



Asset Management in the UK 2011-2012

The IMA Annual Survey

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Contents

About the Survey	6
Survey Foreword	7
Key Statistics	10
PART ONE: UK INDUSTRY	11
1. Industry Overview	13
Key Findings	13
Total Assets under Management	14
Scottish Business	15
Wider Industry	15
Client Type	16
Historic evolution	17
Type of Management	18
Asset Allocation	19
Geographic Split	21
Difficult Market Conditions	23
Client Needs and Industry Operating Environment	25
Pension funds	25
Insurance clients	26
Retail behaviour	27
Regulatory and political pressures	27
Complex operating environment	28
2. UK Institutional Market	29
Key Findings	29
Market Overview	30
Pensions	31
Insurance	31
Further client categories	32
Third Party Institutional Market	32
Mandate breakdown	33
Specialist mandates	34
Geographic allocation	35
Natural Buyers of Equities?	37
Active vs Passive	40
Segregated vs Pooled	40
A Year of Pension Reform	41
DC can deliver, but support for individual savers is needed	42
Stability is essential for building confidence	42
Good outcomes require the right policy framework	43
Investment communication must evolve	43
3. UK Fund Market	44
Key Findings	44
Total Funds under Management	46
Flows vs performance	47
Asset mix	48

Retail Investor Flows	49
Determinants of flows	51
Asset class choices	52
Mixed asset funds	53
Fixed income funds	55
Weakening equity fund sales	56
Index tracker funds	58
On-going move towards absolute return	59
Property funds	59
Ethical funds	60
Newly launched funds	60
Individual Savings Accounts (ISAs)	61
Distribution Dynamics and their Implications	62
UK Industry Concentration and Structure	63
Measuring concentration	64
The European Context	67
Retail Distribution Review (RDR)	70
Broad objectives	70
Impact on fund industry, advisers and consumers	70
Main challenges to implementation	71
How will consumers benefit?	72
Does transparency produce consumer understanding?	72
Impact on availability of advice	73
Implications for product development	73
Broader issues	74
Consumer Protection and Mis-selling	75
4. International Dimension	77
Key Findings	77
Four International Dimensions	78
Overseas clients	78
Overseas-headquartered firms	79
Overseas fund domiciles	80
Overseas locations for asset management	80
The UK in a Comparative Context	81
Fund management	82
5. Operational and Structural Issues	85
Key Findings	85
Revenue and Costs	86
Performance Fees	87
Employment	89
Outsourcing	91
Risk Management	92
Client scrutiny	93
Global Investment Performance Standards (GIPS)	94
Industry Concentration	95
Changing Ownership	97
Boutiques	99

PART TWO: REGULATORY CHANGE	101
6. Geographies of Regulation	103
Key Findings	103
Global Regulatory Environment	104
Challenges to global coordination	104
Consequences of fragmentation	106
Emerging extra-territoriality	107
Danger of protectionism?	108
Extension of European Powers	108
General attitudes to European integration	109
Broad support for UCITS	109
Range of concerns about ESAs	110
Opportunities to express the UK voice	111
UK Regulatory Environment	112
Prudential supervision and the role of the ICAAP	112
Relationship with the industry	113
Impact on Locational Decisions	114
7. Banks and Capital Markets	120
Key Findings	120
Prudential and Banking Reforms	121
Liquidity provision	123
Alternatives to bank finance in the capital markets	123
Capital Markets	125
Equities	125
Broker relationships	126
Corporate bond trading	127
OTC derivatives clearing and trading	127
Appendix One: IMA Membership – Assets under Management in the UK	130
Appendix Two: IMA Membership – UK Institutional Client Market	132
Appendix Three: IMA Membership – UK Third Party Institutional Market	134
Appendix Four: Survey Respondents	136
Appendix Five: Firms Interviewed	138

Index of Charts, Tables and Figures

Charts

Chart 1:	Total assets under management in the UK and in UK authorised funds (2005–2011)	15
Chart 2:	Assets managed in the UK by client type	16
Chart 3:	Assets managed in the UK by client type (2005–2011)	17
Chart 4:	Active and passive assets as a proportion of total UK assets under management (2006–2011)	18
Chart 5:	Monthly performance of selected equity and bond indices (2011)	19
Chart 6:	Overall allocation of UK-managed assets (2007–2011)	19
Chart 7:	Growth of Sterling- and Euro-denominated IMMIF assets (2008–2011)	19
Chart 8:	Proportion of respondents managing different asset classes in the UK	20
Chart 9:	UK-managed equities by region (2006–2011)	21
Chart 10:	Allocation of UK-managed fixed income by type and region	22
Chart 11:	Performance of FTSE All-Share index (1998–2011)	23
Chart 12:	Ten-year gilt yield (1998–2011)	23
Chart 13:	The profile of UK recession and recovery	24
Chart 14:	UK institutional market by client type	30
Chart 15:	Third party UK institutional market by client type	32
Chart 16:	Third party UK institutional client mandates	33
Chart 17:	Specialist mandates by asset class	34
Chart 18:	UK pension fund specialist mandates by asset class	34
Chart 19:	Specialist equity mandates by client type	35
Chart 20:	UK pension fund specialist equity mandates	35
Chart 21:	Fixed income specialist mandates by client type	36
Chart 22:	UK pension fund fixed income specialist mandates	36
Chart 23:	Overall UK pension fund asset allocation (1970–2011)	37
Chart 24:	Overseas ownership of UK equities (1963–2010)	38
Chart 25:	Active and passive mandates by institutional client type	40
Chart 26:	Segregated and pooled mandates by institutional client type	40
Chart 27:	Industry funds under management (2001–2011)	46
Chart 28:	Funds under management as percentage of GDP (1960–2011)	47
Chart 29:	Changes in funds under management by sales vs performance (1993–2011)	47
Chart 30:	Funds under management by fund/asset type	48
Chart 31:	Proportion of industry funds under management represented by equities (1992–2011)	48
Chart 32:	Monthly net retail sales by asset category (2011)	49
Chart 33:	Net retail sales (2002–2011)	49
Chart 34:	Net retail sales vs sales as percentage of gross household disposable income (1960–2011)	50
Chart 35:	Quarterly retail funds under management vs total financial assets (2005–2011)	50
Chart 36:	Quarterly net retail sales as percentage of retail funds under management vs Bank of England base rate (Q4 1986–2011)	51
Chart 37:	Net acquisition of currency and deposits by UK households and net retail sales of UK authorised funds vs Bank of England base rate (2007–2011)	51
Chart 38:	Net retail sales of mixed asset funds vs FTSE All-Share index (1992–2011)	53
Chart 39:	Net retail sales of fettered and unfettered funds of funds (1992–2011)	54
Chart 40:	Net retail sales of fixed income funds (1992–2011)	55
Chart 41:	Monthly net retail sales of equity funds vs MSCI World index (2011)	56
Chart 42:	Net retail sales of UK and non-UK equity funds (1992–2011)	56
Chart 43:	Net retail sales of tracker funds by index investment type (2002–2011)	58
Chart 44:	Funds under management of tracker funds by index investment type (2002–2011)	58
Chart 45:	Monthly net retail sales of absolute return funds vs absolute return funds under management as percentage of total funds under management (2008–2011)	59
Chart 46:	Net retail sales of property funds vs IPD UK All-Property index (1992–2011)	59
Chart 47:	Net retail sales of ethical funds vs ethical funds under management (1992–2011)	60
Chart 48:	Net retail sales of newly launched funds by fund/asset type	60
Chart 49:	Funds under management in ISAs by investment type (tax year ending April 2000–2011)	61
Chart 50:	Net ISA sales (tax year ending April 2000–2011)	61
Chart 51:	Average implied holding periods of retail investors (1997–2011)	62
Chart 52:	Top ten UK fund operators by total funds under management	63
Chart 53:	Top ten UK fund operators by retail funds under management	63
Chart 54:	Combined market shares of top firms by funds under management (1995–2011)	64

Chart 55:	CIS fund operator ranking by net retail sales	64
Chart 56:	Combined market share of top funds by funds under management (1995–2011)	65
Chart 57:	Combined share of top funds by gross sales (1995–2011)	65
Chart 58:	Breakdown of funds under management by fund domicile, selected countries	68
Chart 59:	Net sales of UCITS by asset class as percentage of total UCITS funds under management, selected countries	69
Chart 60:	Net sales of equity funds per capita, UK and Europe ex UK (2001–2011)	69
Chart 61:	UK assets under management by region of parent group headquarters (2003–2011)	79
Chart 62:	Comparative asset growth, UK, Hong Kong, Singapore (2003–2010)	81
Chart 63:	Fund assets by domicile, UK, Ireland, Luxembourg (2000–2011, projected to 2015)	83
Chart 64:	Fund domicile market share by asset size, UK, Ireland, Luxembourg (2000–2011, projected to 2015)	83
Chart 65:	Total number of funds by domicile, UK, Ireland, Luxembourg (2000–2011)	84
Chart 66:	Industry net revenue vs revenue and costs as percentage of average assets under management (2006–2011)	86
Chart 67:	Industry headcount estimate (2007–2011)	89
Chart 68:	Size of Compliance, Legal and Audit as a proportion of overall headcount (2007–2011)	90
Chart 69:	Breakdown of Compliance, Legal and Audit as a proportion of overall headcount (2007–2011)	90
Chart 70:	Percentage of non-UK nationals in respondent firms by staff size	90
Chart 71:	IMA member firm ranking by UK assets under management (June 2011)	95
Chart 72:	Market share of largest firms by UK assets under management vs HHI (June 2003–2011)	95
Chart 73:	Top ten firms by UK and global assets under management	96
Chart 74:	Breakdown of UK assets under management by parent type (2003–2011)	97
Chart 75:	Percentage change in UK-managed assets across boutique IMA members (2010–2011)	99

Tables

Table 1:	Net retail sales by fund type (2009–2011)	52
Table 2:	Net retail sales and funds under management of mixed asset funds by sector (2010–2011)	53
Table 3:	Net retail sales and funds under management among equity sectors (2010–2011)	57
Table 4:	Mean and median fund sizes (2002–2011)	66
Table 5:	Distribution channels for the top 10 UCITS distribution countries	67
Table 6:	Use of performance fees in the industry (2008–2011)	87
Table 7:	Proportion of assets under management subject to performance fees	87
Table 8:	Change over past year and expectation of future use of performance fees	88
Table 9:	Distribution of staff by activity (direct employment)	89
Table 10:	Use of outsourcing in the industry (2007–2011)	91
Table 11:	GIPS compliance among respondents, matched sample (2009–2011)	94
Table 12:	External verification of GIPS compliance, matched sample (2009–2011)	94
Table 13:	Assets managed in the UK by IMA firm size	95
Table 14:	Notable M&A deals in the UK asset management sector (2009–2011)	98
Table 15:	Post-trade transparency in equity markets after MiFID implementation	126
Table 16:	Use of IMA model terms of business in negotiating broker relationships	126
Table 17:	Proportion of corporate bond trades executed with market makers	127
Table 18:	Proportion of different types of OTC derivatives cleared centrally	128

Figures

Figure 1:	IMA member characteristics	14
Figure 2:	Wider asset management industry	15
Figure 3:	Potential opportunities in the DC pensions environment	26
Figure 4:	Complex industry operating environment	28
Figure 5:	UK pensions landscape	31
Figure 6:	International dimensions of the UK asset management industry	78
Figure 7:	Assets under management in Europe (December 2010)	81
Figure 8:	European investment funds by country of domicile (December 2011)	82
Figure 9:	Timeline of UK regulatory events	116
Figure 10:	Timeline of EEC/EU regulatory events	118

About the Survey

The Survey focuses on asset management activity in the UK on behalf of domestic and overseas clients. The results are based on the questionnaire responses of 85 IMA member firms, who between them manage £3.7trn in this country (90% of total assets managed in the UK by IMA members).

We also conducted in-depth interviews with 30 senior figures from 20 IMA member firms. Their views are reflected both in the commentary and in the direct quotations, reproduced on an anonymous basis throughout the Survey.

The Survey is in two main parts.

Part One, UK Industry, is divided into the following chapters:

- 1 Industry Overview**
- 2 UK Institutional Market**
- 3 UK Fund Market**
- 4 International Dimension**
- 5 Operational and Structural Issues**

Part Two, Regulatory Change, is sub-divided into two main chapters:

- 6 Geographies of Regulation**
- 7 Banks and Capital Markets**

Timelines of the main UK and EEC/EU regulatory events of the past twenty-five years are provided at the end of Chapter Six. A summary of the findings can be found in Appendices One, Two and Three.

Questionnaire respondents are listed in Appendix Four and firms interviewed in Appendix Five.

A number of general points should be noted:

Unless otherwise specified, all references to 'UK assets under management' refer to assets under management in the UK by IMA members as at December 2011.

Unless otherwise specified, the IMA survey and internal databases are the source of all data cited.

Not all respondents have been able to provide information for all questions and not all questions have been answered on the same basis. Response rates, therefore, differ across questions.

The Survey has been designed with comparability to the previous surveys in mind. However, even where firms replied in consecutive years, they may not have responded to the same questions. Where meaningful year-on-year comparisons were possible, they have been made.

The IMA would like to express its gratitude to member firms who provided detailed questionnaire information, as well as to the individuals who gave their time for interviews.

Survey Foreword



Richard Saunders
Chief Executive

This is the IMA's tenth annual survey of the UK asset management industry. Assets managed in the UK on behalf of both domestic and international clients now stand at nearly £4.2trn, the highest we have recorded.

A focus on regulation this year...

It has been some five years since the first stirrings of the credit crisis in the summer of 2007; a crisis to which regulators in the UK and internationally continue to respond with a stream of new and revised regulations. Over the last couple of years IMA member firms have become increasingly conscious of the potential impact that these proposals may have on their clients and business, and we considered the time was right to take the temperature on the issue.

...a necessary response to the credit crisis...

There is no kneejerk opposition among IMA members to any form of enhanced regulation. For example, the significant benefits from the European UCITS directives for investors and fund management firms alike were widely acknowledged. And there was broad acceptance that action needed to be taken to seek a more stable banking system than the one whose shortcomings had become evident during the crisis. We accordingly found a good deal of support for the reforms recommended in the UK by the Vickers Commission.

...but beware unintended consequences which end up harming investors...

There were, however, caveats. The first was an underlying concern that reforms directed at improving financial stability would harm investment returns. For example, attempts to insulate investors (and the wider financial system) from undue risk may end up pushing institutions such as pension funds and insurance companies into assets that are far from 'risk-free' at this stage of the economic cycle.

Another concern was that the sheer volume of new regulation currently being introduced or in the pipeline would mean there would be inadequate analysis of the likely consequences, with the result that the desired outcomes were not achieved. The litmus test for regulation should be whether it furthers the interests of end-investors. The perception across the industry was that many current proposals will not do this.

A particular example has been the move to bring derivatives clearing into centralised and regulated arrangements. While this has many attractions, and the danger of excessive costs to some pension funds and other investors has receded compared with earlier proposals, there remain fears that clients' risks may become more difficult and expensive to hedge.

..or the risks of protectionism

The regulatory response is intended to be global under the auspices of the G20. In many areas, however, implementation on both sides of the Atlantic has been inconsistent and at times contradictory. At the same time, both the US and EU have introduced legislation with potentially extraterritorial reach or which erects barriers against firms trying to operate on a global level. These, in turn, create complication and cost for investors seeking access to global markets.

The European dimension

Much of the regulatory change for the UK industry is effected through European legislation and institutions. The European single market has become a significant reality in the fund management sector and the industry has been a major beneficiary of this process. But it has also meant that the regulatory centre of gravity has moved from the national to the EU level.

In principle, many IMA member firms welcome this as a way to entrench the single market. A common observation was that the new European Supervisory Authorities could bring benefits. However, there remain concerns that policy development over the coming years will be politicised, and characterised by constrained resources and insufficient regard to UK, as opposed to continental European, business models.

The evolution of the UK investment landscape

Ten years of the IMA survey offer the opportunity to observe a significant evolution in investor behaviour. The general story can best be told by going back to the 1990s. Chart 23 of p.37 and Chart 31 on p.48 track a significant change in the proportion of equities in institutional and retail portfolios. Faced with a range of pressures, pension funds have moved strongly towards fixed income and alternative asset classes, while retail investor fund holdings have diversified from what was a very strong bias towards equities.

This is perhaps not surprising after the highly volatile performance of the stock market over the last decade or so, which has ultimately resulted in little or no overall gain for investors. At the end of August 2012, the FTSE 100 index was at the same level as in the summer of 1998, fourteen years before. Such periods are not unprecedented, and can be found at several points throughout the twentieth century: 1906-1924, 1936-1952, and 1968-1982. All of these periods of underperformance were followed by strong bull markets, but these are timescales which can suit only those investors with long time horizons.

Those we interviewed had mixed views about the longer-term trend in investor behaviour. Some believed that it was cyclical, but others were convinced that the industry product mix would have to change significantly in the coming years. This latter group argued that the shape of things to come was indicated by the strong growth in 'liability-driven' strategies, and the interest in more outcome-oriented approaches, such as target date funds in defined contribution pensions.

Our figures suggest, however, that talk of a "flight from equities" in absolute terms is overdone. For example, the value of equities under management in UK authorised funds at the end of 2011 was £333bn compared with £57bn at the end of 1992, far outstripping equity market growth.

But there has been a significant shift out of UK equities into more international investment by both retail and institutional clients. At the end of 2011, just 37% of total equity holdings managed in the UK by IMA members were allocated to UK equities, whereas at end-2006 it was still 60%. As a result, we estimate that some 34% of shares (by value) in UK companies are now managed by UK investment managers; in 2006 the proportion was 47%.

Again, though, there has been a shift in composition. We estimate that UK authorised retail funds now hold approximately 10% of total UK equities, double the proportion of two decades ago. Over the same period, by some estimates, the share of insurance and pension funds has declined by three quarters.

The future for the industry

While assets under management are at record levels, the industry is increasingly focused on challenges ahead. These are multiple. A continuing financial crisis, combined with the slowest recovery from recession in over 100 years, will result in ever greater scrutiny of the role played by financial services. Industry charges have received a lot of media attention in 2012, and the Survey sheds interesting light here too. We found total industry revenues to be some £12bn, earned from assets of £4.2trn. That implies that on average clients across the board are paying fees of a fraction over 0.3% a year.

However, the debate ultimately needs to be about value and the industry's ability both to provide and demonstrate it. Nowhere is this more likely to be critical than in pensions. The inexorable transition from defined benefit to defined contribution pensions will move asset management increasingly into the spotlight because individuals will become more dependent not on a promise from an employer or the state, but on the returns from their savings.

The increased emphasis on personal saving, both through auto-enrolment and other developments, presents the industry with great opportunities. But with that will come ever greater scrutiny and the challenge will be to deliver value for money to investors.



Richard Saunders

Chief Executive, Investment Management Association
September 2012

Key Statistics

£4.2trn

[£3.9trn in 2010]

Total assets managed in the UK by IMA member firms as at December 2011

£575bn

[£587bn in 2010]

Managed in UK authorised funds (OEICs and unit trusts)

£1.6trn

[£1.4trn in 2010]

Assets managed in the UK on behalf of overseas clients

£765bn

[£693bn in 2010]

UK-managed funds domiciled offshore

34%

[38% in 2010]

UK domestic market capitalisation accounted for by IMA members' UK equity holdings

£12bn

[£11bn in 2010]

Revenue earned by UK-based asset management firms

£2.4trn

[n/a]

Assets managed worldwide on behalf of UK institutional clients

PART ONE: UK INDUSTRY

The first part of this year's Survey focuses on the UK industry, from both an asset management location and UK client perspective:

- **Industry Overview** looks at the asset management industry in the UK, regardless of where clients or funds themselves are based. It breaks down the asset base by client type, asset allocation and management approach (active vs passive, segregated vs pooled). It also outlines some of the central challenges facing both clients and the industry in the current economic, regulatory and political environment.
- **UK Institutional Market** analyses the UK institutional client base, and includes wider estimates of the size of the UK pension asset base as well as mandate types (specialist, multi-asset, LDI). It then considers in more detail the trends in asset allocation, particularly in the context of reduced exposures to equities. Finally, it elaborates on some of the challenges and opportunities emerging as UK pension reform accelerates.
- **UK Fund Market** presents an overview of retail fund investor behaviour, examining both flows during 2011 and the evolution of flows since the credit crisis. In particular, it looks in detail at what drove record retail inflows in 2009 and 2010 and whether those drivers are likely to continue.
- **International Dimension** gives more information about the international nature of the UK asset management industry. There are four broad dimensions; a very large overseas client base whose assets are managed in the UK, a diverse set of overseas-headquartered asset management firms operating here, significant management in the UK of assets in overseas-domiciled funds, and global management by UK-headquartered firms of assets both for UK and overseas clients.
- **Operating and Structural Issues** provides a range of broad operating statistics, including revenue, costs, headcount, industry concentration and ownership patterns. It also looks at changes in firms' approach to operational risk, raising themes on regulation picked up in Part Two.

1. Industry Overview

Key Findings

1

Industry size

- IMA members managed a total of £4.2trn assets in the UK as at December 2011; an increase of 3.4% on a matched basis.
- Wider industry assets are estimated at £4.9trn, of which IMA members managed 85%. The remainder is accounted for by niche players and other firms outside IMA membership.

Management location

- While most of the activity continued to be concentrated in London, 12% (£500bn) of total assets were managed in Scotland, with total headcount amounting to 15% of the UK industry headcount.

Client type

- Institutional clients represented nearly 81% of total UK assets under management; retail and private clients accounted for 18% and 1.2%, respectively.
- The largest institutional client type category continued to be pension funds (38%), followed by insurance companies (24%).

Type of management

- Segregated mandates represented 56% of total assets, against 44% of pooled assets.
- Passively managed assets accounted for 22% of the total (half of all pooled assets).

Asset allocation

- Of the £4.2trn under management in the UK, the largest proportion was invested in equities (42%), followed by fixed income (38%), cash/money market instruments (8.1%) and property (3.0%). The 'other category' is significant (8.9%), covering a range of alternative asset classes and structured solutions.
- Of the 42% invested in equities, UK equities accounted for 37%, continuing a relative decline. Emerging market equities grew to 13% of the total.
- Of the 38% invested in fixed income, £ Sterling corporate (25%), UK Government (21%) and UK index-linked gilts (14%) together with other UK bonds accounted for 68% of the total.

Client needs and industry operating environment

- The evolving needs of pension funds, both defined benefit (DB) and defined contribution (DC), suggest that there will be further opportunity for asset managers to develop more tailored products rather than remaining specialists in certain investment areas.
- In the context of Solvency II, and changing insurance company requirements, a number of those we interviewed observe that the consequences may be significant. They fear that regulatory action may prove pro-cyclical and damaging both to clients and the wider markets.
- A combination of current market conditions, unprecedented regulatory change and growing political pressures are creating a challenging operating environment for the industry.

1. Industry Overview

The UK is an important centre of asset management activity, providing services to a wide range of domestic and overseas clients. It is second-ranked in the world after the US, in terms of its scale and the breadth of services provided. While the UK industry is largely concentrated in London, there is also a significant Scottish cluster.

Investment services are provided in two broad ways: through a variety of pooled vehicles, which commingle assets from different investors, and through segregated mandates, where the client's assets are managed separately. The Survey focuses on both, looking in particular detail at the UK retail and institutional markets served by IMA members. Figure 1 provides a broad overview of the IMA membership base.

Figure 1: IMA member characteristics

IMA members fall into five general categories:

- 1 Asset managers with a large global asset and client base.** These firms undertake a wide range of asset management activities across the institutional and retail market in the UK and abroad. They also tend to manage substantial amounts of overseas client assets in the UK.
- 2 Large and medium-sized firms,** which offer a diverse range of services but are primarily UK- and/or Europe-focused at client level.
- 3 Fund managers,** whose business is based primarily on investment funds.
- 4 Specialist boutiques and private client managers** with a smaller asset base and typically a specific investment and/or client focus.
- 5 Occupational Pension Scheme (OPS) managers** running in-house asset management operations.

Within the Survey, we refer to assets under management as a 'catch-all' term covering all forms of asset management activity, including funds and segregated mandates. Where we refer specifically to UK authorised funds, which account for the majority of the UK retail collective investment market, we use the term 'fund industry'.

Total Assets under Management

As at the end of 2011, IMA members had a total of £4.2trn in UK assets under management. This figure comprises both in-house and third party client assets managed in segregated mandates and pooled vehicles. The pooled vehicles include:

- Authorised unit trusts.
- Open-ended investment companies (OEICs).
- Unauthorised investment vehicles (eg. unauthorised unit trusts).
- Life funds.

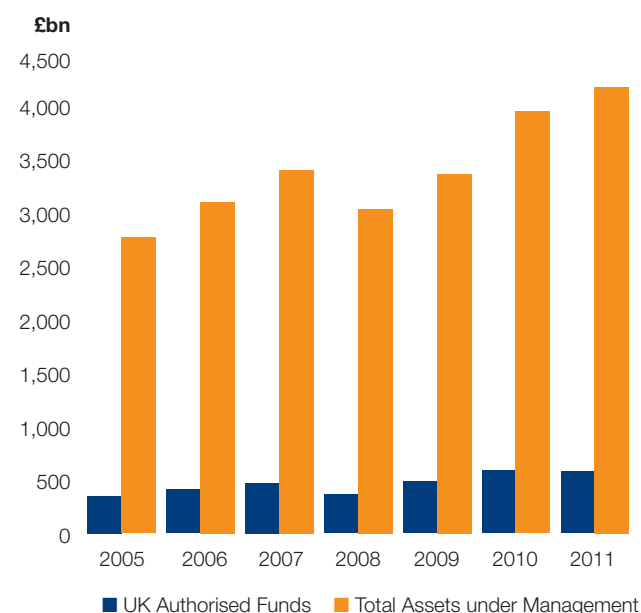
The twelve months to December 2011 saw a 5.1% increase in total assets under management compared to the year before, and 23% compared to the levels seen in 2009. This was driven by three factors: flows, market movements and changes in the IMA membership base.¹ On a like-for-like basis in membership terms, the change in assets under management was 3.4% since December 2010.

In contrast, the £575bn in UK authorised funds as at the end of 2011 decreased by 2.0% compared to the year before, although it still showed an increase of 19% relative to 2009. Reasons for this and other developments affecting the UK fund industry will be further elaborated on in Chapter 3. As a proportion of total UK assets under management, the size of UK authorised funds changed only marginally, decreasing by one percentage point to 14% at the end of 2011.

¹ We do not collect flow information at this level. Flow is driven both by client decisions and by changes in business organisation (ie. decisions as to where money is actually managed) by the many global firms operating in the UK.

Chart 1 illustrates the development of assets and funds under management over the seven years since December 2005. During this period, total assets under management grew 8.7% on a compound annual basis, compared to 12% for UK authorised funds. Projecting this forward, these growth rates suggest that total assets will have passed £6trn and total funds £1trn by 2016.

Chart 1: Total assets under management in the UK and in UK authorised funds (2005–2011)



Scottish Business

As at the end of 2011, assets managed in Scotland accounted for 12% (£500bn) of total UK assets under management,² and for 15% of the overall UK industry headcount. As well as Scottish-headquartered firms, a number of IMA firms - both UK and overseas-headquartered - have significant operations in Scotland. Like their counterparts in other regions of the UK, several Scottish asset management firms also have significant overseas operations.

² This represents a 0.7% decrease in asset size compared to last year's revised Scottish AUM (£514bn).

³ This is significantly higher than last year's estimate (£4.4trn). The single largest reason for this is improved data on certain aspects of the wider industry.

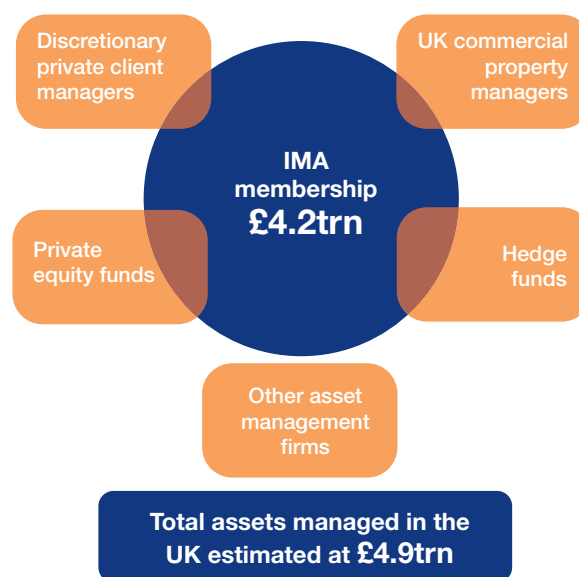
⁴ Source: HedgeFund Intelligence.

Wider Industry

IMA members account for 85% of total UK-managed assets, which at the end of 2011 we estimate to be £4.9trn.³ The parts of the wider industry outside the IMA membership base are primarily more niche asset management segments. As shown in Figure 2, these can be classified into the following categories:

- Discretionary private client managers.
- UK commercial property managers.
- Private equity funds.
- Hedge funds.

Figure 2: Wider asset management industry



Source: IMA, BVCA, ComPeer, HedgeFund Intelligence, IPD

IMA members operate across all four areas, particularly property, but each universe extends more widely. As at the end of 2011, our respondents ran nearly £40bn in hedge funds (2010: £30bn), 22% of the estimated UK total of £185bn.⁴ In 2011, hedge funds were run by 36% of our respondents.

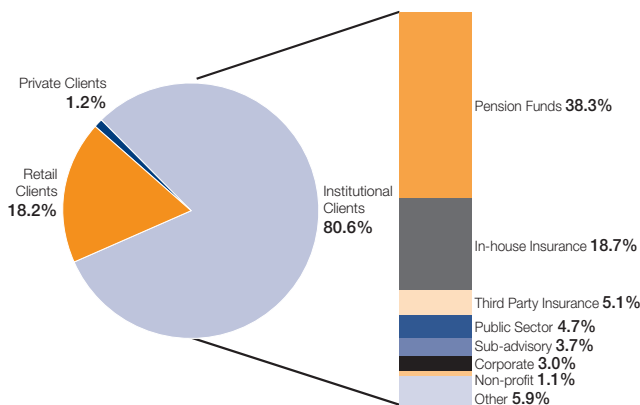
Client Type

The breakdown of UK assets under management by client type (both domestic and overseas) remained relatively unchanged from the year before. As shown in Chart 2, the vast majority of the UK asset base (81%) was accounted for by institutional clients, up from 78% a year earlier.

Retail holdings (including both UK and overseas retail client assets managed in the UK) fell to 18% from 20%; a headline change that is confirmed by matched samples. Given the relative resilience of the UK fund market, it is likely to reflect changes elsewhere, including Europe where UCITS (Undertakings for Collective Investment in Transferable Securities) fund assets were down 6.2% over the year (see p.67).

Private client assets represented 1.2% of total UK assets under management. This category captures only those parts of the private client market visible to IMA members (ie. where there are specific private client investment services). It does not reflect the overall size of private client assets managed in this country.⁵

Chart 2: Assets managed in the UK by client type



The institutional client base splits out as follows:

- The largest institutional category is pension funds with 38% of the total asset base (an estimated £1.6trn). On a headline basis, this represents an increase of one percentage point compared with 2010, and of nearly two percentage points when looked at on a matched basis.
- The second largest category are insurance companies with 24%; in-house insurance assets represent 19% of the total. These types of assets are primarily run for life insurance parent companies and include products such as life funds and annuities.

While in-house insurance assets saw some decrease compared to the year before, and third party insurance assets grew, these changes are very small and all but disappear when looked at on a matched basis. Thus, while the insurance industry is moving away from the in-house manager model, the pace of change appears slow.

The institutional client category also includes a number of smaller client types, namely public sector clients (4.7%), sub-advisory assets (3.7%), a variety of corporate and non-profit clients (accounting for 3.0% and 1.1%, respectively) and a cluster of other clients (5.9%). The latter mostly consist of pooled vehicles, such as investment trusts, commingled funds and others, where it was not possible to identify the underlying client type.

⁵ ComPeer estimates discretionary private client assets under management in the UK at £284bn as at December 2011.

Historic evolution

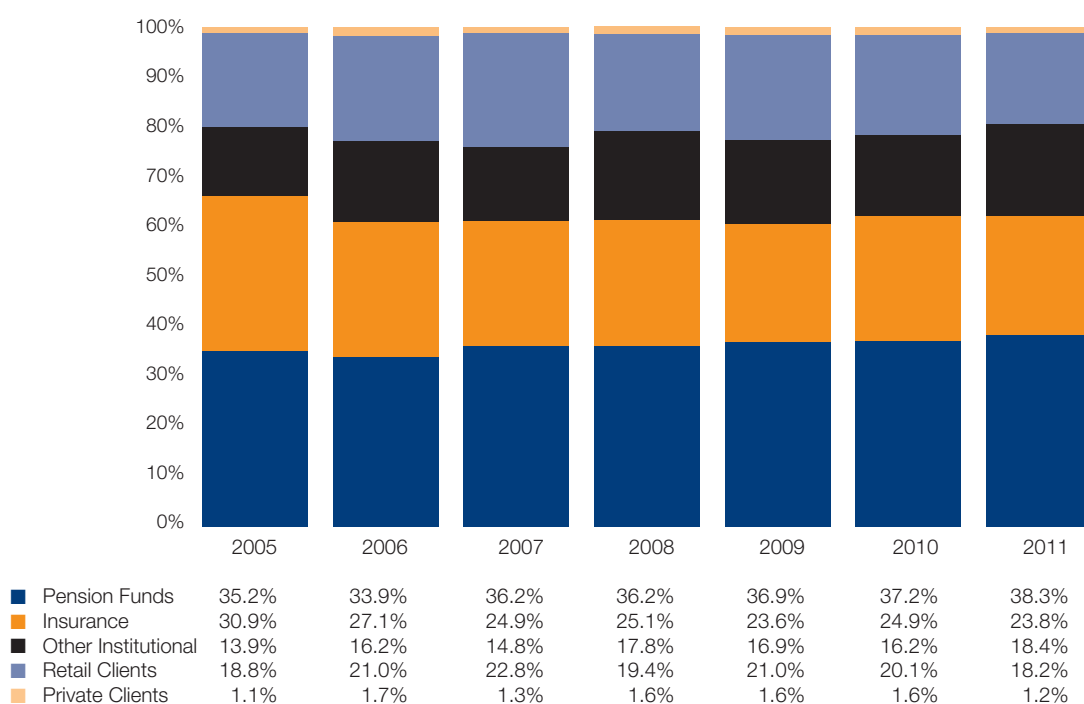
As shown in the evolution of the main client categories since 2005 (see Chart 3), pension funds have seen an increase in their share of UK assets under management from 35% to 38%. This is not surprising given aggregate growth rates in UK and global pension fund assets.⁶

In contrast, insurance assets have fallen in relative significance. On an absolute basis, however, insurance assets increased from an estimated £852bn in 2005 to £994bn in 2011.

In 2011, retail assets (managed for both UK and overseas clients) seem even further removed from their high in 2007, accounting for only 18% of the total UK asset base. Despite the significant year-on-year shift in 2010-2011, no clear long-term trend is apparent from this data. Retail assets experienced a period of peaks and troughs in 2005–2011. Given the greater sensitivity of retail flows internationally to market conditions, this is to be expected.⁷

The private client category remained at around 1-2% of the total.

Chart 3: Assets managed in the UK by client type (2005–2011)



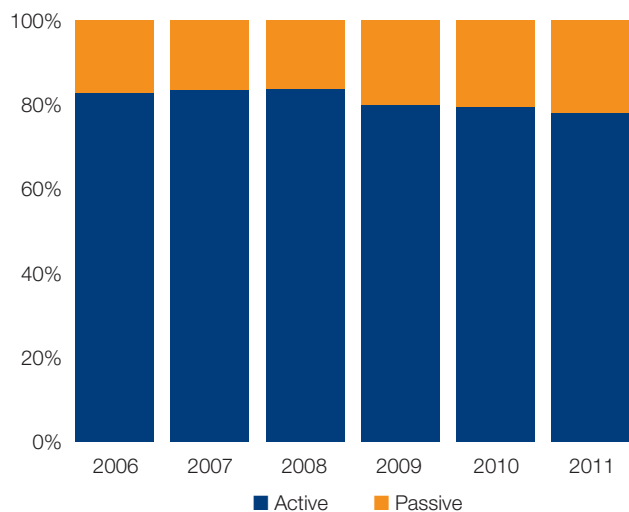
⁶ See, for example, Towers Watson, *Global Pensions 2011*, p.13, which shows a compound annual growth rate of around 6% over the last decade for both the UK and the global average.

⁷ While institutional investors, such as pension funds, are fully invested, retail investors are not. Fund investment may sit alongside other financial (eg. cash deposits) and non-financial holdings (eg. property).

Type of Management

Chart 4 illustrates the increasing use of passive management across the UK-managed asset base, growing from 17% of assets in 2006 to 22% at the end of 2011. As we show in Chapter Two, its use is far more prevalent in the UK institutional than in the retail market.

Chart 4: Active and passive assets as a proportion of total UK assets under management (2006–2011)



The full extent of the use of passive vehicles by clients internationally is not captured in the Survey, because IMA members are not an extensive part of the exchange-traded fund (ETF) provider base. Whilst assets in ETFs have grown strongly in recent years, ETFs continue to be run only by a small minority of our respondents.

At the end of 2011, 44% of assets were managed through pooled vehicles, compared to 56% managed through segregated accounts. On a matched as well as on a headline basis, this represents a small decrease in pooled assets compared to the year before, when the headline number was 46%.

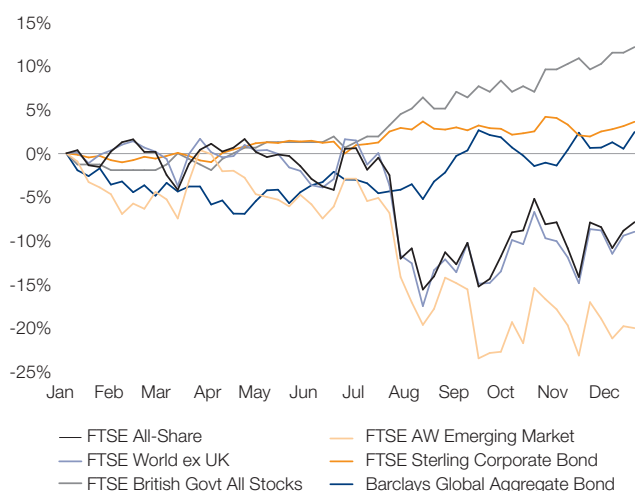
Asset Allocation

At an aggregate level, asset class movements during 2011 were broadly consistent with poor relative equity market performance (see Chart 5), although evidence from the UK market also points to an on-going client re-allocation away from equities.⁸

It is not possible in this data to distinguish between market performance and client re-allocation:

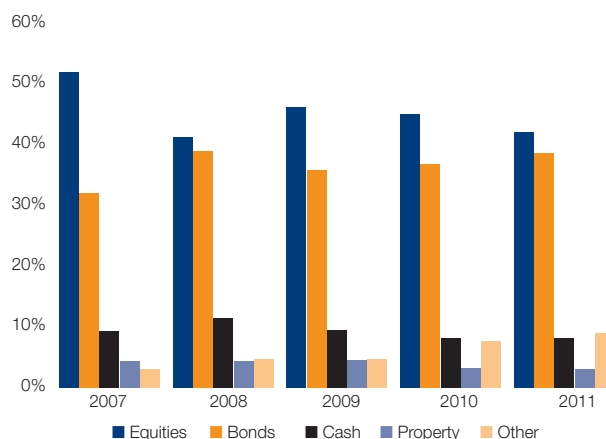
- Overall equity holdings were down by almost three percentage points to 42% (see Chart 6).
- In contrast, fixed income assets increased by nearly two percentage points to 38% (2010: 36%).
- Property assets remained at 3.0%. While a relatively small part of the overall asset base managed by IMA members, a number of firms have very significant property management businesses.
- Cash holdings fell to 8.1%, from a high of 11% in 2008, which appeared to reflect a flight to safety amid exceptionally turbulent market conditions. The cash holdings reported in this survey are a mixture of assets held in institutional money market funds (IMMFs), other money market funds and uninvested cash held in other forms.

Chart 5: Monthly performance of selected equity and bond indices (2011)



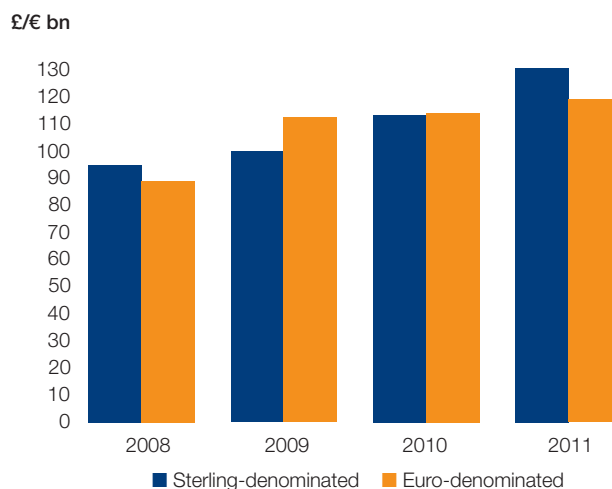
Source: Lipper IM (calculated on a capital return basis)

Chart 6: Overall allocation of UK-managed assets (2007–2011)



As at the end of 2011, IMMF assets were managed by 34% of respondents and amounted to £174bn, with the total UK-managed IMMF assets estimated at £206bn. Data from the Institutional Money Market Fund Association (IMMFA) shows a steady increase in both sterling- and euro-denominated IMMF assets since 2008 (see Chart 7). This is consistent with what one would expect in a broader economic environment in which corporates have been conserving cash.

Chart 7: Growth of Sterling- and Euro-denominated IMMF assets (2008–2011)



Source: IMMFA

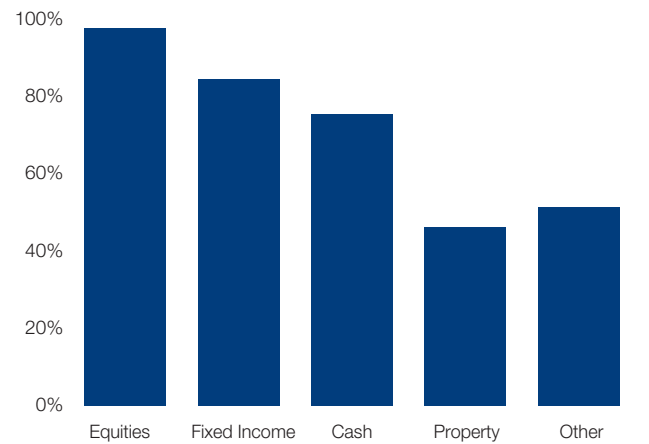
⁸ See *WM UK Pension Fund Annual Review 2011*, p.10.

The 'other' category of asset classes has witnessed considerable growth over the past five years, from 3.0% in 2007 up to 8.9% in 2011. This can be largely attributed to the increasing popularity of structured solutions such as liability-driven investment (LDI), where derivatives may be used extensively.

This category also includes alternative asset classes, such as currency, private equity and commodities, although these have never accounted for a significant part of the UK-managed asset base, each category always representing less than 1% of the total.

Chart 8 illustrates the broad mix of asset management activity within the survey respondent base. As might be expected, the majority of respondents report equity (97%) and fixed income holdings (84%), while property is managed by just 46% of respondents. Over half of the respondent group (51%) also managed other asset classes and instruments.

Chart 8: Proportion of respondents managing different asset classes in the UK



Geographic Split

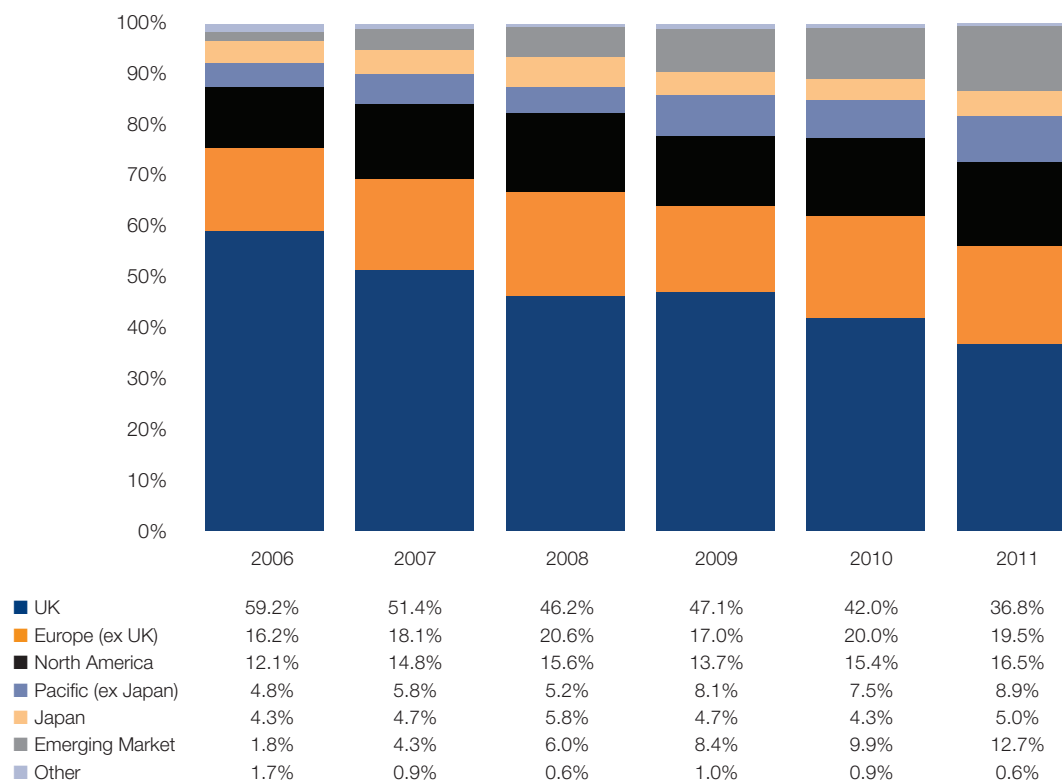
In addition to a general fall in equity holdings, 2011 also saw a significant decrease in the holdings of UK equities as a proportion of total equities. As illustrated in Chart 9 below, the share of UK equities decreased by over one third to 37% in 2011 (equivalent to 34% of the UK domestic market capitalisation), compared to nearly 60% in 2006. This is to a large part a result of the increasingly global investment outlook of the industry's client base.

Consistent with this trend is the remarkable growth of emerging market equities, up from a very low base of 1.8% in 2006 to 13% at the end of 2011 (2010: 9.9%); the most significant increase in the equity category.

The pattern is mixed in other regions:

- North American equity holdings increased to 16%, up from 15% in 2010. This also represents a steady increase from 12% in 2006.
- European (excluding UK) equities have increased over the last five years, from 16% in 2006 to 19% in 2011.
- Japanese equities experienced marginal growth, and have throughout the last five years remained at between 4-6% of the total equity holdings.
- Pacific (excluding Japanese) equities represent another growing regional allocation, growing from just under 4.8% in 2006 to 8.9% in 2011.
- Other regions consist of investments in Asian, Middle Eastern, African or otherwise uncategorised markets, and remain mostly below 1%.

Chart 9: UK-managed equities by region (2006–2011)



This year we have changed the classification of fixed income categories, replacing the UK Corporate with the £ Sterling Corporate category, in order to be more consistent with the fixed income categorisation used among our member firms. This prevents us from being able to make comparisons with previous years in the same way as we have been able to in the equity category.

Chart 10: Allocation of UK-managed fixed income by type and region

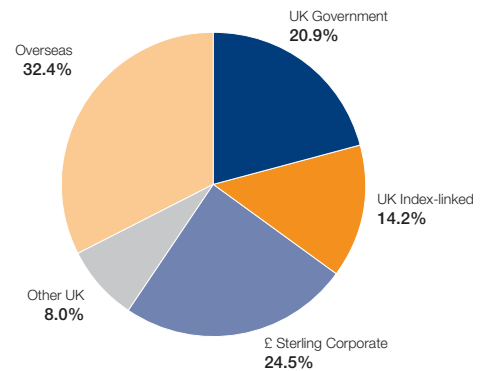


Chart 10 shows the breakdown of fixed income holdings as at 2011, where £ Sterling Corporate (25%), UK Government (21%), UK index-linked (14%) and other UK bonds account for 68% of the total. The remainder (32%) is represented by overseas bonds.

Difficult Market Conditions

The current market environment is characterised by a number of features that are creating challenges for asset managers. In particular, those we interviewed highlighted the following:

- A secular equity bear market in developed countries dating from the turn of the millennium. The FTSE All-Share index ended 2011 no higher in capital return terms than it had been in 1998 (see Chart 11).
- ‘Risk-on/risk-off’ behaviour, which has seen significant degrees of correlation in price movements and made it more difficult for active managers to invest according to perceived fundamentals or price anomalies.
- Falling government bond yields (see Chart 12) in the context of unprecedented central bank activity.
- Increasing sovereign solvency risk, which has also forced a reconsideration of what should be perceived as ‘risk-free’ assets.

Chart 11: Performance of FTSE All-Share index (1998–2011)



Source: Lipper IM (calculated on a capital return basis, rebased to 100)

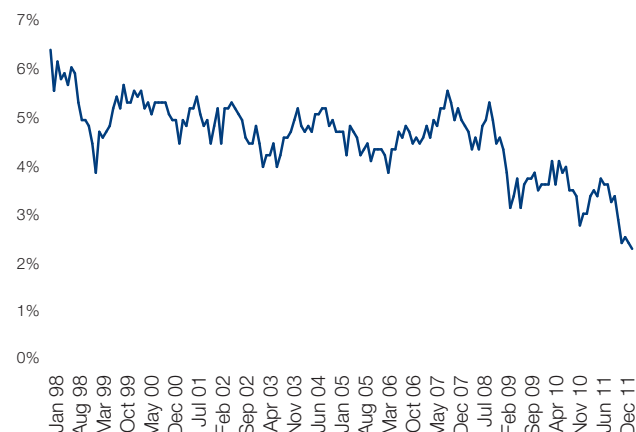
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Challenges in current markets

“ Markets are not reflecting fundamentals. When you enter an environment like last year in which, regardless of the quality, people were just buying dividends, that’s a difficult place. You cannot cope with many years like that, one after another, because it becomes a very significant risk to your business. ”

“ Think of all the entities required to own government bonds - which by the way is just another form of financial repression with yields at this level. I think there’s an unwritten covenant between anybody who manages a paper currency and those who hold it: namely, that the person who manages it is going to preserve the value of it. If you have a lengthy period of time with negative interest rates, you drive a coach and horses through that covenant. The UK and the US did it in the 1970s and they are doing it again today. ”

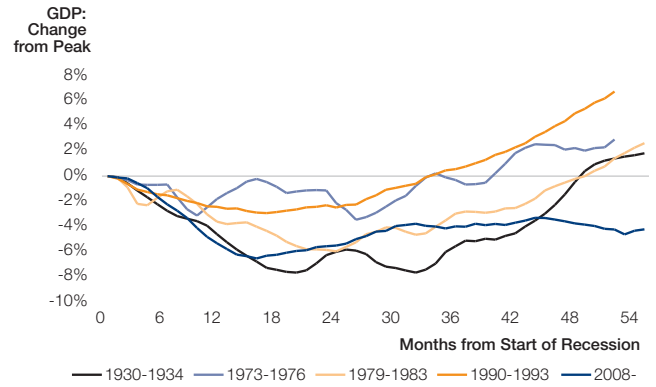
Chart 12: Ten-year gilt yield (1998–2011)



Source: Lipper IM

While doubts about the future of the eurozone loom large, market worries extend far more widely. The US suffered a ratings downgrade by S&P in August 2011, reflecting on-going doubts about the pace of fiscal consolidation. Meanwhile, in the UK, the extent of the growth challenge is made apparent by a stark comparison with previous recessions (see Chart 13). The recession that began in 2008 has seen a loss of output that is still some distance from being recovered, even four years later. Estimates from the National Institute of Economic and Social Research (NIESR) suggest that UK output will not recover to its 2008 peak until 2014.

Chart 13: The profile of UK recession and recovery



Source: NIESR (2012)

Client Needs and Industry Operating Environment

These market and broader economic conditions have to be put in the context of evolving client needs. While the UK industry is serving a very diverse client base, a number of consistent themes have emerged in recent years, which focus attention on how the industry may provide a different kind of product set to both institutional and retail clients.

Pension funds

Corporate DB schemes in the UK and elsewhere are increasingly diversifying away from equities, with growing exposure to fixed income and alternative asset classes, and greater use of LDI approaches. These shifts are a reflection of a number of factors, including evolving regulatory and accounting requirements, and have been apparent for some time.

More recently, with government bond yields falling and the risk perception of different assets changing in the context of the sovereign debt crisis, some UK pension funds have been looking for sustainable alternative sources of bond-like return. In the context of constrained public finances, there has been a particular focus on the potential role of pension fund investment in infrastructure. However, as we discuss later in the Survey, growing constraints on bank activity are also seeing a (currently small) number of asset managers think about other directions for meeting institutional clients' requirements (see p.123-124).

Underlying the challenges facing DB pension schemes are a series of global longevity and demographic shifts.

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New opportunities for asset managers?

“Deleveraging is causing banks to retreat from certain areas of activity, such as direct lending, commercial mortgage-lending, CLOs, social housing or infrastructure. This creates opportunities for asset managers, although these areas are still very new for most of them and very resource- and infrastructure-intensive. Some of these areas are ideal for long-dated liabilities and where illiquidity is not an obstacle.”

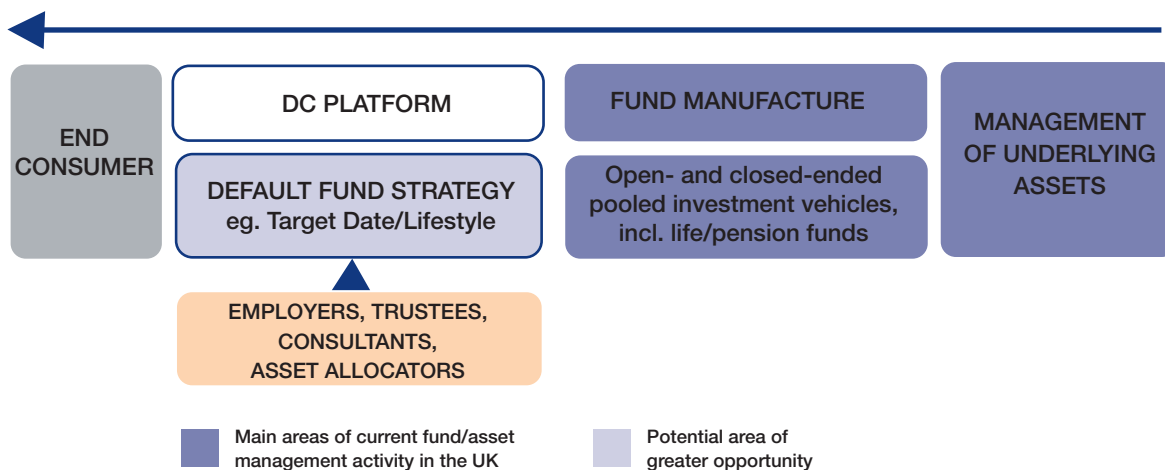
Herein lie both opportunities and challenges:

- The opportunity for the asset management industry is considerable expansion in assets under management and product scope as populations in many parts of both developing and developed markets find themselves increasingly responsible for pension provision above and beyond state minimums.
- The challenge for the industry lies in being able to deliver effectively for those needs, particularly in environments such as the UK that are heavily intermediated, making direct connection with clients much more difficult.
- Within the UK DC market, the design of the default fund will be critical given the absence of active choice that is likely to be a long-term characteristic of scheme member behaviour. While consultant-driven asset allocation remains a defining characteristic of the DC market, there are signs of increasing asset manager involvement.⁹

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⁹ See, for example, DCisions, *Calibrating DC Outcomes: Three Lenses on UK Workplace Savings*, 2012.

Figure 3: Potential opportunities in the DC pensions environment



The evidence from the past three years (2009-2011), which saw LDI assets under management grow from £190bn to £320bn, suggests that the focus on more tailored solutions for clients is set to intensify. This will be seen both in the DB market through LDI and in the DC market through products such as target date or diversified growth funds. The different roles that asset managers may play in the DC market are illustrated in Figure 3.

Insurance clients

With the implementation of Solvency II imminent, insurance clients (both in-house and third party) may have very different requirements of asset managers. For now, this focus remains primarily on data provision. However, both the nature of data provision (eg. the extent of looking through into underlying funds) and, longer-term, the impact of Solvency II capital charges on insurance companies’ balance sheets, may drive some degree of asset re-allocation.¹⁰ The debate within the financial services industry has been whether this might take the form of further moves out of equities. Those we spoke to expressed a number of views on this; some were supportive of the current direction of policy while others were extremely concerned.

One particular worry was the perceived risk associated with traditionally ‘safe’ assets, for example, as illustrated in the falling gilt yield in Chart 12 (p.23).

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Contrasting views on risk-based solvency requirements

“ We should all remember Equitable Life. Solvency II is trying to tackle the same issue. In the end, you’re just trying to protect policyholders from a run on the insurance company or undue risk that’s been taken by the insurers. ”

“ As a product of risk-based solvency, we have seen people being driven towards ‘safer’ assets such as sovereign triple-A rated bonds, which are at a 100-year high, when the golden rule of investment is to buy low. Furthermore, while bonds are seen as a very stable asset class, across cycles they are very volatile. The technical way in which solvency requirements are put together for banks and insurance companies, is having profoundly disturbing consequences, and is adding to the volatility of financial markets. ”

¹⁰ See, for example, EFAMA/KPMG, *Solvency II: Data Impacts on Asset Management*, June 2012.

Retail behaviour

In the aftermath of 2008 many retail clients in the UK and in Europe have sought a combination of diversification, yield and capital preservation. As we discuss in Chapter 3, this has seen significant UK retail flows into investment funds, and a particular interest in mixed asset, fixed income and absolute return vehicles. While UK retail investors are still attracted by opportunities in the equity (and particularly global equity) markets, the share of equity funds as a proportion of total funds under management is at a twenty-year low (see Chart 31 on p.48).

For the UK fund industry, this poses a double set of questions:

- Are the strong flows of recent years sustainable and irreversible, given evidence that record inflows in 2009-2010 appear to have been related to savings substitution effects as clients switched from poor-yield bank and building society returns?
- Is the move towards greater diversification of asset and fund types permanent and a sign of real change in client expectations, or a reflection of prevailing market conditions (or a combination of both)?

Absolute return vehicles are of course not just used by retail clients. This year we asked our members about the size of their absolute return funds (although to avoid double-counting, we excluded those run as hedge funds).¹¹ Over £46bn was managed through these vehicles among the 47% of respondents who run them, representing approximately 1.3% of our respondents' asset base. While there is evidence that their usage has increased in both the retail (see Chapter 3) and the DC pensions environment, such strategies remain a very small part of total assets under management.

Regulatory and political pressures

As we outline in Chapter 6, the industry is facing an arguably unprecedented period of regulatory change, caused both by measures aimed specifically at the industry itself and, indirectly, by measures targeted at other parts of the financial services industry. These regulatory changes may eventually have a significant impact on the functioning of the industry as well as on the competitive landscape.

Regulatory change is in some ways inseparable from the political climate, in which distrust of the financial services industry in general has become a prevalent theme internationally. While it is the banking industry, more than the asset management sector, that has borne the brunt of both criticism and scrutiny, asset managers are nonetheless also under pressure to justify a number of aspects of their activities, such as remuneration, voting behaviour, and charging structures.

¹¹ There is clearly a definitional overlap between 'hedge funds' and 'absolute return' funds. This partly reflects a wider overlap between the 'mainstream' asset management industry and the 'alternative' industry in terms of strategies deployed and vehicles used. For the purposes of the Survey, a hedge fund is defined as a vehicle marketed as a hedge fund, whereas absolute return is an investment objective that may be used in a variety of non-hedge fund products.

Among those we interviewed both last and this year, there is wide recognition of the need for the industry to ensure that it preserves and develops client trust. In the UK, this issue is particularly acute in the context of the impending automatic enrolment reforms, which will bring the industry into closer contact with consumers that could be termed ‘accidental investors’: long-term savers who may not have actively chosen to invest in asset management products but who find themselves saving into a pension as a result of Government policy initiatives (see p.41-43).

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Trust and confidence

“ We do overcomplicate things and we do tend to use jargon. If we’re really to expand into the pensions market, we need to keep it to simple, very clear-cut messages, which do exist, but so far we’re not very good at. ”

“ As an industry, we’ve been focused for too long on the inputs and jumping on the bandwagon regardless of whether you actually have the capability to run such a product over the long term. So, it’s no surprise that you get sub-optimal outcomes that can result in a lack of trust. The industry needs to work more closely together to help people satisfy their saving needs. ”

Complex operating environment

The combined impact of changing client needs, difficult market conditions, intense regulatory activity and political pressure make for a complicated operating environment, which we outline in Figure 4.

Figure 4: Complex industry operating environment

ECONOMIC AND SOCIETAL BACKGROUND

- Strained government and household balance sheets in many developed economies
- Macro-economic outlook at best mixed in US and Europe
- Changing population dependency ratios generating sustainability issues for welfare provision, particularly in pensions arena.

FINANCIAL MARKET CONDITIONS

- Secular equity bear market
- Constrained bank lending activity
- Historically low interest rates
- “Risk-on/Risk-off” behaviour in asset class movements
- Intensifying stress in eurozone

REGULATORY ACTIVITY

- Fragmented global approach to regulation with increasing degree of extra-territoriality
- UK asset managers facing 30-40 EU legislative initiatives with relevance to industry
- Supervision process also changing within UK and across EU
- Significant proposed changes to structure and regulation of banking industry
- Major distribution reforms due to start in UK

POLITICAL CLIMATE

- Signs of distrust of financial services among elites and wider population
- Expectation that players within financial system need to behave differently in future
- Frequent lack of differentiation between business models, incentives and alignments
- Pressure on financial services to justify role in system, remuneration structures and charges

2. UK Institutional Market

Key Findings

Market size

- Total assets managed by IMA members on behalf of UK institutional clients were estimated at £2.4trn.
- Of this £2.4trn, third party mandates managed on behalf of UK institutional clients amounted to £1.5trn. The remainder was accounted for by in-house insurance (£756bn) and in-house occupational pension assets (£119bn).
- The wider UK institutional market (including non-IMA members) is estimated at £2.6trn of which pension assets account for £1.9trn.

Third party mandates

- Pension funds (71%) and insurance companies (9.3%) continue to represent the largest UK institutional client type, followed by sub-advisory business (6.1%).
- Excluding LDI, some 88% of UK third party institutional client mandates reported by IMA members are single-asset or specialist, while multi-asset or balanced mandates accounted for just 12%.
- The wider third party LDI market is estimated at £320bn.

- Within specialist mandates, 44% are equity followed by fixed income (37%). The third largest category is 'other' (9.0%), which includes alternatives and structured solutions.
- Global equity is the largest category within specialist equity mandates, accounting for 35% of the total. It is closely followed by UK equities (31%).
- Within fixed income, £ Sterling Corporate bond mandates (37%) are followed by UK index-linked (20%) and global bond mandates (20%).

Outlook for the UK institutional market

- Challenging market conditions coupled with regulatory pressures continue to raise questions over the long-term future of equity investment particularly among UK pension funds.
- Upcoming pension reforms are highlighting a desire among the industry for a stable policy environment. At the same time, the shift to DC requires considerable consumer support to ensure positive member outcomes. The design of default strategies will be critical.

2. UK Institutional Market

Market Overview

Last year we started collecting data specifically on the UK institutional client market, which focuses on mandates managed worldwide on behalf of UK clients. Methodologically, we make here a clear distinction between ‘assets’ and ‘mandates’, asking respondents not to break out their UK client mandates into underlying holdings, but rather to report to us their size according to the nature of the mandate. All references to the proportion of mandates are made according to their value, and not according to the number of mandates.

Compared with £2.2trn in 2010, estimated UK institutional client mandates stood at £2.4trn as at the end of 2011, with the wider institutional market (including non-IMA members) estimated at £2.6trn. We believe our first estimate last year was too low. Matched samples indicate that there was little year-on-year change. A more complete set of returns this year suggests the total is higher, but there is still further refinement needed, particularly in the insurance market estimates.

The largest ten survey respondents account for 70% of total institutional assets in our respondent base (including in-house institutional assets). To the extent to which the Survey is less representative of the boutique end of the industry (notably hedge funds and private equity), it somewhat over-states the concentration in asset terms. Nonetheless, taken as a proportion of the estimated total institutional assets, the top ten still represent 61%.

At the same time, smaller and medium-size firms typically seen as retail also report UK institutional clients. This reflects one aspect of the blurring between the institutional and retail space that we have been reporting over the lifetime of the Survey. Although attention has focused particularly on two areas (the impact of platforms and the broadening of investment strategies within authorised funds), there is also a third: the willingness by some institutional clients to use high-performing managers whose reputation was built within the retail market.

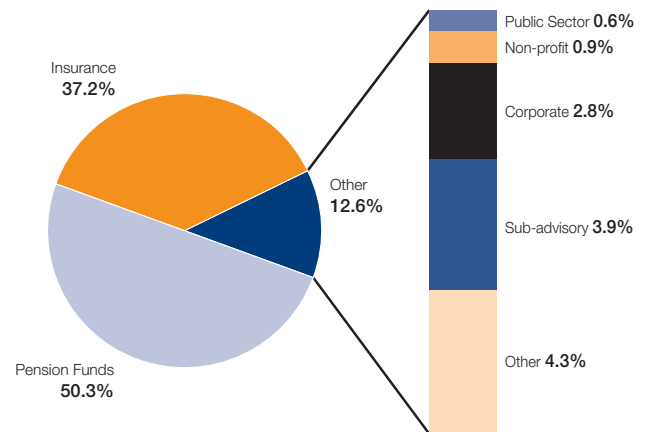
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On-going retail / institutional convergence

“ It’s the institutional side moving closer to the retail rather than the retail changing significantly. We’re seeing much more of a blurring of the boundaries between institutional and retail. A far greater number of institutions and pension funds are looking at retail funds whereas they wouldn’t look at them ten years ago. ”

Chart 14 shows the breakdown of UK institutional clients (irrespective of management location). Most of the assets (94%) are managed in the UK, with the remaining proportion split relatively evenly between Europe (excluding the UK) and other overseas locations.

Chart 14: UK institutional market by client type



Pensions

Pension funds are the largest UK institutional client category, accounting for half of the total and equivalent to an estimated £1.2trn for IMA members:

- Of these, the greatest proportion by far (42%) is accounted for by corporate pension funds (an estimated £1.0trn in mandates, of which in-house occupational pension assets amount of £119bn).
- A smaller proportion (5.8%) is represented by Local Government Pension Schemes (LGPS), which translates to an estimated £142bn.
- The remaining 2.2% (£52bn in estimated client mandates) includes other types of pension fund clients, typically trade unions or various not-for-profit organisations.

The pension assets included in this category are managed for both DB and DC schemes. These are primarily assets for trust-based DB and DC. Due to the complex nature of the DC and personal pension distribution structure, we are unable to break out DC and personal pension assets under management by IMA members.

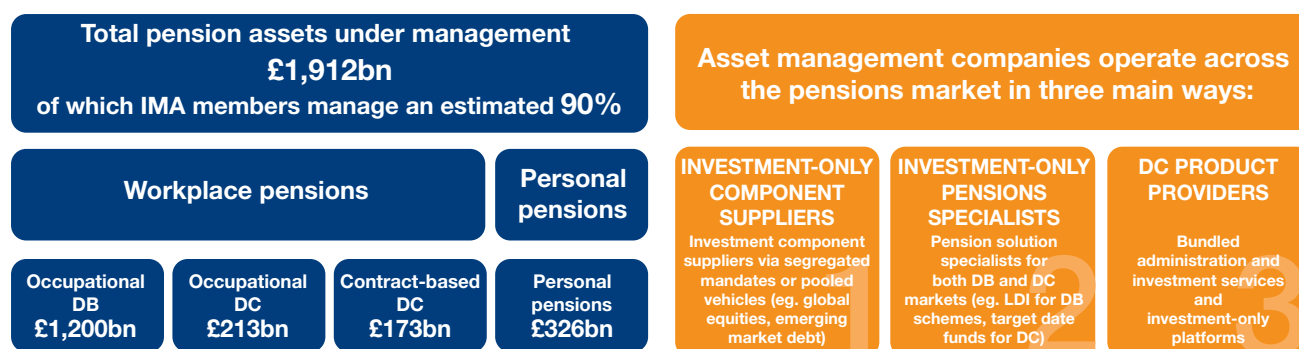
Based on third party sources we break down the UK pension market as follows (see Figure 5):

- As at the end of 2011, total UK pension fund assets stood at £1.9trn, with IMA members managing 90% of that total.¹²
- The overall DB/DC split is 64%/36% (with the latter including personal pensions).¹³
- The workplace DB/DC split is still heavily weighted towards DB, which accounts for 78% of total workplace pension assets under management.

Insurance

The second largest UK institutional category continues to be insurance, with 37% of UK client mandates (equating to around £900bn). Of these, in-house insurance represents the vast majority (31% or £756bn), the remaining 6% being accounted for by third party insurance mandates.

Figure 5: UK pensions landscape¹⁴



¹² In the Survey, these assets are split between our pensions and insurance reporting channels, with the remaining assets managed outside the membership base (eg. hedge funds, private equity investment).

¹³ DC data sourced from Spence Johnson and ONS. DB data based on PPF and DCLG.

¹⁴ These estimates are for UK client assets, not the location of asset management. They are based on estimates from a number of sources. On the DB side: DCLG, ONS and PPF. On the DC side: Spence Johnson.

Further client categories

Beyond pensions and insurance, there is a cluster of other, smaller UK institutional client types:

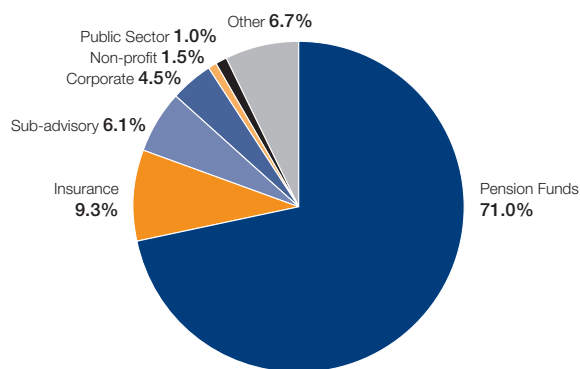
- Sub-advisory mandates amount to 3.9%.
- Corporate (non-pension) clients represent 2.8% of the total UK institutional client market.
- Non-profit and public sector client mandates account for 0.9% and 0.6%, respectively.

The 'other institutional' client category has 4.3%. It mostly consists of investment trusts, institutional pooled vehicles, alternative clients such as private equity, venture capital or property funds as well as various multi-manager and fund-of-funds clients. This figure is much reduced from last year due to improved granularity in respondent returns.

Third Party Institutional Market

Similar to last year, we provide a picture of the third party UK institutional client market, excluding in-house occupational pension scheme and in-house insurance mandates. The estimated total of £1.5trn offers a very different picture than the overall breakdown of the UK institutional market.

Chart 15: Third party UK institutional market by client type



As shown in Chart 15, taking this perspective highlights the relative dominance of third party pension fund mandates (71% of UK client mandates), while third party insurance with an estimated £144bn only represents 9.3%. This is a similar proportion relative to other client types, such as sub-advisory (6.1%), corporate (4.5%) and 'other institutional' (6.7%).¹⁵

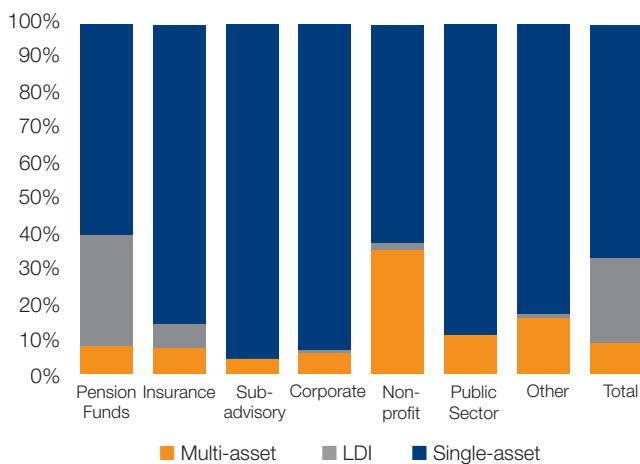
¹⁵ Third party insurance includes both unit-linked business (ie. funds manufactured by firms and distributed with their brand through a life platform) and other third party assets.

Mandate breakdown

This year we split out UK LDI mandates from the specialist (single-asset) and balanced (multi-asset) mandate categories. Chart 16 illustrates the breakdown between these three categories. Specialist mandates continue to dominate at aggregate level, representing a total of 67% of UK institutional client mandates. Excluding LDI mandates (ie. just taking specialist and balanced mandates), the specialist category accounts for 88% of the total.

Survey interviews over the last few years suggest that the 'limits of specialisation' are being reached within the industry. There are a number of reasons for this. For many firms with broad capability sets, it reflects both recognition of the complex nature of the challenges facing institutional clients, and a desire to deploy asset management capabilities more explicitly in areas such as asset allocation.

Chart 16: Third party UK institutional client mandates



Survey data confirms this shift away from component manufacture specialisation primarily through the sharp increase in LDI mandates:

- These are predominantly used by pension funds (primarily corporate pension funds), where they represent 32% of institutional third party assets.
- Adjusting for sample composition and non-respondents, the wider third party market is estimated at £320bn. This is a 28% increase on last year's estimate of £250bn.
- The pension fund LDI market remains very concentrated, with three respondents accounting for 95% of total assets subject to LDI mandates.

In the context of the current challenges facing the banking industry and regulatory reforms affecting both banks and market structure (notably clearing), some of those we interviewed expressed concerns about their continued ability to deliver these mandates in the most efficient way. With respect to centralised clearing in particular, there have been specific concerns expressed by LDI providers in the context of the European Market Infrastructure Regulation (EMIR) directive (see also p.127-128).

industryview

LDI delivery challenges

Broad liquidity challenges

“Liquidity will be more difficult and will impact how we manage positions. And risk management will have to be re-evaluated, especially in fixed income. Combined with the increasing cost of long-dated swap positions, this means that solutions for pension funds may be narrower in scope and less efficient for clients.”

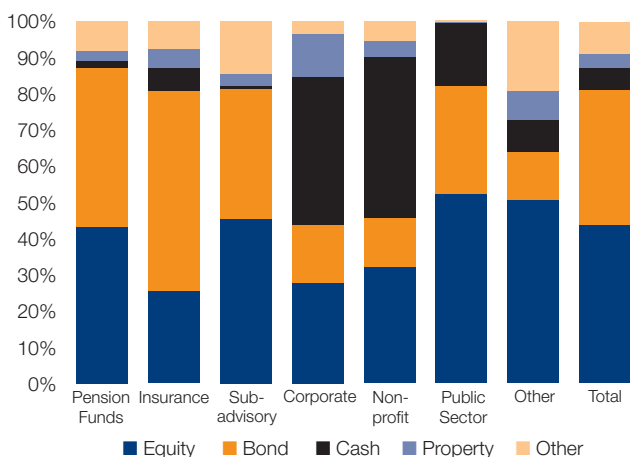
Potential impact of central clearing

“I am concerned about the unintended consequences of central clearing, for example, and about the regulators potentially squeezing out risk-reducing activities such as LDI hedging by not recognising the different characteristics of different participants. There is a possibility that, in making derivative markets more expensive to trade in, you may damage liquidity there, which may then have knock-on consequences on liquidity in the cash markets.”

Specialist mandates

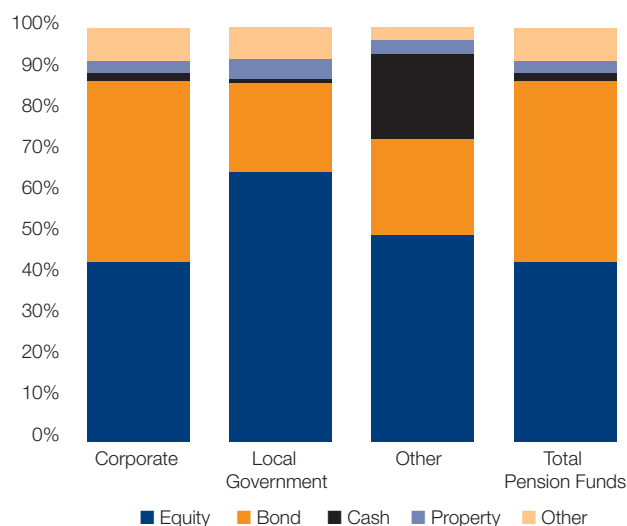
Chart 17 shows the breakdown of specialist mandates, with specialist equities as the largest category (44%), but with significant fixed income mandates (37%). These are seen especially in the pension fund and third party insurance client categories. The third largest category is 'other' (9.0%), which mostly consists of alternatives and structured solutions.

Chart 17: Specialist mandates by asset class



As in previous years, there are some interesting variations within the pension fund category (see Chart 18). These show the extent to which de-risking has gone much further in the corporate pension fund environment than in LGPS, with fixed income mandates a larger component than equities. This is likely to reflect different funding and regulatory/accounting pressures between the corporate and LGPS environments.

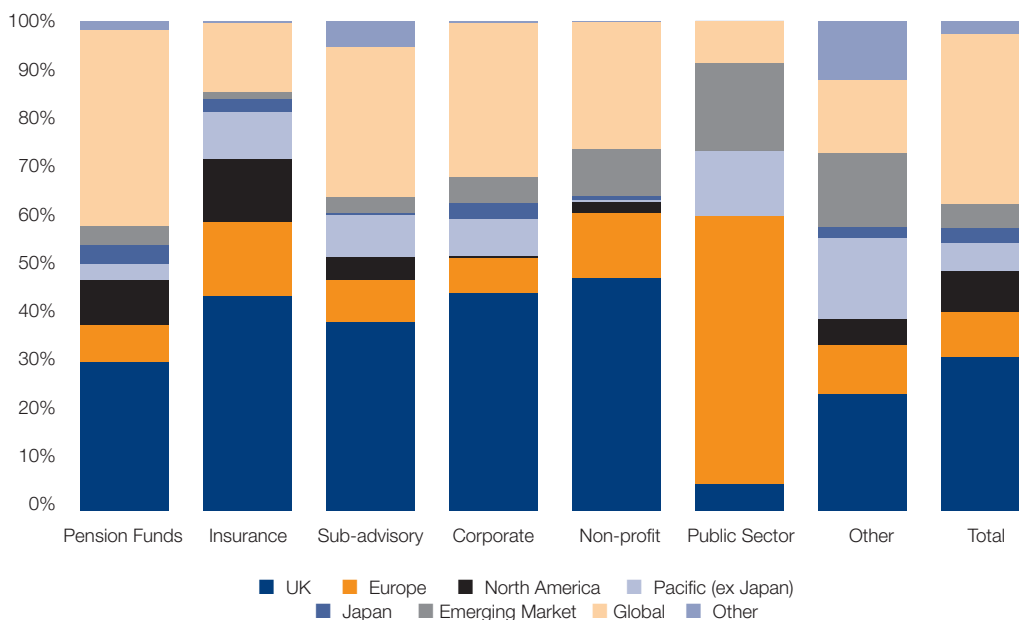
Chart 18: UK pension fund specialist mandates by asset class



In previous years we have commented that a number of firms and their clients have been uncomfortable with a benchmark-centric approach, which has often been associated with the specialisation of the UK institutional market. In that respect, there have been attempts to develop more 'unconstrained' approaches that allowed managers greater freedom in portfolio construction. We asked respondents about the extent to which unconstrained equity mandates were in use in the UK institutional market:

- These mandates were held by nearly a quarter of respondents, accounting for just under half (46%) of their total specialist equity mandates in asset terms.
- As a proportion of total specialist equity mandates across the industry, this represents an estimated 17% in asset terms.

Chart 19: Specialist equity mandates by client type



Geographic allocation

Results of the geographical allocation of UK third party institutional client mandates illustrate the extent to which specialist regional and global mandates are displacing domestic equity exposure. As shown in Chart 19, global equity mandates represent the largest specialist equity mandate type (35%), followed by UK equity mandates (31%). This is further illustrated in the historic pension fund asset allocation data (see p.37).

Looking at pension funds more specifically (see Chart 20), the heavy focus on global equity mandates can be seen in all categories.

Chart 20: UK pension fund specialist equity mandates

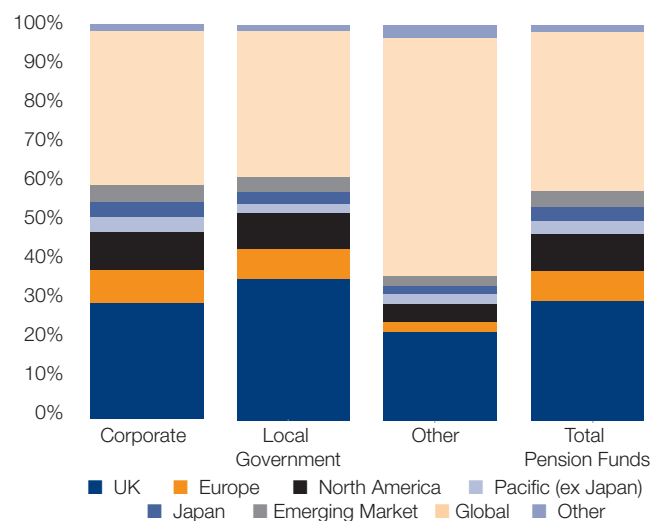


Chart 21: Fixed income specialist mandates by client type

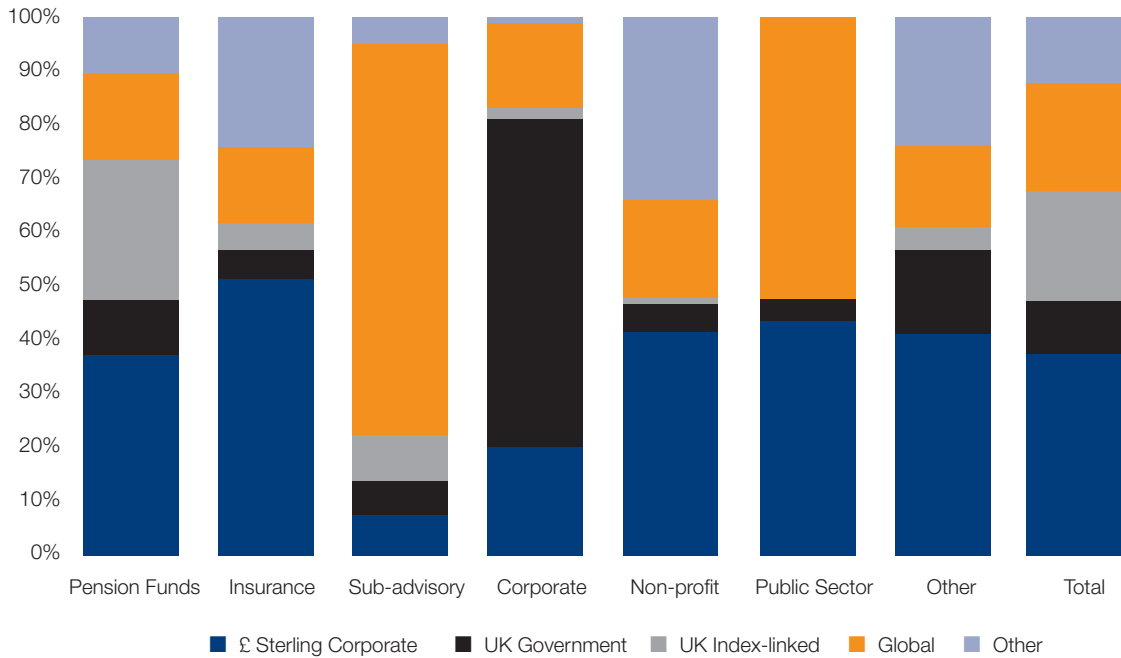
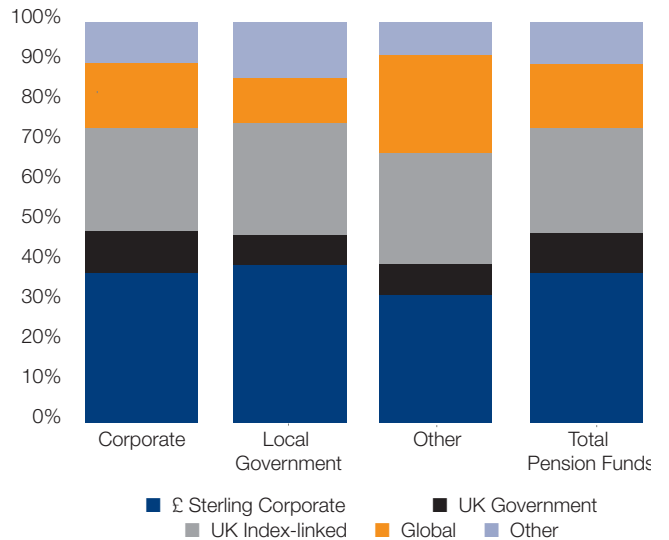


Chart 21 shows specialist fixed income mandates of UK third party institutional clients.¹⁶ The largest category by far is £ Sterling Corporate, which represents 37% of the UK third party fixed income allocation. This is followed by UK index-linked gilts with 20%, with the greatest exposure – unsurprisingly – among pension funds (26%). The third largest category among specialist fixed income mandates is global fixed income, accounting for almost 20%. Chart 22 shows responses from pension funds in more detail.

If in-house insurance mandates were included in the breakdown, £ Sterling Corporate mandates would be far more prominent with the total increasing to 46%.

Chart 22: UK pension fund fixed income specialist mandates



¹⁶ This category has been changed this year to align more explicitly with mandate and fund benchmarks. The £ Sterling Corporate category replaces the UK Corporate category.

Natural Buyers of Equities?

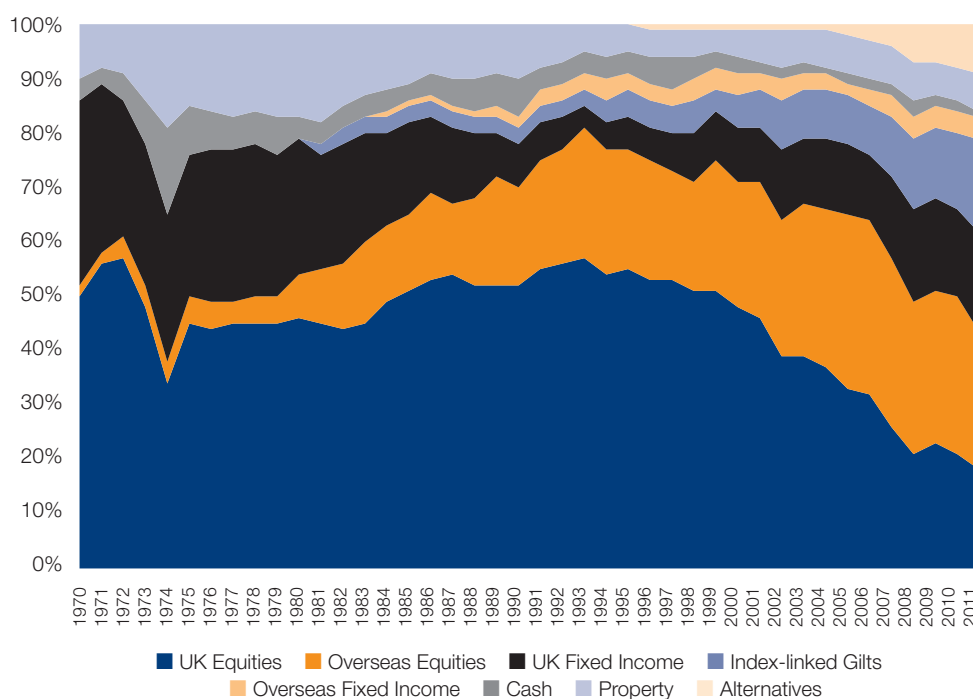
The behaviour of pension funds and insurance companies over the last two decades has led to an observation in some quarters that there are no longer obvious natural buyers of equities. This observation has been given further impetus by the on-going challenges faced by DB pension schemes and the potential impact of changing capital requirements for insurance companies.

When analysing UK pension fund behaviour, two features are apparent:

- The equity exposure that reached levels as high as 80% by the early 1990s has fallen dramatically (see Chart 23). However, this only really unwinds the overall asset allocation back to the position in the 1960s and 1970s when fixed income and property exposures were more significant.
- Perhaps just as striking is the stark decline in the position of UK equities within pension fund portfolios. From 50% of total exposure in 1970, UK equity holdings ended the 1990s at similar levels. Over the last decade though, this has more than halved to a fifth of total portfolios. While overall equity exposure still remains significant on average, three-fifths of that exposure are accounted for by overseas equities.

2

Chart 23: Overall UK pension fund asset allocation (1970–2011)

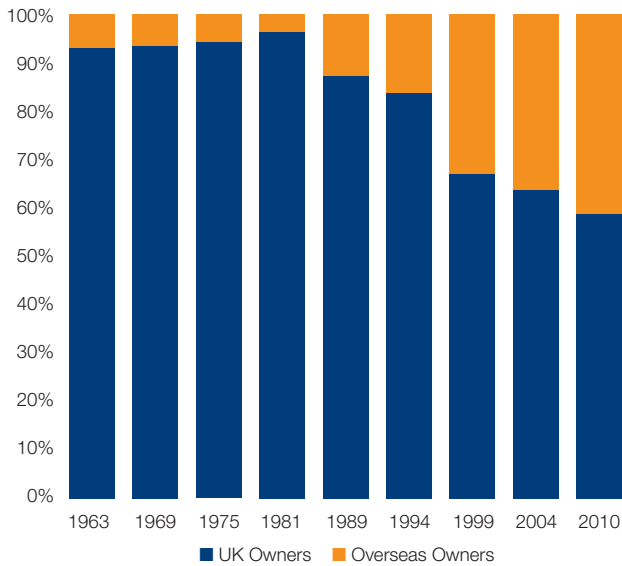


Source: UBS Pension Fund Indicators (2012)

As has been widely reported, this is part of an international trend that has seen the erosion of ‘home bias’ as investors have sought both to diversify and access a global opportunity set, particularly in the context of the strong growth in emerging markets. This trend can partly be seen in the data from the Office for National Statistics (ONS) tracking overseas holdings in the UK equity market (see Chart 24).

The majority of those we spoke to took the view that pension fund movements out of equities would continue and that equity holdings would decline as a consequence. Similar expectations characterised insurance company balance sheets, although DC business (ie. unit-linked individual accounts) is likely still to see significant equity holdings over the savings lifecycle.

Chart 24: Overseas ownership of UK equities (1963–2010)



Source: ONS

There was a range of views about whether this on-going re-allocation was a desirable consequence:

- Some believe that the allocation shifts represent a sensible evolution that still leaves institutions with room for risk assets. Others are concerned that some of the regulatory pressure (notably Solvency II for insurers and the threat of Solvency II-like European regulation for pension funds) is profoundly pro-cyclical and could eventually lead to significant difficulties. There is also concern about where the future source of risk capital will come from for initial public offerings (IPOs) and other forms of company capital-raising.
- Whether recent shifts are seen as positive or negative, there is some degree of consensus about a shift in ‘natural buyers’, away from pension funds and insurance companies towards institutional clients (eg. sovereign wealth funds or family offices) without the same degree of defined liability or associated regulatory pressure.
- A number of interviewees see significant consequences beyond the institutional market. Within the retail market, a range of pressures could negatively impact equity funds, particularly given recent market conditions. As we point out in Chapter Three, while equity funds under management remain at high levels in absolute terms, the share of equity funds within the investment funds universe remains at a 20-year low.

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Changing attitudes to equities, but a range of views

Acceptance in some quarters...

“Traditional buyers aren't going to disappear completely. They have a legitimate risk budget they can deploy and equities will no doubt be part of that. But the fact that they have taken too much risk before shouldn't be a reason for us to object to a reduction of their risk exposure at this point.”

Regret and concern in others...

“The long-term buyers of equity like insurers or pension funds are diminishing due to Solvency II. The threat of applying insurance Solvency II-type regulation to pension funds will no doubt create a further distortion. The main beneficiaries of this distortion will be very wealthy clients and family offices who really have the opportunity of a lifetime to buy illiquid assets and equities at incredibly low prices.”

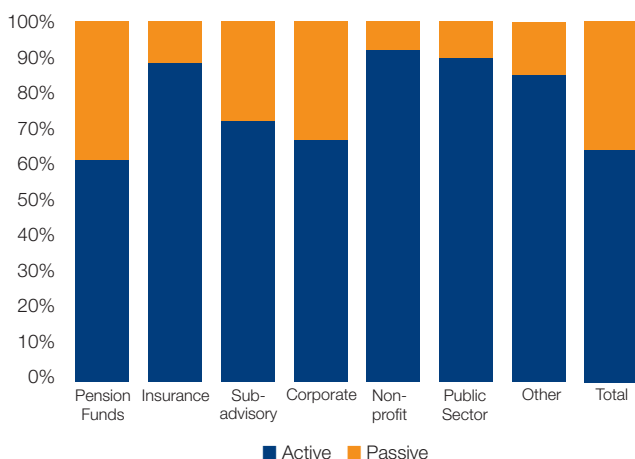
“A Solvency II-type approach would kill DB pension plans. Every piece of regulation since the 1980s has made providing pensions here more expensive through the DB vehicle. Meeting Solvency II would cost pension schemes an insane amount of money.”

“I think people are finally giving up on thinking that insurance companies and pension funds are going to buy equities. And it's a shame because, historically, the life companies and pension funds were huge sources of long-term risk capital and I think that's coming to an end. I don't know who's going to supply it.”

Active vs Passive

As shown in the breakdown by institutional client type in Chart 25, 64% of third party institutional client mandates were managed on an active basis. Active management is particularly widespread among non-profit and public sector clients, amounting to 92% and 90% of their overall institutional client mandates, respectively. In contrast, passive management is most widely used in UK pension mandates, accounting for 42% overall, of which the largest proportion are corporate pension funds (including DB and DC) with 45%.

Chart 25: Active and passive mandates by institutional client type



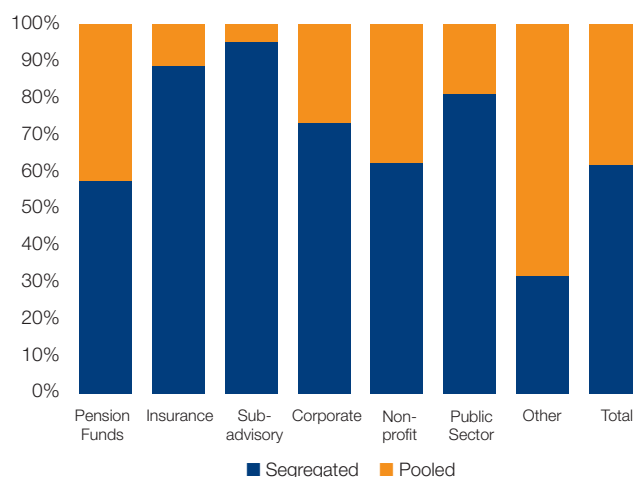
Given the presence of large indexing houses in the respondent sample, these headline data almost certainly overstate passive exposure in the wider market. Looking at total passive mandates captured within the Survey as a proportion of the total estimated corporate pension fund market, passive represents a third of total assets.

If we looked at both the in-house and third party institutional client market, the total for actively managed mandates would increase to 76%, mostly due to the widespread use of active management among in-house insurance clients (95% of insurance assets are managed on an active basis).

Segregated vs Pooled

Chart 26 shows the split between segregated and pooled mandates by client type. While the third party institutional market has 62% in segregated mandates as opposed to 38% in pooled, there are significant differences among client type. The largest proportion of segregated mandates can be found among sub-advisory and third party insurance mandates, accounting for 95% and 89%, respectively. Pension funds, on the other hand, are amongst those client types with sizeable pooled mandates; 42% overall. This is in turn likely to reflect the greater use of indexing vehicles.

Chart 26: Segregated and pooled mandates by institutional client type



A Year of Pension Reform

One of the biggest changes in the UK pension market in several decades comes in 2012 as the Government introduces reforms automatically to enrol millions of employees not currently covered by employer schemes. A statutory minimum contribution of 8% of gross qualifying earnings will apply for eligible workers once the reform is implemented in full.¹⁷

Given the decline in DB provision over the past decade, the majority of those being automatically enrolled in a staged process over the next five years will become members of DC schemes. For those employers who do not wish to use an existing private sector provider, or nominate one to deliver a scheme, the Government has created a quasi-state universal service provider, the National Employment Savings Trust (NEST).

For the asset and fund management industry business, the DC market is quite diverse:

- The majority of asset managers will remain providers of segregated or pooled investment services to a variety of schemes and platforms. A number of large institutional firms are contracted to NEST in that capacity.
- A small group are currently offering more tailored investment-only services (eg. target date funds or specific DC accumulation strategies).
- A minority offer DC investment platforms and/or bundled DC (ie. both administration and investment).

From a strategic perspective, one of the key battles for market share will take place at the level of the default strategies operated within schemes. With experience internationally suggesting that the majority of scheme participants will not make an active decision with respect to asset allocation, the design of the default strategy is recognised to be critical. Some strategies will be built within a single pooled vehicle; others will use multiple funds to gain relevant exposures. As we have reported in recent years, asset managers in the UK are showing increasing interest in helping to deliver more focused DC products for their clients.

At the same time, asset managers increasingly recognise that the decumulation market will require new approaches. This is likely to see a combination of annuity and investment drawdown products as the 'at retirement' market matures.

We asked those we interviewed for their views both on the appropriate role for Government in pension policy and specifically on automatic enrolment. All those we spoke to were broadly supportive of automatic enrolment, but a number of messages emerged addressed both to Government and to the industry itself.

¹⁷ This will consist of 3% from the employer and 5% from the employee (including tax relief).

DC can deliver, but support for individual savers is needed

The majority view within the industry is that, with the right policy support and delivery architecture, DC will deliver. In that regard, several respondents were concerned about the tendency to idolise DB provision, while criticising the perceived deficiencies of DC.

At the same time, there is a clear recognition that individuals will need significant support and cannot simply be left with the responsibility of making difficult investment choices. This will entail governance responsibilities for all those who are involved in the delivery of schemes, including asset managers. One response to this has been the development of the Investment Governance Group (IGG) DC principles.¹⁸

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Challenges of DC

“Most individuals are never going to be, despite all efforts to educate them, truly capable of making proper decisions about their retirement saving – how to save, what to invest in, and the impact of factors like longevity etc. on wealth creation. You shouldn’t leave too many things up to the individual.”

“In the US, DC has overtaken DB, yet there’s still a perception in some quarters that DC is bad – and that needs to be challenged. Indeed, research in the US shows that these perceptions are not universally shared, certainly not by the younger generation; they want to save and they want to be told to save. Guided architecture and products such as target date funds are essential in making this process work, although they are not without risk.”

Stability is essential for building confidence

While it is clear that reforms such as automatic enrolment are sometimes necessary to shift the underlying parameters of behaviour, asset managers are concerned to ensure that the pension and long-term savings environment is not characterised by continual tinkering. This is particularly true of tax incentives. Although broader pension policy is inevitably about distribution, and in that respect inevitably political, the desire to ensure that pensions are not subject to policy changes within short political cycles is evident among respondents.

Respondents also believe that providing a stable policy environment will make it easier to develop consistent Government messaging, particularly to help ensure that people save adequately for retirement. This is felt to be especially true given the poor understanding of the levels of saving required to deliver a decent pension in retirement.

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Stable frameworks and political consensus

“The most important thing is not to meddle; get the system up and running, create a stable framework and then leave it alone rather than have everybody coming up with the next best mousetrap every year.”

“What should the Government’s role be in improving pension outcomes? It should get the politics out of it and deal with pensions as a national issue.”

¹⁸ For more information see <http://www.thepensionsregulator.gov.uk/about-us/principles-igg-dc.aspx>.

Good outcomes require the right policy framework

For those firms seeking to develop products better tailored for DC savers, there is also a need to ensure that they can deliver the investment processes that they believe are in the best interests of end-consumers.

In this respect, those we interviewed expressed a range of concerns about actual and potential constraints. These included:

- The danger of prescriptive legislation and/or regulation with respect to the design of DC schemes.
- Regulatory views on the nature of investment risk which might militate in favour of asset classes perceived as 'safe', to the detriment of diversification and satisfactory long-term returns.
- A focus on charges that did not take into account different product characteristics.

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Building the right policy framework

“From a regulatory perspective, there is a danger that the regulators become so risk-averse that you’ll see investors in turn becoming risk-averse. Where you have an ageing population and you have a funding need in order to deliver long-term returns, you need good diversification and exposure to risk assets.”

“The Government needs to appreciate the fact that this is not just about cost. It comes back to the ability to accumulate a portfolio of assets that is diversified and able to deliver a return across investment cycles. And if you push low charging enough and you constrain the ability to invest, you’ll force people to buy beta, which is inexpensive but incredibly volatile, which means that its ability to deliver returns is unpredictable.”

Investment communication must evolve

Several respondents emphasised the importance of communication and the need for the industry to improve communication with DC clients. A significant challenge in this respect is the highly intermediated nature of asset management, both in the retail and institutional market, which has put increased distance between parts of the industry and the end client base.

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Communication and client distance

“We still remain very distant from our end-clients and we’re not in control of our information flow to the end-client. That, for any supplier, creates vulnerability and a weakness in the system.”

3. UK Fund Market

Key Findings

Total funds under management

- Total investment funds (including both UK authorised and overseas funds) managed in the UK are estimated at £1.3trn.
- UK authorised funds totalled £575bn as at December 2011, 2.0% lower than the previous year.
- Equity funds accounted for the largest proportion of assets under management at 53%, with fixed income funds at 18% and mixed asset funds at 14%. Property funds represented 2.2% of total funds under management.

Sales trends

- Total (ie. retail and institutional) net sales of UK authorised funds showed an inflow of £23bn compared to £51bn in 2010.
- Evidence from wider savings flows suggests that the record retail sales of 2009-2010 were influenced by factors specific to the financial crisis that began in 2007-08, and that may now have run their course.
- The inflows in 2011 were driven primarily by retail investors who contributed £18bn of new money, compared to £29bn in 2010. The remaining £5.3bn came from institutional investors.
- In a year of difficult markets, retail investors were attracted to the diversification opportunities offered by mixed asset funds¹⁹ and committed £5.6bn of new money to these funds in 2011.
- Fixed income funds were popular for the third consecutive year and saw £4.5bn of new retail investment.

UK industry concentration and structure

- The fund industry remains very unconcentrated compared to other parts of the financial services industry. However, fund sales are becoming slightly more concentrated, with the top 100 funds taking 51% of total gross sales in 2011 compared with 48% in 2005.
- While the top ten firms' share of the fund market is steady, the share of the next ten firms is increasing at the expense of the smallest firms.

European comparisons

- European investment fund assets stood at €7.9trn (£6.6trn) at the end of 2011, a fall from €8.2trn (£6.8trn) a year earlier.
- The UK continues to have a much higher equity allocation (60% of UCITS funds) compared to the European average (29%). Money market funds have a larger profile in Europe (19%) whereas in the UK they have a minimal uptake (0.8%).

¹⁹ Mixed asset funds are those in the Active Managed, Cautious Managed, Balanced Managed and UK Equity and Bond Income sectors. The first three of these were renamed in January 2012 to Flexible Investment, Mixed Investment 20-60% Shares and Mixed Investment 40-85% Shares. There were also some slight definitional changes made. UK Equity and Bond Income retained its name.

Retail Distribution Review

- There was broad agreement with the principles of RDR, but concern about the current lack of clarity.
- Preparation for implementation was made more challenging through continuing uncertainty about the operational implications for fund managers, including platform charging and the treatment of 'legacy business'.
- While transparency is seen as a benefit, questions remain over its potential to increase complexity, particularly in light of the anticipated reduced availability of advice.
- Possible implications for product development include greater interest in in-built advice and solution products.

Consumer protection and mis-selling

- Responsibility for investment outcomes was perceived as a difficult area given the high degree of intermediation. Firms had different opinions on their ability to monitor the sales process, with some undertaking significant distribution monitoring.
- There were significant frustrations within the industry over the current structure of the Financial Services Compensation Scheme (FSCS).
- While more effective enforcement of conduct-of-business rules is seen as desirable, respondents also emphasize the importance of cultural change.

3. UK Fund Market

This part of the Survey covers UK authorised unit trusts and OEICs. These funds are thought of primarily as retail vehicles, although institutional investors such as pension funds and insurance companies may also invest in them for a variety of reasons; for example, to access certain manager skills or to reflect investor preferences within unit-linked life products that offer access to third party funds.

The analysis in this section is based mainly on IMA fund data, which are both more detailed and have a longer history than the Survey (which started in 2002). Most importantly, they capture funds under management and flow data on a monthly basis. The IMA collected data on 2,421 funds throughout 2011. Some 18% are institutional vehicles.²⁰

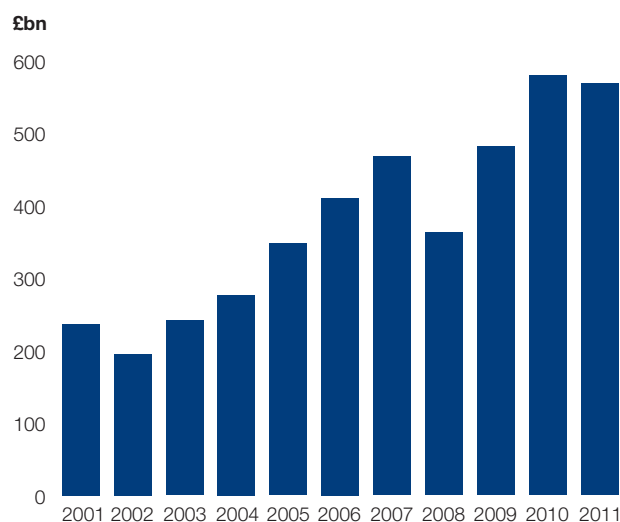
From June 2011, the IMA has been including sales of funds of funds in the regular monthly statistics publications and the same approach is taken for this survey. However, estimates of sales of funds to funds of funds have been excluded since these are internal to the fund industry.

Total Funds under Management

Total funds under management at the end of December 2011 were £575bn, down by 2.0% from £587bn a year earlier. Including overseas-domiciled funds managed in the UK (£765bn), total investment funds managed in this country were £1.3trn.

As Chart 27 shows, the industry has grown in nominal asset terms by 40% over the last five years and by 143% since the end of 2001. During the past decade, despite the economic dislocation of the ‘Dot-com’ crash and the credit crisis, the compound annual growth rate was 9.3% in nominal terms and 6.6% in real terms.²¹ This compares to a compound rate for the FTSE All-Share of 4.8% in nominal terms, including re-invested income.

Chart 27: Industry funds under management (2001–2011)



²⁰ Within the IMA funds database, 441 funds fulfil the criteria of being purely institutional (ie. with a minimum lump sum investment of £50,000). These have a total of £122bn under management.

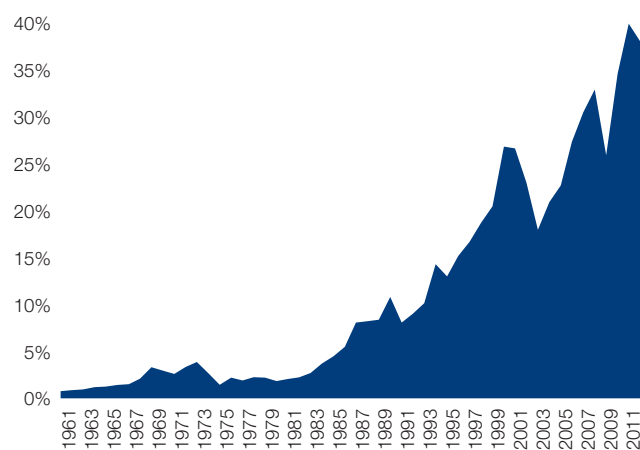
²¹ A GDP deflator has been used to calculate the inflation impact.

Looking back over a longer historical period, the annualised growth rate from 1960 to 2011 is 17% in nominal and 11% in real terms. Such expansion rates are clearly greater than those for the UK GDP, with fund industry growth rates particularly strong in the 1980s. At the end of 1960, funds under management equated to less than 1.0% of GDP (see Chart 28). By the end of 2011, the figure was almost 38%.

The growth of the fund management industry over this period reflects a number of factors:

- While unit trusts have been in existence since the 1930s, it was only in the late 1950s and into the 1960s that the industry started to develop more rapidly.
- Industry growth rates through the 1980s and 1990s benefited from buoyant equity markets and strong demand for equity funds.
- Growth rates over the last decade have been sustained by both retail and many institutional investors choosing to invest in pooled funds rather than holding securities directly.

Chart 28: Funds under management as percentage of GDP (1960–2011)



Flows vs performance

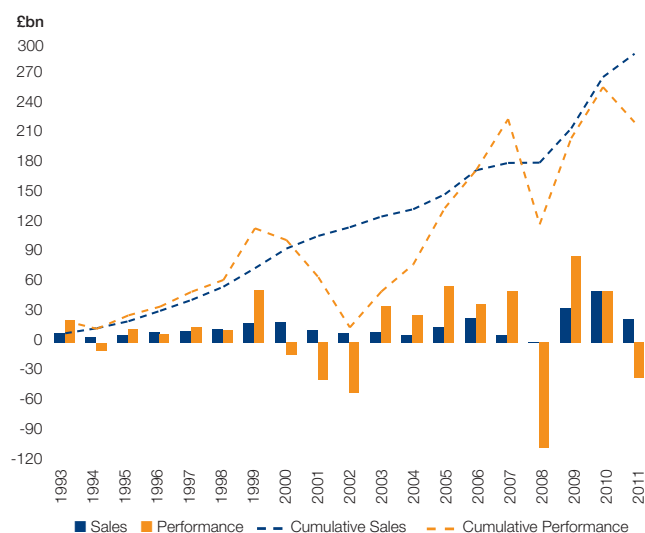
Total (ie. retail and institutional) net investment into the UK fund industry was £23bn during 2011, significantly lower than the record flows of £51bn seen in 2010:

- The main proportion of total net sales for 2011 came from retail investors who invested a net £18bn.
- At only £5.3bn net institutional investment was much lower than in 2010. The main driver of the record figures seen in 2010 (£22bn) was the restructuring of insurance products into OEICs, something that did not happen to the same extent in 2011.

As we outline in Chapter One, a combination of shocks and uncertainties made 2011 a difficult year for the global economy. The 2.0% contraction in UK authorised funds under management was due primarily to poor market conditions. Market movements accounted for a reduction of £35bn in funds under management, offsetting the net inflows of £23bn.

Chart 29 shows the changes in funds under management since 1993, broken down into net flows and performance of the underlying assets. Looking year-on-year, asset performance is the main driver of annual fluctuations in funds under management. Long-term, net inflows are more important and have accounted for over half of the increase in funds under management since 1993.

Chart 29: Changes in funds under management by sales vs performance (1993–2011)

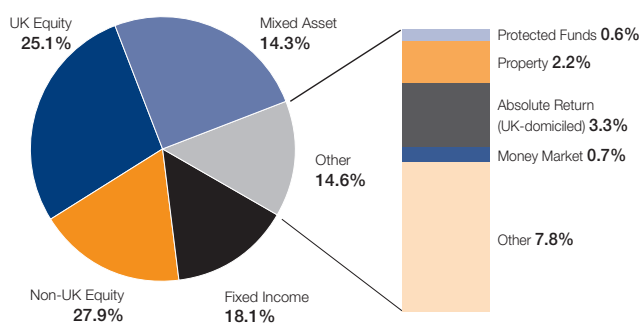


Asset mix

The overall asset mix of UK funds as at the end of December 2011 is shown in Chart 30:

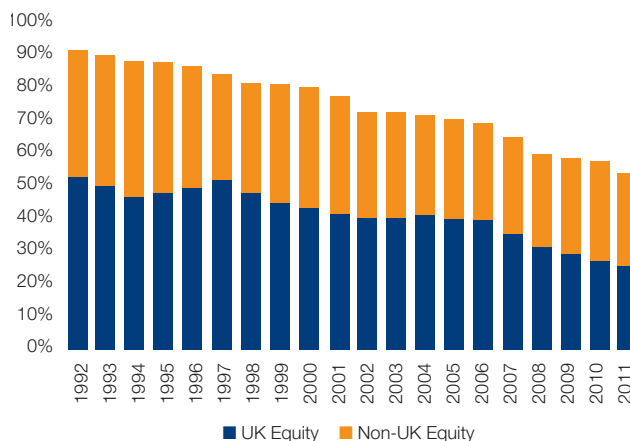
- Equities continued to account for the largest proportion of funds under management at 53% (£333bn), down from 57% at the end of 2010.
- Funds under management of fixed income funds increased to 18%, up from 17% at the end of 2010.
- Mixed asset funds made up just over 14% of total funds under management, in line with their market share at the end of 2010.
- The market share of property funds increased slightly year-on-year to 2.2% (from 2.1%), but was still down from 3.0% at its peak in 2006.
- UK authorised absolute return funds continued to increase in significance, up from 2.6% in 2010 to 3.3% of total funds under management.
- Retail money market funds (as distinct from the very large institutional money market fund business managed out of the UK, see p.19) continued to account for a tiny proportion of funds under management at 0.7%.

Chart 30: Funds under management by fund/asset type



Taking a longer-term view, Chart 31 shows how the share of total funds under management represented by equity funds has diminished significantly over the last 20 years, with the erosion of ‘home bias’ seen in the institutional market mirrored here in the comparative shares of UK and non-UK equity funds. However, equity funds still account for more than one-half of all funds under management. It is also important to emphasise that these are relative and not absolute changes. The fund market in 1992 totalled only £63bn in assets, compared to £575 at the end of 2011.

Chart 31: Proportion of industry funds under management represented by equities (1992–2011)



Reflecting this, UK equity funds accounted for an estimated 5% of domestic market capitalisation in 1992; this has risen steadily to around 8% in recent years. Including other sectors which have some UK equity exposure, total equity holdings of investments are likely to be closer to 10% of market capitalisation, at a time when UK institutional ownership as a proportion of total ownership has been falling.

Retail Investor Flows

Retail investors made a net investment of £18bn into funds in 2011. It was very much a year of two halves, with £13.6bn of inflows during the first half of the year and only £4.5bn thereafter. Chart 32 shows net retail flows by asset category throughout 2011 and shows a clear drop from July. It also illustrates a diminishing appetite for risk among investors, as flows into equities turn negative.

Taking the year as a whole, net inflows were significantly lower than the levels seen in 2009 and 2010 (£30bn and £29bn, respectively). This appears to bring to an end the period of very high net retail sales seen throughout 2009 and 2010 (see Chart 33). From January 2009 to June 2011, average monthly net retail sales were over £2.4bn; a stark contrast to the monthly average of £0.8bn in the seven years prior to this. However, the 2011 net retail sales figure is still higher than all but one of the years between 2002 and 2008.

Chart 33: Net retail sales (2002–2011)

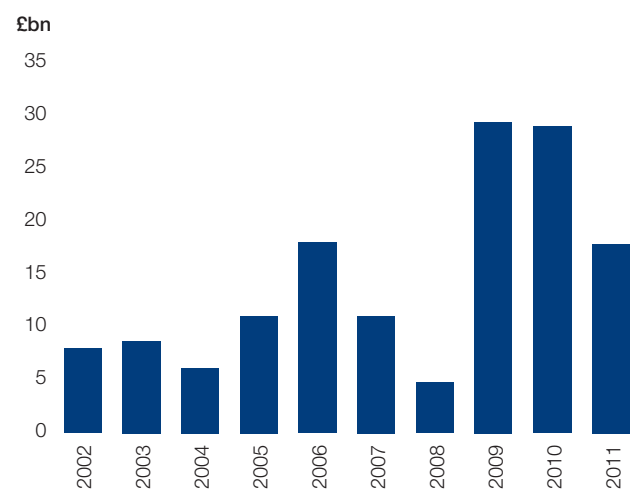


Chart 32: Monthly net retail sales by asset category (2011)

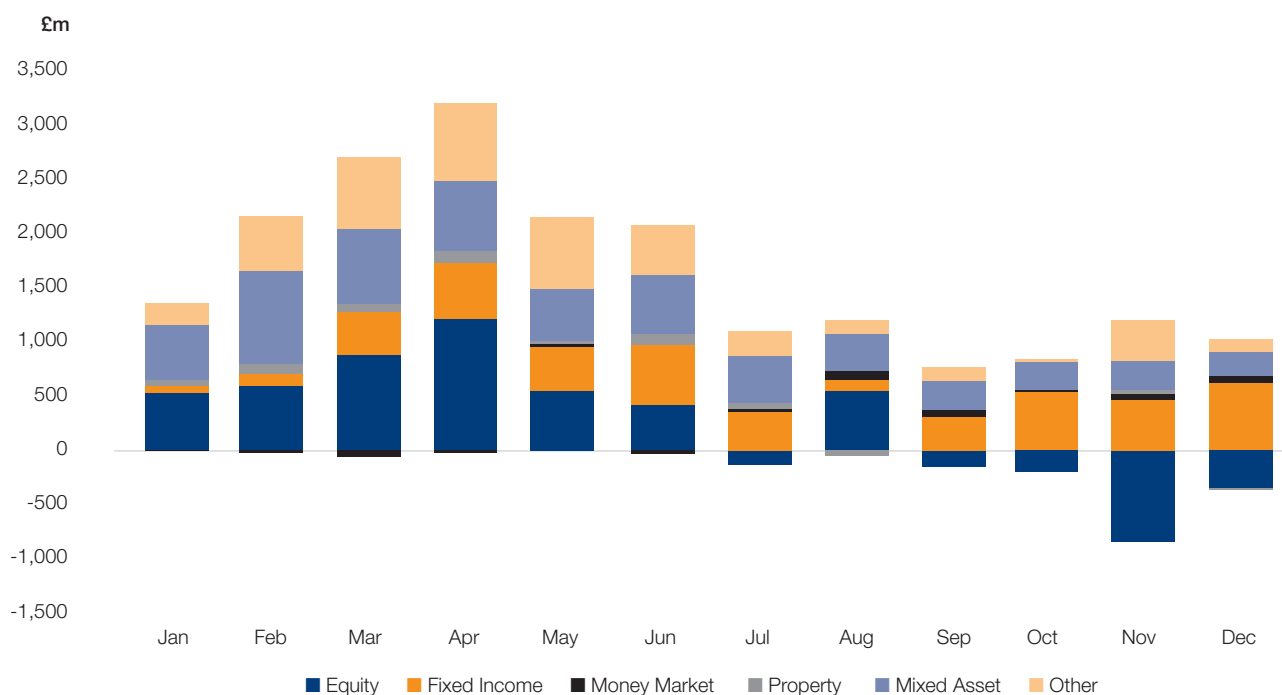
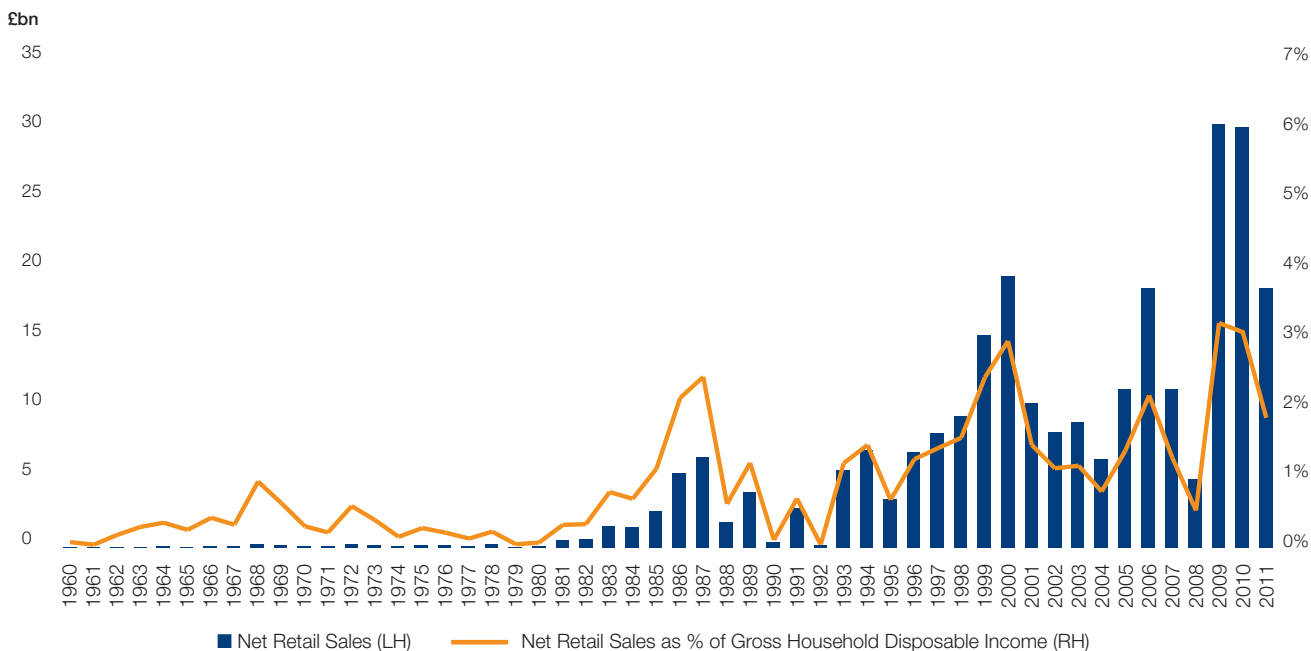


Chart 34: Net retail sales vs sales as percentage of gross household disposable income (1960–2011)

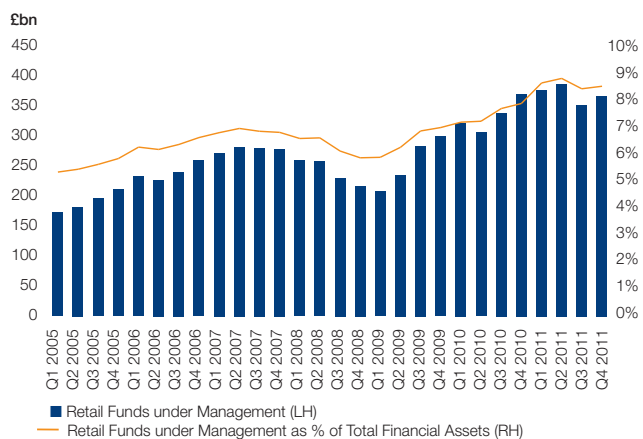


Source: IMA, ONS

The same pattern can be seen in net retail sales as a proportion of household income (see Chart 34). Net investments into funds by households fell from 3.0% of gross household disposable income in 2010 to 1.8% in 2011, still higher than most years during the 2000s.

As Chart 35 shows, the popularity of funds among retail investors over the last three years has taken retail funds under management to a much higher level as a proportion of household gross financial assets, representing 8.6% at the close of 2011. This was slightly down on the mid-year figure as a result of difficult market conditions in the second half of 2011, but still up from 8.0% at the end of 2010. The most recent figure is actually higher than at the end of 2007, before the full onset of the financial crisis, when retail funds under management were 6.9% of household financial assets.

Chart 35: Quarterly retail funds under management vs total financial assets (2005–2011)

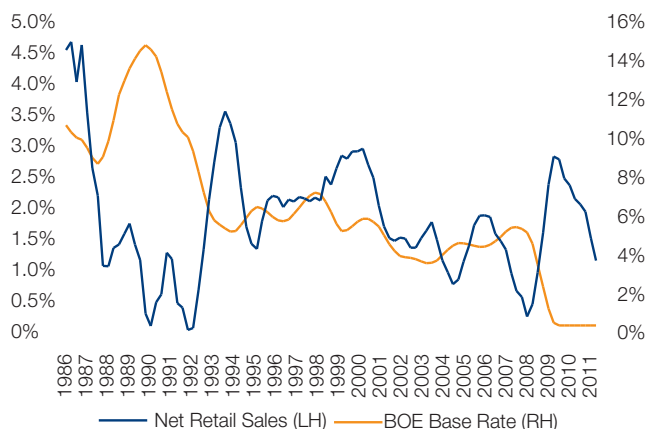


Source: IMA, ONS

Determinants of flows

As we showed in last year’s report, it is very difficult to reach firm conclusions about what determines savings behaviour from data that aggregates the decisions of a wide variety of investors. Nonetheless, one can offer some observations about broad drivers.

Chart 36: Quarterly net retail sales as percentage of retail funds under management vs Bank of England base rate (Q4 1986–2011)



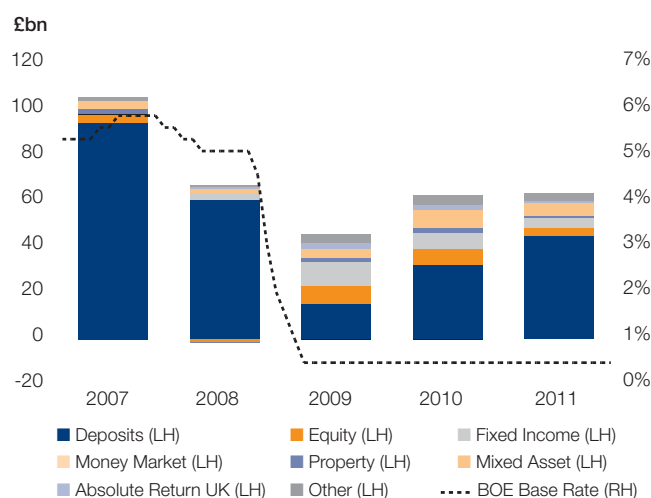
Source: IMA, ONS

Notably, as Chart 36 shows, interest rates appear to bear a historical relationship to fund flows. During the recession of the early 1990s in particular, fund flows fell sharply as interest rates rose. There are a number of possible reasons for this; for example, constrained discretionary saving as mortgage repayments rose, product substitution from high-yielding savings accounts and/or the need for precautionary saving held in liquid vehicles.

With interest rates falling through 2008 to reach 0.5% in March 2009, where they have remained ever since, there is again evidence of an inverse relationship between interest rates and fund flows at a time of economic stress. This time, however, it is in the opposite direction to that seen in the 1990s.

Taking a closer look at the recent period, Chart 37 shows net retail sales of UK authorised funds along with net household deposits into bank and building society accounts. It also shows the movement of the base rate over the same period.

Chart 37: Net acquisition of currency and deposits by UK households and net retail sales of UK authorised funds vs Bank of England base rate (2007–2011)



Source: IMA, ONS

Looking at banks and building societies in isolation, there is a stark contrast between net flows before and after 2008, with which the falling base rate appears to be directly correlated.²² With returns on deposits substantially lower after 2008, it would not be surprising if retail investors looked elsewhere for capital growth and income opportunities, and fund flow data for 2009 and 2010 supports this hypothesis. It appears that monies that would have been deposited in banks and building societies up until 2007 have been directed, in part, towards the fund industry. Post-2008, a lack of trust in the banking sector may have also been a factor.

With the base rate stationary throughout 2011, one might expect continuing high net retail sales, similar to those seen in 2009 and 2010. This was not the case, however; from July 2011 there has been a marked reduction in flows.

Detailed information on individual investor behaviour is unavailable and there are a number of possible complementary explanations as to what has been happening:

- If it is correct that significant product substitution occurred in 2009 and 2010 as savers and investors sought yield, it would be likely that at some point the availability of assets to reallocate would erode.
- Another factor may have been investor anxiety about the eurozone leading to reduced equity investment. As already mentioned, in the second half of 2011, net retail sales of equity funds were negative following substantial inflows in 2009, 2010 and the first half of 2011.

Investor asset class choices will be discussed in detail later in this chapter but Chart 37 shows the evolution of overall behaviour over the last five years. In particular, there have been strong flows into mixed asset funds and fixed income funds. While the extent of the post-2008 market dislocation made such behaviour unsurprising, it is also consistent with investors moving from deposits to products perceived as providing yield and/or limited risk.

Asset class choices

Table 1 shows net retail sales broken down by fund type, and highlights a number of key features:

- Mixed asset funds were the highest-selling fund type in 2011, with many investors using funds of funds to access them.
- Funds under management of funds of funds were at an all-time high following another year of strong net retail sales, representing almost one-third of the total.
- Waning appetite for risk made equities only the third highest-selling asset category. For the second consecutive year, global equity funds made up the largest proportion of total equity funds under management. It is only the second time this has occurred since 1992, and it reaffirms a global bias in terms of investor preferences.
- Index-tracking funds continued to be popular; in 2011, their highest-selling year on record, they made up 8.1% of gross retail sales of equity funds.

Table 1: Net retail sales by fund type (2009–2011)

Fund type	Net retail sales (£bn)		
	2009	2010	2011
Mixed asset funds	3.8	7.8	5.6
Fixed income funds	10.0	6.8	4.5
<i>of which trackers</i>	0.1	0.5	0.5
Equity funds	7.9	6.9	3.2
<i>of which trackers</i>	0.3	1.3	1.4
Absolute return funds (UK-domiciled)	2.6	2.3	0.9
Property funds	1.8	1.8	0.5
Money market funds	0	-0.1	0.2
Other funds	3.8	3.9	3.3
TOTAL	29.8	29.4	18.1
<i>of which funds of funds</i>	3.9	6.5	5.2

²² Drawing conclusions from the net deposit data is complicated for a number of reasons not least due to also reflecting re-invested interest. However, even after this has been taken into account, one can still see a substantial reduction in net deposits.

Mixed asset funds

Mixed asset funds were the best-selling asset type in 2011 and their increasing popularity has become more pronounced in recent years (see Chart 38).

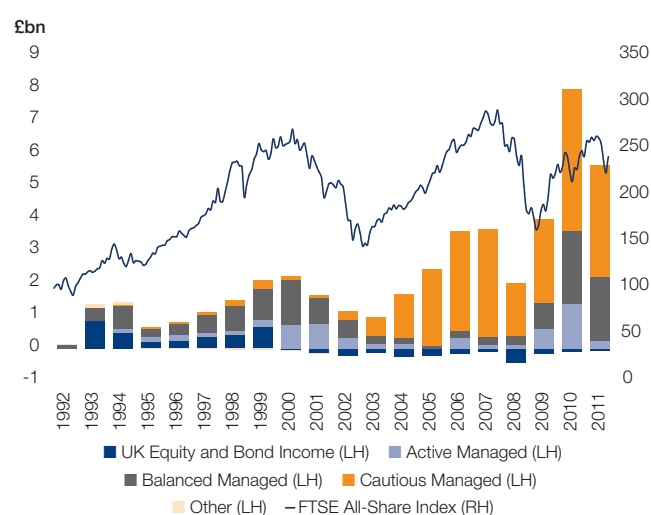
Since 2003, there has been a steady increase in net retail sales, with 2010 seeing a record inflow of £7.8bn.

Chart 38 shows that, since 2003, retail investors in mixed asset funds have favoured the Cautious Managed sector, replacing the previously most popular Balanced Managed sector. Indeed, Cautious Managed has been the best-selling sector across all IMA sectors in five of the seven years since 2005.²³

Whilst sales of mixed asset funds fell in 2011 compared with 2010 (see Table 2), they were still the second highest ever; £5.6bn net retail sales compared with £7.8bn in 2010. The Cautious Managed sector accounted for £4.3bn and £3.4bn in 2010 and 2011, respectively. Funds in the Cautious Managed sector had a cap (up to 60%) on the level of equities that could be held at a given time.

The Balanced Managed sector also had a strong showing in 2011 with net retail sales of £2.0bn. This is comparable with 2010 despite lower overall mixed asset sales.

Chart 38: Net retail sales of mixed asset funds vs FTSE All-Share index (1992–2011)



Source: IMA, Lipper IM (calculated on a capital return basis, rebased to 100)

Table 2: Net retail sales and funds under management of mixed asset funds by sector (2010–2011)

Sector	Net retail sales (£m)		Funds under management (£m)
	2010	2011	2011
Cautious Managed	4,320	3,420	34,036
Balanced Managed	2,253	1,971	39,057
Active Managed	1,363	238	13,385
UK Equity & Bond Income	-107	-58	3,335
TOTAL	7,829	5,571	89,913

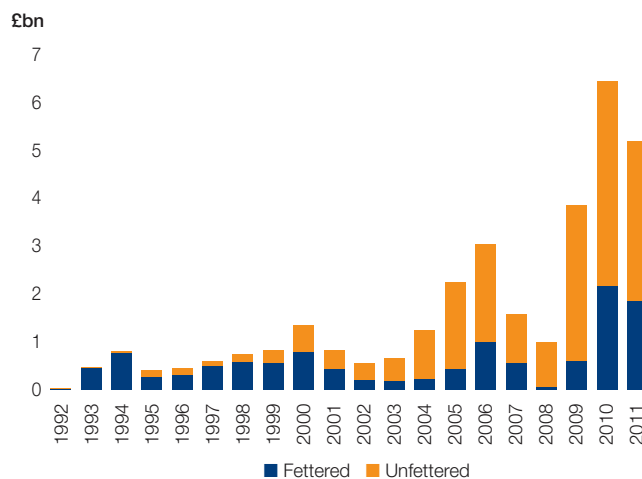
²³ The names of the managed sectors were changed from 1st January 2012 (see footnote 19 on pg 44).

Funds of funds made up a large proportion of mixed asset funds; 39% at the end of 2011.

- Despite a difficult year in the markets, funds under management of funds of funds were at an all-time high of £60bn at the end of 2011, a 6.4% increase from the end of 2010. This compares with a fall in overall industry funds under management.
- Funds of funds represented 10% of the total funds under management at the end of 2011.
- Net retail investment into funds of funds continued to be strong and totalled £5.2bn in 2011 compared to £6.5bn in 2010.

Mixed asset funds accounted for 58% of the total funds under management among funds of funds.

Chart 39: Net retail sales of fettered and unfettered funds of funds (1992–2011)



As Chart 39 shows, unfettered funds of funds (ie. those investing in external, rather than internal funds) took the majority of net retail investment in 2011, continuing the pattern over recent years. The data reflects the gradual shift to open architecture and ‘best-in-breed’ manager selection practices.

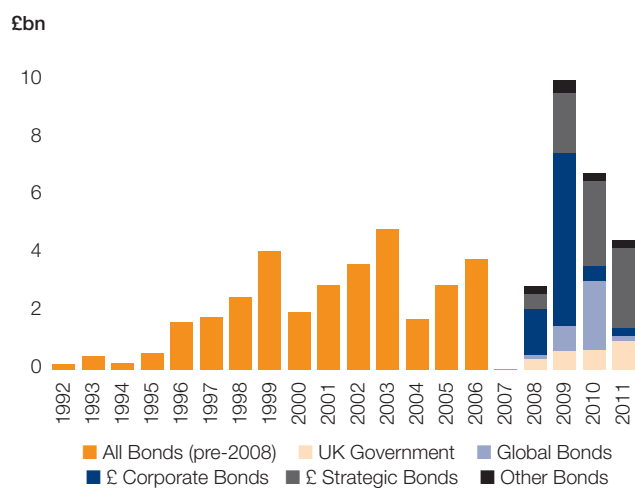
Unfettered funds have taken in 72% of net retail investment over the past decade. Indeed, the proportion of funds under management held within unfettered funds was 51% at the end of 2011, a significant increase from 10 years earlier when the figure was 36%.

Fixed income funds

Fixed income funds sold well throughout 2011, with particularly strong flows in the second half of the year, as investors moved away from equities. Persistently low interest rates encouraged fund inflows as the search for yield continued. Net retail sales totalled £4.5bn compared to £6.8bn in 2010.

Chart 40 shows net retail sales of fixed income funds since 1992. From 2008, sales are presented by sector to show how investor preferences have developed over recent years.

Chart 40: Net retail sales of fixed income funds (1992–2011)



Historically, the majority of net retail investment into fixed income funds has been focused on corporate bond funds. Indeed, in 2009 the £ Corporate Bond sector had its record year with an inflow of £6.0bn. The two years that followed were a stark contrast to this, with net retail flows of only £504m in 2010 and £267m in 2011.

More recently, investors have been attracted to a more flexible approach in the form of the £ Strategic Bond sector launched in 2008. The funds in this sector may hold a range of different bonds, with no limit on levels of exposure. In terms of net retail sales in 2011, £ Strategic Bond was the second highest-selling sector overall with a total of £2.8bn.

Funds that invest in gilts have shown a steady increase since 2008, and sold particularly well in 2011 with net retail flows of £997m (2010: £685m).

Global bonds had a disappointing year, with a net retail investment of only £168m (2010: £2.4bn). Despite this, the increasing popularity of global bond funds has been evident since the credit crisis of 2008. This goes hand in hand with the global bias seen in other asset categories over the same period.

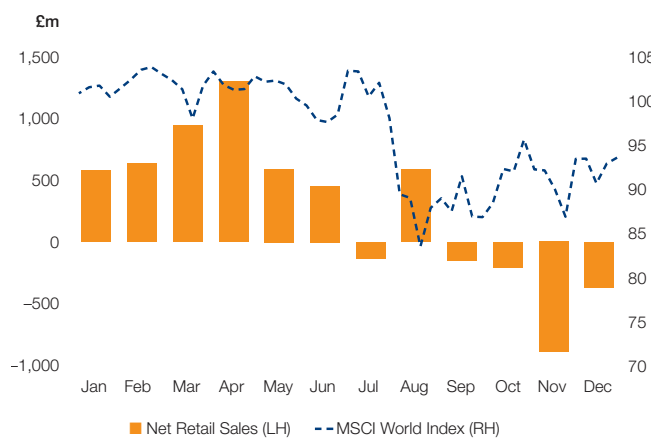
Weakening equity fund sales

In the context of volatile markets, net retail sales of equity funds were significantly lower in 2011 than in the previous years, with a total of £3.2bn compared to £6.9bn in 2010. Flows were particularly weak in the second half of the year with five out of six months experiencing outflows.

Chart 41 shows monthly equity fund net retail sales over the course of the year along with the movement of the MSCI World index. This flight from riskier assets may go some way to explain the relatively strong flows into other asset categories; net retail sales into fixed income funds increased in the second half of 2011.

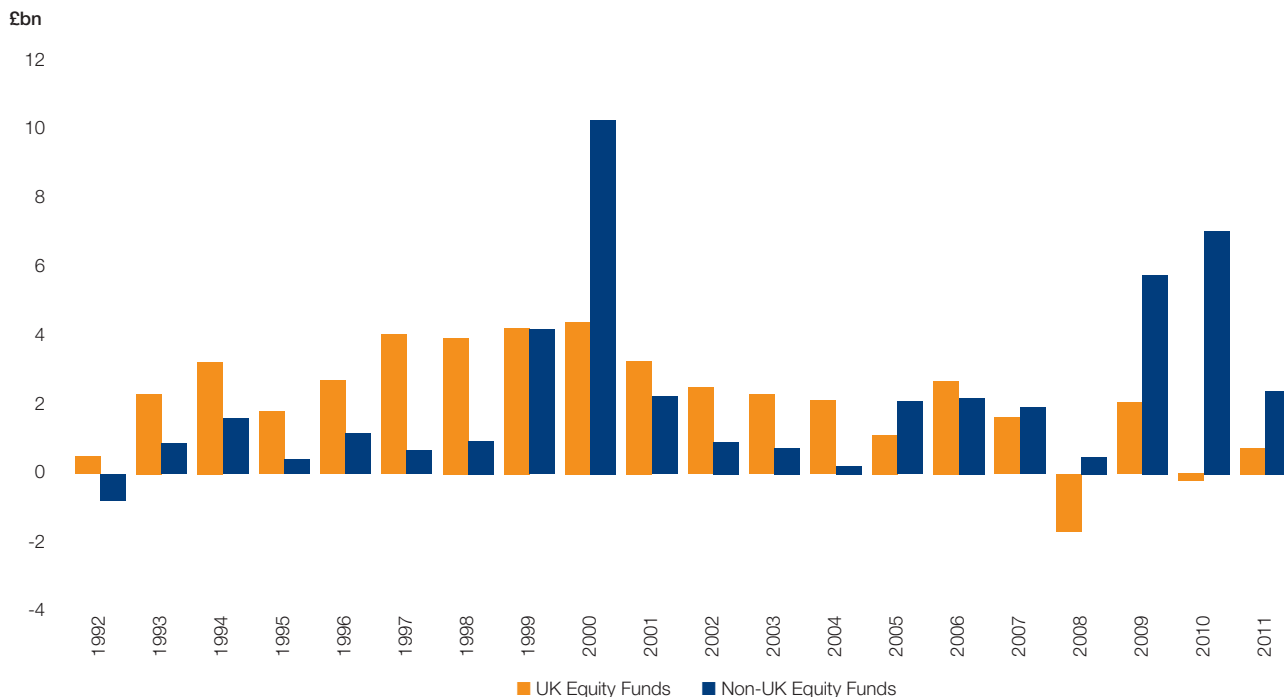
Within the lower overall equity fund sales seen in 2011, there was a continuation of the trend towards non-UK equity funds that was apparent in 2009 and 2010 (see Chart 42).

Chart 41: Monthly net retail sales of equity funds vs MSCI World index (2011)



Source: IMA, Lipper IM (calculated on a capital return basis, rebased to 100).

Chart 42: Net retail sales of UK and non-UK equity funds (1992–2011)



This global bias is further supported by considering equities at the sector level. Table 3 shows net retail sales for all equity sectors in 2010 and 2011.

Global Growth (renamed Global in 2012) was by far the best-selling equity sector with more than £2.2bn in new retail money over the course of the year. This was greater than in 2010 despite total equity fund net retail sales being down by £3.7bn; a real testament to investors' appetite for the sector. Global Emerging Markets, which was very popular in 2010, also had a strong showing in 2011 with net retail sales of £752m.

Three IMA equity sectors are purely UK-focused; UK All Companies, UK Smaller Companies and UK Equity Income. Together, these sectors saw a net inflow of £747m in 2011, more than reversing the outflow of £189m from the previous year.

There were some striking variations across UK equity sectors:

- In terms of funds under management, UK All Companies remains the largest IMA sector overall, representing 15% of the total at the end of 2011, including 3.9% in tracker funds. However, this sector saw a net retail outflow of £168m in 2011, with a divergence between active funds with an outflow of £642m, and passive funds with an inflow of £474m.
- In contrast, UK Equity Income, a sector that focuses primarily on dividend income as opposed to capital appreciation, saw good sales; £876m during 2011, up from £281m in the previous year. With dividend income relatively stable, UK equity income fund performance can be more resilient to market volatility. The popularity of the sector may also reflect yield-hunting in the context of low interest rates.
- The two worst-performing sectors in terms of net retail sales both focus on Europe. European Smaller Companies and Europe Excluding UK experienced net outflows of £319m and £676m, respectively. This may not be surprising given increasing concerns over the eurozone throughout 2011.

Table 3: Net retail sales and funds under management among equity sectors (2010 – 2011)

Sector	Net retail sales (£m)		Funds under management (£m)
	2010	2011	2011
Global	1,927	2,233	53,150
UK Equity Income	670 ²⁴	876	54,469
Global Emerging Markets	1,614	752	12,347
Japan	174	687	7,261
Specialist	1,755	293	21,171
North American Smaller Companies	112	47	1,111
UK Smaller Companies	81	39	6,560
Asia Pacific Including Japan	46	21	1,497
Technology and Telecommunications	94	1	676
Japanese Smaller Companies	8	-27	225
North America	749	-80	21,117
Europe Including UK	-11	-109	2,740
China/Greater China	0	-160	1,752
UK All Companies	-939	-168	96,833
Asia Pacific Excluding Japan	1,057	-252	23,350
European Smaller Companies	302	-319	2,411
Europe Excluding UK	-763	-676	26,824
TOTAL	6,876	3,158	333,494

²⁴ This figure includes £388m from the UK Equity Income and Growth sector in 2010, which was subsequently discontinued.

Index tracker funds

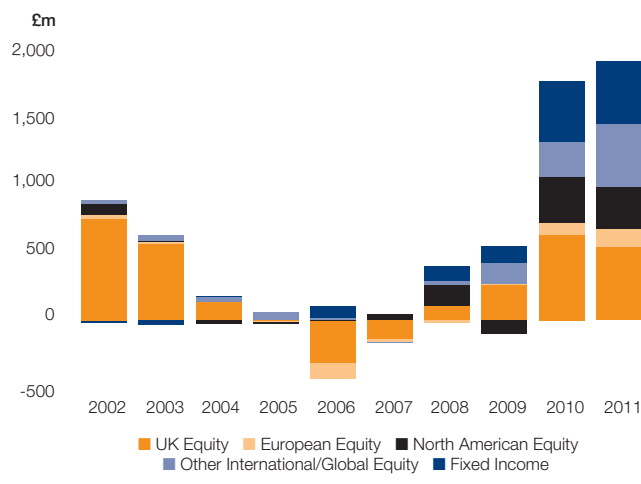
Trackers had a successful year in 2011 when they saw net retail sales of £1.9bn, the highest on record and up on the £1.8bn in 2010. This is the third year of strong net retail sales. In recent years a number of large index-tracking funds have lowered their total expense ratios (TERs) and this may have increased their appeal to investors looking for low-cost access to the market.

Ten years ago, most net investment into tracker funds went into funds that tracked UK equity indices. As can be seen from the analysis in Chart 43, last year these funds attracted less than one-third of the net flows.

The largest proportion of the flows continues to go into equity trackers (£1.5bn), though, at £469m, fixed income tracker sales have been robust for the second consecutive year. Global equity trackers also sold well during 2011; their sales were £467m compared to £259m in 2010.

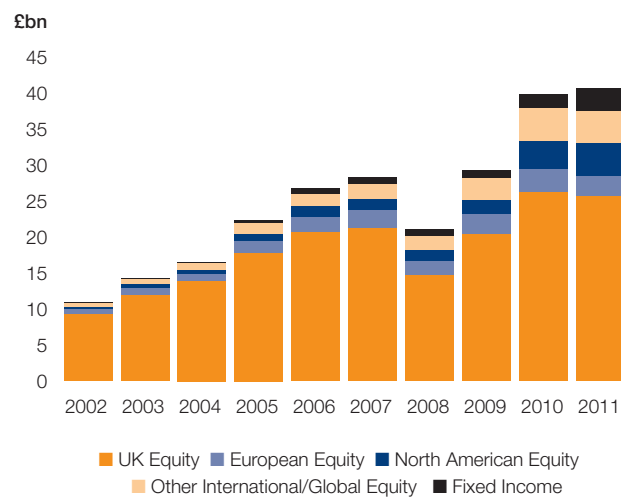
The popularity of tracker funds may be best demonstrated by the success of funds tracking European equity. These took in a net £136m at the same time as their actively managed counterparts saw substantial outflows totalling £995m.

Chart 43: Net retail sales of tracker funds by index investment type (2002–2011)



The strong sales of all types of tracker funds meant that, despite faltering equity markets across the world in the second half of the year, funds under management of trackers increased to £41bn, up by 2.1% on 2010. As Chart 44 indicates, trackers of fixed income indices did particularly well with their funds under management increasing significantly to £3.1bn (2010: £1.8bn). Overall, index-tracking funds represented 6.4% of total industry funds under management at the end of 2011.

Chart 44: Funds under management of tracker funds by index investment type (2002–2011)



Index exposure can also be obtained through ETFs. We do not collate data on ETFs, but data from other sources indicate that these products continued to be popular throughout 2011. By the end of the year funds under management in ETFs with a primary London listing reached £60bn, up from £43bn at the end of 2010.²⁵

²⁵ Source: Blackrock Investment Institute, Bloomberg.

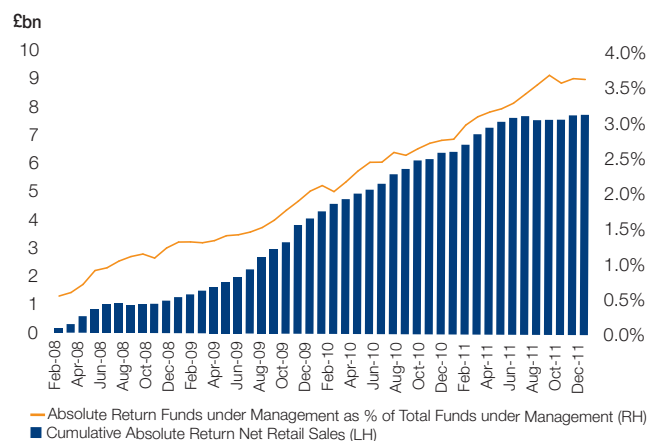
On-going move towards absolute return

Absolute return funds increased their share of industry funds under management in 2011, and by the end of the year represented 3.6% (2010: 2.7%). A designated IMA sector for absolute return funds was created in April 2008, and it includes both UK- and overseas-domiciled funds.

In line with the overall industry, net retail sales of absolute return funds were strong in the first half of the year and then tailed off thereafter (see Chart 45). Total net retail sales for the sector were £1.4bn, just over half the amount seen in 2010. Nevertheless, funds under management in the sector increased to £24bn. This represents a significant increase of 30% year-on-year on the back of strong institutional sales and good relative performance of absolute return funds compared with equity and mixed asset funds. A number of funds launched in 2011 were absolute return funds, indicating an on-going interest in the sector.

In the context of a low interest rate environment and concerns about volatility in the markets, investor demand for return-based or outcome-oriented products may continue. As we have noted for several years, a number of firms believe that there may be a permanent shift in retail investors' expectations, while others are more circumspect and believe that market conditions will ultimately determine patterns of demand.

Chart 45: Monthly net retail sales of absolute return funds vs absolute return funds under management as percentage of total funds under management (2008–2011)

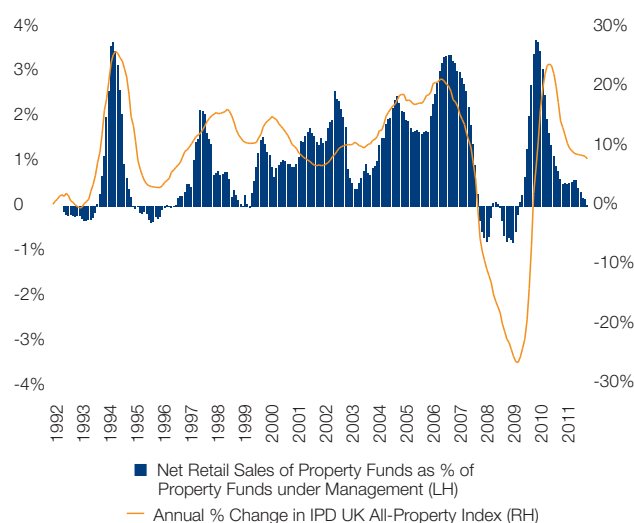


²⁶ Net retail sales of property funds are charted as a six-month moving average of net retail sales as a percentage of property funds under management over the period. The IPD UK All Property Index performance is charted as the year-on-year change of the IPD UK All Property Monthly TR Index.

Property funds

In terms of net retail sales, 2011 was not a good year for property funds. Monthly flows were waning towards the end of 2010 and this continued throughout 2011. Total inflows amounted to £523m compared to £1.8bn in 2010.

Chart 46: Net retail sales of property funds vs IPD UK All-Property index (1992–2011)²⁶



Source: IMA, Lipper IM

As Chart 46 shows, net retail sales as a percentage of property funds under management closely tracked movements in the property market. The recovery experienced by the property market following the 2007-08 crash showed signs of slowing in early 2010 and this continued throughout 2011. Net retail flows followed suit and all but dried up in the second half of 2011.

Ethical funds

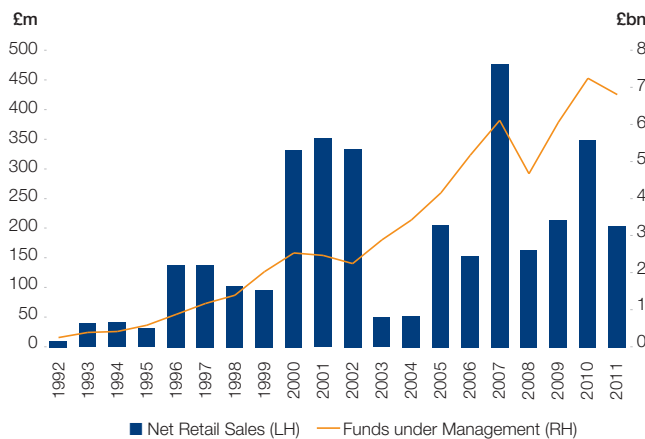
We flag ethical funds in accordance with EIRIS (Experts in Responsible Investment Solutions) classification. There are a number of definitional issues in this area, but the ethical flag essentially covers funds that would be considered to be Socially Responsible Investment (SRI).

Ethical funds under management stood at £6.8bn at the end of 2011, a contraction of 6.1% when compared to the end-2010 figure. However, the number of ethical funds classified in IMA sectors increased slightly to 59 (2010: 57).

The largest proportion of ethical funds under management was concentrated in the UK All Companies and Global sectors, which between them accounted for 56% of total ethical funds under management.

Chart 47 shows the progression of ethical funds under management and net retail sales from 1992 to 2011. Net retail sales were £203m in 2011, down on the 2010 figure (£347m) and slightly lower than the average of the 10 years prior to this which was £234m.

Chart 47: Net retail sales of ethical funds vs ethical funds under management (1992–2011)

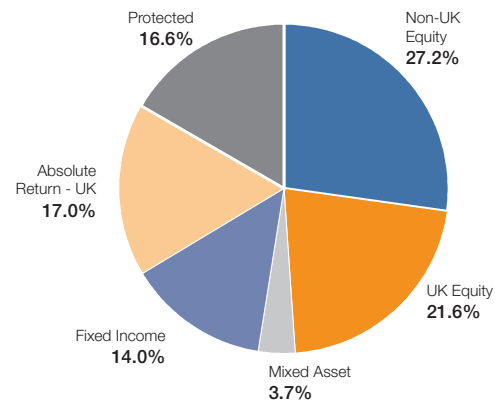


Newly launched funds

During 2011, we received data for 96 newly launched funds, which generated £1.2bn in net retail sales over the course of the year. Chart 48 shows how these net retail sales were distributed over various categories:

- In line with the sales of established equity funds, the single greatest share (27%) of flows into newly launched funds was into non-UK equity funds.
- UK equity funds took the second largest proportion of new flows with 22%.
- UK-domiciled absolute return funds and protected funds each accounted for 17% of the total.

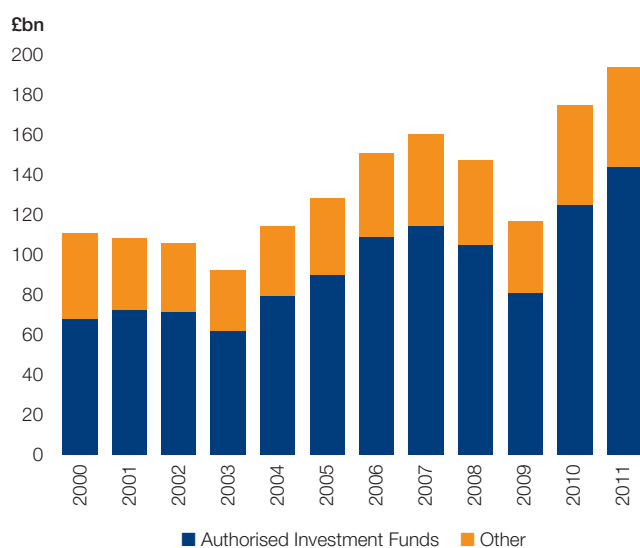
Chart 48: Net retail sales of newly launched funds by fund/asset type



Individual Savings Accounts (ISAs)

HMRC data show that almost three-quarters of the value of investments in stocks and shares ISAs is held in authorised funds (see Chart 49). At the close of the 2010/11 tax year, the value of funds held in ISAs reached £143bn out of a total of £193bn.

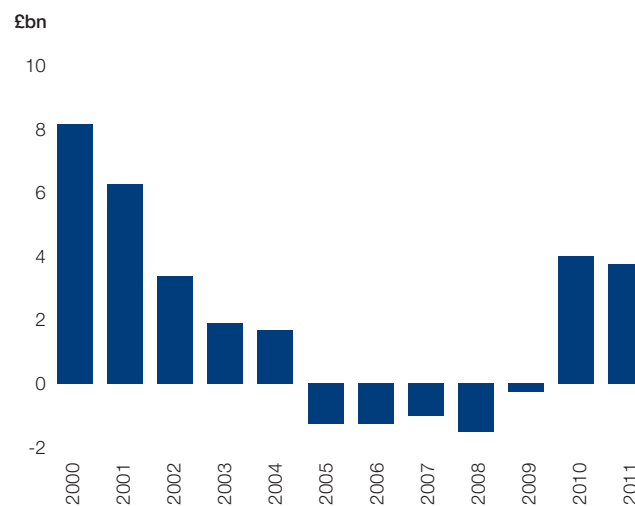
Chart 49: Funds under management in ISAs by investment type (tax year ending April 2000–2011)



Source: HMRC

This indicates that ISAs accounted for 25% of industry funds under management compared with a peak value of 33% back in March 2004. As our own figures show, net sales of funds within ISA wrappers fell sharply after the 'Dot-com' boom and from 2004 turned negative (see Chart 50). By March 2009, ISAs accounted for only 23% of industry funds under management. However, later in 2009, ISA investment limits were increased substantially for investors over 50 years of age, which caused an immediate increase in fund sales through ISA wrappers. From 2010, the ISA allowance increase was extended to all investors.

Chart 50: Net ISA sales (tax year ending April 2000–2011)



The figures we collect cover ISAs operated by the largest fund platforms and by fund managers themselves. These figures show that the stronger trend in fund sales through ISA wrappers in the 2009/10 and 2010/11 tax years continued into 2011/12, though the pace slowed somewhat in line with overall fund sales. As the Survey went to print, HMRC figures for 2011/12 were not yet available.

Distribution Dynamics and their Implications

Fund platforms continued to gain market share in terms of gross retail sales.²⁷ IMA data collected from fund managers shows that in 2011, they accounted for 41% of the total compared with 36% in 2010. Total net sales over 2011 were £11bn, slightly lower than the £13bn the year before.

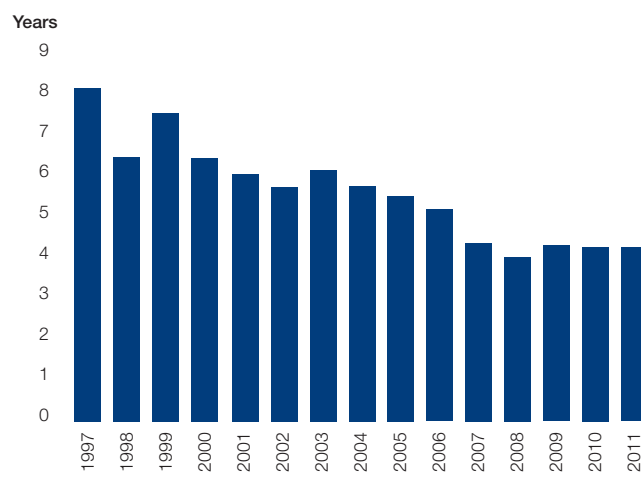
We also collect more detailed information from five large fund platforms,²⁸ which account for four-fifths of the platform market in terms of total transactions.

By the end of 2011 the five platforms had funds under management of £109bn, up 1.9% on the year before (2010: £107bn). This shows the steadily increasing market share of platforms, which is especially significant considering the 2.0% fall in industry funds under management.

The majority of these platforms' gross sales were made through tax-efficient wrappers with the greatest share through personal pensions (including Self-invested Personal Pensions or SIPPs) and ISAs, each of which accounted for 28% of the total. In 2011 the five platforms reported £9.4bn in gross ISA sales compared with £6.4bn reported by fund managers. This is a notable change from 2008, when they were both reporting roughly the same amounts.

The internet has made it easier for investors and financial advisers to buy and sell funds, as well as monitor their performance, and fund platforms have played a big part in this change. These developments are likely to be one reason why fund managers have been experiencing greater flow volatility. The average time for which investors hold funds has declined in recent years. Looking at Chart 51, calculated as the inverse of the average redemption rate for retail funds, the holding period declined to 4.2 years in 2011 from 8.0 years in 1997.

Chart 51: Average implied holding periods of retail investors (1997–2011)



²⁷ All flows through platforms are considered retail.

²⁸ These platforms are Cofunds, Fidelity, Hargreaves Lansdown, Skandia and Transact.

UK Industry Concentration and Structure

By the end of 2011, we collected data on 99 fund operators (ie. companies operating funds but not necessarily performing the investment function). This reflects a steady decline over recent years, down from 118 companies six years ago.

At the end of 2011, the UK fund management industry remains a highly competitive environment, with the top ten firms representing approximately 44% of total industry UK authorised funds under management, a similar level to the early 1990s. Chart 52 shows the top ten fund operators by total retail and institutional funds under management while Chart 53 shows the top ten firms only in terms of retail funds under management.²⁹

Chart 52: Top ten UK fund operators by total funds under management

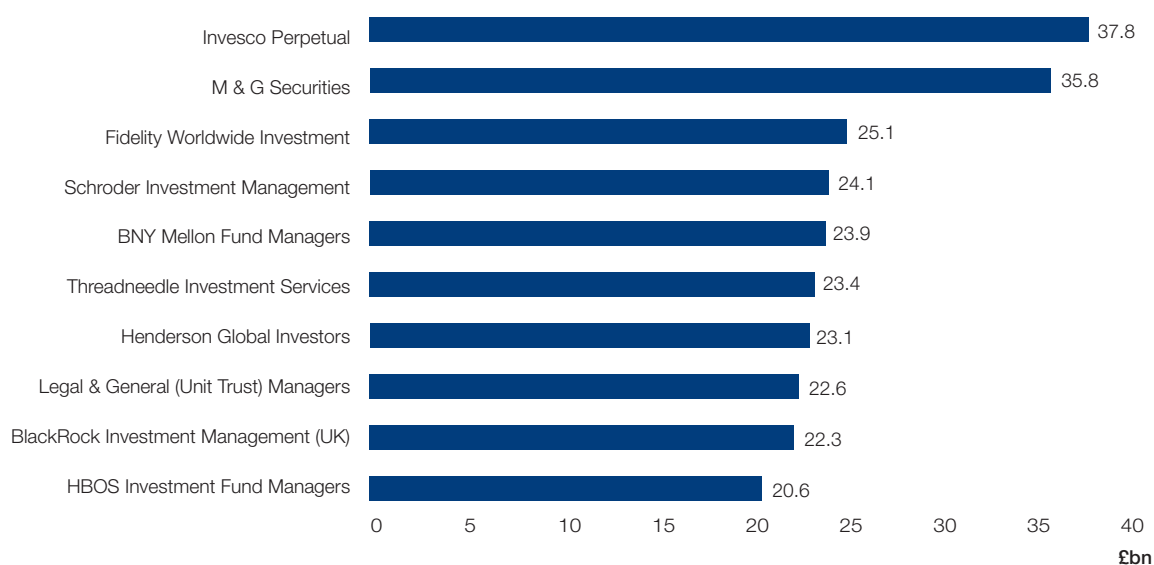
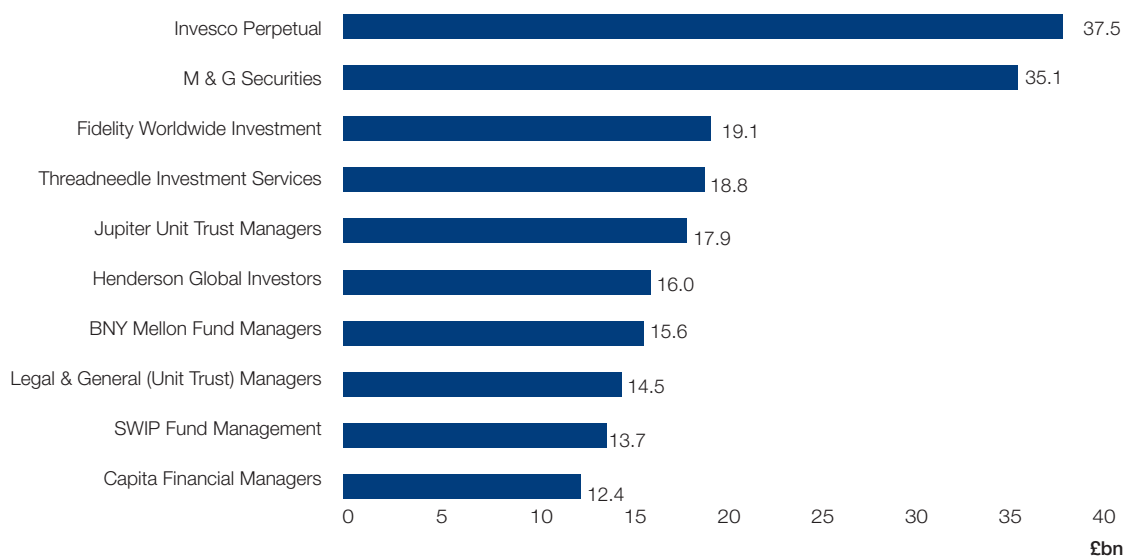


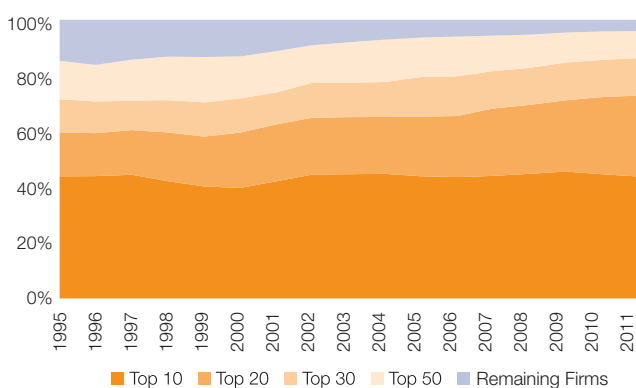
Chart 53: Top ten UK fund operators by retail funds under management



²⁹ In this context, retail funds are defined as funds with a minimum lump sum investment amount of up to £10,000 and with at least one-third of gross sales over the preceding three years being retail.

While the share of the top ten firms in terms of total funds under management has changed little over the last fifteen years (see Chart 54), the composition has changed significantly. Only five companies have remained in the top ten since 1995. The top ten companies in 2011 had between them 34% of the market in 1995.

Chart 54: Combined market shares of top firms by funds under management (1995–2011)



Bigger changes have taken place outside the top ten. The combined market share of the fund companies ranked between 11th and 20th increased from 16% to 29% between 1995 and 2011. Thus, the top 20 companies increased their share from 60% to 73%.

The market share of companies ranked between 21st and 30th increased marginally, from 12% to 13% over the same period. Overall, the top 30 companies took 86% of the market at the end of 2011. However, the market share of companies outside the top 30 declined substantially from 29% in 1995 to 14% in 2011.

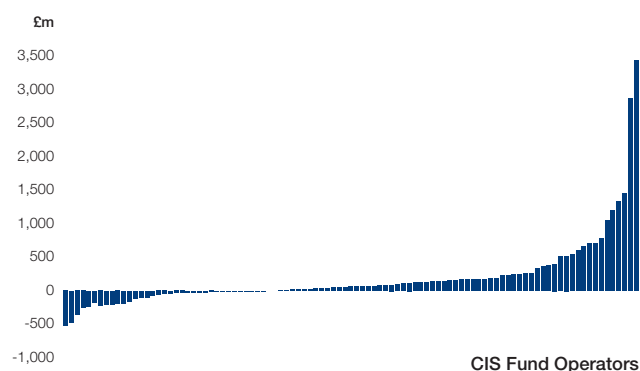
Measuring concentration

Using the Herfindahl-Hirschman Index (HHI) as a measure of concentration shows that the industry remains very competitive. A reading on this index of over 1,000 is usually taken to indicate mild concentration and a value of over 1,800 indicates high concentration. The reading at the end of 2011 for the UK fund industry was 309 compared with 303 a year earlier.

In measuring concentration, we have used market shares of funds under management (rather than sales, for example). This is because funds under management are the main determinant of the industry’s revenue stream, and are most representative of the service that the industry delivers to its investors – the management of their money.

Chart 55 shows the net retail sales of the 99 fund operators that we collected data on in 2011. Despite a difficult year for the global economy, 63 operators posted positive net retail sales, with two firms exceeding £2.5bn.

Chart 55: CIS fund operator ranking by net retail sales



As well as sales performance, there are other factors that affect the evolution of firms’ shares of industry funds under management; the rate of redemption of their units by investors, the investment performance of their funds and company takeovers.

One can also look at whether flows into individual funds have become more concentrated in recent years. Chart 56 shows the shares of the top ten, 20, 50 and 100 funds in terms of funds under management and Chart 57 does this in terms of gross sales:

- As noted earlier, the IMA collected data on 2,421 funds in 2011. Just ten of these funds accounted for 12% of funds under management, with the top 100 funds taking 44%. Both were slightly up on 2010 but in line with the figures over most of the last 15 years.
- Fund sales are more concentrated than funds under management. As with funds under management, the market share of the top funds has fluctuated over the years. During 2011, the top ten funds accounted for 16% of total gross sales, down from 17% a year earlier. The top 100 funds took 51%, a fall from 56% in 2010. As mentioned on p.47, the comparatively high figures seen in 2010 were driven by a number of large institutional flows, which occurred as part of changes within insurance company portfolios which saw an expansion in the use of investment funds.

Chart 56: Combined market share of top funds by funds under management (1995-2011)

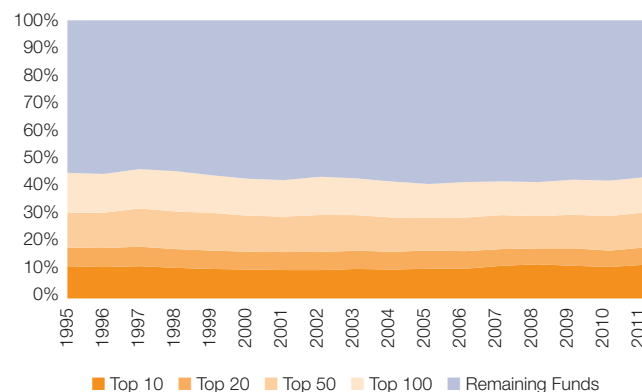
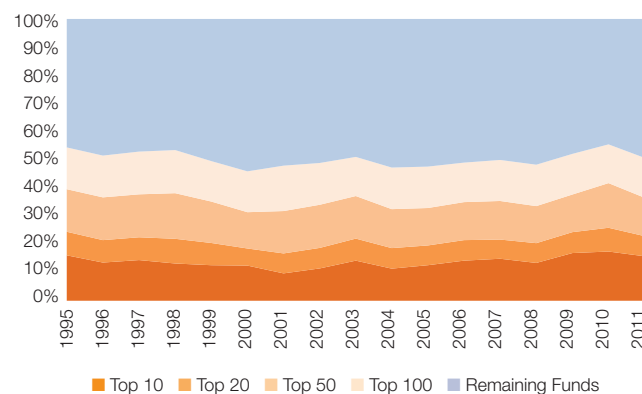


Chart 57: Combined share of top funds by gross sales (1995-2011)



The trend towards greater concentration can also be seen in Table 4 with the median fund size rising more slowly in recent years than the mean fund size. Whilst the top ten funds in 2011 had an average £7.0bn funds under management, one-half of all funds managed less than £68m. The distribution of fund sizes is highly skewed.

Table 4: Mean and median fund sizes (2002–2011)

Year	No. of funds	Mean (£m)	Median (£m)
2002	1,971	103.4	30.9
2003	1,929	131.1	40.6
2004	1,970	147.6	47.2
2005	2,003	185.1	63.0
2006	2,034	215.9	71.3
2007	2,178	230.6	69.6
2008	2,366	165.5	46.6
2009	2,411	217.0	59.6
2010	2,434	261.7	69.9
2011	2,421	259.6	68.0

In summary:

- The top ten firms control only 44% of funds under management, similar to 15 years ago.
- Gross fund flows have become somewhat more concentrated in recent years with the top 100 funds taking 51% of sales in 2011 compared with 48% in 2005.
- There is a trend towards greater concentration in the mid-market, and in particular firms ranked between 11th and 20th place, at the expense of the smallest firms. However, the HHI shows that the industry continues to be very unconcentrated.

The European Context

European funds under management decreased to €7.9trn (£6.6trn) at the end of 2011, a fall of 2.8% from €8.2trn (£6.8trn) a year earlier. UCITS, which accounted for 71% of the most recent figure, experienced a greater contraction (6.2%) leaving their year-end funds under management at €5.6trn (£4.7trn).

In terms of UCITS distribution across Europe, the UK continues to be an exception to the most commonly used distribution channels. As Table 5 shows, retail and private banks are the dominant distribution channel for UCITS; nine out of the top ten European countries in terms of UCITS distribution use them as their main

channel. In the UK, retail funds are primarily distributed through independent financial advisors (IFAs), and are now further intermediated by platforms.

The difference in distribution has a number of implications, both domestically for asset management firms, but also internationally, as UK-based fund managers export products into markets where they have to compete with funds and other products from vertically integrated financial institutions (eg. banks and insurance companies). As we have noted in previous reports, bank balance sheet concerns in the aftermath of the 2008 Lehman shock are widely seen to have resulted in a move away from funds in parts of the continental European distribution chain.

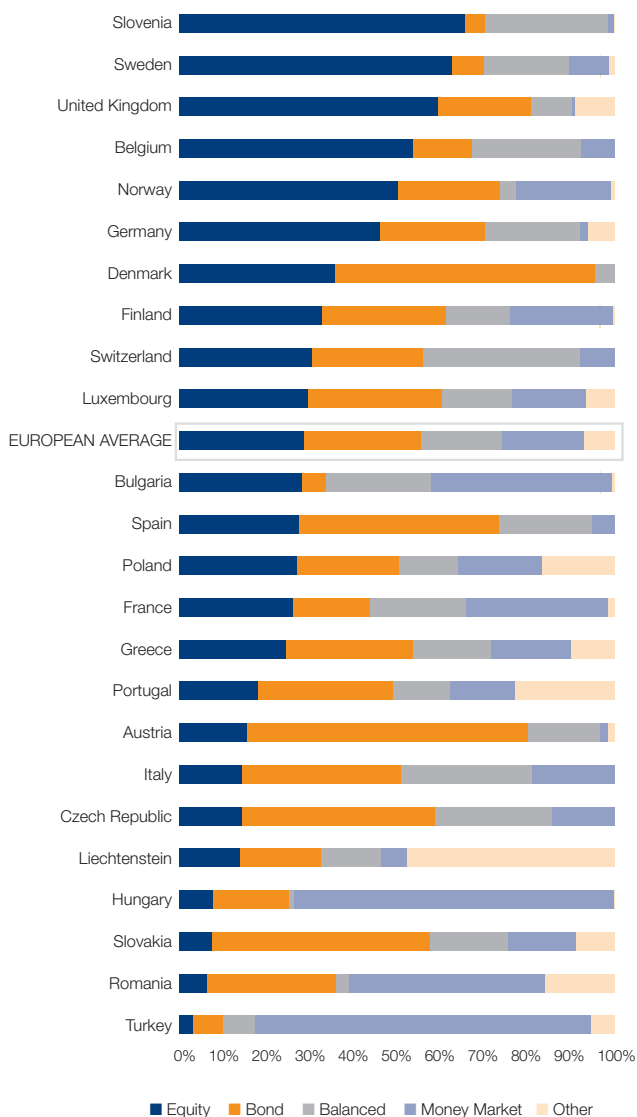
Table 5: Distribution channels for the top 10 UCITS distribution countries

Ranking	Country	Traditional fund distribution channels	Main channel and players
1	Germany	Private banks, retail banks, funds of funds, insurance, fund supermarkets, institutions, pensions, IFAs	Retail banks (over 40%)
2	Austria	Private banks, retail banks, funds of funds, insurance, pension funds, fund platforms, online brokers, IFAs	Retail banks
3	Switzerland	Private banks, retail banks, funds of funds, insurance, fund supermarkets, institutions, pensions, IFAs	Private banks (over 40%)
4	Netherlands	Private banks, retail banks, funds of funds, wrappers, fund supermarkets, online brokers, IFAs	Retail banks
5	Spain	Private banks, retail banks, funds of funds, fund supermarkets, online brokers, pensions, IFAs	Retail banks (over 60%)
6	UK	Private banks, retail banks, funds of funds, wrappers, insurance, fund supermarkets, online brokers, institutions, pensions, IFAs	IFAs (over 50%)
7	France	Private banks, retail banks, funds of funds, insurance, institutions, pensions, IFAs	Retail banks, insurance companies and private banks (60% altogether), banks (over 20%), insurance (over 20%), private banks (over 10%)
8	Italy	Private banks, retail banks, funds of funds, insurance, fund supermarkets, institutions, pensions, IFAs, promoters	Retail banks (over 50%)
9	Sweden	Retail banks, funds of funds, wrappers, insurance, funds supermarkets, pensions, IFAs	Retail banks
10	Finland	Retail banks, insurance, asset management companies, small private market operators	Retail banks

Source: PWC UCITS Distribution Trends (June 2011)

Another clear distinction between the UK and the rest of Europe is the popularity of money market funds. Some European retail investors use money market funds as many UK investors would use bank or building society deposit accounts. The European average (excluding the UK) for money market funds under management was 21% of the total at the end of 2011, while the UK figure remained at less than 1%.

Chart 58: Breakdown of funds under management by fund domicile, selected countries



Source: EFAMA

However, at the institutional level, money market funds are a significant part of the UK asset management market, with several hundred billion of sterling- and euro-denominated money market funds managed in the UK (see p.19).

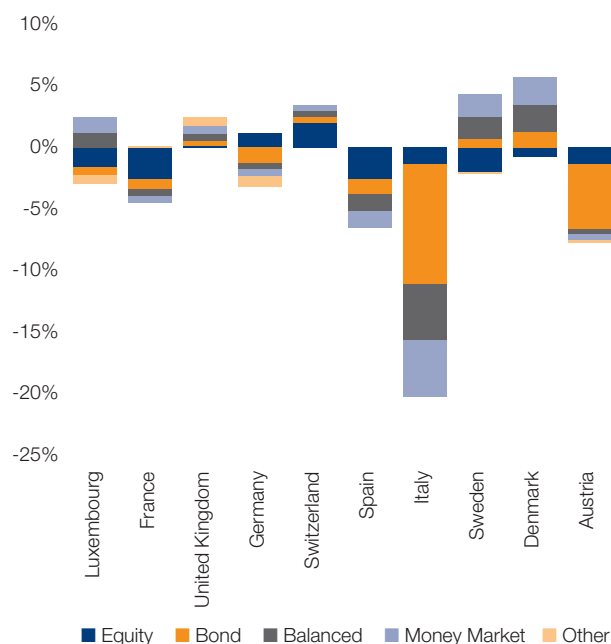
As Chart 58 shows, equities have been traditionally popular in the UK, with only two other European countries showing a higher exposure; Slovenia and Sweden. Sweden is by far the largest market of the two and has been boosted by compulsory funded pension contributions. The European average (excluding the UK) is only 28% compared with 60% in the UK.

In this respect, it is important to note that this is not necessarily a reflection of high risk-taking among UK retail investors. What we are observing is that fund holdings and overall wealth and risk exposure should be assessed in terms of other holdings such as bank and building society savings or property ownership. Nonetheless, it is widely observed that, historically, UK (and US) retail investors have a tolerance of equity risk that is generally unmatched in other large European markets, such as France, Germany and Italy.

In terms of sales, European UCITS suffered net outflows of €88bn (£74bn) during 2011. This represents a significant decline in demand compared with the €166bn (£139bn) of net inflows seen in 2010. Outflows were experienced in equity, bond and money market funds although, in line with the UK experience, mixed asset funds saw net inflows of €19bn (£16bn) during the year.

Chart 59 displays net sales of UCITS by asset class for the top ten countries (ranked by the size of their total funds under management),³⁰ expressed as a percentage of average UCITS assets during 2011.

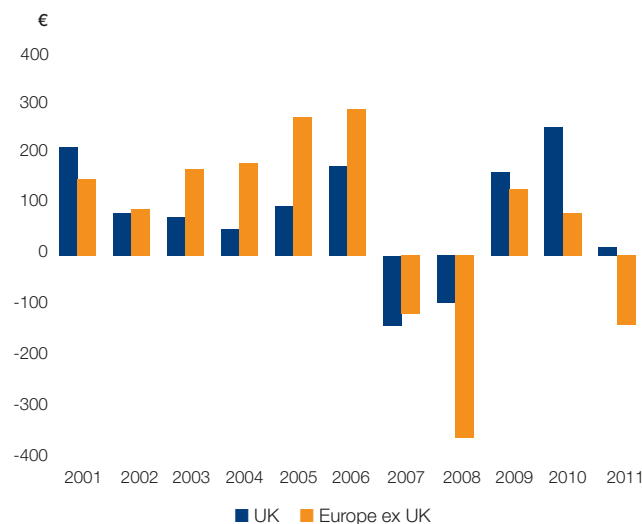
Chart 59: Net sales of UCITS by asset class as percentage of total UCITS funds under management, selected countries



Source: EFAMA

Despite the contrasting cultures, European investors were putting increasing amounts into equity funds ahead of the financial crisis, catching up with the UK in terms of equity investment. This can be seen from Chart 60 which shows net sales of UCITS equity funds per capita in the UK and in Europe over the last 11 years.³¹

Chart 60: Net sales of equity funds per capita, UK and Europe ex UK (2001–2011)



Source: IMA, EFAMA, Eurostat

As seen in Chart 60, both UK and other European investors began to sell equity funds during 2007. The following year, European investors sold equity funds worth €356 (£298) per capita compared with €92 (£77) per capita in the case of UK investors. These net redemptions by non-UK European investors amounted to 6.0% of funds under management in equity funds at the beginning of the year compared with 1.0% for UK investors calculated on the same basis.

Both UK and other European investors returned to net investment in equity funds in 2009 and 2010, with UK investors showing greater confidence by adding to their holdings of equity funds at a higher rate. In 2011 there was a reversal on the part of Europeans, while UK investors continued to add to their equity portfolios, albeit at a much lower level than in 2010.

³⁰ Excluding Ireland and Belgium, as granular asset level data is not available.

³¹ These figures include sales to retail and institutional investors as EFAMA (the European Fund and Asset Management Association) does not show retail investors separately.

Retail Distribution Review (RDR)

RDR has its genesis in a speech by Callum McCarthy, then Chairman of the FSA, at Gleneagles in 2006 in which he asked: "Is the present business model bust?". In that speech his contention was that the existing industry system of remunerating advisers through the payment of commission was no longer appropriate and led to widespread consumer detriment. He pointed to a number of examples of mis-selling to illustrate this point.

A period of industry engagement followed, including the establishment of a number of industry working groups set up by the FSA to consider the issues identified in McCarthy's speech. Commencing in June 2007 with 'DP07/01 – A review of retail distribution', a major consultation and policy development process was initiated. This is culminating in the implementation of RDR on 31 December 2012.

Broad objectives

Essentially, RDR is based upon three broad objectives:

1 Improving the requirements relating to professionalism

This objective concerns the establishment of higher competence and qualification requirements for all advisers. This is intended to raise the quality of advice received by consumers.

FSA requirement: Individual advisers must adhere to consistent professional standards, including a code of ethics

2 Improving the clarity of services offered to consumers

This objective aims to ensure the consumer can ascertain whether an adviser is acting independently on the consumer's behalf and researching retail investment products from the entire market or, conversely, acting for a single company and offering a restricted range of products from a single or limited number of providers.

FSA requirement: Advisory firms must clearly describe their services as either independent or restricted

3 Eliminating commission bias and mis-selling

The overarching intention behind this objective is that product providers should play no part in setting or supplying remuneration to the advisers. Providers would no longer be able to 'buy' market share through increasing commission rates and consumers should no longer be mis-sold inappropriate or unsuitable products because the adviser could receive a higher payment from doing so.

FSA requirement: Advisory firms must explicitly disclose and separately charge clients for their services

To meet this objective regarding adviser charging, rules have been made which prevent providers from paying commission and advisers from receiving it. The cost of giving advice incurred by the adviser would have to be paid for by an agreed fee arrangement between the adviser and the consumer.

Impact on fund industry, advisers and consumers

Over a number of years the fund management industry has become increasingly intermediated in the way it distributes funds and, with the growth in platform business propositions, fund managers have found themselves increasingly distanced from advisers and advice giving. Very few IMA members maintain sales forces or process large amounts of direct business. A significant proportion of retail funds in the UK are now distributed through some sort of platform arrangement (see p.62).

Therefore, the effect of increased professionalism within the adviser community has been broadly welcomed and supported but has not had a material effect on fund managers' activity. Equally, the distinction between independent or restricted advice giving propositions has little impact, generally, on fund managers.

The main effect of RDR on the fund management industry has been through development of the adviser charging requirements. The result of these requirements is to prohibit the ability for fund managers to rebate a proportion of the annual management charge (AMC) to advisers as trail commission. A further development is that, in its latest consultation paper, the FSA also proposes to ban similar arrangements to pay platforms.

RDR and distribution costs

Impact on commission

All distribution costs, including payment of trail commission to advisers and rebates to platforms are funded by rebates from the AMC.

Post-RDR environment

Distribution costs cannot be met by rebates, and therefore cannot come from the AMC. These costs must now be met and paid for directly by the investor.

However, the rules recognise that the investor may be unable to meet the on-going costs for on-going service by the adviser. Therefore the rules allow product providers to facilitate the payment of on-going adviser charges 'from the product'. In the case of funds, this could only be achieved through the redemption of units in the fund.

Consequently, fund managers have been unable to make decisions regarding the establishment and offering of new share classes in the lead-up to the implementation of RDR at the end of 2012. Whilst it has been clear for some time that fund managers would have to introduce retail share classes that do not contain any charge rebatable to the adviser, it has been less clear whether retail share classes could contain an element of the AMC which could be rebated to platforms by way of payment.

This uncertainty has resulted in considerable planning delays across the industry, amid concern that the commercial and operational consequences could be significant. Delays have occurred through firms being unable to ascertain which additional share classes would be appropriate in a post-RDR world, particularly as it was unclear whether the share class was to be permitted to carry a rebate element for payment to platforms.

Additionally, fund managers have been unable to develop and test systems in conjunction with their third party administrators to process new business where no rebates were paid.

Main challenges to implementation

There have been considerable challenges to the fund industry in implementing aspects of RDR.

From an industry perspective, the FSA was perceived as not appreciative of the fact that if rebates to advisers were eliminated, fund managers would only have the redemption of units in a fund as a mechanism for facilitating on-going charges and on-going service provided by the adviser. The potential consequences for consumers were in turn unclear. This seems to have resulted in a marked reluctance among fund managers to facilitate adviser charging.

In the industry's view, there also appear to have been delays in the FSA recognising the increasing part platforms played in the intermediation process for fund managers, and the method of remunerating platforms for their aggregation and marketing activity through rebates of the AMC. This has led to a need to consult further on the appropriateness of such rebates within the context of RDR.

One additional effect of RDR has been to create a significant proportion of 'legacy business' for fund managers. This has occurred where there were funds under management which, since they were invested in under the pre-RDR regime, continue to pay rebates. The FSA rules currently do not envisage any sort of 'cut-off' point after which fund managers would have to cease to pay trail. Therefore, these funds could remain extant and require managing ad infinitum, with cost and complexity implications along the distribution chain.

How will consumers benefit?

With only one or two exceptions, those we interviewed supported the three broad principles behind RDR.

For some, a key reason for this support was the notion that consumers would have a better idea of what they were paying for fund management as opposed to advice or, potentially, platform distribution. In other words, transparency would increase to the benefit of both clients and the fund management industry, which is frequently criticised for charging levels that are not related explicitly to the operations of the fund itself.

industryview

Support for broad principles of RDR

“Given the amount of the revenue stream in investment products that goes to distribution anyway, it’s good for manufacturers to make that explicit, because I don’t think anyone has any notion of how much we give to distribution. So, when people hammer us about the cost of the product, this is a useful way for us to highlight the share that distribution has in it.”

“I actually think commission for selling anything should be abolished. None of our salespeople get commission. When we introduced that several years ago, everyone said that we would see staff leave. But no one has left, it aligned our salespeople’s interest with our clients’, and made sure that when they went out with the fund manager, they weren’t trying to do the sale, but were trying to build a relationship for the longer term.”

Does transparency produce consumer understanding?

There was also a strong counterview with respect to whether this form of transparency would genuinely empower consumers. The perceived danger here was that an overload on information might occur, with different components identified separately and the consumer considerably challenged in putting all the pieces together to identify an overall charge.

industryview

Transparency may not empower

“The unintended consequence may be that you ultimately disillusion, if not disenfranchise, investors. They’re getting more transparency, but they’re not quite sure of what. It’s much like when you get your utility bill.”

“Transparency brings complexity which people can’t understand. You can have all the data you want, it won’t make you any wiser. So the question is ‘will you do anything different than before as a result of having that data?’ I’m not sure.”

Impact on availability of advice

This concern was coupled with a view, expressed by a majority of those we spoke to, that one unintended consequence of reforming the system of adviser remuneration under RDR would be that certain parts of the market would be less well-served. This could occur for two reasons; some advisory firms would not be able to service less affluent parts of the market, while many clients might be put off by an explicit advice fee compared to one embedded in the product.

industryview

Advice might be harder to obtain for some

“All I know is that if you move away from a model where you pay, say, 150bps for an active UK equity fund, the subsidy to the smaller investor has gone. So you won't be able to go to an adviser and get that little bit of advice on which ISA to go for, for example.”

“What people do need is advice, and the danger is that they're less likely to get it. We have quite a lot of retail investors who have no idea what they bought on an execution-only basis. They have no idea if it's an OEIC or if it's an investment trust. All they know is that it's an ISA.”

industryview

More client-tailored products?

“What creates a problem is the flawed idea that if you pay for advice, you get good advice, but if you pay via commission that's bad. What people need are products that cover a whole range of eventualities. For most people, a well-managed balanced fund is the right thing.”

“Is it going to be more of a savings-led, multi-asset, multi-strategy product in an open-end format? Mixed products and embedded advice might be the result, potentially. A lot more people are already looking towards general, global funds as opposed to specialised funds, and towards savings products as opposed to pure investment products.”

Implications for product development

In some cases, those we interviewed did not feel that asset management products would end up being affected by potential changes in the way in which advice was paid for. However, as in previous years, several respondents believed that, as less affluent consumers face difficulties in accessing independent financial advice, this would result in greater pressure on asset managers to produce more generic products to serve savings needs. In some quarters, these products are referred to as having 'embedded advice', in the sense that asset allocation is undertaken within the fund itself according to specific objectives. This connects also to the growing focus within the industry on more outcome- or solution-focused products.

3

The fear was also expressed that one consequence of less advice would be excessive risk aversion:

industryview

“ If people don't have advice, my experience has been that, rather than going into riskier assets, most are actually recklessly conservative and will sit in cash for thirty years rather than choosing to take a bit of risk which they could actually bear. If we get out of the habit of using an IFA and we no longer have those links, that's going to be extremely damaging to the industry in the long term. ”

Broader issues

Finally, the interview discussions on RDR raised some broad issues, including the asset management industry's attitude to the provision of advice, both in the retail and institutional environment. While many firms feel uncomfortable in this arena, there is also the view that it should be made easier to have conversations with clients with respect to investment decisions. A minority of interviewees also voiced concerns about the distance from the end-client that is ultimately unhelpful for both firms and their clients.

industryview

Industry distance from end-clients

“ We haven't got the administration competence to manage direct books and manage customer sales. We've delegated and outsourced that away over the past 25 years, so platforms and large conglomerate brokers have taken the space. We could, in theory, have an improved deal for the client but actually there is a risk that we just become a smaller brick in the wider component. ”

Returning to a theme that has been raised in previous reports, several respondents raised the question of alignment with Europe, and the danger that RDR would end up as a unilateral UK move in a fund market that for many firms is characterised as pan-European.

industryview

Inconsistency across Europe

“ The operational side of RDR is not helpful, but I would be much more comfortable with it if it was pan-European, and if it was a clean system. What I don't like is one set of operational capabilities for one market - where would we be if everybody in Europe started 'gold-plating' every directive? In a way we're setting a very bad example in the UK with this 'go-it-alone' strategy, because we would be screaming if the Spanish and the Italians had all done something like that. And I feel deeply uncomfortable about this. ”

Consumer Protection and Mis-selling

As we comment above, RDR draws attention to the highly intermediated nature of the fund management industry, particularly in light of the increasing prominence of platforms. We spoke to firms about some of the implications of this disintermediation with respect to responsibilities towards consumers.

A number of interviewees were concerned about the absence of a consensus between the industry and regulators with respect to where responsibilities lay in the value chain, and in particular that the FSA was attempting to make manufacturers and wholesalers of funds liable for matters wholly outside their control, especially in an international context.

industryview

Responsibility for investment outcomes

“I can have perfect, stress-tested, disclosed, responsible products, and they can all be mis-sold.”

“It is very difficult for our marketing guys to launch a new product. But we might have a Chilean pension fund that invests in our global range in Luxembourg that’s distributed through Hong Kong and managed in London. And all these different jurisdictions have different regulation, therefore how do you actually police who does what, what they’re investing in and what stage they need to understand? If we just focus on the UK, we can do some work on IFAs. The Key Investor Information Document helps a bit as do the SRR³² numbers, but a lot of our funds go through the platforms, so we can only go so far.”

industryview

Product control beyond manufacture?

“I don’t think we can just create a product and forget about it once it leaves the door; we can’t monitor every single sale but we need to take some responsibility for how our products get distributed.”

“We do sample-test distribution material that IFAs are using, and we do mystery-shopping.”

“The onus on the industry itself is on TCF monitoring, dashboards, etc., where we and others have the capability to identify trends, where complaints accumulate for a specific product or a specific IFA. That’s a clear alarm bell.”

industryview

“All these mis-selling incidents have had an impact on the way IFAs behave. There’s a danger that IFAs will de-risk their recommendations and dumb everything down or that they won’t pick any funds and just pass all their clients to discretionary managers because they will not want to run the risk. We have seen incidents where this has happened, and it would be a shame if we got to a situation where advisers felt they couldn’t make proper recommendations.”

In contrast, other respondents acknowledged it was sometimes an open question as to what was indeed outside their control, and that a variety of mechanisms and approaches were available for them to monitor the distribution process.

3

³² Stands for ‘Synthetic Risk and Reward Indicator’.

While RDR seeks to address commission bias in some products, there is a wider concern among the firms we spoke to about instances of mis-selling or poor disclosure of financial services products, such as payment protection insurance or life settlement-backed bonds, that were unconnected with fund managers.

The impact on firms manifests itself in two ways. First, it reduces confidence amongst consumers in all financial services. Second, through the operation of the compensation scheme, it can lead to fund managers having to cross-subsidise the cost of failure amongst intermediaries. This happened in 2011 when the Keydata scandal³³ resulted in £233m having to be paid by fund managers to fund the UK's compensation scheme.

We also asked whether current regulation on the conduct of business offered enough protection against such mis-selling and how it might be improved. One common theme that emerged was that firms wished to see more effective enforcement of existing rules as opposed to finding themselves subject to compensation claims or new product rules. There was little feeling that a Keydata-like cross-subsidy would be a one-off; the impact was not merely one of sheer scale, akin to an almost double-figure tax rate, but its imposition on an event-driven basis. The FSA had at the time of the interviews committed to a funding review of the scheme.

industryview

Where should the burden fall?

“ We seem to carry the greater burden of supervision, when arguably we are the firms who have the more robust compliance and risk teams and better infrastructure. Is it more efficient for us as payers, ultimately, to pick up the compensation bill through the FSCS or is it more efficient for us to pay the FSA a greater fee year-on-year to regulate the market? It's very frustrating. I'd probably rather have increased fees year-on-year than see a blip of millions of pounds coming through periodically, because that distorts our shareholder returns. ”

“ The compensation issue is certainly interesting in light of the spikes in recent years, and one of the questions there is whether there should be a pre-funding requirement to avoid event-led compensation. It would certainly give you a better smoothing effect, particularly as mis-selling and collapse are likely to get worse in volatile markets, which is when firms are arguably going to be more financially stretched to be able to afford paying compensation. ”

Ultimately, though, there was agreement that conduct of business rules themselves had limited power, and regulators would always have finite resources with which to identify and pursue abuses. In this respect, several firms pointed to the need for the broader distribution culture to change at a fundamental level.

industryview

Importance of change in culture

“ Regulation can only do so much, and so I think mis-selling can only be eliminated through a change in culture. That takes a long time though. ”

“ Changing ethics in the marketplace and improving the culture is a big task for the new regulator, in particular the FCA. ”

³³ Keydata is an investment firm that had sold life insurance-linked investment products from Luxembourg vehicles SLS and Lifemark. It was declared insolvent and closed down by the FSA in 2009.

4. International Dimension

Key Findings

Four international dimensions

- The total share of assets managed in the UK on behalf of overseas clients was 37% (£1.6trn), up from a revised 36% in 2010.
- The proportion of UK-headquartered firms decreased to 48% from a revised 49% in 2010.
- Overseas-domiciled funds increased to £765bn in 2011, up from £693bn at the end of 2010. Of these, the largest part (73%) continues to be domiciled in Dublin and Luxembourg.
- IMA members and the groups of which they are part manage an estimated £22trn around the world (2010: £20trn).

UK in a comparative context

- The UK increased its market share in terms of European assets under management to 33% thus confirming its position as the leading European asset management centre, and the second largest asset management location in the world after the US.
- As a fund domicile, the UK is at an unchanged fifth place, accounting for over 10% of the European fund industry (2010: 9.9%).
- Asian centres continued to experience strong asset growth. Aside from Japan, however, which accounted for an estimated £2.7trn in assets under management, their size remains small relative to the UK.

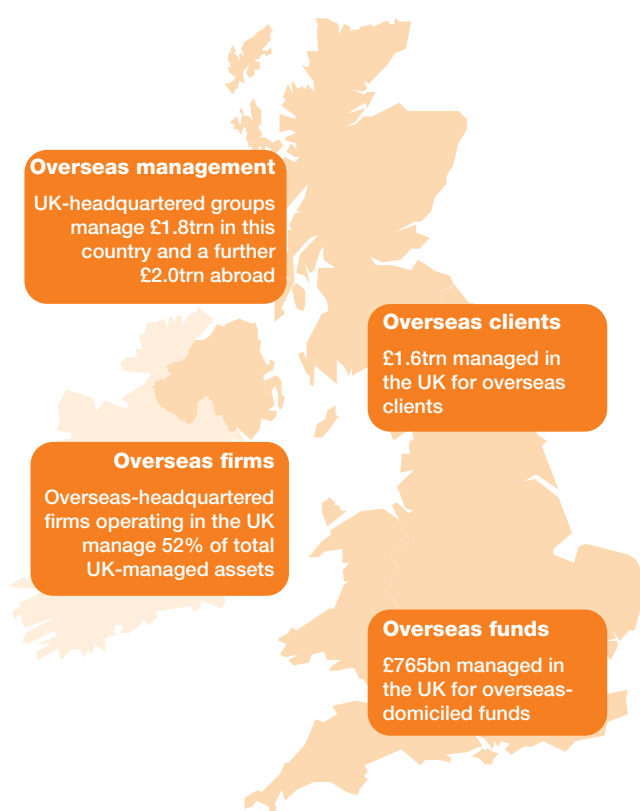
4. International Dimension

Four International Dimensions

As Figure 6 shows, the international nature of the UK asset management industry is reflected in almost every major aspect of it:

- Overseas locations for asset management.
- Overseas clients.
- Overseas-headquartered firms.
- Overseas fund domiciles.

Figure 6: International dimensions of the UK asset management industry



Overseas clients

While the management of overseas client assets has traditionally been a feature of the UK asset management industry, in recent years, this proportion has started to grow significantly as a share of our members' total asset base. As at the end of 2011, 37% of assets were managed in the UK on behalf of clients from outside the UK. This translates into an

estimated £1.6trn in UK assets under management industry-wide. Of these, 49% (or £769bn) is managed on behalf of clients across the EU and the remaining 51% (£790bn) represents clients from other overseas locations.

On a matched basis, both of these proportions remained roughly unchanged year-on-year although, on a headline basis, the share of overseas client assets under management increased from a revised 36% (£1.4trn) in 2010. This is largely the result of improved reporting from among our respondents.

As we have commented for a number of years, asset managers based in the UK are tapping into a number of areas of international opportunity:

- At a general level, changing growth dynamics and global demographics are creating significant opportunities for the export of investment services.
- These opportunities are seen in different ways. Some are classically institutional, eg. sovereign wealth funds and other forms of government asset pool (eg. pension reserve funds). Others are more retail in terms of individual savings pools.
- In the funds environment specifically, UCITS has been an extremely successful European and global brand.
- At the same time, previously 'closed-architecture' distribution networks have become more accessible. This has been particularly evident in Europe, as bank and insurance networks have increasingly carried third party offerings.

None of these opportunities is irreversible, and as we note in Chapters Six and Seven, there is increasing concern about some of the potential consequences of current regulatory change for the openness of the international investment services market. There are also other pressures; for example, as banks struggle to rebuild their balance sheets, a race for deposits may work to the detriment of investment funds.

Overseas-headquartered firms

Alongside the growth of autonomous asset managers, which often had their headquarters in the UK, we have also seen the gradual entry into the UK market of an increasing number of overseas-based managers.

This is reflected in Chart 61 which shows the breakdown of UK assets under management by the region of firm (or, where appropriate, parent firm) headquarters. It shows a decline of UK-headquartered firms, which in 2003 accounted for 57% of the UK asset base, to 48% at the end of 2011 (2010: 49%).

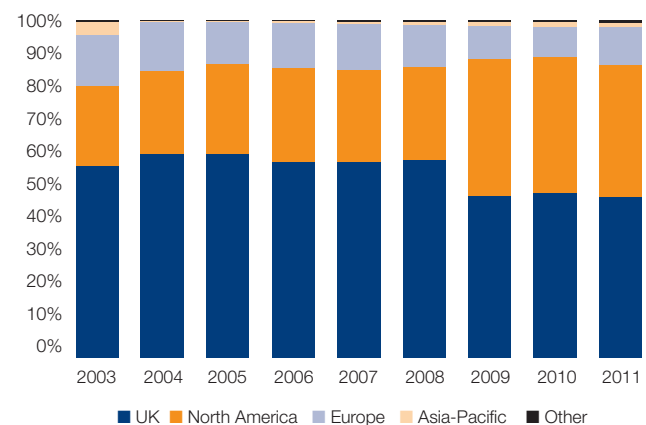
European-headquartered firms decreased during the same period from 15% to 11% in 2011. Firms and parent groups from the Asia-Pacific region also fell significantly in proportion from 3.8% to 1.0% at the end of 2011. North American firms and parent groups, in contrast, considerably increased their share of the UK asset base from 24% to 39% in 2011.

This, however, has not happened in a gradual fashion, but rather, as shown in the chart, through a small number of large-scale deals. The most significant one is reflected in a step change between 2008 and 2009, where the share of North American-headquartered firms increased from 27% to 40% due to the merger of BlackRock and Barclays Global Investors (BGI).

The falling share of European parent groups, from 15% down to 11% at the end of 2011, in part reflects M&A activity as a result of a number of banks partially or wholly divesting their asset management arms following the onset of crisis. However, as can be seen from the preceding years, the fall has been more long-term in nature, reflecting also the relative loss of position of European-based firms to UK and North American asset managers.

Given what we have said about the differences in ownership between UK, North American and European asset management firms, the greater significance of these changes is, in this respect, not in the geography of ownership but in their nature (ie. the emergence of a larger body of independent asset management firms).

Chart 61: UK assets under management by region of parent group headquarters (2003–2011)



Overseas fund domiciles

A considerable proportion of funds that are managed in the UK are domiciled overseas. The Survey suggests that, as at the end of 2011, this amounted to £765bn managed by our member firms. This represents 53% of the entire UK-managed pooled asset base. The headline increase from last year's report (£617bn) is misleading. A range of reporting changes within member firms has resulted in an increased estimate, with a year-on-year change of 10% from £693bn at the end of 2010.

Luxembourg and Ireland remain the most popular overseas domiciles, accounting for 40% and 33% of the total, respectively. On a matched basis, Irish-domiciled funds have increased from 2010 while Luxembourg-domiciled funds have slightly decreased. This is in line with EFAMA numbers (see Figure 8 on p*).

Other fund locations nevertheless continue to account for a considerable proportion (27%) of overseas-domiciled UK-managed funds. Of these, the US is prominent, followed by offshore locations such as the Cayman and Channel Islands. The remainder includes other locations from across Europe and the Asia-Pacific region.

In terms of the composition of overseas-domiciled funds, institutional money market funds are the largest single component, accounting for £208bn from £167bn in 2010. Almost all institutional money market funds whose assets are managed in the UK are domiciled in Dublin and Luxembourg. Other overseas-domiciled vehicles comprise a range of institutional and retail products, including hedge funds and ETFs.

The size of overseas-domiciled funds could rise by up to a further £145bn for those hedge funds not covered by IMA membership.

Overseas locations for asset management

As we comment in Chapter Two, most UK client assets are managed in the UK. However, asset management remains very flexible in terms of the cross-over between client and management location. While some firms centralise their asset management, many have the reverse philosophy (ie. portfolio management and trading being located in the region of the asset rather than the client). The latter will either delegate formally or manage the assets directly in overseas offices in the relevant region. For example, regardless of where the client is based, a firm might manage its UK and European equities out of the UK but run its US equities out of North America or its Asian equities out of Tokyo, Singapore or Hong Kong. Hence, many of our firms manage assets outside the UK on behalf of both UK and international clients.

Our UK-headquartered respondents managed £1.8trn in the UK as at the end of 2011; an increase of 7.6% on the year before. In Europe (excluding the UK), these firms managed more than £206bn. Globally, our UK-headquartered respondents' assets under management increased to a total of over £3.8trn.

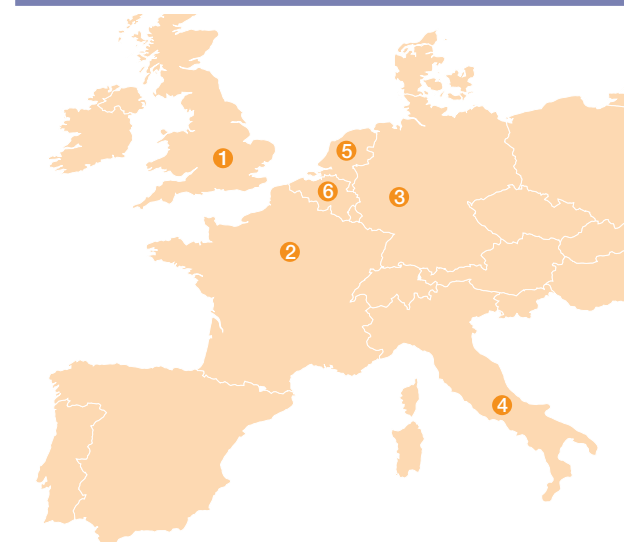
We estimate that, as at the end of 2011, IMA members and the groups of which they are a part had a total of £22trn in assets under management. On a headline basis this represents an increase of 7.5% from a year earlier when this figure stood at £20trn.

Year-on-year comparisons in both cases continue to be affected by changes in the IMA membership as well as in corporate activity at parent group level.

The UK in a Comparative Context

The UK has traditionally been the largest asset management centre in Europe, and this continued to be the case during 2011. As shown in Figure 7, the UK increased its market share of European assets under management to 33% at the end of 2010 (the latest year for which data is available) from 31% the year before. Comparison with previous years shows very little change in the composition of the country rankings, indicating broad stability despite changes in the UK share, which were caused in part by exchange rate fluctuations.

Figure 7: Assets under management in Europe (December 2010)



Country	Net assets (€bn)	Market share
1 UK	4,599	32.7%
2 France	2,904	20.7%
3 Germany	1,496	10.7%
4 Italy	670	4.8%
5 Netherlands	492	3.5%
6 Belgium	227	1.6%
7 Other	3,647	26.0%

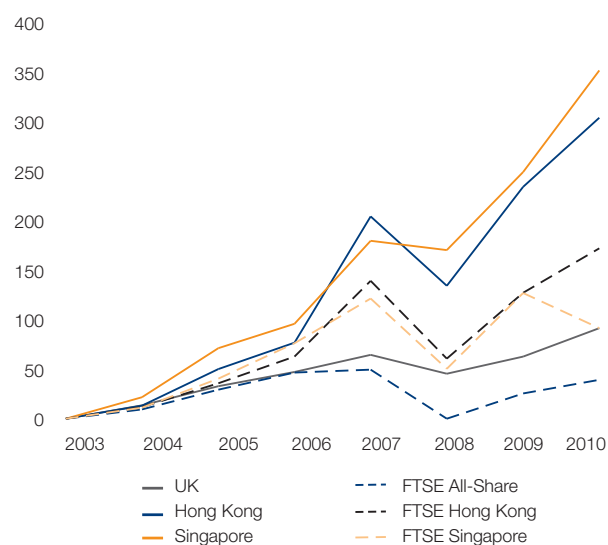
Source: EFAMA

It is difficult to estimate accurate wider comparative data on the basis of management location, as that tends to be based on individual market sizes. However, all available data point to the UK being the second largest asset management centre in the world, after the US.

Aside from the US and Europe, the closest rival to the UK industry in terms of size is Japan with an estimated £2.7trn (¥361trn) in assets under management as at March 2012; virtually unchanged from the year before.³⁴

The Hong Kong and Singapore industries, which we started reporting on in the last Survey, remain comparatively small in absolute terms, with assets under management at the end of 2010 at £346bn³⁵ and £375bn,³⁶ respectively. Both of these centres have experienced very strong expansion in recent years, which appears to have been driven both by market movements and substantial new asset flows (see Chart 62).

Chart 62: Comparative asset growth UK, Hong Kong, Singapore (2003–2010)



Source: IMA, MAS, SFC, Lipper IM (calculated on a capital return basis, rebased to 0)

In 2010, both Hong Kong and Singapore grew strongly in terms of assets under management. If such growth rates were to be sustained, Hong Kong and Singapore would have combined total assets under management of over £4trn by 2020, although this would still account for just over one third of the projected assets of the UK.³⁷

³⁴ Source: Nomura Research Institute.

³⁵ Source: Securities and Futures Commission *Fund Management Activities Survey 2010*.

³⁶ Source: Monetary Authority of Singapore *2010 Singapore Asset Management Industry Survey*.

³⁷ The data for Singapore includes estimates for discretionary management from 2004. The compound growth rates used for the projection are 20% for Hong Kong, 17% for Singapore and 10% for the UK.

Opinions voiced during our interviews this year indirectly attest to this, speaking of great potential in Asia long-term, both in terms of economic growth and investor appetite for risk assets.

industryview

Future centres of growth

“The gathering wealth will come from Asia. The demographics in Europe aren’t conducive to a risk-taking private population. What they’re desperate for is income generation, which is what you’re seeing in today’s products. I don’t know who will take risk in Europe over the coming 10-20 years.”

“It would not surprise me if, ten years down the line, our organisation had moved its headquarters to Asia. Asia is easily up there with the most important regions for us; not just in terms of revenue or assets, but also if you think about where the economic growth is, and where the savings are going to be over the next 40-50 years.”

Fund management

As we report on p.67, the combined net assets of the investment fund market in Europe (ie. the market for UCITS and non-UCITS funds) stood at €7.9trn (£6.2trn) at the end of 2011. The year-end figure represents a decrease of 2.8% from the year before, when the total size of investment funds stood at €8.2trn (£7.0trn).³⁸

As shown in Figure 8, Luxembourg continues its lead as a European fund domicile of choice, ahead of France, Germany and Ireland. In 2011 the UK marginally improved its market share relative to other fund domiciles by increasing to over 10% (2010: 9.9%), but it remained in fifth position. Including overseas-domiciled funds whose assets are actually managed in the UK (see p.80), the size of UK-managed funds would double to £1.3trn.

Figure 8: European investment funds by country of domicile (December 2011)



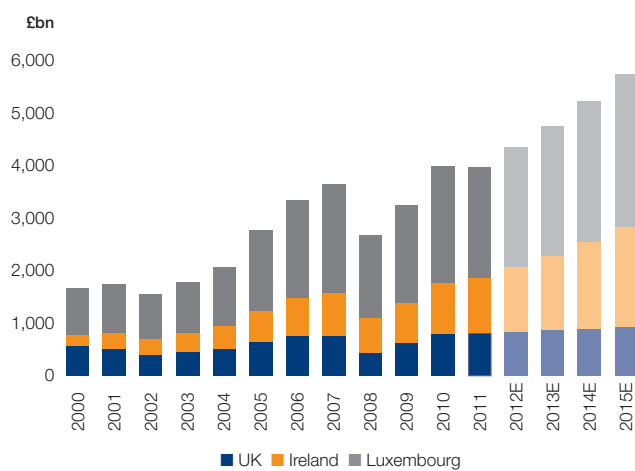
Country	Net assets (€bn)	Market share
1 Luxembourg	2,097	26.5%
2 France	1,381	17.4%
3 Germany	1,134	14.3%
4 Ireland	1,055	13.3%
5 United Kingdom	805	10.2%
6 Switzerland	273	3.4%
7 Italy	193	2.4%
8 Spain	156	2.0%
9 Sweden	150	1.9%
10 Denmark	139	1.8%

Source: EFAMA

³⁸ Source: EFAMA.

Looking at a historical comparison between the UK and other European centres, the data show how the UK has lost out as a fund domicile relative to Dublin and Luxembourg. This is illustrated in Chart 63, which shows the comparative growth of the UK, Ireland and Luxembourg including our projections for fund size growth if recent growth rates were to be sustained.

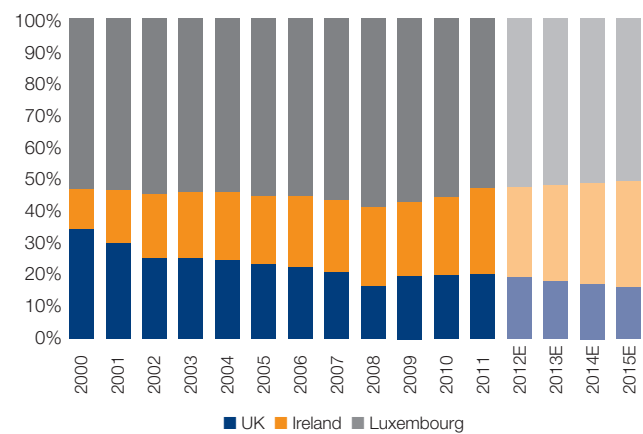
Chart 63: Fund assets by domicile, UK, Ireland, Luxembourg (2000-2011, projected to 2015)



Source: IMA, EFAMA

When looking at the historical development of the UK, Ireland and Luxembourg as fund domiciles, it is also interesting to see the changes in the relative market share of the three countries. As shown in Chart 64, Luxembourg has maintained a steady proportion of the overall funds domiciled in the three locations (50-60%), while the size of UK-domiciled funds has gradually declined.

Chart 64: Fund domicile market share by asset size, UK, Ireland, Luxembourg (2000-2011, projected to 2015)



Source: IMA, EFAMA

If recent growth rates were to continue, by 2015 the UK's market share would further decrease to 16%, while Irish fund assets would grow to 33%; an almost complete reversal of the situation from the beginning of the 2000s.

The contrast between the UK and these two fund centres is also well-illustrated by the number of funds domiciled in the respective countries (see Chart 65). Over the past eleven years, average annual growth rates were 7.2% in Ireland and 6.0% in Luxembourg. In contrast, the UK remains virtually static with a growth rate of 1.0%.

Chart 65: Total number of funds by domicile, UK, Ireland, Luxembourg (2000–2011)



Source: IMA, EFAMA

industryview

UK lost out as domicile

“ The UK lost the argument with its belated introduction of OEICs. By taking ten years to get the OEIC regime out, it was overtaken as a continental brand by UCITS. OEICs could have been a global export, but the UK really missed the mark. And that’s why the FSA is concentrating on the consumer; they can’t do anything with the product itself. ”

5. Operational and Structural Issues

Key Findings

Revenue and costs

- Total industry revenue is estimated at £12bn, up 11% on 2010 albeit practically unchanged if expressed as a percentage of average assets under management (30bps).
- Industry-wide costs are estimated at £8.1bn. While this is an increase of 10% from 2010, as a proportion of assets it shows little change, accounting for 20bps.
- The industry gross operating margin remained at 34%, with headline profitability at 10bps.

Performance fees

- Performance fees were used by 82% of our respondents, a slight decrease on the headline result from our last Survey (2010: 85%). At 15% of the respondents' total assets under management, assets subject to these types of fees continue to represent a small proportion of the market.
- Usage of performance fees is most widespread across institutional, absolute return and hedge fund offerings.

Employment

- Total direct industry employment is estimated at 29,500, a 3.6% increase from 2010 on a matched basis. Some 18% of the industry's direct headcount are foreign nationals.
- The direct employment estimate again understates the total industry headcount as it does not include the size of indirect employment through outsourcing. That was used by 78% of our respondent firms in 2011.

Operational risk

- Interview results this year also highlight the changes in operational risk and reporting that firms have observed as a result of the regulatory upgrade since the onset of the crisis.

Industry concentration

- The UK industry remains very unconcentrated, with the top five and top ten firms accounting for 35% and 51% of total industry assets, respectively.
- Looked at in terms of industry composition by parent type, independent asset managers continue to grow their market share with 37% of total assets, compared to insurance companies as the second largest category with 28%. This represents a decrease compared to last year's figures and is the result of a change in methodology.
- M&A activity slowed down in 2011 compared to the year before in asset terms, with the overwhelming majority of deals pursued to buy into strategic capabilities.
- Boutique IMA members continued to outperform the industry average, growing by 14% year-on-year compared to 3.4% for the industry overall.

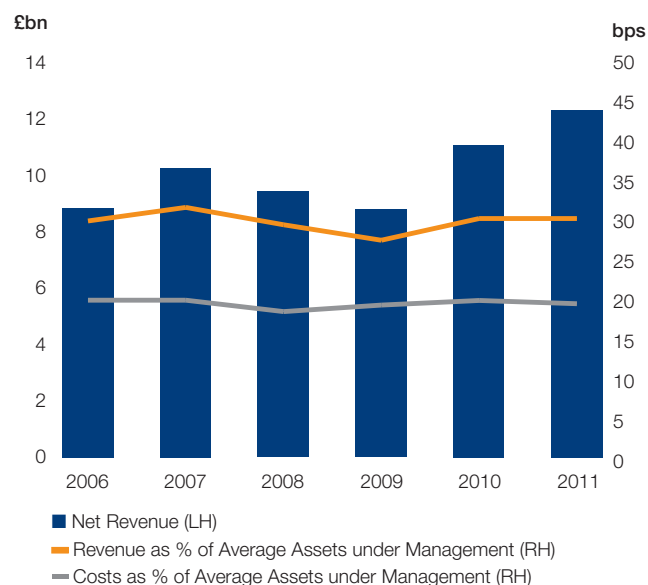
5. Operational and Structural Issues

Revenue and Costs

Firms were asked to report total cost and revenue numbers. The data presented below includes both in-house and third party activity:

- Total industry revenue (net of commission) rose 11% during 2011, having increased 26% during the market recovery of 2010. This is broadly in line with the increase in average assets under management and takes the overall estimated revenue to £12bn, up from £11bn in 2010. While this is well above the levels seen in 2007 (see Chart 66), expressed as a percentage of average assets under management, 2011 revenue is still slightly lower (30bps vs 32bps in 2007).
- Total costs rose by 10% compared to 2010, and at the end of 2011 were estimated at £8.1bn. As a proportion of assets, this represents 20bps, broadly unchanged from a year earlier. Cost increases have been driven by a range of factors, including higher headcounts, variable compensation arrangements, business development and regulatory compliance.
- Headline profitability was 10bps. The overall industry gross operating margin was 34%, unchanged year-on-year.³⁹

Chart 66: Industry net revenue vs revenue and costs as percentage of average assets under management (2006–2011)



Expressed as a proportion of GDP, industry net revenue represented 0.7%.⁴⁰ This once again represents an increase year-on-year, driven by faster revenue than GDP growth. The revenue contribution of the wider asset management industry (including hedge funds and private equity) is estimated to be closer to 1.3%. Factoring in downstream and outsourced activity would lead to a significantly higher contribution.

³⁹ Calculated as net revenue less costs divided by net revenue.

⁴⁰ Based on net revenue adjusted for output that may be accounted for in other market sectors.

Performance Fees

This year we again asked about the use of performance-based fees across their business. On a headline basis, this applies to over 82% of respondents; a slight decrease on 2010 (see Table 6). Similarly to previous years, however, the proportion of assets subject to this type of fee remains relatively low, affecting on average 21% of assets amongst the members who use them, or 15% of total assets under management across our respondent base.

Table 6: Use of performance fees in the industry (2008–2011)

	2008	2009	2010	2011
Percentage of firms using performance fees	81%	82%	85%	82%

Indeed, as shown in Table 7, a third of firms by the size of their assets under management generally do not use performance fees on more than 5% of their assets, with another third of the respondents reporting not more than 10%.

We also enquired about the areas of business where performance fees were most widespread. While institutional business still dominated, accounting for over one third of responses, absolute return and hedge fund products were also frequently cited and together represent over 25% of responses.

Table 7: Proportion of assets under management subject to performance fees

Proportion of assets under management subject to performance fees	Percentage of respondents	Total UK assets under management (£bn)	Assets under management subject to performance fees (£bn)
0%	20%	196	0
<5%	23%	979	30
5-10%	15%	919	67
10-25%	18%	453	85
25-50%	8%	512	188
>50%	16%	149	98
TOTAL	82%	3,209	468

As regards the development of performance fee usage over 2011, the majority of respondents (78%) reported no increase, and most of them do not expect further increases in the coming year (see Table 8). Firms that have increased the use of performance fees across their product ranges, however, also expect further increases in future, citing institutional business and

absolute return products as the most likely areas. Firms with higher performance fee usage are typically also the ones reporting further increases going forward.

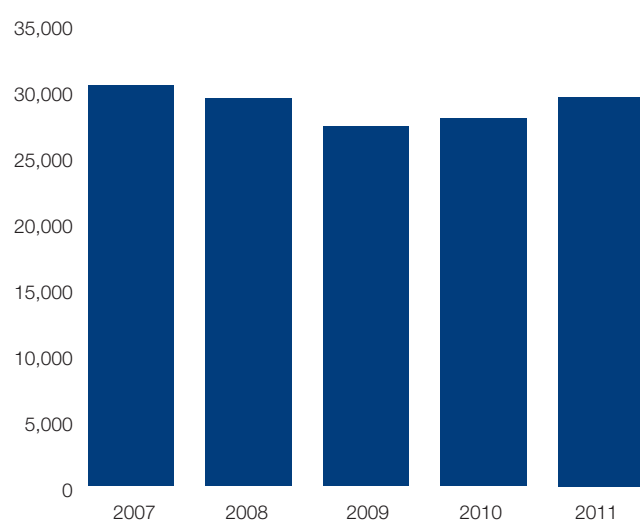
Table 8: Change over past year and expectation of future use of performance fees

Has the use of performance fees in your product range become more prevalent over the past year?	Percentage of respondents	Total UK assets under management (£bn)	Assets under management subject to performance fees	
			Proportion	£bn
Yes	22%	994	13.4%	134
No	73%	2,197	14.3%	314
Same	5%	177	11.3%	20
Of those who answered YES , do you expect further increases in the coming year?				
Yes	86%	969	13.6%	132
No	0%	0	0%	0
Don't know	14%	25	5.5%	1
Of those who answered NO , do you expect further increases in the coming year?				
Yes	4%	357	1.1%	3.9
No	79%	1,602	14.6%	234
Don't know	17%	238	31.9%	76

Employment

Changes to our methodology for calculating direct headcount have resulted in a higher level of overall employment.⁴¹ We estimate this at 29,500 in 2011, up 3.6% on a matched basis. Looking historically, this represents a clear recovery from the marked falls that characterised 2008 and 2009, but still leaves the total industry headcount lower than before the crisis (see Chart 67).

Chart 67: Industry headcount estimate (2007–2011)



Headcount is growing for a number of reasons. At a general level, it is a sign of industry recovery, with some firms performing strongly. To some extent, it also reflects business reorganisation; in several cases, firms had experienced increases in direct headcount due to operational changes, such as temporary projects or reallocation within larger financial groups. Finally, there is evidence that the increase reflects the changed environment post-2008, resulting in growing demands on internal monitoring and oversight, increased operational complexity, and the commensurate growth of related staff sectors.

Further detail can be seen in the distribution of direct employment by staff segment (see Table 9). Core functions such as fund management, research and analysis and dealing still represent the largest proportion of the headcount with 27%, unchanged from the previous years. Business development and client services (19%) showed a clear expansion year-on-year. Compliance, legal and audit represents 5% in 2011, a slight increase from 2010 on a headline basis.

Table 9: Distribution of staff by activity (direct employment)

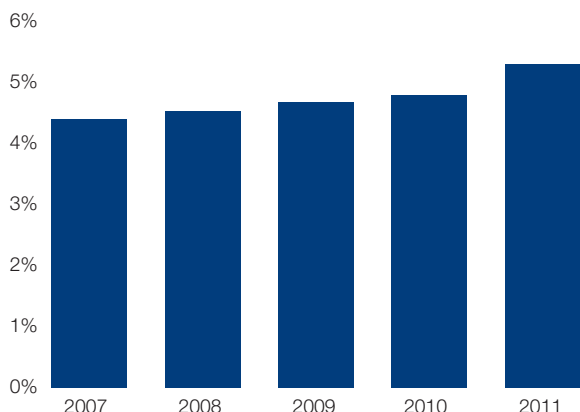
Activity	Percentage of total headcount
Fund Management of which:	27%
Fund management (strategic and operational)	68%
Research, analysis	24%
Dealing	8%
Operations and Fund Administration of which:	19%
Transaction processing, settlement	24%
Investment accounting, performance measurement, client reporting	39%
Other fund administration (including CIS administration)	37%
Business Development and Client Services of which:	19%
Marketing, sales, business development	70%
Client services	30%
Compliance, Legal and Audit of which:	5%
Compliance	57%
Legal	32%
Audit	11%
Corporate Finance and Corporate Administration of which:	11%
Corporate finance	45%
HR, training	21%
Other corporate administration	35%
IT Systems	12%
Other Sector	6%
Total Industry Headcount	29,500

⁴¹ We now have firmer evidence on correlations between staff and asset size, which suggests that previous estimates under-stated the employment within smaller firms which are under-represented in the Survey. Revised historical data is used in this report.

In the past two years we also started exploring in greater detail the growth of certain staff sectors that we would expect to be impacted by greater regulatory oversight. In 2010 we analysed a matched sample of our member firms⁴² over a period of five years from 2005, showing how the size of their compliance, legal and audit teams gradually increased as a proportion of the total headcount.

Extending this analysis to 2011 among an increased sample of firms offers an even more convincing picture of this trend (see Chart 68), providing further evidence of the regulatory impact on our members' operational structure.

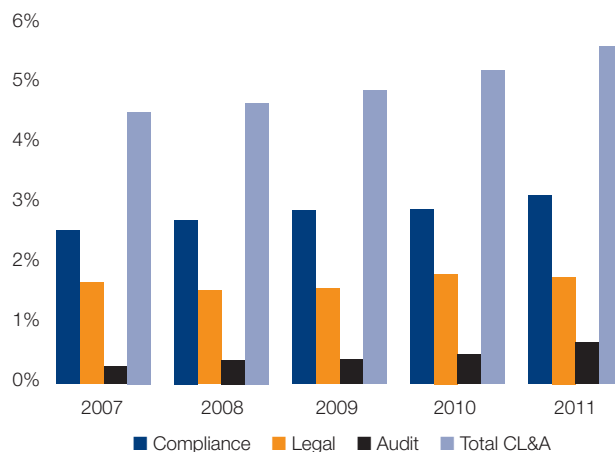
Chart 68: Size of Compliance, Legal and Audit as a proportion of overall headcount (2007–2011)



Looking at the relative composition of compliance, legal and audit over this time period enables us to see a more detailed picture of the changes. As Chart 69 illustrates, the period following the onset of the crisis saw particular growth of compliance and to a lesser degree, audit headcount.

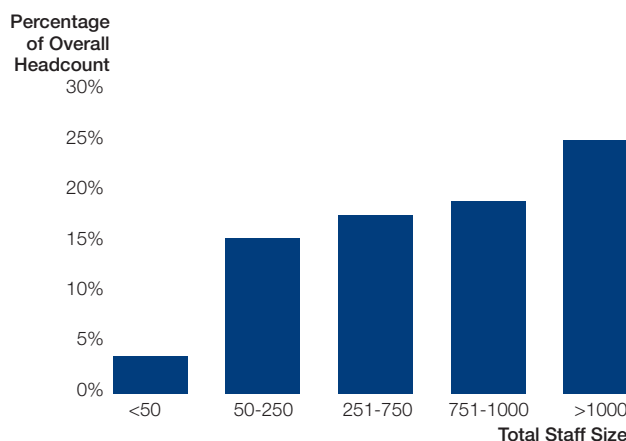
This year we also looked more closely at the functions included in 'other sector', which in 2011 accounted for 5.8% of the entire direct staff count. The greatest share of this category is taken up by various management and support functions (featuring in almost 50% of responses). However, a significant part is also accounted for by risk teams, which featured in almost one-fifth of responses.

Chart 69: Breakdown of Compliance, Legal and Audit as a proportion of overall headcount (2007–2011)



For the first time this year we have also included a question on the percentage of foreign nationals amongst our firms. Responses were received from 38 firms, managing £1.1trn in the UK. Foreign nationals comprise on average 18% of the UK industry staff count, although their proportion differs considerably by size of firm, varying from 0-50%. As shown in Chart 70, larger asset managers are more likely to have foreign nationals amongst their staff than smaller firms. This is unsurprising both because of the international nature of the industry and the proportion of large overseas-headquartered firms among our membership base.

Chart 70: Percentage of non-UK nationals in respondent firms by staff size



⁴² The sample consisted of a number of firms of different asset sizes, which at the end of 2011 managed a total of over £500bn in assets under management.

Outsourcing

As mentioned in previous years, the estimate of total industry-wide employment is made difficult by the firms' outsourcing of different parts of the asset management value chain. At the end of 2011 this was reported by 78% of respondents. While this represents little change year-on-year, Table 10 shows steady growth in the use of outsourcing since 2008. It is unclear to what extent this is coincidental, or to what extent there is any connection with the financial crisis. Key current areas of change such as compliance and operational risk functions are less likely to be outsourced.

Table 10: Use of outsourcing in the industry (2007–2011)

	2007	2008	2009	2010	2011
Proportion of firms outsourcing part of their activity	74%	74%	75%	76%	78%

This year we have also taken a closer look at the different levels of outsourcing by staff function. In line with previous results, the most outsourced areas of asset management business, both in terms of industry take-up and the degree of outsourcing, are back office functions.

Specifically, these are operations and fund administration followed by audit, dealing, and IT systems:

- Operations and fund administration are outsourced by two-thirds of our firms. Two sub-categories, 'transaction processing, settlement' and 'other fund (including collective investment fund) administration' are outsourced the most; 23% and 38% of our respondents, respectively, outsource them entirely. Investment accounting, performance measurement and client reporting is, on a comparative basis, more often managed in-house (only 12% outsource it completely), and if outsourced, then to a smaller degree.
- While compliance and, to a lesser degree, legal are managed in-house by an overwhelming majority of our respondents, 17% wholly outsource their audit function.
- Unsurprisingly, a proportion of our respondents also outsource their IT systems, with one-fifth outsourcing them at least partly, and 9% doing so entirely.
- Within the fund management area, dealing is the only function that is outsourced to any degree at all, although with only 5% outsourcing it wholly, this is still very little on a comparative basis. Generally, any outsourced dealing would go to another part of the same group. As expected, research, analysis and investment management (be it strategic or operational) are outsourced only minimally, and if so, in very small proportions.

Outsourcing does not seem to depend on firm size and is typically undertaken by specialist third party administrators or other asset management firms offering such services.

In terms of the location to where the above functions are outsourced, we find that an overwhelming majority remains in the UK, which is why the actual UK industry headcount for many back office functions is likely to be considerably higher than is captured by the Survey. Among the small number of firms that do outsource abroad, however, a popular locational choice for operations and fund administration is Ireland and, to a lesser degree, other European and Asian destinations.

Risk Management

We asked about firms' approach to the management of risks that arise in running an asset management business. As examples, this would cover operational errors caused by the manager but also the management of counterparty exposures. We wanted to know how this area has evolved since the outbreak of the crisis.

Many respondents highlighted the changed focus on counterparty risk after the shocks of the Lehman collapse. Whilst, historically, systems were designed to track positions on a client-by-client and asset-by-asset basis, few presumed the failure of a global investment bank. The ability to assess exposure on a bank-by-bank basis across any client and any asset now carries greater emphasis. This change of focus was a prime example of a significant enhancement in firms' risk management.

industryview

Counterparty risk

“ We have to change the way we manage counterparty exposures. Whereas in the past, it was possible to have diversified counterparty exposure, the downgrades throughout the industry force us to rethink the duration of our counterparty relationships. These need to be very transparent, and you need to make compromises on both sides in terms of the expected returns. We're still unclear how best to do this.”

“ There is a huge focus on counterparty risk. We've adjusted our thinking. The Counterparty Risk Committee used to meet quarterly, and now they meet monthly and we talk about it constantly.”

“ We continue to try and reduce the number of counterparties, partly because it allows us to analyse counterparty risk better, and that makes them a bit hungrier for giving us information, listening to us.

Before, counterparty risk to us was a quarterly issue and suddenly, for a while was meeting every 24 hours. We have a whole army of people looking at client money and we've heightened our attention to breaches of client guidelines etc.”

Firms are increasing resources in the area of risk management and, as previously mentioned, also of internal audit, to bolster independent checking of internal controls.

industryview

Broader changes in risk management

“ We spent a lot of money improving our processes, bringing in better people and better systems to manage risk, and changing our culture.”

“ The size of our monitoring team doubled as did our internal auditing team. Our risk, compliance and audit teams are almost unrecognisable from before.”

“ There've been huge advances in what data we can get hold of and how quickly. It's immeasurable.”

There has also been a notable elevation of the importance of risk management reporting and governance, such that it is now embedded at the highest levels of organisations. This would have been less true several years ago.

industryview

Elevation in corporate hierarchy

“ If you look at the governance of our business, the Board with Independent Directors, a fit-for-purpose risk management function and a fit-for-purpose internal audit function sitting alongside compliance; three years ago we hardly had any of these. This is something that is hugely time-consuming for senior management.”

“ We've had to prepare for Solvency II for a long time, and so had to go through the formalisation of risk committees and their involvement in compensation and other aspects of the business, whereas before you would only have a finance committee point of view. And I think that's healthy.”

“ Several years ago you'd see only a very limited number of asset management firms who had a Chief Risk Officer. That's now increased, not just in number but also in prominence.”

Whilst there was complete agreement that senior management now had to consider risk as a top priority, the benefits behind the appointment of a Chief Risk Officer were not universally acknowledged. For those who had reservations, the worry was that the presence of a 'Chief' Risk Officer might indicate to other staff that controlling risk was not their concern as well.

industryview

Risk of having a Chief Risk Officer

“Some of our peers have been approached by the FSA as to why they don't have a designated Risk Officer. But one of the things we don't want is for someone to think 'I don't have to think about risk because that's the job of this person over here'.”

Other examples related to an even faster internal escalation and more serious treatment of breaches of client guidelines, as well as increased requirements on outsourced services and agents to support the demand for timely information.

The need for firms internally to articulate external and internal risk issues more clearly was reported by several firms as allowing them to communicate their attitude to risk, including investment risk, more clearly to their clients as well. This was also seen as an antidote to a reflex risk aversion amongst some clients. By developing a clearer language about risk for internal purposes, firms felt better able to maintain confidence amongst clients so that risk-based products could be used in order to provide longer-term benefits.

Additionally, how risk was assessed had changed as well, in particular scenario-testing and stress-testing. This was not seen as a temporary reaction to the crisis but as a new and permanent approach. When deciding how extreme factors regarding defaults or pricing catastrophes should be included in any stress-testing, a far more draconian approach was taken. That many of the events experienced in the crisis arose from an under-estimation of what were thought to be low-probability events (so-called 'black swans'), was a fact that had not been lost on asset managers.

industryview

Changes in risk assessment

“We're not changing our approach, but are raising the bar on what the left tail could look like; it's a fatter left tail.”

Client scrutiny

If the greatest driver of change was experience of the crisis itself, firms' views about the role of clients and even of regulators was much more mixed. Some clients, and their advisers, were said to be more demanding, showing interest in areas such as counterparty risk and securities lending.

Firms saw risk management as a key component of their ability to better serve their clients. Though some reported mixed experience of any clients showing a proactive interest in the subject, the heightened emphasis on risk analysis was seen as an advantage when dealing with clients.

industryview

Client interest in risk management

“Clients and advisers are much more sensitive to auditing and checking what you do; that's welcome and we encourage that. Those companies with good risk and back office systems are starting to distinguish themselves. It's positive for the industry.”

While client scrutiny of controls was generally welcome, one interviewee questioned the logic of clients (usually their advisers) spending too much time looking at the risk controls of a manager, in contrast to considering whether the balance sheet had the strength to withstand losses. In this regard, several firms also reported an emerging interest of clients and their advisers in the asset management company’s own balance sheet and other aspects of corporate strength.

industryview

Greater focus on balance sheets

“ Before the crash, I can’t remember a client who asked about our balance sheets. Now, some of our RFPs⁴³ and some of the bigger sovereign wealth funds ask about them. Life has changed. ”

“ Certainly more clients ask about the corporate strength than they did five years ago, but it’s still probably one in 50 that really focuses on it. ”

“ Sometimes I question whether the idea of clients looking at asset managers’ risk controls is actually very logical because, ultimately, things like operational risk cost our shareholders money, but they don’t cost our clients anything. If anything goes wrong, it’s a problem for us, not for them. ”

Global Investment Performance Standards (GIPS)

GIPS are an international set of standards to guide firms with respect to institutional client reporting on performance. GIPS compliance among respondents remains at a high level, with 82% of respondents confirming that they are GIPS compliant, and 98% of those obtaining external verification of this process. Those that reported not following GIPS were retail or private client-focused managers.

On a matched basis there seems to have been little change since 2009, both in terms of GIPS compliance and in terms of its external verification (see Tables 11 and 12).

Table 11: GIPS compliance among respondents, matched sample (2009–2011)

	2009	2010	2011
Yes	83%	83%	83%
No	17%	17%	17%

Table 12: External verification of GIPS compliance, matched sample (2009–2011)

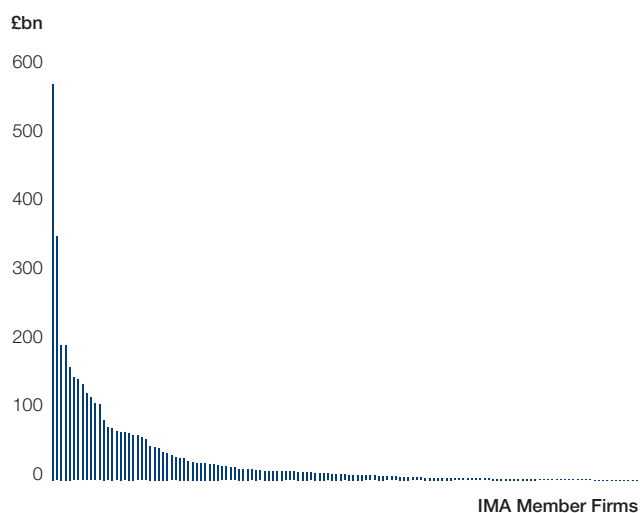
	2009	2010	2011
Yes	97%	93%	100%
No	3%	7%	0%

⁴³ Stands for Request for Proposal; a type of bidding solicitation.

Industry Concentration

As has already been often reported by us, the UK asset management industry is very unconcentrated, characterised by a small number of large firms in terms of asset size, which then rapidly decrease to a long tail of medium- to small-sized firms (see Chart 71). This continues to be the case this year. As at June 2011, average assets under management stood at £29bn, up from £26bn over the year before. During the same period, however, the median decreased slightly from £7.4bn to £7.1bn.⁴⁴

Chart 71: IMA member firm ranking by UK assets under management (June 2011)



Looking at this range of firms in more detail, Table 13 breaks down our membership and respondent base by the size of assets under management. As at June 2011, 12 firms had an asset base of over £100bn, two more than in 2010. At the other end of the spectrum, 101 firms managed less than £15bn (2010: 92), and 29 of these managed less than £1bn (2010: 28). This underlines the highly unconcentrated and diverse nature of the industry.

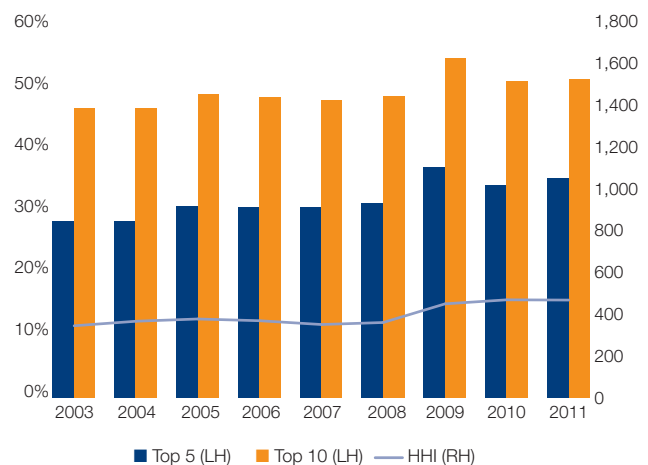
Table 13: Assets managed in the UK by IMA firm size

Assets under management	No. of firms (Jun 2011)	Survey respondents (Dec 2011)
>£100bn	12	12
£51-100bn	11	9
£26-50bn	10	10
£16-25bn	12	11
£1-15bn	72	33
<£1bn	29	3
TOTAL	146	78

In spite of these changes, Chart 72 illustrates that industry concentration has not been affected since 2010, remaining at 466 on the HHI.⁴⁵

The chart also shows the market share of the largest five and ten firms as a proportion of our members' total UK assets under management. Following a noticeable uptick in 2009 caused by the merger of BlackRock and BGI, both measures have now stabilised on a slightly lower level, despite a marginal increase in 2010 from 34% and 50%, respectively, in 2010 to 35% and 51% in 2011. However, the fall from 2009 levels is the result of IMA membership changes rather than competitive dynamics.

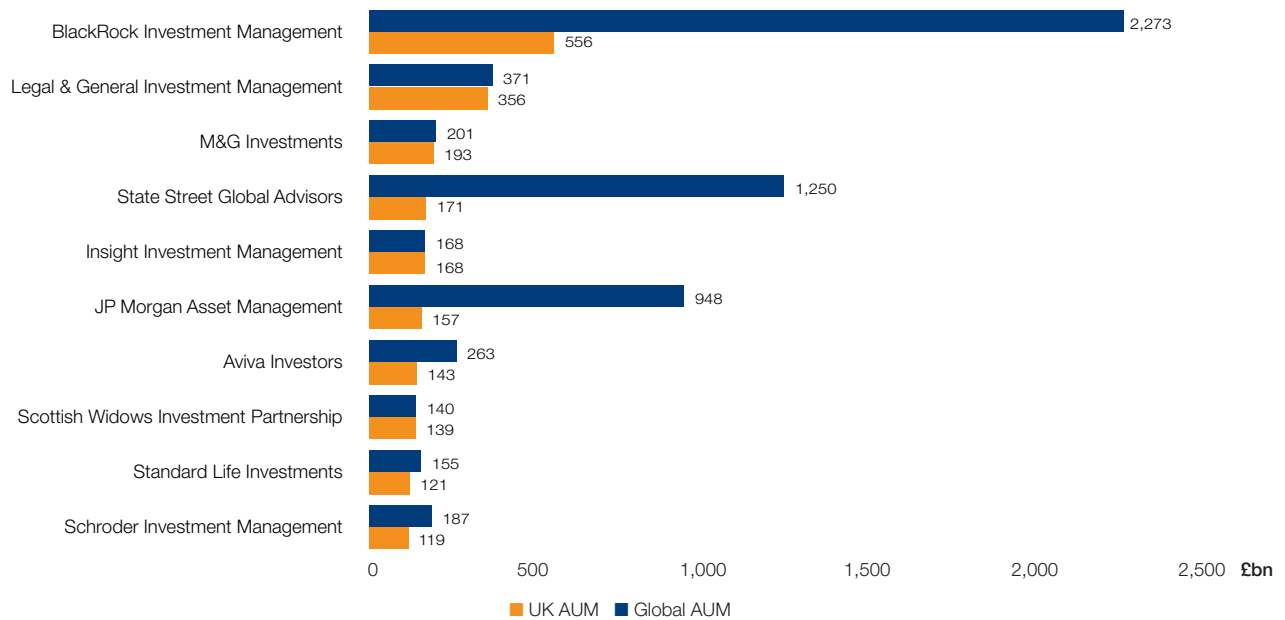
Chart 72: Market share of largest firms by UK assets under management vs HHI (June 2003–2011)



⁴⁴ The data from June 2011 is based on the total IMA membership, and not questionnaire responses.

⁴⁵ According to this measure, markets with a concentration level of between 1,000 and 1,800 are considered to be moderately concentrated, with the maximum possible value at 10,000.

Chart 73: Top ten firms by UK and global assets under management



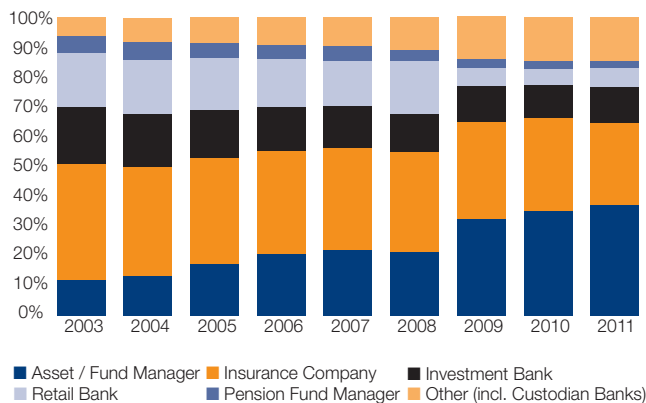
A more detailed picture of the top end of the industry spectrum is provided in Chart 73, which shows the top ten asset management firms by the size of their UK and global assets under management as at December 2011. The group is again headed by BlackRock, followed by Legal and General Investment Management and M&G Investments. It is noteworthy that the top five firms have several features in common, including significant indexing and LDI businesses.

The chart also usefully illustrates the difference between the size of our largest firms' UK and global assets under management, which is particularly stark in the case of overseas-headquartered firms.

Changing Ownership

For some time now, we have reported on the breakdown of UK assets under management by the type of parent company. This has served to track the developments in the relative market share of autonomous asset managers and the more traditional parent firms of asset management businesses, namely banks (both investment and retail) and insurance companies (see Chart 74).⁴⁶

Chart 74: Breakdown of UK assets under management by parent type (2003–2011)



It is clear that the past decade has seen significant growth of autonomous asset managers, accounting for as much as 37% of total assets at the end of 2011 from a very low base of 12% in 2003. During the same period, banks and insurance companies have gradually decreased their market share from 37% and 39% to 28% and 18%, respectively. This has been driven by a variety of factors, including significant divestment of bank-owned asset managers in the aftermath of the crisis. Table 14 overleaf shows the main M&A deals since 2009.

Some of our interviewees this year expected that consolidation will also be driven by the costs and operational complexity brought about by current regulatory reforms.

industryview

Regulation as potential driver of consolidation

“ We see a lot of consolidation in the industry. Larger entities with fund management businesses will either be selling them off or outsourcing. The associated cost of regulation is increasing and with it there's going to be greater complexity in how we bring products to market, how we structure them, how they're presented in marketing etc. ”

⁴⁶ This year we have slightly changed the methodology applied to the classification of different parent group types, basing it in Chart 74 on the legal ownership of a company and disregarding brand or business autonomy. Widely varying ownership patterns (for example, where independently listed firms with overwhelmingly third party business are majority owned by insurers) have made it increasingly difficult to draw the line between legal and de facto independence. For consistency, we have therefore reverted to a legalistic definition. An independent firm with a majority shareholding by another financial institution is classified according to the parent company.

Table 14: Notable M&A deals in the UK asset management sector (2009–2011)

Acquirer	Target
2011	
BT Investment Management	JO Hambro Investment Management
Close Asset Management	Cavanagh Wealth Management
Close Asset Management	Allenbridge Group
Cyrun Finance	SVM Asset Management
Franklin Templeton Investments	Rensburg Fund Management
Henderson Global Investors	Gartmore Investment Management
Investec Asset Management	Evolution
Liontrust Asset Management	Occam Asset Management
Principal Global Investors	Origin Asset Management
Punter Southall	Brewin Dolphin (corporate pensions arm)
Royal London Asset Management	Royal Liver Asset Managers
Societe Generale Private Banking Hambros	Barings Asset Management (private client business)
Threadneedle Asset Management	Liverpool Victoria Asset Management
Williams de Broë	BNP Paribas Private Investment Management
2010	
Aberdeen Asset Management	Royal Bank of Scotland Asset Management (multi-manager and fund-of-hedge-funds business)
Alpha Real Capital	Close Brothers Property Funds
Affiliated Managers Group	Artemis Investment Management
Aviva Investors	River Road Asset Management
Close Asset Management	Chartwell Group
F&C Asset Management	Thames River Capital
Investec Asset Management	Rensburg Sheppards
Man Group	GLG Partners
Marlborough Fund Managers	SunLife Financial of Canada Investment Managers UK
Schroder Investment Management	RWC Partners
State Street Global Advisors	Bank of Ireland Asset Management
2009	
BlackRock Investment Management	Barclays Global Investors
BNP Paribas	Fortis
BNY Mellon	Insight Investment Management
Henderson Global Investors	New Star Asset Management
Ignis Asset Management	Axial Investment Management
Invesco Perpetual	Morgan Stanley (retail fund business)
Marlborough Fund Managers	Apollo Investment Management
Neuberger Berman Group	Lehman Brothers (buy-out of asset management business)
Rathbone Investment Management	Lloyds TSB Private Banking, Royal Bank of Scotland Portfolio Management Service
Sumimoto Trust	Nikko Asset Management

Boutiques

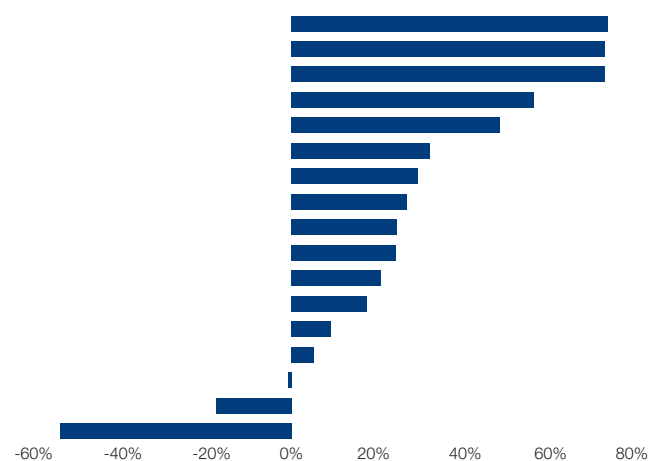
We believe that our past observations about a more challenging commercial and operating environment for smaller players coupled with increasing regulatory burdens remained at least as relevant in 2011 as in the preceding years. We have, therefore, once again tracked the development of a particular group within our membership, namely those who we identify as boutique asset managers. They are broadly defined as firms with the following characteristics:

- UK assets under management of less than £5bn.
- Independent ownership.
- A degree of specialisation.
- Self-definition.

Looking at asset growth, boutique asset managers have again substantially over-performed the industry average. While, from June 2010 to June 2011, the industry grew by 17% on a matched basis, the group of boutique asset managers in our membership base experienced 29% growth year-on-year. As might be expected, however, performance varied considerably between firms. The range in the percentage of asset growth year-on-year is illustrated in Chart 75.

Despite the generally favourable performance of boutique firms relative to the rest of the industry, our interviewees have for a number of years been commenting on a gradual rise to the low barriers to entry, which have traditionally characterised the industry. In recent years this has been attributed to the comparative advantage that the upgrade in regulatory oversight may have provided larger players in the industry.

Chart 75: Percentage change in UK-managed assets across boutique IMA members (2010–2011)



industryview

Larger players favoured by regulatory upgrade?

“The cost and complexity of regulation favours large companies, in terms of the time spent, the quality of the people you need to employ and the number of pieces of regulation you need to pay attention to, multiplied by the number of jurisdictions you operate in. And this is creating new barriers to entry for smaller firms among asset managers as well as financial firms in general.”

“There’s massive intervention in capital markets through central banks and Governments, which is causing a major distortion of capital flows, and there are many unintended consequences in terms of people’s perception of risk.

That causes much more concentration among the winners, as well as consolidation and shifts in markets, and this is set to continue. Unless you’re a pure-play specialist manager, in which case you’ll reach capacity, you’ll face greater barriers to entry.”

PART TWO: REGULATORY CHANGE

The second part of this year's report focuses on regulation. It is based primarily on findings from our senior practitioner interviews. However, it also draws on quantitative Survey data with respect to views on market evolution.

- **Geographies of Regulation** looks at the different actors in the international regulatory process at three levels: global, European and UK. It considers both how institutions and decision-making are evolving and how that evolution is playing out in practical terms.
- **Banks and Capital Markets** focuses on areas of financial services activity that are critical to the functioning of the asset management industry. It first examines the changing role of the banking industry and the implications for asset managers and their clients. It then looks at a range of capital market issues, including views on some significant actual and proposed European measures affecting equity and bond trading and OTC derivative clearing and trading.

The messages are wide-ranging. Many firms welcome reform of the banking sector and recognise that asset managers themselves have lessons to learn in certain areas. We have already commented on changing risk management processes in Chapter 5. There is also broad acceptance of the need for significant regulatory oversight in certain areas. For example, UCITS is seen as a major success story both in Europe and internationally.

At the same time, there is considerable uncertainty, and concern in three main areas; the implications of a lack of coordination internationally, the need for appropriate focus and the risk of unintended consequences. Firms are worried, above all, about how their ability to deliver the best outcomes for their clients may be affected. The call is not for less regulation, but regulation that allows investment managers to deliver to clients the services they seek, without being subject to inappropriate levels of constraints and/or costs.

In light of the evolution of both the international regulatory and economic environment, the UK should not lose sight of the need to retain and promote its attractiveness and competitiveness as a base for serving clients on a European and global basis.

6. Geographies of Regulation

Key Findings

Global regulatory environment

- While many regulatory measures are still under discussion, and years away from full implementation, it is clear that a new geography of regulation is emerging, with a new global regulatory architecture at the heart.
- Although global coordination is in principle welcomed, the reality of global regulatory activity for asset managers is more immediately characterised by fragmentation, creeping extra-territoriality and signs of protectionism. This is a source of additional complexity, cost and, consequently, concern.
- Extra-territoriality is not in and of itself new, but firms identified a particular aggressiveness in the current climate, affecting firms who may not have an especially international operating base.

Extension of European powers

- For UK asset managers, the new geography is dominated by significant changes at the EU level, particularly the increasing authority of the European Supervisory Authorities (ESAs).
- Many UK firms have benefited significantly from the European single market, and in particular the international success of the UCITS brand. However, while generally supportive of the single market, UK asset managers are cautious about the implications of the considerable expansion of power by the ESAs.

UK regulatory environment

- In terms of UK oversight, there were a range of views expressed on the quality of supervision and relationships between firms and the regulator. As the industry awaits the new Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA), there is a desire to ensure constructive two-way dialogue.
- The range of regulatory change facing the industry globally is making decisions about location choice more complicated. While there are still warnings about the need to preserve the UK's attractiveness as a place to do business, respondents did not feel that regulatory considerations would have a significant negative impact on location choice.

6. Geographies of Regulation

Global Regulatory Environment

The crisis has introduced several new high-level narratives to guide or explain what policymakers are seeking to achieve, but one in particular has a special impact as it comes from a new actor, the expanded G20 (itself a reaction to the crisis). The G20's objectives are:

- Policy coordination between its members in order to achieve global economic stability and sustainable growth.
- Promotion of financial regulations that reduce risks and prevent future financial crises.
- Creation of a new international financial architecture.

Together they set the context of the new geography of regulation and new philosophies of supervision. The twin aim of financial stability and sustainable growth is now a key concern of legislators re-designing financial services regulation.

In terms of institutional initiatives, the G20 in April 2009 formed the Financial Stability Board (FSB) and has signed up to a variety of regulatory changes and international commitments. The FSB is not entirely new. Its forerunner, the Financial Stability Forum, formed by the G7 in 1999, was intended to improve stability in the international financial system. But with the wider membership of the G20 and strong political support, the FSB has already become a senior source of policy and standards globally.

Challenges to global coordination

Among the firms we spoke to, the desire for consistency was often strongly expressed, particularly among international firms operating in multiple jurisdictions. However, although many reforms have been initiated by G20 commitments, and so ought to be addressed globally, there are emerging differences in the US and EU approaches. Given the high-level nature of G20 commitments, each country can still claim to be acting consistently with any particular commitment in support of its own approach, even if overlapping or inconsistent with approaches in other countries.

industryview

Challenges of the G20 process

“ One of the problems is that the G20 process is pretty much a framework. So the G20 process pulls the lever, and says ‘we have committed to this, now go on and implement it’ with insufficient support and guidance to jurisdictions on how to do it... But we shouldn't be too pessimistic either. There are genuine attempts to have genuine coordination. ”

We asked interviewees how significantly the fragmentation of a global approach to regulation impacted their business. Respondents gave negative feedback in a number of areas, notably:

- The US Foreign Account Tax Compliance Act (FATCA); Dodd Frank and the impact of the Volcker Rule.
- Europe's recent proposals on third country actors and activities as seen in the Alternative Investment Fund Managers Directive (AIFMD) and proposed in the Markets in Financial Instruments Directive (MiFID) II.

On a more positive note, it was also recognised that the G20 process has meant that derivative clearing has had to be addressed in the US and EU without allowing either to claim too great an advantage.

Key legislative initiatives

Foreign Account Tax Compliance Act (FATCA)

FATCA is US legislation designed to counter US tax evasion by identifying US account holders of non-US financial institutions. HM Treasury together with the governments of the US, Germany, Spain, Italy and France have published a model intergovernmental agreement (IGA) for implementing FATCA. Financial institutions in these territories will need to comply with the IGA and not the FATCA regulations.

Given the current wide-ranging definition of a foreign (ie. non-US) financial institution, FATCA will have a significant impact on the UK investment management industry. It will impact funds, fund operators, asset managers, pension funds and distributors. Regulations reflecting the UK's commitments under the IGA will likely be introduced in the 2013 Finance Bill.

Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)

Dodd-Frank sets out the US financial services reforms following the global crisis, and marks the greatest legislative change to the US financial landscape since the 1930s. The general framework marks a historic shift in the regulation of US banking, securities, derivatives, executive compensation, consumer protection and corporate governance. It will affect the regulation of US and non-US financial institutions, banking entities and commercial companies.

Dodd-Frank became law on 21 July 2010, however, few provisions were effective immediately; Congress designed it to become effective in stages. Many provisions of Dodd-Frank rely on rulemaking and interpretation by financial regulators.

The 'Volcker Rule', which is part of Dodd-Frank, generally prohibits any 'banking entity' from engaging in proprietary trading, and limits investment in a hedge fund or private equity fund.

Alternative Investment Fund Managers Directive (AIFMD)

The AIFMD will regulate managers (AIFMs) of any collective undertaking – whether open-ended or closed-ended, authorised, listed or unregulated – which is not a UCITS. It imposes detailed regulation on non-UCITS funds as well as managers since it will introduce requirements relating to the safekeeping of assets, leverage, liquidity management, and valuation and pricing.

So far as the UK is concerned, the majority of funds in scope are not hedge funds or private equity funds, but nationally regulated retail schemes, charity funds and pension pooling vehicles.

The Directive came into force in July 2011. Member states have until July 2013 to enact the necessary laws to implement the AIFMD.

Consequences of fragmentation

Fragmentation, in the sense that firms have to deal with different rules in different jurisdictions, is a familiar problem, which creates additional cost and complexity. While this is a source of frustration, firms are realistic about the nature of the challenge.

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Challenges of global operation

“The environment has definitely been renationalised, and we’ve definitely been affected. It’s difficult to know what the prevailing ‘gold standard’ is. Sometimes you may think you know what it is, but suddenly you realise that you cannot do that in another part of the world. It’s a changing scenery that has made life quite complicated.”

“It’s inconceivable that we will have a global authority at any point, but we are operating globally. Therefore, we simply need to have a flexible enough business model to cope with these things. We’ve been doing it for so many years now that it’s just another thing we need to throw into the pot.”

A real example of a different type of cross-border fragmentation relates to the Lehman failure, the fallout from which still impacts some firms. The cross-border arguments between insolvency practitioners leaving assets still tied up in claims revealed practical limits to cross-border coordination of bank failures. As Europe addresses crisis management and cross-border resolution through legislation, so will it become more urgent to address the issues arising from globally disparate insolvency regimes.

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Timely focus on insolvency rules

“The cash-flows between investment managers on behalf of clients and investment banks were always set up to protect in the event of a default of the investment firm, not to cover the fallout in a default of the investment bank counterparty. That’s the fundamental issue. It’s only now that regulators are starting to look at insolvency rules, which is what they should’ve done a long time ago.”

It was noted that fragmentation would also increase regulatory arbitrage, which is unlikely to prove beneficial. Concerns amongst the G20 about the risk of regulatory arbitrage as well as gaps in regulation have led the FSB to launch a series of work-streams under the banner of shadow banking. The European Commission has begun to consider this theme as a cross-cutting issue too.

Emerging extra-territoriality

Assertive extra-territoriality is a more recent trend, with firms expressing a strong concern about the direction of travel in this respect. Extra-territoriality has an impact well beyond international firms who may be used to dealing with the complexities of operating in multiple jurisdictions. It can affect domestically-focused asset management firms who happen to be caught under legislation because of certain links with the country where the legislation originates (eg. having clients with that nationality, even if they are based overseas).

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Regulatory imperialism?

“It’s not the logistics of dealing with so many regulators, but the fact that some regulators are trying to export their own regulation. Regulatory imperialism has no benefit whatsoever.”

“We’ve tended to avoid the US as a place to do business. But we do of course observe, through FATCA and various other initiatives, that the invisible hand is reaching out and impacting our businesses.”

Several themes emerged from the increasing perception of extra-territorial imposition of one country’s rules upon another:

- Extra-territorial rules are invariably over-burdensome, both in cost and complexity.
- Fragmentation adds to operational costs within a firm, for example in needing to report information and organise data in multiple ways, each specific to every regulator.
- Different regulators may not agree with respect to jurisdiction over firms operating internationally.
- The nature of global asset management is that business is delegated to other countries and other parts of a global group; restricting this increases costs and reduces investor choice and returns.

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Consequences of extra-territoriality

Risk of disproportionate costs

“If people regulate extra-territorially, they don’t go through the cost-benefit discussion in the same way and they don’t play out the implications. And that’s partly because the benefit is in one country and the cost is elsewhere. They have no way of knowing what havoc they’re creating somewhere else, and they don’t have the time or the resources to think it through across so many other countries.”

Incompatible demands from different regulators

“We’ve had situations where competing regulators couldn’t agree on who the overarching regulator in that particular area was, and we’re caught in the middle, for example around the issue of independent non-executive directors or remuneration. We end up giving everybody as much as we can but it makes it more difficult.”

Specific consequences for clients and business in certain geographies

“US investors living overseas will find it more difficult now to find homes for their money because no one will want their money.”

Danger of protectionism?

An additional issue is outright protectionism, which could be triggered by extra-territorial issues as countries respond by raising their domestic barriers. Several firms commented that the AIFMD had worrying elements of protectionism.

The AIFMD may also have significant broader negative impacts for European asset management, according to those we asked. Although capturing some hedge funds and highly leveraged funds, it also impacts hundreds of billions of assets in institutional pools and closed-end funds such as investment trusts, as well as many non-EU funds which might be used by EU investors.

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Dangers posed by the AIFMD

“ We’re seeing increased protectionism, but that’s particularly an issue within Europe, such as with the AIFMD or third country access. And some of it is basically product regulation through the back door, which is a great concern. We’re going to be significantly impacted by the AIFMD, although not in the way we should be. It’s the unregulated fund ranges that will get caught; it’s capturing everything that’s not UCITS, not capturing the heart of the hedge fund activity. Our LDI funds, for example, are caught particularly badly within this. ”

Extension of European Powers

The Survey comes at the end of a period of 25 years under which legislation and policy from the European institutions has had a significant impact upon the regulation of financial services in the UK.

For an asset manager in the UK the regulatory environment of the late 1980s had the following features:

- Supervision by a self-regulatory organisation.
- Statutory prescription principally at the level of what areas had to be covered, rather than how they were covered.
- Little significant European influence.

Currently, regulation is almost entirely statutory and the European single market is moving beyond issues of free movement of services and capital to a harmonised regime not only of rules, but increasingly of supervisory process as well. A very large majority of the rules to which an asset manager is subject derive from EU legislation; more still is planned.

The ESAs not only have an increased role in legislation, where it is a growing presumption of directives that the ESAs write the detail, but they will also now set standards to secure consistent supervisory approaches and play a role in contributing to financial stability. In this they support the European Systemic Risk Board (ESRB), another creation of the credit crisis. In another development, the European Securities and Markets Authority (ESMA), one of the ESAs, now directly supervises credit rating agencies, for the first time bypassing national supervision.

The timelines at the end of the chapter summarise 25 years of regulation in the UK and EU from the point of view of asset managers. Seen historically, the shift from the national to European-wide represents a dramatic shift in power and approach. At the European level, there is also a dramatic shift in scope.

General attitudes to European integration

We asked interviewees whether the gradual expansion of power of the ESAs would benefit UK asset management firms. For many, the idea of having a deeper single market with access to clients throughout the EU was a prime objective. This was particularly true of firms with fund exporting businesses, which have benefited from European financial services integration.

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Benefits of European integration

“Unless we absolutely integrate the European market and make it as fluid as the US market, we can't be as competitive as we could be. So we should aim for as much integration of the European market as we can have.”

“Some people see the UK and Europe as separate landscapes whereas we see it as one marketplace, so of course we're operationally more impacted by diverse sets of rules for the different marketplaces. Anything that ESMA can do to standardise and harmonise I'm all for; I want to see the FSA work through ESMA, not unilaterally on UK initiatives which to me look like 'gold-plating'.”

Broad support for UCITS

Indeed, when asked to name the best piece of regulation over the last decade, UCITS was the most commonly cited by interviewees (67%). Nevertheless, a minority of firms we spoke to wondered whether UCITS might have gone too far in extending the brand to a wider range of financial instruments.

industryview

Mixed views on extended UCITS powers

The enthusiasts

“UCITS has been an extraordinarily powerful piece of regulation, defined and rolled out responsibly, that's enabled Europe to export its activity into the Middle East, Latin America and Asia.”

“UCITS III wider powers enabled us to compete with the alternatives industry. Now we've got the same instruments in our armoury, but I think we're better controlled because we have better governance, better supervision, better segregation of assets. While some people worry that UCITS III went too far, I think it's a question of understanding that complexity doesn't equal risk. Complexity is helping to manage risk.”

The more cautious

“I'd be cautious about the areas that UCITS has ventured into. It would be better to have a UCITS standard for hedge funds and a standard for non-hedge fund vehicles. There's also a risk question. Is running a NASDAQ index fund really less risky than running a long-short bond fund with 5% volatility? That effort of muddying the two has raised more questions about UCITS as an exportable brand.”

“I worry about the possibility of a major problem within a regulated product. The UCITS brand, whether a SICAV or an Irish UCITS, is a global commodity now, and my big fear is some sort of scandal in UCITS.”

Range of concerns about ESAs

While supportive of UCITS, many more critical comments were focused on issues intrinsic to the ESA regime itself and why a truly harmonised approach was still unlikely in the near future. A range of concerns were expressed:

- The European process was seen as reflecting political compromise rather than coherent, focused and pragmatic rule-making. Furthermore, to date, respondents had little practical experience of a truly harmonised approach on which to base an optimistic view.
- Some thought asset management as an industry was not sufficiently understood in the EU, especially given the dominance of the bancassurer model on the continent.
- Several interviewees had experience of what one described as “*the infinite smartness of local regulators to bypass integration efforts*”.
- There were concerns as to whether ESMA had the resource for the tasks it was being given; the rule-making tasks alone seemed too much, let alone action to foster harmonised application and interpretation.

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Concerns about extended European supervision

Practicalities of a harmonised approach

“The single market is a great idea, but there are different levels of sophistication, different cultures and different priorities. How are you supposed to have a harmonising supervisory approach when you have such disparity?”

“In principle, harmonisation should be a good thing. The danger is when it becomes politicised and other factors creep into the process; that’s when it becomes problematic. And certainly the track-record on harmonisation isn’t good.”

Experience and resources

“The idea of having a deeper, real single market with access to clients throughout Europe is good, but it depends on the balance and the resources and the backgrounds of the people in ESMA. The scale of ESMA is tiny and the time they are given by their political masters is extremely limited. That is unhelpful.”

“UK regulation is on average more knowledgeable, more resourced and more pragmatic than European regulation. You give that up when you enter the European context.”

Unfamiliarity of businesses with ESAs

“We just have to up our game in working with ESMA and working with European infrastructure. You read the press and the scaremongering about Europeans and European solvency crises and you encounter a lot of emotional issues. That’s where there is a lack of confidence or enthusiasm for getting involved, and it makes us slightly worse off than we should be given the weight and strength of our financial services capabilities.”

“Businesses also need to be better at understanding what the ESAs do. We’re all aware by now that they have taken over the advice-giving role that the committees used to have, and now their technical standards are starting to be produced. But the ESAs also have product intervention powers and they undertake annual risk surveys, which few people are aware of. Firms will get used to it with time as the sector becomes more used to these new powers.”

Cultural differences within financial services

“Continental Europe has fewer companies like us. They have big banks, which is what the whole mentality is steered towards. We don’t hold our clients’ money and we don’t invest on our own book, but the whole discussion about capital requirements, is predicated on the European banking system, not on firms like us.”

However, it was also acknowledged that nation-specific consumer and distribution issues would mean that not every issue could be dealt with at a European level, even if that was the direction of travel:

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“Clearly, to the UK consumer and the local level, the UK will still be incredibly important but there will be overarching European influences. And product intervention will be part of that.”

Furthermore, interviewees who were heavily engaged in distribution across many European states described the choice not as between the UK or Europe, but as between a single pan-European regime and many different national regimes:

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“If I have a choice between working with a single European regime that’s a bit slower, not as confident and not as well-resourced, or dealing with 13 out of 27 different regimes, give me the European regime. So the harmonisation aspect is important.”

Opportunities to express the UK voice

Several firms also saw this as an opportunity for the UK to be more assertive in directing policy and providing resource to ensure solutions better reflected the UK industry and its desire for a more harmonised approach. Despite an acknowledgement that the FSA does influence the technical work at ESMA on particular dossiers, they wished that UK regulators were more pro-active strategically. If they were more pro-active, it was hoped that there would also be less temptation for the UK to ‘go it alone’ in Europe or introduce new policies ahead of European proposals, as it had occurred with the imposition of remuneration limits on some UK UCITS managers.

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Opportunities for UK regulators

“The role for the UK is policy influence and hopefully through ESMA technical implementation rather than ‘gold-plating’ through the FSA.”

“Where ESMA could be very useful to all of us is if it was successfully lobbied by the FSA and came up with a standard template for the whole of Europe. That’s what we want; clarity and consistency across our markets.”

“What I would love is for the UK to be as pro-active in its strategies as the French are. Because what they do is think ‘what do we need for our industry 4-5 years hence’ even though they may not have all the details there. Our regulatory set-up is not as forward-thinking or pro-active.”

The context of these discussions was not only the new powers of the ESAs but the unprecedented broader level of regulatory change facing asset managers. With the gradual revision of every major directive and regulation that affects managers, and several new ones being introduced (such as the AIFMD and EMIR), there was a general sense of regulatory ‘overload’, and uncertainty as to what the European marketplace would look like. Nor was it clear whether it would remain competitive, once the changes came through in a few years’ time.

UK Regulatory Environment

We considered several aspects of UK regulation with those we interviewed, including the quality and priorities of FSA supervision, and the impact of that on the UK's attractiveness as an asset management centre.

Prudential supervision and the role of the ICAAP

The FSA's prudential (non-conduct) supervision of asset managers focuses on how firms manage the risk to which they are subject outside issues such as investment risk; for example, this would include the risk of operational errors, causing loss to clients for which the manager would be liable. However, the FSA was not seen as the prime mover of recent changes. Firms were already implementing changes in the wake of the dislocation of 2008.

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Firms or regulator driving change

“The changes are partly driven by the FSA but partly driven by an internal desire to have better controls and better governance inside our business. So, in that respect they were pushing an open door, really.”

“I wouldn't say the changes date from regulation. The crisis, however, has absolutely made us pay more attention to operational risk.”

Nonetheless, much of the prudential supervision of asset managers by the FSA revolves around the Individual Capital Adequacy Assessment Process (ICAAP), which is derived from EU legislation. Firms assess the risks to which they are subject, their controls and mitigants, and they set a capital level accordingly. The FSA reviews this and agrees or imposes a higher capital requirement. Carried out conscientiously it can be a very searching review and involves stress-testing several scenarios. Since asset managers do not take market risk onto their balance sheets, a key risk for them is operational risk and a key crisis scenario is that of a forced wind-down.

Views on the ICAAP were varied. There was acknowledgment of the focus it brought to management information and Board reporting. But some felt it had gone too far and was too influenced by an approach that treated everyone as banks or on a scale with banks in terms of capital requirements.

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Relevance

“One of the benefits to us has been some of the capital adequacy requirements under the ICAAP. Before that came about, fund managers didn't really think about capital requirements, they didn't stress them. And as a result you learn to explain and articulate risks in a business which no-one has done before because it's quite difficult. So it's made people concentrate on it and think about what can destroy a company.”

“Some aspects which are designed to solve the banking issue are in my view just irrelevant for us, such as the huge focus on capital and the fact that every element of our risk framework has to have some sort of capital number against it.”

“It's impacting the priorities of our regulator towards us in ways that raise questions and concerns as to what their focus is. With the FSA, the big priorities have been an emphasis on the ICAAP and doing aggressive, worst-case-scenario analyses on our business. Almost looking at our business as a potential source of systemic risk and treating us like a bank.”

Developing the theme about what the FSA was seeking to achieve, there were many comments in this area, supporting a view that there was little faith or confidence in the focus of the regulatory environment (although this was not confined to the UK).

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Appropriate focus

“A lot of the reporting requests we get are certainly intrusive but they also strike us as naïve; we don't really know what Luxembourg or the FSA are going to do with all this data, and it's not the data that we would have collected to answer the questions that we think they're asking.”

We don't understand the rationale behind questions on certain exposures, for example. We would understand it if we were a bank, but we're not; we're an asset manager and it's other people's money we're managing, not our own.”

“The regulatory focus placed on the area of cash-flows over the past couple of years has been wholly disproportional to the risk we have in that area.”

Some of the comments relating to a lack of confidence in what the FSA was seeking to achieve reflected upon its priorities given the resources both the FSA and industry had to commit to the ICAAP; among the latter particularly firms that had an international operational structure.

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Frustrations of international firms

“... We wonder if that's the best use of the FSA's resources for a business like ours. And they don't ask for our global numbers. We're treated as a standalone UK business, which we're not.”

“When we're trying to do our ICAAP, the very low-probability, high-impact risks require a huge amount of brainstorming on a very senior level. It is probably a good exercise but is it a scalable exercise for a global company? Because if we did that in every place we operated in, the amount of time we'd burn up would be enormous and the result may not be any different.”

Two firms highlighted the FSA's policy not to provide guidance on EU regulations and in particular how, as UCITS funds began using more derivatives, the Dublin and Luxembourg regulators had had good engagement with fund managers and provided greater clarity on what was needed. Those firms welcomed the closer engagement and prescription about derivative risk management plans and fund governance offered in the other fund centres.

Relationship with the industry

The transition from the FSA to the FCA was also seen as introducing risks, not least in the turnover of staff and perceived loss of market knowledge from a level that many thought was inadequate anyway. Together it was feared that these would increase the level of uncertainty as to what was expected of firms by the regulator.

There was a desire for a better level of partnership with the FCA than had been experienced with the FSA. In this respect, some remembered earlier times when contact with the regulator (a self-regulatory organisation, or SRO) was far more frequent and the balance of rules and supervisory oversight very different.

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Benefits of closer interaction?

“Everywhere has become harder, and the relationship with the regulator is changing, partly because the regulator is re-imposing their authority. And you want that to some degree, but as they re-establish their authority, how does that manifest itself? The importance of this partnership has never been greater.”

“The relationship with the regulator was very different 25 years ago. Weekly, if not every other day, there would be some conversation at some level of the organisation with somebody from them. That's no longer the case.”

“Or if you want less regulation, then better to reintroduce the more hands-on approach of the Bank of England. Because now we have layers and layers of regulation and regulators wanting to attend Board meetings. It's absurd. Better to have less regulation and more intrusion, with a closer relationship with the regulators including the Bank of England.”

Impact on Locational Decisions

We asked interviewees to what degree good regulation was still seen as a reason to be located operationally in the UK. There was little talk of relocation and it was noted that some hedge fund operators had recently come back to the UK. For some, the answer to the question was quite straightforward; they could not leave. Many clients want and expect their manager to be in the UK. For firms with a practically exclusive focus on their domestic market this, however, also increased both the exposure to their regulator and, commensurately, the stake they had in a productive relationship with them.

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The vulnerability of 'one-country' firms

“The biggest risk for us is being lost at the FSA. We're a predominantly one-country firm, and the FSA therefore has a significant impact. Factors such as staff turnover and how the transition to the FCA is handled make a big difference.

The UK regulator is the referee we have and shapes the playing field we play on, so if it goes badly, it will have a more direct impact than any single piece of regulation.”

Equally, for many it was not a choice of one regulator or another, but the day-to-day experience of facing perhaps up to 35 regulators globally. Some were mentioned as being more difficult to deal with than the FSA. Certainly the FSA's policymaking was generally preferred. It was said that there were few other countries that could allow such a range of activities to be carried out within financial services generally, to the benefit of asset management.

For most, the UK regulatory culture was still seen as more attractive than that of the US, as not every conversation with the FSA needed to be intermediated by lawyers as was the experience with the SEC. There was a fear, however, that this may change under the new UK regulatory architecture. Nevertheless, there were said to be attractions to the US rule-based regime in the greater certainty it provided.

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The merits of rule-based regulation

“The attractiveness of a rule-based system is that it makes complying with regulations a fairly straightforward exercise. A disadvantage of this approach is that rules can get outdated and have unintended consequences. For a principles-based regime to work well, the regulatory environment needs to be stable and the regulatory agencies must have large staffs with high quality, experienced people.”

'Gold-plating' arose as a distinct downside to being UK-regulated, for example in relation to the new remuneration principles,⁴⁷ and unlike any of the major competitor countries in Europe. At the same time it was noted that one consequence of a lot of the problem regulations coming from Europe or the US is that they applied wherever a business was based.

There were also calls for the UK to be more strategic in seeking to attract business; comparisons were made with the French who were perceived as being closely focused on this issue, or to Luxembourg and Dublin to whom the UK has lost its position as a fund domicile.

⁴⁷ These have applied to fund managers since January 2011.

As we have commented in the past, a complex range of considerations apply with respect to firm location choice, of which regulation is one, albeit an important one. In this respect, firms noted that the UK had built up a highly successful brand as an asset management centre, building on familiar factors such as language, time zone, co-location with other market participants and strong support infrastructure. However, such a brand could be easily tarnished.

industryview**Appreciation and concerns for London's locational advantages**

“London is in a tough spot, although with its multiculturalism, time zone and other advantages it will continue to be a dominant financial centre. Also, there is flexibility here that we don't find in the US. But as the UK tries to do a balancing act between the East and West, I am not sure how well it is handling its relationships with Europe, the US and Asia. That's a major challenge.”

“The business environment is like a rainforest ecosystem; it takes centuries to build and a few years to destroy. And we should be very careful because it has never been created almost as perfectly as here. Because once destroyed, it will not be rebuilt.”

Figure 9: Timeline of UK regulatory events

1980s	1990s
<p>Introduction of the modern regulatory system; self-regulation among asset managers, statutory oversight of banks and insurers.</p> <ul style="list-style-type: none"> ■ The Financial Services Act 1986 (FSA 1986) marks a step change in the nature and extent of UK investment business regulation. ■ April 1988 sees the introduction of a regulatory system that has investor protection as its main aim. ■ The system is based on five self-regulating organisations (SROs);⁴⁸ membership organisations tasked with the creation, monitoring and enforcement of rules for their respective members. ■ The SROs cover five different areas of financial services; futures broking and dealing, financial intermediation, investment management, life assurance broking and securities broking. Asset managers are represented by the IMRO. ■ The SROs are approved and overseen by the Securities and Investments Board (SIB), a regulator with statutory powers. ■ Banks and insurers are under statutory regulation by the Bank of England and the Department of Trade and Industry (DTI), respectively. 	<p>Self-regulation becomes increasingly diluted. A series of perceived regulatory failures leads to a commitment to a unitary single-tier regulator.</p> <ul style="list-style-type: none"> ■ In April 1990, the “New Settlement”, proposed under the auspices of second SIB Chairman, Sir David Walker, introduces a three-tier structure of standards imposed upon firms. <ul style="list-style-type: none"> ❖ At the top tier, the Ten Principles of business seek to present a universal statement of the expected standards, applying directly to the conduct of investment business and to the financial standing of all authorised persons. They are qualitative, high-level and frequently behavioural in their expression. ❖ The second tier designates a number of Core Rules, binding upon SRO members in certain key areas, such as those relating to financial resources, conduct of business and client money. ❖ The third tier are the SRO rules. ■ A series of perceived regulatory failures (not least the Maxwell pension funds scandal), provides the context for the 1993 Large report. In stopping short of proposing the end of self-regulation, Andrew Large proposes more leadership by the SIB, while recognising that the objectives of regulation are not sufficiently clear and self-regulation can be too synonymous with self-interest. ■ The EU Investment Services Directive 1993 (ISD) imposes from the beginning of 1996 some capital and reporting requirements upon managers on an EU-wide basis and so cuts further across self-regulation. ■ Organisational mergers in 1991 and 1994 reduce the number of SROs to three,⁴⁹ with the IMRO as the only surviving original body. ■ The failure of Barings Bank in 1995 and a change of political administration in 1997 result in independent monetary policymaking for the Bank of England, and a name-change of the SIB into the Financial Services Authority (FSA), ushering in the end of self-regulation.

⁴⁸ The Association of Futures Brokers and Dealers (AFBD), the Financial Intermediaries, Managers and Brokers Regulatory Association (FIMBRA), the Investment Management Regulatory Organisation (IMRO), the Life Assurance and Unit Trust Regulatory Organisation (LAUTRO), and The Securities Association (TSA).

⁴⁹ The Investment Management Regulatory Organisation (IMRO), the Personal Investment Authority (PIA) in place of the FIMBRA and the LAUTRO in 1994, and the Securities and Futures Authority (SFA) replacing the AFBD and TSA in 1991.

New millennium

Introduction of a unitary regulatory structure and an era of ‘more principles-based regulation’. While the legislative balance of power shifts to the EU, supervisory approaches remain national.

- Introduced by the Financial Services and Markets Act 2000, from late 2001 the FSA oversees a statutory and unitary system for the regulation of investment business, banking and insurance in the UK.
- The FSA now has four statutory objectives supported by a set of principles of good regulation. The objectives are:
 - ❖ Market confidence (maintaining confidence in the UK financial system).
 - ❖ Public awareness (promoting public understanding of the financial system).
 - ❖ Consumer protection (securing an appropriate degree of protection for consumers).
 - ❖ Financial crime reduction (reducing the possibility of regulated businesses to be used for purposes connected with financial crime).
- The supervisory culture at the FSA is often characterised by a series of overarching approaches and themes, such as ‘more principles-based regulation’ and ‘Treating Customers Fairly’.
- The FSA Handbook, a set of rules to which regulated firms are subject, becomes increasingly prescribed by EU legislation. This is aided by the FSA’s move to the so-called ‘copy-out’ approach, transposing directives word for word, where possible, in order to avoid ‘gold-plating’.
- The FSA grows in size and cost through greater activity for the Financial Ombudsman Service and increasing calls on the Financial Services Compensation Scheme, fuelled by a growing number of consumer complaints especially around bank charges and payment protection insurance.
- The FSA also increases its enforcement activity, especially on market issues and in terms of stepping up fine sizes.

Financial crisis and beyond

The single regulatory structure is restructured as a response to the crisis. National supervisors face greater harmonisation of practice at EU level.

- The need to prop up the banking system introduces a new actor, the Resolution Authority (in the UK a role of the Bank of England), as the Tripartite Authorities⁵⁰ put in place legislation to deal with bank resolution after the collapse of Northern Rock. Major banks are now required to have recovery and resolution plans (‘living wills’).
- Government announces the planned break-up of the FSA in 2012. It transfers the prudential supervision of banks and insurers to the Prudential Regulatory Authority (PRA), a new subsidiary of the Bank of England, with clearing house supervision to be undertaken directly by the Bank of England.
- Financial stability becomes a key objective of the new regulatory regime. The interim Financial Policy Committee, a new committee of the Bank of England, is charged with responsibility over this area, and is planned to become part of the new regulatory structure.
 - ❖ The FSA’s objectives are altered by the Financial Services Act 2010, with Public awareness replaced by Financial stability (contributing to the protection and enhancement of stability in the UK financial system).
- The FSA is to be re-named to the Financial Conduct Authority (FCA), introducing more intrusive supervision. This will, alongside other changes, include a commitment to challenge a firm’s own judgement concerning their business models, strategy, and product development.

⁵⁰ HM Treasury, the Bank of England and the FSA.

Figure 10: Timeline of EEC/EU regulatory events

1980s	1990s
<p data-bbox="185 506 751 607">The Single Market project picks up momentum, marking the first steps towards a pan-European fund vehicle.</p> <ul style="list-style-type: none"> <li data-bbox="185 640 719 770">■ The EU White Paper on the Single Market 1985 and the subsequent Single European Act 1986 propose a single market for completion by 1992. <li data-bbox="185 808 746 938">■ The EEC introduces a directive to establish common basic rules for the authorisation and supervision of the activities of open-ended collective investment schemes (UCITS). <li data-bbox="185 976 751 1077">■ This is passed in 1985, with Luxembourg, the first adopter, implementing the directive in March 1988. <li data-bbox="185 1115 759 1216">■ The Directive expects the cross-border sale of funds across the EEC area to commence from 1 October 1989. 	<p data-bbox="839 506 1501 573">Greater commitment to the Single Market but slow progress on supranational harmonisation and UCITS.</p> <ul style="list-style-type: none"> <li data-bbox="839 640 1509 707">■ The ISD imposes requirements on investment firms and enables the cross-border passporting of business. <li data-bbox="839 745 1501 909">■ The Directive does not, however, envisage secondary legislation to detail any requirements and only requires minimum harmonisation. National approaches remain and countries can still mandate the use of national stock exchanges for share-trading. <li data-bbox="839 947 1509 1077">■ A proposal to introduce improvements to UCITS, including widening the range of permitted investments, never completes the parliamentary process. However, the work forms the basis of UCITS III in late 2001. <li data-bbox="839 1115 1509 1402">■ The EU reaches political commitment on the 1999 Financial Services Action Plan (FSAP), which consists of a series of policy objectives and legislative measures to tackle three strategic objectives: <ul style="list-style-type: none"> <li data-bbox="879 1261 1461 1294">❖ A single market for wholesale financial services. <li data-bbox="879 1312 1286 1346">❖ Open and secure retail markets. <li data-bbox="879 1364 1477 1397">❖ State-of-the-art prudential rules and supervision.

New millennium

A step change in the European supervisory structure sees the creation of CESR and the emergence of UCITS III.

- The FSAP, endorsed by the Lisbon Council in March 2000, is planned for implementation by 2005, with three independent European supervisory committees established as part of the process:
 - ❖ The Committee of European Securities Regulators (CESR).
 - ❖ The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).
 - ❖ The Committee of European Banking Supervisors (CEBS).
- For most purposes, asset management and capital markets issues fall under CESR, whose role is to:
 - ❖ Improve co-ordination among securities regulators.
 - ❖ Act as an advisory group to assist the European Commission, in particular in its preparation of draft implementing measures in the field of securities.
 - ❖ Work to ensure more consistent and timely day-to-day implementation of community legislation in the member states.
- The FSAP and the supervisory committees drive greater harmonisation in the single market for financial services. This is evidenced in the Markets in Financial Instruments Directive 2007 (MiFID), which replaces the ISD and opens up national stock exchanges to competition.
- MiFID has so-called 'Level 2 legislation', based partly on advice from CESR, providing a great deal of detail to ensure better harmonisation. It also imposes a maximum harmonisation approach preventing countries from 'gold-plating' except in restricted circumstances.
- In 2001 UCITS III (a package of 2 directives) addresses some of the cross-border distribution issues and opens up new investment possibilities for UCITS, particularly in the wider permitted use of derivatives.

Financial crisis and beyond

Introduction of a new European supervisory structure; the trend towards maximum harmonisation continues.

- The European Systemic Risk Board (ESRB) is formed as an independent body responsible for the macro-prudential oversight of the EU financial system. It is part of the European System of Financial Supervision (ESFS), and it supervises the three independent European Supervisory Authorities (ESAs)⁵¹ that replace the supervisory committees.
- ESMA, in place of CESR, has the authority to:
 - ❖ Draft legally binding technical standards.
 - ❖ Resolve disagreements between national authorities.
 - ❖ Invoke emergency powers, including proposals to impose short-selling bans and product intervention.
 - ❖ Monitor systemic risk of cross-border financial institutions.
 - ❖ Directly supervise credit rating agencies, bypassing any national approaches to regulation.
- UCITS IV, in force since July 2011, marks the introduction of a management company passport, and seeks to address the remaining barriers to well-regulated cross-border distribution.
- This period sees the review and revision of many of the FSAP directives. Among others, this includes:
 - ❖ EMIR introducing OTC clearing.
 - ❖ CRD IV revising the capital requirements for asset managers.
 - ❖ MiFID being updated and expanded in MiFID II and MiFIR, proposing significant changes in market regulation.
 - ❖ UCITS V addressing the remuneration and depositary liability of managers following AIFMD.

⁵¹ The European Banking Agency (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

7. Banks and Capital Markets

Key Findings

Prudential and banking reform

- Asset managers and banks both play a critical role in the capital markets, and asset managers therefore have a strong interest in the shape of the banking industry.
- Broad support exists for structural reform of banks, amid uncertainty and concern about the calibration of new regulation. Firms are wary about the potential impact on the asset management industry and its clients.
- One consequence of banking reform will be investment banks spinning off their proprietary trading desks. While not a new phenomenon, it is seen by some as having the potential for increased competition while for others it signals recruitment opportunities in an increased talent pool.

Liquidity provision

- There were mixed views on the impact of bank reform for market liquidity. While some firms were relatively sanguine, others were more worried.

Alternatives to bank finance in the capital markets

- Expectation of a deleveraging banking industry has raised questions over the possibility of asset managers stepping into the banking space, eg. through liquidity provision or capital intermediation.
- A small number of large firms indicate that their role is likely to change. However, the majority view among those we spoke to is that the challenges are significant and a reformed, better functioning banking sector was the most desirable outcome.

Capital markets

- Post-trade transparency in equity markets has decreased following MiFID implementation; 52% report this for UK markets, and 39% for European (ex UK) markets.
- In terms of addressing data fragmentation, the vast majority of respondents (89%) replied that a regulator-driven consolidated tape for equity post-trade data would be the best result given the lack of a market solution.
- Execution in corporate bond markets remains dominated by dealers, with 65% of firms using dealers for over 95% of their corporate bond trades. Some 78% of respondents thought that the Commission's pre-trade proposals for fixed income would harm liquidity.
- Despite a mixed response about central clearing from the firms we spoke to, there is an expectation that the next five years will see an increasing proportion of centrally-cleared derivatives trades, reflecting the level of regulatory change underway.

7. Banks and Capital Markets

Capital markets exist to ease the movement of capital to businesses and governments. Asset managers and banks both play a critical part in the capital markets. The relationship is symbiotic and each participant needs the other.

Asset managers therefore have a strong degree of interest in the regulation and structure of the banking industry and its effects both on financial stability in general and the operation of financial markets in particular. Furthermore, to the extent that both asset managers and banks are turntables of capital to the broader economy, a number of asset managers are also watchful with respect to the level and nature of bank activity in this area.

The role that banks play in the capital markets benefits from a great breadth of transactional expertise. Banks handle primary issuance and support secondary market liquidity. Amongst other things, they will look after the legal and accounting requirements, gauge market demand, price transactions and ease the natural mismatches in supply and demand. It is in reality a complex mesh of moving parts involving many different disciplines and professions within and outside banks.

Current regulatory developments present a conundrum to asset managers. On the one hand, they want banks to be safe and well-capitalised; but on the other they want banks to provide liquidity to the market, which means putting capital at risk.

Prudential and Banking Reforms

Prudential reform is a major plank of the regulatory changes proposed after the crisis. Prudential oversight of some sort has been a feature of the regulatory environment for decades, but now has been elevated to the super-regulatory league; globally with the Financial Stability Board (FSB), in Europe with the European Systemic Risk Board (ESRB) and domestically in the UK with the (interim) Financial Policy Committee.

At the same time, structural reform of banking is also underway, in the main to deal with the problem of banks being 'too big to fail'. The US through the Volcker Rule and the UK through Vickers (yet to be implemented) both propose forms of division between 'utility' banking services and proprietary trading activities.

We asked firms about how they saw these developments. That there was a need for structural reform in the banking industry was not controversial. The introduction of recovery and resolution plans and the Vickers Report on ring-fencing were welcomed generally.

However, there was also little doubt that the reforms would carry costs, even if it was too early to see where they might ultimately fall. Asset managers expressed concerns as to what the combined impact of all these changes might be, as well as the difficulty facing regulators in ensuring that they calibrated requirements in a way that did not mean that cost exceeded benefit. The worry was clearly that costs would fall both on asset management firms as bank clients (on behalf of their own end-clients) and as shareholders (again on behalf of their own clients).

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Potentially significant consequences for asset managers

“The financial system will be more stable, but I think one of the big issues for us overall is whether the cost of insurance is worth the benefits of it, and whether anyone has thought of what over-insurance looks like.”

“More capital requirements at banks, de-risking and restructuring; none of these are going to be achieved without cost from the banking industry perspective, and quite a number of them are going to impact the operational complexity of the markets. Some of the cost is no doubt going to be picked up by the banks' shareholders; but some of it is going to be passed on either directly or indirectly to the customers.”

“It's a difficult situation we find ourselves in. The pendulum is swinging too far the other way. Everything has changed in the banking environment and there are massive ramifications. It affects the way we invest, the way we use banking services, and the way we assess counterparty risk.”

Several interviewees expressed their concern that yesterday's issues rather than future risks were being addressed. However, these observations are generally made with the recognition that a future crisis is highly unlikely to take exactly the same form as that which hit the global financial system in 2008.

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How to future-proof reform?

“ We do feel more secure because the chance of another Lehman happening has been lowered, but there could always be other things that could go wrong. We're always fighting the last war. ”

“ A lot of the regulation is 'closing the gate after the horse has bolted' and there's a lack of proactive thinking. ”

“ I have a great fear of the unintended consequence, and a profound belief that regulators aren't very good at playing chess; they very rarely think more than one move ahead. ”

In the context of bank structural reform, we discussed with firms the commercial consequences in terms of bank and asset management activity. Despite the level of divestment seen as a consequence of the credit crisis to date, some firms mentioned the possibility that banks would re-enter asset management. One interviewee reflected upon the impact on banks' own incentive structures and that fee business would be re-emphasised over balance sheet activity. This, it was suggested, would lead to a desire to capture a greater proportion of assets directly.

However, this was not a majority view. More firms focused on the impact of divestment of investment banks' proprietary trading desks. Some saw the brunt of these resulting in individuals forming hedge funds that subsequently become competitors to asset managers. Some also envisaged an expansion of the talent pool available to the asset management industry, including potential cultural differences.

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Increasing competition in the asset management market?

“ It's a continuation of what's been happening over the past 15-20 years when hedge funds have been created from prop desks of investment banks spinning themselves out, and that now compete with us on a boutique-type basis. There's nothing new about this. ”

Some see it as a threat

“ We are keeping an eye on the competition from banks as they divest their balance sheets of assets and, under the Volcker rule, have to get rid of their prop trading desks or divest themselves of hedge fund businesses. That is obviously going to increase competition for us. ”

Some as an opportunity

“ The advantage is the potential of real talent spinning out from the banks and entering the investment community, so whichever way they get set up or funded, it could be an opportunity because fresh talent will come into our industry. ”

Beyond discussion of the impact of deleveraging at any individual bank, there was a view that the banking sector as a whole was going to shrink and consolidate, and that would provide challenges and opportunities for asset managers. The challenges could be seen in terms of consequences for markets, such as less liquidity. The opportunities might first be in the shape of banks selling off loan books and other assets against which they can no longer afford to hold capital, and later by creating space in the marketplace for asset managers to take on new roles.

Liquidity provision

We discussed the risk that banks would, in response to reform requirements, withdraw in whole or in part from capital market activities. Views among respondents about current and future market conditions varied, reflecting different experiences, even within the same markets. One large equity manager reported that trading conditions at least for equities were still pretty benign. Others were more concerned.

industryview

Different views on liquidity

“There are always scare stories, whether it is short-selling bans or abolishing high-frequency trading, that liquidity in the markets will diminish. I don't believe that.”

“The biggest impact of the bank reforms will be on liquidity, although I believe that has been over-magnified as a requirement, especially if you're a long-term investor. We should cautiously ask for the maintenance of liquidity services provided by banks as counterparties in the marketplace, but at the same time not exaggerate the importance of that if you're not a high-frequency trader.”

Some managers also observed that there was little else on offer. As one interviewee recalled, the Bank of England discount window for repo was, for example, unavailable directly for non-bank firms:

industryview

“The problem we had in the UK is that liquidity locked up really badly during the crisis because there was no means for non-bank financial institutions to have access to any kind of repo market with the Bank of England even though they had high liquidity to repo.”

Alternatives to bank finance in the capital markets

We asked whether asset managers should consider taking on a new role in the capital markets, replacing some aspects of the bank intermediation role.⁵² Discussions focused on the role asset managers could play in bringing the providers of capital together with those who needed it. The issues discussed extended widely into alternative forms of credit intermediation and considered whether new non-bank finance markets may be more resilient in any future banking crisis, to the benefit of the wider economy. Such new conduits of credit might even avert the worst reactions that crystallised during the current crisis.

Interviewees identified a range of possibilities:

- Some had in mind credit intermediation activities that were associated with banking, but that did not involve leverage or maturity transformation; for example, a loan fund that locked in investors over a period of years and so was not subject to the kind of liquidity risk that a bank might be in the case of deposits, effectively borrowed short but multiplied and lent long.
- Opportunities may arise from banks seeking to sell elements of their debt portfolios to improve their capital position. Asset managers might help to intermediate this with institutional end-clients.
- Some saw an opportunity to step more directly into lending activity through credit funds; an example would be creating property bonds, which fixed income clients could use to fund property transactions.

⁵² This is widely referred to as “shadow banking”. However, the activities that asset management firms described in interviews are in our view better described as “market finance” since they do not involve the kind of maturity transformation and/or significant leverage commonly seen in the banking industry.

Changing asset management roles?

“You’ve got groups of institutions, who can no longer afford in either a risk, regulatory or capital framework to own the assets they currently own, and therefore they’re looking to offload them to those who are interested, be it pension funds or other investors. Our clients are also interested in these quasi-opportunistic sets of securities.”

“As banks seem less capable of providing loans, corporates have to rely more on the markets, and then there’s the question of whether they can remain the originators of bond issues if they’re not investors or providers of liquidity, or whether the market should start organising itself outside of the banks.”

Several themes emerged:

- Some firms are clearly innovating. Unless the whole economy is to shrink as a result of reduced bank intermediation, there need to be other ways of supplying money to the industry for private needs.
- There was recognised to be sporadic activity in non-traditional areas of financing; for example banks offering a collateralised loan obligation or bank debt portfolio to a pension scheme or direct lending between institutions.
- Managers running money market funds could not avoid being drawn into the debate given the FSB’s interest in exploring the possibility of liquidity and shock transmission risks that need to be addressed in such funds.

However, most mainstream asset managers had very limited involvement in non-bank market finance. For several reasons, there was significant reticence about moving towards greater involvement in lending or financing activities traditionally more associated with banks:

- **Regulatory implications.** Significant potential regulatory implications could be seen notably in the form of increased capital requirements.
- **Skill sets.** Individual firms may not have the required level of expertise, although asset managers which are part of insurance and banking groups may be better positioned (by being potentially able to leverage existing technical capability).
- **Capacity.** It was suggested that improving liquidity management of some large funds was challenging enough without taking on more risk management.
- **Scale and efficiency.** On the one hand, individual firms would need to be niche or nimble enough to extend into these new business areas; on the other they may lack the ability to gain proper scale, leading to less efficiency in providing capital sources for funding.
- **Product limits.** The absence of an appropriate cross-border closed-ended fund regime was cited as an obstacle by several firms. It was suggested that such funds would be more appropriate for institutions looking to make medium- to long-term investments during which the institution was unconcerned about volatile pricing.
- **Risks.** Given that it is difficult for individual firms to act in isolation (to have the scale), these potential business lines raise questions over the risks of potential co-operation of asset managers with both bank and non-bank financial institutions.

Overall, a reformed banking sector able to fulfil origination and underwriting is seen as the better option.

Capital Markets

In 2007 the European Union implemented the MiFID legislation, which amongst other things introduced far-reaching change into securities markets. Since then, this part of the Survey has consistently focused on certain aspects of the members' experience in these markets, more recently including over-the-counter (OTC) derivatives markets.

Equities

MiFID aimed to bring much greater competition to trading services. To a degree this has been achieved, albeit at the cost of increased fragmentation of information in the market. The impact has been felt principally in equity markets, where ownership of data has moved from exchanges to a broader range of trading venues, including banks. This change has resulted in data availability that is fragmented rather than consolidated, thus providing only a partial view of market activity.

MiFID

What is MiFID?

MiFID (Markets in Financial Instruments Directive) is the flagship European directive dealing with the regulation of securities markets, brokers, dealers and asset managers in the conduct of their various businesses.

MiFID was brought fully into effect in 2007, replacing the much slighter 1993 ISD (Investment Services Directive).

A principal aim was to introduce greater competition in trading services, and to this end commercial freedoms were imposed in place of the former exchange hegemony.

A balancing factor was the introduction of demanding conflicts of interest regulation, and, for equity markets, specific provisions about the carrying out of OTC trading activity within firms.

On a commercial footing, MiFID substantially strengthened the "passport" for investment firms, which is the means by which investment services can be provided on a cross-border basis across the EU.

What is the MiFID Review?

The MiFID Review is a new legislative proposal (called MiFID II and MiFIR) that deals with unfinished business in MiFID and sets out to meet G20 commitments on trading of OTC derivatives. While still very much under discussion, the key proposals include:

- Fundamental changes to the trading regimes for fixed income and derivatives ("pre-trade transparency"), including more publication of trade data ("post-trade transparency").
- The introduction of Organised Trading Facilities, with the intention of capturing virtually all financial market trading on some form of regulated venue, potentially spelling the end of OTC trading as it is currently known.
- Provisions to address concerns expressed about "high-frequency trading", where some market participants use speed of technology to seek short-term trading advantage.
- Changes to rules about the acceptability and use of inducements by firms (an area already covered in UK regulation).

The responses in Table 15 are consistent with previous years. They show the relatively greater diminution of information in UK equity markets compared with European equity markets, reflecting the greater starting transparency (pre-2007) in the UK and the compromised quality of OTC data owing to a lack of monitoring. Indeed, on an asset-weighted basis, the UK results are even more striking in terms of the decrease in transparency.

Table 15: Post-trade transparency in equity markets after MiFID implementation

	Increased	Decreased	Same
UK Equities	21%	52%	27%
– <i>weighted by size of UK equity holdings</i>	22%	70%	8%
European Equities (ex UK)	28%	39%	33%
– <i>weighted by size of European (ex UK) equity holdings</i>	27%	41%	32%

Disappointingly, the introduction of competition between trading venues does not appear to have translated into reduced costs for clients either. Managers report a broadly similar experience as last year, with 55% of respondents (and 64% if weighted by their equity holdings) reporting no reduction in the cost of trading in equities Europe-wide.

Because the impact of data fragmentation remains largely unaddressed, we asked respondents whether the best result for equity post-trade data would be a single consolidated tape mandated by regulators. There is a possibility that could be introduced through the MiFID Review.

The vast majority of respondents (89%) replied that a consolidated tape for equity post-trade data mandated by regulators would be the best result, given that the market had failed to deliver one post MiFID implementation.

Broker relationships

Respondents were asked again whether they used the IMA's model terms when negotiating their relationships with equity brokers (see Table 16). The significance of this question reflects the very real difficulties faced by managers in negotiating contractual terms of business with their various bank counterparties in financial markets. UK capital markets require complex contractual protections to be built into the broker relationship, for example to ensure that client assets and money are segregated from those of brokers. The IMA model terms responded to a demand for robust model contractual wordings that could be used by all market participants.

Table 16: Use of IMA model terms of business in negotiating broker relationships

	Yes	No	Partly
Proportion of firms using the IMA model terms of business	21%	42%	38%
– <i>weighted by size of UK equity holdings</i>	20%	32%	48%

Corporate bond trading

Supporting the previous comments about liquidity concerns, the responses show that the vast majority of fixed income managers still rely on the banks for liquidity provision, with 86% of respondents executing with them between 80 and 100% of their trades by value (see Table 17). This is even more pronounced when weighted by the size of their bond holdings. Such a high proportion is noteworthy particularly in light of the difficulties experienced during 2007/8, when the market barely functioned.

Table 17: Proportion of corporate bond trades executed with market makers

	<80%	80-94%	95-100%
Proportion of corporate bond trades executed with market makers	14%	21%	65%
– weighted by size of corporate bond holdings	0.1%	10%	90%

Firms have also expressed significant concern regarding the European Commission's proposals for a pre-trade transparency regime for fixed income in the MiFID Review. Higher levels of transparency could lead to a withdrawal of risk capital by bank market makers and to higher execution costs as banks widen dealing spreads in order to hedge some of their risk.

Some 78% of respondents by number (and 98% on an asset weighted basis) thought that the Commission's pre-trade proposals for fixed income would harm liquidity.

OTC derivatives clearing and trading

We considered the impact of the ground-breaking regulatory proposals for the OTC derivative markets last year, in particular in the EU (through EMIR) and the US (through Dodd-Frank). While these proposals continued to find support from many members, they also raised concerns, principally around their impact on liquidity, the concentration of risk in the event that something went wrong with a central clearing house, and increasing costs.

industryview

Mixed responses to OTC clearing

Support in many parts of the industry

“ We like OTC clearing; more transparency, greater knowledge of who knows what and where. ”

“ The clearing of OTC helps us because it takes out systemic risk under the assumption that central clearing houses would be organised in a risk-free way. ”

But with some concerns

“ If it's not done right, then the amount of liquidity available, and the amount of business that can go through it, is going to be decreased, which means that some of the markets may become less efficient, more difficult to hedge, less accessible, and generally more sub-optimal. ”

“ We've been a very active promoter of central clearing as we believe that it will take some of the risk out of the system. But it needs to be done correctly as there's always the risk that you end up with one big clearing centre, and when something goes wrong there, you have a big problem. ”

“ Certainly, clearing house settlements of derivatives help. We've made some progress, but it's added more cost and as a result of the increasing cost of hedging, people can't hedge risk as effectively and readily as before. ”

The drive for greater on-exchange trading and central clearing of OTC derivatives provided the backdrop to broader observations:

- A continued concern was that some derivative trades used today by clients, such as pension schemes, to reduce risk may just become too expensive. The net impact for society would be that more risk would be carried in pension schemes even if banks themselves appeared safer.
- There was now a pressing need for asset managers to engage in market structure themes, such as in governance representation in clearing houses and exchanges, and in securing the proper protection of collateral for clients in a centrally cleared environment.

Some of the concerns we heard extended beyond derivatives:

- Bank downgrades were reducing choice, and so competition, amongst service providers of custodial and settlement services because asset managers' own risk frameworks precluded the use of some banks.
- In other areas, such as depositary liability proposed as part of the AIFMD, it was not clear whether regulation was over-insuring the risks and so imposing a disproportionate cost on savers.
- Concerns remained over the proper segregation of client money and assets in all markets, and indeed the need for greater clarity over what was and what was not protected, both under OTC clearing reforms and generally. Despite the reforms it was thought there was still insufficient political attention given to the protection of client assets:

industryview

“We, as an asset manager, would welcome segregated assets being segregated without an additional due diligence burden on us. We absolutely need to rely on those aspects of the banking side being properly regulated in order to give us the necessary assurances.”

Responses by members also indicate very clearly what a substantial change is being wrought. The Survey asked members to estimate the likely percentage of OTC derivatives trades that will be cleared in one and in five years' time (see Table 18). The responses give a feel for the rolling adoption expected in the industry across the main classes of derivative:

- Whereas, at the end of 2011, 97% of members were not clearing their credit derivatives transactions, 41% of members expect to be clearing over one-half of those trades in a year's time.
- In five years' time, 85% expect to be clearing between 76-100% of their OTC credit derivatives transactions and 96% expect to be clearing more than half.
- In the much bigger interest rate swaps market, the equivalent figures in one and five years are much the same.

Table 18: Proportion of different types of OTC derivatives cleared centrally

CDS/Credit	Now	In 1 yr	In 5 yrs
0%	97%	14%	0%
<25%	0%	17%	0%
25-50%	3%	28%	4%
50-75%	0%	7%	11%
>75%	0%	34%	85%

Equity	Now	In 1 yr	In 5 yrs
0%	85%	55%	21%
<25%	0%	10%	0%
25-50%	3%	7%	11%
50-75%	0%	0%	7%
>75%	12%	28%	61%

Interest rate	Now	In 1 yr	In 5 yrs
0%	97%	18%	4%
<25%	0%	21%	4%
25-50%	0%	21%	0%
50-75%	0%	7%	7%
>75%	3%	32%	85%

Other	Now	In 1 yr	In 5 yrs
0%	100%	57%	20%
<25%	0%	29%	5%
25-50%	0%	5%	30%
50-75%	0%	0%	5%
>75%	0%	10%	40%

APPENDICES

Appendix One: IMA Membership – Assets under Management in the UK¹

Data as at December 2011. Sample sizes vary between categories

	TOTAL
Assets under Management in the UK (£m)	4,170,294
Segregated or Pooled (%)	
Directly invested on a segregated basis	55.5%
Managed on a pooled basis	44.5%
Active or Passive (%)	
Actively managed	77.9%
Passively managed	22.1%
Asset Allocation (%)	
Equities of which:	41.8%
UK	36.8%
Europe (ex UK)	19.5%
North America	16.5%
Pacific (ex Japan)	8.9%
Japan	5.0%
Emerging Market	12.7%
Other	0.6%
Fixed Income² of which:	38.3%
£ Sterling Corporate	24.5%
UK Government	20.9%
UK Index-linked	14.2%
Other UK	8.0%
Overseas	32.4%
Cash/Money Market	8.1%
Property	3.0%
Other	8.9%

¹ This includes all assets under management in this country, regardless of where clients or funds are domiciled. Caution should be used in undertaking direct year-on-year comparisons with previous Surveys. Where relevant or possible, we have used matched results in the Survey analysis to validate observations of change.

² With holdings of UK Government and corporate debt quite concentrated among IMA members, direct extrapolations from the Survey headline findings are likely to overstate the value of these securities held.

INSTITUTIONAL								ALL INSTITUTIONAL	RETAIL	PRIVATE CLIENT
Pension Fund	Public Sector	Corporate	Non-profit	Sub- advisory	In-house Insurance	Third Party Insurance	Other Institutional			
1,597,001	197,618	123,701	44,986	155,624	780,021	214,382	246,264	3,359,596	759,767	50,932
38.3%	4.7%	3.0%	1.1%	3.7%	18.7%	5.1%	5.9%	80.6%	18.2%	1.2%

Appendix Two: IMA Membership – UK Institutional Client Market¹

Data as at December 2011. Sample sizes vary between categories

	TOTAL
Total Institutional Market (£m)	2,420,401
Segregated or Pooled (%)	
Directly invested on a segregated basis	68.9%
Managed on a pooled basis	31.1%
Active or Passive (%)	
Actively managed	75.7%
Passively managed	24.3%
Multi-asset, LDI or Specialist (%)	
Multi-asset (balanced)	23.3%
LDI	17.3%
Specialist (single-asset) of which:	59.4%
Equities of which:	38.8%
UK	35.4%
Europe (ex UK)	9.0%
North America	8.3%
Pacific (ex Japan)	5.5%
Japan	3.2%
Emerging Market	4.8%
Global	31.4%
Other	2.4%
Fixed Income of which:	41.6%
£ Sterling Corporate	40.4%
UK Government	11.3%
UK Index-linked	16.7%
Global	15.0%
Other	16.6%
Cash/Money Market	6.6%
Property	4.8%
Other	8.1%

¹ This includes UK institutional client mandates, regardless of where assets are managed.

Pension Funds			Public Sector	Corporate	Non-profit	Sub-advisory	In-house Insurance	Third Party Insurance	Other Institutional
Corporate	Local Government	Other							
1,023,060 42.3%	141,590 5.8%	52,145 2.2%	15,184 0.6%	68,950 2.8%	22,851 0.9%	93,659 3.9%	756,039 31.2%	143,594 5.9%	103,328 4.3%
59.9%	62.7%	33.4%	81.2%	73.4%	62.5%	95.4%	81.9%	88.7%	32.1%
40.1%	37.3%	66.6%	18.8%	26.6%	37.5%	4.6%	18.1%	11.3%	67.9%
59.7%	72.4%	69.6%	89.9%	67.1%	92.2%	72.4%	95.0%	88.5%	85.3%
40.3%	27.6%	30.4%	10.1%	32.9%	7.8%	27.6%	5.0%	11.5%	14.7%
8.3%	7.3%	10.6%	10.9%	6.0%	35.3%	4.2%	57.4%	7.4%	16.0%
33.5%	17.8%	5.6%	0.0%	0.6%	2.1%	0.0%	2.0%	6.8%	1.1%
58.2%	74.9%	83.9%	89.1%	93.4%	62.6%	95.8%	40.6%	85.8%	83.0%
41.4%	65.1%	49.7%	52.1%	27.7%	31.9%	45.4%	23.8%	25.3%	50.4%
29.3%	35.9%	22.5%	5.4%	44.5%	47.6%	38.5%	67.2%	43.9%	23.8%
8.7%	7.5%	2.6%	54.7%	7.1%	13.1%	8.5%	6.2%	15.0%	10.0%
10.0%	9.4%	4.6%	0.0%	0.3%	2.3%	4.9%	6.1%	13.0%	5.3%
3.8%	2.1%	2.3%	13.3%	7.6%	0.6%	8.5%	4.8%	9.5%	16.7%
4.2%	3.1%	2.2%	0.0%	3.3%	0.7%	0.4%	2.6%	2.7%	2.2%
4.2%	3.6%	2.4%	18.0%	5.3%	9.5%	3.2%	2.3%	1.3%	15.0%
38.2%	36.9%	60.1%	8.6%	31.6%	26.0%	30.8%	10.8%	14.2%	15.0%
1.6%	1.5%	3.3%	0.0%	0.3%	0.2%	5.2%	0.0%	0.4%	11.9%
44.5%	21.4%	23.2%	29.9%	16.0%	13.7%	35.7%	55.3%	55.5%	13.3%
35.0%	39.5%	31.8%	43.5%	20.1%	41.5%	7.6%	51.4%	51.4%	41.2%
9.7%	7.4%	8.0%	4.1%	61.1%	5.2%	6.2%	15.2%	5.3%	15.5%
29.8%	28.1%	27.8%	0.0%	2.1%	1.2%	8.7%	1.0%	5.0%	4.3%
16.0%	11.1%	24.3%	52.4%	15.6%	18.1%	72.6%	3.9%	14.2%	15.0%
9.4%	13.9%	8.2%	0.0%	1.1%	34.0%	4.9%	28.5%	24.1%	23.9%
2.1%	0.8%	20.6%	17.4%	40.7%	44.4%	1.1%	10.2%	6.2%	9.0%
3.7%	4.9%	3.3%	0.3%	11.9%	4.4%	3.1%	6.1%	5.3%	7.9%
8.2%	7.9%	3.2%	0.4%	3.7%	5.6%	14.7%	4.6%	7.7%	19.4%

Appendix Three: IMA Membership – UK Third Party Institutional Market¹

Data as at December 2011. Sample sizes vary between categories

	TOTAL
Third Party Institutional Market (£m)	1,545,332
Segregated or Pooled (%)	
Directly invested on a segregated basis	62.0%
Managed on a pooled basis	38.0%
Active or Passive (%)	
Actively managed	64.4%
Passively managed	35.6%
Multi-asset, LDI or Specialist (%)	
Multi-asset (Balanced)	8.7%
LDI	24.4%
Specialist (Single-asset) of which:	66.9%
Equities of which:	43.6%
UK	31.4%
Europe (ex UK)	9.1%
North America	8.5%
Pacific (ex Japan)	5.6%
Japan	3.1%
Emerging Market	5.0%
Global	34.6%
Other	2.8%
Fixed Income of which:	37.4%
£ Sterling Corporate	37.4%
UK Government	10.0%
UK Index-linked	20.5%
Global	19.9%
Other	12.2%
Cash/Money Market	5.8%
Property	4.0%
Other	9.0%

¹ This includes UK institutional client mandates, less in-house insurance and in-house managed OPS assets, regardless of where the assets are managed. We do not have additional granularity.

Third Party Pension Funds			Public Sector	Corporate	Non-profit	Sub-advisory	Third Party Insurance	Other Institutional
Corporate	Local Government	Other						
904,031	141,590	52,145	15,184	68,950	22,851	93,659	143,594	103,328
58.5%	9.2%	3.4%	1.0%	4.5%	1.5%	6.1%	9.3%	6.7%
58.3%	62.7%	33.4%	81.2%	73.4%	62.5%	95.4%	88.7%	32.1%
41.7%	37.3%	66.6%	18.8%	26.6%	37.5%	4.6%	11.3%	67.9%
54.5%	72.4%	69.6%	89.9%	67.1%	92.2%	72.4%	88.5%	85.3%
45.5%	27.6%	30.4%	10.1%	32.9%	7.8%	27.6%	11.5%	14.7%
7.9%	7.3%	10.6%	10.9%	6.0%	35.3%	4.2%	7.4%	16.0%
35.1%	17.8%	5.6%	0.0%	0.6%	2.1%	0.0%	6.8%	1.1%
56.9%	74.9%	83.9%	89.1%	93.4%	62.6%	95.8%	85.8%	83.0%
43.2%	65.1%	49.7%	52.1%	27.7%	31.9%	45.4%	25.3%	50.4%
29.6%	35.9%	22.5%	5.4%	44.5%	47.6%	38.5%	43.9%	23.8%
8.2%	7.5%	2.6%	54.7%	7.1%	13.1%	8.5%	15.0%	10.0%
9.7%	9.4%	4.6%	0.0%	0.3%	2.3%	4.9%	13.0%	5.3%
3.7%	2.1%	2.3%	13.3%	7.6%	0.6%	8.5%	9.5%	16.7%
3.9%	3.1%	2.2%	0.0%	3.3%	0.7%	0.4%	2.7%	2.2%
4.1%	3.6%	2.4%	18.0%	5.3%	9.5%	3.2%	1.3%	15.0%
39.2%	36.9%	60.1%	8.6%	31.6%	26.0%	30.8%	14.2%	15.0%
1.6%	1.5%	3.3%	0.0%	0.3%	0.2%	5.2%	0.4%	11.9%
43.7%	21.4%	23.2%	29.9%	16.0%	13.7%	35.7%	55.5%	13.3%
37.4%	39.5%	31.8%	43.5%	20.1%	41.5%	7.6%	51.4%	41.2%
10.4%	7.4%	8.0%	4.1%	61.1%	5.2%	6.2%	5.3%	15.5%
25.8%	28.1%	27.8%	0.0%	2.1%	1.2%	8.7%	5.0%	4.3%
16.3%	11.1%	24.3%	52.4%	15.6%	18.1%	72.6%	14.2%	15.0%
10.1%	13.9%	8.2%	0.0%	1.1%	34.0%	4.9%	24.1%	23.9%
2.1%	0.8%	20.6%	17.4%	40.7%	44.4%	1.1%	6.2%	9.0%
2.7%	4.9%	3.3%	0.3%	11.9%	4.4%	3.1%	5.3%	7.9%
8.2%	7.9%	3.2%	0.4%	3.7%	5.6%	14.7%	7.7%	19.4%

Appendix Four: Survey Respondents

Aberdeen Asset Management	Guinness Asset Management
Aberforth Partners	Henderson Global Investors
Aerion Fund Management	Hermes Fund Managers
Alliance Trust Asset Management	HSBC Global Asset Management
AllianceBernstein	Ignis Asset Management
Allianz Global Investors	Impax Asset Management
Architas Multi-Manager	Independent Franchise Partners
Artemis Fund Managers	Insight Investment Management
Ashmore Investment Managers	Invesco Perpetual
Aviva Investors	Investec Asset Management
AXA Investment Management	JO Hambro Capital Management
BAE Systems Pension Funds Investment Management	JP Morgan Asset Management
Baillie Gifford & Co	Jupiter Asset Management
Baring Asset Management	Kames Capital
BlackRock Investment Management	Lazard Asset Management
BP Investment Management	Legal & General Investment Management
Brewin Dolphin	Liontrust Investment Funds
Brooks Macdonald Asset Management	M&G Investments
Canada Life Asset Management	MAM Funds
Cazenove Capital Management	Martin Currie
CCLA Investment Management	Merrill Lynch Portfolio Managers
Daiwa Fund Asset Services	Momentum Global Investment Management
Dimensional Fund Advisors	Mondrian Investment Partners
Edinburgh Partners	Morgan Stanley Investment Management
Family Investment Management	Newton Investment Management
FF&P Asset Management	Nomura Asset Management
FIL Investment Services	Northern Trust
First State Investments	Odey Asset Management
Franklin Templeton Investment Management	Pictet Asset Management
GAM UK	PIMCO Europe
GLG Partners	Premier Asset Management

Principal Global Investors
Pyrford International
Rathbone Unit Trust Management
Record Currency Management
Royal London Asset Management
Santander Asset Management
Schroder Investment Management
Skagen
Scottish Friendly Asset Managers
Sharefunds
Skandia Multifunds
St James's Place Unit Trust
Standard Life Investments
State Street Global Advisors
Scottish Widows Investment Partnership
T. Rowe Price International
The Co-operative Asset Management
Threadneedle Asset Management
UBS Global Asset Management
Vanguard Asset Management
Veritas Asset Management
Virgin Money Management Services
Wellington Management International

Appendix Five: Firms Interviewed

Aberdeen Asset Management

Allianz Global Investors

Aviva Investors

BlackRock Investment Management

F&C Investments

GAM UK

Ignis Asset Management

Invesco Perpetual

Investec Asset Management

JP Morgan Asset Management

Jupiter Asset Management

Legal & General Investment Management

M&G Investments

Newton Investment Management

PIMCO Europe

Schroder Investment Management

Standard Life Investments

State Street Global Advisors

Threadneedle Asset Management

UBS Global Asset Management