1 UK INVESTMENT MANAGEMENT INDUSTRY: A GLOBAL CENTRE

KEY FINDINGS

SIZE OF THE UK INDUSTRY

- Assets under management (AUM) by IA members reached almost £10.0 trillion in 2021, a 6% increase on the £9.4 trillion reported the previous year. This is below the 11% compound average annual growth rate observed over the last ten years.
- Scotland remains an important centre for the UK investment management industry, with assets under management in Scotland surpassing £700 billion in 2021 and continuing to account for 7% of total UK AUM.
- Total assets under management within the wider industry reached £11.6 trillion this past year. This is a 5% increase on the previous year,

UK INVESTMENT MANAGEMENT INDUSTRY IN A GLOBAL CONTEXT

- Global AUM reached £83 trillion in 2021. The UK continues to be a centre for excellence in investment management – the largest industry in Europe and second only to the United States worldwide.
- The UK investment management industry is one of the world's leading international centres, 46% of UK AUM is managed on behalf of overseas clients, up from 37% since 2016. The majority of overseas clients are European (at 59%), with North American clients being the second largest overseas client group accounting for one fifth (19%) of overseas assets. There has been very little change in the regional composition of the overseas client base over the years.
- Assets in overseas-domiciled funds have seen accelerated growth over the past couple of years. As of the end of year 2021, 65% of the £4.1 trillion in investment funds sit in overseas-domiciled funds; up from 63% in 2020, and 9 percentage points higher than in 2016.

This chapter provides an overview of the UK investment management industry – highlighting areas of growth, placing it in a European and global context and emphasising the ways in which the UK investment management industry continues to thrive as a globally recognised centre for excellence in portfolio and asset management.

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 1.

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 the investor to undue risk.

The industry's role goes beyond investing in different asset classes. Investment managers help to ensure that capital markets work effectively so that investment can take place. Allocating capital on behalf of investors 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 role. 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 of the companies they invest in to promote good governance and to protect the company's 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.

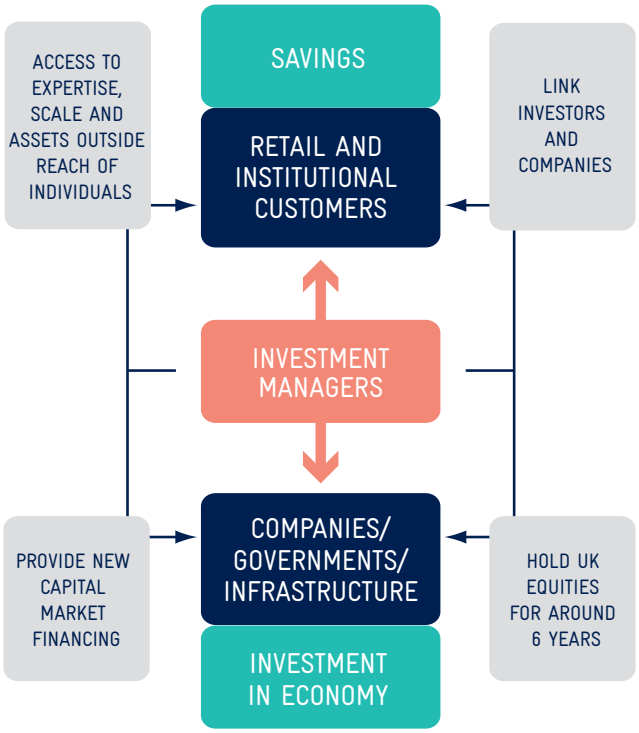
FIGURE 1: WHO ARE THE IA'S MEMBERS?

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.

[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

Between December 2020 and December 2021, IA member UK managed assets under management (AUM) reached £10.0 trillion, a 6% increase from the £9.4 trillion reported last year. This growth is well below the 11% compound average growth rate for the past ten years.

UK authorised and recognised funds under management (FUM) rose to £1.6 trillion by the end of 2021, up from £1.4 trillion in 2020 which represents a growth rate of 11% on the previous year, outpacing the growth of AUM for the third year in a row. This growth is in line with the compound average growth rate observed over the past ten years.

Chart 1 looks at the evolution of industry AUM and FUM over the last fifteen years. Assets increased threefold over that period, buoyed by the longest bull run in history which began in 2009 and lasted until the Covid-19 pandemic hit in 2020. 2020 saw markets crash in March and recover quickly to reach record highs,

BOX 1: GLOBAL CAPITAL MARKET PERFORMANCE IN 2021

In this section we offer a high-level analysis of global capital market performance in 2021 and, in Figure 3, highlight the annual total return[2] of selected indices. Market performance was split in 2021 – equity markets performed extremely well, in large part thanks to the flurry of economic activity in a world emerging from lockdown, but bond markets suffered from fears around rising inflation.

The successful Covid-19 vaccine trials of November 2020 acted as a driving force for the impressive performance of equity markets in 2021. The sense of optimism that the worst of the pandemic was over prompted a surge in consumer spending and supported a positive outlook for the post-pandemic economic recovery.

Equity markets experienced strong returns throughout the year despite a range of challenges – including severe supply chain disruptions, high energy prices and rising inflation. Total returns for global equity markets ended the year up 20%, compared with 13% in 2020, which was already a strong year for capital market performance.

US equities were a major contributor to Global market performance[3], generating total returns of 27% over the year. This is largely attributed to a strong tilt towards high growth sectors such as technology, which performed extremely well throughout 2021.

UK equity markets fared much better in 2021 than they did in previous years. UK equity performance was impeded by suspensions/cancellations of dividends in 2020, which are a big component of the FTSE's total returns[4]. As the UK emerged from lockdown and the economy reopened in 2021, dividend payments resumed and market performance picked up, contributing to a total return of 18% over the year, on par with Europe. Despite the strong performance, UK equities still underperformed US equities. This broadly reflects the composition of the UK equity market which has a higher weight to defensive stocks which perform better relative to other industries when inflation, and consequently interest rates, are rising. This has helped UK equities perform better than other markets, including the US, in 2022.

Asian equity markets rose alongside US, European and UK equity markets until autumn 2021, when political and financial turbulence in China eroded international investor confidence with repercussions for the entire region. The Chinese government's regulatory crackdown on the tech sector, the declaration of bankruptcy of the Chinese property giant Evergrande and the slowing growth in the housing market, and a return into strict lockdown (as part of China's Zero-Covid policy) negatively impacted the economy and damaged market performance. The Asian equity market ended the year with positive returns at 2%, compared with 18% in 2020.

BOND MARKETS

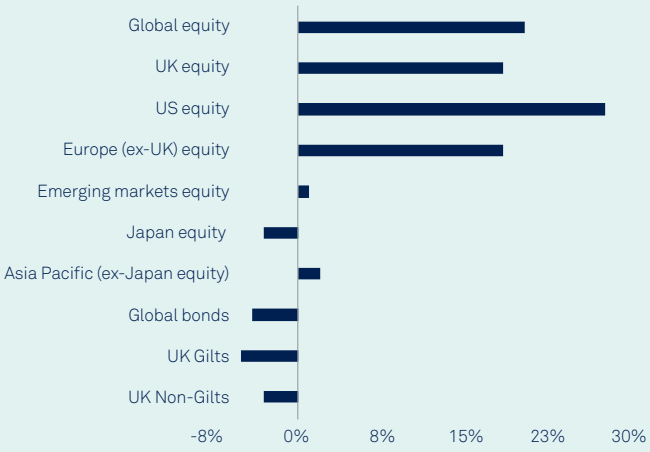
In 2021, all major bond indices experienced significant losses not seen since the 1980s and ended the year in the red. This underperformance is largely attributed to rising inflation, which presents a significant challenge for the bond market as it erodes the value of future fixed interest payments.

From the very beginning of 2021, a rise in yields hit UK Corporate Bonds and UK Government Bonds total returns. Returns started to recover as the economy re-opened, but in Q3 escalating gas and oil prices exacerbated the impact of rising inflation on bond markets in the UK and other developed markets around the world[5]. Although inflation had been increasing through the year, by Q3 markets began to make adjustments on the basis that inflation was no longer transitory, and the Bank of England (BoE) signalled interest rates would likely be raised to temper the impact of inflation on the economy.

Though the BoE did not raise interest rates until the 15th of December, through Q4 bond markets adjusted to reflect persistent inflation. This prompted a drop in total returns of UK Gilts and Non-Gilts, which ended the year at -5% and -3%, respectively. This was echoed in the US (-1% total returns) and in the Global bond market (-4%). By comparison, in 2020 UK Gilts and Non-Gilts outperformed Global bonds, which ended the year with returns of 9%, 8% and 6%.

The challenges facing bond markets have so far intensified in 2022. As the invasion of Ukraine solidified the rise of inflation, sterling denominated bond prices have tumbled and fixed income funds have sustained heavy outflows. After yields spiked in the first quarter of the year, US bond prices recovered in Q2. (See page 70 in chapter 5 for more information on the impact of inflation on fund flows in retail markets.)

FIGURE 3: TOTAL RETURN OF SELECTED BOND AND EQUITY MARKETS IN 2021



Source: Morningstar

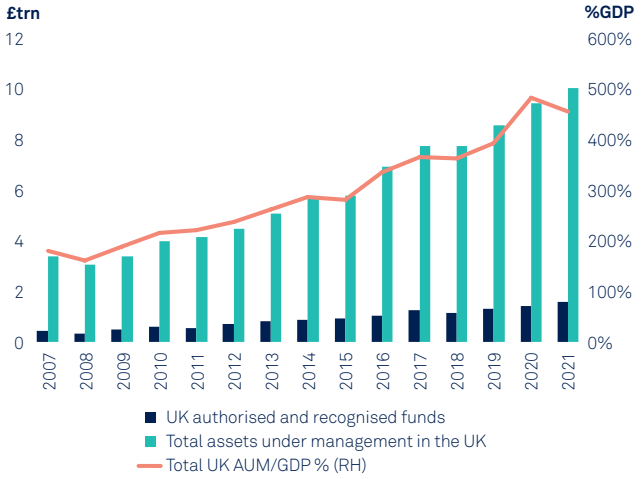
[2] Total return is more representative of the return an investor would receive than capital returns. Total returns include income distributions through dividends or share buyback as well as the rise and fall of stock or bond prices that are measured through capital returns.
[3] At the time of writing, the MSCI World Index has a 69% weighting/exposure to the US.
[4] In 2020, headline dividends fell by 44% to £61.9 billion (the lowest annual total since 2011) and two thirds of companies cancelled or cut their dividend payments (Link Group, UK Dividend Monitor Q4 2020).
[5] The UK Consumer Price Index rose from 0.6% in December 2020 to 2.5% in June 2021 and finally reached 5.4% at the end of the year. This is the steepest rise in inflation developed economies have had to reckon with for years (ONS data, Consumer price inflation, UK: December 2021).

further pushing up FUM and AUM. In 2021, capital market performance was quite varied depending on the asset class and region you were invested in (see Box 1). Whilst most equity markets grew, bonds saw negative returns for the year. This is likely to have contributed to a slowdown in growth at the AUM level.

There were pandemic related jitters throughout 2021, with the first quarter spent in lockdown, followed by the impact of the spread of the Delta and then Omicron variants but overall, equity markets performed strongly while fixed income market performance was more challenging. As the economy reopened, surging demand resulted in supply chain disruptions and inflation continued to rise, particularly in the last quarter of the year.

The story in 2022 is different, the global economy is entering a period of great uncertainty and rising volatility. Many economists have commented that The Great Moderation – the period of stable growth and inflation since the mid-1980s – has come to an end. The war in Ukraine has further exacerbated some of the supply chain shocks that emerged post pandemic, with food and energy prices in particular soaring. UK inflation reached a 40 year high of 9.4% by mid-year despite a number of interest rate rises by the Bank of England. Central banks have so far been hawkish and we have seen a number of rates rises which will have a direct impact on growth.

CHART 1: TOTAL ASSETS UNDER MANAGEMENT IN THE UK AND IN UK FUNDS (2007-2021)



Source: IA data, Office of National Statistics (ONS)

In this period of uncertainty, it is unlikely that the sustained growth observed in Chart 1 will continue at the same rate and may reverse, at least for some time.

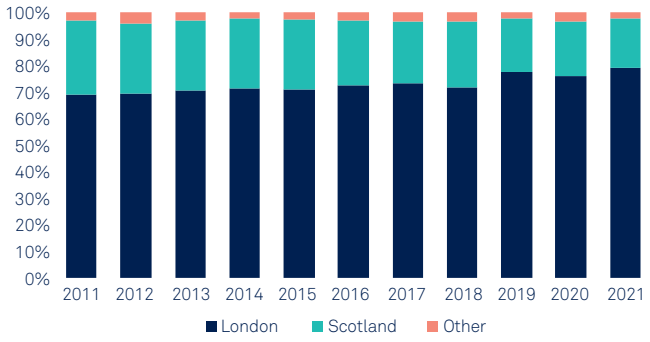
The right-hand side of Chart 1 also looks at the size of the UK investment management industry relative to GDP. We see that the AUM as a proportion of gross domestic product (GDP) has fallen for the first time in the past four years, which suggests that growth in AUM was outpaced by the year on year growth rate of the UK GDP. However, assets managed within the industry are still over four times bigger than the size of the UK economy.

SCOTLAND AS A MAJOR CENTRE

There are two primary city hubs in the UK for investment management; London is by far the largest both in terms of headcount and level of assets managed within the city, with Edinburgh coming in as the second largest hub. In 2021, assets managed from Scotland reached £700 billion, a small increase on the previous year. This is equivalent to 7% of total AUM. The longer-term trend observed over the past decade has been an overall decrease in the proportion of assets managed in Scotland. In 2011, the proportion of Scotland-managed assets was 12% of UK AUM, almost double the level observed in 2021. This is a reflection of merger and acquisition activity among Scottish firms which has caused growth to stall, as well as the faster relative growth in London and elsewhere in the UK, rather than a fall in Scottish managed assets in absolute terms.

Chart 2 shows the location of regional headquarters for UK-based investment management firms. Over ten years, we see a ten-percentage point increase in the proportion of firms headquartered in London. The share of Scotland headquartered firms has fallen from 28% in 2011 to 19% in 2021 and the share of other regional locations has remained relatively unchanged, fluctuating between 2 and 3%. Much of the portfolio management capability of Scottish headquartered firms is based in London, which is why we see a difference between the 7% of assets managed in Scotland versus the 19% of assets managed by Scottish headquartered firms. For more detail on the regional location by function see Chapter 6 of this report.

CHART 2: UK-MANAGED ASSETS BY UK REGIONAL HEADQUARTERS (2011-2021)



SCALE OF WIDER INDUSTRY

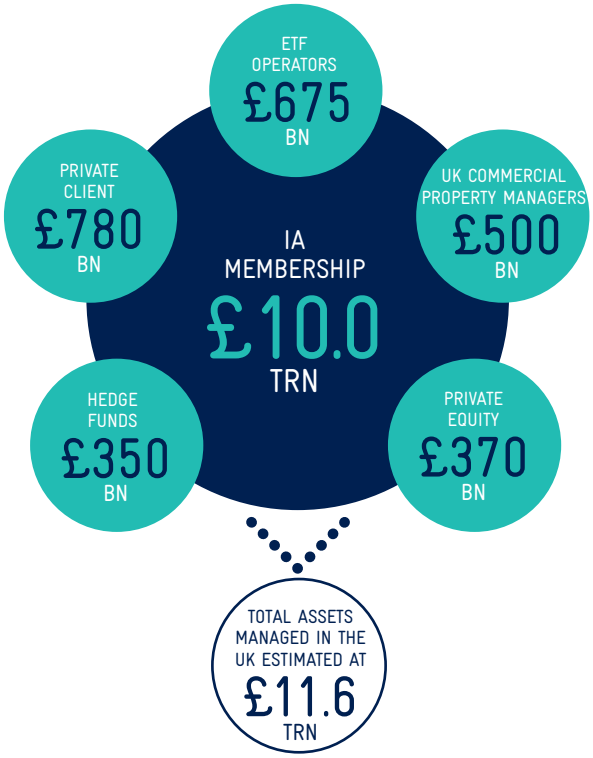
The Investment Associations' members are responsible for the majority (83%) of assets managed in the UK as part of the investment management industry. While the IA membership remains diverse, most of the firms not covered in this report can be categorised as follows:

- Hedge funds
- Private equity funds
- Commercial property management
- Discretionary private client management
- A small number of dedicated ETF operators

There are also some firms who are not members of the IA other than those listed above, but it is difficult to accurately size this group as there is no consistent third-party data available.

Figure 4 estimates the contribution of these firms to total assets under management in the UK as £11.6 trillion. Many of our member firms are active participants in the industry niches listed above so there will be some degree of overlap between this number and the total AUM managed by IA member firms in Figure 1, particularly the ETF asset numbers. We have estimated that total assets managed in the wider industry have grown 5% from a revised £11.1 trillion in December 2020 to £11.6 trillion in December 2021.

FIGURE 4: WIDER INVESTMENT MANAGEMENT INDUSTRY



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

UK INVESTMENT MANAGEMENT IN EUROPEAN AND GLOBAL CONTEXT

As of December 2021, global assets stood at £83 trillion. Together, the US, the UK and Europe are responsible for almost four fifths (77%) of global AUM – with the US alone responsible for more than two thirds.

As the UK grapples with the growing challenge of competitiveness in a post-Brexit environment, it continues to be seen as a centre of excellence for portfolio management more globally. The industry has maintained its standing as the second largest investment management centre (Table 1) behind the US which is nearly four times larger at £37 trillion in AUM. To put the size of the US market in context, total European AUM stood at £27 trillion in 2021. Japan is also a notably large asset management centre, with approximately £5 trillion of assets under management recorded for 2021.

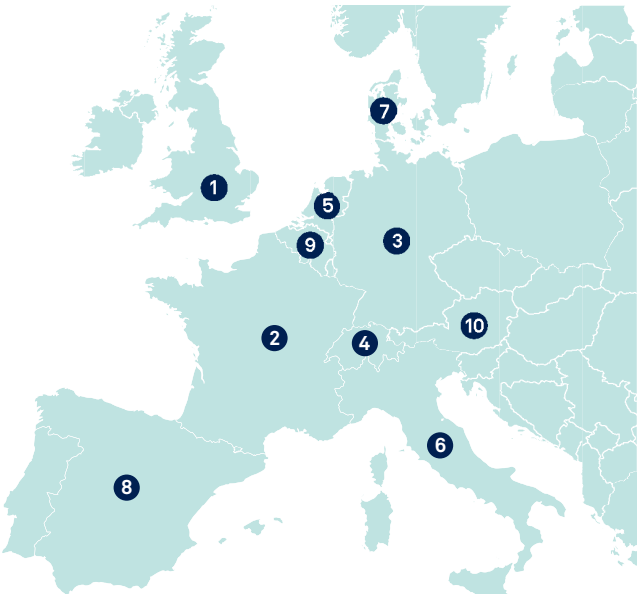
As discussed earlier in this chapter, the total value of UK-managed assets under management grew by 6% between 2020 and 2021. The US market grew at a much faster rate than the UK, as well as all other major investment management centres with a 12% growth rate. Meanwhile, the European market grew by 8% and growth in Japan has stalled.

TABLE 1: GLOBAL ASSETS UNDER MANAGEMENT IN 2021

	Assets under management (local currency)	Assets under management (£ equivalent)
United States	$50 trillion	£37 trillion
Europe	€32 trillion	£27 trillion
Japan	¥825 trillion	£5 trillion

Within Europe, the UK investment management industry is the largest and has a market share of 37%, a figure that has remained relatively stable over the past few years. This is illustrated in the rankings listed in Figure 3, where we see that the UK's market share is larger than the next three combined – with France at 16%, Germany at 10% and Switzerland at 9%.[6] The Netherlands, which has one of the largest funded pensions markets in Europe moved into the top five largest European asset management centres in 2020, with AUM rising a substantial 29% over the year.

FIGURE 5: ASSETS UNDER MANAGEMENT IN EUROPEAN COUNTRIES (DECEMBER 2020)



Country	AUM (€bn)	Market share
1. UK	10,442	37%
2. France	4,582	16%
3. Germany	2,882	10%
4. Switzerland	2,488	9%
5. Netherlands	1,826	6%
6. Italy	1,553	6%
7. Denmark	492	2%
8. Spain	405	1%
9. Belgium	346	1%
10. Austria	151	1%
Other	3,258	12%
TOTAL	**28,423**	

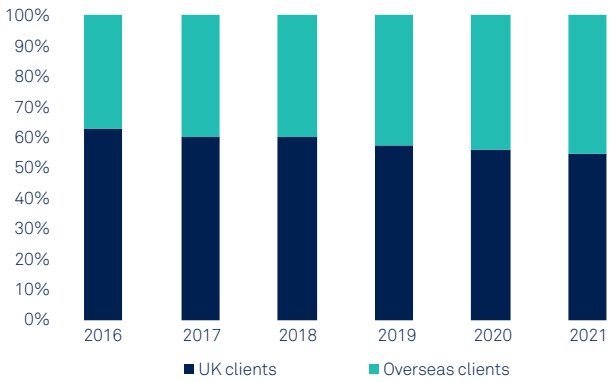
Source: EFAMA

[6] This is based on December 2020 data published by EFAMA.

OVERSEAS CLIENT MARKET

Despite some of the concerns highlighted in Chapter 2 regarding the UK's competitiveness as a financial centre following Brexit, the UK retains its position as a leading global investment management centre of excellence. The £10.0 trillion figure for total assets under management includes an estimated £4.6 trillion (46%) managed on behalf of overseas clients. Chart 3 shows that in the last five years, overseas clients have commanded an increasing share of the asset base, rising nine percentage points from 37% in 2016 to 46% in 2021.

CHART 3: CHANGE IN PROPORTION OF UK AND OVERSEAS CLIENTS (2016-2021)



The locations of the UK industry's overseas client base are illustrated in Figure 6. European clients continue to make up the majority at 59% (a one-point increase on the previous year), with UK-based investment managers overseeing £2.7 trillion on their behalf. Most of these assets are managed for clients from the European Economic Area (around £2.4 trillion). Of the remaining assets, the majority (approximately £200 billion) is managed on behalf of Swiss clients.

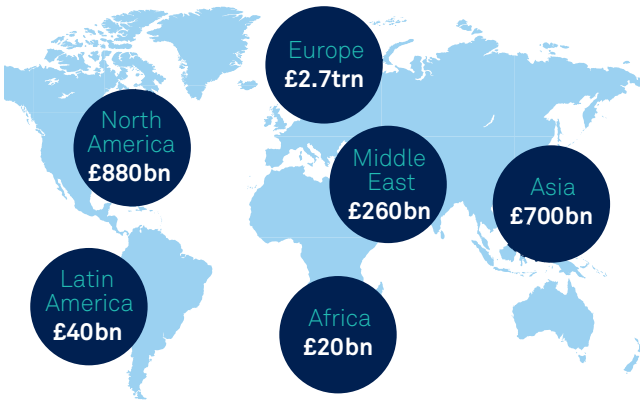
This year the IA has collected more information on the European clients our members serve. Of the £2.7 trillion managed on behalf of European clients, two fifths (40%) of the assets are managed within segregated mandates, or £1.1 trillion in nominal terms. Of this £1.1 trillion in segregated mandate business, approximately £380 billion is managed on behalf of clients located in the Netherlands and £110 billion on behalf of German clients.

Between 2020 and 2021, the value of assets managed in the UK on behalf of North American clients grew to £880 billion, a relatively small £20 billion increase on the previous year. However, the US is consistently the second largest client base for the UK industry.

By comparison, Asian client assets increased by close to £100 billion to reach £700 billion. This year, we were able to collect more detailed data from our member firms on their Asian clients and can report the following breakdown: of Asian client assets managed in the UK, 36% is managed on behalf of Japanese clients (upward of £250 billion) and 7% for Chinese clients (close to £50 billion).

Assets managed on behalf of Middle Eastern clients has seen little growth in previous years in nominal terms, which has resulted in the decline of its share of the UK industry's overseas client base. As of December 2021, however, there was an increase of nearly £40 billion in assets managed on behalf of clients in the Middle East which contributed to a rise in their market share from 5% in 2020 to 6% in 2021.

FIGURE 6: ASSETS MANAGED FOR OVERSEAS CLIENTS



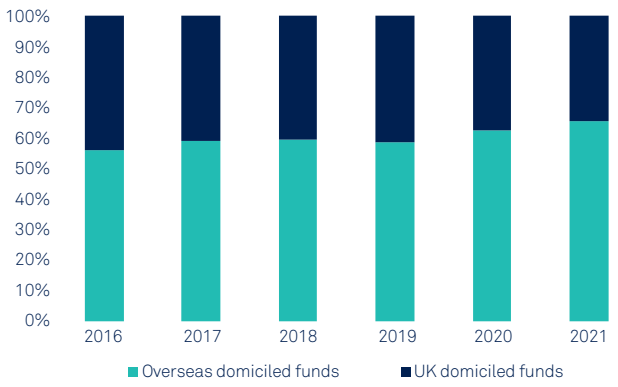
SERVICES TO OVERSEAS FUNDS

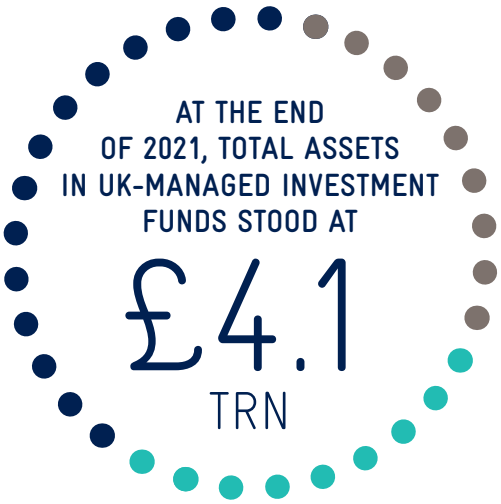
Another global dimension of the UK investment management industry is the level of assets that sit within investment funds domiciled overseas, that are being managed from IA members UK-based teams. The delegation of these assets from overseas funds to UK based portfolio managers allows UK investment management expertise to be accessed from around the world.

Each year, we capture data on assets that sit in open ended funds, investment trusts, ETFs, hedge funds and money market funds (MMFs). At the end of 2021, total assets in UK-managed investment funds stood at £4.1 trillion. Almost two thirds (65%) of these assets sit within overseas-domiciled funds, and of that, 84% are in funds domiciled in the EEA, primarily Ireland and Luxembourg.

Chart 4 illustrates the increase in the proportion of overseas-domiciled funds over the past few years. In 2016, assets in overseas-domiciled funds stood at 56% of total UK-managed investment fund assets; this increased to 59% in 2017 and then stagnated. The step change recorded in 2016 is attributed to the fact that many IA members transferred European client assets from UK to overseas domiciled funds as part of their Brexit preparations. In 2020 and 2021, however, we saw a shift in the level of assets in overseas domiciled funds. Assets rose from 59% to 63% in 2020 and reached 65% in 2021. One possible reason for this could be the inclusion of ETFs in this data which have seen significant growth in assets in the last few years and are almost entirely domiciled overseas.

CHART 4: CHANGE IN PROPORTION OF ASSETS MANAGED FOR UK AND OVERSEAS FUNDS (2016-2021)





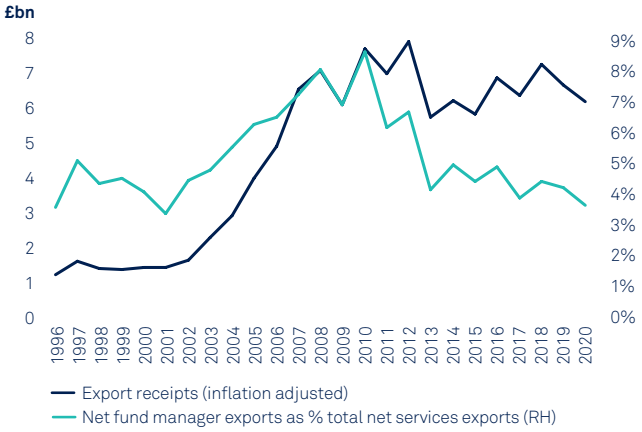
IMPORTANCE TO UK SERVICE EXPORTS

The growth in assets within overseas domiciled funds where portfolio management is delegated to the UK and the increasingly international client base demonstrates an opportunity for UK investment management to export its services globally.
Chart 5 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 £6.1 billion in 2020.[7] This is slightly down from the £6.3 billion in 2019.

The right-hand side of Chart 5 indicates that fund manager contribution as a proportion of total net exports stood at 3.6%. The proportion of fund manager exports increased from the 1990s all the way up to the global financial crisis, when it peaked at 8.5% in 2010. Since then, fund management services as a share of total exports has decreased.

Chart 5 captures earnings by independent asset managers and is likely to understate earnings from asset managers that are part of a wider financial services group such as an investment bank or insurer. As such, the actual contribution of asset management overall to service exports is likely to be higher.

CHART 5: EXPORT EARNINGS AND RELATIONSHIP TO UK SERVICE EXPORTS



Source: ONS

[7] This is based on the latest data from the ONS, which has a two-year lag on figures.