4 UK INSTITUTIONAL MARKET

KEY FINDINGS

MARKET OVERVIEW

- IA members managed £3.9 trillion on behalf of UK-based institutional clients in 2022, down 16% from £4.6 trillion in 2021, reflecting a significant downward movement in fixed income assets as interest rates rose through the year.
- Together, UK pension funds and insurers accounted for over 80% of UK institutional client assets in 2022.
- The proportion of assets managed on behalf of UK pensions has now fallen back to 57%, after increasing almost consistently between 2011 and 2018 to reach 65%.
- The relative performance of pension scheme and insurance assets resulted in a rise in the proportion of insurance assets under management (AUM), to 25% from 23%, but a fall in nominal terms year-on-year.
- Other client assets showed a mixed picture, with an absolute as well as relative increase in sub-advisory assets.

EVOLUTION OF PENSIONS MARKET

- UK pension fund assets managed by IA members globally were £2.2 trillion in 2022, falling 22% year-on-year from £2.9 trillion. Although global data suggest that the UK pensions market was one of the hardest hit in 2022 in asset terms, sharp falls in the value of DB pension scheme assets were accompanied by even sharper falls in liabilities. This contributed to a marked overall improvement in funding position.
- The IA estimates that assets in the wider pensions market in the UK stood at £3.7 trillion, down from £4.2 trillion at the end of 2021.
- Private sector pension participation rates have doubled over the past decade from 32% to 74% by the end of 2021. Although 2022 data has not yet been published, the proportion of automatically enrolled private sector employees opting out of their workplace pension has risen through 2022 reaching 10.2% (up from 7.6% in January 2020).

THIRD-PARTY MANDATES

- Once in-house mandates are excluded, AUM for third-party UK institutional clients stood at £3.3 trillion in 2022 (down from £4.0 trillion in 2021). Pension assets account for 63% of the third-party institutional market, down from 69% the previous year.
- Liability driven investment (LDI) portfolios were heavily impacted in 2022 falling to £1.17 trillion. Based on a matched sample, total assets fell by approximately 28% over the year.

MANDATE TYPES

- Once LDI assets are excluded, we see that single asset mandates dominate the market, though in 2022 the proportion of multi-asset mandates were up to 20% (from 19% in 2021) following three years of falls.
- Reflecting sharp falls in fixed income markets, we see significant falls in assets in specialist fixed income mandates, particularly for pension fund clients. Fixed income mandates account for 32% of specialist mandate assets in 2022 (down from 36% in 2021, and the lowest proportion on record) while equities were down one percentage point to 38%.

This chapter takes a detailed look at the UK institutional client market. Please note that Chapter 4: UK Institutional Market differs from previous and subsequent chapters of the report in two key respects:

- It covers all assets irrespective of whether they are managed from the UK or offices overseas as we estimate that at least 90% of the assets are managed in the UK.
- The primary focus is on the nature of a mandate rather than on the underlying assets. For instance, a global equity mandate is presented as such, without further breakdown into the underlying constituent countries.

Full details of the asset allocation and investment strategy for the entire institutional market are available in Appendix 2 of this report.

MARKET OVERVIEW

As of 2022, IA members manage £3.9 trillion of UK institutional client assets globally, down from £4.6 trillion in 2021. The 16% annual fall in assets, exceeds the 12% fall in total UK-managed assets reported in chapter 1 reflecting significant falls in fixed income and liability driven investment (LDI) assets.

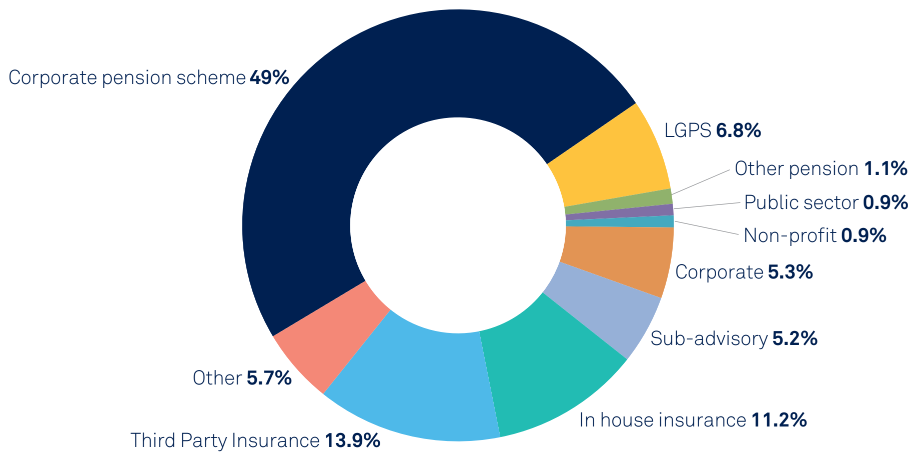
Estimates for UK institutional flows indicate aggregate inflows over the year totalling approximately £65 billion, suggesting that the drop in assets is primarily a market driven fall.

CLIENT BREAKDOWN

Chart 19 provides a breakdown of the £3.9 trillion of UK institutional market assets by client type, indicating that the majority (82%) of assets continue to be managed on behalf of pension funds and insurers. There have been some notable movements in this breakdown between 2021 and 2022:

- Pension fund assets fell from 62% of UK institutional assets in 2021 to 57% in 2022. Corporate pension scheme assets fell from 55% to 49%. The share of Local Government Pension Scheme assets stayed relatively stable (6.8% from 6.5%). Other pension assets halved from 2.7% to 1.2%.
- Over the same period, insurance assets increased from 23% to a quarter (25%). Assets managed on behalf of in-house insurance clients were broadly unchanged, accounting for 11% of institutional market assets, and assets managed on behalf of third-party insurance clients is up to 13% (from 12%).

CHART 19: UK INSTITUTIONAL MARKET BY CLIENT TYPE (2022)

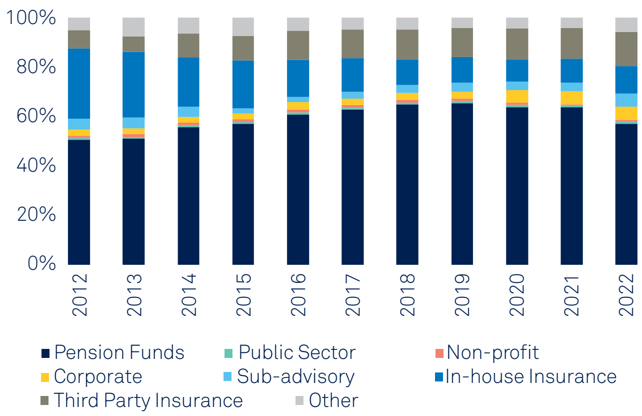


Source: The Investment Association

Chart 20 illustrates the change in distribution of UK institutional market assets by client type over the past ten years. Notable trends include:

- **Pension funds:** Between 2012-18, the share of pension fund assets was steadily increasing, peaking at 65% and remaining reasonably stable until 2021. Market events in 2022 precipitated a sharp adjustment in the proportion of institutional assets managed on behalf of pension funds, falling to their lowest level since 2014.
- **Insurance:** The share of assets managed on behalf of insurers had progressively decreased over the past ten years before jumping two percentage points to 25% in 2022. The deviation from the trend in the 2022 data is a further relative returns story. Pension scheme and insurance assets both fell in nominal terms over the year, but insurance assets fell less significantly.
- **Other client groups:** Institutional assets managed on behalf of other clients (including corporate and sub-advisory) has fluctuated between 12% and 16% over the past ten years. The increased share of institutional market assets to 18% is largely attributable to a significant nominal increase in sub-advised client assets which now account for 5.2% of assets (up from 3.5% in 2021).

CHART 20: UK INSTITUTIONAL MARKET BY CLIENT TYPE (2012-2022)



Source: The Investment Association

EVOLUTION OF THE UK PENSIONS MARKET

Using both proprietary IA data and third-party data, this section presents a detailed overview of the UK pensions market, looking at assets managed within both Defined Benefit (DB) and Defined Contribution (DC) schemes, and 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 of December 2022, UK pension fund assets directly managed by IA members amount to £2.2 trillion, which is down from £2.9 trillion in 2021 (equivalent to a 22% fall year-on-year). Global data[21] suggest that the UK pension market was among the hardest hit in 2022, largely because of the high allocation to domestic bonds which fell over the year (See Box 1 on global capital market performance). Indirectly, investment managers will also be managing a significant proportion of remaining UK pension assets, particularly through insurance vehicles.

Overall, pension fund assets directly managed by investment managers can be categorised into the following three categories:

- **Corporate pension funds** (CPF), which can be either DB or DC schemes, account for the majority of UK pension fund assets and are estimated to stand at £1.9 trillion. CPF includes an estimated £115 billion managed by Occupational Pension Scheme (OPS) managers.
- **The Local Government Pension Scheme** (LGPS), which is the largest public sector DB pension scheme in the UK, with over 6 million members. IA members are directly managing over £260 billion of LGPS assets which is approximately three quarters of LGPS assets based on the most recent estimates.[22]
- **Other pension funds**, which includes both DB and DC assets managed for pension schemes that do not fit into either category listed above, such as pension schemes run for not-for-profit organisations. Other pension fund assets account for just 1% of total UK pension scheme assets, or an estimated £45 billion.

[21] OECD Pension Markets in Focus 2023, Preliminary Data.
[22] According to the Department of Levelling Up, Housing & Communities, the "market value of LGPS funds at end of March 2022 was £364 billion.

4

SIZING THE MARKET

Given the complexity around the distribution of Defined Contribution (DC) and personal pension products, we cannot provide a breakdown of assets by type of pension fund. Using third-party sources however, we are able to map out the UK pension landscape and provide estimates for the size of the UK DB and DC pensions markets.

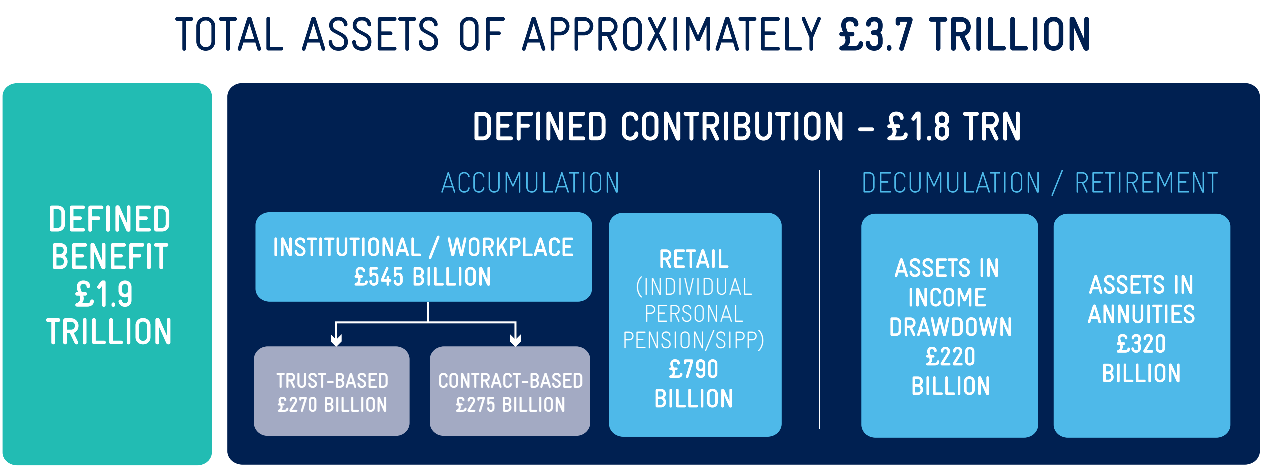
We have broadly split DC pension assets into two categories (Figure 10):

- Assets in the **accumulation** phase of pension saving covers the growth stage over which the aim is to increase the value of contributions made through a workplace pension or a retail pension product until the time of retirement.
- Assets in the **decumulation** phase pertain to the holdings of retirees who are drawing down their pension savings to generate income during their retirement. This income can be derived through various methods such as income drawdown strategies or the purchase of an annuity, which guarantees a fixed annual income until the end of their life.

We have estimated the wider size of the UK pension market to be £3.7 trillion as of December 2022 (down from an estimated £4.2 trillion in 2021). Figure 10 provides estimates for the breakdown of these assets in 2022, we note the following:

- DB pensions were particularly impacted by the autumn gilt market shock, with assets falling 19% to £1.9 trillion by the end of 2022 (see pages 66-67). However, data from the UK Pension Protection Fund (PPF) suggests that over 2022, a fall in asset values of 22% within its universe was accompanied by a fall in liabilities of 39%, contributing to a significant improvement in overall funding positions.
- DC assets in the accumulation phase was the only segment to increase year-on-year: between 2021 and 2022, we estimate that while individual and self-invested assets remained stable, assets in DC workplace pensions increased by 11% to reach £545 billion. Given the performance in capital markets, this would suggest that net contributions have increased in 2022.
- For decumulation assets, the latest available data for 2021 suggests assets in income drawdown were approximately £220 billion. Assets backing annuities, which sit on insurers balance sheets, fell to £320 billion in 2022, down 25% from £425 billion the previous year. This reflects the significant allocations to fixed income assets, which were particularly impacted by rising interest rates in 2022.

FIGURE 10: OVERVIEW OF THE UK'S PENSION LANDSCAPE IN 2022



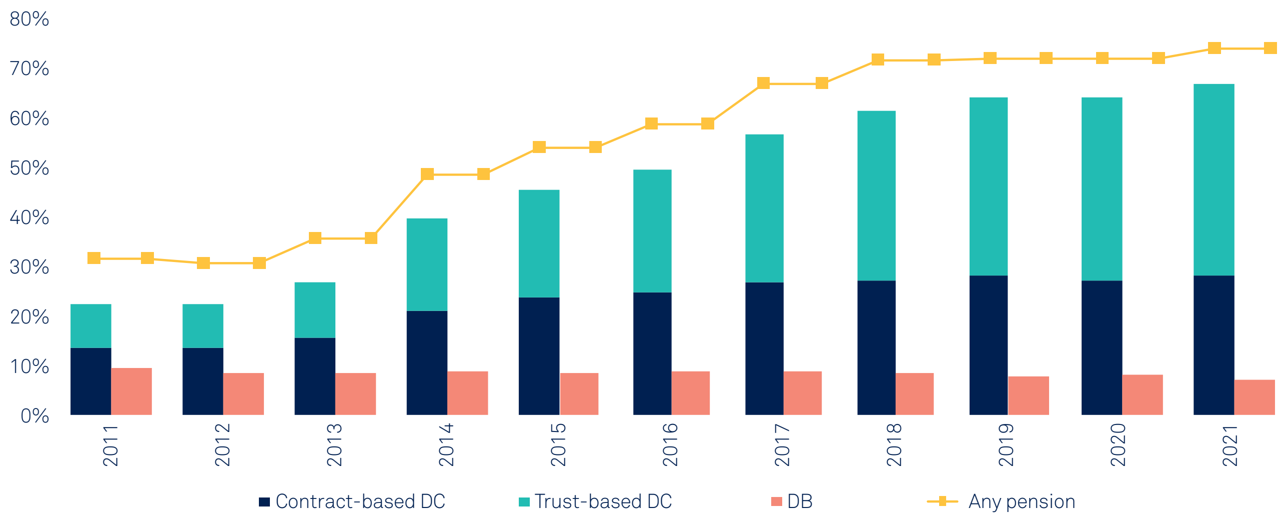
Sources: The Bank of England, Department for Levelling Up Housing & Communities, Financial Conduct Authority, The Investment Association, MoreToSIPPs, Office of National Statistics, Pensions Policy Institute, Pensions Protection Fund 7800 Index

As figure 10 shows, the majority of workplace pension assets currently sit in DB schemes, however the direction of travel in terms of new members and flows has shifted to DC schemes. There were 930,000 active members in private sector DB schemes in 2022 (approximately 10% of all DB scheme members), while 4.1 million members (43%) are pensioners. By comparison, there are approximately 16 million active DC members.[22]

Chart 21 illustrates pension participation rates for private sector jobs over the last ten years, broken down into DC and DB participation and highlights the growing significance of DC schemes in the UK pension market:

- Private sector DB scheme participation rates fell to 7% in 2021, the lowest level in a decade. Prior to this, participation in DB schemes had fluctuated between 8% and 9%.
- The threefold increase in DC pension participation rates from 22% to 67% coincides with the introduction of auto-enrolment in 2012. The phased roll out meant that by 2017 all eligible employees were automatically enrolled into a workplace pension, at which point we see the growth of participation rates slow.
- Participation rates were resilient despite the temporary spike in auto-enrolment opt-out rates in 2020 (to approximately 11% from 8-9%) at the height of the Covid-19 pandemic. With members facing sustained cost pressures while inflation remains elevated, the proportion of newly enrolled employees opting out of their workplace pension rose again to 10.2% in 2022, up from 7.6% in January 2020.

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



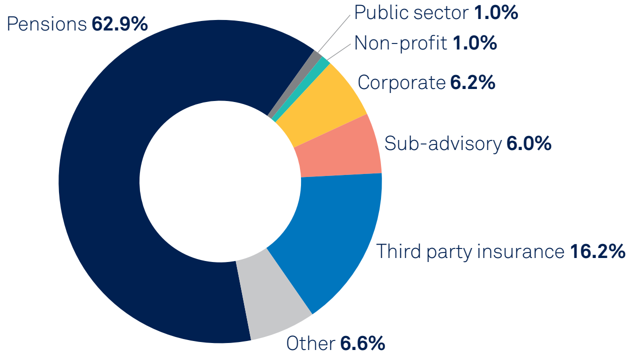
Source: The Office of National Statistics

[23] See 'The Purple Book 2022', Pension Protection Fund and 'DC trust: scheme return data 2022 to 2023', The Pensions Regulator. See also 'Ten years of Automatic Enrolment in Workplace Pensions: statistics and analysis', Department for Work & Pensions

TRENDS IN 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.

CHART 22: THIRD PARTY UK INSTITUTIONAL CLIENT MARKET BY CLIENT TYPE IN 2022



Source: The Investment Association

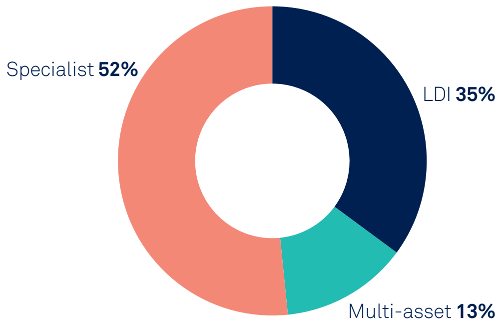
Once in-house insurance mandates are excluded, total third-party client assets managed by IA members globally stands at £3.3 trillion as of the end of 2022 (down from £4.0 trillion). In chart 22, we see that the pension funds account for an even larger share of the third-party market, at almost two thirds of total assets (63%, which is down from 69% in 2021). Much of the lost share in pension assets has gone to the sub-advised category (at 6%, up from 4% in 2021) which experienced a nominal increase in 2022 and the third-party insurance category (at 16% up from 15% in 2021), which saw a slower relative decline.

MANDATE BREAKDOWN

Chart 23 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 2022, assets managed in single asset strategies increased two percentage points to 52% of mandates.
- **Multi-asset, or 'balanced' mandates**, which cover a number of asset classes and regions. Balanced mandates were used in 13% of assets managed by third-party clients at the end of 2022, up two percentage point since 2021.
- **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 35% of total mandates in 2022, down four percentage points from the previous year. We cover LDI assets in more detail in the next section.

CHART 23: UK THIRD PARTY INSTITUTIONAL MANDATES INCLUDING LDI IN 2022



Source: The Investment Association

LIABILITY-DRIVEN INVESTMENT AND THE AUTUMN 2022 GILT MARKET SHOCK

As we have reported in editions of the Investment Management Survey over the past decade, the role of liability driven investment (LDI) has significantly increased. From around £450 billion in assets under management in 2012, total assets attributed to LDI reached a revised estimate of £1.5 trillion by the end of 2021. Until 2022, this part of the institutional market had been stable with the notional value of assets increasing each year. In 2022 however, we record a sharp fall in assets of 28% on a matched basis, and total LDI assets fell to £1.17 trillion.[24]

The Autumn 2022 Gilt market shock

One consequence of this direction of travel has been that DB schemes are the largest holders of long-dated and index-linked gilts. This concentration of investment strategies and gilt ownership means that the long-dated and index-linked gilt markets quickly become vulnerable to dislocation when large numbers of pension funds are seeking to sell these assets.

This is exactly what happened in late September/early October 2022, when gilt yields rose dramatically over a very short period of time: over three working days in late September, gilt yields rose by around 130 basis points. A rise in yields of this magnitude over this time frame was beyond any historical experience.

BOX 6: WHAT IS LDI?

Liability-driven investment (LDI) is an investment strategy that Defined Benefit (DB) pension schemes use to manage the financial risks they face in their provision of pension benefits.

LDI strategies invest in assets that have interest rate and inflation sensitivities which broadly match those of the scheme's liabilities. This strategy ensures the scheme's funding position (i.e. the difference between its assets and liabilities) remains more stable as it is hedged against movements in interest and inflation rates. Such liability hedging is a normal part of risk management by DB schemes and has been extensively used in the UK with the approval and encouragement of regulators.

The role of leverage, repo and collateral

Gilts are heavily used in LDI strategies as they provide exposure to interest rates and inflation without introducing significant additional risks. However, underfunded DB schemes also need to invest in growth-seeking assets to close any deficits. In order to have sufficient money to invest in these assets, schemes use leverage to gain greater exposure to the gilt market, freeing up more money for investing in growth assets.

One way for DB schemes to create leverage is by entering into gilt repo agreements, under which they sell gilts to a counterparty in exchange for cash and an agreement to repurchase those gilts at a pre-agreed price in the future. The cash they receive can then be invested elsewhere, for example in growth assets or in more gilts.

The repo facilitates exposure to the change in the value of gilts which schemes seek in order to gain the exposure to interest rates and inflation to match that of their liabilities. However, in entering into this agreement, both sides in the transaction face the risk of the other party failing to complete the agreement at its termination. This counterparty risk arises because as the price of the gilts in the repo changes, the pre-agreed re-purchase price becomes more or less attractive to one or other of the parties.

To mitigate this counterparty risk, collateral must be posted as the repo position changes in value. The party for whom the repo agreement has become less valuable will post collateral which will be retained by the other party in the event that the counterparty fails to re-purchase the gilts. The amount of collateral required to cover leveraged LDI positions has generally been low and relatively predictable as gilt yields do not typically change significantly over short periods of time. However, in extreme market conditions collateral calls can be higher than expected.

[24] Given that the number of LDI managers is fairly concentrated, IA figures are likely to represent a top range estimate.

In this situation, many DB schemes using LDI strategies needed to rapidly sell assets for cash to respond to collateral calls. The most common assets they would sell in this situation were equities and corporate bonds. However, some schemes either did not have liquid assets to sell (or chose not to) and instead cut their hedging levels to reduce collateral calls. This was achieved by reducing their exposure to gilt repos, effectively selling gilts.

The unprecedented situation of many DB schemes reducing their gilt repo positions, and effectively selling gilts at the same time, drove the gilt price down further, triggering more collateral calls and thus a further need to sell, resulting in a negative market spiral.

"The events were triggered by an extreme market shock that was compounded by the fact that there's no diversification in the ownership of gilts. We now need to understand that once in every 400 year events do happen and could happen more frequently. Long term structurally LDI will be in a much better place than it was beforehand."

Large redemptions were seen in other asset classes as DB schemes had to sell additional assets to raise cash. In the context of volatile markets across a whole range of asset classes, the need to either raise cash at short notice, or reduce hedging levels by selling gilts was a challenge for some DB schemes, and in the view of the Bank of England, a threat to the UK's financial stability. The Bank stepped in to act as a purchaser of long-dated and index-linked gilts for a two-week period at the end of September/early October, giving DB schemes the time to recapitalise their LDI strategies and adjust their overall portfolios. The Bank's intervention successfully ended the negative market spiral.

After the shock: increasing LDI resiliency

Following the resolution of the immediate crisis, regulatory action – led by the Bank of England's Financial Policy Committee[25], in partnership with the FCA[26] and The Pensions Regulator[27] – has focused on increasing the steady state resiliency of LDI strategies. This can be summarised as improved management of leverage through enhanced liquidity management. This is achieved in two overarching areas:

- Larger collateral buffers to cover the effect of further gilt yield rises on leveraged LDI positions,
- Faster operational timelines to recapitalise buffers when necessary.

"We hadn't modelled for the government doing massive unfunded borrowing in a rising interest rate environment. The industry needs to keep making sure that it is stress testing with good scenario modelling and that it thinks about tail risks and black swan events. It needs to make sure that investors are fully cognisant about the levels and implications of embedded leverage."

Whereas pre-crisis buffers were resilient to yield shocks in the order of 100bps[28], the new steady state resiliency requirements are for buffers to cover yield increases of 300-400bps (see Figure 11). As far as operational timelines are concerned, pension schemes must now be in a position to respond to recapitalisation events within five working days. If they cannot meet this standard, they must hold higher levels of collateral buffers.

Through the spring and early summer of 2023, gilt yields again rose significantly, although the speed and scale of these moves was lower than during the stress period in 2022, with 30-year gilt yields rising by around 80bps between the end of March and late May, compared with over 120bps in three days in September 2022. In the face of this volatility, the revised resilience framework is functioning as intended, with LDI strategies maintaining levels of resilience above the minimum required levels, with recapitalisations being initiated at far higher levels of resilience.[29]

The events of September/ October 2022 created a liquidity crunch for the DB pensions sector. In solvency terms, the effect of rising gilt yields is, in aggregate, positive for the sector, since it reduces the present value of its liabilities, leading to improved funding levels. While the aggregate funding ratio (on a PPF benefits measure of liabilities) stood at 127% before the shock at the end of August 2022, by the end of October, it had increased to 136%[30]. While the effects are heterogeneous across schemes, this generally means that many schemes will have a shortened journey to buyout or other risk-transfer solutions.

[25] Financial Policy Summary and Record – March 2023, FPC, Bank of England.
[26] Further guidance on enhancing resilience in Liability Driven Investment, FCA, April 2023.
[27] Using leveraged liability driven investment, TPR, April 2023.
[28] This is interpreted as the size of yield increase the capital buffer can tolerate before it is exhausted and needs to be recapitalised.
[29] July 2023 Financial Stability Report, FPC, Bank of England.
[30] PPF 7800 Index.

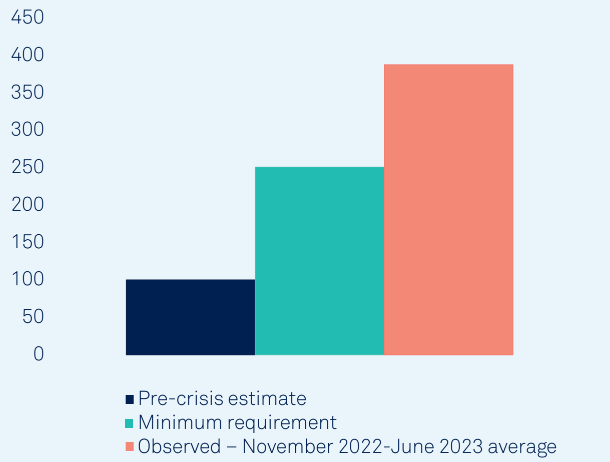
FIGURE 11: THE GILT MARKET CRISIS IN THREE CHARTS

CHART 24: GILT YIELDS SUFFER UNPRECEDENTED SPIKE FOLLOWING SEPTEMBER FISCAL EVENT

This was:
2x increase ahead of the Spring 2020 Covid-19 lockdown
3x larger than any other historical move over a similar period

Source: The Bank of England

CHART 25: LDI RESILIENCE INCREASES SIGNIFICANTLY IN THE AFTERMATH OF THE GILT MARKET SHOCK



Source: Adapted from FPC July 2023 Financial Stability Report

CHART 26: OVERALL, DB PENSION SCHEME UNIVERSE FUNDING POSITION MUCH BETTER AS A RESULT OF INTEREST RATE REGIME CHANGE

Source: PPF7800 Index

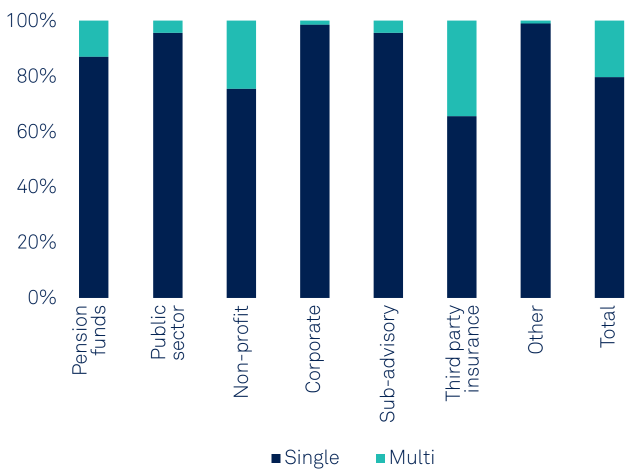
MULTI-ASSET VS. SPECIALIST MANDATES

Given that LDI strategies are used almost exclusively by DB pensions, their inclusion in the data can mask some interesting trends in the broader market. The analysis presented on pages 69 to 72 excludes the value of LDI mandates to allow us to uncover some of those trends.

Chart 27 indicates UK institutional clients have a strong preference for single asset (specialist) mandates, which make up 80% of total third-party mandates, excluding LDI. This is one percentage point lower than in 2021.

Focusing in on the two largest client segments, we observe that the use of multi-asset mandates is most prevalent among third-party insurance clients, accounting for over one third (34%) of assets managed for this group. Assets managed for pension funds sit largely in mandates focusing on a single asset class or region, with just 13% of assets in multi-asset strategies.

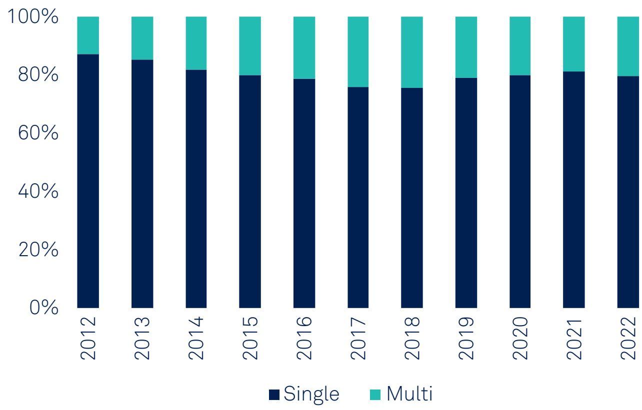
CHART 27: UK THIRD-PARTY INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST IN 2022



Source: The Investment Association

The ten-year trend for the balance between single and multi-asset mandates in the third-party client market is presented in Chart 28. Multi-asset mandates grew consistently as a proportion of third-party client assets until 2018, reaching a high of 24%, before falling consistently to 19% in 2021. The one percentage point rise in 2022 to 20% is the first increase in four years and comes as a result of significantly higher falls in assets in specialist mandates rather than a nominal increase in AUM in multi-asset mandates.

CHART 28: UK THIRD-PARTY INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST (2012 – 2022)



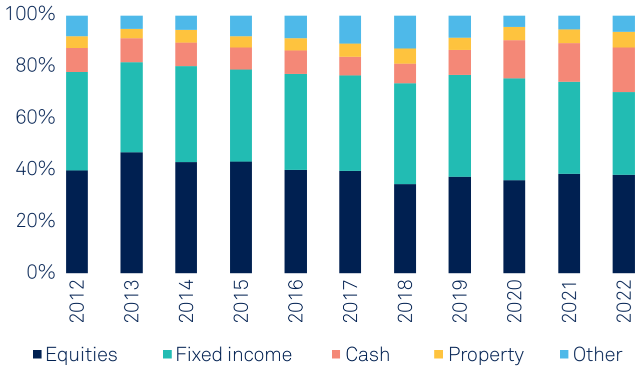
Source: The Investment Association

ASSET ALLOCATION TRENDS WITHIN SPECIALIST MANDATES

Chart 29 looks at the long-term trend in the breakdown of specialist mandates by asset class with some particularly significant movements in 2022:

- The tough return environment in global bond markets since the end of 2021 and through 2022 reduced the share of assets in **fixed income mandates** to their lowest level on record, from 36% at the end of 2021 to 32% in 2022. This is substantially lower than the average 38% share of assets in fixed income specialist mandates between 2012 and 2020.
- Assets in **equity mandates** have been more volatile over the last decade with more pronounced year-on-year changes in years with strong market movements (most notably 2013 and 2018). Despite a weak equity performance environment in 2022, the one percentage point year-on-year fall in assets to 38% was modest, cushioned by even weaker fixed income returns.
- The rise in the proportion of specialist **cash allocations** is a standout trend of the past five years. As of December 2022, specialist cash allocations account for 17% of assets, more than double the 7% recorded in 2017. The demand for liquidity during the 2020 'dash for cash' saw this trend accelerate, though the two-percentage point increase in 2022 is more a reflection of a lower relative fall in nominal terms rather than a surge in demand.
- The proportion of assets in **other specialist mandates** increased one percentage point to 6% of assets, again reflective of a lower relative fall in nominal terms. Additional data collected this year suggests that about a quarter of these assets are in private equity and infrastructure specialist mandates.

CHART 29: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS (2012-2022)

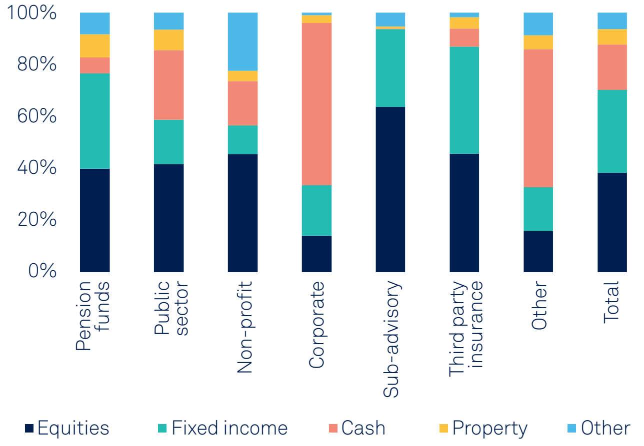


Source: The Investment Association

Asset allocation patterns differ quite substantially across different segments of the institutional market. Chart 30 highlights some distinct differences in the asset allocation profiles for each group:

- Pension funds and third-party insurers have similar asset allocation profiles, with both investing the majority (77% and 87% respectively) of assets in equities and fixed income, roughly in equal measure. Pension fund holdings in fixed income however, were down four percentage points year-on-year, while the proportion of third-party insurance assets in fixed income increased two percentage points over the year.
- Corporates hold a substantially higher proportion of highly liquid assets with almost two thirds (63%) of assets invested in cash in 2022, which is up from 48% in 2021. Some of the year-on-year changes may be explained by corporate demand for cash buffers in an uncertain business environment, improvements in reporting by member firms make annual comparisons difficult in 2022.

CHART 30: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS IN 2022

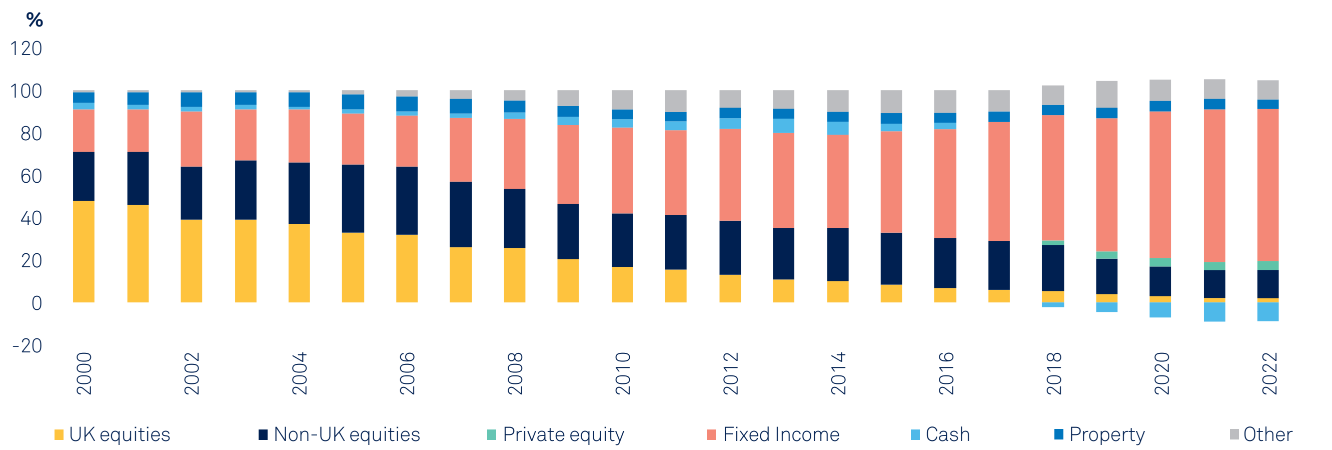


Source: The Investment Association

Given that defined benefit (DB) schemes still make up the vast majority of UK pension assets, we use external data to look at asset allocation patterns of funded DB schemes more closely. The latest data shown in Chart 31 is as of 31 March 2022, and was broadly unchanged from 2021. Market performance was the worst in the second and third quarters of 2022, so the chart does not capture the full extent of the 2022 market downturn. We make two key observations on asset allocation of DB schemes over the last two decades:

- UK DB schemes were heavily invested in equities in 2002, making up 64% of total assets, of which 39% was invested in UK equities. By 2022 the total equity allocation had fallen to 15% with UK equities accounting for 2% of this. The fall in allocation to UK equities is not specific to DB pensions schemes and is a theme discussed elsewhere in this report.[31] Although UK equities have underperformed other global equity markets over the past decade, the fall in allocation pre-dates the underperformance of UK equities. The main driver of this trend is likely a broader appetite to de-risk portfolios through more global diversification.
- The other substantial shift has been the growing dominance of fixed income in DB portfolios, now responsible for 72% of assets, up from 20% in 2002. Within fixed income, the long-term shift has been the growth in the proportion of assets in index-linked bonds which are responsible for 48% of fixed income assets (up from 34% in 2008), while government bonds (excluding index linked) investments have fallen from 33% to 22% over the same period. The very high allocation to fixed income by UK DB schemes provides further context to the 2022 fall in pension assets managed by IA members.

CHART 31: UK DB PENSION FUND ASSET ALLOCATION (2000-2022)



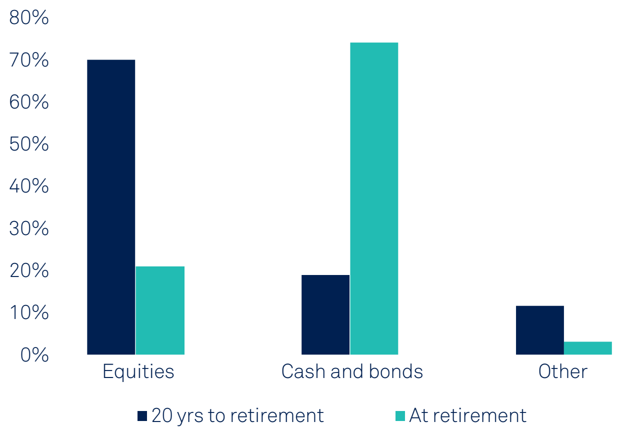
Sources: UBS Pension Fund, Pension Protection Fund – The Purple Book 2022

[31] See Chapter 3 for asset allocation trends at AUM level (p.51) and Chapter 5 for asset allocation trends in the retail funds market (p.83-85).

Chart 32 compares asset allocation of DC savers in the accumulation phase of pension saving, with twenty years until retirement, against the allocations at retirement. The allocations are based on the average allocation for master trust default strategies, which 96% of scheme members are in.

- The asset allocation for DC savers at retirement is broadly in line with the aggregate allocation of DB assets: almost three quarters (74%) of assets are invested in fixed income or cash and just over a fifth (21%) in equities.
- The savers who are 20 years away from retirement and who can withstand higher levels of volatility have more aggressive allocations with 70% invested in equities, and just 20% in fixed income or cash.

CHART 32: UK DC ASSET ALLOCATION, 20 YEARS PRIOR TO RETIREMENT AND AT RETIREMENT IN 2022

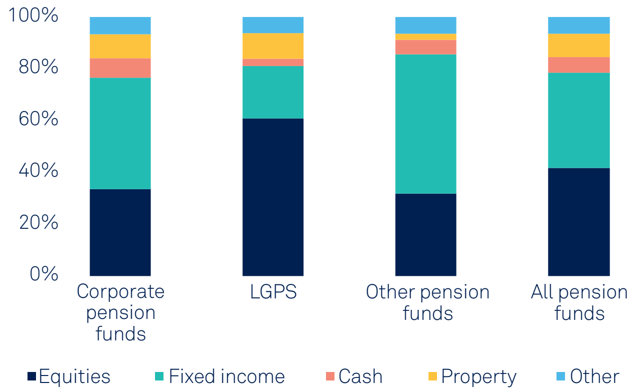


Source: Pension Policy Institute

External data illustrating the size of workplace DB schemes relative to DC and the asset allocation of each provides helpful context to the breakdown of corporate pension fund assets shown in Chart 33, which we compare against the allocation of LGPS clients:

- LGPS clients, which are DB schemes still open to new members, have a significantly higher weighting to equities (61%) compared to fixed income (20%). Year-on-year changes show a six-percentage point fall in the proportion of both fixed income and equity investments. Meanwhile, cash, which historically makes up a very small proportion of LGPS investments, and property both saw nominal increases in assets which took the proportion of assets up four percentage points to 13%.
- By comparison, corporate pension fund assets have a much higher allocation (42%) to fixed income assets than LGPS clients, though this is six percentage points lower than in 2021. The allocation to equities is almost half the LGPS allocation, accounting for a third (33%) of corporate pension fund assets.

CHART 33: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS AMONG UK PENSION FUNDS IN 2022



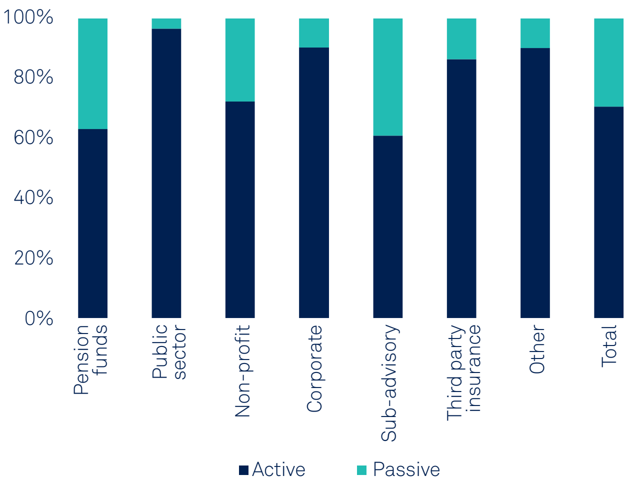
Source: The Investment Association

ACTIVE VS. INDEXING

The majority (71%) of third-party institutional client assets are actively managed, slightly higher than was recorded in 2021 (69%). Unlike what we see in the wider asset management industry data in chapter 3, this figure has not been increasing consistently over the last five years, but rather fluctuating between 69% and 72%.

Chart 34 shows the balance of active and indexing strategies for each segment of the UK institutional market. Pension funds and sub-advised clients are the biggest users of indexing strategies relative to the size of their overall asset base. Over a third (37%) of pension assets and close to two fifths (39%) of sub-advised assets are in index tracking strategies, both two percentage points higher than reported in 2021.

CHART 34: ACTIVE AND INDEX THIRD-PARTY MANDATES BY CLIENT TYPE IN 2022 (SAMPLE-ADJUSTED)

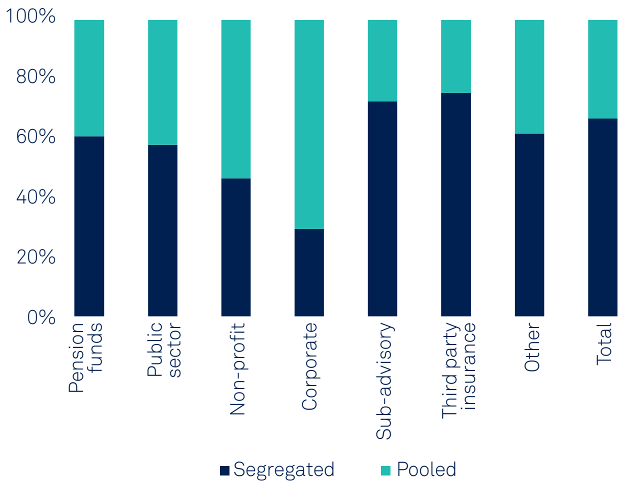


Source: The Investment Association

SEGREGATED VS. POOLED

Chart 35 shows that the majority (67%) of assets managed for third-party UK institutional clients were managed through segregated mandates in 2022, marginally higher than the previous year and up ten percentage points since 2012. The preference for assets managed through bespoke segregated mandates versus pooled funds varies by client. While most client types have a clear preference for segregated mandates, Corporate clients and Non-profit clients typically invest through pooled vehicles.

CHART 35: SEGREGATED AND POOLED MANDATES AMONG THIRD PARTY PENSION FUNDS (2022)



Source: The Investment Association