1 UK INVESTMENT MANAGEMENT INDUSTRY: A GLOBAL CENTRE

KEY FINDINGS

SIZE OF THE UK INDUSTRY

- As at December 2020, IA members' UK-managed assets reached £9.4 trillion, an 11% increase since 2019. Growth in total assets were buoyed by strong global capital market performance, particularly in the last quarter of 2020.
- In the UK retail market, UK authorised and recognised funds experienced similar growth, increasing 10% in 2020 to reach £1.4 trillion in total assets.
- Outside of London, where the majority of investment management activity is concentrated, Edinburgh remains the second largest hub of investment management in the UK. Total assets managed in Scotland reached £690 billion, an increase of £100 billion on the previous year. In relative terms this remains unchanged at 7%.
- Looking beyond the IA's membership, there is a broader ecosystem of investment management services which includes private equity funds, hedge funds, wealth management and UK commercial property. Total managed assets within the wider industry reached £11.0 trillion in 2020, up from a revised £10.0 trillion in 2019.

UK INVESTMENT MANAGEMENT INDUSTRY IN A GLOBAL CONTEXT

- Global assets under management surpassed the $100 trillion mark in 2020. The UK hosts the largest investment management centre in Europe and the second largest globally behind the US.
- While the US industry serves a largely domestic market, the UK investment management industry is a leading international centre. In 2020, UK managed assets on behalf of overseas clients grew for the second year in a row and are now responsible for just under half (44%) of total assets, a one percentage point increase over the last year. The majority (58%) of these assets are managed on behalf of European clients.
- The UK also serves as a global hub for portfolio management expertise. Total UK managed assets in investment funds reached £3.7 trillion in 2020. Over three fifths (63%) of these assets sit within funds domiciled overseas where the portfolio management is delegated to a UK based investment manager. This has increased eleven percentage points since 2015.

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

FIGURE 1: WHO ARE THE IA'S MEMBERS?

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

1. **Large investment management firms** (both UK and overseas-headquartered), which may be independent or part of wider financial services groups such as banks or insurance companies. They undertake a wide range of investment management activities across both retail and institutional markets and manage substantial amounts for overseas client in the UK. Such firms will typically be managing >£100 billion from the UK, but a number of international firms have a smaller UK footprint.
2. **Small and medium-sized investment management firms**, primarily focused on UK and/or European clients, which undertake a diverse range of activities, of which investment management is a constituent part.
3. **Fund managers**, whose business is based primarily on authorised investment funds.
4. **Specialist boutiques and private client managers** with a smaller asset and client base and, typically, a specific investment or client focus.
5. **Specialist pension scheme managers,** both Occupational (OPS) scheme managers running in-house investment management services for a large scheme, and Local Government Pension Scheme (LGPS) pools, supporting the LGPS investment process.

ROLE OF INVESTMENT MANAGEMENT

The investment management industry has a central role in the economy, channelling savings into long-term investments in order to deliver returns for a wide range of clients, whether these are individual savers or institutions such as pension schemes. These two aspects are illustrated in Figure 2.

Services to clients involve wide expertise in areas such as risk management and giving access to a wide range of assets that would normally be out of reach for individual investors. The ultimate goal is to provide customers with a basket of shares, bonds and other assets such as property, which can deliver returns over many years without exposing them to undue risk.

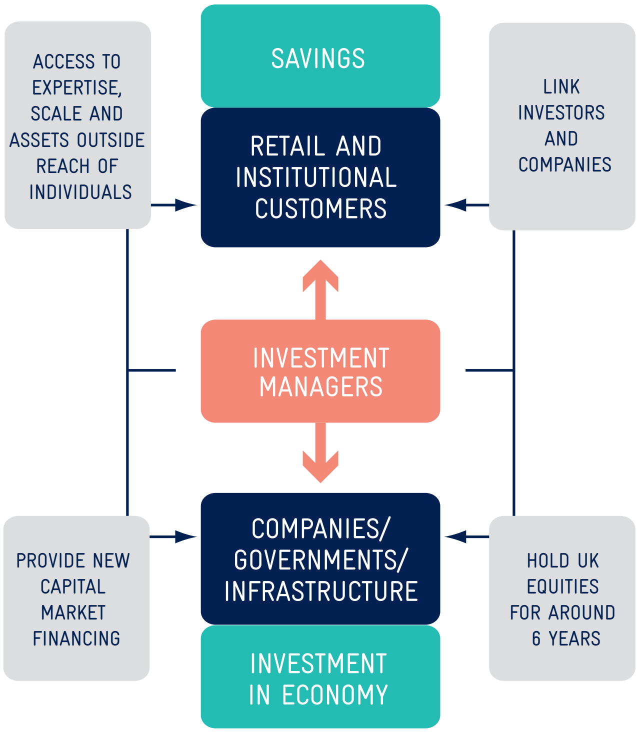
The industry's role goes beyond the actual investment in different asset classes. Investment managers help to ensure that capital markets work effectively for this investment to take place. In doing so, investment manager activity contributes to efficient markets which price information correctly and allow buyers and sellers to transact. This facilitates both primary issuance when companies or governments are trying to raise money, and secondary trading of different instruments. Without efficient markets, market economies cannot grow effectively or may even destabilise.

Investment managers are not unique in this as other financial institutions and individuals contribute to capital market efficiency, but the industry has historically been at the heart of long-term capital allocation, whether through shares, bonds or other assets. As long-term holders of investments, UK investment managers hold UK equities over many years.[1] The industry therefore has an important responsibility to undertake stewardship activity over the companies they invest in to protect the value for their clients.

As we discuss in other parts of the Survey, the role of the industry increasingly extends to broader issues such as combating climate change and executive remuneration policies. This wider role is expected to become even more important in future years as part of the focus on responsible and sustainable investment.

[1] A study undertaken for the IA found that investment managers hold UK equities for an average of six years. See *The contribution of asset management to the UK economy*, July 2016, Oxera.

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



SIZE OF UK INDUSTRY

IA members managed £9.4 trillion in the UK, as of the end of 2020, an increase of 11% on the previous year (see Chart 1). This growth comes on the back of a very volatile year in global capital markets, and is in line with the annual growth rate over the last five years. Industry assets under management (AUM) stood in £8.5 trillion in December 2019 and had risen to £8.6 trillion by June 2020, which tells us that most of the growth in assets occurred over the last six months of 2020.

Total funds under management (FUM) for UK investors in UK authorised and recognised funds have seen a 9% increase year on year, reaching £1.4 trillion in 2020. This is marginally lower than the 10% annual growth rate recorded over the last five years.

GLOBAL CAPITAL MARKET PERFORMANCE IN 2020

2020 was characterised as a year of extreme movements in capital markets. This was in large part due to the Covid-19 pandemic which caused a total shutdown of large sectors of the global economy and was the source of major uncertainty. Though most markets recovered by the end of the year – even reaching record highs –markets suffered one of the quickest declines on record in March. Table 1 shows the annual total return of selected indices.

Pandemic related jitters emerged in equity markets in late January following the lockdown in Wuhan, though this was short lived and many markets reached record or near record highs in February. By late February the virus was spreading quickly through Europe and the lockdown in Northern Italy initiated a flurry of activity in markets. The initial dip in equity markets in late February was driven by a flight to safety as investors sold off equities in favour of less risky assets which resulted in a sharp fall in bond yields as strengthening demand caused bond prices to rise.

By 12th March when the WHO declared Covid-19 a global pandemic, the UK had reported its first Covid-19 death, and crude oil prices had collapsed triggering trading circuit breakers. Governments were faced with difficult decisions regarding containment measures. The next ten days or so saw a 'dash for cash' as investors continued to sell off assets across asset classes in order to build up their liquid reserves. Bond yields rose sharply in the dash for cash and large scale redemption requests from Money Market Funds (MMFs) caused severe strains in the commercial paper market. When the market bottomed out in late March 2020, global equities were down 20% from the start of the year. Substantial intervention from central banks around the world using a combination of quantitative easing, interest rate cuts and emergency monetary policy measures, were critical in restoring stability to global markets.

Overall global stock markets rebounded strongly through the rest of 2020. Much of the clawback in returns was immediate with global equities returning 20% in Q2. There were dips across markets at the start of Q3 and Q4, in response to the imposition of renewed lockdown measures but these were short lived as investors acclimatised to weathering Covid-19 related announcements. Investors' confidence improved as Pfizer BioNTech announced the results of its successful vaccine trial in November, which offered hope that the virus could be contained, and economic restrictions eased. This contributed to an annual total return of global stocks of 13% in Sterling terms in 2020, in spite of the market correction in March.

Similar to other markets, UK equities tumbled in Q1 with the FTSE 100 experiencing the second largest single day loss (-10.2%) on record in March. The initial rebound in UK equities, though strong, was not as pronounced as the bounce back in other markets. Growth stagnated in Q3 despite the Bank of England pumping an extra £100 billion into the UK economy. News of the vaccine saw UK equities return 11% in the last quarter of 2020, however this was not enough to make up for the losses in March as total return for the year closed out at -10%. Dividends are a larger component of total returns in the UK equity market compared with the other m ajor equity markets. In 2020, two thirds of UK companies cut or cancelled dividend payments with total dividends for the year almost half the level they were the previous year.[2]

The other equity markets posted double digit returns in 2020, with the exception of European equities which ended the year with returns of 9%. The US equity market weathered 2020 well, reaching 15% returns by the end of the year recovering very strongly from March losses. The sharp recovery rates are attributed to the Federal Reserve's rates cuts and the newly elected Biden administration's announcement of a $2 trillion stimulus package at the end of 2020.

Asia Pacific equities returned 18% by the end of the year, with market resilience mainly attributed to a swift and strong response to the pandemic, which helped Asian economies return to growth earlier than in the West. Japanese equities were amongst the top performing equity markets despite a difficult Q1, ending the year with 18% returns. Emerging market equities bounced back in Q2 and recorded strong quarterly returns. Emerging markets equities ended the year with 12% returns.

In the bond markets, yields fell sharply as demand rose between late February and early March. However, as asset values plummeted in the middle of March, and the demand for cash rose, investors began selling out of fixed income markets resulting in some severe strains, including stale prices. Central bank rates cuts and bond repurchase programmes have been the driver of price stabilisation and growth in the bond market. Global bonds ended the year with 6% returns, higher than the 3% return in 2019. UK gilts and non-gilts (primarily made up of corporate bonds) outperformed global bonds returning 9% and 8% respectively.

TABLE 1: TOTAL RETURN OF SELECTED BOND AND EQUITY MARKETS IN 2020

UK equity	-10%
Global equity	13%
Europe (ex UK) equity	9%
Asia Pacific (ex Japan) equity	18%
Emerging market equity	12%
Japan equity	18%
US equity	15%
Global bonds	6%
UK Gilts	9%
UK Non-Gilts	8%

Source: Morningstar

[2] UK Dividend Monitor, Link Group.

Growth in industry assets is a function of market performance and flows. Market performance in 2020 was incredibly volatile as the coronavirus pandemic unfolded and expectations regarding future growth were adjusted. The initial impact in March 2020 was extreme but short lived, with most equity markets recording double digit growth over 2020 *[See Review of global markets 2020 overleaf]*.

We do not collect comprehensive flow data across the £9.4 trillion of industry assets, however, we do collect very detailed flow data for the UK funds market and flow data for UK institutional clients. This data would suggest that most of the remarkable growth over the last decade has been driven by very strong capital market performance. Based on total funds under management and cumulative net sales over the last decade, market movements account for approximately 70% of the growth in total FUM. We have collected flow data for UK institutional clients since 2018 and again, market movements have been responsible for approximately 75% of the growth in the UK institutional market over the last three years.

CHART 1: TOTAL ASSETS UNDER MANAGEMENT IN THE UK AND IN UK FUNDS (2006-2020)

Source: IA, ONS

The size of the industry relative to GDP (as illustrated by the right hand side of Chart 1) has increased to almost five times the size of the UK's economy. This is an indication of the growth of industry assets during a period of significant economic strain. UK GDP contracted 10% between 2019 and 2020, the largest year on year fall on record.

By comparison, the latest data available for Europe excluding the UK indicates that in Europe, the average size of the domestic investment management industry is just over double the size of local GDP. This gives a helpful way to compare the scale of investment management activity internationally and reflects the ongoing importance of the UK as a global centre.[3]

SCOTLAND AS A MAJOR CENTRE

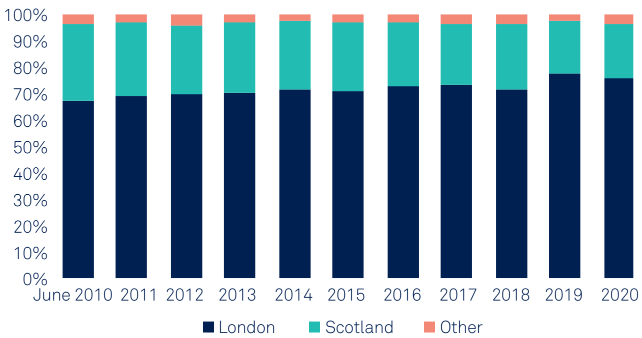
The majority of investment management activity takes place in the City of London, but Edinburgh is the second largest hub for investment management in the UK. Our latest estimate puts assets managed in Scotland at £690 billion, equivalent to 7% of total assets. In nominal terms, this represents a £100 billion increase year on year, but is unchanged as a proportion of total assets. By way of comparison, the proportion of assets managed in Scotland in 2010 stood at 14%. The fall in the proportion of assets over the last decade is a reflection of faster relative growth elsewhere in the UK rather than a fall in Scottish managed assets in absolute terms.

[3] IA analysis of EFAMA data.

Among UK-headquartered investment managers, one fifth (21%) of assets are managed by firms with headquarters in Scotland. Chart 2 shows how the regional split has evolved over the last 10 years. UK managed assets have become increasingly dominated by firms headquartered in London, a trend that has accelerated in 2019 due to M&A activity in Scotland.

The difference between the proportion of assets managed in Scotland and the proportion of assets based in UK regional headquarters is a reflection of the fact that a firm can be headquartered in Scotland, while some of their portfolio managers are located elsewhere, most likely in London.

CHART 2: UK-MANAGED ASSETS BY UK REGIONAL HEADQUARTERS (JUNE 2010-2020)



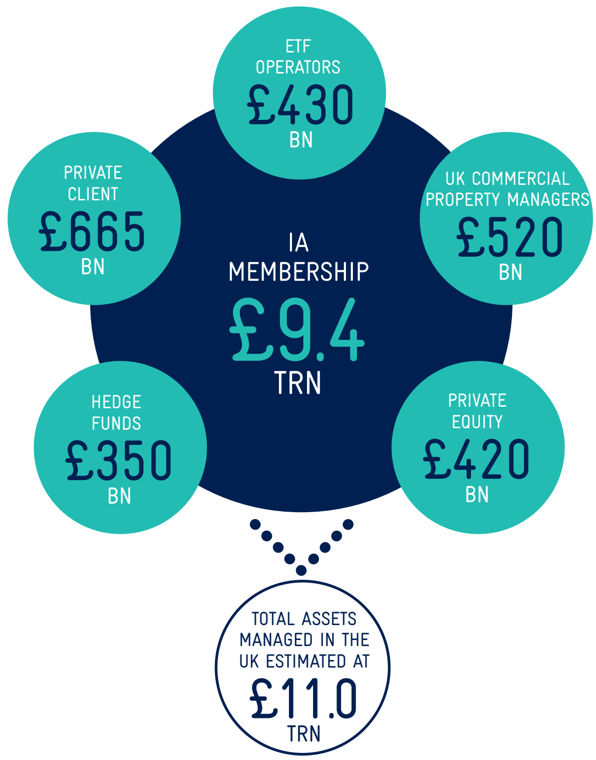
SCALE OF WIDER INDUSTRY

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

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

Figure 3 provides estimates to show how these wider parts of the industry contribute to total assets under management in the UK. Many IA members are also active players in the areas of investment management outlined in the list above. There is therefore some overlap in the figures presented in Figure 3 below. As of December 2020, we estimate the size of the wider industry at £11.0 trillion up from a revised £10.0 trillion in 2019.

FIGURE 3: WIDER INVESTMENT MANAGEMENT INDUSTRY



Source: ComPeer, Morningstar, Preqin, Investment Property Forum, IA estimates

[4] This last group is more difficult to size as there is no consistent third party data available.

UK INVESTMENT MANAGEMENT IN EUROPEAN AND GLOBAL CONTEXT

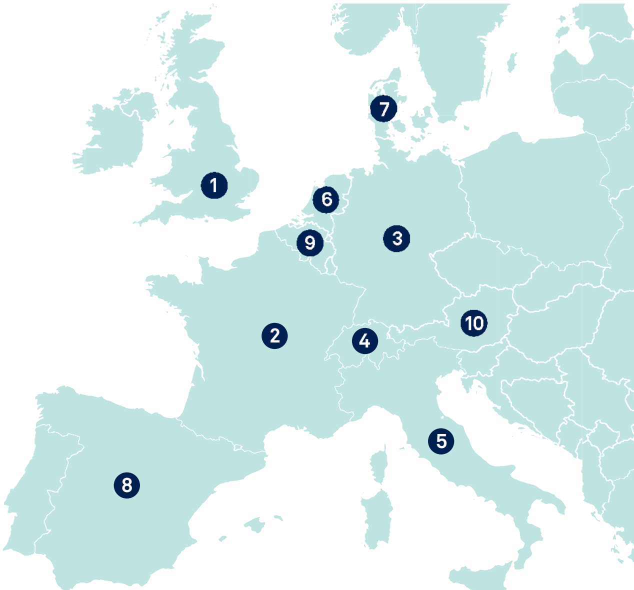
The UK is the second largest investment management centre in the world behind the United States. The US accounts for just under half of the £75 trillion ($103 trillion) of global assets under management and most of the £33.0 trillion in US AUM is managed in the US. This puts US AUM higher than the total assets under management across all European nations combined (Table 2). Outside Europe and the US, Japan is a notable investment management centre with total assets under management of about £5.0 trillion.

TABLE 2: GLOBAL ASSETS UNDER MANAGEMENT

	Assets under management (local currency)	Assets under management (£ equivalent)
US	$45 trillion[5]	£33.0 trillion
Europe	€27 trillion[6]	£24.4 trillion
Japan	¥700 trillion[7]	£5.0 trillion

Figure 4 looks at the size of the UK investment management industry compared with other European countries. Net assets are estimated based on the most recent market share data available (December 2018). The UK is by far the largest investment management centre in Europe with a market share of 37%.[8] This proportion has remained fairly stable over the last decade. Looking at the rankings in Figure 4, the UK's share of the European market is larger than the combined total of France, Germany and Switzerland.

FIGURE 4: ASSETS UNDER MANAGEMENT IN EUROPEAN COUNTRIES (DECEMBER 2018)



Country	Net assets (€bn)	Market share
1. UK	8609	37%
2. France	4072	18%
3. Germany	2190	10%
4. Switzerland	1912	8%
5. Italy	1315	6%
6. Netherlands	1207	5%
7. Denmark	387	2%
8. Spain	369	2%
9. Belgium	287	1%
10. Austria	131	1%
Other	2617	11%
TOTAL	**23,069**	

Source: EFAMA

[5] Estimate based on North America Data. Global Asset Management 2021: The $100 Trillion Machine, BCG, 2021.
[6] Provisional estimates for Asset Management in Europe, 12th Annual Review, EFAMA.
[7] Financial Services in Japan 2019/2020, NRI.
[8] This is based on December 2018 EFAMA data.

OVERSEAS CLIENT MARKET

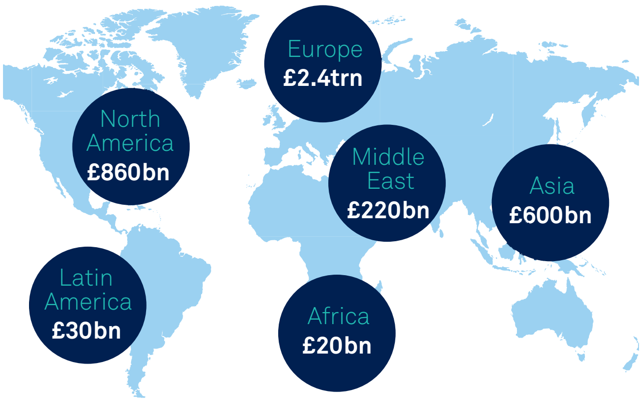
The UK has long been regarded as a leading centre of excellence for investment management and as we discuss in more detail in chapter 2, has many competitive advantages that make it an attractive investment hub for overseas investors. That remains true, despite the UK's departure from the European Union on the 31 January 2020. As of the end of 2020, overseas client assets account for 44% of total AUM (equivalent to £4.2 trillion), a one percentage point increase year on year. Until 2019, total assets had fluctuated at the 40% mark for a number of years. 2019 marked a step change with total assets reaching 43% and this growth continued in 2020, reaching a new high.

Figure 5 shows the distribution of overseas clients' assets across the world. European clients continue to make up the majority (58%) of the overseas client base, with UK based investment managers overseeing £2.4 trillion on their behalf. The European share of the overseas market has remained fairly stable over the last five years. European client assets are managed predominately for clients in the EEA (about £2.2 trillion) with Swiss clients accounting for 80% of the Non-EEA European assets.

Assets managed on behalf of North American clients reached £860 billion in 2020, an increase of 22% on the previous year. This growth means that North American clients now account for 21% of the overseas client market, up from 17% in 2017. Much of the growth in 2020 is a result of improvements in data and reporting by our member firms.

Growth in Asian clients' assets slowed in 2020, but Asia still maintains a 14% share of overseas client AUM. Client assets outside Asia, North America and Europe tend to experience more fluctuation each year. Middle East and African client assets dipped in 2020, each experiencing falls of about £10 billion. Assets managed on behalf of clients in the Middle East have remained fairly stable in absolute terms over the last five years as assets managed on behalf of other markets have grown and so its proportion of the overseas market has fallen three percentage points to 6% since 2016.

FIGURE 5: ASSETS MANAGED FOR OVERSEAS CLIENTS



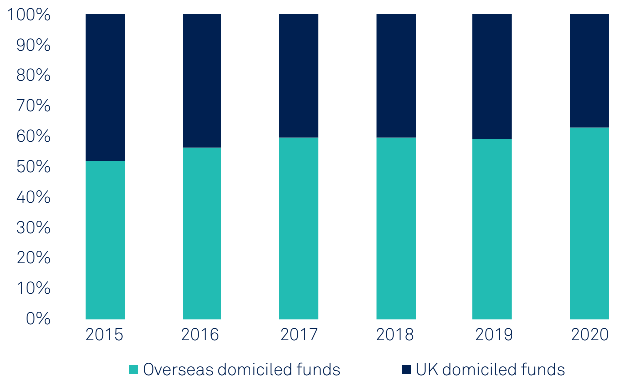
SERVICES TO OVERSEAS FUNDS

The attractiveness of the UK as a centre for investment management is reflected in the volume of assets within funds domiciled overseas that are being managed by IA members from UK offices. The delegation of these assets from overseas funds to UK based portfolio managers allows UK investment management expertise to be accessed from around the world.

The data in Chart 3 includes UK managed assets in open ended funds, investment trusts, ETFs, hedge funds and money market funds (MMFs). Total assets in UK managed investment funds at the end of 2020 stood at £3.7 trillion. The majority (63%) of these assets sat within funds domiciled overseas, primarily within funds domiciled in Ireland and Luxembourg.

Chart 3 shows that overseas funds have seen an eleven percentage point increase since 2015 when total assets in overseas domiciled funds stood at 52%. Much of this trend has been attributed to IA members transferring European clients to overseas domiciled funds as part of their Brexit preparations. Most of these transfers were complete by the end of 2017 at which point the trend towards the growth of assets in overseas funds stagnated. However, in 2020 based on a matched sample,[9] total assets in overseas funds recorded growth of 22% year on year while assets in UK domiciled funds increased 8%.

CHART 3: CHANGE IN PROPORTION OF ASSETS MANAGED FOR UK AND OVERSEAS FUNDS (2015-2020)

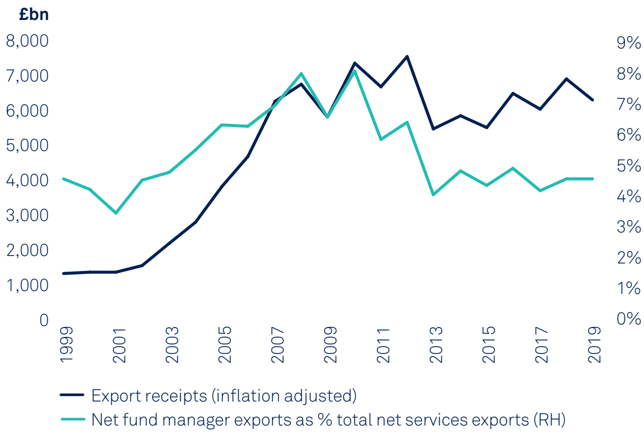


IMPORTANCE TO UK SERVICE EXPORTS

The growth in assets within overseas domiciled funds and the increasingly international client base presents an opportunity for UK investment management to export their services globally. Chart 4 looks at the investment management industry's contribution to the UK's total export earnings over the last two decades. Once adjusted for inflation, this contribution has increased from £1.2 billion in 1999 to £6.3 billion in 2019.[10]

The right hand side of Chart 4 indicates fund manager contribution as a proportion of total net exports stood at 4.5% in 2019. The proportion of fund manager exports peaked at 8.0% in 2010, largely driven by the slowdown in the growth of other services exports following the global financial crisis. It remained volatile for a few years after the crisis but has remained fairly stable, averaging 4.5% over the last five years.[11]

CHART 4: EXPORT EARNINGS OF FUND MANAGERS AND CONTRIBUTION TO SERVICES EXPORTS (1999-2019)



Source: ONS

[9] The matched sample consists of data from firms who have supplied both 2019 and 2020 data.
[10] Chart 4 uses the latest reported data by the ONS (December 2019).
[11] The data in Chart 4 captures earnings by independent investment managers but is likely to understate earnings from investment managers that are part of a wider financial services group such as an investment bank or insurer. As such, this estimate is conservative and the actual contribution of investment management overall to service exports is likely to be higher.