4 UK INSTITUTIONAL MARKET

KEY FINDINGS

MARKET OVERVIEW

- IA members manage £4.5 trillion for UK institutional clients from their global offices, which is up from £4.0 trillion in 2019. We estimate that the vast majority (90%) of these assets are managed in the UK.
- Members reported over £100 billion of net inflows from institutional clients in 2020, a large proportion of which was inflows into cash mandates.
- The UK institutional market is dominated by assets managed on behalf of UK pension funds. In 2020, the proportion of pension fund assets fell for the first time in almost a decade to 64%, a one percentage point fall from 2019.
- Assets managed on behalf of corporate clients saw a substantial increase in 2020, with assets more than doubling in nominal terms to £230 billion, equivalent to 5.1% of total assets.

EVOLUTION OF PENSIONS MARKET

- In 2020, pension funds accounted for more than half of the UK institutional client base (64%), with assets totalling £2.9 trillion. The majority of pension funds were managed by corporate pension funds schemes, responsible for £2.4 trillion.
- The IA estimates that the wider pensions market – including individual pensions, drawdown and assets backing the annuity book – reached £4.0 trillion at the end of 2020, with IA members managing a significant proportion of this through institutional mandates and funds.

THIRD PARTY MARKET

- At the end of 2020, assets under management stood at £3.9 trillion once in-house mandates are excluded, which is up from the £3.4 trillion recorded in 2019.
- In the third party market, pension funds represent an even greater share of total assets, accounting for 68% of third party assets.
- In 2020, assets in LDI mandates accounted for 38% of total mandates, equivalent to an estimated £1.5 trillion and which is up from £400 billion in 2011.

MANDATE TYPES

- When LDI mandates are excluded, there is a growing preference among institutional investors for specialist mandates which make up 80% of assets. Multi-asset mandates account for 20% of total mandates, which is down one percentage point on the previous year. The last two years have marked a shift away from the trend towards multi-asset strategies observed between 2011 and 2018.
- Within specialist mandates, the breakdown by asset class has fluctuated over the past nine years. The most pronounced trend has been a fall in specialist equity mandates (from 43% in 2011 to 36% in 2020).
- 2020 saw a notable increase in the proportion of assets within cash specialist mandates, increasing five percentage points year on year to 15% of total third party assets. Much of this growth has come from corporate clients who have faced liquidity pressure in 2020.
- Nearly three quarters (72%) of assets were actively managed in 2020 – an approach favoured by all institutional client types. Index strategies are most prevalent amongst pension scheme clients where 35% of assets are managed on an index basis.
- Two thirds (67%) of third party institutional mandates were managed on a segregated basis in 2020, which is up from last year's 64%.

This chapter takes a detailed look at the UK institutional client market. It differs from previous chapters in two key respects:

- It covers all assets irrespective of whether the asset are managed in the UK or managed from offices overseas: we estimate that more than 90% of the assets are managed in the UK.
- 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.

MARKET OVERVIEW

As of 2020, IA members manage £4.5 trillion[21] for UK institutional clients globally, this is up from £4.0 trillion in 2019. Data provided by IA members suggest that over £100 billion of the growth in assets in 2020 was a result of net inflows from institutional clients over the year. We do not collect monthly flow data on the institutional market but several firms that we spoke to in 2020 and 2021 described a considered response from institutional clients compared with a more reactive response from retail clients through the steep market declines in March 2020. Many spoke about the lessons learned from 2008, which saw institutional clients de-risking during the market turbulence and moving away from equities. In 2020, rather than selling out of equities or bonds, members reported that a more agile institutional client market was ready to take advantage of falling markets by purchasing undervalued securities.

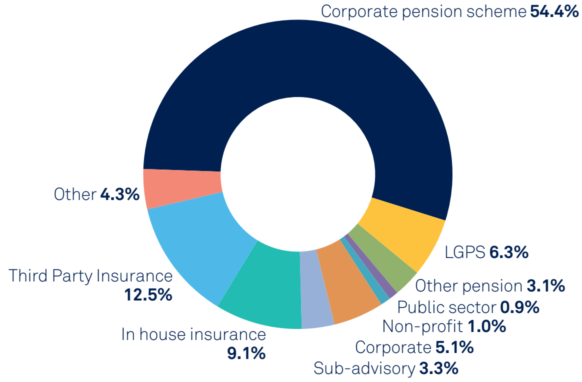
CLIENT BREAKDOWN

The breakdown of the UK institutional client base in Chart 21 shows UK pension funds dominate the market, accounting for 64% of total institutional assets in 2020. This is down one percentage points from the previous year and marks the first time in almost a decade that the pension fund share of the institutional market did not increase year on year. In absolute terms pension assets increased 8% in 2020, but were outpaced by growth in assets held by other clients.

The second largest client group in the institutional market are insurance companies, which make up just over a fifth (22%) of total assets. In-house insurance assets have been declining for some time and fell another two percentage points in 2020 to 9%. Third party insurance assets have been fairly stable as a proportion of total assets for the last few years but saw a one percentage point increase to 12.5% in 2020.

The corporate client category saw the largest increase in assets with AUM more than doubling in absolute terms to £230 billion. Corporate client AUM now accounts for 5.1% of total assets (up from 2.9% in 2019). Much of this growth reflects inflows into cash or cash like assets from corporate clients as the demand for liquidity rose through 2020 as a result of the global pandemic.

CHART 21: UK INSTITUTIONAL MARKET BY CLIENT TYPE (2020)



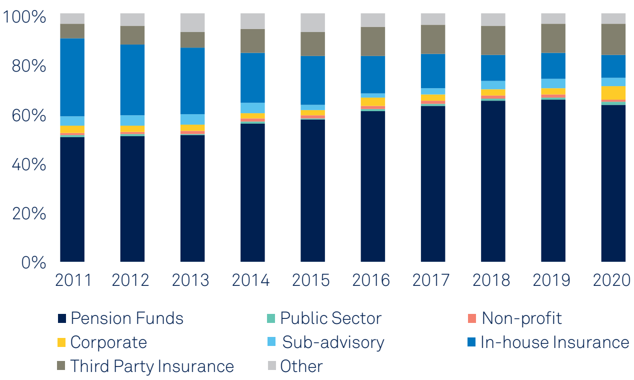
[21] Implied figure based on data collected on an estimated 83% of the institutional client base.

Chart 22 looks at the long-term trend in the proportion of assets broken down by client type. Two notable trends can be observed:

- The first point is around the dominance of assets managed on behalf of UK pension funds, which have increased from 50% in 2011 to 64% in 2020. Until 2020, this growth was consistent year on year.

- The second point is the significance of the fall in the assets managed on behalf of insurers, which accounted for 37% of total assets in 2011 and has dropped fifteen percentage points to 22% in 2020. This fall in assets reflects a number of factors, including a changing product focus within the insurance industry and corporate restructuring. However, within the insurance category, third party insurance assets have increased from 6% in 2011 to 13% in 2020. This is the result of increasing outsourcing of investment management by insurers, which can occur for reasons that include overall business model (eg. life and pension asset aggregators) or targeted approaches to external specialist investment mandates.

CHART 22: UK INSTITUTIONAL MARKET BY CLIENT TYPE (2011-2020)



EVOLUTION OF PENSION MARKET

Given that pension funds make up such a large part of the industry's client base, this section takes a deeper dive into the UK pensions market and utilises third party data. The IA defines pension funds as DB and DC schemes where the investment manager has a direct relationship with the pension fund rather than it being distributed via a wrapped product through an insurance company.

As we saw in Chart 21, pension funds accounted for more than half of the UK institutional client base in 2020 with assets totalling £2.9 trillion. The IA divides pension scheme assets into three categories:

- **Corporate pension funds** (CPF) account for the majority of UK pension fund assets at £2.4 trillion. Occupational Pension Scheme (OPS) managers, who manage an estimated £215 billion in assets, are also included in the category.

- **The Local Government Pension Scheme** (LGPS), accounted for £280 billion in assets, which indicates that IA members manage the majority of these assets.

- **Other** assets managed for pension schemes that do not fit into either category listed above, such as pension schemes run for not-for-profit organisations, account for £140 billion of total UK pension scheme assets.

Defined benefit (DB) pensions still make up the bulk of corporate pension assets and at the end of 2020 accounted for £2.2 trillion of pension assets.[22]

[22] Includes assets in the PPF 7800 index plus an estimate of assets in crown guaranteed schemes. This figure is not a direct subset of the £2.8 trillion managed for corporate pensions by IA members as some DB assets will be managed by non-IA members.

SIZING THE MARKET

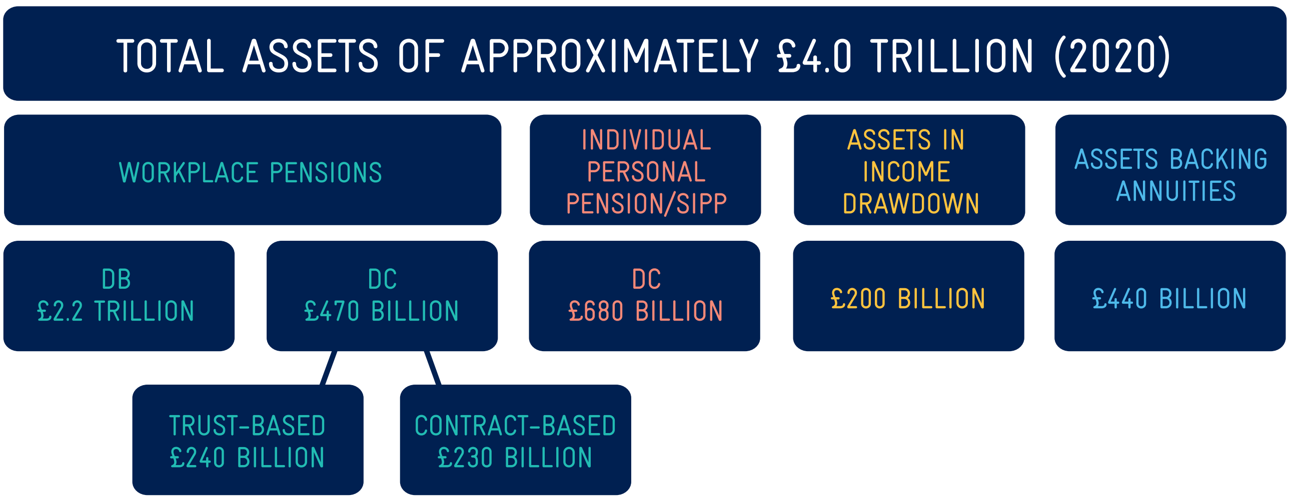
When we look across the landscape of pension provision, the IA estimates that the size of the UK pensions market stood at £4.0 trillion at the end of December 2020. This figure includes all assets in DB and DC workplace pensions and personal pensions as well as assets in income drawdown and assets backing annuities. Assets backing annuities sit on insurers' balance sheets and so our categorisation of pension fund assets is likely to underestimate total pension assets managed by IA members. Figure 13 provides an overview of how the £4.0 trillion is broken down across the different arrangements.

As shown in Figure 13, DB (funded) assets continue to account for the majority of pension assets. DB schemes which are still open to new members are largely in the public sector, most private sector DB schemes have closed to new members and accruals. In 2012, the UK Government introduced a phased rollout of automatic enrolment which would eventually require every employer to enrol eligible employees into a workplace DC pension scheme and make minimum contributions of 3%.

Chart 23 looks at the split between DB and DC pension provision in the private sector since the introduction of automatic enrolment. The chart illustrates that DB pension participation amongst private sector employees has remained constant but automatic enrolment has resulted in the rise of pension participation rates overall. Pension participation increased from 32% in 2011 to 67% in 2017 when the initial rollout was complete and has remained constant at 72% since 2018.

In April 2019, minimum contributions for employees automatically enrolled in a DC workplace pension were increased from 5% to 8%. Initial opt-out rates remained low at 8% as of early 2020. The global pandemic and subsequent lockdowns in 2020 have placed significant pressure on employees in many sectors. Early signs from 2020 suggested that pension contributions held up well through the crisis, though this was largely aided by the Government furlough schemes which covered contributions as part of the financial support offered to employers. Faced with higher contributions and economic uncertainty, data from Nest shows member opt out rates between April and September 2020 had risen from 8% to 11%.

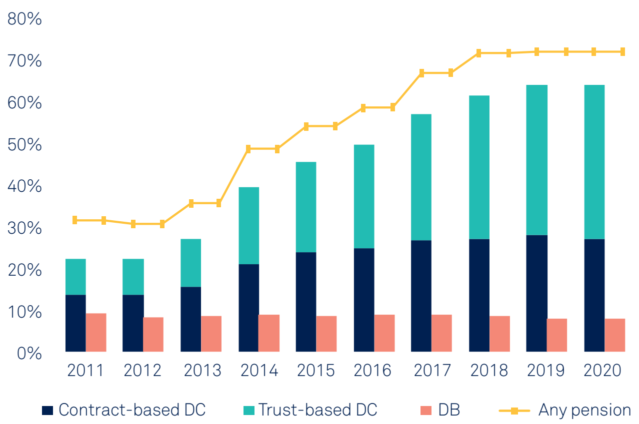
FIGURE 13: OVERVIEW OF THE UK'S PENSION LANDSCAPE[23]



Source: ONS, FCA, PPI, IA, DCLG, MoretoSIPPs.

[23] Estimates are provided on a best efforts basis.

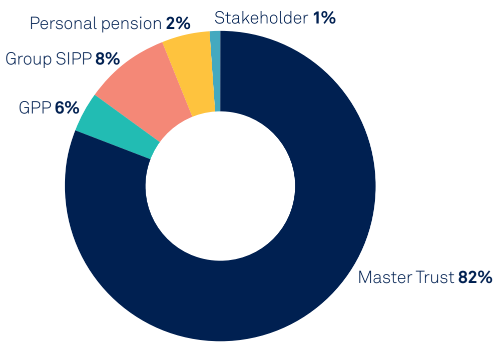
CHART 23: PENSION PARTICIPATION FOR PRIVATE SECTOR JOBS (2011-2020)



Source: ONS

Many of these new savers have been enrolled into master trust arrangements. The low cost master trust Nest has a public service obligation to accept all employers that wish to use it to auto enrol employees, and will have enrolled significant number of savers in the final stages of auto-enrolment when small and micro employers were phased in. There are 38 authorised master trust schemes in the UK, down from 90 before authorisation was required by The Pensions Regulator, representing 16.6 million DC pension savers. A recent survey of pension providers showed that 81% of DC scheme members are in a master trust arrangement (Chart 24).

CHART 24: DC MEMBERS BY SCHEME TYPE (2020)



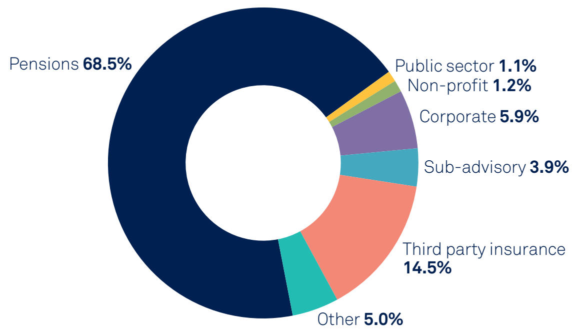
Source: Pensions Policy Institute

TRENDS IN THE THIRD PARTY INSTITUTIONAL MARKET

Full details of the asset allocation and investment strategy for the entire institutional market are available in Appendix 2 of this report. The remainder of this chapter looks more closely at IA data from the institutional market that is available to third parties, that is, excluding mandates managed in-house by insurance parent groups and occupational pension schemes, as at the end of 2020.

Assets under management stand at £3.9 trillion, up from £3.4 trillion in 2019, once in-house insurance mandates are excluded from the institutional data. In Chart 25, we see that pensions dominate the market even more once in-house mandates are excluded, though if the proportion of in-house insurance assets continues to fall, Chart 21 and Chart 25 will become more closely aligned.

CHART 25: THIRD PARTY UK INSTITUTIONAL CLIENT MARKET BY CLIENT TYPE (2020)



MANDATE BREAKDOWN

Chart 26 breaks the institutional market down into three categories of mandate:

- **Single-asset**, or 'specialist' mandates, which focus on a specific asset class or geographical region. In 2020, 49% of mandates were managed on this basis which is up four percentage points from the previous year, a testimony to the popularity of specialist mandates among institutional investors.
- **Multi-asset**, or 'balanced' mandates, which cover a number of asset classes and regions. At the end of 2020, balanced mandates were employed for 12% of assets managed by third party clients. Stripping out the LDI mandates from the data, the balance between specialist and multi-asset is 80% single asset versus 20% multi-asset.
- **LDI mandates** are specifically designed to help clients meet future liabilities. These mandates frequently make greater use of derivative instruments and are therefore included on the basis of the notional value of liabilities hedged, rather than the value of physical assets held in the portfolio. Assets in LDI mandates accounted for 38% of total mandates in 2020, equivalent to an estimated £1.5 trillion.

CHART 26: UK THIRD PARTY INSTITUTIONAL CLIENT MANDATES INCLUDING LDI (2020)

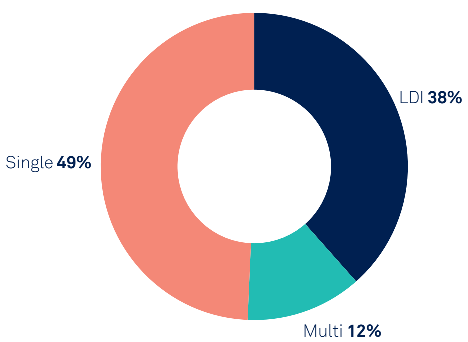
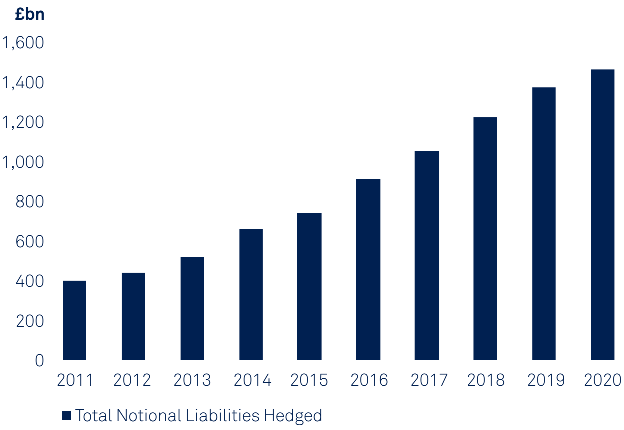


Chart 27 illustrates the growth in the notional value of LDI from £400 billion in 2011 to almost £1,500 billion in 2020. LDI mandates are used almost exclusively by pension fund clients and more specifically by defined benefit pension schemes seeking LDI strategies to manage their future liabilities. Regulatory changes around the DB funding regime in the UK have reinforced this shift towards liability management and growth in LDI mandates will likely continue in the near future. Growth in LDI is also a reflection of a broader trend, which is mirrored in the retail market, away from specialist offerings towards solutions type products.

CHART 27: NOTIONAL VALUE OF LDI (2011-2020)



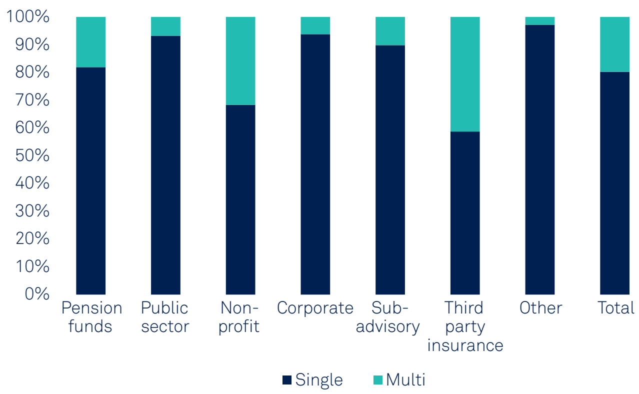
Source: IA/KPMG LDI Survey

Since 2016, the proportion of assets in LDI mandates has increased from 29% in 2016 to 38% in 2020. Although DB pension schemes remain a significant proportion of the institutional market, the fact that they have very specific requirements means that their LDI allocations can mask trends that might otherwise be observed in the market. For that reason we exclude the value of LDI mandates from the asset allocation analysis on pages 61 to 65 and focus purely on whether clients are favouring multi-asset or specialist solutions other than explicit liability management.

4

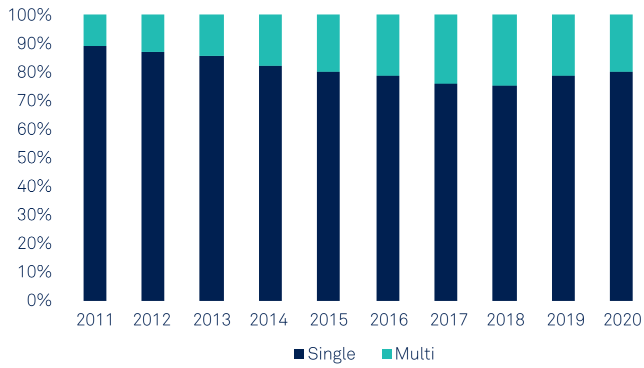
Chart 28 shows the balance between single and multi-asset mandates, excluding LDI. This increases the proportion of specialist mandates to 80% but this preference varies by client type. For instance, multi-asset mandates account for around one third (33%) of non-profit client assets and four fifths (42%) of third party insurance assets. Once you strip out LDI, pension funds rely more heavily on specialist mandates. As the definition of pension funds in this report reflects mainly defined benefit and larger defined contribution schemes, it is not surprising that they are more likely to have both the level of assets and the expertise to appoint specialist managers.

CHART 28: UK THIRD PARTY INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST (2020)



Looking at the long-term trend of multi-asset versus specialist mandates (Chart 29), we can observe that between 2011 and 2018 the proportion of third party multi-asset mandates increased from 11% to 24%. Revised 2019 data and the latest data show that this trend reversed over the last two years with multi-asset mandates making up 20% of total third party assets. Driving the reversal of the trend appears to be the significant movement of some large multi-asset mandates that are possibly being restructured now.

CHART 29: UK THIRD PARTY INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST (2011-2020)



In past reports it was suggested that the growth in multi-asset strategies between 2011 and 2018 shown in Chart 29 was a reflection of increased pension contributions through the automatic enrolment scheme, where default strategies tend to be medium risk balanced strategies. However, external data show the use of multi-asset funds remains limited in default strategies (see Chart 33). Pension schemes and/or consultants are increasingly controlling the allocation directly, building strategies based on segregated mandates and/or component funds.

INVESTMENT TRENDS WITHIN SPECIALIST MANDATES

Chart 30 looks at the long-term trend in the breakdown of specialist mandates by asset class and shows some volatility year on year, though there appears to be a small fall in the proportion in specialist equity mandates:

- Specialist equity mandates in 2020 account for 36% of the total third party institutional market, a one percentage point fall year on year.
- Fixed income mandates remain unchanged at 40% of the market in 2020.
- Perhaps most indicative of the impact of Covid-19 has been the substantial increase in the specialist cash mandates, which increased by five percentage points year on year to 15% of total third party assets.

This is borne out in the institutional net flow data collected in this year's Survey which shows net outflows of £10 billion from specialist equity mandates while fixed income and cash specialist mandates attracted net inflows of £15 billion and £30 billion respectively.

CHART 30: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS (2011-2020)

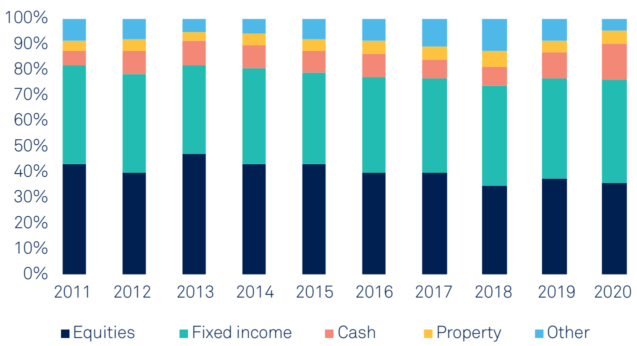
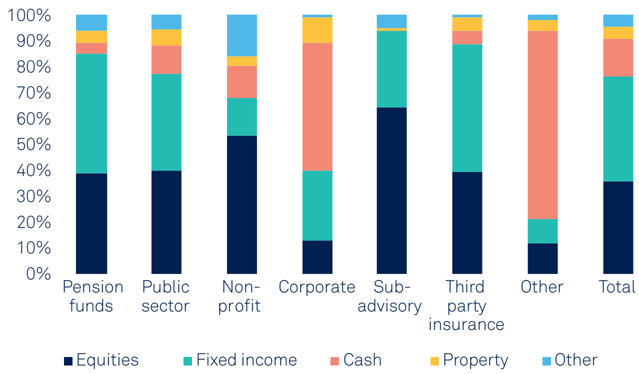


Chart 31 provides an indication of the client groups driving the 2020 shifts in demand for certain asset classes. As we saw, corporate client assets have grown considerably in 2020, more than doubling over the year. Much of this growth has come from the demand for liquidity from corporate clients who were faced with an extremely challenging business environment in 2020. The global lockdowns caused a severe hit to corporate balance sheets. Faced with mounting liabilities and severely restricted revenue growth prospects, corporates increased their investment in liquidity strategies. In 2020, half (50%) of assets managed on behalf of corporate clients were in specialist cash strategies compared with a fifth (20%) in 2019.

Other notable trends include increasing allocation to fixed income mandates from pension funds, up four percentage points to 46% of assets. Total assets in specialist fixed income mandates on behalf of third party insurance clients fell as a proportion of the total from 57% to 49% while the proportion of assets in specialist equity mandates rose from 31% to 39%.

CHART 31: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS (2020)

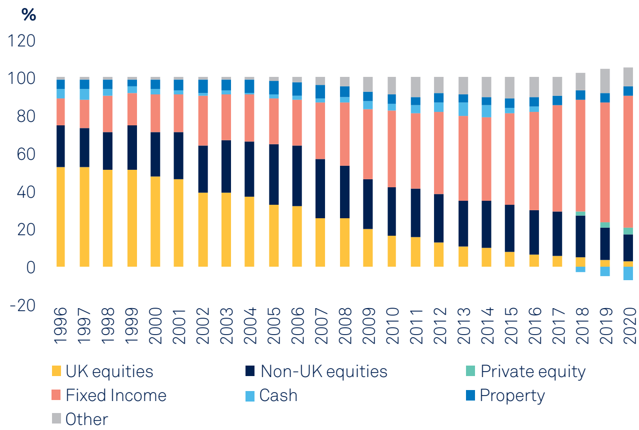


The asset allocation of DB schemes (Chart 32) has seen a dramatic shift since the move away from traditional scheme-specific asset allocation benchmarks toward strategies such as LDI, which matches their assets to their liabilities more closely and manages deficit volatility.

Reflecting on trends that we have seen throughout the report, a typical DB scheme is now likely to hold a much smaller proportion in equities overall, but a significantly small proportion of domestic equities. Equities account for just 21% of DB scheme investments compared with 75% twenty five years ago. In particular, the allocation to UK equities has fallen dramatically since 1996 from 53% to just 3% of the overall asset allocation in 2020.

Over the same period, pension funds have adopted aggressive de-risking strategies which have resulted in a considerably larger allocation to fixed income assets (69%) compared with what we saw over two decades ago (14% in 1996). The proportion of assets held in cash and deposits has turned negative. This is likely related to investments such as swaps and repurchase agreements.

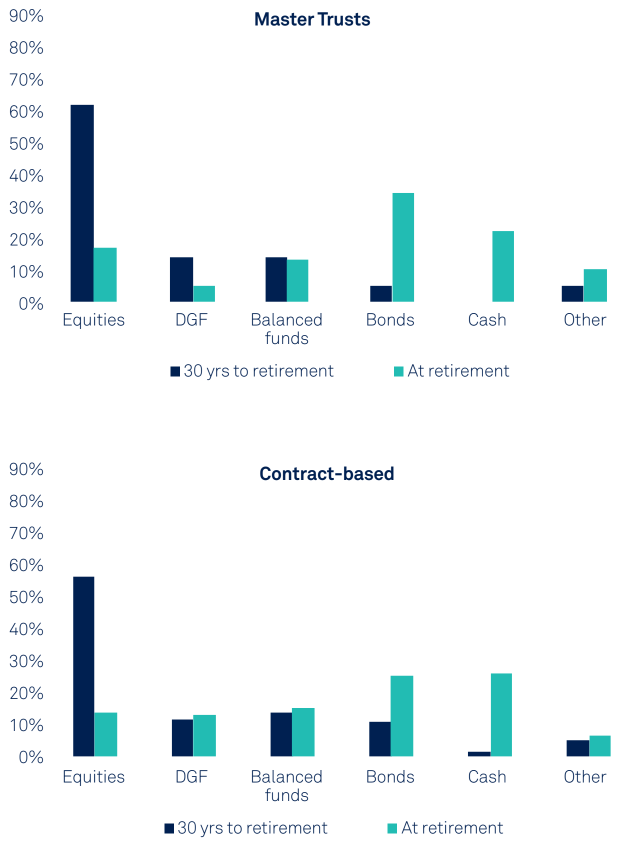
CHART 32: UK DB PENSION FUND ASSET ALLOCATION (1996-2020)



Source: UBS, PPF/TPR Purple Book

In contrast to DB schemes, Chart 33 shows that both contract based and master-trust DC schemes have a much higher allocation to equities, but this is considerably higher during the accumulation phase than at retirement. They also have a significantly lower allocation to fixed income both at retirement and in the accumulation phase compared with DB schemes.

CHART 33: DC ASSET ALLOCATION, 30 YEARS PRIOR TO RETIREMENT AND AT RETIREMENT[24]



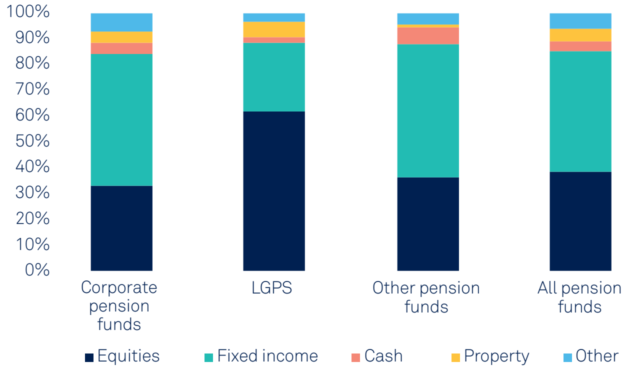
Source: Willis Towers Watson FTSE 350 DC pension survey

[24] Asset allocation in DC varies by age cohort, reflecting the principle that members' capacity to bear investment risk reduces as they age. So we tend to see investment risk in DC strategies reduced over time through shifts out of equities and into bonds and other diversifiers.

The LGPS is a public sector scheme that is one of the few DB schemes still open to new members. Most corporate DB schemes that have closed to new members have a more mature membership and so have a very different investment approach to the LGPS schemes whose members continue to build up entitlements. LGPS schemes are investing over longer time horizons and operate under a less restrictive regulatory framework and therefore have different asset allocation approaches.

Chart 34 looks at the pension fund asset allocation across corporate pensions, LGPS and other types of pension fund. We observe that given the points raised above, LGPS have higher allocation to return-seeking strategies and so the proportion invested in equities (61%) is almost double that of corporate pension funds, which are predominantly DB assets (34%). Greater de-risking and older scheme members among DB pensions also results in a significantly higher allocation to fixed income among corporate pensions compared with LGPS (50% vs. 27%).

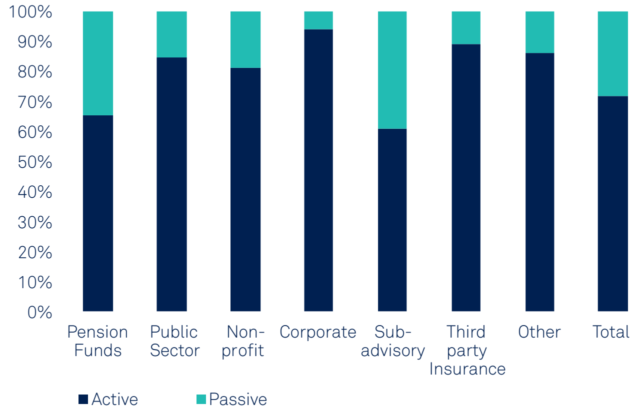
CHART 34: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS AMONG UK PENSION FUNDS (2020)



ACTIVE VS. INDEXING

Almost three quarters of institutional client assets (72%) were managed by IA members on an active basis, which is three percentage points higher than in 2019. Pension funds account for the largest use of index strategies, which make up 36% of pension fund assets. Indexing strategies are used extensively by both DB and DC pension schemes.

CHART 35: ACTIVE AND INDEX THIRD PARTY MANDATES BY CLIENT TYPE (SAMPLE-ADJUSTED) (2020)



4

SEGREGATED VS. POOLED

Chart 36 shows that segregated mandates represented two thirds (67%) of assets managed for third party institutional mandates at the end of 2020, up three percentage points from 2019. Third party insurance clients and sub-advised clients typically prefer segregated mandate arrangements with 86% and 92% of assets in mandates. Corporate clients are most likely to utilise pooled investment vehicles with 60% of assets in these types of arrangements. One third of pension client assets are within pooled arrangements, perhaps a reflection of the greater use of indexing through pooled vehicles.

CHART 36: SEGREGATED AND POOLED MANDATES AMONG THIRD PARTY PENSION FUNDS (2020)