Bond	183	-423	2,074
£ Corporate Bond	-206	-169	55,356
£ High Yield	-281	-354	8,517
£ Strategic Bond	1,926	-222	31,854
Global Bonds	-333	144	12,406
UK Gilts	192	412	17,466
UK Index Linked Gilts	-30	94	4,586
<b>Total</b>	<b>1,451</b>	<b>-519</b>	<b>132,259</b>

The £ Strategic Bond sector had its first annual outflow since the inception of the sector in 2008.

The £ Corporate Bond sector had another negative year in terms of sales with an outflow of £169 million; 2015 was the third year in a row investors have reduced holdings in the sector.

Global Emerging Market Bonds and £ High Yield also saw outflows of £423 million and £354 million respectively in 2015.

**CHART 54: NET RETAIL SALES OF FIXED INCOME FUNDS (1996-2015)**



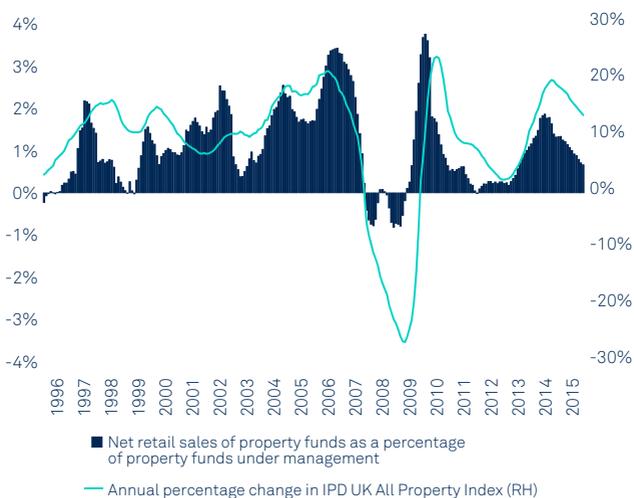
## PROPERTY FUNDS

Property funds performed well in 2015 and continued to attract investors looking for income. The IPD UK All Property index returned 13.8% in 2015 as property values and rent increased. Net retail sales were £2.7 billion in 2015, slightly down on 2014 net retail sales of £3.8 billion, but still the third best sales result since the sector was introduced.

The IA Property sector comprised 44 funds at the end of December 2015 with total funds under management of £29.4 billion. The sector consists of two types of funds; those that buy shares in property related companies and those that buy buildings (direct property funds). Within the IA property sector, there were 16 funds which invest directly in UK commercial real estate (CRE) managing assets of £24.6 billion.

Flows into property funds are heavily retail-oriented with the majority coming through advisers or wealth managers. Flows tend to track sentiment on house prices, as can be seen clearly in Chart 55, although the correlation between house prices and commercial property is actually relatively low, at 0.49.

**CHART 55: NET RETAIL SALES OF PROPERTY FUNDS VS. IPD UK ALL PROPERTY INDEX (1996-2015)<sup>34</sup>**



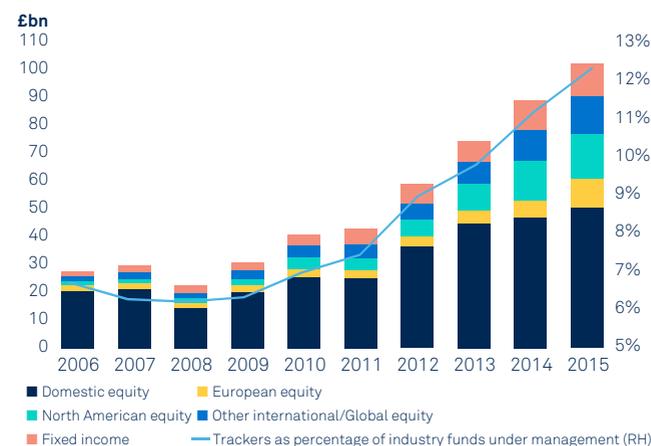
## PASSIVE INVESTMENT STRATEGIES

The IA universe of passive investment strategies accounts for index tracking funds but not ETFs. Index trackers continue to gather assets at a fair pace and are becoming an increasingly significant part of the UK fund management industry:

- At the end of 2015, index tracking funds accounted for 12% of total industry assets, up from 6.6% in 2005.
- In 2005, there were 77 index tracking funds in IA sectors. This had grown to 119 in 2015 with more recent entrants helping to drive the increase in sales.

Index tracking continues to be predominantly concentrated in the equity sectors, as Chart 56 shows, with UK trackers the largest amid major growth (60%) in European market funds under management.

**CHART 56: FUNDS UNDER MANAGEMENT OF TRACKER FUNDS BY INDEX INVESTMENT TYPE (2006-2015)**



<sup>34</sup> Net retail sales of property funds are shown as a six month moving average of net retail sales as a percentage of property funds under management over the period. The IPD UK All Property index performance is charted as the year-on-year change of the monthly total return index. Property correlation data sourced from Knight Frank.

Table 10 provides more detail on both funds under management and sales of tracker funds in the past two years.

**TABLE 10: FUNDS UNDER MANAGEMENT AND NET RETAIL SALES OF TRACKER FUNDS BY REGION (2014-2015)**

	2014		2015	
	Funds under management	Net retail sales	Funds under management	Net retail sales
	£m	£m	£m	£m
Global Equity	6,614	704	7,877	1,026
Mixed Asset	983	407	1,872	852
European Equity	6,500	442	10,372	771
UK Bonds	9,186	201	10,010	586
Asian Equity	4,383	159	5,255	520
UK Equity	46,667	1,173	50,626	511
North American Equity	14,059	1,179	16,061	489
Global Bonds	1,206	92	1,619	103
Other	3,596	165	4,004	78
<b>Total</b>	<b>93,194</b>	<b>4,523</b>	<b>107,696</b>	<b>4,936</b>

In sales terms, equity tracker growth was driven primarily by global trackers, although European sales were also robust, contributing to the funds under management increase (Chart 57). In line with the wider popularity of tracker funds, net retail sales of fixed income trackers increased 135% from 2014. The increase in sales was observed across all sterling fixed income sectors; £ Corporate bond, UK Gilts and UK Index Linked Gilts.

**CHART 57: NET RETAIL SALES OF TRACKER FUNDS BY INDEX INVESTMENT TYPE (2006-2015)**

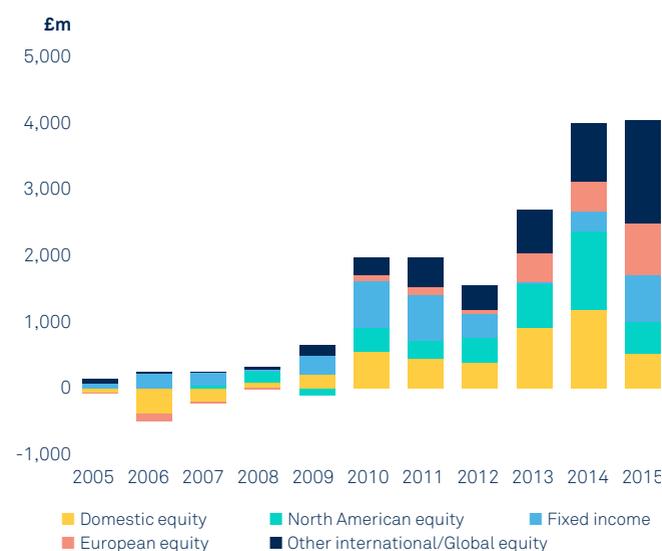


Chart 58 breaks down the growth in tracker funds under management by two contributing factors, net sales and asset appreciation from investment return. For this chart we use total (retail and institutional) net sales. In 2006 strong investment returns contributed more to funds under management than sales growth. In the post crisis years it is evident that the growth in index funds has been driven by sales rather than asset appreciation as investment returns have generally been lower since 2008.



**CHART 58: CONTRIBUTION TO FUNDS UNDER MANAGEMENT OF TRACKER FUNDS (2006-2015)**

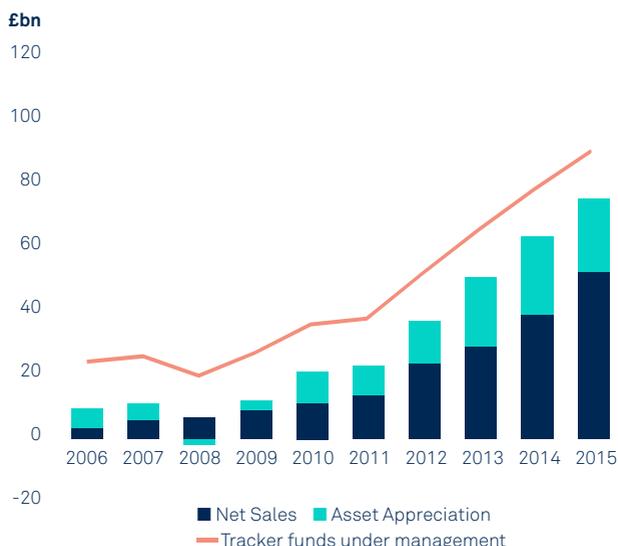
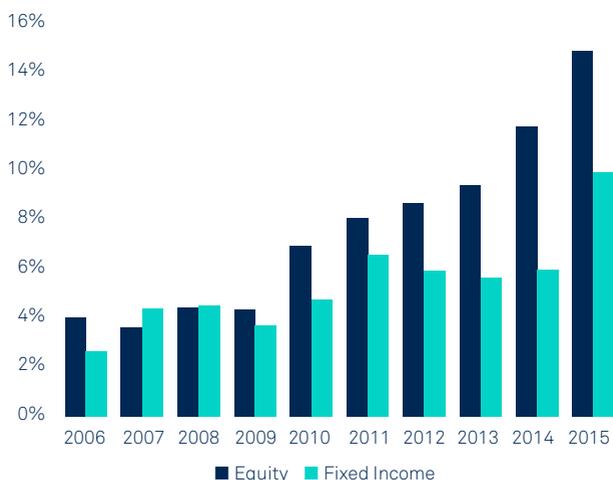


Chart 59 shows sales of tracker funds as a proportion of total sales. In 2015, 15% of equity fund sales and 10% of fixed income fund sales were allocated to index tracking funds. This is in comparison to 2006, when equity and fixed income trackers accounted for just 4% and 3% respectively.

**CHART 59: GROSS RETAIL SALES OF TRACKER FUNDS AS A PERCENTAGE OF GROSS RETAIL SALES BY ASSET CLASS (2006-2015)**



## FUND DISTRIBUTION

For the first time since the IA started collecting such data, platforms' share of gross sales fell year-on-year.<sup>35</sup> In 2015, platforms facilitated 52% of gross retail sales (£83 billion), down from 55% in 2014 (£85 billion). Direct sales rose to 8.1% (£13 billion) from 7.5% in 2014 and other intermediaries (including IFAs, wealth managers and stockbrokers) took a higher share than in 2014, with 40% in 2015 (£64 billion) up from 38%.

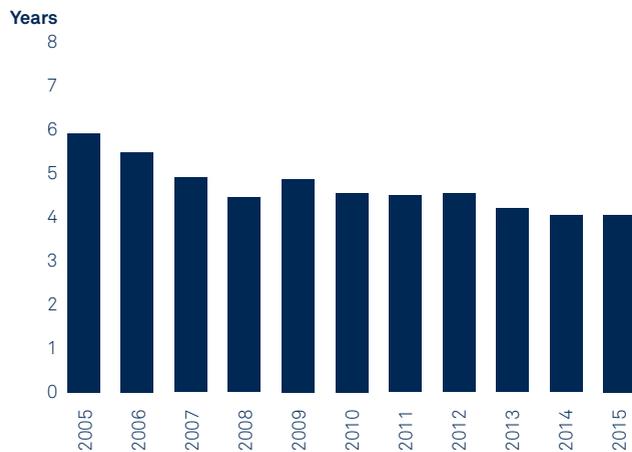
Net retail sales told a slightly different story, as direct net retail sales were -£1.8 billion, lower than 2014's outflow through direct channels of -£622 million. Net retail sales through intermediaries were £4.3 billion, up from £3.7 billion in 2014 and platforms made net retail sales of £15.1 billion in 2015, down from £18.5 billion in 2014.

Following changes to pension rules that allow savers to take more control of their pensions, personal pensions were the best-selling tax efficient product on the five fund platforms that provide data to the IA with £5.5 billion in net sales. Funds bought as part of savers ISAs attracted £3.5 billion in net sales, and Insurance bonds saw a small outflow of £11 million. Unwrapped sales, those made outside of any tax efficient vehicle, were £3.7 billion net.

<sup>35</sup> UK fund platforms covers fund companies' transactions (reported by fund companies) with the following: Ascentric; Aviva Wrap; AXA-Elevate; Cofunds; Fidelity; Hargreaves Lansdown; James Hay Wrap; Novia; Nucleus; Old Mutual Wealth (including Selestia, Skandia Multifunds and Skandia Life); Standard Life Savings; Transact.

Chart 60 shows the average fund holding period for a retail investor, this has reduced over the past 11 years from 5.9 years in 2005 to 4.1 years in 2015. Fund platforms are a major driving force behind this as platform technology makes it simple for retail investors to switch between funds. Furthermore, there is no charge for switching between funds through a fund platform. There is also more information available to the retail investor than ever before; platform recommendation lists, independent research houses and consultancies, fund rating companies and professional fund selectors such as model portfolios and fund of funds.

**CHART 60: AVERAGE HOLDING PERIODS OF RETAIL INVESTORS (2005-2015)**



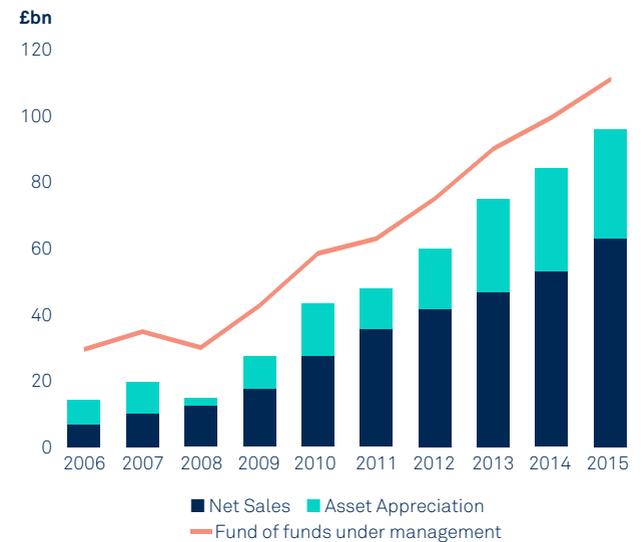
## FUND OF FUNDS

Fund of funds remain very popular in the retail market. The last time there was a net retail monthly outflow was October 2008.

Fund of funds appeal to investors with a relatively small pot of money that requires diversification. The investor effectively outsources the asset allocation and research processes to the fund of funds manager and gains the opportunity to invest in funds that they may not be able to access by themselves. For these reasons fund of funds are a popular choice with financial advisers that may not have in-house research capabilities.

Funds under management grew to £110 billion in 2015 (Chart 61), which means fund of funds now account for nearly 13% of the total fund management industry in the UK, up from 7% in 2006.

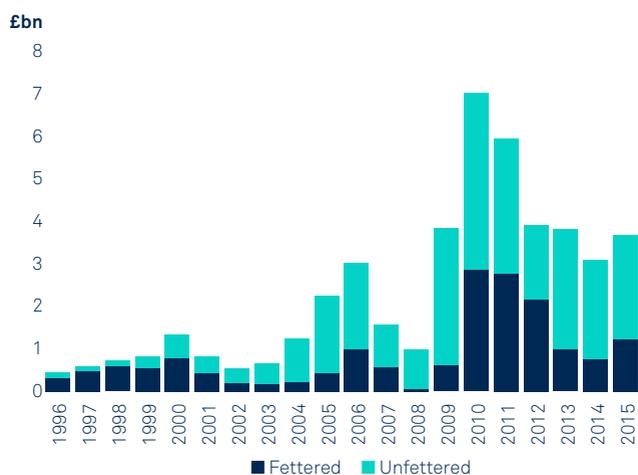
**CHART 61: CONTRIBUTION TO FUNDS UNDER MANAGEMENT OF FUND OF FUNDS (2006-2015)**



The split of assets between fettered (only buys in-house funds) and unfettered (can invest in whole of market) fund of funds is practically equal with £56 billion (51%) in fettered funds and £54 billion (49%) in unfettered funds.

Net retail sales into fund of funds was £3.7 billion in 2015, an increase of £587 million (19%) on 2014. Fettered funds brought in net retail sales of £1.2 billion and unfettered funds attracted £2.5 billion in 2015. Chart 62 shows the shape of net retail sales flows since 1996. Between 1996 and 2002 fettered funds outsold unfettered, but, excluding 2012, unfettered funds have significantly outsold fettered funds. The reason for this is that some investors believe one asset management firm cannot be the best at everything. Excluding the spike in sales in 2010 and 2011, net retail sales have remained relatively stable since 2009.

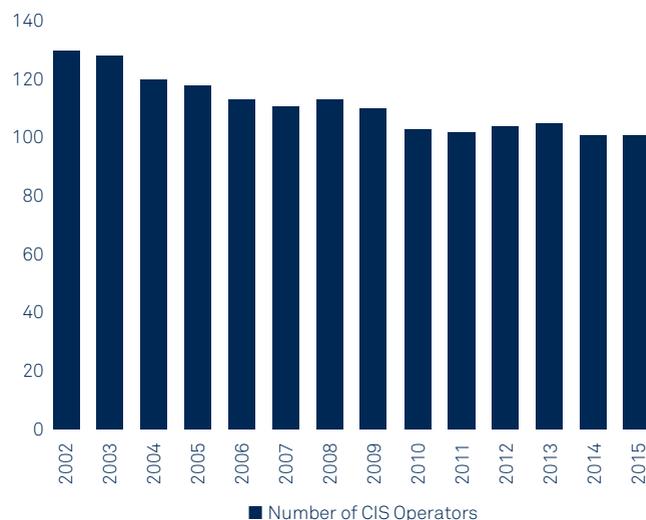
**CHART 62: NET RETAIL SALES OF FETTERED AND UNFETTERED FUNDS OF FUNDS (1996-2015)**



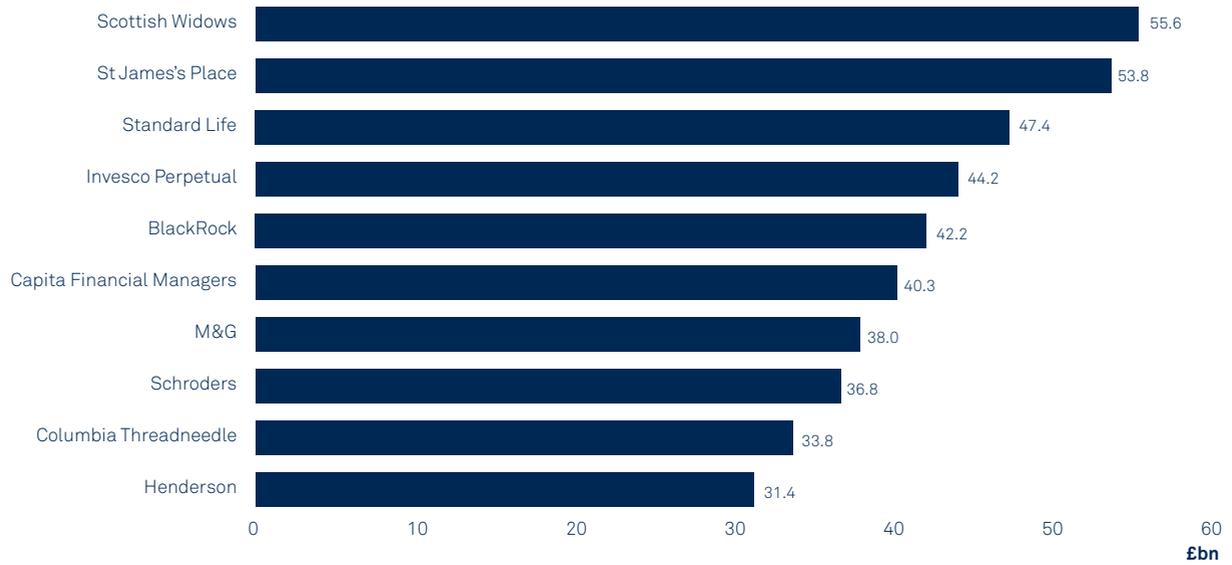
## UK INDUSTRY CONCENTRATION AND STRUCTURE

Chart 63 shows that in 2015 there were 101 asset management firms reporting fund data to the IA. This is based on the number of Collective Investment Scheme (CIS) Operators, which are the firms operating funds, therefore the number of firms carrying out investment management duties is larger. The fall in the number of firms can be attributed to two factors; M&A activity and third party CIS Operators. The use of third party CIS Operators has grown. They are particularly useful for newly launched and small firms, as they help reduce staff costs.

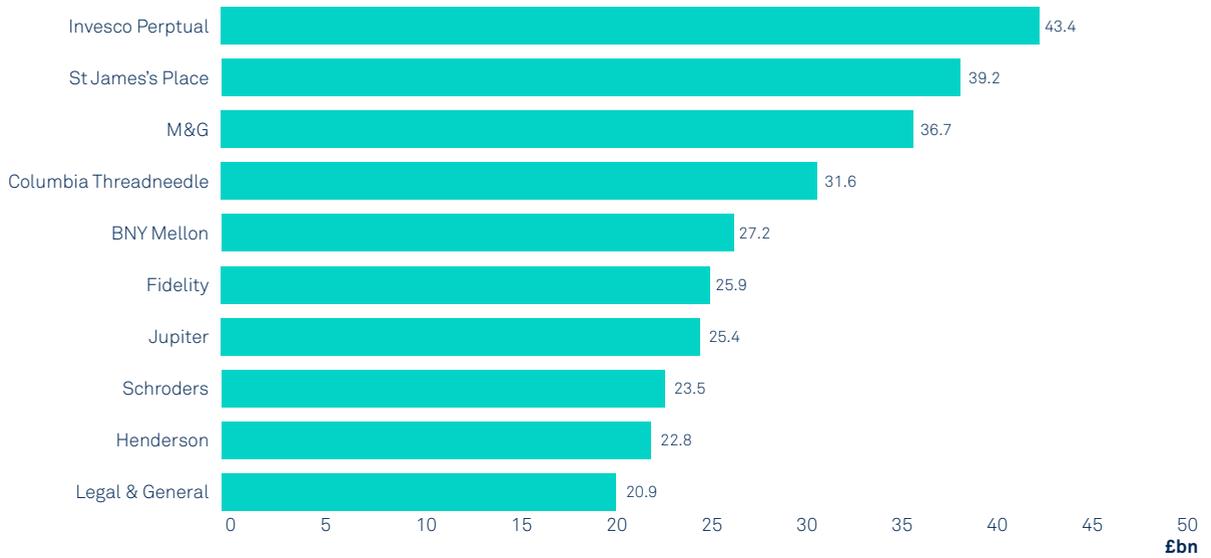
**CHART 63: NUMBER OF FIRMS REPORTING TO THE IA**



**CHART 64: TOP TEN UK FUND OPERATORS BY TOTAL FUNDS UNDER MANAGEMENT AS AT END OF 2015**

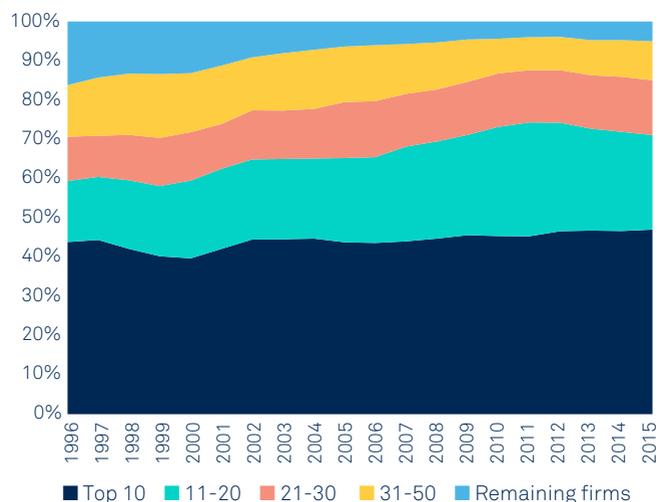


**CHART 65: TOP TEN UK FUND OPERATORS BY RETAIL FUNDS UNDER MANAGEMENT AS AT END OF 2015**



The combined market share of the top ten firms by funds under management was 47% in 2015 and has varied little as a proportion of total funds under management in the last twenty years (Chart 66). However, the composition of the top ten firms has changed significantly. For example, none of the top three in 2015 was in the top ten in 2010 and only one was in the top ten in 2005.

**CHART 66: COMBINED MARKET SHARES OF TOP FIRMS BY FUNDS UNDER MANAGEMENT (1996-2015)**



We can also look at the extent to which it is the same or different funds that feature as largest in the market. Chart 67 shows, for three sectors, the number of funds from the top 25 in 2015, which also appeared in the top 25 in 1995 and each five year interval in between. It shows that the composition of the top 25 changes significantly over time. Furthermore, we observe new entrants into the Top 25 in each time period.

**CHART 67: NUMBER OF FUNDS IN CURRENT TOP 25 THAT APPEARED IN PAST YEARS, BY SECTOR**

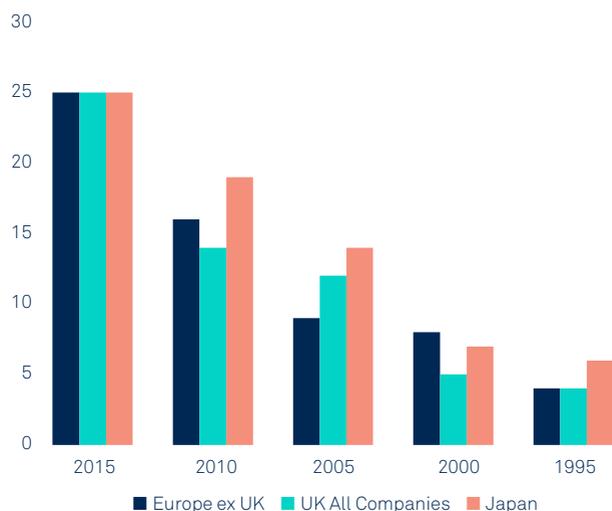
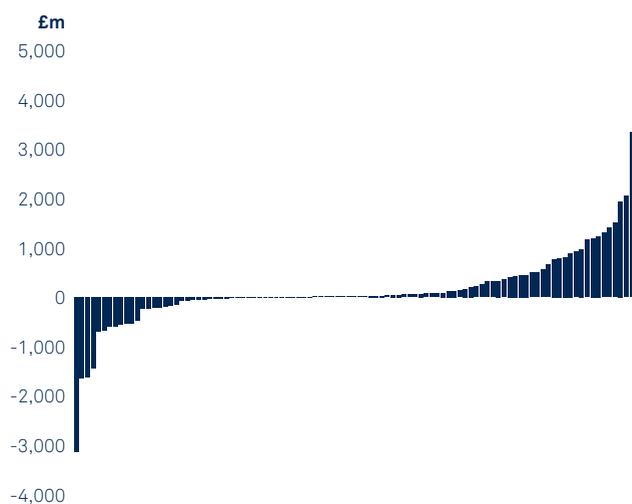


Chart 68 shows the range of net retail sales for the 101 CIS operators that report to the IA. Positive net retail sales were reported by 59 CIS operators amounting to £32 billion, largely unchanged from 2014. Forty two reported net retail outflows, totalling £14.4 billion, up from £11 billion in 2014.

**CHART 68: FUND OPERATOR NET RETAIL SALES 2015**



### CONCENTRATION AT ASSET CLASS LEVEL

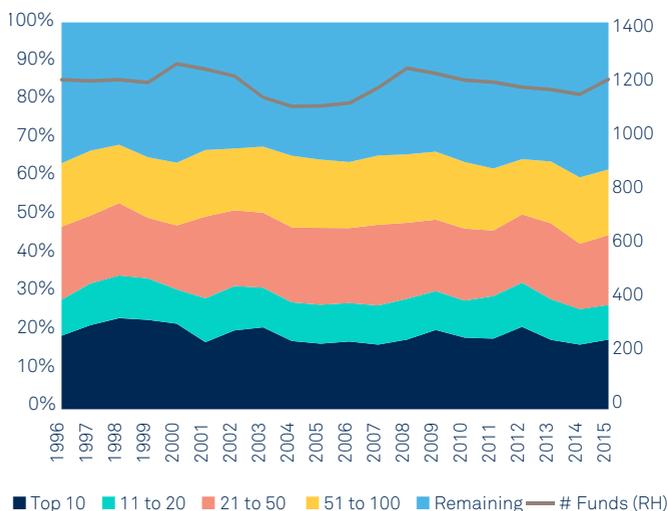
This section considers the concentration of gross sales of funds within the major asset classes; equity, fixed income and mixed asset:

- The top ten funds within all asset classes received a smaller share of sales in 2015 than they did 20 years ago.
- The larger universe of funds available to investors in 2015 makes it more difficult for any single fund to dominate the market.
- The 25 largest funds in a sector in 2015, differ greatly to the top 25 in 1995.

The UK funds industry continues to be dominated by equity funds in terms of assets and number of funds available to investors. Over the past 20 years the top 50 funds have received 48% of gross sales into equity funds. Within the top 50, the top ten account for 19% of sales and the next ten (11-20) received 10% of sales. The remaining 30 funds in the top 50 receive 19% of sales over 20 years.

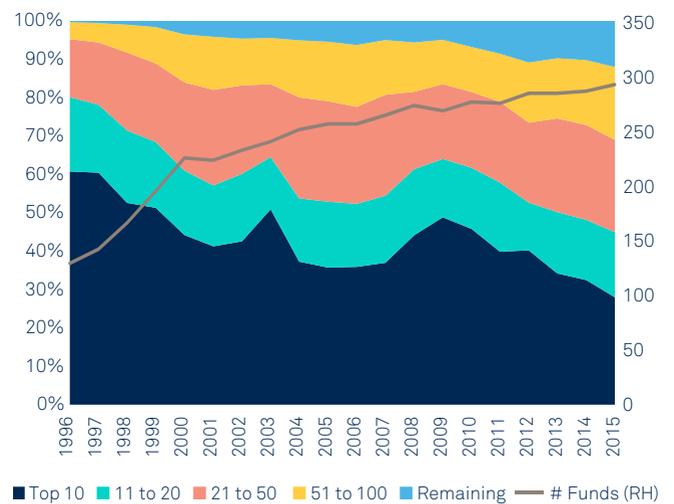
In 2015 there were 1,194 equity funds in IA sectors. The top 10 funds attracted 18% of gross sales in 2015, the top 50 received 45% of sales, whilst the top 100 funds made 62% of sales in 2015 (Chart 69). This is broadly in line with the long term average.

**CHART 69: COMBINED MARKET SHARE OF TOP EQUITY FUNDS BY GROSS RETAIL SALES (1996-2015)**



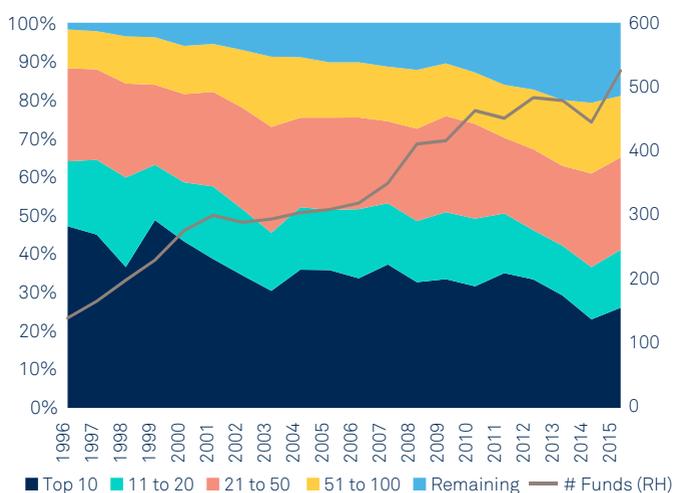
The number of fixed income funds available to investors has more than doubled over the last twenty years from 126 in 1995 to 292 in 2015. As investors have more choice the share of sales that the ten largest funds receive has fallen dramatically. The top ten peaked in 1996 taking 61% of sales, in 2015 they attracted 28% (Chart 70).

**CHART 70: COMBINED MARKET SHARE OF TOP FIXED INCOME FUNDS BY GROSS RETAIL SALES (1996-2015)**



Mixed-asset funds followed a similar pattern to fixed income, but to a greater extent. In 1995 there were 124 mixed-asset funds in the IA sectors, the top ten funds in terms of sales accounted for 58% of the total. In 2015 the number of funds had grown to 525 and the top ten's share of sales had more than halved to 26% (Chart 71).

**CHART 71: COMBINED MARKET SHARE OF TOP MIXED-ASSET FUNDS BY GROSS RETAIL SALES (1996-2015)**



## RETAIL MARKET AND VALUE FOR MONEY

A number of drivers, including the FCA Market Study and the automatic enrolment pension reforms (which include a charge cap) are resulting in a significant emphasis on cost, and on value for money. We spoke at length to a selection of members about what the asset management industry could do to show that it is a competitive industry that provides investors with value for money. There was a recognition among members that the industry had been harmed reputationally by the financial crisis and that more needed to be done to explain the benefits of asset management and provide satisfaction to those who believe that charges and costs are insufficiently clear.

“WE NEED TO LOOK OUR CLIENTS IN THE EYE AND BE ABLE TO SAY WE ARE BEING PAID TO DO THE JOB YOU WANT US TO AND NOTHING MORE.”

While costs are obviously a significant factor in determining outcome, value for money is seen in the asset management industry in a way that is similar to how it is perceived in many other sectors of the economy: value should be synonymous with delivery and quality of outcome rather than lowest cost product per se.

“WE NEED MORE TRANSPARENCY AND CONSISTENCY SO THAT PEOPLE CAN MAKE MEANINGFUL COMPARISONS WITH THE SAME SET OF NUMBERS. WHEN YOU BUY A WHITE GOOD AND YOU CAN SEE HOW ENERGY EFFICIENT IT IS, YOU COULD HAVE THE SAME THING WITH INDUSTRY CHARGES.”

Ultimately, firms interviewed saw value as measurable in broad terms by whether clients were provided with

the service they expected over time. Members felt that there were many managers providing value for money but there was recognition that performance persistently out of line with client expectations, even from a minority of funds, was a reputational risk to the wider industry. Given recent controversy over 'closet tracking', firms agreed that a spotlight should be shone on any funds that were not delivering on strategies in line with the way they were marketed.

“... IF THERE ARE THOSE THAT AREN'T DOING WHAT THEY SAY, THEY SHOULD BE CALLED OUT RAPIDLY – PEOPLE CHARGING ACTIVE FOR CLOSET TRACKING IS NOT BEHAVIOUR ANYONE WANTS TO SEE.”

Those we spoke to felt advisers also had a key role to play here as they were in the position to undertake proactive reviews of client holdings to move investments away from funds that were not delivering over the long term.

One of the major challenges in the retail market is that asset managers remain highly intermediated and the customer delivery chain extends far beyond the manufacture of investment products and services. Indeed, in the post-RDR retail market, the total cost of investment and the total cost of fund ownership are very distinct, with both advice and distribution paid for separately. While this provides much greater transparency for different services, it is still too early to judge the long-term impact on investor decision making. In measuring the value for money for the end investors it was important to take the entire value chain into consideration.

“YOU CAN'T LOOK AT THE ASSET MANAGEMENT INDUSTRY IN ISOLATION BECAUSE IT'S SUCH AN INTERMEDIATED MARKET. WE SEE FUND FLOWS COMING IN FROM NATIONAL IFA FIRMS WHO USE A RATINGS AGENCY TO SELECT A PANEL OF FUNDS AND WE GET SELECTED ON THE PANEL AND GET BUSINESS; WE HAVE IFAS WHO SELECT THEMSELVES; OTHERS WHO OUTSOURCE THE SELECTION PROCESS; OTHERS THAT BELONG TO NETWORKS. SO THERE IS A MASSIVE AMOUNT OF INTERMEDIATION AND IT'S DIFFICULT TO LOOK AT THE COMPETITIVE PART OF THIS WITHOUT LOOKING AT THE ENTIRE CHAIN – DISTRIBUTION AND ASSET MANAGEMENT TOGETHER.”

On the subject of passive management and whether indexing provides better value for money than active management, the general view among members was that this came back to the key issue of whether the asset manager was delivering the investor's objective. To a certain extent it was more straightforward to meet expectations via passive strategies, as the outcome is clear and fairly easy to measure. However, both active and passive providers make the point that better education and communication is critical in ensuring that investors understand the associated risks in all products, including index trackers, which can obviously experience significant market volatility.

“WHY IS INDEX SO POPULAR? IT’S CHEAPER AND THE INTENDED OUTCOME IS THE EXPERIENCED OUTCOME. THERE IS SOMETHING SIMPLE AND REASSURING ABOUT THAT. THE ISSUE IS THAT INDEXES CAN GO DOWN AS WELL AS UP SO YOU DON’T NECESSARILY DELIVER THE OUTCOME THAT A CUSTOMER WANTS BUT YOU DELIVER WITH ACCURACY WHAT YOU SAID YOU WOULD DELIVER.”



In this regard, a number of those interviewed this year stressed the importance of being better able to understand the overall objectives of the end investor and developing a more direct relationship with them. It was thought that the industry had undergone a fundamental positive change and now had a much better understanding of customer need, and a focus on providing strategies that were likely to result in a good long-term outcome for investors, with fewer investment shocks along the way.

“WE NEED TO FIND A WAY OF TALKING ABOUT THE BENEFITS OF ACTIVE MANAGEMENT. PASSIVE IS NOT THE ONLY ANSWER. THAT’S WHY SOLUTIONS ARE IMPORTANT – LET US DO THE ASSET ALLOCATION FOR YOU.”



However, the heavily intermediated nature of the industry created challenges in this area. Assets that reach managers via platforms, for instance, may afford limited information about the underlying investor and therefore make it harder for asset managers to ensure that the strategies they are providing are meeting the objectives of the investor at every stage of their savings journey.



Those interviewed also raised the point that it would be helpful to place the value offered by asset managers in the context of the wider savings environment.

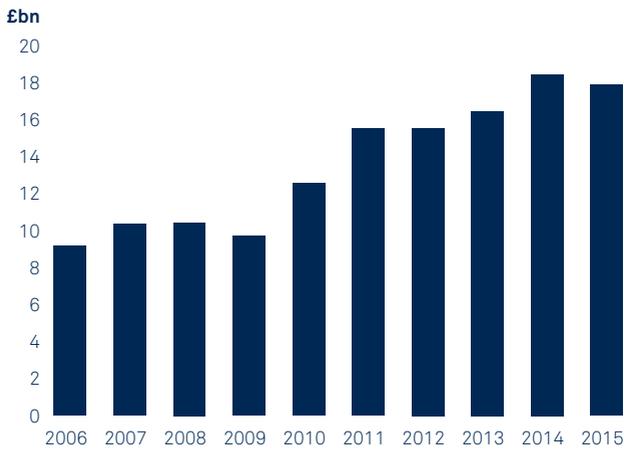
For instance, in a period of very low interest rates, when it is difficult to make money from cash and there is low growth globally, there is an opportunity for asset management to deliver products and services that can provide a return to savers, particularly for those seeking income. Retail sales over the past eight years clearly indicate many households and individuals are using fund management products for precisely this goal. However, there is a recognition in the industry that the potential market is far greater. This leads back to broader issues not just about trust and confidence in financial services, but about access to products and the role of different kinds of support mechanism, whether regulated advice or guidance (see page 87 on robo-advice).

## INCENTIVES AND LONG-TERM SAVING

### ISAS

Subscriptions into stocks and shares ISAs amounted to £17.9 billion in the 12 months to the end of April 2015. Despite the increased ISA allowance, this is a reduction on the previous year's total of £18.4 billion (Chart 72).

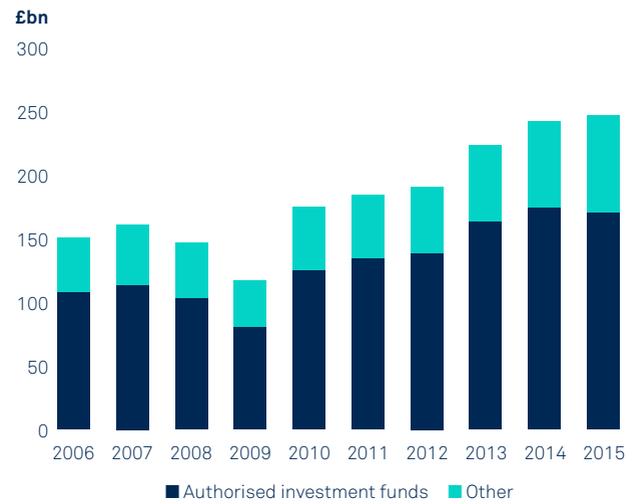
**CHART 72: GROSS SUBSCRIPTIONS INTO STOCK AND SHARES ISAS (2006-2015)**



Source: HMRC

Authorised investment funds are the most popular vehicles for savers using a stocks and shares ISA; 69% or £170 billion was invested through funds.

**CHART 73: FUNDS UNDER MANAGEMENT IN ISAS (TAX YEAR ENDING APRIL 2006-2015)**



Source: HMRC

From April 2017 investors will have a new savings vehicle designed for use to either purchase a first home or to generate savings for use after the age of sixty. The introduction of the Lifetime ISA (LISA) follows on the heels of a number of changes to pensions saving:

- Lowering of the lifetime allowance to £1 million.
- Reduction of the standard annual allowance to £40k.
- Removal of the requirement to secure an income in retirement, meaning assets can remain invested throughout an individual's life.

Members reinforced comments from last year's interviews, stressing the importance of simplicity and stability in the savings and pensions environment. The constant tinkering with legislation was seen as unhelpful. Nevertheless, those we interviewed were generally positive about any move that made it easier for people to save, in particular the focus on incentivising younger people to save.

“I WAS PLEASANTLY SURPRISED THERE WAS SOME TAX INCENTIVE FOR YOUNG PEOPLE TO SAVE BECAUSE THEY HAVE BEEN SQUEEZED AT THE EXPENSE OF THE ELDERLY. WHETHER THEY CAN AFFORD TO SAVE OF COURSE IS A DIFFERENT MATTER, BUT EVEN IF YOU LOOK AT IT AS A POTENTIAL HANDOUT FOR A HOUSE DEPOSIT IT WILL BE WELCOMED. YOU'LL GET INTO THE SAVINGS HABIT.”

In the context of Budget 2016, there was optimism that the LISA could be a good introduction to investment and may well lead to an element of higher-risk investment better suited to provide long term outcomes, particularly with the 25% 'free' contribution that would be received from the government. Again, better communication and education emerged as key themes, even if it was challenging for fund managers directly given the high levels of intermediation.

However, several areas of caution emerged in interviews:

- **Attractiveness of long-term investment ISA.** A number of firms wondered how easy it would be to widen the popularity of the ISA brand in light of the lack of take up of other types of long-term savings vehicle such as the child trust fund, which were based on investment rather than cash saving. Evidence on the high number of ISA cash subscriptions relative to ISA investment subscriptions reinforced this point.<sup>36</sup>
- **Conflicting objectives.** Linked to the first point, the dual nature of the LISA, allowing it to be used for house purchase or retirement, raised the concern that this could lead to savings in LISA's being directed to, and remaining in, cash. In the long term this would be unlikely to be in the best interests of the investor, should they ultimately want to use the proceeds of the LISA for their retirement income. International evidence does suggest that when retirement savings may be used for other purposes at an earlier point in life, this does lead to people adopting lower-risk investment strategies.<sup>37</sup>
- **Potential complexity.** From a practical perspective, the complexity of administering the LISA did not go un-challenged. As the LISA can be used for both long-term saving and saving for a property, the reason for a withdrawal would need to be verified, relevant government bodies would need to be informed and it was far from clear at the time of our interviews how this would work in practice.
- **Investor apathy.** While the connection to house purchase might be a motivating factor, firms pointed to the difficulty in persuading people pro-actively to save for long-term goals, such as retirement income. Investor apathy highlights the importance of policies that require minimal individual intervention, as evidenced by the success so far of automatic enrolment.

“I THINK INCENTIVES ARE HUGELY IMPORTANT BUT I DON'T KNOW WHETHER TAX IS THE WAY TO DO IT. FOR MOST PEOPLE IT'S JUST TOO ABSTRACT. MATCHING FROM THE EMPLOYER IS VERY CONCRETE.”

<sup>36</sup> HMRC ISA statistics, April 2016

<sup>37</sup> Briefing note 82 – Lifetime ISAs- the international evidence, PPI, 2016

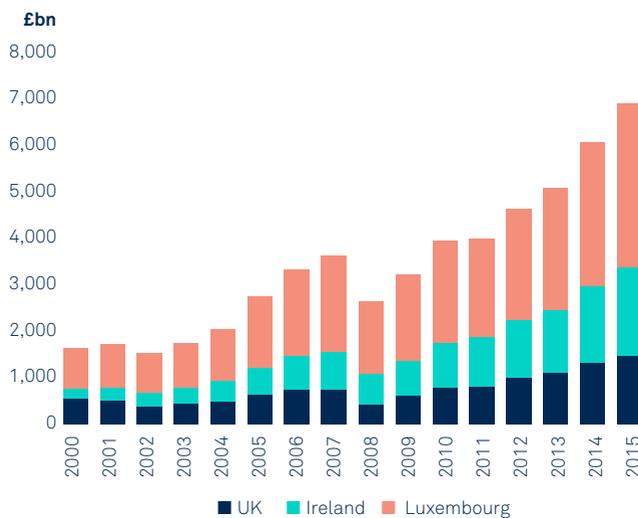
<sup>38</sup> EFAMA data includes UCITS and non-UCITS funds and is inclusive of fund of funds.

## INTERNATIONAL CONTEXT

Globally, investment funds under management stood at \$40.1 trillion at the end of 2015. North America continued to be the largest fund market in the world with \$19.4 trillion held in US domiciled funds. European domiciled funds totalled \$13.3 trillion and there were \$4.8 trillion in funds domiciled in the Asia-Pacific region.

In euro terms, there were €12.6 trillion held in investment funds domiciled in Europe, an 11% increase on the 2014 total of €11 trillion. As a fund domicile (as opposed to an asset management centre), the UK remained the fifth largest centre in Europe with €1.5 trillion in funds under management (€1.3 trillion in 2014).<sup>38</sup> Luxembourg was the most popular European country for hosting funds with €3.5 trillion and Ireland second most popular with €1.9 trillion (Chart 74).

**CHART 74: FUND ASSETS BY DOMICILE, UK, IRELAND, LUXEMBOURG (2000-2015)**



Source: The IA, EFAMA

**FIGURE 7: EUROPEAN INVESTMENT FUNDS BY COUNTRY OF DOMICILE (DECEMBER 2015)**



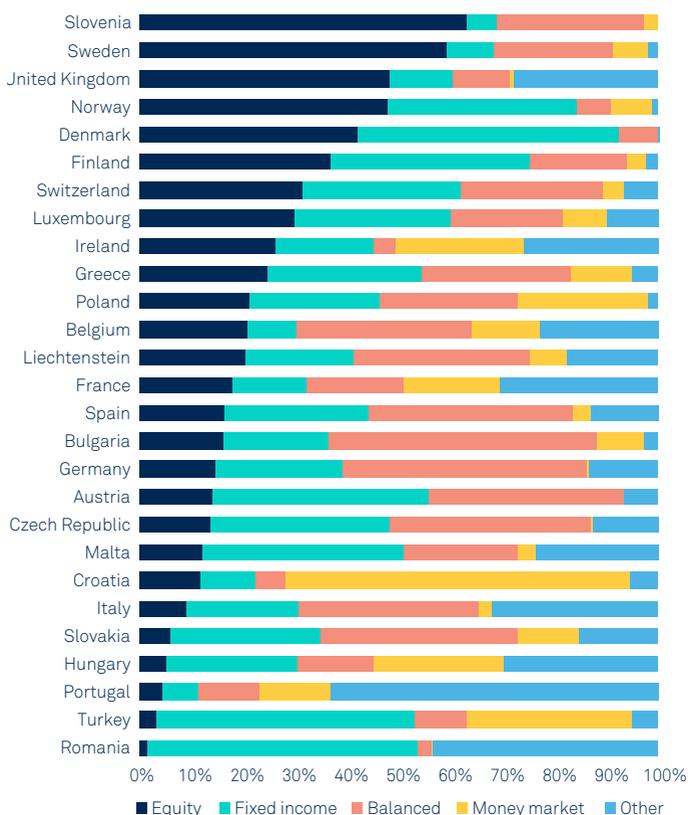
Country	Net assets (£bn)	Market share
1 Luxembourg	3,506	27.9%
2 Ireland	1,899	15.1%
3 Germany	1,729	13.7%
4 France	1,683	13.4%
5 United Kingdom	1,480	11.8%
6 Switzerland	502	4.0%
7 Sweden	286	2.3%
8 Italy	282	2.2%
9 Denmark	258	2.1%
10 Spain	254	2.0%
Other	701	5.5%
<b>TOTAL</b>	<b>12,580</b>	<b>100.0%</b>

Source: EFAMA

Across Europe, net sales were the highest on record at €717 billion, in contrast to the slowdown in sales seen in the UK. The ECB's continued negative interest rate policy and the low inflationary environment were the main driver of these record sales as investors and savers sought positive returns. With very few European banks offering interest on savings accounts, savers were inclined to move their savings into funds offering a greater opportunity of positive returns. A broad range of investment strategies, offering a range of risk levels, has provided investors with greater choice. Furthermore, continued ECB policy to promote growth in the Eurozone has encouraged investors to allocate to European focused investment funds.

Chart 75 provides some insight on investor choice across European countries. Slovenian domiciled funds are heavily equity focused, this is unsurprising because of the relatively young bond market in Slovenia. The Slovenian bond market is heavily weighted to government issuance and this tends to be bought by large international emerging market debt funds. It is also euro denominated and subject to low euro yields.

**CHART 75: BREAKDOWN OF FUNDS UNDER MANAGEMENT BY FUND DOMICILE**



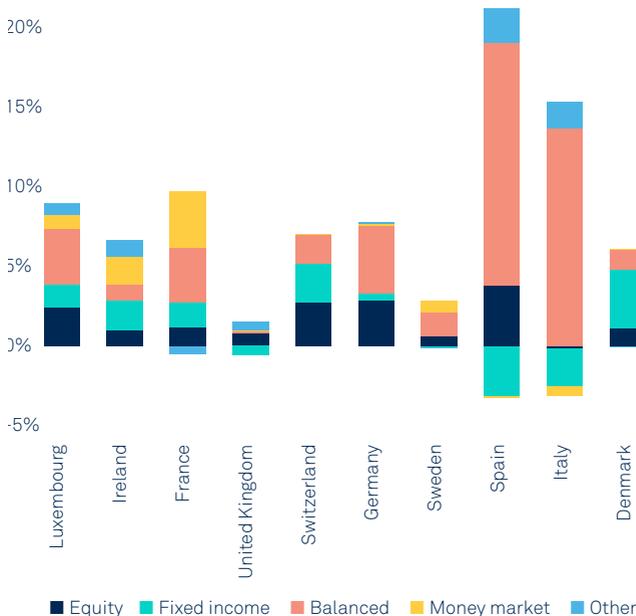
Source: EFAMA

Investors in the UK and Nordic countries show a clear preference for equity funds. Investors in these countries tend to have high levels of personal wealth in savings and property ownership which would allow greater risk taking.

German bunds have produced low or negative yields for some time and the pfandbriefe (covered bond) market has shrunk significantly since 2008. German investors have traditionally held large amounts of their wealth in bonds, but over recent years have moved toward multi-asset products.

Low savings rates and bond yields across euro-zone countries have led investors to look for return elsewhere. This has resulted in increased use of mixed-asset and absolute return funds in the larger European economies and a reduction in the use of money market funds (Chart 76). However, money market and bond funds are still popular amongst investors in countries that are not subject to negative ECB rates, as these products are still able to provide investors with a respectable level of return.

**CHART 76: NET SALES OF UCITS BY ASSET CLASS AS PERCENTAGE OF TOTAL UCITS FUNDS UNDER MANAGEMENT, SELECTED COUNTRIES**



Source: EFAMA



# UK AUTHORISED FUNDS

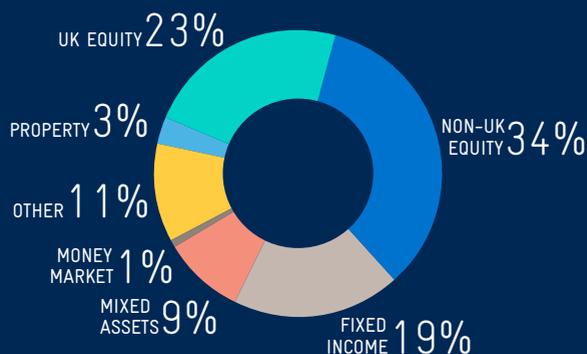
## JUNE 2016 YEAR-TO-DATE UPDATE NEW REPORTING BASIS FOR 2016

The IA's authorised fund statistics below reflect sales of funds to UK investors (including sales of overseas domiciled funds) rather than sales of UK domiciled funds. From 2016-2017 the full IA Annual Survey will be prepared on this new reporting basis.

### FUNDS UNDER MANAGEMENT:



### FUNDS BY ASSET TYPE:

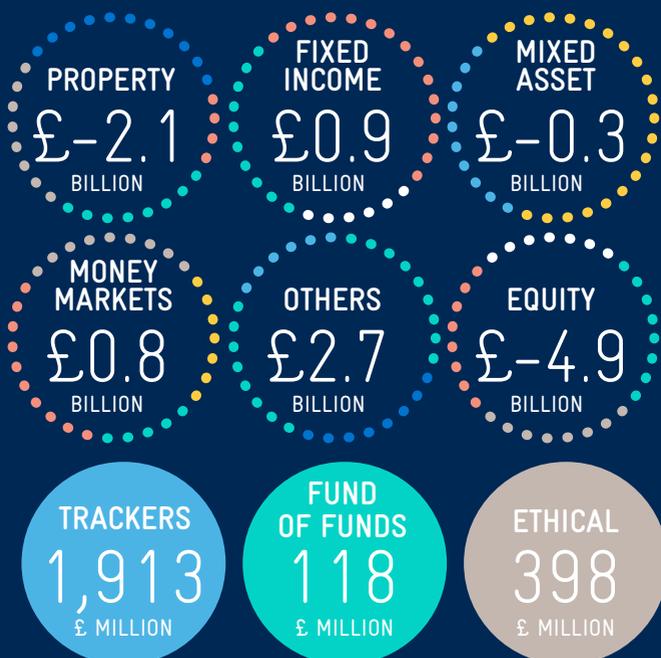


### UK INVESTORS:

	TOTAL FUM £BN	OF WHICH HELD IN UK DOMICILED FUNDS	OF WHICH HELD IN OVERSEAS DOMICILED FUNDS
2012	701	648	53
2013	818	751	67
2014	884	810	74
2015	925	837	88
JUN-16	948	850	97

## NET RETAIL SALES

### ASSET CATEGORY:



### DISTRIBUTION CHANNEL

UK FUND PLATFORMS	£1,878 MILLION
OTHER UK INTERMEDIARIES INCLUDING IFAS	£36 MILLION
EXECUTION ONLY INTERMEDIARIES	-£143 MILLION
NON-UK INTERMEDIARIES	-£542 MILLION
TRUSTEES AND CUSTODIANS	-£554 MILLION
DISCRETIONARY MANAGER	-£946 MILLION
DIRECT	-£2,602 MILLION

# 5 OPERATIONAL AND STRUCTURAL ISSUES

## KEY FINDINGS

### REVENUE AND COSTS

- Average industry net revenue (including all activity – in-house and third party) grew around 6% in absolute terms, unchanged from 2014 (revised), at 30bp of total assets.
- Total operating costs in 2015 increased 7%, equivalent to 20bps of total assets, little changed from last year.
- Operating margin fell slightly as a consequence to 34% (from 35% in 2014).
- Use of performance fees remains broadly stable and is still a comparatively small part of overall industry activity.

### EMPLOYMENT IN THE ASSET MANAGEMENT INDUSTRY

- We estimate that the UK asset management industry directly employed 37,000 people at the end of 2015, although the total employed in direct and indirect roles is more than 90,000.
- Staff in Compliance, Legal and Audit have grown most significantly since 2011 with almost 50% more people being employed in these roles than at the start of the period.
- The level of firms outsourcing some part of their business remained relatively stable at three quarters of firms (76%).

### INDUSTRY CONCENTRATION

- Concentration of the UK asset management industry remains relatively low. Assets managed by the top five firms were unchanged at 39%. Assets managed by the top ten firms in 2015 increased by one percentage point to 56%.
- The median figure for assets managed by IA member firms was £10 billion compared to a mean figure of £41 billion. This indicates that the industry is very skewed towards smaller firms.
- The number of boutique managers has dropped to 24 as a result of relatively higher asset growth among boutique managers and ongoing merger and acquisition activity.

### ASSET MANAGER OWNERSHIP

- The proportion of assets run by independent asset managers was almost unchanged at 40% (41% in 2014). Ownership figures overall were very similar to last year.

### A NEW LOOK TO ASSET MANAGEMENT IN THE UK?

- Merger and acquisition activity has been stimulated by a number of factors. Operational issues, such as running costs could have ramifications for future entrants to the industry.
- The industry of the future is likely to favour larger firms offering a full suite of services, alongside small targeted managers with unique product offerings.

### THE OPPORTUNITY AND RISKS OF INCREASED USE OF TECHNOLOGY

- Asset managers are focusing extremely high levels of resources on cybersecurity, with the primary concern being the safety of client data and the potential reputational risk associated with security breaches.
- There is a clearly a gap in advice services for a proportion of investors. While most asset managers agree with the need for some form of cost effective “robo-advice”, those without vertical integration see the solution being driven by distributors rather than asset managers directly.

# 5 OPERATIONAL AND STRUCTURAL ISSUES

## REVENUE AND COSTS

The figures shown in Chart 77 cover both in-house and third party business.

- Total average industry revenue after commission stood at £17 billion in 2015, a 6% increase in nominal terms and in line with average asset growth. This equates to 30bps of total assets, the same as 2014 (revised).<sup>39</sup>
- Total operating costs in 2015 were £11 billion, no change in relative terms from 2014, at 20bps.
- These figures imply an operating margin of 34%, down slightly from 35% in 2014.<sup>40</sup>

**CHART 77: INDUSTRY NET REVENUE VS. REVENUE AND COSTS AS PERCENTAGE OF AVERAGE ASSETS UNDER MANAGEMENT (2006-2015)**

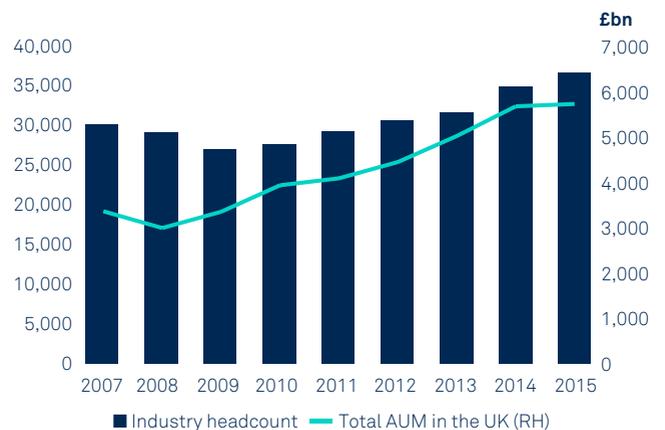


When calculated on an asset-weighted basis, our data suggests that around 13% of industry assets overall are subject to performance-based fees, broadly unchanged from previous years. Fewer than 5% of respondents reported that the prevalence of performance fees had increased over the last year. The overwhelming majority felt they had either remained static or decreased in prevalence.

## EMPLOYMENT IN THE ASSET MANAGEMENT INDUSTRY

We estimate that the number of people directly employed in the asset management industry in the UK increased by 5% in 2015 from 35,100 to 37,000 showing the industry continued to grow, albeit at a slower rate (Chart 78).

**CHART 78: INDUSTRY HEADCOUNT ESTIMATE VS. UK ASSETS UNDER MANAGEMENT (2007-2015)**



Eighty two per cent of respondents this year reported that they used performance-based fees, slightly down from 2015 (83%) but in line with the average of recent years.

<sup>39</sup> While total AUM as measured at December 2015 remained unchanged from 2014, revenue is measured on AUM calculated as the average of AUM at the beginning and end of each calendar year. The revenue increase is consistent with the average change in assets under management between 2013/14 and 2014/15.

<sup>40</sup> Calculated as net revenue (before amortisation and exceptional items and excluding finance expenses) less costs (fees retained after payment of any commission or sales revenue retained by third parties) divided by net revenue

As we illustrated in Figure 4 (see page 23) the IA estimates that over ninety thousand people are employed in activities related either directly or indirectly to asset management including fund and wider administration and securities and commodities dealing activities.<sup>41</sup> Due to the difficulty in obtaining staffing data by job type, especially for organisations that have a wide financial service remit, this figure is likely to be a conservative estimate of the actual numbers employed in asset management related activity.

Although London and Scotland remain the key centres for the UK asset management industry, it supports a significant number of jobs in all regions of the United Kingdom. Respondents this year told us they had offices in many locations outside of London and Scotland, including Bristol, Norwich, Peterborough, Leeds, York, Bournemouth, Cardiff, Oxford and Chester.

Table 11 provides more detail on the number of employees directly employed by asset managers in the UK by function. The proportion of people employed in investment management research and dealing remained relatively stable year on year. The number of (directly employed) staff working in operations and fund administration fell back to 17%, in line with numbers seen in 2013. Employment in IT increased by two percentage points, consistent with the message we received during this year's interviews that IT has seen significant investment.

**TABLE 11: DISTRIBUTION OF STAFF BY ACTIVITY (DIRECT EMPLOYMENT)**

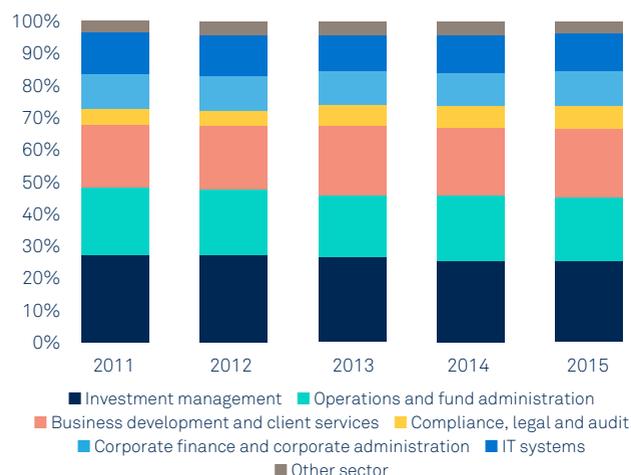
Activity	Percentage of total headcount
<b>Investment Management of which</b>	<b>25%</b>
Investment management (asset allocation and stock selection)	66%
Research, analysis	27%
Dealing	7%
<b>Operations and Fund Administration of which</b>	<b>17%</b>
Investment transaction processing, settlement, asset servicing	35%
Investment accounting, performance measurement, client reporting	38%
Other fund administration (incl. CIS transfer agency, ISA administration etc.)	27%
<b>Business Development and Client Services of which</b>	<b>23%</b>
Marketing, sales, business development	67%
Client services	33%
<b>Compliance, Legal and Audit of which</b>	<b>7%</b>
Compliance	37%
Risk	29%
Legal	29%
Internal audit	5%
<b>Corporate Finance and Corporate Administration of which</b>	<b>11%</b>
Corporate finance	38%
HR, training	21%
Other corporate administration	41%
<b>IT Systems</b>	<b>13%</b>
<b>Other Sector</b>	<b>4%</b>

<sup>41</sup> Source ONS, IA, individual company data

As absolute year on year changes by staff segment are generally relatively small it is potentially more helpful to consider the trend in distribution by staff segment on a like-for-like basis over the last five years. Chart 79 shows some substantial changes in staffing on a like for like basis:

- Staffing in Compliance, Legal and Audit has grown by almost 50% since 2011, from 4.7% of the total, to 7% of the total. This is consistent with the views we encountered during our survey interviews that the regulatory obligations on firms have increased significantly in recent years.
- Staffing in investment management is 6% lower than its level in 2011.

**CHART 79: DIRECT EMPLOYMENT BY STAFF SEGMENT (2011-2015)**

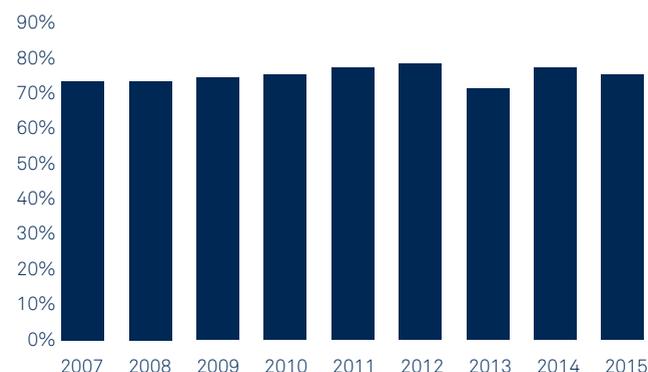


	2011	2012	2013	2014	2015
Investment Management	27%	27%	27%	25%	25%
Operations and Fund Administration	21%	20%	19%	21%	20%
Business Development and Client Services	20%	20%	22%	21%	22%
Compliance, Legal and Audit	5%	5%	7%	7%	7%
Corporate Finance and Corporate Administration	11%	11%	10%	10%	11%
IT Systems	13%	13%	11%	12%	12%
Other Sector	3%	4%	4%	4%	4%

Staffing in operations and fund administration has been relatively stable and stands at 20%, the average level over the last 5 years.

Levels of outsourcing remain high among asset managers and a proportion of staffing continues to be outsourced both within and outside of the UK. The exact amount is difficult to estimate as firms may not be aware of the precise number of employees taking part in outsourced activities. However, Chart 80 indicates the number of firms reporting that they outsource some part of their activity is significant and there is no meaningful sign of the proportion decreasing. Over three quarters (76%) of firms outsourced some part of their activity at the end of 2015.

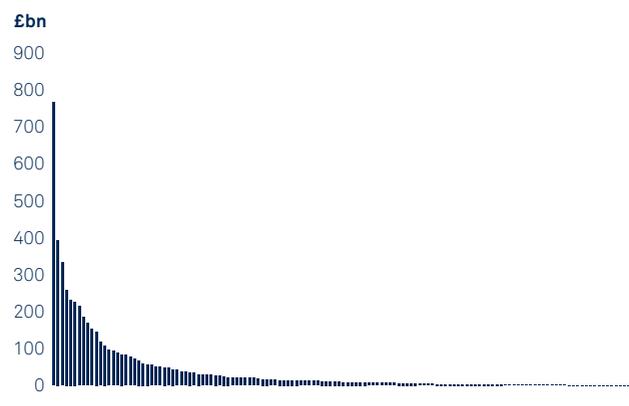
**CHART 80: PROPORTION OF FIRMS OUTSOURCING SOME PORTION OF THEIR ACTIVITY (2007-2015)**



## INDUSTRY CONCENTRATION

Chart 81 illustrates that the asset management industry in the UK comprises a small number of very large firms but a long tail of medium- and small-sized organisations. This has historically been the pattern within an industry that has been characterised by a diversity of operating model and comparatively low barriers to entry, although many within the industry believe this may be changing post-2008.

**CHART 81: IA MEMBER FIRMS RANKED BY UK ASSETS UNDER MANAGEMENT (JUNE 2015)**



The IA monitors the distribution of member firms by the level of assets they have under management. The distribution has remained relatively stable in recent years, as shown in Table 12. However, the number of smaller firms with assets below £1 billion has fallen once again to 15 (down from 22 in 2014).

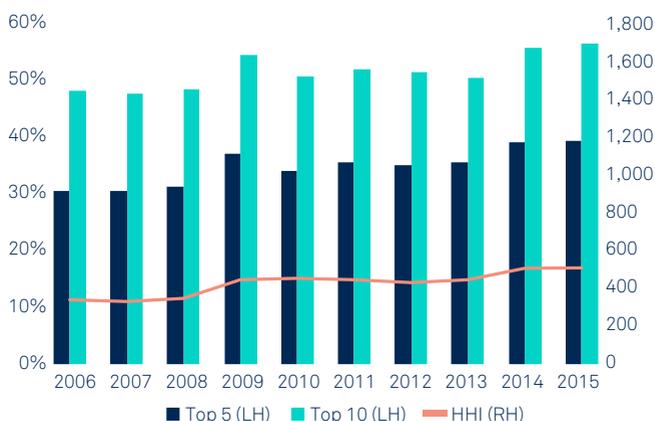
**TABLE 12: ASSETS MANAGED IN THE UK BY IA MEMBERS BY FIRM SIZE**

Assets under management	No. of firms (June 2015)	Survey respondents (Dec 2015)
>£100bn	13	12
£50-100bn	14	10
£25-50bn	13	7
£15-25bn	13	7
£1-15bn	68	27
<£1bn	15	3
<b>Total</b>	<b>136</b>	<b>66</b>

All of this points to the relatively low concentration of the UK asset management industry, although there has been a mild trending increase in concentration over the last ten years. Nevertheless a value of less than 1,000 on the Herfindahl-Hirschmann Index, a standard measure of competition, represents low concentration. The value for the asset management industry at the end of 2015 stood at 505 and has averaged 421 over the last decade (Chart 82).

The five largest firms represented 39% of assets in 2015, compared to 31% ten years ago, and the ten largest firms represent 56% of industry assets, up 8 percentage points in the last ten years.

**CHART 82: MARKET SHARE OF LARGEST FIRMS BY UK ASSETS UNDER MANAGEMENT VS. HHI (JUNE 2006-2015)**



**AVERAGE ASSETS UNDER MANAGEMENT AT JUNE 2015**



Chart 83 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>42</sup> The top ten includes a mix of active and primarily passive managers. There is also a wide variety of group types in the top ten, including independent asset managers, managers that are part of a larger insurance group, or bank.

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

**CHART 83: TOP TEN FIRMS BY UK-MANAGED AND GLOBAL ASSETS UNDER MANAGEMENT<sup>43</sup>**



<sup>42</sup> Based on headline data supplied to The IA in response to the Survey Questionnaire

<sup>43</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.

## BOUTIQUES

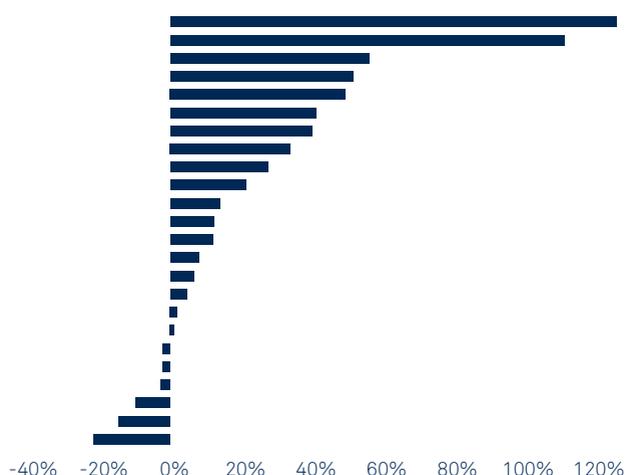
The IA membership contains a number of boutique managers, firms that we broadly define as:

- Being independently owned
- With assets of £5.5 billion or less<sup>44</sup>
- Providing a degree of investment specialisation
- Self definition

According to this definition the number of such firms in the IA membership fell to 24 in June 2015. The fall in numbers results from a number of boutique members being acquired by other asset managers, however there are others whose rate of growth no longer qualifies them for boutique classification according to our criteria.

Assets managed by boutique managers grew strongly in 2015 (Chart 84), increasing by 19% year on year to June.

**CHART 84: PERCENTAGE CHANGE IN UK-MANAGED ASSETS ACROSS BOUTIQUE IA MEMBERS (2014-2015)**

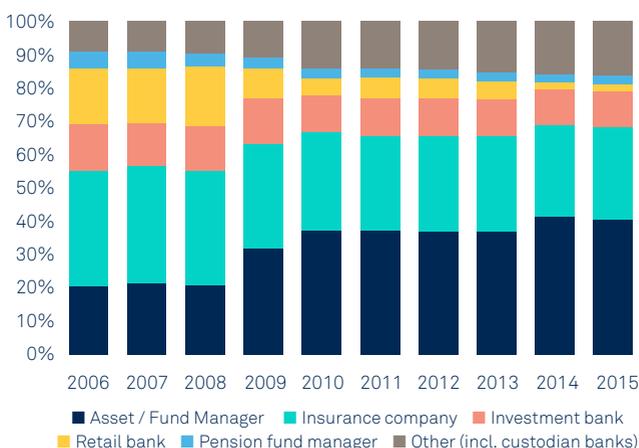


<sup>44</sup> Based on June data.

## CORPORATE CHANGE

As we saw in Chapter 1, there has been a structural shift in the ownership of asset management companies. Chart 85 shows that the number of independent asset managers now stands at 40%, stabilising on last year's number but still up from 18% ten years ago.

**CHART 85: BREAKDOWN OF UK ASSETS UNDER MANAGEMENT BY PARENT TYPE (2006-2015)**



Appendix 4 contains highlights of the merger and acquisition activity that has taken place in the UK in the past few years. Acquisition activity may take a variety of forms:

- Outright purchase and rebranding by the new parent of the acquired firms product set.
- A 'multi-boutique' approach where individual brands co-exist and compete with a shared set of common resources provided by a parent company.
- Variations of the above, where groups contain distinct brands with their own separate operations.
- Purchase of specific capabilities through the lift-in of investment teams from rival companies, which some see as much more efficient than purchasing an entire company, which was likely to come with a number of unwanted elements

We spoke to members this year about what they felt the reasons were for the strength of M&A activity the industry has witnessed in recent years.



The increasing cost of legal and regulatory expenses was mentioned as one reason behind merger and acquisition activity, as smaller managers in particular were finding it increasingly difficult to meet the costs involved. Consequently, this was also predicted to be a significant hurdle to investment managers considering setting up in the industry in the future. This may have significant consequences for the number of specialist or boutique managers that enter the industry in the future.

For many we spoke to, particularly larger firms, scale was felt to be a key requirement to respond to the pace of regulatory change. Scale in terms of service and performance would also be critical from a broader competition perspective, with firms needing simultaneously to retain coherent investment philosophies and product innovation capabilities. However, scale was not possible in all products without compromising investment return. Such strategies would need to be kept within capacity, meaning that efficiencies of scale would not always be achievable.

“GETTING ACCESS TO DISTRIBUTION WILL BE KEY, BEING ASSOCIATED WITH STRONG BRANDS. IT’S REALLY HARD TO DO THAT IF YOU’VE GOT LOTS OF SMALL BUSINESSES COMPETING FOR SMALL POTS OF MONEY.”



In line with comments made to us in recent years those interviewed felt that the future would be a positive environment for two primary types of asset manager:

- Large firms with very strong brands offering a full suite of products.
- Small targeted managers with a very specific niche offering.

The space in between was expected to be particularly challenging. This remains in line with other long-term expectations of industry change.<sup>45</sup>

Access to distribution was also seen to be key as distributors are looking to work with a smaller range of providers who are able to provide a wide range of products. This has resulted in a variety of firms looking at expanding into new business areas, such as acquiring robo-advice start-ups, as they explore whether to develop a more direct relationship with the end client. This is an attractive proposition as, even if their funds are available for distribution via platforms and IFAs, there is no guarantee that assets will be directed to those funds or that the asset manager’s relationship with the distributor will be profitable.

“NOT ALL ASSET MANAGERS WANT TO BE THE DAIRY FARMER WITH THE DISTRIBUTOR BEING SUPERMARKET.”



<sup>45</sup> The best known of these remains the paper from Huw Van Steenis in 2004 which introduced the term ‘barbell’ as a description of what was foreseen for patterns of competition and industry structure.

## TECHNOLOGICAL CHANGE

### CYBERSECURITY

In the last year two thirds of large UK business have been subject to some form of cybersecurity attack and almost a quarter experienced an attack at least once a month.<sup>46</sup> The Government sees this as a high priority and has created a National Cyber Security Centre.



This was unequivocally considered to be an area of extremely high priority to all of the contacts we interviewed at member firms. Many members had working groups and committees set up to review and monitor security, whose role was to implement best practice.

Those asset managers that were bank-owned generally felt they had benefited from the security banks already had in place. However, for a number of firms, particularly smaller firms, the only realistic way to approach the challenge, because of the huge scale and range of potential risks, was to use external operational support for their cybersecurity.

The biggest concern was the enormous risk that people saw to their organisation's reputation and the consequent loss of trust were any client data to be compromised as a result of a security breach. This was a particular fear for those asset managers holding large amounts of retail investor data, but this extended to concern about all client information, whether retail or institutional.

“THERE'S A MASSIVE RISK TO REPUTATION WHEN OUR BRAND IS SUCH AN IMPORTANT PART OF WHO WE ARE. IF INVESTORS DON'T FEEL THEIR ASSETS, OR THEIR DATA AND INFORMATION, ARE SAFE WITH US THAT IS A HUGE RISK, SO WE ARE DOING PLENTY IN TERMS OF BEEFING UP SECURITY AND INCREASING AWARENESS INTERNALLY, MAKING SURE ALL MEMBERS OF STAFF ARE AWARE OF THE RISKS OF A BREACH.”



Breaches of data security are also a significant concern for investors. Forty five percent of institutional investors recently reported they would leave their current investment firm if confidential information were to be compromised, as did 43% of retail investors.<sup>47</sup>

Interviewees were very cognisant of the fact that it was impossible to guarantee that security measures could be strong enough to defeat every attack. Therefore, not only did they need to have very strong ongoing procedures to test security, but they placed a high priority on managing breach situations and communicating their response to try to minimise the subsequent disruption that would ensue.

<sup>46</sup> Speech by Matt Hancock, Minister for Cabinet Office, 25 May 2016.

<sup>47</sup> From trust to loyalty: A global survey of what investors want 2016. CFA institute

It was evident that those we interviewed were conscious of a large number of directions from which an attack might materialise, including:

- Hacking attacks on systems containing client data.
- Manipulation of trading systems.
- Fake websites and telephone fraudsters purporting to belong to the asset manager.
- Phishing e-mails sent to employees carrying malicious software.
- Fraudulent attempts to withdraw cash from client accounts.
- Weakness in third party security e.g. fund administrators, payment processes.
- Weakness in portable hardware, such as laptops, phones and tablets.

There was less concern about a loss of service issue, for instance the temporary loss of client access to account data. Because of the long-term nature of investment, a limited loss of service, such as an investor being temporarily unable to view their pension value, was not felt to be a high-risk problem.

“I DON'T THINK YOU CAN PROTECT YOURSELF FULLY TO THE LEVEL YOU WANT TO. THE OTHER RISK FOR A LOT OF US IS THAT A LOT OF THE DATA IS HELD OUTSIDE OF OUR ORGANISATION SO WE ARE RELIANT ON THEIR CYBERSECURITY CONTROLS AS MUCH AS OURS.”

A lot of work was being done by firms to educate staff on the ways they could be targeted to obtain access, with firms confirming that staff actions, eg. unwittingly clicking on malicious email links or responding to false phone calls, were a key focus for preventative action.

The challenge of cybersecurity was expected to increase as the asset management industry further embraces technology to assist investment, communication and risk management. While technology will enable the industry to work more smartly, reduce cost and increase efficiency it is likely to have far reaching consequences for the security of client information.

## FILLING THE ADVICE GAP

As we have alluded to throughout this report, a significant proportion of those we spoke to were becoming more and more interested in communicating directly with the end investors. We have touched several times on the challenge of this in a highly intermediated environment but digital communication was seen as a way where some progress could be made in this area.

The potential for digital tools to help customers understand the investment process and narrow down investment opportunities, without incurring the cost of an IFA, was clear. However, members had mixed reactions towards offering full robo-advice themselves.

There are two key issues for the asset management industry in approaching this market:

- The structure of distribution and a tendency by the industry to avoid direct to client sales in a traditionally highly intermediated market.
- The nature of regulation and the ongoing uncertainty about boundaries between regulated advice and guidance. The fact that the Financial Advice Market Review had looked more closely at this challenge was widely welcomed, even if it remains a source of some difficulties.

“MAYBE YOU COULD GO THROUGH A DECISION TREE PROCESS THAT RESULTS IN 'HERE IS A SELECTION OF FIVE PRODUCTS YOU COULD BUY'. THAT'S NOT SELF-SELECT BUT IT'S NOT FULL ADVICE EITHER AND THE LINE IS VERY GREY AT THE MOMENT.”

Therefore, the high interest in this area among many members we interviewed is unlikely to translate into a clear immediate change in direction of travel for asset managers. The likely outcome at the moment is a range of responses:

- **Digital communication.** Some firms may focus mainly on digital communication in the context of a retail sales market that they expect still be dominated by platform and adviser sales. The industry recognises that individuals are becoming

much more digitalised and expect information to be delivered to them in a mobile-friendly way on a 24/7 basis. Banking by phone is now the most popular way for consumers to manage their finances. The asset management industry has been seen as slower to respond but is now beginning to improve accessibility, content and service.

- **New sales options.** Others will continue to explore options to develop a more direct to consumer offering, possibly in combination with robo-advice services. In this regard, the direct to consumer proposition and the provision of robo-advice was seen as a more obvious option for those asset managers that formed part of a vertically integrated offering. However, many others were looking to work with distributors that could take the lead on robo-advice development and some had recently acquired companies that specialised in this area.

Some of the uncertainty about the future role of asset managers in filling the advice gap related to different types of investment and needs in the market:

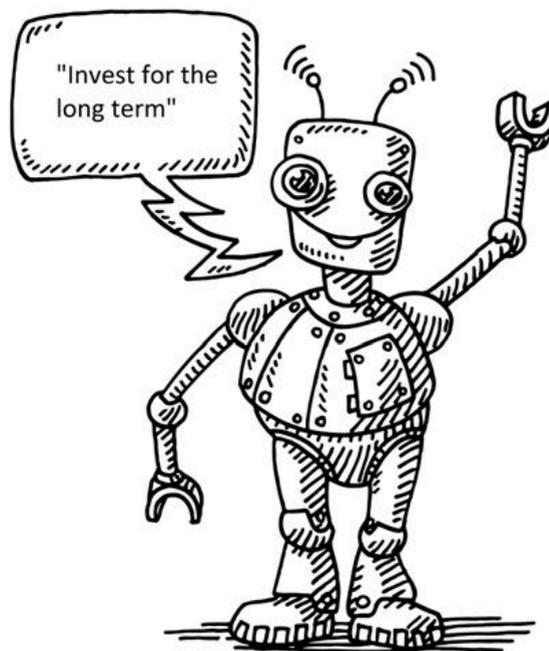
- For those investors with large amounts to invest who have a more complex range of investments it was felt that face to face advice was always likely to be the option most desired by investors, and indeed the most appropriate route. Members were not generally experiencing a drop off of flows via this route.
- In addition, there were some investments that those interviewed were not comfortable offering in the absence of full advice, for example those funds employing derivative instruments or unregulated investment schemes.

However, it was acknowledged that other investors had different needs and members noted a lack of available advice for people with smaller amounts to invest in non-complex investments, for whom an IFA might not always be the best option.

“THERE HAS TO BE A WAY FOR SOMEONE WITH £20,000 TO INVEST TO FIND A WAY TO AN INVESTMENT WITHOUT HAVING TO GO TO AN ADVISER WHO’S GOING TO CHARGE THEM HUNDREDS OF POUNDS OR MORE TO PUT TOGETHER A DETAILED REPORT.”

It was recognised that in the absence of an IFA, investors were still likely to need some assistance in making appropriate investment decisions. This is where robo-advice could have a part to play.

“PEOPLE JUST WANT TO TRUST A BIG BRAND TO TELL THEM QUICKLY AND SIMPLY WHERE TO PUT MONEY. OF COURSE YOU CAN’T HELP THAT TYPE OF INDIVIDUAL EASILY WITHOUT THE RISK OF CROSSING INTO ADVICE. IF WE’RE GOING TO CLOSE THE SAVINGS GAP AND GROW THE PEOPLE INVESTING BY HUNDREDS OF THOUSANDS, TECHNOLOGY COULD WELL PLAY A REALLY IMPORTANT ROLE IN THAT.”



## TECHNOLOGY AND CONSUMER BEHAVIOUR

Several years ago, in a speech entitled ‘The Short Long’, Andrew Haldane asked whether technological change was resulting in a “permanent neurological rewiring” that was seeing shortening attention spans in response to increasing volumes and velocities of information. While he focused particularly on capital markets and institutional investment, some we spoke to in the context of retail market behaviour also wondered about the impact of tools that the industry was developing to help monitor performance.<sup>48</sup>

“THE YOUNGER GENERATION WILL BE SAVING VIA IPHONES. WILL THEY STILL TAKE A LONG TERM VIEW OR DO THEY WANT TO VIEW THEIR INVESTMENTS LIKE THEY DO THEIR BANK ACCOUNT? THIS WILL BE A REAL CHALLENGE.”



IFAs were currently seen to play an important role in behavioural coaching and preventing people from reacting inappropriately to market volatility. This might be more difficult in a world where investors were more dependent on robo-advice. Equally, some firms also worried about concentration risk in both asset allocation and fund selection; a world in which there is a much smaller number of very large allocation algorithms.

<sup>48</sup> Andrew Haldane, *The Short Long, Speech* developed to the 29th Société Universitaire Européenne de Recherches Financières Colloquium: New Paradigms in Money and Finance? Brussels, May 2011.

# 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>5,742,787</b>
<b>Segregated or pooled (%)</b>	
Directly invested on a segregated basis	58.2%
Managed on a pooled basis	41.8%
<b>Active or passive (%)</b>	
Actively managed	73.7%
Passively managed	23.0%
Enhanced index/other	3.3%
<b>Asset allocation (%)</b>	
<b>Equities of which:</b>	<b>39.3%</b>
UK	33.1%
Europe (ex UK)	27.9%
North America	18.3%
Pacific (ex Japan)	5.3%
Japan	5.1%
Emerging market	9.1%
Other	1.1%
<b>Fixed Income of which:</b>	<b>33.3%</b>
UK government	18.3%
Sterling corporate	26.3%
UK index-Linked	13.4%
Other UK	6.4%
Overseas	35.6%
<b>Cash/Money market</b>	<b>6.3%</b>
<b>Property</b>	<b>2.6%</b>
<b>Other</b>	<b>18.5%</b>

<sup>1</sup> This includes all assets under management in this country, regardless of where clients or funds are domiciled. Caution should be used in undertaking direct year-on-year comparisons with previous surveys. Where relevant or possible, we have used matched results in the survey analysis to validate observations of change.

INSTITUTIONAL								ALL INSTITUTIONAL	RETAIL	PRIVATE CLIENT
Pension funds	Public sector	Corporate	Non-profit	Sub- advisory	In-house insurance	Third party insurance	Other institu- tional			
2,306,311	352,811	185,381	70,256	217,422	683,301	356,638	405,950	4,578,071	1,065,582	90,133
40.2%	6.1%	3.2%	1.2%	3.8%	11.9%	6.2%	7.1%	79.7%	18.6%	1.7%

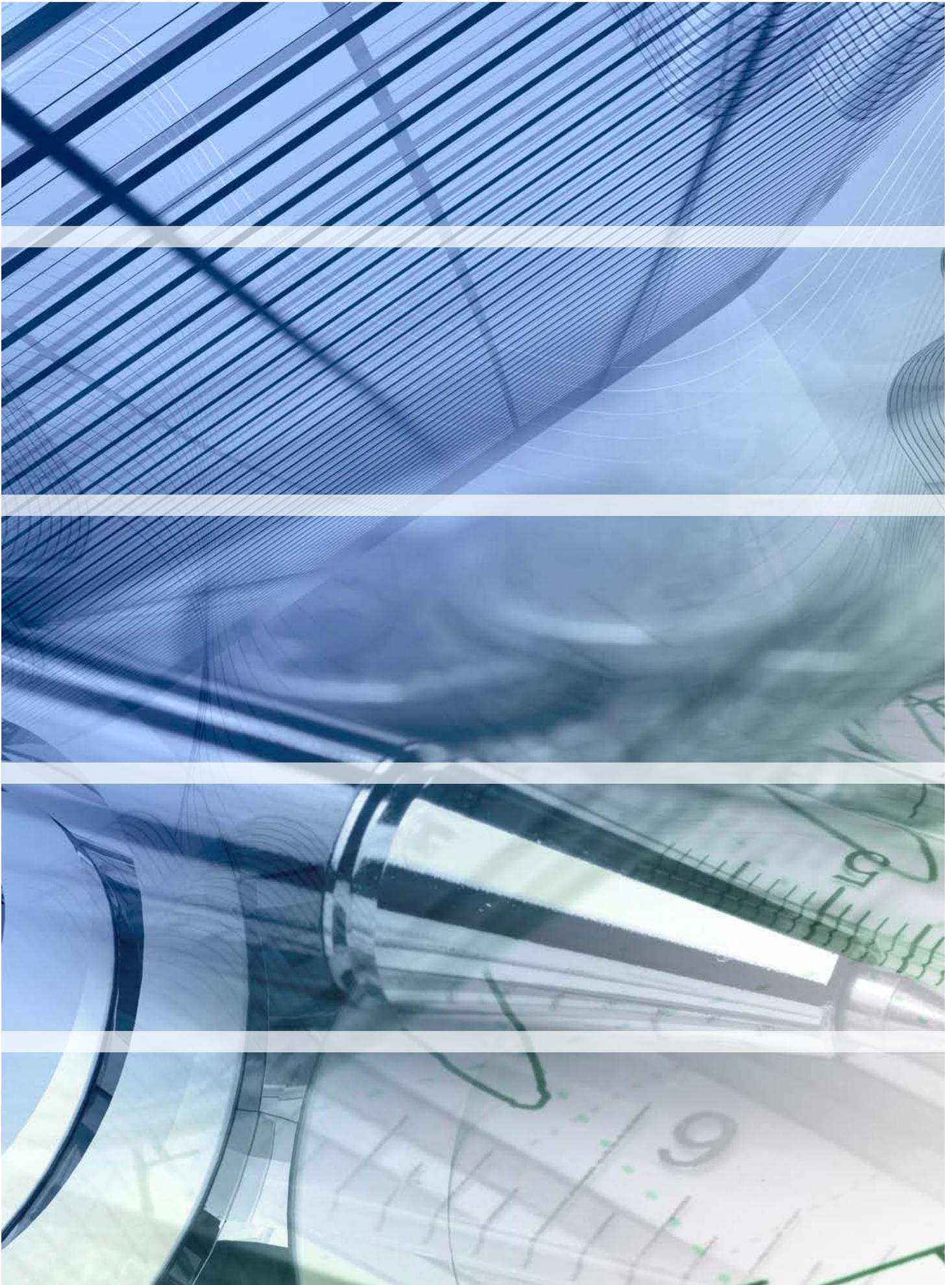
## APPENDIX 2

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

	TOTAL
<b>Total UK institutional client market</b>	<b>3,264,246</b>
<b>Segregated or pooled institutional assets (%)</b>	
Assets directly invested on a segregated basis	69.5%
Managed on a pooled basis	30.5%
<b>Active or passive (%)</b>	
Actively managed	74.3%
Passively managed	25.7%
<b>Multi-asset, LDI or specialist (%)</b>	
<b>Multi-asset</b>	<b>18.2%</b>
<b>LDI (physical)</b>	<b>21.7%</b>
<b>Single-asset / specialist</b> of which:	<b>60.1%</b>
<b>Equities</b> of which:	<b>39.1%</b>
UK	26.2%
European (ex UK)	5.5%
North American	8.2%
Asia-Pacific	3.2%
Japan	2.7%
Emerging market	2.7%
Global	43.0%
Other	8.5%
<b>Fixed Income</b> of which:	<b>39.8%</b>
Sterling corporate	26.2%
Sterling corporate and government	8.1%
UK government (ex index-linked)	11.8%
UK Index-Linked	14.1%
Global	21.0%
Other	18.7%
<b>Cash/Money market</b>	<b>8.1%</b>
<b>Property</b>	<b>6.1%</b>
<b>Other</b>	<b>7.0%</b>

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

	Pension funds			Public sector	Corporate	Non-profit	Sub-advisory	In-house insurance	Third party insurance	Other institutional
	Corporate	Local government	Other							
	1,554,261	179,396	128,756	17,123	72,273	42,963	66,809	635,714	321,158	245,821
	47.6%	5.5%	3.9%	0.5%	2.2%	1.3%	2.0%	19.5%	9.8%	7.5%
	68.6%	59.1%	14.5%	74.4%	55.2%	58.7%	79.4%	94.7%	86.2%	40.7%
	31.4%	40.9%	85.5%	25.6%	44.8%	41.3%	44.8%	5.3%	13.8%	59.3%
	65.4%	69.0%	49.8%	78.5%	69.7%	79.8%	16.8%	95.5%	90.7%	87.1%
	34.6%	31.0%	50.2%	21.5%	30.3%	20.2%	83.2%	4.5%	9.3%	12.9%
	<b>11.4%</b>	<b>11.3%</b>	<b>8.0%</b>	<b>7.2%</b>	<b>16.5%</b>	<b>44.4%</b>	<b>14.7%</b>	<b>23.8%</b>	<b>35.1%</b>	<b>28.6%</b>
	<b>40.7%</b>	<b>11.9%</b>	<b>10.8%</b>	<b>0.0%</b>	<b>13.3%</b>	<b>0.0%</b>	<b>0.4%</b>	<b>0.9%</b>	<b>1.4%</b>	<b>7.6%</b>
	<b>48.0%</b>	<b>76.9%</b>	<b>81.2%</b>	<b>92.8%</b>	<b>70.2%</b>	<b>55.6%</b>	<b>84.9%</b>	<b>75.3%</b>	<b>63.4%</b>	<b>63.8%</b>
	<b>46.3%</b>	<b>60.5%</b>	<b>71.4%</b>	<b>29.6%</b>	<b>23.2%</b>	<b>58.7%</b>	<b>54.3%</b>	<b>22.0%</b>	<b>25.7%</b>	<b>27.6%</b>
	18.5%	26.6%	15.8%	25.8%	24.3%	22.6%	41.1%	57.5%	36.6%	34.1%
	5.4%	6.7%	2.6%	15.5%	2.3%	2.0%	4.1%	2.1%	12.6%	3.2%
	8.6%	10.6%	8.2%	0.0%	2.5%	1.7%	4.2%	7.3%	10.5%	5.3%
	2.3%	2.7%	1.6%	3.3%	1.6%	3.4%	4.4%	3.1%	6.7%	7.1%
	2.5%	3.6%	0.9%	0.0%	2.1%	0.5%	7.9%	2.6%	6.6%	2.4%
	2.9%	3.2%	2.0%	0.3%	5.5%	3.4%	0.0%	1.5%	2.3%	3.6%
	49.6%	42.5%	63.0%	50.1%	61.3%	59.3%	25.9%	25.9%	20.1%	25.0%
	10.1%	4.1%	5.8%	5.0%	0.4%	7.1%	12.3%	0.0%	4.7%	19.3%
	<b>43.1%</b>	<b>17.8%</b>	<b>22.2%</b>	<b>29.9%</b>	<b>41.5%</b>	<b>6.9%</b>	<b>28.2%</b>	<b>57.9%</b>	<b>51.0%</b>	<b>11.3%</b>
	34.2%	26.8%	26.8%	1.3%	4.5%	31.9%	20.9%	18.3%	24.3%	2.0%
	9.2%	13.5%	5.1%	0.9%	1.5%	22.7%	9.5%	5.0%	6.9%	18.1%
	8.7%	7.0%	11.6%	0.1%	1.1%	18.1%	4.5%	15.5%	12.1%	52.5%
	18.8%	27.9%	26.2%	0.3%	0.5%	4.7%	15.8%	13.2%	3.5%	2.5%
	16.1%	12.7%	18.0%	89.1%	61.4%	21.0%	25.3%	34.3%	15.1%	2.1%
	13.0%	12.0%	12.3%	8.3%	31.0%	1.6%	24.0%	13.7%	38.0%	22.9%
	<b>1.4%</b>	<b>0.8%</b>	<b>4.6%</b>	<b>18.0%</b>	<b>19.1%</b>	<b>23.3%</b>	<b>6.6%</b>	<b>7.0%</b>	<b>5.4%</b>	<b>42.1%</b>
	<b>4.3%</b>	<b>6.5%</b>	<b>1.6%</b>	<b>2.2%</b>	<b>8.4%</b>	<b>4.4%</b>	<b>2.4%</b>	<b>10.8%</b>	<b>3.9%</b>	<b>9.3%</b>
	<b>5.0%</b>	<b>14.4%</b>	<b>0.2%</b>	<b>20.2%</b>	<b>7.9%</b>	<b>6.7%</b>	<b>8.6%</b>	<b>2.3%</b>	<b>14.0%</b>	<b>9.6%</b>



## APPENDIX 3

## MAJOR UK AND EU REGULATORY DEVELOPMENTS AFFECTING ASSET 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.
- Although an initial measure would be the imposition of a maximum settlement cycle of T+2 for trades executed on-exchange from January 2015, most European markets, including the UK, anticipated this and moved to T+2 voluntarily in October 2014.
- We expect Regulatory Technical Standards governing settlement discipline, including the operation of the mandatory buy-in regime following a settlement fail, to be adopted in late this year and come into force two years later, ie. at the end of 2018.

**CCP recovery and resolution**

- Whilst most jurisdictions, including the UK, have national rules on CCP R&R, the G20 has mandated global standards, to which national regimes should eventually conform.
- The G20-mandated policy-making remains at a relatively early stage, with global policy-making continuing, but no legislation or rule-making yet to give effect to the global standards.
- However, we expect the global standards to have progressed substantially by the end of 2016.
- The European Commission has committed to deliver a legislative proposal on CCP R&R in late 2016.
- EMIR may be reviewed to address related issues concerning CCP resilience.

**EMIR**

- The ongoing implementation of EMIR continued through 2015. ESMA has expanded the mandatory clearing obligation for certain financial instruments. This included interest rate swaps and certain foreign exchange instruments among others.
- In July 2016 ESMA issued a consultation proposing to delay the application of mandatory clearing for firms with limited volumes.
- Following extensive work by the IA, ESMA and the FCA granted exemptions for a range of pension scheme types from the obligation to centrally clear OTC derivatives contracts under EMIR.
- The European Commission has now endorsed the Regulatory Technical Standards (RTS) on risk-mitigation techniques for OTC derivative contracts not cleared by a CCP under Article 11 of the European Market Infrastructure Regulation (EMIR). The RTS detail the requirements for firms to exchange margins on non-centrally cleared OTC derivatives.
- After more than three years of negotiation, in March 2016 the European Commission endorsed the United States as equivalent in respect of CFTC rules regulating Central Counterparties (CCPs). As a result clearing an OTC derivative contract on a recognised US CCP would satisfy a mandatory clearing obligation imposed by EMIR in respect of that OTC derivative contract.
- ESMA delivered a final report and draft Technical Standards on its own initiative in November 2015 to amend the data required in derivatives trade reporting. These have yet to be endorsed by the European Commission, but it is still anticipated that the new standards will apply before the end of the second quarter of 2017.

**MiFID II**

- Following engagement around the scale of changes and the necessary timelines for implementation, in July 2016 the European Commission formally adopted a 12 month delay to the application of MiFID II. It will now apply to firms from 3 January 2018.

- Those derivatives that become subject to the central clearing requirement under EMIR will also be subject to an obligation to be traded on a MiFID trading venue to provide additional transparency on transactions which are currently traded OTC.
- MiFID II has put in place explicit rules on the acquisition of research. Investment firms offering both research and execution are required to charge for each service separately. Asset managers must demonstrate there is no correlation between the volume & value of transactions executed on behalf of the client and the charges for research. In addition firms must agree a specific research budget with clients before any investment activity occurs. Clients must periodically be given greatly enhanced disclosure information on the research budget and what it was used for.
- High frequency trading: Firms classified as operating a high frequency trading strategy under MiFID II will be subject to additional systems and controls requirements. Market making and presence requirements will be layered on to such firms.
- The definition of algorithmic trading has been widely drawn in the new legislation. Whilst currently the majority of the enhanced SYSC requirements will fall on brokers, there is an obligation for those making use of algorithms to have enhanced due diligence procedures. As buy side firms begin to develop their own algorithms for trading, the extensive testing and control obligations come into play for them.
- MiFID II outlines significant new transparency requirements for both equities and bond markets. The equities double volume cap will have a material impact on the operation of dark pools.
- The new regime for pre and post trade transparency of non-equities will require changes to trading processes. The IA has undertaken extensive work in this area to recalibrate the transparency framework in order to mitigate the impact on liquidity.
- Best Execution
  - MiFID II will require 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 used by asset managers.
- Transaction reporting:
  - The new transaction reporting regime will extend the data that firms are required to report, as well as widening the scope of instruments covered.
  - The FCA has indicated its intention not to extend the reporting obligations to certain non-MiFID firms that undertake their own portfolio management, including UCITS/ AIF manager's and OPS firms, as it does under MiFID I. This was the subject of a consultation at the end of 2015, the final outcome of which is awaited.

#### **Sunset for legacy commission payments**

- The FCA decided not to impose a sunset clause in relation to the grandfathering of ongoing commission payments to advisers for undisturbed business written before the adviser charging rules came into force on 1 January 2013.
- While a 6 April 2016 sunset clause that affects all provider payments to platform service providers meant that the payment of commission to advisers through platforms ended at that date, commission on legacy business that is paid directly by the provider to the adviser was not affected.
- Currently the FCA does not intend to end these trails via the MiFID II implementation into UK regulation. The Association is discussing this with the FCA.

#### **MAR**

- Successful engagement targeted numerous issues including the nature of inside information, chinese walls, dealing by PDMRs and the ability of firms to cancel orders on coming into possession of inside information.

- The UK has opted out of implementing the Criminal Sanctions Market Abuse Directive (CSMAD).
- MAR was implemented on 3 July 2016. Certain aspects tied to MiFID II will not apply until 3 Jan 2018.
- The IA continues to work with the FCA/ESMA to clarify outstanding issues of interpretation/implementation

#### Solvency II

- Directive implemented across Europe 1 January 2016, although it will take some time for issues to be reported.
- Solo insurers will file first report in May 2016, whereas insurers that are part of a Group will report in July 2016.
- Version 3.0 of the Template (TPT) was published in October 2015 and has seen take-up in most European jurisdictions. There are no plans by the European Working group (EWG) to make further changes by introducing Version 4.0 until EIOPA has announced any amendments or changes.
- PRA has said they expect insurers to have oversight of asset managers and carry out due diligence on a regular basis, as investment management of an insurers assets is an outsourced activity.

## FUNDS AND DISTRIBUTION

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

- In July 2016 the European Commission published the draft Regulatory Technical Standards (level 2) measures laying out methodologies how to calculate measures of risks, performance and costs and presentation requirements for the new PRIIP Key Information Documents (KID). Adoption by the European Parliament and Council is expected for Q3 2016.
- 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 2019.
- However, if other PRIIP providers (such as insurers) are using UCITS or NURS in their for example unit linked products, they will require information about the product from manufacturers that are compatible with the PRIIPs regulation. To facilitate this data exchange the IA participates in a European industry initiative that is in the process of adopting a common standard.

#### UCITS V

- The UCITS V Directive came into force on 18 March 2016.
- The Directive broadly extends the AIFMD requirements on manager remuneration policy, depositary liability and sanctions.
- The FCA took an 'intelligent copy-out' approach. This means that it adhered as closely as possible to the UCITS L1 wording, whilst using an alternative wording where needed to align with UK law and practice.
- The UCITS V Level 2 Regulation was adopted by the EU Commission in December 2015 and it applies from 13 October 2016.  
As the Level 2 Regulation has direct effect, the FCA is proposing to make minimal changes to its rules. It does, however, intend to maintain the UK's current approach to ensuring that the management company and depositary act independently. It does this through retaining its current guidance regarding depositary independence.

**AIFMD**

- The Directive and related Regulation has applied since 22 July 2013.
- AIFs are *any* collective investment undertaking that are not UCITS (irrespective of legal structure, listing, authorisation or domicile).
- The Directive therefore captures a wide range of UK vehicles, including NURs, QISs, unauthorised unit trusts (UUTs), charity funds, investment trusts, and specialist vehicles (e.g. hedge funds, private equity funds, venture capital funds and real estate funds).
- It provides a passport for the marketing of AIFs to professional investors and imposes detailed regulation on the managers of AIFs (AIFMs).
- 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. They have recently submitted advice to the Commission regarding twelve third countries. This process has taken over three years so far, and proven politically contentious.

**Venture Capital Funds and Social Entrepreneurship Funds**

- The EuSEF (European Social Entrepreneurship Funds) and EuVECA (European Venture Capital Funds) Regulations, approved in March 2013, created labels or “designations” for small AIFMs and internally managed AIFs that comply with the organisational requirements and investment rules.
- The regimes created a passport enabling registered managers to market their EuVECA and EuSEF to professional and “semi-professional” investors throughout the EEA.
- There has been a reasonable take up of the EuVECA label, with 70 EuVECA funds being notified to ESMA to date. However, the EuSEF label has achieved little success to date, with only four EuSEF funds having been notified to ESMA.
- 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.

**European Long-Term Investment Funds (ELTIFs)**

- The ELTIF Regulation came into force on 8 June 2015 and took effect from 9 December 2015.
- ELTIFs are a regulated sub-set of AIF that invest into long-term illiquid investments such as infrastructure, transport, sustainable energy and small or unlisted companies.
- The fund must be domiciled in the EU, have an EU manager, be closed-ended and of a fixed term. Limited redemption rights may be offered to retail investors from half-way through the lifecycle of the fund.
- Funds authorised under the ELTIF regulation are able to use the label ‘ELTIF’ and market across Europe to professional investors and certain categories of retail investors.
- ESMA provided its proposed Regulatory Technical Standards to the Commission on 8 June 2016. The RTS cover eligible derivative contracts for hedging risk, determining the lifecycle of a scheme, the orderly disposal of assets, cost disclosure and the facilities available to retail investors.
- So far, no UK ELTIFs have been launched and only a small number of ELTIFs have been launched in Europe.

**Money Market Funds**

- Commission proposals for Money Market Funds issued September 2013.
- The proposed Regulation requires:
  - Certain levels of daily/weekly liquidity in order for the MMF to be able to satisfy investor redemptions;
  - Clear labelling on whether the fund is short-term MMF or a standard one;
  - A capital cushion (the 3% buffer) for constant NAV funds that can be activated to support stable redemptions in times of decreasing value of the MMFs' investment assets;
  - Customer profiling policies to help anticipate large redemptions;
  - Some internal credit risk assessment by the MMF manager to avoid overreliance on external ratings.
- There were polarised opinions when the dossier was debated in the European Parliament and the Council of Ministers. The Parliament agreed on a text in April 2015, and following a political compromise, the Council agreed a position in June 2016. Negotiations between both houses will take place in the second half of 2016 to agree on a compromise text for the regulation.
- The US Securities and Exchanges Commission (SEC) adopted new Money Market Funds Reform rules on 23 July 2014. These require a floating net asset value (NAV) for institutional prime money market funds and introduce contemporaneous changes to accounting and tax rules to make the shift work.

**Appropriateness and the treatment of Non-UCITS Retail Schemes (NURS)**

- The final level 2 directive requires that all non-UCITS collective investment funds have to be tested against six criteria to determine whether they are complex in the regulatory sense or not.
- This is a practicable outcome for fund managers as the IA expects most NURS and Investment Trusts to pass the test. Therefore those products can continue to be distributed to retail clients execution only without case-by-case appropriateness assessments.

**Product Governance**

- MIFID firms will be required to put 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 will have to review their products and choice of distribution channels regularly. The FCA may extend the MIFID requirements to non-MIFID firms
- Whilst the MiFID II requirements are broadly similar to the FCA guidance The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD) in some respects, they are not exactly the same. MiFID II also covers matters not covered in the RPPD. The IA has drafted a Gap Analysis – MiFID II vs RPPD – Manufacturer's responsibilities to aid members in identifying potential gaps in their current product governance arrangements. Furthermore, the IA is producing good practice material that will prove useful to manufacturing firms.
- A key requirement of the renewed regime is the identification of 'target markets' for every offering. The first challenge is that manufacturers rarely know the identity of the end client and therefore will find it difficult to define a precise target market. Secondly, regulations will not include explicit criteria for manufactures to apply when defining a 'target market'. ESMA might issue guidance to this extent at some point in 2016.
- In a cross industry effort, the IA, EFAMA and others have drafted this framework to standardise the criteria which can be used to define target markets and for communication with distributors. These criteria shall be the same for products irrespective of domicile and distribution/marketing destination in the EU.

- Further work is being carried out to agree fields for enhanced management information (MA) with distributors so that product manufacturers will be able to oversee sales and distribution within or outside of target markets of their products effectively.

### Local Government Pension Schemes (LGPS)

- In November 2015 the Government announced proposals to require English and Welsh LGPS funds to establish, and invest through asset pools, each with at least £25bn of Scheme assets. These pools rather than the underlying LGPS funds will, from 2018, procure asset management services.
- As of July 2016 detailed proposals had been submitted to Government for the creation of 8 pools, with assets ranging from £13bn - £36bn. Government is now considering these proposals and will respond on next steps later this year.
- The IA is working with the LGPS Scheme Advisory Board to help it develop a cost disclosure template for use across the LGPS. This will be designed to help the LGPS measure its investment costs (fees and transaction costs) on a consistent basis across individual funds. This is closely linked to our wider work on transparency of costs and charges.

## FIRM REGULATION

### CRD IV

- Institutions are required to implement the new Capital Requirements Package from 01/01/2014 with full implementation on 01/01/2019.
- It affects all firms already under the scope of CRD III. The national regulators do have discretion to apply the existing CRD III rules on some MiFID firms. The FCA allows firms who cannot hold client money and who do not carry out MiFID regulated activity which goes beyond portfolio management and the execution of orders on behalf of clients to be subject to the CRD III rules.
- Member states are required to introduce a harmonised sanctions regime.
- The package requires all managers to carry more base capital sets a new, narrower definition of what qualifies as 'capital' for some managers and introduces additional obligations to build up capital buffers.
- Firms are obliged to comply with new liquidity rules and to provide at any time a stock of high-quality liquid assets to meet liquidity outflows. The liquidity coverage ratio will be implemented gradually till 2018.
- New rules on remuneration and bonus caps are introduced.
- Pension fund deficits will have to be deducted from capital.
- The European Commission is currently assessing if there is a need to revise the prudential rules and the remuneration requirements for investment firms. EBA published in December 2015 on behalf of the European Commission a report on the appropriateness and the impact of the current prudential framework on investment firms. This report will be followed by a separate data collection exercise and a consultation process in late 2016. New legislative proposals are not expected before 2017.

### Remuneration

- The EBA guidelines on sound remuneration policies under CRD IV were published in late 2015 and are in force. The PRA and the FCA decided to implement the guidelines in full except for the bonus cap.
- The ESMA guidelines on sound remuneration policies under the UCITS Directive and AIFMD were published in February 2016 and are implemented in the FCA Handbook chapter SYSC 19E. SYSC 19E came into force on 18 March 2016, but managers of UCITS will not have to comply with most of the remuneration requirements until the start of the first full performance period starting after that date.

- Whilst directives target different key staff, and may overlap in specifics, all of them apply on a firm-wide basis and focus on greater alignment between remuneration, risk-taking and the client's best interests.

#### CASS

- A letter was sent to the FCA on behalf of a number of trade associations, requesting some further amendments to the rules regarding unbreakable term deposits (UTDs). Some IA member firms had found it difficult to deposit client money (Cash) at different banks, as per the diversification guidelines - as banks no longer want large amounts of cash that cannot be used.
- The FCA has now responded to the letter and whilst understanding the issues, they do not plan to make any changes to the CASS rules in relation to UTDs.

#### EU Benchmark Regulation

- The level one text has been finalised, with the stated aim of restoring confidence in the integrity of benchmarks.
- Firms will need to identify all the indices that they use (as defined in the Regulation) for their funds, and work to ensure that these will be available to them when the Regulation comes into force.

#### Fourth Money Laundering Directive

- The Level One text has been finalised. The Directive, which extends and tightens up the Third Money Laundering Directive, is scheduled to apply from 26 June 2017.
- Work is ongoing to ensure that the implementing regulations and guidelines are as practical as possible.
- Work is also in train to update the JMLSG, although the timelines to achieve this are now seen as prohibitively tight.
- An amending directive has just been published which may, among other things, bring forward the application date of the 4MLD to December 2016. This is seen as unrealistically impractical.

#### General Data Protection Regulation (GDPR)

- After more than four years of discussion, the new EU data protection framework has finally been adopted and takes the form of a Regulation.
- GDPR will replace the current Directive and will be directly applicable in all Member States without the need for implementing national legislation. It will not apply until 25 May 2018.
- However, as the regulation is not specific to financial services and contains some onerous obligations, it will have an immediate impact.
- Some aspects of GDPR will cause issues for asset management and other financial services and these are being considered by a working group:
  - expanded territorial reach – particularly where controllers and processors are outside the EU
  - additional data protection officers required
  - additional documentation and record keeping
  - change in the role of data processors
  - individuals must be allowed to withdraw consent more easily
  - changes to data breach notification, with additional internal reporting procedures
  - increased penalties with a tiered percentage approach to fines
- There may also be some additional financial crime aspects relating to record keeping and sensitive information.

### Senior Managers & Certification Regime (SMCR)

- Regime already implemented in banks and building societies from March 2016, with a light-version for insurers.
- Three key new requirements for asset management firms, planned for implementation in March 2018:
  - Senior Managers Regime replacing the Significant Influence Function, with senior managers individually responsible and accountable for every area of a firm's activities.
  - Certification Regime that applies to employees who could pose a risk of significant harm to the firm or any of its customers - new Significant Harm Function.
  - Set of conduct rules that apply to the individuals covered above and replaces Statements of Principle and Code of Practice for Approved Persons.
- Other aspects include:
  - consideration of firm's culture
  - clear responsibility maps
  - collective responsibility

### Cybersecurity

- Cybersecurity threats exploit the increased complexity and connectivity of critical infrastructure systems and can place a firm's security, the economy, and public safety at risk. It can drive up costs, impact revenue and harm an organisation's ability to innovate as well as gain and maintain its customers.
- The IA is considering the following four areas, on behalf of member firms:
  - Policy
  - Awareness
  - Testing
  - Training

### Dormant Assets Commission (DAC)

- The UK Cabinet Office appointed eight commissioners to consider whether there were any dormant assets being held by companies. This was to follow on from the work that culminated in the Dormant Accounts Act, which focused solely on dormant cash left in bank and building societies.
- The remit of this new commission was very wide and would consider all assets from those within the financial services (banking, insurance, investments) across to rail refunds, unclaimed tote and unused loyalty points.
- A working group was set up to consider the dormant assets within the investments industry and in order to determine the size of the issue, the Commissioners sent out questionnaires to a number of asset managers and administrators.
- The results of the study will be presented to the Cabinet Office at the end of 2016.

### Enhanced transparency of charges and costs

- Requirements under MiFID II, PRIIPs and UK pensions law will lead to enhanced disclosure of investment charges and transaction costs across all client segments of the asset management industry.
- Given the commonality of the underlying data requirements in these areas, the IA is seeking to revamp its existing disclosure codes to take account of these new requirements.
- The aim is to allow firms to build a data engine that captures all the relevant data points in these regulations, with firms able to disclose on a consistent basis to clients under the relevant regulations.
- This work is also being extended to take account of new MiFID disclosure requirements in relation to Best Execution and Research Payment Accounts.

## APPENDIX 4

## NOTABLE M&amp;A DEALS IN THE UK ASSET MANAGEMENT SECTOR (2009-AUGUST 2016)

	ACQUIRER	PURCHASE	
2015-16 (TO DATE)	Aberdeen	Arden Asset Management, Parmenion Capital, Advance Emerging Capital	
	Aegon	Cofunds	
	Allianz	Rogge Global Partners	
	Amundi	Kleinwort Benson Investors	
	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 Aegon annuity portfolio	
	GAM	Singletery Mansley Asset Management	
	Maitland	Phoenix Fund Services	
	Momentum	London and Capital adviser business	
	Standard Life	AXA portfolio services	
	Stonehage	Fleming Family	
	Threadneedle	Columbia (merger)	
	Vontobel	TwentyFour	
	2014	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	

ACQUIRER	PURCHASE
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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
	Miton	PSigma
	PSigma	Axa Framlington private client business
	Royal London	Co-Operative (Insurance and asset management businesses)
	Schroders	Cazenove Capital Management STW Fixed Income
	Standard Life Wealth	Private client division of Newton

2012	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

## ACQUIRER

## PURCHASE

2010

Aberdeen	RBS' multimanager and alternatives business
Alpha Real Capital	Close Brothers' property fund management business
AMG	Artemis
Aviva Investors	River Road
Close	Chartwell Group
F&C	Thames River Capital
Investec	Rensburg Sheppards
Man Group	GLG Partners
Marlborough	SunLife Financial of Canada's funds
Schroders	RWC Partners (49%)
State Street	Bank of Ireland

2009

BlackRock	BGI
BILLIONP Paribas	Fortis
BILLIONY 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. Asset management services for fund products operated by financial corporations are included under 'Sub-advisory'.

### 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'.

### IN-HOUSE INSURANCE CLIENTS

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

### INVESTMENT FUNDS

All pooled and listed vehicles regardless of the domicile of the client or fund (ie. unit trusts, investment companies with variable capital including ETFs, contractual funds, investment trusts, and hedge funds) but it does not include life or insurance funds.

### LIABILITY DRIVEN INVESTMENT (LDI)

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

### MULTI-ASSET MANDATE

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

### NON-PROFIT CLIENTS

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

### 'OTHER' CLIENTS

Assets managed on behalf of client types that cannot be classified under any other category as well as unidentifiable client types, eg. closed-ended funds or institutional pooling vehicles.

### OVERSEAS BONDS

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 FUNDS CLIENTS

Incorporates both defined benefit (DB) and defined contribution (DC) provision, where the respondent has a relationship with a pension fund, irrespective of type. Where the DC provision is operated via an intermediary platform, particularly a life company structure wrapping the funds, the assets are reflected in 'Insurance'.

### PUBLIC SECTOR CLIENTS

Encompasses central banks, supranational bodies, public sector financial institutions, governmental bodies, public treasuries and sovereign wealth funds as well as the non-pension assets of local authorities and other public sector clients.

### PRIVATE CLIENTS

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

### POOLED

Comprises investment vehicles operated by a manager for multiple clients whose contributions are pooled and invested collectively. This category includes both open and close-ended funds. It also includes assets in segregated portfolios that are held indirectly via pooled vehicles managed by the respondent.

### RETAIL

Includes investment into unit trusts, open-ended investment companies (OEICs) and other open-ended investment funds irrespective of domicile. It incorporates assets sourced through both intermediated sales (ie. made through fund platforms, supermarkets and other third parties) and direct retail sales. It does not include life-wrapped funds, which are classified under 'Third Party Insurance'.

## SEGREGATED

Assets directly invested within segregated portfolios, and managed on behalf of one client. This would also include mandates run on behalf of a single pooled vehicle (eg. a 'pooled' insurance fund run for an insurance parent company).

## SINGLE-ASSET

Also called 'specialist', these types of mandate are overwhelmingly focused on one asset class, and therein usually a specific sub-type (either geographic or other; eg. a US equity mandate or an index-linked gilt mandate).

## 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 managers products).

## THIRD PARTY INSURANCE CLIENTS

Assets sourced from third party insurance companies (ie. from outside the respondent's group), where the mandates are seen as institutional. It includes both unit-linked assets (ie. funds manufactured by the respondent and distributed with the respondent's brand through a life platform) and other third party assets.

## UK ASSETS UNDER MANAGEMENT

Assets where the day-to-day management is undertaken by 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 asset managers by either third party asset managers or overseas offices of the company or group. With respect to fund of funds and manager of managers 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.

## UK INSTITUTIONAL CLIENT MARKET

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

## APPENDIX 6

# SURVEY RESPONDENTS

Aberdeen Asset Management

AB

Aberforth Partners

Architas

Artemis Fund Managers

Aviva Investors

AXA Investment Managers

Baillie Gifford & Co

Barings Asset Management

BlackRock Investment Management

BT Pension Scheme Management Ltd

Canada Life Asset Management

Capita Asset Services

CCLA Investment Management

Columbia Threadneedle Asset Management

Edinburgh Partners

EFG Asset Management

FIL Investment Services

Franklin Templeton Investment Management

Fund Partners

Guinness Asset Management

Henderson Global Investors

Hermes Fund Managers

Hewitt Risk Management

Host Capital

HSBC Global Asset Management

Insight Investment

Invesco Perpetual

Investec Asset Management

JO Hambro Capital Management

JP Morgan Asset Management

Kames Capital

Lazard Asset Management

Legal & General Investment Management

Lindsell Train Ltd

Liontrust Fund Partners

M & G Investments

Man Fund Management UK Ltd

Margetts Fund Management

Martin Currie Unit Trusts

Miton Group

Morgan Stanley Investment Management

Newton Investment Management

Natixis

Nomura Asset Management UK

Northern Trust Global Investments

Odey Asset Management

Old Mutual Global Investors

OneFamily

Pictet Asset Management

PIMCO

Pioneer Global Investments

Premier Portfolio Managers

Principal Global Investors

Pyrford International  
Rathbone Unit Trust Management  
RBS CIF  
Record Currency Management  
Royal London Asset Management  
Ruffer  
RWC Partners Ltd  
Santander Asset Management  
Sarasin & Partners LLP  
Scottish Friendly  
Schroder Investment Management  
Sharefunds  
Skagen  
Standard Life Investments  
State Street Global Advisors UK  
Tesco Pension Investment  
Troy Asset Management  
TwentyFour Asset Management  
UBS Global Asset Management Funds  
Vanguard  
Wellington Management International  
Wise Investments Ltd  
Zurich

## APPENDIX 7

# FIRMS INTERVIEWED

Allianz Global Investors

Aberdeen Asset Management

Baillie Gifford & Co

Blackrock Investment Management

Carmignac Gestion

Columbia Threadneedle Investments

FIL Investment Services

Henderson Global Investors

Independent Franchise Partners

Invesco Perpetual

Investec Asset Management

JP Morgan Asset Management

Kames Capital

Legal & General Investment Management

M&G Investments

Newton Investment Management

Old Mutual

Premier Portfolio Managers Ltd

Schroder Investment Management

Standard Life Investments

UBS Global Asset Management

Vanguard Asset Management

# NOTES

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