4 UK INSTITUTIONAL MARKET

KEY FINDINGS

MARKET OVERVIEW

- IA members managed £4.7 trillion on behalf of UK-based institutional clients in 2021, up from £4.5 trillion the previous year.
- UK pension funds and insurers were responsible for 85% of UK institutional client assets in 2021. The proportion of assets managed on behalf of UK pension funds increased almost consistently between 2011 and 2018 but has remained stable at approximately 64% since then.
- Over the decade, assets managed on behalf of insurers has been declining falling fifteen percentage points from 37% in 2011 to 22% in 2021.

EVOLUTION OF PENSIONS MARKET

- In 2021, IA members managed £3.0 trillion on behalf of UK pension funds. This is largely made up of corporate pension fund assets, which are responsible for £2.6 trillion of this. Over £300 billion of this is managed on behalf of the Local Government Pension Scheme (LGPS), which represents approximately 90% of LGPS assets.
- IA estimates of the wider pensions market in the UK – which includes individual pensions, drawdown and assets backing the annuity book – reached £4.2 trillion at the end of 2021, up from £4.0 trillion the previous year. IA members are managing a significant proportion of this through institutional mandates and funds.
- Pension participation rates increased in 2021, despite a rise in the minimum contribution rates into workplace pensions in 2019 and a rise in inflation and economic uncertainty. In 2022, there are early indications that opt out rates for automatically enrolled employees are beginning to rise as the cost-of-living crisis intensifies and constrains the amount that people are able to save.

THIRD PARTY MARKET

- Once in-house mandates are excluded, assets under management for third party UK institutional clients stood at £4.1 trillion at the end of 2021. The dominance of pension assets becomes even more pronounced when looking at the third party client market, with pensions funds responsible for 70% of the £4.1 trillion.
- In 2021, total assets in Liability Driven Investment (LDI) mandates accounted for 38% of assets, unchanged since the previous year. Over the last decade total assets in LDI strategies have quadrupled, rising from £400 billion in 2011 to almost £1.6 trillion in 2021.

MANDATE TYPES

- We continue to see a reversal of the trend that we observed between 2011 and 2018 which seemed to indicate a shift towards multi-asset mandates. Since 2018, the proportion of UK institutional client assets in specialist mandates has been increasing, rising from 76% to 81% in 2021.
- Within specialist mandates, 2021 shifts in investment across different asset classes most likely reflect capital market performance. We have seen a four percentage point fall in the proportion of assets in fixed income mandates over the year to 35%. We have also seen a corresponding rise in the proportion of assets in specialist equity mandates, rising two percentage points over the year to 38%.
- Asset allocation varies among UK pension funds. The LGPS tends to have a significantly higher allocation to equities at 63% in 2021 compared with just 31% allocation for corporate pension funds which are more heavily invested in fixed income.

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 assets are managed from the UK or 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 2021, IA members manage £4.7 trillion[12] for UK institutional clients globally, this is up from £4.5 trillion in 2020. Data provided by IA members suggest that almost all of this growth was a result of market movements as net inflows for the year were positive but negligible. On aggregate over the year, UK institutional investors took money out of single asset equity strategies (also referred to as specialist mandates in this chapter), with over £60 billion in outflows. Fixed income strategies saw inflows of close to £15 billion. We do not have comprehensive monthly flow data on the institutional market, so it is difficult to understand the drivers of these flows and whether or not institutional investors took money out of fixed income strategies towards the end of year when inflation fears ramped up and fixed income performance worsened.

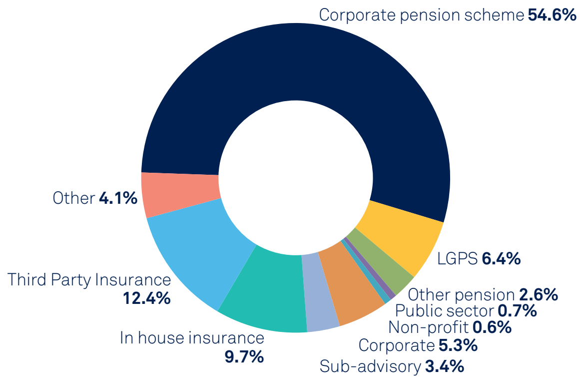
CLIENT BREAKDOWN

Chart 19 shows the breakdown of the UK institutional client market and includes both in-house and third party mandates. There has been very little year on year movement in client type. UK pension funds (64%) and insurers (22%) continue to account for the overwhelming majority of UK institutional assets.

Assets managed on behalf of UK pension funds remained broadly unchanged year on year, though there has been a small reallocation of assets from the 'Other pension' category to 'Corporate pension schemes' in 2021, which remain the single largest client group at 55%.

In-house insurance clients saw marginal rises in 2021, rising from 9.1% to 9.7% of assets. UK third party insurance client assets dipped slightly to 12.4% from 12.5% over the year. Non-profit client assets fell from 1.0% in 2020 to 0.6% in 2021 while sub-advised (3.4%) and public sector (0.7%) remained broadly unchanged.

CHART 19: UK INSTITUTIONAL MARKET BY CLIENT TYPE (2021)

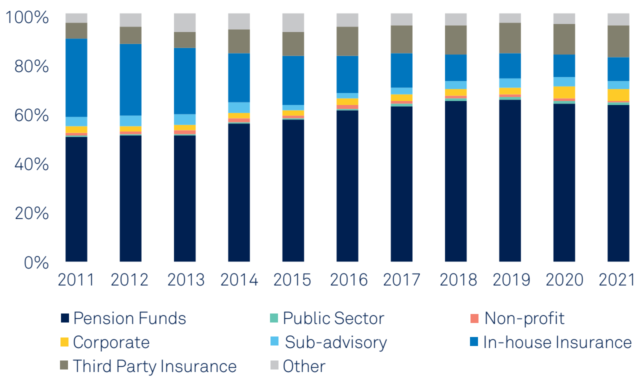


[12] Implied figure based on data collected on an estimated 83% of the institutional client base.

Chart 20 looks at the long-term trend in the proportion of assets broken down by client type.

- Pension funds have increased their share of UK institutional client assets from 50% in 2011 to 63% in 2021. Much of this growth occurred between 2011 and 2018 but has since slowed, with other client groups experiencing more rapid growth in the last three years.
- Assets managed on behalf of UK insurers have declined in the last decade, falling fifteen percentage points from 37% in 2011 to 22% in 2021. This fall happened between 2011 and 2018. Since 2018 however, the proportion of assets managed on behalf of insurers has remained stable at 22%. Much of this decline has been in in-house insurance assets which fell from 31% a decade ago to 10%. By comparison, third party insurance assets have more than doubled, rising from 6% to 13%. Much of this rise reflects a reclassification of assets from in-house to third party for firms who were once part of large insurance groups but have since become standalone asset managers.
- Corporate client assets have increased for the fifth year in a row, reaching 5.3% of assets, almost double the 2.8% recorded in 2011.

CHART 20: UK INSTITUTIONAL MARKET BY CLIENT TYPE (2011-2021)



EVOLUTION OF PENSIONS MARKET

This section utilises both IA and third-party data to present a more detailed overview of the UK pensions market. The IA defines pension funds as Defined Benefit (DB) and Defined Contribution (DC) schemes where the asset 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 19, pension funds accounted for almost two thirds of the UK institutional client base in 2021 with assets totalling £3.0 trillion. The IA divides pension scheme assets into three categories:

Corporate pension funds (CPF) account for the majority of UK pension fund assets at £2.6 trillion. Occupational Pension Scheme (OPS) managers, who manage an estimated £120 billion in assets, are also included in the category. This number is down from £200 billion last year as a number of OPS managers outsourced all or part of their assets to third party managers.

The Local Government Pension Scheme (LGPS), accounts for just over £300 billion in assets, which indicates that IA members manage approximately 90% of LGPS 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 £125 billion of total UK pension scheme assets.

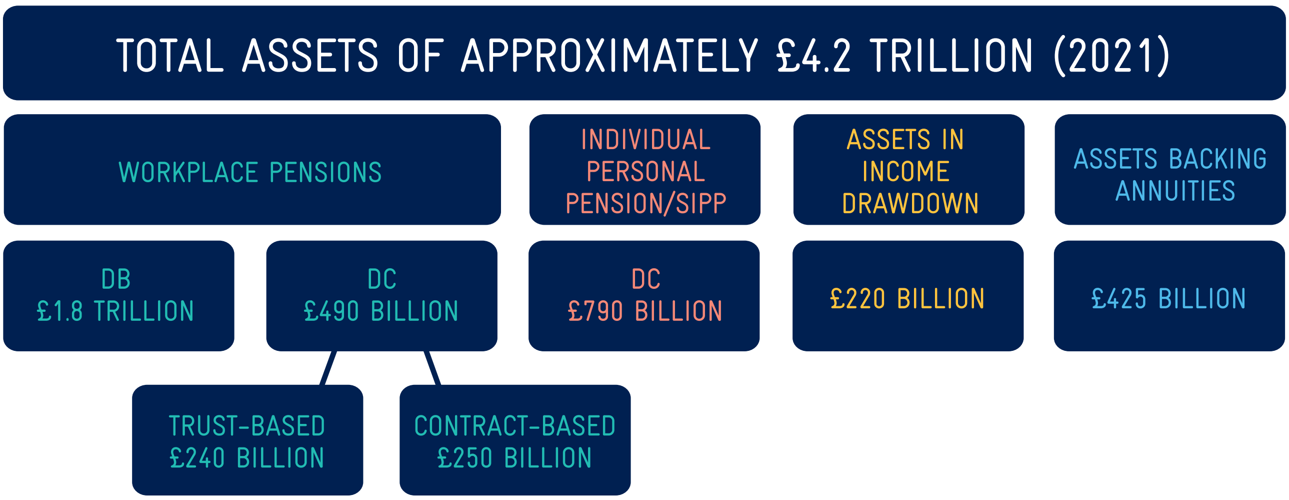
SIZING THE MARKET

Figure 13 provides an overview of the assets in the UK pensions market. In 2021, the IA estimates total assets of £4.2 trillion in UK pensions. Defined benefit pension assets[13] continue to make up the highest proportion of workplace pension assets at £1.8 trillion. The majority of open defined benefit pension schemes are in the public sector where 34% of members are actively accruing benefits.[14] In the private sector, most DB schemes are closed to new members. Pensioners make up 47% of occupational private sector DB membership according to ONS data whereas just 8% of members are actively accruing benefits.[15]

The burden of funding growing DB pension scheme liabilities has caused private sector employers to opt for defined contribution pensions, where the pension saver rather than the employer bears the risk of accumulating enough assets to fund their retirement. DC workplace pension assets now stand at £490 billion. Our estimate puts assets in contract-based DC schemes at over £240 billion and assets in trust-based DC pensions at almost £250 billion. According to ONS data, pensioners account for just 0.1% of the membership of private sector occupational DC schemes compared with active members of 41%, which indicates the younger age profile of DC scheme members.

Once retired, pensioners can decumulate pension assets to take an income in retirement through income drawdown strategies or take out an annuity that provides a guaranteed annual income until death. Assets in income drawdown now account for £220 billion of total pension assets and assets backing annuities, which sit on insurers balance sheets, are £425 billion. In 2015, the Pension Freedoms Act was passed. This gave DC pensioners greater flexibility about how and when they could access their pensions. A key pillar of the act was the removal of the requirement to annuitise pension pots by the age of 75. This enabled pensioners to keep their money invested, taking an income by drawing down their assets rather than annuitising. Whilst drawdown does not provide a guaranteed annual income like an annuity, it does offer more flexibility to pass assets on through inheritance and to grow assets through investment returns. As we noted above, currently the majority private sector DC scheme members are accumulating assets and as more retire, the proportion of assets in income drawdown is set to grow.

FIGURE 13: OVERVIEW OF THE UK'S PENSION LANDSCAPE IN 2021[16]



Source: Bank of England, Department for Levelling Up Housing & Communities, Financial Conduct Authority, IA data, MoretoSIPPs, Office of National Statistics, Pensions Policy Institute, Pensions Protection Fund 7800 Index.

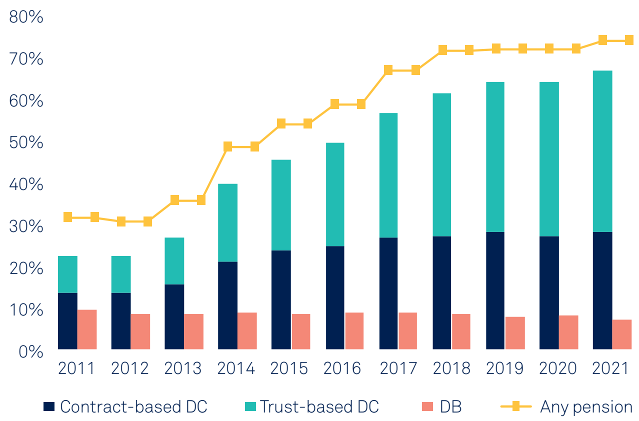
[13] Defined benefit pension schemes pay out scheme members based on the number of years of employment and on their final salary. The employer is responsible for ensuring that the DB pension scheme is adequately funded and that contributions are paid on time.
[14] ONS Occupational Funded Pension Scheme Data, 2021
[15] 45% of private sector DB members are deferred members that are no longer accruing scheme benefits.
[16] Estimates are provided on a best effort basis.

Chart 21 shows the trend to private sector pension participation across defined contribution and defined benefit schemes. Private sector participation has risen substantially since 2012 from just 32% across all types of pension to 74% in 2021. This is largely due to the roll out of auto-enrolment from 2012, requiring employers to automatically enrol eligible employees into DC pension schemes. Participation in DC trust-based and contract-based schemes combined has increased from 23% in 2012 to 67% in 2021.

- The data in Chart 21 show that participation in trust-based schemes rose by 2% year on year to 39% in 2021, an increase of 20% since 2012. The launch of new master trusts following auto-enrolment has contributed to this significant growth and Nest, the pension scheme with a universal service obligation to take on all employers, is run as a master trust. Trust-based pensions are overseen by trustees that have a fiduciary duty to the scheme. They are not subject to conduct or prudential supervision and are therefore regulated by the Pensions Regulator.
- Participation in contract-based schemes has also increased slightly year on year to 28%, just higher than in 2020 (27%). This is up from 14% in 2012. Contract-based schemes are most commonly Group Personal Pensions but include Group Stakeholder Pensions and Group SIPPs. Contract-based schemes are subject to FCA rules. Scheme governance is provided by an Independent Governance Committee that oversees how the pension provider operates the scheme.
- At 7%, private sector DB scheme participation in 2021 is the lowest participation rate in a decade falling by 1% year on year. Prior to 2021, participation in DB schemes had consistently fluctuated between 8% and 9% but as the member base ages, scheme participation will likely fall further.

In 2019, minimum contributions into a workplace pension were increased from 5% to 8% and some experts feared that opt-out rates could rise. The data in Chart 21 suggest that private sector participation rates in DC schemes are resilient as participation rates have increased in 2021 by 3%. Looking ahead, members face increasing pressures on the cost of living as energy and transport costs rise rapidly in 2022 and inflation is forecast to rise further. This could constrain the amount that employees are able to save into their pension each month and may increase pension opt out rates. The Bank of England forecasts that the savings ratio, which also accounts for employer contributions and non-pension saving, will fall from 5 ¼ to 3 ¾ in 2023.

CHART 21: PENSION PARTICIPATION FOR PRIVATE SECTOR JOBS (2011-2021)



Source: Office of National Statistics

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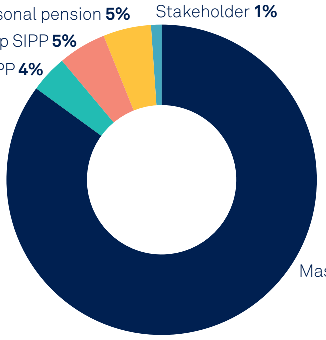
Chart 22 shows DC members split by scheme type. Workplace contract-based schemes account for 10% of members but at 85%, the highest proportion of members are enrolled into Master Trust schemes. Nest, the low-cost pension provider set up by the Government,[17] is run as a master trust and has some impact on the high percentage of members enrolled into master trusts. Nest has a public service obligation to provide a pension to all employers and the self-employed and in March 2021, the scheme had 9.9 million members enrolled, representing around two thirds of the employees enrolled in master trusts.[18]

CHART 22: DC MEMBERS BY SCHEME TYPE IN 2021



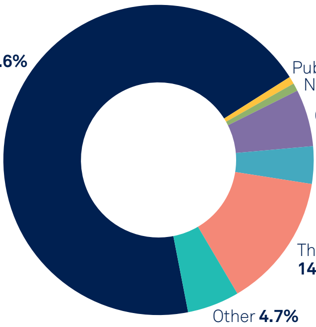
Source: Pensions Policy Institute (PPI) DC Future Book 2021

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 uses IA data to look more closely at the institutional market that is available to third party clients, that is, excluding mandates managed in-house by insurance parent groups and occupational pension schemes, as at the end of 2021.

Assets under management stand at £4.1 trillion once in-house insurance mandates are excluded from the institutional data. In Chart 23, we see that pensions dominate the market even more once in-house mandates are excluded. However, if the trend to a fall in the proportion of in-house insurance assets continues, Chart 19 and Chart 23 will become more closely aligned.

CHART 23: THIRD PARTY UK INSTITUTIONAL CLIENT MARKET BY CLIENT TYPE (2021)



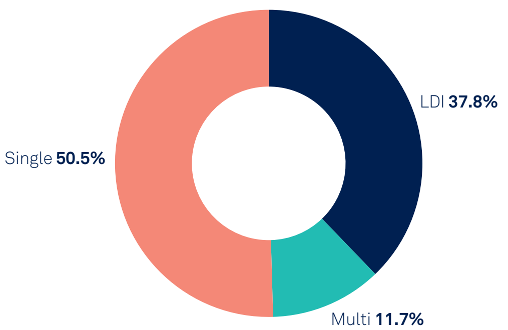
[17] Nest Corporation, the Trustee that runs the Nest scheme, is a public corporation. It is accountable to Parliament through the Department for Work and Pensions but is generally independent of government.
[18] DWP, An Independent Review of the National Employment Savings Trust, 2022.

MANDATE BREAKDOWN

Chart 24 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 2021, assets managed in single asset strategies rose one percentage points to 50% of mandates.
- **Multi-asset, or 'balanced' mandates**, which cover a number of asset classes and regions. At the end of 2021, balanced mandates were used in 12% of assets managed by third party clients.
- **LDI mandates**, which 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 £1.6 trillion.

CHART 24: UK THIRD PARTY INSTITUTIONAL MANDATES INCLUDING LDI IN 2021

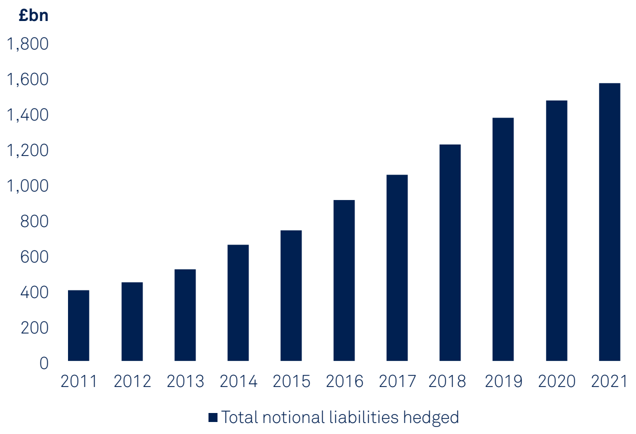


LDI strategies are almost exclusively used by DB pension funds as a way to hedge the inflation and interest rate risk they face in their liabilities. Regulatory changes around the DB funding regime in the UK have reinforced this shift towards liability management and growth in LDI mandates will likely continue in the near future. In 2011, the notional value of LDI stood at £400 billion and this had quadrupled by 2021 reaching £1.6 trillion.

Central banks have raised base rates in 2022 to combat soaring inflation and rate rises and volatility in fixed income prices have impacted the funding positions of LDI strategies. As interest rates have risen, the notional value of some of the derivatives held in LDI portfolios has fallen. The result of this has been a rise in the number and size of collateral calls. The speed at which rates have risen has meant that some LDI managers have had to liquidate larger than expected proportions of their portfolios to meet collateral calls.

While such movement in markets and interest rates are built in to LDI portfolios, the timing of interest rate rises in an environment where virtually all asset classes have depreciated in value has meant that managers have had to liquidate at the bottom of the market and funding positions have worsened.

CHART 25: NOTIONAL VALUE OF LDI (2011-2021)

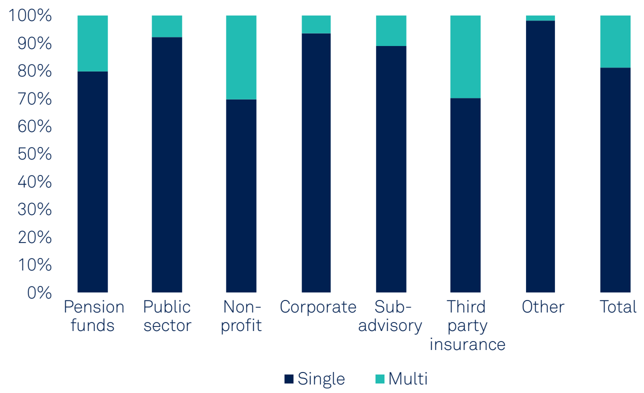


Source: KPMG LDI Survey, IA data

The analysis on pages 57 to 61 excludes the value of LDI mandates. These strategies are used almost exclusively by DB pensions, and as such their inclusion can mask some interesting trends in the broader market.

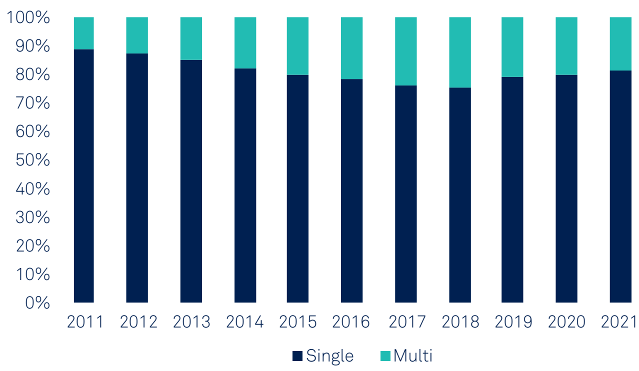
Chart 26 shows the balance between single and multi-asset mandates, excluding LDI. We observe that when we exclude LDI, 81% of assets are managed in single asset strategies, two percentage points higher than in 2020. The preference for single vs. multi-asset strategies varies depending on client type. Almost all (94%) of assets managed on behalf of corporate clients are managed within mandates focusing on a single asset class and region. By comparison, almost a third (30%) of third-party insurance client assets are managed in multi-asset mandates.

CHART 26: UK THIRD PARTY INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST IN 2021



For a number of years, it looked as though there would be a shift to more multi-asset mandates (Chart 27). The proportion of assets in multi-asset mandates had increased consistently since 2011, peaking in 2018 at 24%. Since then, we have seen a reversal in that trend with a shift back towards greater use of single asset strategies. Some of the shift in 2018 and 2019 can be explained by the movement of some large mandates across the industry.

CHART 27: UK THIRD PARTY INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS SPECIALIST (2011-2021)



INVESTMENT TRENDS WITHIN SINGLE-ASSET MANDATES

Chart 28 looks at the long-term trend in the breakdown of assets in specialist or single-asset mandates.

- The performance of equity markets has had an impact on the balance of assets over the last ten years. When equity markets suffered steep falls in Q4 2018, we saw a corresponding 5% drop in the percentage allocation to equities to 35% in 2018. In 2021, despite institutional outflows of £65 billion from equities, asset appreciation helped to increase the proportion of assets in equities to 38%, the highest level since 2017. 2021 saw very strong performance from US stocks in particular, which returned 26% and the majority of major equity markets saw double digit growth.

- The other notable trend in the last two years is the increase in the value of assets in cash to 15%. Before 2019, assets in cash fluctuated between 9% and 10%. Cash assets provide little opportunity for capital appreciation, so a rising allocation indicates either a higher demand for liquidity or a short-term allocation before making tactical asset adjustments as market conditions shift.

- Assets in fixed income have fallen to 35% from 39% in 2020 as equities have rebounded as a proportion of total assets and bonds saw negative annual returns.

- Assets in property have been relatively stable over the past ten years between 5% and 6% of total assets.

CHART 28: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS (2011-2021)

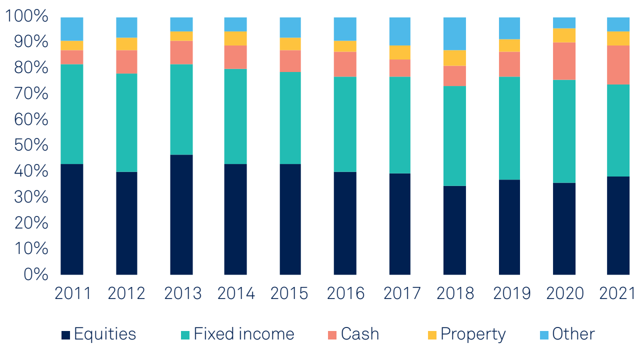


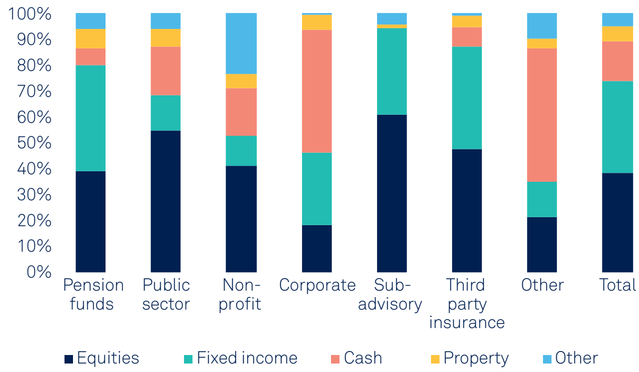
Chart 29 looks at asset allocation in single-asset mandates by different client groups. The chart illustrates that asset allocation can vary considerably depending on the investment objective of the client.

- Pension funds (41%) and third-party insurers (39%) both saw a significant drop of 5% and 10% respectively in the proportion of assets allocated to fixed income. Corporate and government bonds delivered negative returns in Q1 2021, a relatively rare occurrence, and this had some impact on the balance of assets. DB assets still make up a significant proportion of mandates for pension funds and as private sector DB schemes are increasingly closed to new members, the investor base is aging. A higher proportion of assets in fixed income helps to achieve relatively low-risk and stable returns for older scheme members.

- The higher allocation to equities by the public sector (55%) tallies with the data in Chart 32 later on in this chapter, which shows that the Local Government Pension Scheme has a 63% allocation to equities. Public sector DB schemes are still open to new members and accruals. This means that their member base is younger and has longer investment horizons. Equity returns can be volatile but drive higher performance and holding equities over two to three decades smoothes the impact of volatile returns. Sub-advisory mandates also have a high allocation to equities at (61%). These mandates can form part of third-party retail products such as multi-manager products.

- Corporates have maintained nearly half of assets (47%) in cash in 2021. This is only slightly down from 2020 (50%) when we first observed a significant 30% shift in allocation to cash in the face of very uncertain business conditions. Investment in liquid cash strategies can generate a higher return on cash than bank deposits in an environment of very low interest rates, and a high allocation enabled businesses to maintain a cash buffer as lockdowns in 2021 continued to place a strain on cash flows for many industries.

CHART 29: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS IN 2021



Looking more closely at the pattern of allocation to funded DB schemes reveals substantial long-term shifts away from equities as the majority of DB schemes have closed to new members and the age profile of membership matures.

- In Chart 30 in 2000, assets in equities were 74% of the total allocation and UK equities accounted for 48% of assets. The total proportion of equities has fallen to just 19% in 2021 and UK equities make up 2%. Looking at the data behind the chart, on a weighted average basis, at 12% the UK equity proportion of equity assets has fallen below private equity (20%) and overseas equity (68%). This mirrors the long-term trend seen in IA data to a reduced allocation to UK equities in AUM in favour of overseas equities.

- Assets in fixed income now make up 72% of total allocation compared with 20% in 2000. Over the last 15 years, index-lined bonds that are hedged against rising inflation have risen as a percentage of bond allocations to 47% putting DB schemes in a stronger position as inflation rose rapidly through the final quarter of 2021.

- The negative position of -9.5% cash reflects large schemes with investments such as swaps and repurchase agreements.

- Allocations to property have been stable at around 5% over the long-term. The rise in the proportion of assets in other is largely due to an increase in the percentage of annuities from 2% in 2016 to 7% in 2021, a reflection of the ageing member demographic.

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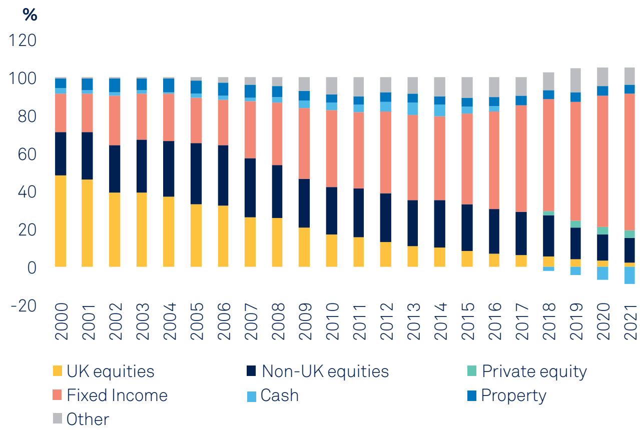
CHART 30: UK DB PENSION FUND ASSET ALLOCATION (2000-2021)

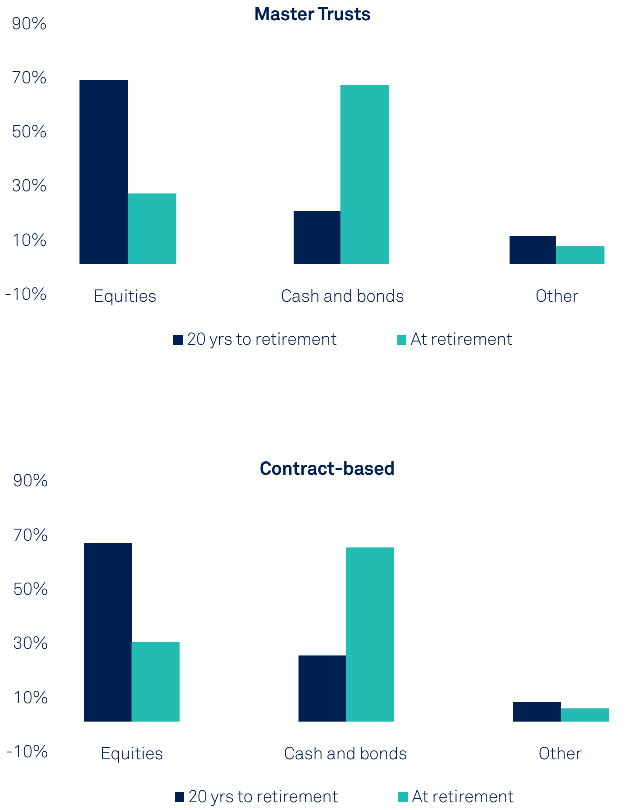


Source: UBS Pension Fund Indicators, PPF purple book 2021

The next charts further illustrate the impact that a younger member age profile has on asset allocation. For DC savers with twenty years until retirement, the proportion of assets in equities is two-thirds for both contract-based and master trust schemes. Although the return on equities is more volatile than bonds, in the accumulation phase of pension saving, an investment horizon of twenty years smoothes out returns and enables savers to achieve a higher overall return whilst building up a pension pot. As DC scheme members move into retirement, they are looking to draw an income from their investments, which can be provided through a higher weighting to bonds.

At retirement the charts show a two-thirds allocation to bonds. Although the return from bonds is lower than equities, there is a lower risk of negative returns, which could erode the capital available to members moving into drawdown.

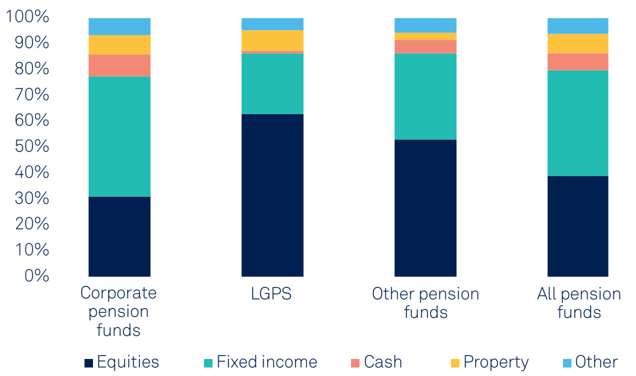
CHART 31: DC ASSET ALLOCATION, 20 YEARS PRIOR TO RETIREMENT AND AT RETIREMENT IN 2021



Source: Penions Policy Institute

Chart 32 illustrates the difference in asset allocation among UK pension funds. It shows a substantial difference between the allocation of corporate pension funds and LGPS.[19] LGPS is a defined benefit public sector scheme that is open to new members and active members account for one third of total scheme members. According to ONS data, active members of private sector DB schemes are just 8% and 47% are receiving their entitlements in retirement. This shows an older age profile of members and helps to explain the lower proportion of assets in equities for corporate pension funds of 31% compared with 63% for LGPS.

CHART 32: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS AMONG UK PENSION FUNDS IN 2021

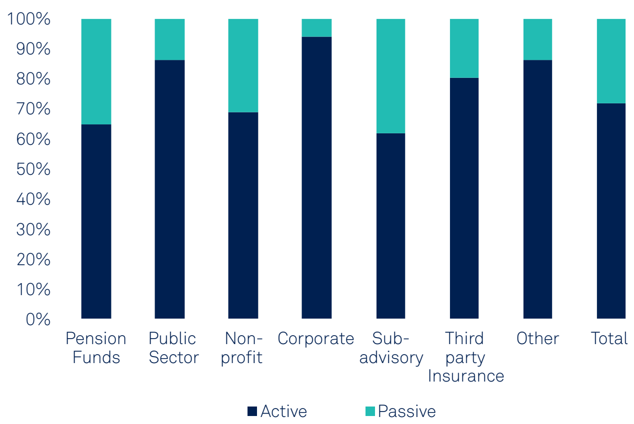


[19] LGPS is administered by 86 local pension funds in England and Wales and has 6.1 million members.

ACTIVE VS. INDEXING

Almost three quarters of institutional client assets (72%) were managed by IA members on an active basis in 2021, unchanged from 2020. Use of index strategies varies depending on client. Public sector, insurance and corporate clients tend to use more actively managed strategies whereas indexed strategies are more widely used by pension funds, non-profit and sub-advised clients. The introduction of the charge cap for DC pension schemes has contributed to the greater use of indexing strategies in order to fall below the 75 basis point cap on charges.

CHART 33: ACTIVE AND INDEX THIRD-PARTY MANDATES BY CLIENT TYPE IN 2021 (SAMPLE-ADJUSTED)



SEGREGATED VS. POOLED

Chart 34 shows that segregated mandates represented two thirds (66%) of assets managed for third party institutional mandates at the end of 2021, down one percentage points on 2020. Corporate clients (55%) and non-profit clients (54%) tend to use pooled vehicles to invest, whereas third party insurance clients and sub-advised clients most typically prefer bespoke segregated mandate arrangements with 85% and 87% of assets managed in this way respectively.

CHART 34: SEGREGATED AND POOLED MANDATES AMONG THIRD PARTY PENSION FUNDS IN 2021