



THE
INVESTMENT
ASSOCIATION

Asset Management in the UK 2016-2017

The Investment Association
Annual Survey

September 2017

CONTENT ENQUIRIES

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September 2017

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ABOUT THE SURVEY

THE UK ASSET MANAGEMENT INDUSTRY SERVES A WIDE VARIETY OF INSTITUTIONAL AND RETAIL CLIENTS FROM ALL OVER THE WORLD. THIS SURVEY FOCUSES ON THE ACTIVITIES OF MEMBERS OF THE IA, ENCOMPASSING MIFID-REGULATED ASSET MANAGEMENT FIRMS AND UCITS-REGULATED FUND MANAGEMENT FIRMS.

FIGURE 1: WHO ARE THE IA'S MEMBERS?

The membership can be broken down into five broad groups.

1 Large asset management firms (both UK and overseas-headquartered), which may be independent or part of wider financial services groups such as banks or insurance companies. They undertake a wide range of asset management activities across both retail and institutional markets and manage substantial amounts for overseas client in the UK. Such firms will typically be managing >£50 billion from the UK, but a number of international firms have a smaller UK footprint.

2 Small and medium-sized asset management firms, primarily focused on UK and/or European clients, which undertake a diverse range of activities, of which asset management is a constituent part.

3 Fund managers, whose business is based primarily on authorised investment funds.

4 Specialist boutiques and private client managers with a smaller asset and client base and, typically, a specific investment or client focus.

5 Occupational pension scheme (OPS) managers running in-house asset management services for a large scheme.

The term 'UK assets under management' covers all forms of asset management activity, broadly split into pooled vehicles (run on behalf of multiple clients who pool their investment exposure in a fund), and segregated mandates (bespoke portfolios managed on behalf of an individual client by an investment manager, governed by a specific agreement).

Pooled vehicles include:

- Authorised unit trusts
- Open-ended investment companies (OEICs)
- Unauthorised investment vehicles (eg. unauthorised unit trusts)
- Close-ended investments (eg. investment trusts)
- Exchange-traded funds (ETFs)
- Life funds, operated by insurance companies

The term 'UK retail funds', in contrast, applies specifically to UK authorised and recognised investment funds, which include (authorised) Unit Trusts and OEICs. These investments are collectively referred to as the 'funds industry' and are analysed in detail in Chapter 5.

The Survey captures asset management undertaken by members of the IA on behalf of domestic and overseas clients from the following perspectives:

- Assets managed in the UK on behalf of institutional and retail clients, irrespective of the country in which the underlying client is located (Chapters 1 and 3).
- Assets managed for UK institutional clients by member firms, irrespective of the country in which the asset management activity is undertaken (Chapter 4).
- UK authorised and recognised Unit Trusts and Open Ended Investment Companies (Chapter 5).

¹ Defined as assets where the day-to-day management is undertaken by managers within the firm and based in the UK. For a more detailed definition please refer to Appendix Five.

IT IS BASED ON:

- Questionnaire responses from 74 IA member firms, who between them manage £5.9 trillion in this country (84% of total UK assets under management by the entire IA membership base).
- Other data provided to the IA by member firms.
- Data provided by third party organisations where specified.
- Publicly available information from external sources where relevant.
- Interviews with senior personnel from 19 IA member firms.

The IA would like to express its gratitude to member firms who provided detailed questionnaire information and to those who took part in the interviews.

THE SURVEY IS IN SIX CHAPTERS:

1. UK Asset Management Industry: A Global Centre
2. A Changing Operating Environment
3. Trends in Client Assets and Allocation
4. UK Institutional Client Market
5. Retail Fund Market
6. Operational and Structural Issues

THERE ARE ALSO SEVEN APPENDICES:

1. Summary of assets under management in the UK
2. Summary of data from the UK institutional market
3. Major UK and EU regulatory developments affecting asset management
4. Notable M&A deals in the UK asset management sector (2009-July 2017)
5. Definitions
6. Survey respondents
7. Firms interviewed

A NUMBER OF GENERAL POINTS SHOULD BE NOTED:

- Unless otherwise specified, all references to ‘UK assets under management’ refer to assets, wherever domiciled, where the day-to-day management is undertaken by individuals based in the UK. The asset value is stated as at December 2016. For a more detailed explanation of the term please refer to Appendix 5.
- Not all respondents were able to provide a response to all questions and therefore the response rate differs across questions.
- The Survey has been designed with comparability to previous years in mind. However, even where firms replied in both years, some may have responded to a question in one year but not in the other or vice versa. Where meaningful comparisons were possible, they have been made.
- Numbers in the charts and tables are presented in the clearest possible manner for the reader. At times this may mean that numbers do not add to 100%, or do not sum to the total presented, due to rounding.

SURVEY FOREWORD



WELCOME TO THE FIFTEENTH EDITION OF THE INVESTMENT ASSOCIATION'S ASSET MANAGEMENT SURVEY, WHICH DOCUMENTS THE CONTINUED IMPORTANCE OF THE UK ASSET MANAGEMENT INDUSTRY TO BOTH UK INVESTORS AND TO INVESTORS AROUND THE WORLD. INVESTMENT ASSOCIATION MEMBERS ARE MANAGING £6.9 TRILLION FOR INDIVIDUALS AND INSTITUTIONS, AND THE UK REMAINS A PRIMARY CENTRE OF ASSET MANAGEMENT EXPERTISE GLOBALLY.

This continued strength comes against an uncertain political backdrop and the prospect of more turbulence as the UK navigates the Brexit negotiations in the coming months and years. The UK manages £2.6 trillion for overseas clients who are capitalising on the expertise and variety of asset management firms that have chosen to locate here. The continued success of the UK will inevitably depend on the extent to which these relationships can continue unhindered, not least where assets are managed in the UK for funds domiciled in the EU.

There is a growing recognition among government and regulators that the strength of the asset management industry has ramifications for the UK economy more widely. This bears out in the earnings asset managers bring in to the UK from overseas clients, the investment they direct towards UK companies, property and infrastructure and the impact they have on the wealth of individuals as they manage their pensions and investments.

Pension funds are still the largest client group and increasingly the assets managed in the UK are shifting from defined benefit arrangements to defined contribution. The accompanying shift in risk, and associated direct exposure to investment returns, is rightly contributing to a much greater focus on consumer protection and ensuring that products are robust and offer good value for savers. This focus is intensifying in the context of the Freedom and Choice reforms, which have introduced much greater flexibility in retirement.

Outside of pensions, a fifth of the assets managed here in the UK belong to individuals, not large institutions. A striking trend over the last decade in retail market behaviour has been the shift towards more 'outcome-focused' products, whether offering yield, a degree of volatility protection, asset allocation or a combination of objectives. Indeed, we see a continued shift in demand for outcome-focused products from all types of investor, including the institutions.

As investment strategies evolve, so does the range of investments asset managers are taking advantage of to achieve good outcomes. For many years we have collected information on the capital asset managers direct to companies via equity and bond allocations, and to commercial property. This year's Survey looks more closely at the importance of asset managers to the country's infrastructure. An increasing number of the Investment Association's members are working with pension funds and insurance companies to invest in social and economic infrastructure ranging from renewable energy to social housing.

The greater recognition of the role asset management plays for the UK economy and its citizens has inevitably increased the scrutiny on the industry from government and regulators. On 28 June, the FCA published the final results of its asset management market study and over the coming months the future of the industry will be shaped by the proposed changes. We must continue striving to provide the best outcomes for investors through clearer and more consistent communication and greater transparency about what we do with the money we manage.

We have a challenging period ahead if we are to maintain the UK's status as a centre of excellence. I hope the contents of this report, which illustrate the depth of expertise the Investment Association's members have to offer, as well as their ability to adapt to the changing requirements of investors, puts the industry in a strong position to take on the uncertainty ahead.

I hope you enjoy reading this report and I encourage you to get in touch with any suggestions you may have to make it better or more useful in the years to come.



Chris Cummings
Chief Executive



EXECUTIVE SUMMARY

- » Total assets managed in the UK by the IA's members reached a new high in 2016, ending the year at a record £6.9 trillion. The strong growth largely reflected increases in the sterling equivalent value of overseas assets as the UK's currency weakened in the wake of the Brexit referendum.
- » The role of the UK as a leading global centre of asset management remained clear as £2.6 trillion was managed in the UK on behalf of overseas investors, half of which was from clients in the EEA. The export of services by UK asset managers to overseas investors has contributed an average of 6% of total net service exports from the UK over the past ten years.
- » Thirty-six percent of assets managed in Europe were managed from the UK.² The UK remained the largest asset management centre in Europe, and is globally second only to the US. At the end of 2016 around £900 billion was managed on behalf of fund ranges in Dublin and Luxembourg, which delegate their fund management activity to the UK. Retaining this delegation arrangement will be key to maintaining the UK's position in a post-Brexit world.
- » Asset managers in the UK continue to facilitate the movement of capital from investors to companies via equity and fixed income allocations. Furthermore, at the end of 2016 IA members reported holding an estimated £29 billion in infrastructure investment. Approximately three quarters of this (73%) was directed to economic infrastructure, with the remainder going to projects offering a social benefit.
- » The allocation to other assets increased to 21%, up from 19% in 2015. Three quarters of this category now reflects investment solutions rather than 'traditional' alternative assets. The shift into outcome-oriented products seems to reflect a structural change in both institutional and retail investor behaviour and is one which IA members expect to continue in the coming years.
- » The allocation to equities has fallen to 39% in recent years. The allocation to European equities, both UK and mainland, fell six percentage points to 54% of the overall equity allocation at the end of the year. The regions of North America and the Asia Pacific were the main beneficiaries.
- » Institutional clients continued to account for the majority (79%) of total assets under management in the UK. This proportion has remained relatively stable in the last decade, but the distinction between retail and institutional is becoming increasingly blurred. As defined contribution (DC) pensions grow, and the investment risk shifts from the employer to the individual, pensions are resembling more retail, rather than institutional, assets.
- » IA members managed an estimated £3.6 trillion for institutional clients at the end of 2016, up from £3.3 trillion in 2015. Pension funds accounted for approximately £2.2 trillion. The use of multi-asset mandates continued to rise among institutional clients (21%), potentially driven by the success of automatic enrolment, and specifically the widespread use of mixed asset funds as the default investment strategy in DC pensions.
- » The value of retail funds held by UK investors reached a record £1,045 billion at the end of 2016 – up by 13% from 2015. Net retail sales by UK investors were at £4.7 billion which was low by the standards of recent years. This was largely driven by investor behaviour around the time of the Brexit referendum.
- » The trend towards outcome-oriented funds continued with positive retail sales of £8.7 billion in 2016. Absolute Return funds were the most popular sector within this asset class with £5.1 billion of net new retail money flowing into the sector.
- » Property and Equity funds had a particularly bad year in 2016, as investors withdrew £2.0 billion and £8.1 billion respectively from them. The bulk of the outflows were in June and July in response to the Brexit referendum.
- » The UK asset management industry remained relatively unconcentrated at the end of 2016, although there were signs of a reduction in the number of the smallest firms coupled with an increase in the number of large firms. This was likely fuelled by continuing M&A activity. Assets managed by the top five firms increased to 40% from 37% in 2015.

² 2015 data from Asset Management in Europe, 9th Edition, EFAMA, May 2017.

KEY STATISTICS

£ **6.9** TRILLION

[£5.7 TRILLION IN 2015]

TOTAL ASSETS MANAGED IN THE UK BY THE IA'S MEMBERS AS AT DECEMBER 2016

£ **1** TRILLION

[£928 BILLION IN 2015]

FUNDS HELD BY UK INVESTORS

£ **2.6** TRILLION

[£2.2 TRILLION IN 2015]

ASSETS MANAGED IN THE UK ON BEHALF OF OVERSEAS CLIENTS

£ **1.1** TRILLION

[£1 TRILLION IN 2015]

UK-MANAGED FUNDS DOMICILED OFFSHORE

34 PER CENT

[31 PER CENT IN 2015]

UK DOMESTIC MARKET CAPITALISATION ACCOUNTED FOR BY THE IA'S MEMBERS' UK EQUITY HOLDINGS

36 PER CENT
IN 2015

[37 PER CENT IN 2014]

TOTAL EUROPEAN ASSETS UNDER MANAGEMENT MANAGED IN THE UK AS AT DECEMBER 2015 (LATEST AVAILABLE).



1 UK ASSET MANAGEMENT INDUSTRY: A GLOBAL CENTRE

KEY FINDINGS

THE SIZE OF THE ASSET MANAGEMENT INDUSTRY IN THE UK

- » Total assets under management grew significantly during 2016, ending the year at a record £6.9 trillion. The strong growth largely reflected increases in the sterling equivalent value of overseas assets following the Brexit referendum.
- » Assets managed in UK funds on behalf of UK investors increased by 13%, to £1 trillion.
- » 9% of assets under management in the UK were managed in Scotland (£620 billion).
- » The size of the UK's asset management industry is 373% of GDP, compared to an average of just over 100% in the rest of Europe.

THE GLOBAL NATURE OF THE INDUSTRY

- » £2.6 trillion is managed in the UK on behalf of overseas investors, half of which comes from clients in the EEA.
- » The UK asset management industry serves clients all over the world. Outside of Europe there are significant assets managed for clients in the US, Middle East and Asia.
- » 36% of assets managed in Europe are managed from the UK, more than the sum of the next three largest countries put together.
- » Asset managers have contributed an average of 6% of total net service exports over the past 10 years.

POTENTIAL IMPACT OF BREXIT ON UK ASSET MANAGEMENT

- » Retaining the ability to delegate fund management activity from the EU to the UK will be key to maintaining the UK's reputation as a centre of excellence for asset management.



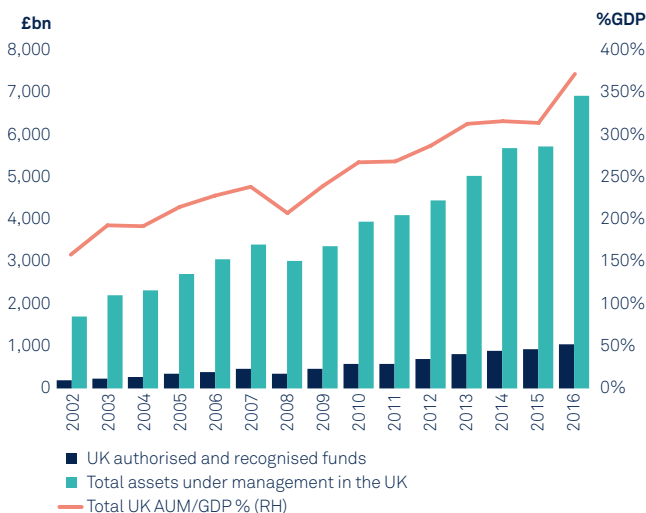


THE SIZE OF THE INDUSTRY IN THE UK

At the end of 2016, IA members managed £6.9 trillion of client money in the UK, a considerable increase (20%) from the end of 2015 (see Chart 1). Given the significant amounts invested in overseas assets³ this growth was largely due to the depreciation in sterling versus all major currencies following the UK's decision to leave the EU in June 2016.⁴

At the same time, funds under management for UK investors in UK funds increased by 13% reaching £1,045 billion at the end of 2016, representing 15% of overall assets under management.⁵

CHART 1: TOTAL ASSETS UNDER MANAGEMENT IN THE UK AND IN UK FUNDS (2002-2016)⁶



Source: IA, ONS

As assets under management increased so did the relative importance of the asset management industry in the UK. At the end of 2016 the size of the industry was 373% of GDP, up by around 50 percentage points from last year. By comparison, the average proportion of GDP represented by asset management in mainland Europe is close to 100%⁷, indicating that asset management is considerably more important to the UK economy than it is to the economies of other European countries.

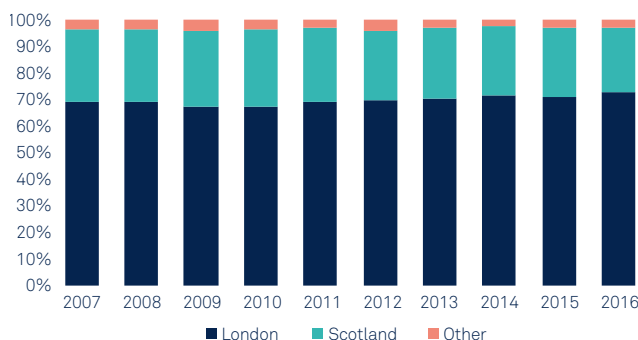
SCOTLAND AS A MAJOR CENTRE

Although the City of London remains the primary centre of asset management activity in the UK, Scotland, and particularly Edinburgh, plays a key role in the industry nationally. Almost a quarter (24%) of the assets managed by UK-headquartered asset managers are represented by managers with headquarters in Scotland. Moreover, assets managed in Scotland represented 9% of total assets managed by IA members at the end of 2016, accounting for £620 billion of total assets.

The fact that lower levels of assets are actually managed in Scotland than would be suggested by the location of firm headquarters is indicative of the fact that, whilst firms may have their headquarters in Scotland, asset management activity is often undertaken elsewhere and is most likely to be located in London (see page 87).

Chart 2 shows that the regional split has remained relatively unchanged from a decade ago, with more than two thirds of assets managed by UK-headquartered firms managed by firms with a headquarters in London.

CHART 2: UK-MANAGED ASSETS BY UK REGIONAL HEADQUARTERS (2007-2016)



³ 69% of equities and 40% of bonds are invested overseas (see Appendix 1).

⁴ During 2016 sterling fell by 17% versus the US dollar, 14% versus the euro and down 19% versus the Japanese yen.

⁵ Includes UK investor assets in both UK authorised and recognised funds.

⁶ 2016 fund assets are calculated on the basis of UK investor rather than UK domiciled funds. See page 61 for more detail.

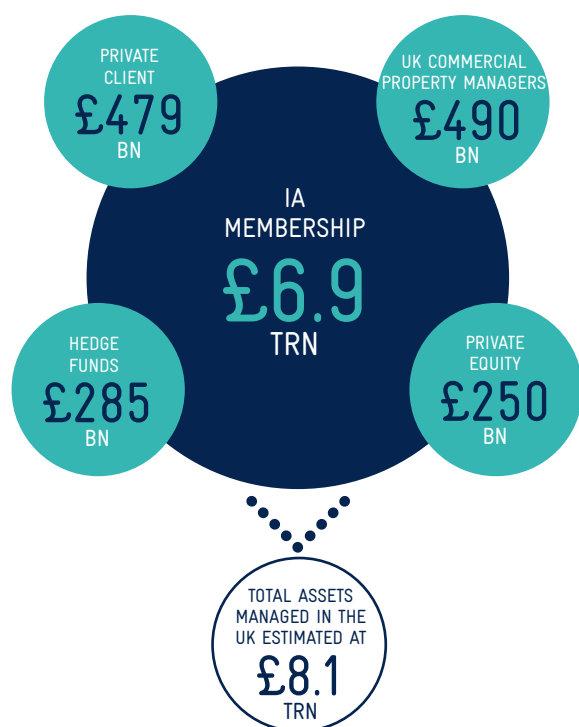
⁷ Asset Management in Europe, EFAMA, 2017 (end 2015 figure)

SCALE OF WIDER INDUSTRY

While the IA's members represent the majority of the UK asset management industry in asset terms (85%), a significant number of firms contributing to the industry's activity lie outside the IA membership and are not covered in detail in this report. These can be broadly categorised into the following groups (see Figure 2):

- Hedge funds
- Private equity funds
- Commercial property management
- Discretionary private client management
- Firms who are not members of the IA reasons not noted above⁸

FIGURE 2: WIDER ASSET MANAGEMENT INDUSTRY



Source: ComPeer, Hedge Fund Intelligence/EuroHedge, Investment Property Forum, IA estimate based on private equity return data.

THE POSITION OF THE UK ASSET MANAGEMENT INDUSTRY IN EUROPE AND WORLDWIDE

The UK is the second largest asset management centre in the world after the United States, and ahead of Japan as third largest.⁹

TABLE 1: GLOBAL ASSETS UNDER MANAGEMENT

	Assets under Management (local currency)	Assets under Management (£ equivalent)
US	\$33 trillion	£27 trillion
Europe	€ 21 trillion ¹⁰	£18.3 trillion
Japan	¥482 trillion	£3.0 trillion

The UK continues to dominate the asset management industry within Europe, although its market share fell slightly from 37% in 2014 to 36% in 2015 (see Figure 3).

In recent years the UK has outweighed the next three largest European countries put together. This is still the case. The only notable change from the last few years is that the Netherlands has overtaken Italy with a market share of 6% compared to Italy's 5%.¹¹

The UK's success as a foremost portfolio management centre is less apparent in fund domicile terms, where it ranks fifth in Europe. The UK's fund market is primarily focused on domestic investors (see page 61) but at the same time the UK is a significant exporter of portfolio management services including significant delegation from EU-domiciled funds, particularly those domiciled in Dublin and Luxembourg. We estimate that almost £900 billion is managed from the UK for these two fund centres. Around one third of this is sterling and euro-denominated money market funds.

⁸ This last group is more difficult to size as there is no consistent third party data available.

⁹ Global Asset Management 2017, Boston Consulting Group. Japan's Asset Management Business 2016/2017, March 2016, NRI

¹⁰ Asset Management in Europe, 9th Annual Review, EFAMA

¹¹ Another notable change is Switzerland appearing in fourth place. However, this relates to a change in EFAMA reporting whereby Switzerland now appears separately from "Other".

FIGURE 3: ASSETS UNDER MANAGEMENT IN EUROPEAN COUNTRIES (DECEMBER 2015)



Country	Net assets (£bn)	Market share
1. UK	7,791	36%
2. France	3,787	18%
3. Germany	2,026	9%
4. Switzerland	1,466	7%
5. Netherlands	1,244	6%
6. Italy	1,156	5%
7. Denmark	367	2%
8. Belgium	279	1%
9. Austria	104	1%
Other	3,249	15%
TOTAL	21,469	

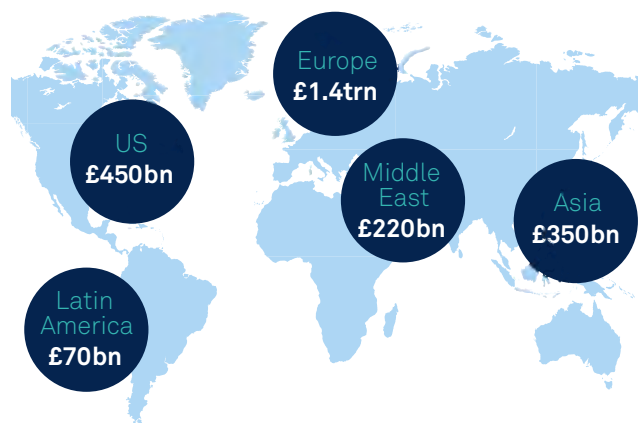
Source: EFAMA

IMPORTANCE OF THE OVERSEAS CLIENT MARKET

As a centre for portfolio management, the UK also caters for investors worldwide with £2.6 trillion, ie. 37%, of assets in the UK being managed on behalf of overseas clients.

- The largest client base remains the EEA, for which the UK industry manages approximately £1.3 trillion. Around £110 billion in assets is managed for clients in other parts of Europe, notably Switzerland.
- A significant proportion of IA members that service overseas clients are managing money for investors in the US (80%) and Japan (70%).
- Beyond these key markets, IA members also reported managing assets for clients all over the globe, including China, Brazil, Australia, New Zealand, Africa and Japan.

FIGURE 4: ASSETS MANAGED FOR OVERSEAS CLIENTS

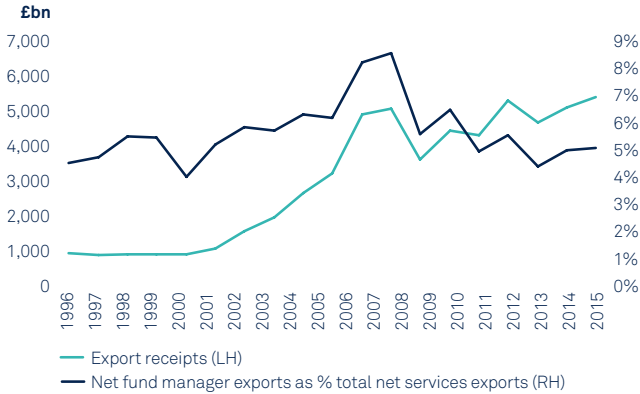


A SIGNIFICANT EXPORT INDUSTRY

Asset managers make a significant contribution to the UK’s service exports and have represented an average of 6% of total net exports over the past ten years. Although as Chart 3 indicates, there has been significant volatility in this figure through the years, the last two years have shown signs of stability.

Notably, the data in Chart 3 captures earnings by independent asset managers but is likely to understate earnings from asset managers that are part of a wider financial services group such as an investment bank or insurer. As such, this estimate is conservative and the actual contribution of asset management overall to service exports is likely to be higher.

CHART 3: EXPORT EARNINGS OF FUND MANAGERS AND CONTRIBUTION TO SERVICES EXPORTS (1996-2015)



Source: ONS

POTENTIAL IMPACT OF BREXIT ON UK ASSET MANAGEMENT

Clearly, for UK managers, 2016 saw the emergence of a significant challenge: preparation for the departure of the United Kingdom from the European Union by 2019. More than half of the overseas client money managed from the UK is managed on behalf of European clients. While firms are far from complacent about the future, there is also a feeling that the UK starts from a very strong position in terms of the breadth and depth of the financial services sector.

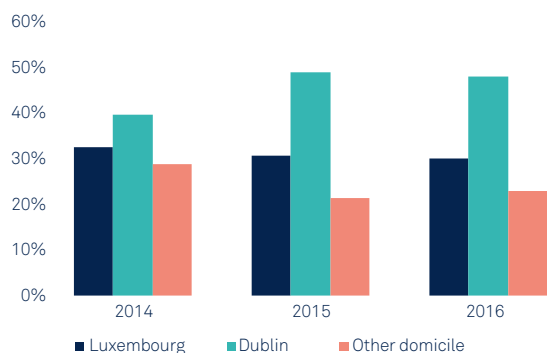
“WHATEVER INDIVIDUAL EUROPEAN COUNTRIES ASPIRE TO, THE FACT OF THE MATTER IS THE DEPTH OF THE CAPITAL MARKETS AND FINANCIAL SERVICES EXPERTISE WE HAVE IS UNRIVALLED GLOBALLY, NOT JUST WITHIN EUROPE.”

Many IA members have longstanding fund ranges set up in Dublin and Luxembourg, which they use to market their asset management services throughout Europe, as well as OEIC ranges that they use to distribute to UK investors. The proportion of OEIC funds sold throughout Europe is relatively small. Of the £1 trillion invested in authorised funds in the UK at the end of December 2016, only £66 billion was invested by overseas investors. Equally there is £105 billion of UK investors’ money in overseas funds that could potentially be affected should the ability to passport funds be lost as part of the Brexit negotiation (see page 61). As we outline in Chapter 5, although still a relatively small part of the UK retail market, the proportion of assets in overseas funds is far from insignificant and is currently growing.



Asset managers in the UK manage £1.1 trillion on behalf of overseas authorised funds. Chart 4 shows that Dublin is becoming increasingly dominant, with an estimated £550 billion managed in the UK on behalf of Dublin-domiciled funds. Luxembourg remains the next largest fund domicile served by UK asset managers, with £350 billion under management.

CHART 4: LOCATION OF OVERSEAS-DOMICILED FUNDS WITH UK-MANAGED ASSETS (2014-2016)



Delegation of portfolio management activity to countries outside of Europe, notably the US, is currently widely undertaken. IA members generally felt that it would be difficult to justify a change that affected the UK but was not extended to the US and Asia. In the event that delegation of front line portfolio management should be significantly impacted by future EU regulatory changes, it could clearly have a major impact on the activity of the asset management industry in the UK.

“TO EVEN IMAGINE A WORLD WHERE WE COULD NOT DELEGATE ASSET MANAGEMENT ACTIVITY IS DEEPLY WORRYING. SAFEGUARDING DELEGATION HAS TO BE THE GOVERNMENT’S KEY PRIORITY FOR THE ASSET MANAGEMENT INDUSTRY DURING THE BREXIT NEGOTIATIONS.”



Members indicated the relative importance of individual EEA countries to their business. This is shown in Figure 5, with the relevance of the country being proportionate to its size in the word cloud. The importance of asset management delegated from the key fund centres of Dublin and Luxembourg is obvious.

FIGURE 5: RELATIVE IMPORTANCE OF EEA COUNTRIES TO UK ASSET MANAGEMENT ACTIVITY



STAFF AND CLIENT CONCERNS

Broadly, members had not had significant concerns or questions raised by their clients at this stage but this was not universally the case. Some European clients had expressed concern about the future and there was anecdotal evidence of potential clients choosing to contract with managers in other jurisdictions rather than face the uncertainty surrounding contracting with a UK-based entity.

A further area of concern raised during our interviews was around European members of staff based in the UK and the uncertainty they faced in making career decisions during the next two years, particularly where this involved the risk of re-locating from offices in mainland Europe (where relevant) to London. Similarly, when recruiting new staff, there was potential for the Brexit vote to reduce the attractiveness of the UK to European nationals. This was not only due to the extended uncertainty, but also because some individuals felt less welcome in the UK than would have been the case before the vote.

“I HAVE PEOPLE IN MY OFFICE MOST DAYS THINKING ABOUT GOING BACK TO EUROPE IF THEY’VE GOT FAMILIES. THEY’VE GOT TO MAKE CAREER DECISIONS FOR THE NEXT TWO YEARS NOT KNOWING WHAT IS GOING TO HAPPEN.”

In conclusion, a year on from the vote there was a sense that the industry would be able to adapt and respond to the UK’s departure from the EU, but there was concern about the uncertainty that would be caused by at least two years of negotiations. Furthermore, there were concerns about measures that could be taken by the EU to tighten up provisions on delegation, or future changes to the EU third country provisions which would be part of the UK-EU negotiation. Business decisions would need to be made before the outcome of the negotiations was known. There was hope that a deal would be reached quickly, based on which the industry could then move forward with more certainty.

“WE ADAPT OR CHANGE TO THE ENVIRONMENT WE FIND OURSELVES IN AND WE MAKE THE BEST OF IT. THAT’S CAPITALISM. BUT WE NEED CLARITY SOONER RATHER THAN LATER.”



2 A CHANGING OPERATING ENVIRONMENT

KEY FINDINGS

A RISE IN EXPECTATIONS AND SCRUTINY

- » Over the past decade, a combination of regulatory and policy drivers, economic and market conditions has created significant opportunities and challenges for the UK industry. These include the shift to individual responsibility for long-term saving, questions about the social utility of financial services, the sources of systemic risk and growing concerns about sustainability and responsibility.
- » In terms of how managers serve clients and the wider economy, regulatory and policy scrutiny has focused on three areas in particular: the alignment of interest between managers and clients, the transparency of their service delivery and the levels of oversight to which they are subject.

KEY CHALLENGES OF AND EVOLVING REGULATORY LANDSCAPE

- » While the industry welcomes a number of areas of regulatory change, the increased volume of regulation has created challenges, both with respect to focus and demand on resources. Firms are keen to achieve a balance that attains greater oversight, accountability and consumer protection while allowing free thinking and innovation to prosper within firms.

EMERGING THEMES

- » The industry is supportive of the move towards improved transparency and governance. The challenge of communicating the value of asset management to investors in a way that encompasses service as well as price remains a key priority.
- » Asset managers broadly expect to remain highly intermediated but predict greater concentration and vertical integration in the UK retail distribution chain.
- » The evolution of the advice market will partly depend on how different players within the value chain adapt to the opportunities afforded by digital innovation, including robo advice.
- » Two years on from the introduction of the pension freedoms, there are mixed views on the extent to which further innovation is required. While the range of strategies available to investors is wide, it was acknowledged there is a potential need for strategies that could provide a regular income alongside some protection from loss of capital.
- » Significant demand for responsible investment strategies remained largely confined to parts of the institutional market. However, increasingly firms are embedding ESG principles into mainstream investment strategies and some firms believe that a generational effect may also drive interest in the longer term.

This Chapter looks in particular at the impact on the asset management industry of a range of regulatory, policy and wider market changes over the past decade. It draws on interviews conducted with senior figures across the industry, as well as on IA policy insight. It is structured in three main parts:

- **A rise in expectations and scrutiny** that sets out a number of key drivers of regulatory and policy change, and associated themes.
- **Key challenges of an evolving regulatory landscape** and some of the concerns asset managers have about the approach to regulation, including a number of observations about the importance of clear communication about value.
- **Emerging themes** in three particularly salient areas in the UK: changing competition dynamics in the retail distribution chain; the experience of the new Pension Freedoms; and an increasing focus on responsible investment.

A RISE IN EXPECTATIONS AND SCRUTINY

Over the past decade, a combination of regulatory and policy drivers and wider economic and market conditions has created both significant opportunities and challenges for the UK asset management industry. These drivers are diverse and include:

- An **accelerating shift to individual responsibility for long-term saving** in a DC landscape that has seen the automatic enrolment of over eight million people since 2012. This is an unprecedented expansion of the long-term investor base and a definitive shift away from the defined benefit (DB) culture that characterised workplace pensions through the second half of the twentieth century. Automatic enrolment has been accompanied by a liberalisation of the retirement income regime in the UK, moving away from an expectation of annuitisation towards greater choice for individuals. It has also been accompanied by a charge cap in the default accumulation arrangement.

- A **post-2008 economic, regulatory and policy environment** that has questioned the social utility of financial services, demanded changes in behaviour from firms and seen an emphasis on broadening the role of market-based finance. The broader economic concerns have driven a variety of initiatives in the UK and Europe, from the Kay Review of UK equity markets and long-term decision-making to the Capital Markets Union. While the themes raised have generally not been new, the impetus has changed as a number of governments and institutions have sought to reinvigorate economic activity in the aftermath of the global financial crisis.
- A **global regulatory interrogation of the sources of systemic risk** that has resulted in a wide net cast as regulators seek to understand the role and interconnection of different parts of the financial system. In the context of the ever-more important role of the asset management industry, significant questions are being asked about whether asset management activity, and/or that of its client base, poses a potential challenge to systemic stability.
- A **slowly evolving, but increasingly dynamic, debate about issues of sustainability**, particularly in the context of concerns about the intensifying impact of climate change and the consequences of environmental damage. This is linked to broader themes around responsibility, extending into the social arena, for example social impact investment aimed at enhancing specific aspects of local economic and community life.

In terms of expectations of how asset managers serve their clients and the wider economy, this climate of challenge and opportunity has seen three key themes consistently feature in regulatory and wider public policy debate, most recently in the context of the FCA Asset Management Market Study:¹²

- **Alignment of interest.** In the United Kingdom, the Retail Distribution Review, implemented from the end of 2012, began to fundamentally change the remuneration structure through the UK retail market. MiFID II picks up elements of this through the European retail market, while also extending intervention in the area of dealing commission and research procurement. The Asset Management Market Study once again returns to the theme of how to ensure agency businesses best serve their clients, with proposed remedies that include the next two areas.
- **Transparency of delivery.** Transparency is a theme currently running through UK and EU regulation for both client reporting (e.g. templates for institutional business, PRIIP Key Information Document) and underlying market activity (e.g. MiFID II pre and post trade requirements). At client level, the direction of travel is towards both charge and cost aggregation (ie. single numbers through the investment, product packaging and distribution process) and total cost accountability to include areas of activity previously outside regulatory requirements (notably, implicit costs in capital markets). The transparency question further extends into how clients are informed about the investment process, whether on a pre-sale or post-sale accountability basis.

- **Oversight internally and externally.** The question of internal oversight is picked up strongly through MiFID II product governance and target market requirements. While this is an example of incremental change, current proposals arising from the Asset Management Market Study will result in more far-reaching structural change for UK fund governance. These arise from a combination of requirements for independent directors and individual accountability via the Senior Managers and Certification Regime (SMCR). External oversight – the exercise of scrutiny by asset managers on other parts of the market – was a major theme of the Kay Review and the UK industry has significantly engaged, notably through the 2016 Productivity Action Plan.¹³

These themes build together in a wider debate about the question of how asset managers provide ‘value for money’ (VfM) to their clients – whether in the institutional or retail market. Aspects of the VfM debate, particularly the role and performance of active management, are not new. However, what is arguably new is the level of regulatory interest and intervention in the context of a product set that is now far more diverse. The reality of a charge cap in the DC market has also provided an important indicator of the political salience of the value question. For industry, and a number of other stakeholders, including regulators, a key concern is the potential unintended consequences of charge caps. Firms are keen to see a debate more broadly focused on cost in the context of overall product objectives and delivery.

¹² FCA published the terms of reference for the asset management market study in November 2015. It set out their intention to understand how asset managers compete to deliver value to both retail and institutional investors. The final report and remedies were published in June 2017.

¹³ Supporting UK Productivity with Long-Term Investment, The IA's Productivity Action Plan, March 2016

BOX 1: COMPLEX AND FAR-REACHING REGULATORY CHANGE

The UK asset management industry finds itself in the midst of multi-dimensional regulatory change with significant implications for firms and their clients. To a certain extent, this is shared with firms across Europe, but EU regulatory evolution is being overlaid by two distinctly domestic elements: Brexit and the FCA Asset Management Market Study. Appendix 3 outlines developments in more detail. MIFID II, SMCR and PRIIPs illustrate in particular how far-reaching the process is.

MiFID II

MiFID II, which will apply from 3 January 2018, sets out comprehensive rules for businesses across the EU that provide investment services and activities. These will cover investment intermediaries and will bring about significant changes in investor protection, market structure, market transparency and market abuse.

Key changes include:

- Unbundling of research from execution, and extending best execution requirements
- Enhanced product governance and target market analysis
- Aggregated reporting mechanisms for charges and transaction costs through the delivery chain

PRIIPs

The PRIIPs regulation stems from a European Commission initiative to harmonise disclosure and selling practices for all substitutable retail investment products sold in Europe. It will apply from 1 January 2018, although UCITS will remain exempt from PRIIPs regulation until December 2019.

PRIIPs will introduce standardised disclosure for all retail products (including open-end funds, unit linked products etc.) in the form of the Key Information Document. This will include a risk indicator, performance scenarios presenting possible future outcomes, and a new charges and costs presentation incorporating transaction costs, both explicit and implicit. On charges and costs, the presentation features not just aggregation, but aggregation of the effect of charges and costs.

STRUCTURAL OVERVIEW OF MIFID II



Senior Managers & Certification Regime (“SMCR”)

In the wake of the financial crisis and some cases of misconduct (e.g. LIBOR rigging), the UK Parliament recommended the development of a new accountability and increased responsibility system, focusing more on senior managers. The SMCR has applied to banks, building societies, credit unions and PRA-designated investment firms since March 2016, replacing the Approved Persons Regime.

In July 2017, the FCA published a paper consulting on extending SMCR to almost all other financial services firms, including asset managers, with implementation expected to take place in 2018. As part of the proposed changes, there are three key elements to the “Core regime”. Asset management firms will need to identify individuals that hold the most ‘senior management functions’ and allocate prescribed responsibilities to them, that they will need to take “reasonable steps” to fulfil. People who perform less senior roles but that still “involve, or might involve a risk of significant harm” to firm or customers would be “self certified” by the firms themselves. Almost all other staff will be required to adhere to a set of basic Conduct Rules.

KEY CHALLENGES OF AN EVOLVING REGULATORY LANDSCAPE

Almost ten years after the onset of the global financial crisis we asked members how different they thought the asset management regulatory landscape was today and what had been the most significant changes they had had to make to their businesses. The increase in volume of regulation since the financial crisis was unanimously mentioned, with a number of specific underlying objectives from those we spoke to for the regulatory direction of travel.

Enhanced accountability processes that foster, not stifle, individual decision-making

Some areas of regulation were welcomed where they had improved, or had the potential to improve, the professionalism of the models and practices in the industry. At the same time, there was a desire to ensure that the right balance is achieved between scrutiny and accountability on the one hand and a culture in which effective decision-making and innovation can thrive on the other. SMCR was seen as an opportunity to meet that need for balance, with the desire within industry for a proportionate application as preparation continues through 2017.

“THE CULTURE OF AN ACTIVE MANAGER IS ONE OF ENTREPRENEURIALISM AND FREE THINKING. YOU HAVE TO BE CAREFUL THAT NONE OF THAT GETS CONTAMINATED BY A FOCUS ON PROCESS FROM THE REGULATOR.”



An evidence-based, results-driven consumer protection regime

The increased focus on consumer protection was broadly welcomed as a positive move. Still, there remained concerns among those that we spoke to that the sheer extent and ambition of all the strands of new regulation was so great that there was little clarity as to how the aggregate outcome is going to be beneficial to the end investor. Perhaps there needed to be a shift towards implementing regulation that had passed robust cost benefit analysis criteria and was based on clear consumer testing. One example that often arises in this context is the PRIIP Key Information Document (KID). The KID started with a positive ambition of providing comparative data across different product types, but has become increasingly complex in terms of calculations and explanations, moving away from the more straightforward approach that characterised the UCITS Key Investor Information Document.

A regulatory environment that does not inhibit dynamism and innovation at firm and product level

The cost of dealing with regulation had also significantly increased, which it was thought could form a barrier to entry to new asset managers to the market. It was also felt to pose an incremental challenge to those already operating, which was believed to have been one factor contributing to the merger and acquisition activity that has been so prevalent in recent years (see Appendix 4).

The increase in the time it now takes to bring new products and strategies to market was frequently referred to as a further feature of the changing regulatory landscape. Beyond an impact on the domestic market, this may also have wider ramifications for the UK's perceived international competitiveness as a fund domicile.

“ONE CONSEQUENCE IS YOU SEE AN OPPORTUNITY AND IT TAKES A LONG TIME TO GET A PRODUCT TO MARKET. PLUS IF IT HAS DERIVATIVES IN IT THAT'S AUTOMATICALLY BAD NEWS, WHEN ACTUALLY MOST DERIVATIVES ARE THERE FOR INVESTOR PROTECTION.”



Interviewees commonly mentioned the increased staffing levels required in the areas of legal, risk and compliance. This is reflected in the IA's own data, which has seen a 60% increase in the proportion of staff that works in the Compliance, Legal and Audit functions in just five years (see page 86).

For the first time this year, there were frequent references to a significant impact on roles outside of these business areas, whereby portfolio managers and business management were also having to spend an increasing proportion of their time on regulatory issues.

The divergence of regulation on an international level was a common theme once again this year. In some instances, asset managers reported they would work to the strictest regulatory regime but there were some localities where regulation was so different that operations had to be specifically tailored to access that market. This restricted the ability of overseas asset managers to access some markets, particularly in Asia.

“THERE ARE SOME JURISDICTIONS WHERE IF WE WEREN'T ALREADY THERE WE WOULDN'T THINK ABOUT TRYING TO START BECAUSE THEY ARE GROWING THE LEVEL OF CHALLENGE TO NON-DOMESTIC ASSET MANAGEMENT FIRMS AND THEY WANT TO CLEARLY GROW THEIR OWN MORE.”



For some, there was a sense that the US could move towards a more relaxed regulatory environment, making it a more attractive centre than Europe as a whole but this was not a widespread view. Moreover, despite expectations in some quarters that the UK might adopt a more flexible regime outside the EU, those we spoke with did not expect Brexit to significantly change the regulatory approach in the UK.

EMERGING THEMES

There are multiple changes at work in UK client markets that may have a significant impact on the way in which the industry evolves. Some, such as the drive towards pension fund pooling particularly among the local government pension funds, are still at an early stage and we will return to these in future Surveys. This year, we focus on four areas: enhanced communication; patterns of competition in the retail distribution chain; the impact of the 2015 Pension Freedoms; and the demand for responsible investment products.

ENHANCED COMMUNICATION

Ahead of the final report of the FCA Asset Management Market Study, we asked those we interviewed this year how they felt the industry could better communicate value for money to investors and help them make informed decisions. Clearly, a number of these issues will now be considered as part of workstreams being established by the UK regulator to implement its proposed remedies.

The industry is supportive of the overall direction of travel within the Study towards improved transparency and governance, and a key priority is to ensure that value is about the service delivered for a given price, and not just about the price. Firms are conscious of the challenges inherent in communicating the value of asset management to investors. Relative to other products, from consumer goods to real estate property, investment in asset managers' products and services is of an intangible nature and has uncertain pay-offs, particularly as products are designed to be held for a number of years before the full impact can be seen.

This has created a considerable hurdle to communicating the benefits of investment to individuals, particularly the young who face additional and more pressing hurdles, such as paying off student loans or getting onto the housing ladder.

“THE OBJECTIVES THEMSELVES MAY BE CLEAR, BUT YOU ARE ALWAYS BUYING SOMETHING THAT MIGHT GO UP AND MIGHT GO DOWN. THAT’S ALMOST DIFFERENT TO ANYTHING ELSE YOU EVER BUY.”



Those interviewed noted that the frequent emphasis of regulators and governments worldwide on the concept of ‘simple’ products highlighted a central challenge: simplicity of product (for example, exposure to equities in a given country or region) was not necessarily the same thing as simplicity of outcome. For example, if savers required greater certainty and less volatility over a given period, this might require a potentially complex process of diversification and possibly hedging.

As a consequence, some of these solutions for investors might be difficult to explain. For example a multi-asset fund that is aiming to produce a return of cash plus 3% per annum could be complex to describe to an investor. However, depending on an individual’s risk/return objectives, it may be more suitable for them than an equity fund that is exposing an investor to the volatility of a single index.

For some in the industry, there was a clear delivery risk for the active industry in the move towards targeted outcomes. Failure to produce consistent results could disappoint investors to the extent that they might move away from such products, either remaining in cash or tracking indices.

When it came to explaining both performance and the costs of investment, there was a general consensus that quoting returns and costs in basis points or in percentages was not the clearest and most helpful way to communicate with end investors.

Examples in monetary terms could provide a better way of communicating the value of asset management. For example, illustrating what investing £100 into a fund 5/10/15 years ago would have been worth today. However, this method of illustration, though clearer, was acknowledged to present challenges because it is necessarily based on past performance which is not a predictor of future return.

There were suggestions that funds could be given a different sort of value score based on criteria that are more relevant to individuals, rather than whether the fund has outperformed an index.

“WE DON’T SAY WE ARE GOING TO OUTPERFORM AN INDEX. WE SAY “THIS PRODUCT IS DESIGNED TO PROVIDE A DIVERSIFIED PORTFOLIO THAT WILL PROVIDE INCOME FOR YOU”. WE MEASURE THAT BY ASKING:

- HAS THE FUND DELIVERED INCOME?
- HAS THE FUND GROWN THAT INCOME?
- WHAT IS THE VOLATILITY OF THE CAPITAL VERSUS SIMILAR FUNDS OR OTHER ASSET CLASSES?”



In this scenario too there remained the challenge of communicating the output of this analysis in a way that is meaningful to the end-investor, whether by means of a traffic light system or an overall ‘value’ score. For any method to be truly effective there was a belief that it would also need to be used consistently across industry so that investors could compare managers on a like-for-like basis.

There was agreement by all those we spoke to that the asset management industry needed clear and transparent pricing models. These models then needed to be integrated with the rest of the value chain to provide investors with the full cost of ownership. However well asset managers explained and presented the cost of asset management, there would still be advisory fees and distribution fees associated with investment. True transparency would require the costs and value of each of these elements to be defined and explained clearly.

In this regard, MiFID II cost aggregation was quoted as the way to provide total accountability for both charges and transaction costs through the entire chain. The question remained as to how best to ensure that potential and existing investors could make use of the pre-sale and ongoing reporting in order to understand the value being provided by the different parties of the chain:

- the fund managers in investing in a given set of markets;
- the distributors providing the access points to the products; and
- the advisers working to help investor decision-making.

Ultimately, a fund manager should be held accountable for the performance of a given fund in the context of the fees they levied to deliver that performance. If additional fees for advice and distribution erode that return further, causing shortfall relative to the client’s investment objective, those fees and their impact on performance needed to be considered in their own terms.

“IT WOULD BE USEFUL TO HAVE A SENSE OF WHAT WE MEAN BY VALUE IN EACH OF THE BITS OF THE VALUE CHAIN. WHAT DOES VALUE FOR MONEY MEAN FOR MANUFACTURING, FOR DISTRIBUTION, FOR ADVICE.”



Post-RDR, unbundled share classes offer the opportunity to assess value in this way. This marked a significant shift from the previous bundled models in which fund management delivery relative to a benchmark would be assessed in the context of all charges, including advice and distribution.

“I THINK WE NEED TO MAKE CLEAR OUR VALUE PROPOSITION TO OUR CUSTOMERS BUT OUR CUSTOMERS ARE NOT THE END CONSUMERS. WE CAN DO ALL WE LIKE TO SAY THIS IS GREAT VALUE FOR MONEY BUT IF IT’S THEN WRAPPED BY SOMEONE WHO ADDS VAST CHARGES IT MAKES NO SENSE AT ALL.”



There was also a sense that IFAs had a role to play in the communication of value because funds often formed part of a customised investment solution for an individual for whom value might have a different definition. Pure cost was not thought to be a high priority for investors meeting with IFAs but rather whether the investment portfolio would be able to deliver their desired objective.

“CLIENTS DON’T COME TO YOU ASKING FOR A FUND THAT COSTS THIS – THEY ASK FOR A FUND THAT DOES THIS.”



COMPETITIVE DYNAMICS IN THE UK ADVICE AND DISTRIBUTION MARKET

With the FCA Asset Management Market Study and the Platform Market Study, the UK regulators are looking closely at patterns of competition at different points in the delivery chain. One key feature of the UK retail market is also that asset managers are increasingly competing with other parties along the value chain on asset allocation and client solutions. We asked industry leaders how they thought increased competition from discretionary fund managers and model portfolio providers would change the way in which asset managers sought to compete along the retail value chain.

Those interviewed thought that the role of advisers in retail distribution had changed since RDR. Whilst financial advisers could still add value to investors via fund selection, advisers were now focusing less on fund research and this was helping drive a growth in model portfolios, DFMs and multi-asset funds. As a consequence, asset managers are competing not only with their fellow asset managers, but many others in the world of asset allocation (see Box 2).

“WE ARE REALLY SENSING THE COMPETITION IN THE MARKET FOR MULTI-ASSET PRODUCTS. THREE YEARS AGO WE WOULD LOOK AT THE LIST OF THE TOP SELLERS AND IT WOULD BE ALL KINDS OF FUND GROUPS. NOW WHEN WE LOOK AT THAT LIST, IT’S ALL PEOPLE WHO ARE EFFECTIVELY BUILDING VERTICALLY INTEGRATED DISTRIBUTION. THAT LANDSCAPE CHANGES A PART OF THE MARKET FOR THE DISTRIBUTION OF FUNDS, BUT IN THE END YOU STILL HAVE TO PRODUCE THE INVESTMENT ENGINE AND DELIVER THE OUTCOME FOR THE CLIENT.”



BOX 2: COMPETITION IN THE CONTEXT OF AN INTERMEDIATED RETAIL MARKET

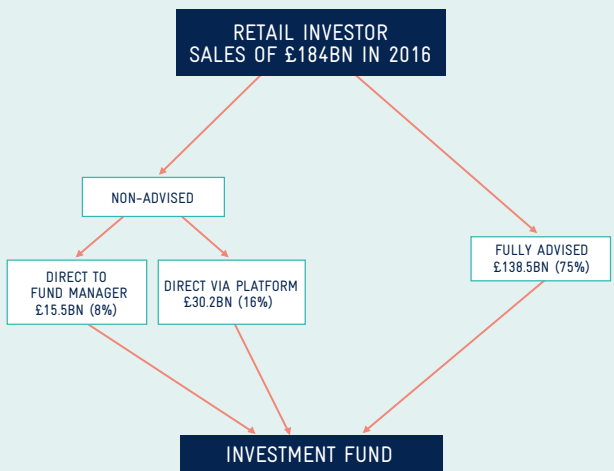
The retail funds market is highly intermediated with only 8% of gross retail sales being directly with the fund management company (see Page 74). In most cases, the journey to a retail fund involves different types of intermediaries such as platforms, advisers, discretionary fund managers etc. or a combination of the above.

Advised sales still account for the majority of sales, with estimates suggesting that the proportion is close to 80% on an asset-weighted basis.

The shape of the retail market was significantly impacted by the Retail Distribution Review (RDR) in 2012, which saw the introduction of professionalism requirements for retail investment advisers as well as the unbundling of the cost of investment management from that of advice and distribution. Since its introduction concerns have arisen that an ‘advice-gap’ has been created for investors with smaller amounts of money.

The joint FCA/HMT Financial Advice Market Review (FAMR) published in March 2016, made a number of recommendations to:

- remove barriers to accessing and engaging with financial advice
- develop new and cost-effective ways of providing advice and guidance, particularly with greater use of technology



In July 2017 the FCA launched an investment platform market study aiming to assess to what extent platforms and similar firms compete on price and quality and whether their investment solutions offer value for money. The study will cover all firms that offer access to retail products through an online portal including other intermediaries such as wealth managers, life companies, banks and financial advisers and consequently, is likely to look at the competition dynamics between those fulfilling an asset allocation function as shown in the figure. Notably, the competition dynamics between financial advisers are not going to be within the platform market study scope.

A report with the interim findings is expected in summer 2018.

This has prompted increased interest from some asset managers in the direct-to-consumer distribution model that was more prevalent thirty years ago. However, the cost of dealing directly with the end investor was still seen as substantial by those we spoke to given the need to own the manufacturing, advice and distribution steps in the value chain.

As such, it was thought that only a limited number of firms would be in a position to build a vertically integrated business model and that the vast majority of asset managers would continue to operate via distribution intermediaries. In addition, a number of those interviewed referred to the increased regulatory scrutiny into vertically integrated models in the context of the wider discussion about value for money and competition as reflected in the Terms of Reference for the FCA Platform Market Study, published in July 2017.

There was a relatively consistent view among interviewees that the intermediated model of distribution would continue but that the market was likely to become more concentrated with a smaller number of larger intermediaries. A direct consequence for asset manager firms would be that ensuring funds are being distributed by the key firms would become even more important, and potentially difficult. This could create the potential to drive down asset management fees further and particularly to put pressure on small and medium sized firms, who were already operating in an increasingly challenging environment.

“THOSE CONTROLLING DISTRIBUTION ARE TAKING MORE CONTROL OF THE VALUE CHAIN. ASSET MANAGERS MIGHT WANT TO MOVE INTO THAT SPACE BUT INCREASINGLY THE WRAPPERS AND CLIENT INTERFACE ARE COMING THROUGH THE LIFE SIDE OF THE INDUSTRY, WHILE ASSET MANAGERS ARE PROVIDERS OF SPECIALIST INVESTMENT MANAGEMENT.”

The evolution of the distribution and advice market will of course be significantly determined by how different players within the chain adapt to the opportunities afforded by digital innovation, including the evolution of robo-advice.

We have revisited the question of robo-advice in the Survey on a number of occasions in recent years. Views on the impact and importance of robo-advice remained mixed this year. While a number of asset management firms had acquired robo-advisers, there was no sense that this would replace the existing advice system. Rather, it was viewed as a potential enabler for some people to bypass the IFA route.

“THERE IS A GENERAL BREAKDOWN OF THE TRADITIONAL MODELS AT THE MOMENT, EVERYONE IS LOOKING FOR OTHER WAYS OF DOING THINGS AND I THINK THERE IS ALWAYS THE DISTRUST THAT THE PUBLIC HAS TOWARDS FINANCIAL SERVICES. THE ENVIRONMENT IS RIPE FOR PEOPLE THAT ARE LOOKING AT IT IN A DIFFERENT WAY.”



A key question for asset managers potentially looking to find a more direct route to market is the extent to which robo-advice could offer a new way to connect with clients, or just extend the existing distribution model in a digital space where clients wish to access a product set from multiple potential providers and not just a single manufacturing source.

There was still concern about what would constitute advice rather than guidance in this area. It was felt that further discussion and agreement was needed with the regulator about what guidance could be provided without the risk of incurring liability which could deter asset managers from engaging in this way. The general sense was that until that takes place, there will be reluctance from providers about crossing lines that could lead to future accusations of mis-selling. An element of pragmatism would be needed to ensure that individuals are helped as much as possible without deterring participation by the industry.



RESPONSE TO GREATER FREEDOMS IN PENSION INVESTMENT

Two years on from the introduction of the pension freedoms, a range of market assessments are taking place, including by the FCA. We asked members whether more innovation was required and what the key drivers and obstacles to innovation were. There was a mixture of views among firms, with some caution about a rush to new product design.

Some of those interviewed for this year's Survey believed the asset management industry had enough product diversity to satisfy the needs of investors in retirement, particularly given the expertise in income generation and the availability of insurance-based solutions for those looking for greater certainty through the annuity market. Still, some noted that individuals could find accessing appropriate products challenging, particularly where the cost of financial advice did not make financial sense relative to the size of the investment.

Despite the existing product diversity for asset accumulation, others we spoke to believed there is a need for more innovation in the decumulation market. The strategies most commonly mentioned were solutions that could provide a regular income while providing some protection from loss of capital, falling short of providing a guarantee. Although there are many funds available that offer income generation, they often have some form of capital growth objective. To those in retirement, particularly in the latter stages, capital growth may not necessarily be the most important objective, but what is clearly important to individuals is to manage loss of capital.

While asset managers could never provide a guarantee to investors it was felt there was a gap in the market for products that were income focused but offered some way of managing downside capital risk. This view has been echoed in parts of the advice market and, recently, in the findings of the Interim Report of the Retirement Outcomes Review, which found that innovation had been limited in the mass market.¹⁴

One significant barrier to innovation at the moment is that DC decumulation is still in the very early stages. Although around half a million people reach retirement age each year,¹⁵ the median size of a DC pot at retirement is currently around £26,000, so asset managers developing specialist products for this market will need to take a long-term view and accept that it will be some years before this market is of substantial size and for many years the flows into these products may be minimal.

Some we spoke to felt that, although the pensions freedoms offered a great opportunity to the asset management industry as a whole, the question of direction of flow would be critical, particularly if pension savers opted to take retirement income through their existing pension provider rather than access the wider investment funds market. It was thought unlikely that people would move from being automatically enrolled and invested into a default fund with no active decision making asked of them, and then suddenly become engaged in their investment decisions at the point of retirement.

The pensions dashboard, being introduced in 2019, will allow individuals to view all of their pension entitlements, DC, DB and state pension in one place. This could well increase engagement from investors at the point of retirement and there may be significant consolidation of pots at this stage. This might in turn result in significant competition between asset managers to deliver the desired combination of income and growth for savers from these decumulation assets.

¹⁴ For further details, see <https://www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report.pdf>.

¹⁵ Population Estimates for UK, England and Wales, Scotland and Northern Ireland: mid-2015, ONS

BOX 3: RETIREMENT OUTCOMES FOLLOWING PENSION FREEDOMS

Following the introduction of pension freedoms in April 2015, the FCA carried out a review on how the retirement income market has evolved since then. The interim findings need to be considered in the context of a still relatively young DC market consisting of a large number of small pension pots. The FCA reported that:

- over one million DC pension pots have been accessed
- most pensions are accessed by people under 65
- 53% of (mostly small) pots have been fully withdrawn
- purchases of drawdown products have increased while those of annuities have decreased

The FCA indicated concerns that competition may not be working well for consumers who do not seek advice and that drawdown products are complex to manage and for consumers to understand. Potential remedies included:

- the introduction of default investment pathways possibly subject to a charge cap
- extending the role of IGCs to decumulation products with a default investment pathway
- the creation of product comparison tools

The FCA is currently consulting on these ideas and will publish a final report in the first half of 2018 setting out the future shape of regulation in this market.

There was some concern about creating retirement solutions for distribution where the investor was not receiving advice. While this partly links to the broader theme of advice in the retail market, those we interviewed also expressed concern about individual financial knowledge, particularly given the range of choices, and associated risks, within the retirement income market.

“FROM THE INDIVIDUAL’S POINT OF VIEW YOU HAVE A PENSION POT MANAGED BY MANAGER XYZ. YOU MIGHT HAVE SEEN SOME OF THOSE NAMES ON THE SIDE OF A RUGBY PITCH OR ON THE BACK OF A CAB BUT HOW ARE YOU EVER GOING TO PICK ONE TO MANAGE YOUR ASSETS.”



Where the investor was accessing products via a financial adviser, there was a belief among many that we interviewed this year that IFAs were still finding their feet in a market that had previously been out of bounds to them. The construction of decumulation retirement solutions has been a limited requirement in the past as the majority of pension savers would simply have invested in an annuity. Now that most investors would be looking for some sort of drawdown solution that would provide them with an income for life, there would be increasing demand for appropriately skilled IFAs.

DEMAND FOR RESPONSIBLE INVESTMENT APPROACHES

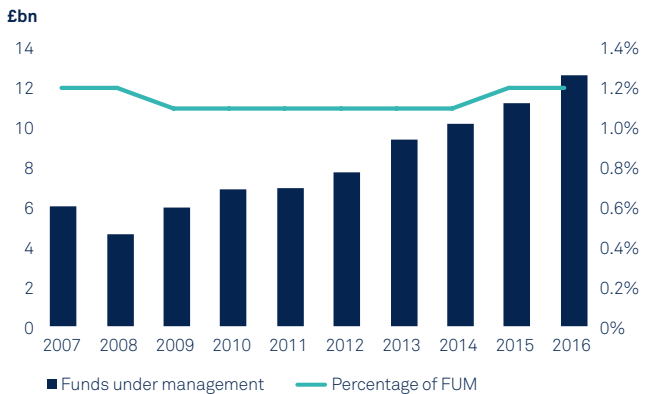
It is noticeable that the growing importance of responsible investment has been a recurring theme during interviews in the last few years. This partly reflects the increasing attention that this topic has been attracting from regulators and policymakers both internationally and domestically.

On a European level, the EU’s High Level Expert Group on Sustainable Finance published its interim report in July 2017 setting out steps to create a financial system that supports sustainable investments.¹⁶ This report made a number of recommendations such as including sustainability as a factor within segregated mandates, introducing requirements for increased disclosures for sustainability, and creating a European standard and label for green bonds and other sustainable assets, as well as labels for sustainable funds.

Domestically, there has been an increasing focus on Social Impact investment, which has more specific social utility objectives. Towards the end of 2016, the UK Government set up an Advisory Group to look at how British savers could be offered investment choices that aimed to combine positive social outcomes and financial returns.

Currently, the level of interest domestically and internationally in this area is not reflected in the IA’s data on retail market behaviour. This shows that the share of the specifically flagged ethical¹⁷ fund market has remained stable over the last decade at around 1.2% although there have been strong net sales since 2012 and funds under management have been increasing at a steady pace (see Chart 5).

CHART 5: ESG FUNDS UNDER MANAGEMENT AND AS A PROPORTION OF TOTAL (2007-2016)



“ESG DEFINITELY RESONATES AND THERE’S A LOT OF ENGAGEMENT, BUT PEOPLE ARE AT DIFFERENT STAGES IN TERMS OF KNOWING HOW TO PUT IT INTO AN INVESTMENT CONTEXT”



One reason for this may be that the increasing interest in ESG has largely been a characteristic of the institutional market and in particular those interviewed have repeatedly spoken of the importance of pension funds in northern Europe, particularly Scandinavia.

“WE ARE COLLECTING THE CARBON FOOTPRINT DATA OF ALL THE COMPANIES THAT WE ARE INVESTING IN. WE WEREN’T DOING THAT FIVE YEARS AGO.”



¹⁶ For further details, see https://ec.europa.eu/info/sites/info/files/170713-sustainable-finance-report_en.pdf.

¹⁷ Ethical funds, also known as Socially Responsible Investments (SRIs), are funds which aim to avoid companies involved in activities believed to be harmful, such as tobacco production or child labour. Some funds also aim to actively invest in companies which promote ethical policies such as recycling.

One of the difficulties with monitoring the growth in ESG investment is that there is no standard definition of what it means. Some institutional clients will have very explicit expectations of an asset manager, which need to be met before a mandate is awarded. Others might ask the manager what their policy to ESG investment is to ensure that it is sufficiently robust to warrant investment before awarding a mandate.

More broadly, asset managers are increasingly incorporating ESG criteria into their mainstream investment strategies. This reflects the view that companies that behave in a responsible manner in relation to environmental or social criteria are likely to perform better in the long-term. The impact of the Deepwater Horizon spill on BP and the emissions scandal surrounding Volkswagen were both cited as examples of how important it was to take the potential environmental impact into account.

“THERE ARE NOW MANAGERS WHO BELIEVE THAT THE WAY COMPANIES TREAT THE ENVIRONMENT AND SUSTAINABILITY WILL ALSO HAVE AN IMPACT ON THE SHARE PRICE SO THEY ARE FOCUSING ON THAT AS A WAY OF ADDING ALPHA BUT IT’S VERY DIFFICULT TO TRACK.”

“THE QUESTION IS ACTUALLY WHETHER ESG IS A SEPARATE PRODUCT, OR IS IT ACTUALLY JUST PART OF WHAT YOU DO? IN THE PAST WE HAD A DEDICATED TEAM LOOKING AT THIS FOR CERTAIN PORTFOLIOS, WE ACTUALLY THOUGHT THIS SHOULD APPLY TO ALL PORTFOLIOS.”

There is also increasing attention from fund research houses, which are beginning to rate funds according to ESG criteria. While this may lead to increased interest from individual investors there was a sense among those we interviewed that this was not something that was part of a typical discussion between an IFA and a client. Therefore, as long as distribution remained IFA-led for many asset managers, the demand from retail investors for ESG was likely to remain limited.

“THE IRONY IS THAT THE PEOPLE WHOSE MONEY WE’RE MANAGING WOULD RATHER INVEST WITH THEIR HEADS AND GIVE WITH THEIR HEARTS AND THEY SEPARATE THE TWO.”

Several among those we interviewed thought there was a generational factor at play here. While much of the evidence in this area remains anecdotal, many were of the impression that this could well change as younger investors feed through into the market. Younger savers are often believed to be more concerned about ESG criteria and this may lead to a change in the way investors invest directly. This may also lead to greater pressure on DC trustees and governance committees to consider further the importance to ESG requirements.

“I DON’T SEE THE DEMAND IN RETAIL. HOWEVER, THERE ARE SOME OPTIONS IN THE PENSIONS MARKET THAT MILLENNIALS HAVE BEEN SNAPPING UP IN THEIR DC SAVINGS SO I THINK IT’S A MATTER OF TIME. THE REASON YOU ARE NOT SEEING IT JUST YET IS THAT THOSE PEOPLE THAT DO AND WILL CARE JUST DON’T HAVE ENOUGH POOLS OF ASSETS OR THEY ARE NOT SAVING AS MUCH YET.”

3 TRENDS IN CLIENT ASSETS AND ALLOCATION

KEY FINDINGS

CLIENT TYPE

- » Institutional clients continue to account for the majority (79%) of total assets under management in the UK.
- » The largest client group remains UK and overseas pension funds, accounting for 44% of total assets.
- » Assets managed on behalf of insurance fell again during the year, by two percentage points, and represented 16% of all assets at the end of 2016.
- » 57% of assets were managed in segregated mandates, compared to 43% in pooled arrangements. This ratio has been largely stable over the last four years.

ACTIVE AND PASSIVE

- » The shift towards passive management continues. Around three quarters of assets are managed on an active basis compared to 83% a decade ago.

ASSET ALLOCATION

- » The equity allocation remained stable at 39% at the end of 2016. The fixed income allocation fell by one percentage point to 32%.
- » The allocation to other assets increased to 21% (19% in 2015). Three quarters of this category now reflects investment solutions.
- » Property holdings were down slightly at 2% and allocations to cash fell by one percentage point to 5%.
- » European equities, both UK and mainland, fell out of relative favour following the Brexit vote, falling six percentage points to 54% of the total equity allocation. The regions of North America and Asia Pacific were the main beneficiaries.
- » The structural shift into outcome-oriented products is expected to continue with solutions, multi-asset portfolios and absolute return strategies all expected to increase in popularity.

CAPITAL MARKET FINANCING

- » IA members invested an estimated £29 billion in infrastructure at the end of 2016. Around three quarters of this (73%) is directed to economic infrastructure, with the remaining quarter going to projects offering a social benefit.



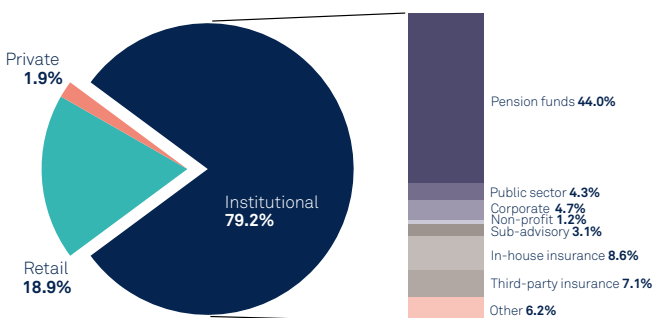
This Chapter looks across the entire UK-managed asset base of the UK asset management industry and documents how these assets are split between different client groups, how they are allocated across different asset classes and geographies, and what proportions are actively or passively managed. The distinctions are not always entirely clear, for example the line between retail and institutional is becoming increasingly blurred in the context of the growth in DC pensions. The institutional and retail markets are covered separately and in more detail in Chapters 4 and 5 respectively.¹⁸

CLIENT TYPES

The £6.9 trillion of assets managed in the UK is managed for a broad range of client types. Chart 6 shows the breakdown by client type, reflecting assets managed in the UK for both institutional and retail clients and includes assets from clients based overseas as well as those in the UK.

Around four fifths of assets managed in the UK are managed on behalf of institutional investors (79%). Pensions continue to dominate the client breakdown having grown once again as a proportion of the client base, reaching 44% of assets under management in 2016.

CHART 6: ASSETS MANAGED IN THE UK BY CLIENT TYPE



The definition of pension funds in the Investment Association's data is all schemes, both defined benefit (DB) and defined contribution (DC), where

the scheme has a direct relationship with the asset manager, notably DB schemes and some of the larger DC schemes, including master trusts. However, the direction of travel in the pension provision market, with the ever increasing importance of DC schemes, is making the distinction between the different client types more challenging.

In the first instance, where DC pension assets are operated via life companies wrapping funds, they are not included in pension fund assets but are rather reflected in assets managed on behalf of insurance companies. This will include assets managed for personal pension and GPPs. This blurs the line between pension and insurance assets and means that the allocation to pension funds understates actual pension investment.

Secondly, this blurring of the designation between pension and insurance assets continues to impair insight into the ultimate bearer of the investment risk which, for DC pension schemes falls entirely on the individual pension saver. DC pension saving is therefore arguably closer to a retail investment than institutional, so the broader breakdown between retail and institutional assets shown in Chart 6 is not as clear cut either.

The number of people investing via DC pension schemes has increased dramatically as a result of automatic enrolment. Outside of the public sector almost all employees are being automatically enrolled into DC schemes with over eight million people automatically enrolled to date. The DWP estimates that by 2019/2020 an additional £17 billion will be saved each year into workplace pension as a result of automatic enrolment.¹⁹ Many of these investors may well be first-time investors with little or no knowledge of the asset management industry (see page 50).

“DC TEAMS HISTORICALLY SAT IN INSTITUTIONAL TEAMS BECAUSE IT IS PENSION, BUT ACTUALLY MORE AND MORE ASSET MANAGERS ARE STARTING TO THINK THAT DC SHOULD SIT IN RETAIL, BECAUSE DC IN THE END IS A RETAIL PRODUCT.”

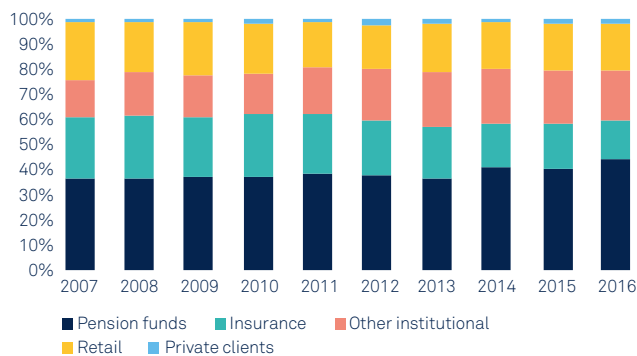
¹⁸ Chapter 4 relates to money managed for UK institutional investors by IA members globally. It does not reflect money managed in the UK for all institutional clients.

¹⁹ Workplace pensions: Update of analysis on Automatic Enrolment 2016

LONGER-TERM EVOLUTION OF CLIENT BASE

Looking at the long term trends, there has been a sustained decline in insurance assets relative to pension funds and other institutional clients as they fell again from 18% of the client base at the end of 2015 to 16% in 2016 (see Chart 7). The brief stabilisation observed last year does not therefore seem indicative of any halt in the long-term fall in the relative proportion of insurance assets. Moreover, the strong growth in total assets under management means that each of these markets, even the insurance category, continues to increase in absolute terms, but insurance assets have increased at a much slower rate than pensions.

CHART 7: ASSETS MANAGED IN THE UK BY CLIENT TYPE (2007-2016)



There has been a noticeable increase in pension fund assets since 2012. This is likely to reflect the growth of liability driven investment (LDI) mandates managed by the IA's members on behalf of DB pension schemes looking to manage the run off of their liabilities. To a lesser extent it will also reflect the increased pension participation resulting from automatic enrolment.

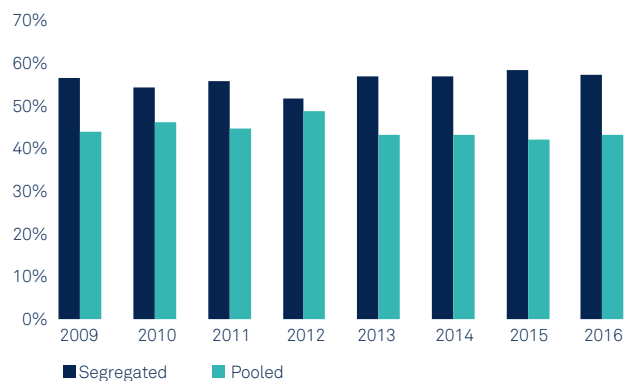
Investments by retail investors continue to account for around one fifth of assets at a headline level amid an increased blurring between the definitions of retail and institutional investment.

The private client figures included in Chart 7 only relate to the portion of the private client market where members of the IA provide dedicated private client investment services. As can be seen from Figure 2 the actual private client market is significantly larger than this and IA members are estimated to manage around one quarter of this market.

SEGREGATED VS POOLED INVESTMENT

Chart 8 shows the split between segregated and pooled investment. The figures have fluctuated somewhat year on year but remained roughly 57% segregated and 43% pooled for the last four years.

CHART 8: SEGREGATED VERSUS POOLED INVESTMENT (2009-2016)

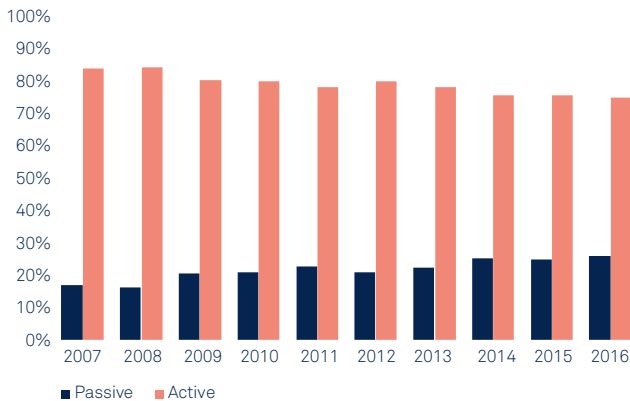


BALANCE BETWEEN ACTIVE AND PASSIVE

Across the overall base of UK-managed assets, the use of passive is continuing to grow but at a very slow rate as a percentage of overall assets under management. Three quarters of assets are still actively managed, down from 83% a decade ago (see Chart 9).

The increase in passive mirrors trends internationally, and may in part reflect a trend towards greater use of ETFs. Chart 9 has been adjusted to take account of the estimated growth in assets of UK listed ETFs run by IA members since 2012, but does not include the wider ETF market.

CHART 9: ACTIVE AND PASSIVE AS A PROPORTION OF TOTAL UK ASSETS UNDER MANAGEMENT (2007-2016)



The split between active and passive at this macro level will be impacted by factors other than shifts seen at individual asset class level (for example, greater use of passive products for equity market exposure). One factor relates to changes in the allocation between asset classes whereby more money is allocated to strategies that involve by nature more active management such as multi-asset or outcome-focused. Another factor may reflect different investment returns from different asset classes.

Data at flow level in the retail market shows a more striking trend towards passive product, particularly in equity fund selection (see Chart 10). Nonetheless, it is starting from a relatively low base. This is discussed in more detail in Chapter 5.

CHART 10: GROSS RETAIL SALES OF TRACKER FUNDS AS A PERCENTAGE OF GROSS RETAIL SALES BY ASSET CLASS (2007-2016)



With a greater use by clients of solution or outcome-focused approaches, as opposed to component building blocks such as an equity mandate or fund, the active v passive debate is also evolving. Allocation or targeted return / volatility strategies involve an inherently active set of decisions. The portfolio construction itself may draw upon a range of funds, both active and passive, but even if it were entirely passive, it would still require an active decision to allocate across the selected passive funds.

MOVING BEYOND TRADITIONAL ASSET CLASSES

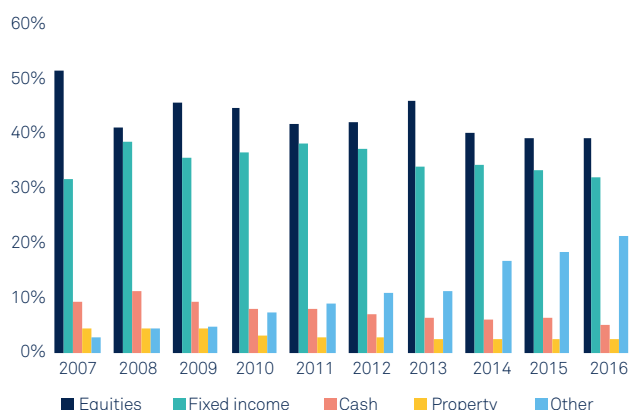
Equity markets and fixed income both posted double digit positive returns during 2016.²⁰ All else being equal, investment returns would have led the proportion of equities to increase during 2016 and fixed income to decrease. The allocation to fixed income did fall by one percentage point to 32% but equities were stable at 39%. The main beneficiary was the allocation to ‘other’ assets which continued to increase, finishing the year up by two percentage points at 21%. This suggests that there were some further investment flows out of equities during the year, which is consistent with the outflows of £8.1 billion observed from equity retail funds during 2016 (see page 66).

The ‘other’ category contains alternative assets such as commodities, private equity and infrastructure but to an increasing extent it also includes solutions-driven investments customised to meet specific client outcomes in both the institutional and retail market. We estimate that solutions now represent around three quarters of this category, reflecting both the use of derivative instruments to deliver exposure and multi-asset products, which cannot be broken down into underlying asset classes.

Because ‘other’ assets encompasses such a broad range of asset classes, it is difficult to ascertain how much of the shift in allocation is due to investment growth and how much is due to flows into the asset class. Nevertheless, the consistency of the growth in ‘other’ assets in the last decade is clear from Chart 11 and is therefore likely to be indicative of a structural shift in investor preference.

Property holdings were down slightly at 2% and allocations to cash fell by one percentage point to 5%.

CHART 11: OVERALL ASSET ALLOCATION OF UK-MANAGED ASSETS (2007-2016)



The shift in investor preference is reflected in the proportion of IA members that invest in other asset classes. Almost three fifths (59%) now invest in alternative assets or dedicated solutions-based strategies, up from 51% five years ago.

TABLE 2: PROPORTION OF IA MEMBERS INVESTING BY ASSET CLASS

	Percentage of firms
Equities	96%
Fixed income	85%
Cash	69%
Property	41%
Other	59%

The overwhelming view of those we interviewed was that the growth of solutions-based products was likely to continue in the coming years and that assets moving into solutions-based products would outweigh building-block products by a significant ratio.

²⁰ Global equities performed more strongly, returning 27% in sterling terms compared to 20% for global bonds. Returns in local currency terms based on weekly data from Morningstar, 29 December 2015 until 26 December 2016

“IT’S GOING TO BE ABOUT WORKING WITH THE CLIENT TO UNDERSTAND WHAT THE REQUIREMENT IS AND THEN PUTTING TOGETHER A RANGE OF ASSET CLASSES DESIGNED TO MEET THAT REQUIREMENT. I THINK EVENTUALLY THAT WILL EVOLVE TO THE PERSONAL LEVEL.”



Solutions, though frequently used to refer to multi-asset products, encompass a wide range of investment strategies that mean different things to different investors. In the institutional world of pension funds and sovereign wealth funds, this was reported as manifesting itself in the form of very specific demands for customised mandates, be they to match a particular future liability set or an investment to meet a specific risk factor using a specially customised benchmark. As a consequence, portfolio management teams that might have previously worked independently and in silos, were now working more closely together to deliver client-specific solutions.

“I DON’T THINK SOLUTIONS IS A FAD. IT’S A MASSIVE TREND THAT WILL CONTINUE FOR MANY YEARS. BUT WHAT IT MEANS IS DIFFERENT DEPENDING ON WHETHER YOU ARE AN INDIVIDUAL OR A PRIVATE BANK. WHAT WE ARE FINDING IS THAT WE NEED TO BUILD PRODUCTS AND SUGGEST COMBINATIONS THAT ARE SPECIFIC TO A CLIENT’S NEEDS.”



As the focus shifts more towards outcome-focused products investors are becoming much more aware of return in absolute terms rather than relative. As well as multi-asset products, individuals are showing increasing interest in absolute return products and investment in a wider set of products that have previously only been available to institutional investors such as infrastructure and private equity. However, the extent to which individuals can access this type of asset, even if the demand is there, is constrained by the liquidity issues discussed on page 45.

DETAILED ASSET ALLOCATION

Beyond the shifts between asset classes the IA also monitors the evolution of equity and fixed income allocations according to type of exposure and this section considers the changes within these asset classes in more detail.

REGIONAL EQUITY

Chart 12 shows equity allocations on a regional basis. It was observed last year that the fall in the proportion of UK equities appeared to have stalled and even recovered slightly between the end of 2014 and 2015. Chart 12 makes clear that this correction did not continue into 2016 and there were significant changes from the regional allocations at the end of 2015.

- The UK allocation fell three percentage points to 31% during 2016.
- The Europe ex-UK allocation fell from 26% in 2015 to 23% in 2016.
- The allocation to North America increased from 19% to 21%. Nineteen percent of equities, almost all the North America allocation, is invested in the US.
- Asia-Pacific ex Japan increased from 5% to 8%.

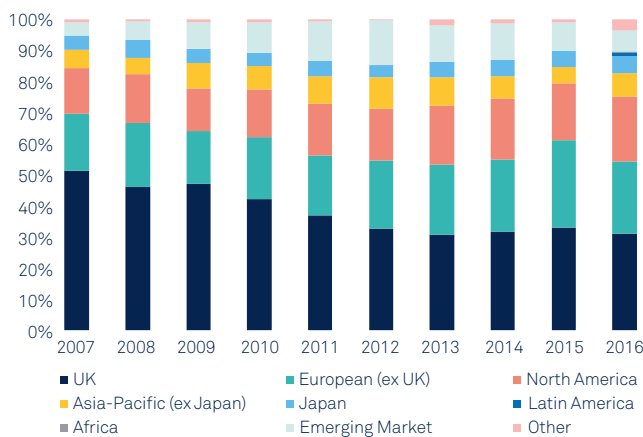
These changes are most likely a reflection of investor reaction to the UK’s vote to leave the EU in June of 2016.

“THE DECISION OF BREXIT AT THE TIME DEFINITELY MADE EUROPE OUT OF FAVOUR. IT’S MADE EUROPEANS MORE NERVOUS ABOUT THEIR OWN ECONOMY AND MARKETS AND IT’S MADE FOREIGN INVESTORS, THE AMERICANS IN PARTICULAR, MUCH MORE NERVOUS ON EUROPE. AS A REGION TO INVEST IN.”



The IA is now collecting more granular data on the allocation to Latin America and Africa, and these are detailed separately in the 2016 segment of Chart 12. Although these allocations are small it should be noted that comparisons to the 'Other' country segment will not be directly comparable with previous years.

CHART 12: UK-MANAGED EQUITIES BY REGION (2007-2016)



FIXED INCOME

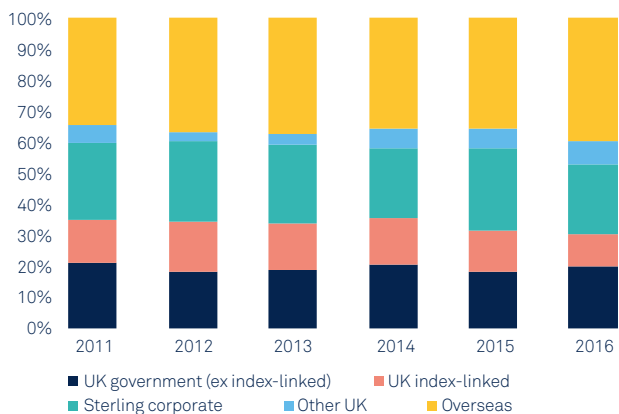
Within fixed income, there were significant changes as exposure to UK corporates reduced in favour of overseas bonds.

The allocation to index-linked bonds in the UK continued to fall. Although the share of conventional gilts rose slightly, overall the allocation to UK government bonds decreased.

Chart 13 illustrates these shifts in more detail:

- The allocation to UK government debt fell by a further two percentage points in 2016 to 30%.
- The allocation to UK corporate bonds decreased from 26% to 23%.
- The overseas bond allocation was the key beneficiary during 2016 as the allocation increased four percentage points to 40%.

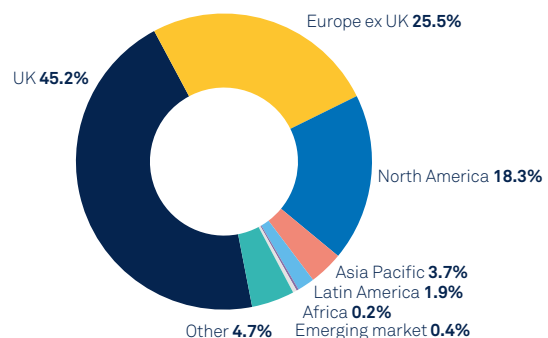
CHART 13: ALLOCATION OF UK-MANAGED FIXED INCOME BY TYPE AND REGION (2011-2016)



The IA classifies sterling corporate debt as any corporate bond issued in sterling irrespective of the location of the issuer. In an increasingly globalised market, many bonds issued in sterling are issued by organisations located overseas.

Within the sterling corporate bond allocation, just under half of all bonds were issued by UK corporations (45%). The significance of exposure to overseas corporations provides further evidence of the global importance of the asset management industry both to investment in UK companies but also to economic development around the globe (see Chart 14).

CHART 14: CORPORATE BOND ALLOCATION BY COUNTRY OF ISSUER



FIXED INCOME ALLOCATION BY CLIENT TYPE

Fixed income allocations differ depending on the category of the underlying client. Insurance companies, for example, have requirements unlike other types of institutional investor. They receive premiums which must be invested to closely match the nature of the insurance they provide. The combination of regulation and need for prudence leads insurance companies to invest heavily in fixed income securities. Solvency II legislation, which became applicable in all EU member states from 1 January 2016, places greater financial requirements on insurers and one of its aims is to encourage insurers to match their investments (and capital) even more closely to their liabilities than previously.

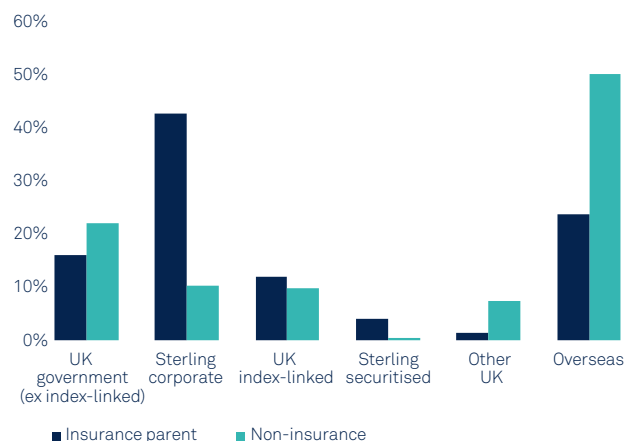
If we look at how the allocation alters depending on whether the asset manager has an insurance parent or not (see Chart 15) that difference becomes very clear. Insurance-owned groups have a much higher exposure to sterling corporate securities and, to a lesser extent, to index-linked gilts. This will in part explain the decrease in the proportion of total assets managed for insurance clients. Their greater preference for sterling denominated fixed income will mean they benefited to a lesser extent from the depreciation of sterling that contributed to the rise in value of overseas assets and the increase in overall assets under management.

The respondent sample to the IA's survey data tends to over-represent insurance-owned asset managers, although this over-representation is diminishing as the importance of insurance assets reduces as a proportion of overall assets under management. When the sample is adjusted to be more representative of the market as a whole, it shows that the allocation to sterling corporate holdings drops slightly and the allocation to overseas bonds increases to 43% (see Table 3).

TABLE 3: HEADLINE VS. SAMPLE-ADJUSTED FIXED INCOME OWNERSHIP

	Headline	Sample-adjusted
UK government (excl. Index-linked)	19.8%	20.4%
UK index-linked	10.6%	10.3%
Sterling corporate	22.7%	19.3%
£ Securitised	1.9%	1.5%
Other UK	5.1%	5.8%
Overseas bond	40.0%	42.8%

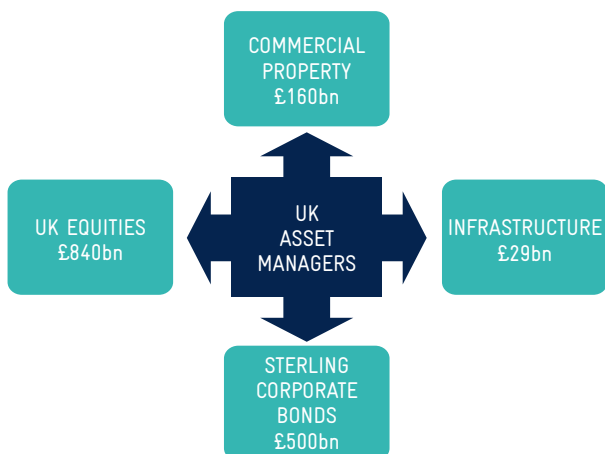
CHART 15: FIXED INCOME OWNERSHIP BY PARENT GROUP TYPE (INSURANCE VS. NON-INSURANCE) 2016



EVOLUTION OF CAPITAL MARKET FINANCING

Even though overall UK equity exposure has fallen as a proportion of holdings over the past twenty years, the asset management industry plays a key role in the allocation of capital to UK businesses and to projects. As Figure 6 shows, this allocation takes place across asset classes, traditionally focused on equities, corporate debt and commercial property. IA members still hold around a third (34%) of the UK's equity market cap. Like in the US, and in contrast to much of continental Europe, market-based finance has very strong foundations in the UK.

FIGURE 6: SUPPORTING THE UK ECONOMY²¹



After the financial crisis, the reduction in bank lending led to asset managers becoming a more important source of capital for companies looking for investment. This is also recognised at a European level where one of the most significant initiatives by the European Commission looks at how to strengthen capital markets to ensure well-functioning economies with multiple sources of funding (see Box 4).

In this context, we asked members we interviewed this year whether they felt there were any notable trends in the way capital is being raised in the UK and elsewhere and whether the role of public markets had changed.

²¹ The majority of property investment is in commercial property, however a small amount may be allocated to residential accommodation, notably student housing. The majority of infrastructure investment is UK but some may be invested overseas.

BOX 4: ASSET MANAGERS AS FOCAL POINT FOR ACHIEVING THE CAPITAL MARKETS UNION OBJECTIVES

The Capital Markets Union (CMU) is one of the European Commission's landmark projects and was launched in February 2015 with the key aim of creating a single market for capital in the EU. The underlying objective is to facilitate and foster cross-border investment and develop capital markets as an alternative source of corporate financing. The latter was seen as essential for ensuring financial stability, an issue that became particularly pertinent during the 2008 financial crisis for economies that largely relied on the banking sector for funding.

The CMU action plan, published in September 2015, covered points such as:

- national barriers to cross-border investment
- developing venture capital investing
- reviewing regulatory barriers to infrastructure investments
- facilitating access to public markets
- fostering retail and institutional allocation into investment products

The mid-term review published in June set out a number of new priority actions including strengthening the powers of ESMA, reviewing the prudential treatment of investment firms, and facilitating the cross-border distribution and supervision of UCITS and alternative investment funds.

The asset management industry is going to be instrumental in this in two principal ways:

- the industry can be a significant source of finance across Europe as it already is in the UK.
- the products and services that asset managers offer to retail and institutional investors provide the capital that is then channelled to capital markets. As such, the themes of enhanced transparency and governance and better communication of how the industry is delivering value for money are critical for regaining investors' trust and achieving the CMU objectives.

There was no sense that the importance of public markets was decreasing in any significant way, but some felt that traditional models were being challenged at the moment as investors and asset managers look for other ways to meet their objectives. This was increasing the attractiveness of private markets, which encapsulate a wide range of investment types, including infrastructure, private equity and private debt, as well as the securitisation of insurance assets.

The view of members interviewed was that those with equity and fixed income in their portfolios must be looking to diversify into other markets such as infrastructure and private equity for several reasons:

- They broaden the range of investments in portfolios that would at the very least increase diversification at a time when major corrections in public markets are expected, but that could also offer a substantial illiquidity premium.
- Information levels on private markets are lower, as are competition levels, which offers an increased opportunity set for active managers.
- The long term nature of private markets encourages a strong relationship between the client and the asset manager.

“THERE IS LESS INFORMATION ON PRIVATE MARKETS AND THEREFORE POTENTIALLY MORE OPPORTUNITY.”

“I THINK PEOPLE WILL WANT THE ILLIQUIDITY PREMIUM BECAUSE THERE ARE NOT MANY OTHER PREMIUMS LEFT IN THE WORLD. THE ILLIQUIDITY PREMIUM IN PRIVATE ASSETS IS AN ATTRACTIVE PLACE SO I THINK THAT TREND HAS GOT A LONG WAY TO RUN.”

While the long term nature of private markets was raised as a potential benefit to investors, the accompanying illiquidity was also highlighted as a possibly limiting factor, particularly for investment from retail investors. Investors and/or their intermediaries often expect daily liquidity, even where it is not specifically required by regulators. Members suggested that high liquidity requirements could potentially be counterproductive, particularly in relation to pensions investment, where investors – and those taking decisions on their behalf in default arrangements – were taking a long-term view on their investment positions.

“THE MORE THE INDUSTRY AND REGULATORS CAN DO TO FACILITATE INVESTMENT BY RETAIL INVESTORS INTO LONGER TERM LESS LIQUID MARKETS, WHICH CAN OFFER THEM REAL DIVERSIFICATION, THE BETTER. BUT IT HAS TO BE ACCOMPANIED BY THE EVOLUTION OF REGULATION.”

A number of those we spoke to also emphasised the importance of the role that listed equity has historically served in financing business and the economy and would continue to serve in the future .

“THE EQUITY MARKET REIGNS AND LONG TERM EQUITY REMAINS THE BEST WAY TO FINANCE A BUSINESS. YOU CAN'T REALLY GET AWAY FROM THAT. THAT WILL DRAW THOSE REQUIRING CAPITAL BACK TO THE LISTED MARKETS.”

INFRASTRUCTURE AS A GROWING ASSET CLASS

Asset managers in the UK have for many years directed capital from investors towards companies via equity and fixed income holdings. They also play an important part in the funding of commercial property, with just under 3% of assets under management (£160 billion) invested in property at the end of 2016.

Today, asset managers are increasingly facilitating infrastructure investment, largely in response to the needs of DB pension schemes which find infrastructure attractive in a world where traditional fixed income yields are so low. Investors are therefore looking for higher yields than are available elsewhere as well as dependable long-term cash flows that will help schemes to meet future pension payments.

The amount invested by IA members into infrastructure is relatively low compared to some of the more traditional investments which have dominated their activity in the past. Nevertheless, an estimated £29 billion was invested in infrastructure by IA members at the end of 2016.

The UK Government first published a National Infrastructure Plan in October 2010, in which it outlined its vision for UK economic infrastructure. There have been regular updates to the plan in the years following 2010 and in March 2016 the Government published the National Infrastructure Delivery Plan 2016-2021²², which brought together the government's plans for economic infrastructure with those supporting delivery of housing and social infrastructure. This plan includes an objective for 50% of the financing of projects to come from the private sector. The government sees institutional investors, predominantly pension funds and insurance companies as a key source of infrastructure investment under the plan.

The unlisted UK-based infrastructure fund market is the largest in Europe. Over the last three years the capital raised by funds based in the UK represented 49% of the total capital raised for Europe-based infrastructure funds.²³

IA members invest predominantly in UK infrastructure projects although there is an element of overseas investment, most notably in Europe. Infrastructure investment is complex and IA members indicated that rather a small proportion of available projects can satisfy the quality, ethical and risk requirements of UK institutions.

“THE DEMAND FOR INFRASTRUCTURE IS CURRENTLY GREATER THAN THE SUPPLY OF GOOD INVESTMENT OPPORTUNITIES. THERE ARE PLENTY OF LOW QUALITY PROJECTS BUT NOT ENOUGH SUPPLY OF HIGH QUALITY OPPORTUNITIES.”



Almost three quarters of the £29 billion invested by IA members at the end of 2016 (73%) was in economic infrastructure, which includes projects such as energy, transport, utilities and environmental. The remaining quarter was invested in projects which offer a social benefit, particularly social housing and healthcare-related projects (see Figure 7).

²² National Infrastructure Delivery Plan 2016–2021, Infrastructure and Projects Authority

²³ The UK Infrastructure Market, Prequin, 2016

FIGURE 7: INFRASTRUCTURE INVESTMENT BY IA MEMBERS

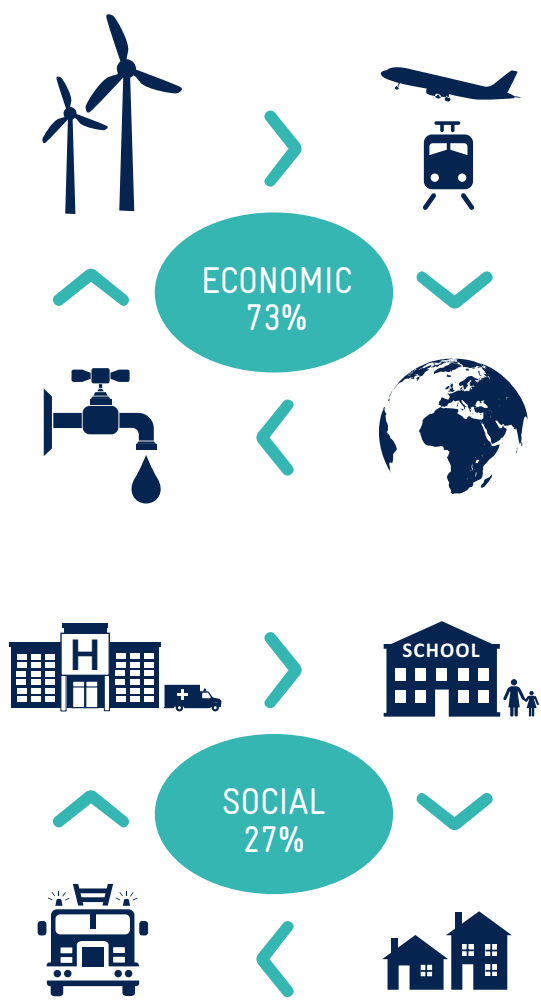


Table 4 shows that asset managers use a broad range of methods to facilitate their infrastructure investment, although around 60% of the responses related to infrastructure debt in preference to infrastructure equity investment, which is in line with the requirements that exist among institutional investors for stable cash flows.

TABLE 4: METHODS OF ACCESS TO INFRASTRUCTURE INVESTMENT REPORTED BY IA MEMBERS IN 2016

Infrastructure Loan Securitisation Vehicle	✓
Listed Bond (direct project finance only)	✓
Listed Equity (direct project finance only)	✓
Listed Infrastructure Equity Fund	✓
Listed Infrastructure Bond Fund	✓
Private Placement	✓
Unlisted Equity	✓
Unlisted Infrastructure Bond Fund	✗
Unlisted Infrastructure Equity Fund	✓
Other	✓

The proportion of asset managers currently investing in infrastructure is relatively low. We consider that the IA data captures the majority of investment by asset managers in the UK. Infrastructure investment is also facilitated by companies outside of the IA membership such as overseas asset managers and specialist infrastructure managers, which will not be captured.

4 UK INSTITUTIONAL CLIENT MARKET

KEY FINDINGS

MARKET OVERVIEW

- » IA members managed an estimated £3.6 trillion for institutional clients, up from £3.3 trillion in 2015. Pension funds account for substantially more than half of all institutional assets, £2.2 trillion (61%).
- » At £1 trillion, insurance asset represent 27% of institutional mandates, down from 29% in 2015.

THIRD PARTY MARKET

- » An estimated £2.9 trillion was managed for third party mandates, up from £2.5 trillion in 2015. This excludes in-house insurance assets.
- » Pension funds account for more than two thirds (70%) of third party assets, £2 trillion in total.

PENSIONS

- » Use of LDI strategies by DB pensions schemes continued to increase. More than £900 billion in notional pension liabilities are now hedged in LDI mandates.
- » The shift from DB to DC pensions continued apace. DC pension membership in the private sector now outstrips DB by a ratio of 5:1.

MANDATE TYPES

- » The use of multi-asset mandates continued to rise among institutional clients (21%, up from a revised 20% in 2015) reflecting a clear shift away from specialist, single-asset mandates.
- » The proportion of specialist mandates allocated to equity mandates decreased to 40% in 2016 from 43% in 2015.
- » The allocation to specialist UK equity mandates was little changed from 2015, at 24%.
- » Sterling corporate mandates made up 27% of specialist fixed income, remaining the largest category of specialist fixed income mandates.
- » Just over two thirds of mandates were managed on an active basis (67%), largely unchanged from 2015.
- » 68% of third party mandates were segregated at the end of 2016, up from 65% the previous year.



This Chapter examines more closely the shape of the UK institutional client market and reports on specific aspects including the different client types and their relative importance, the size of the third party mandate market and the long-term trends in mandate types, as well as the developments in the pensions market and particularly the shift from DB to DC.

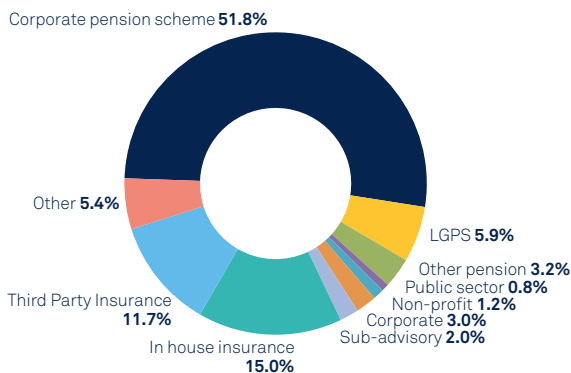
The analysis differs from that in Chapters 1 and 3 in two ways:

- It focuses on the nature of a mandate rather than on the underlying assets. So a global equity mandate will appear as such, rather than being broken down into the underlying constituent countries.
- It looks at the UK institutional client market regardless of asset management location (ie. the focus is on clients based in the UK rather than on assets managed in the UK). However, we estimate that an overwhelming majority of the assets are managed in the UK (approximately 93%).

CLIENT BREAKDOWN

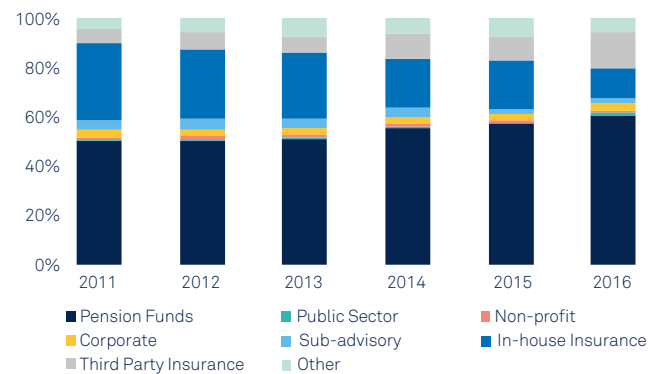
IA members manage £3.6 trillion²⁴ for UK institutional clients globally. As Chart 16 indicates, pension funds and insurance companies (including in-house and third party management) account for the majority of UK institutional assets (88%).²⁵ Pension funds remain the largest client type.

CHART 16: UK INSTITUTIONAL MARKET BY CLIENT TYPE



The trend in client breakdown over recent years highlights the steady reduction in insurance assets and, most markedly in-house insurance (see Chart 17). At the same time there has been a significant increase in pension fund assets and an increase in other types of institutional client.

CHART 17: UK INSTITUTIONAL MARKET BY CLIENT TYPE (2011-2016)



²⁴ Implied figure based on data collected on an estimated 84% of institutional client base

²⁵ The remaining 12% of assets is made up from mandates managed for corporations (outside of pension assets) sub advisory, not for profit mandates and public sector mandates. Just over half of this (7%) is managed for 'other' client types, which generally refers to a variety of open- and closed-ended pooled vehicles, and investors from the more specialist areas of private equity, venture capital and property.

PENSION SCHEMES

IA pension fund data includes DB and DC schemes where the asset manager has a relationship with the pension fund rather than it being distributed via a wrapped product through an insurance company. In 2016 pension funds continued to account for more than half of the institutional client base (£2.2 trillion).

DC pension assets operated via an intermediary platform through an insurance company are reflected in insurance assets. Insurance mandates account for 27% of institutional business, down by two percentage points from 2015.

The IA divides pension scheme assets in three categories:

- Corporate pension funds, which at £1.9 trillion represented the majority of UK pension fund assets in 2015. This category includes a number of in-house Occupational Pensions Scheme (OPS) managers, which we estimate manage around £140 billion in assets.
- The Local Government Pension Scheme (LGPS) which accounted for £210 billion of assets in 2016.
- Assets managed for pensions schemes that do not fit into either of these categories, such as those run for not-for-profit organisations, representing £115 billion.

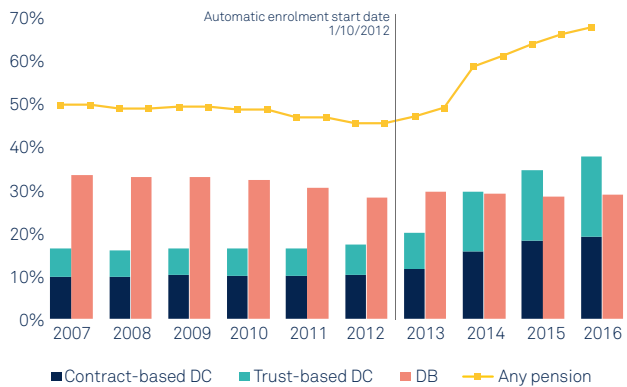
Corporate pension scheme assets are still dominated by DB schemes, which held £1.5 trillion in assets at the end of December 2016 (total liabilities were £1.7 trillion)²⁶. These schemes are almost entirely closed to new entrants, with only 13% still being open in March 2016 and almost a third having closed to future accrual for all members.²⁷ As these schemes continue to mature the pressure to de-risk investment holdings will become stronger.

THE SHAPE OF THE UK PENSION MARKET

We estimate the size of the UK pension market to be £2.8 trillion at the end of December 2016.²⁸ This includes all assets in DB and DC pensions, as well as those assets in some form of drawdown arrangement, plus assets backing annuities.²⁹ Figure 8 provides an overview of how these assets are broken down across the different scheme types.

DB (funded) assets continue to make up the majority of the UK pension market. However, due to the continuing closure of private sector DB schemes, the number of savers into DC schemes now exceeds those actively saving into DB schemes. This shift is largely a result of the introduction of automatic enrolment and is clearly visible in Chart 18.³⁰

CHART 18: MEMBERSHIP OF UK PENSION SCHEMES (2007-2016)



Source: ONS

²⁶ This figure does not directly relate to the £1.9 trillion managed for corporate pensions by IA members as some DB asset will be managed by non-IA members and some DC pension assets will be directly managed by IA members.

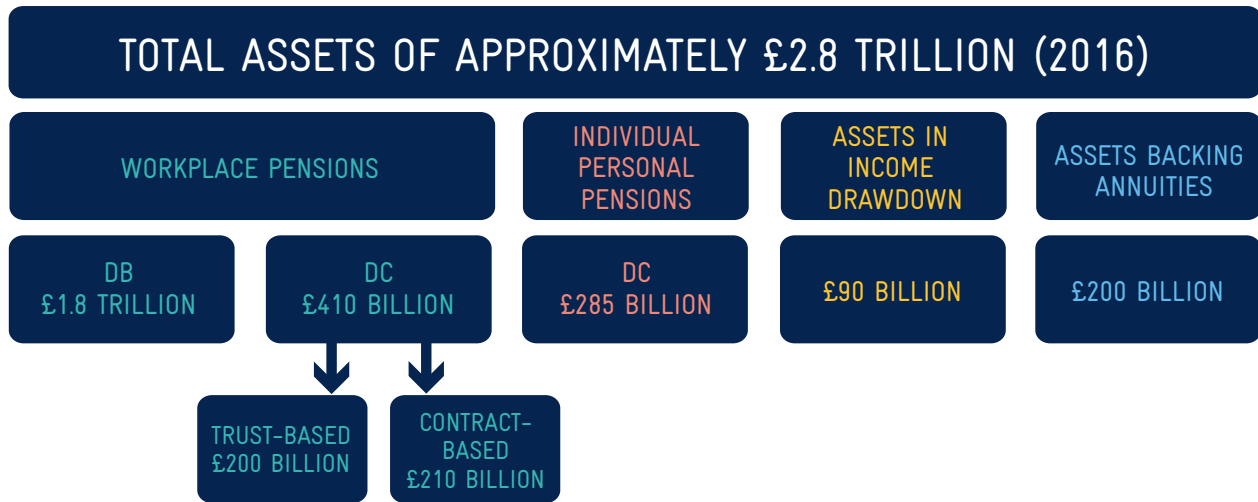
²⁷ The Purple Book, TPR/PPF

²⁸ Last year we published an overview of the UK pension landscape from this survey for the first time in several years as the lack of available information about the DC market in the UK had led high levels of uncertainty around the size of the market. Significant progress has been made in the last two years and the data below has been collected and inferred from a number of sources. External sources include ONS, Pensions Policy Institute, PPF and TPR. Nevertheless this data should still be considered indicative as not all data are updated with the same frequency or at the same date. Where possible estimates have been made to equalise the data at the end of 2016. Data on the DC market sourced from a number of sources at different dates. Numbers have been estimated so they are comparable at end December 2016 using returns on the IAs mixed investment 40-85% shares sector, a proxy for a typical DC default investment.

²⁹ The assets of DB schemes are reported in Figure 8. The liabilities attributed to these schemes would result in higher figures as funding levels currently average around 85%.

³⁰ ASHE pension tables, ONS, 2016. Includes DB members in unfunded public sector schemes

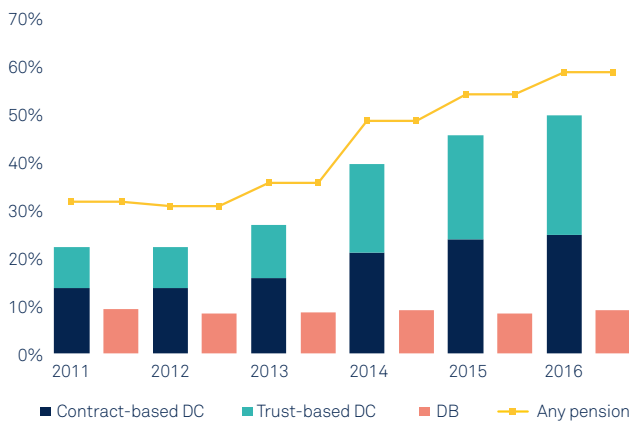
FIGURE 8: OVERVIEW OF THE UK'S PENSION LANDSCAPE



The majority of DB schemes that remain open to new members are linked to jobs in the public sector. Therefore when only private sector pension saving is taken into account the shift from DB to DC is even more stark (see Chart 19).

Charts 18 and 19 highlight the increasing importance of asset management in the UK for individual pension savers but only reflect a part of the picture. Significant assets are attributable to deferred pension savings from previous employment. Once these assets are also taken into account, it transpires that 76% of all households in the UK are invested in a UK pension scheme. Much of this is managed by UK asset managers in addition to the assets that are managed for households in stocks and shares ISAs and authorised investment funds.³¹

CHART 19: ESTIMATED PENSION PARTICIPATION FOR PRIVATE SECTOR JOBS



Source: ONS

³¹ Wealth and Assets Survey 2012-2014, ONS

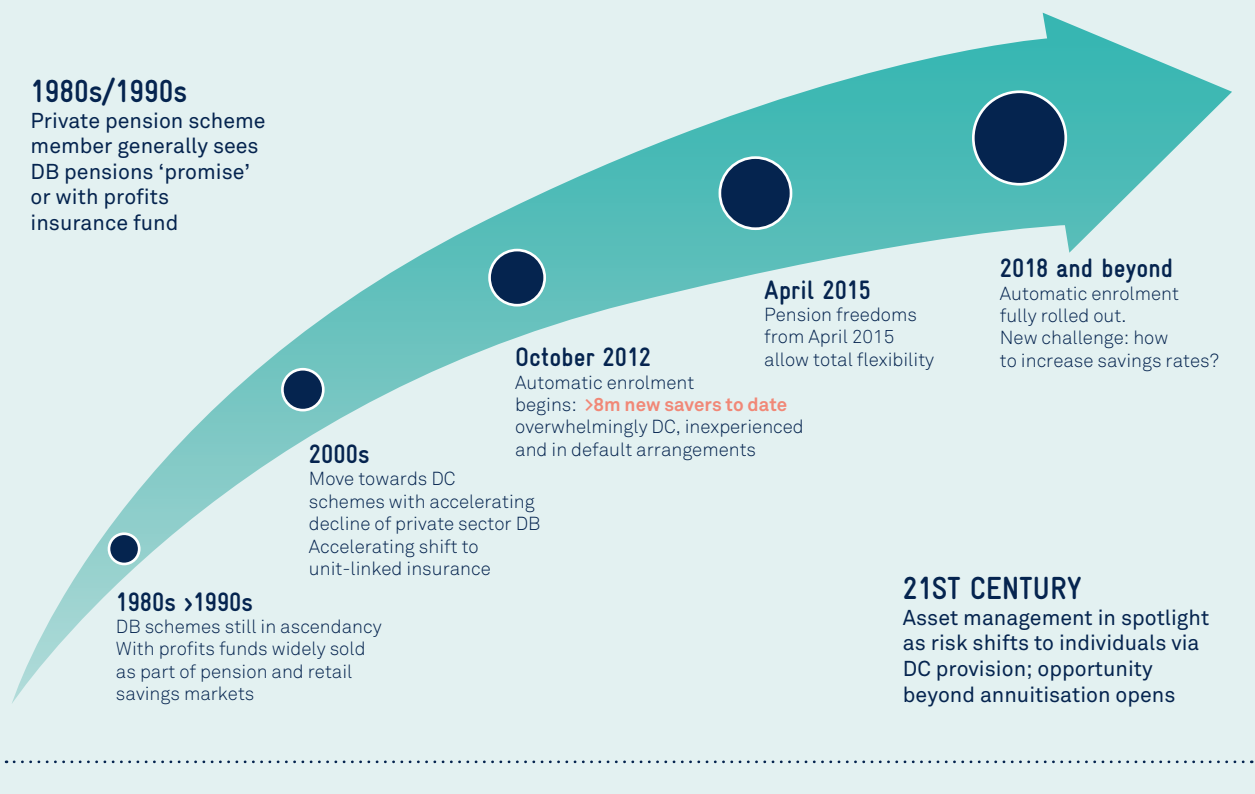
BOX 5: THE INCREASING RESPONSIBILITY IN LIGHT OF A CHANGING PENSIONS FRAMEWORK

Although DC pension schemes have existed since the 1980s, it was the combined effect of companies in the private sector closing their DB schemes and the introduction of automatic enrolment that created new impetus in the growth of the DC market. Since 2015 the pension freedoms have created a new market for decumulation products for DC savers. At the same time, DB pension schemes remain the asset management industry's single largest client group and are faced with funding pressures due to a challenging set of macroeconomic and demographic factors.

The combined effect of these developments means that the asset management industry has a threefold responsibility:

- Supplying DB schemes with a variety of products and services that help scheme fiduciaries meet their goals
- Developing transparent, cost-effective products to help individuals in DC schemes accumulate retirement savings
- Develop new products to meet different requirements and personal needs in the DC pension decumulation phase

The shift to DC in particular, with the transfer of investment and longevity risk from the sponsoring employer to the individual, significantly increases the visibility of the industry in the provision of the pensions of millions of UK individuals.

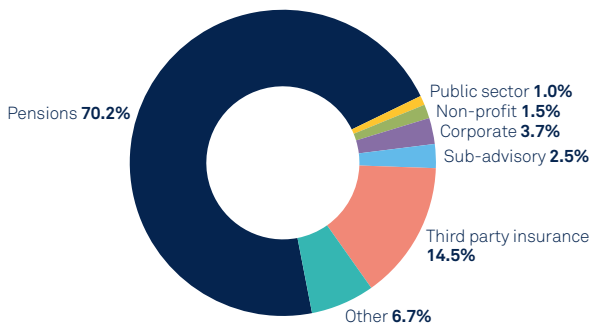


TRENDS IN THE THIRD PARTY INSTITUTIONAL MARKET

Full details of the asset allocation and investment strategy for the entire institutional market are available in Appendix 2. The remainder of this chapter looks more closely at IA data from the institutional market that is available to third parties, therefore excluding mandates managed in-house by insurance parent groups and occupational pension schemes, as at the end of 2016.

Once in-house mandates are excluded from the institutional data assets under management reduce to £2.9 trillion. Pension funds become even more dominant (see Chart 20), representing more than 70% of third party assets, with the remaining insurance assets representing only 15% of the market.

CHART 20: UK INSTITUTIONAL CLIENT MARKET BY CLIENT TYPE



MANDATE BREAKDOWN

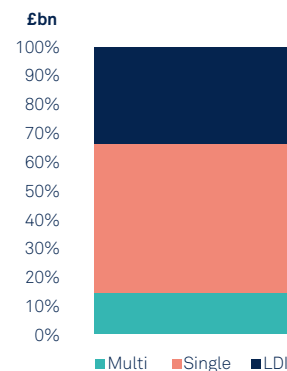
Chart 21 breaks the institutional market down into three categories of mandate:

- Single-asset, or ‘specialist’ mandates, which focus on a specific asset class or geographical region. Specialist mandates remain the most popular form of investment among institutional investors, with more than half of assets managed on this basis for third parties (53%).

- Multi-asset, or ‘balanced’ mandates, which would cover a number of asset classes and regions. These account for 14% of total mandates. Stripping out the LDI mandates below, the balance between specialist and multi-asset is 79% single asset versus 21% multi-asset.
- LDI mandates are specifically designed to help clients meet future liabilities. These mandates frequently make greater use of derivative instruments and are therefore included on the basis of the notional value of liabilities hedged, rather than the value of physical assets held in the portfolio.
- Around one third of institutional assets are managed in LDI mandates. This is in line with other industry estimates, which suggest that more than £900bn of notional pension liabilities are now being hedged using LDI strategies.³²

In previous years the IA has used external data on notional LDI values to estimate the proportion of assets invested by institutional investors. Due to continuing improvements in the IA’s data collection, Chart 21 is now based entirely on the data provided directly by IA members in response to our Survey.

CHART 21: UK INSTITUTIONAL MANDATES INCLUDING LDI

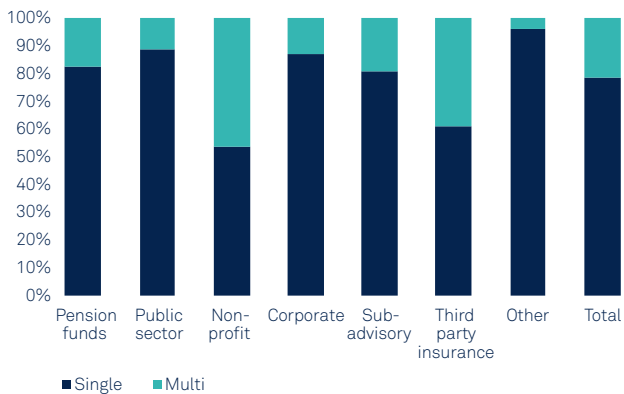


³² See, in particular, No End to Growth in Sight, UK LDI Market, KPMG, 2017.

LDI strategies, are largely employed by DB pension funds to manage the run off of their liabilities. This generally takes place in two stages. Initially schemes looking to match their liabilities may be seeking a greater element of return generation in their LDI mandates to recover deficits. As schemes mature further the emphasis may shift towards a greater element of income generation, as schemes then need to sustain cash outflows to meet pensions in payment.

Although DB pension schemes remain a significant proportion of the institutional market, the fact that they have very specific requirements means that their LDI allocations can mask trends that might otherwise be observed in the market. For that reason we exclude the value of LDI mandates from the IA's asset allocation analysis on pages 54-58 and focus purely on whether clients are favouring multi-asset or specialist solutions outside of explicit liability management. Chart 22 signifies that the preference for specialist mandates remains high, with 79% of assets being invested in this way.

CHART 22: UK INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST

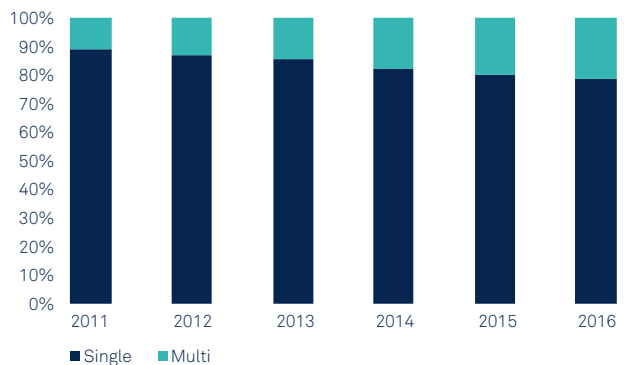


INVESTMENT TRENDS

Twenty one percent of third party institutional assets were allocated to multi-asset mandates at the end of 2016, up from 20% (revised) in 2015 (see Chart 23).³³

It seems likely that the use of multi-asset funds in DC default strategies may be driving this increase. If this is the case, future surveys will show an acceleration in the growth of multi-asset funds as automatic enrolment contribution rates begin to escalate, provided opt-out rates remain low.³⁴

CHART 23: UK INSTITUTIONAL CLIENT MANDATES: MULTI-ASSET VS. SPECIALIST (2011-2016)



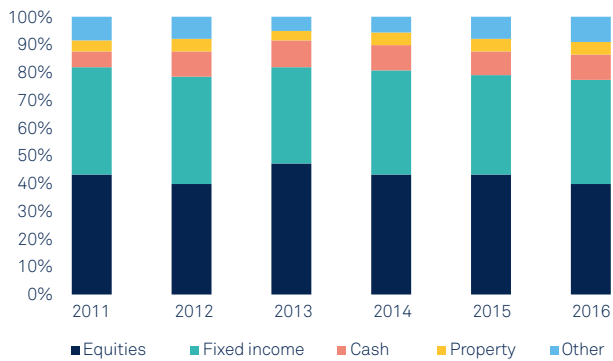
³³ Excludes any assets managed in-house by occupational pension schemes or insurance companies

³⁴ Minimum contribution rates for automatic enrolment pensions will increase from 6 April 2018,

NATURE OF SPECIALIST MANDATES

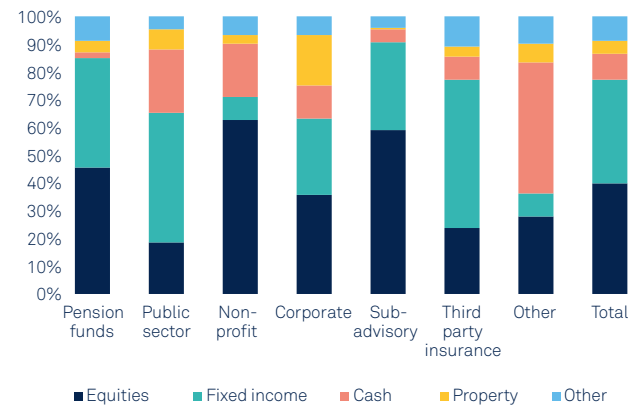
Specialist equity mandates were still the most popular type of specialist mandate but the proportion fell to 40% from 43% at the end of 2015. There were small increases across all other asset classes, most significantly towards other assets, which include mandates such as private equity, infrastructure, and currency overlay. A number of members also included fund of hedge fund allocations in this category. Chart 24 shows the progression since 2011.

CHART 24: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS (2011-2016)



Different classes of institutional client have very different requirements and the headline split between single asset classes masks a wide variation in the type of mandate used by different client types. Insurance companies for example have particularly high allocations to fixed income mandates. Pension funds also have higher than average fixed income allocations, led by particularly high allocations among corporate pension schemes (see Chart 25).

CHART 25: SPECIALIST MANDATE BREAKDOWN BY CLIENT TYPE



Eighty seven percent of private sector DB schemes are closed to new entrants or future accrual. These schemes therefore have very specific requirements that need to meet the needs of a maturing membership. They will be in need of assets which will provide a regular income stream to meet pensions in payment but may also still require an element of capital appreciation if their funding position is below 100%. As schemes seek new sources of return and income generation, the allocation to alternative assets also continues to increase.

Chart 26 shows how the asset allocation of a typical defined benefit (DB) pension scheme in the UK has changed over the last 20 years. In the early nineties the scheme would likely have been heavily invested in equities (>80%), with a small allocation to fixed income assets and other asset types, notably property. The growing appetite to hold assets that behave in a similar way to liabilities has led schemes to a re-assessment of investment strategies. The shift out of equities into fixed income is well established and has been going on since the early 1990s. However, many DB schemes are moving from using traditional scheme-specific asset allocation benchmarks to those that more closely match their liabilities and manage their deficit volatility.



CHART 26: OVERALL UK PENSION FUND ASSET ALLOCATION (1996-2016)

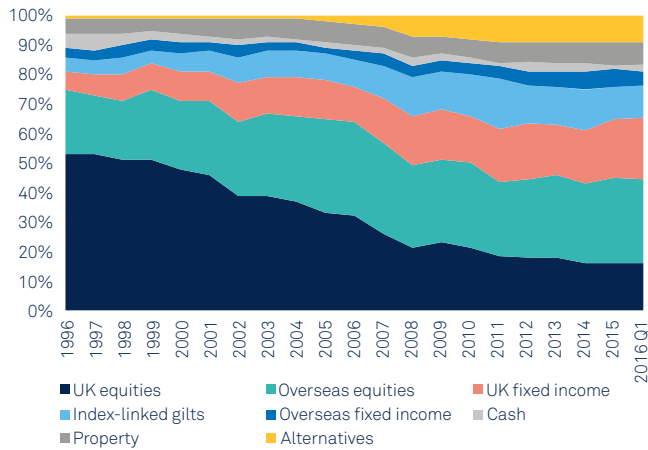
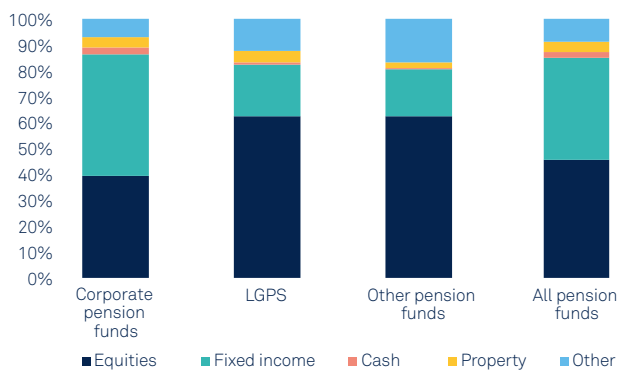


Chart 27 shows the asset allocation of pension schemes in aggregate. However, there is a wide variation depending on the type of pension scheme in question. This year's data is consistent with the findings of previous years, and the LGPS has a higher allocation to equities than corporate pension schemes (62% vs 40%). Scheme membership is comparatively less mature than closed corporate DB schemes and the LGPS funds function within a different regulatory framework to corporate schemes and therefore experience less pressure to implement de-risking investment strategies.

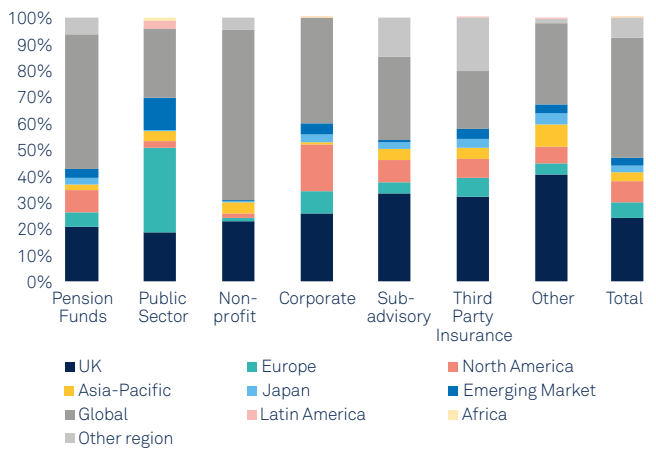
CHART 27: SPECIALIST MANDATE BREAKDOWN BY ASSET CLASS AMONG UK PENSION FUNDS



GEOGRAPHIC ALLOCATION

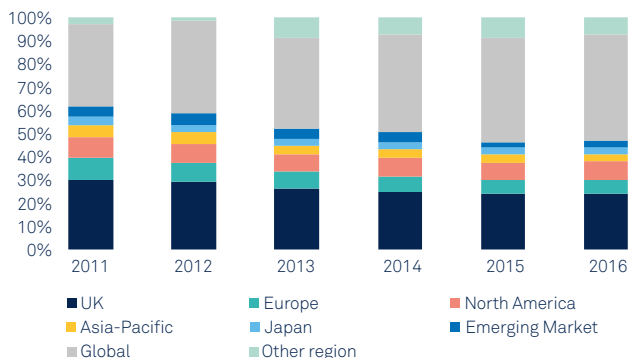
Chart 28 shows the breakdown of specialist mandates in 2016.

CHART 28: GEOGRAPHICAL EQUITY ALLOCATION OF SPECIALIST MANDATES BY CLIENT TYPE



The globalisation of investment in the institutional market remains clear. More than three quarters of specialist equity mandates are non-UK. Chart 29 shows that global equity mandates represented 45% of all specialist mandates at the end of 2016 compared to 35% five years ago. Specialist UK mandates have fallen to 24% from 30% over the same period.

CHART 29: GEOGRAPHICAL EQUITY ALLOCATION OF SPECIALIST MANDATES (2011-2016)



Looking at UK pension funds, once again it is evident that there are further significant differences between the LGPS and other schemes. 24% of LGPS specialist mandates managed by IA members at the end of 2016 were in UK equity mandates (see Chart 30).

This is in contrast to corporate pension funds which held only 20% in UK equity mandates. So the LGPS remains more focused on equities and within that, on domestic equities.

CHART 30: GEOGRAPHICAL EQUITY ALLOCATION OF SPECIALIST MANDATES AMONG UK PENSION FUNDS

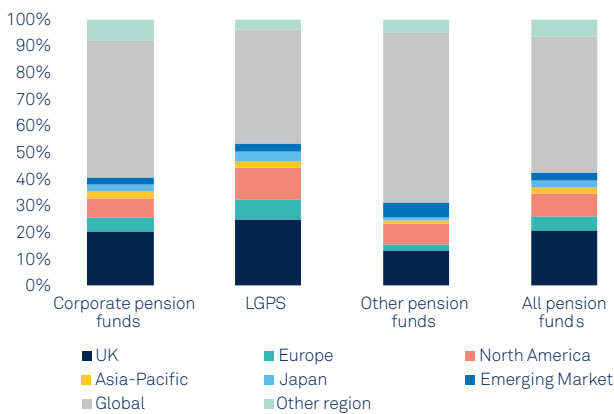
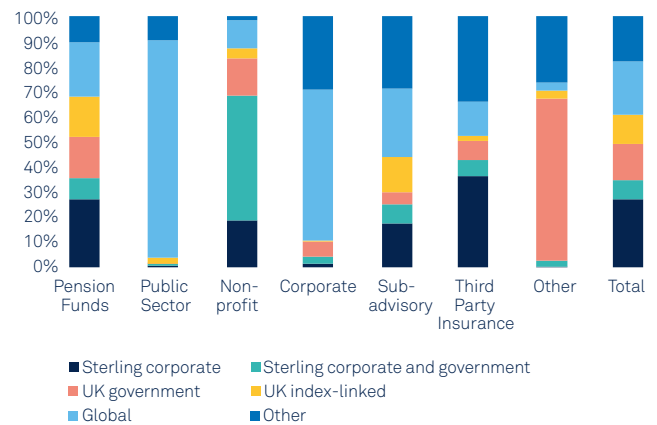


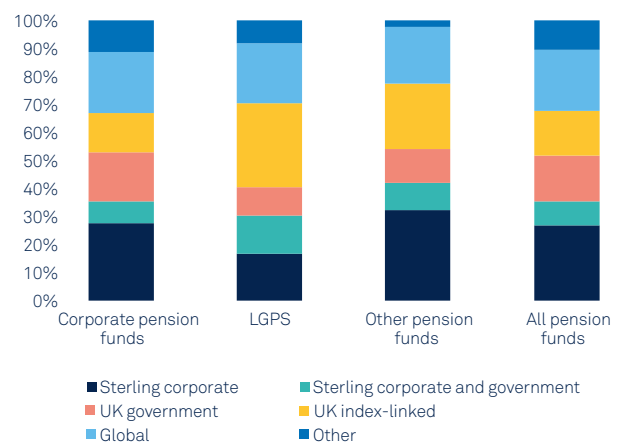
Chart 31 shows that within fixed income, sterling corporate mandates remained the largest category of specialist fixed income mandate (27%), but there has been a big increase in the allocation to global bonds in the past year, from 17% to 21%. The amount allocated to index-linked gilt mandates fell by three percentage points to 11% but the allocation to conventional gilt mandates increased, so overall government bond mandates were almost unchanged at 26%.

CHART 31: SPECIALIST FIXED INCOME ALLOCATION BY CLIENT TYPE



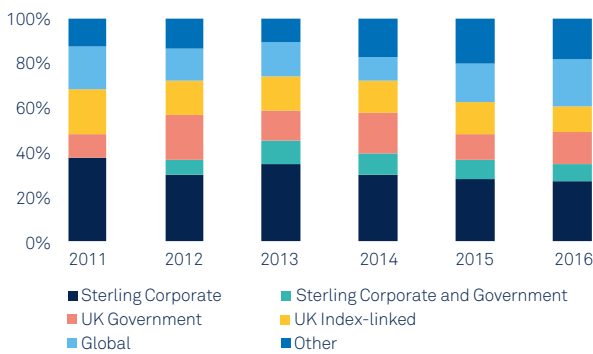
Pension schemes continued to exhibit significant disparity in their fixed income allocations with the LGPS having a significantly higher allocation to index-linked gilts than corporate pension schemes and a much lower allocation to sterling corporate bond mandates (see Chart 32).

CHART 32: FIXED INCOME ALLOCATION OF SPECIALIST MANDATE TYPES AMONG PENSION FUNDS



Looking at the trend in fixed income allocation over the last five years, sterling corporate bonds have consistently been the most prevalent form of specialist fixed income mandate but the increase in global bonds in 2016 is clear (see Chart 33). Although this may well be a ‘Brexit’ effect rather than a reflection of a long term trend, there are indications of a trend to allocate more to other fixed income assets, which together with a broadening of investments into overseas bonds may be indicative of the search for yield as traditional fixed income markets remain expensive. The IA does not collect detailed data on which securities are included within the other fixed income category but this is likely to include mandates of mortgage-backed and asset-backed securities among others.

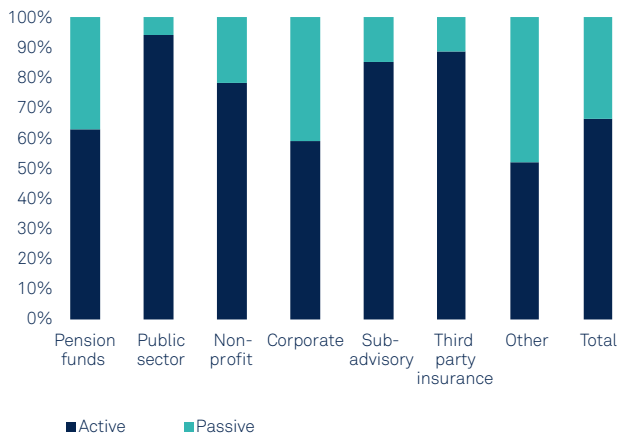
CHART 33: SPECIALIST FIXED INCOME ALLOCATION (2011-2016)³⁵



ACTIVE VS PASSIVE

Just over two thirds of assets (67%) were managed by IA members on an active basis. No single institutional client type in 2016 was more likely to be managed on a passive rather than active basis (Chart 34).

CHART 34: ACTIVE AND PASSIVE MANDATES BY CLIENT TYPE (SAMPLE-ADJUSTED)

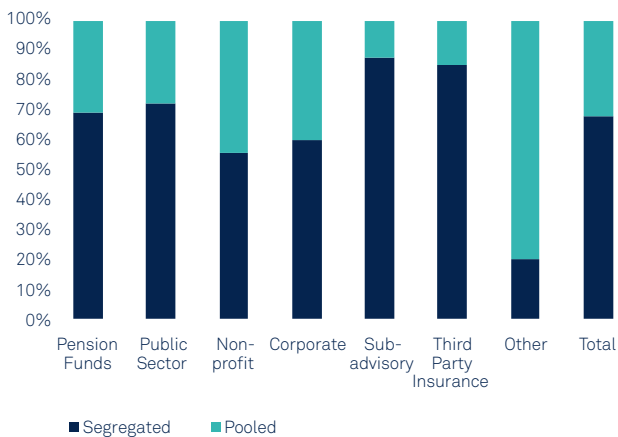


³⁵ £ Corporate and Government not separated out in 2011

SEGREGATED VS POOLED

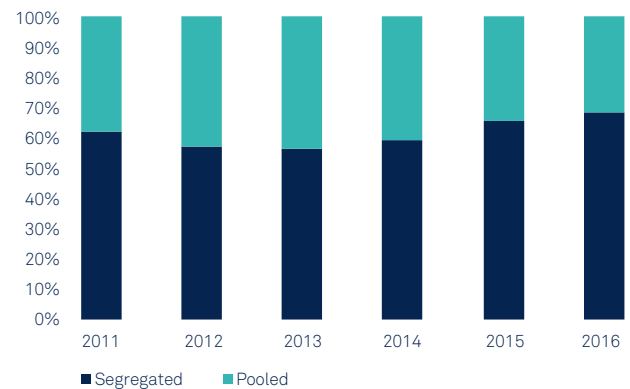
Chart 35 shows that segregated mandates represented just over two thirds (68%) of assets managed for third party institutional mandates at the end of 2016. Almost all mandates managed for third party insurance and sub-advised mandates were managed on a segregated basis. Other clients represent a range of clients including family offices and private wealth firms. These assets are significantly more likely to be managed on a pooled basis.

CHART 35: SEGREGATED AND POOLED MANDATES BY INSTITUTIONAL CLIENT TYPE



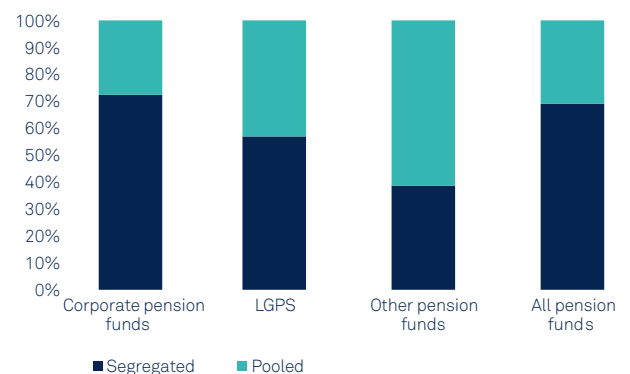
The increase in segregated mandates that was first evident in the data last year seems to be continuing (see Chart 36). This may reflect the growth in LDI mandates, which are more likely to be managed on a segregated basis.

CHART 36: INSTITUTIONAL SEGREGATED AND POOLED MANDATES (2011- 2016)



This may in turn partly explain why corporate pension schemes use segregated mandates much more than LGPS and other pension schemes (see Chart 37), although scale may play a part here. The pension schemes in the 'Other' category, will include pensions for smaller institutional clients such as charities which are more likely to use pooled management arrangements.

CHART 37: SEGREGATED AND POOLED MANDATES AMONG THIRD PARTY PENSION FUNDS



5 RETAIL FUND MARKET

KEY FINDINGS

TOTAL FUNDS UNDER MANAGEMENT

- » The value of funds held by UK investors was £1,045 billion at the end of 2016, increasing by 13% from 2015.
- » The increase in overall funds under management (FUM) was largely due to asset appreciation.
- » Overseas investors own £66 billion (7%) of UK domiciled funds and UK investors have £105 billion invested in non-UK domiciled funds.

RETAIL SALES FLOWS

- » Net retail sales to UK investors totalled £4.7 billion in 2016, a significant drop compared to recent years.
- » The shift towards outcome-oriented funds continued in 2016 with retail sales of £8.7 billion. The most popular sector within this asset class was Absolute Return as retail investors allocated £5.1 billion of net new money to it.
- » Money Market funds had their best-selling year on record as investors allocated an extra £2.4 billion to them.
- » Property and Equity funds fared badly as they had net retail outflows of £2.0 billion and £8.1 billion respectively. The bulk of the outflows were in June and July in response to the Brexit referendum.

ASSET MIX

- » Equities were still the dominant asset class amongst UK investors with equity funds accounting for 54% of total assets in 2016.
- » Within equities, the market share of non-UK equity funds increased to 34% while that of UK equity funds fell to 20%.

- » Fixed Income funds made up 18% of the market in 2016, down from 21% in 2012.
- » Absolute Return funds gained the most in terms of market share, making up 6% of the UK funds market in 2016, compared to 4% in 2012.

PASSIVE INVESTMENTS

- » Passive funds remained popular with retail investors in 2016 with net retail sales of £4.9 billion. This was a 27% drop from the record £6.7 billion inflow in 2015.

DISTRIBUTION

- » Platforms continued to dominate retail sales flows in 2016, accounting for almost half of gross retail sales (47%).
- » Sales made directly with the fund manager fell 2.5 percentage points to 8.4% in 2016.

RETAIL INVESTOR BEHAVIOUR

- » The average holding period for UK retail investors has been between three and four years since 2012.

INTERNATIONAL CONTEXT

- » The UK remains the fifth largest domicile in Europe with 10% of assets by domicile.
- » However, the UK is the largest market in Europe in terms of location of asset management activity.

This Chapter looks at the long-term trends in the UK retail fund market. This includes funds that are available for sale to retail investors in the UK and domiciled either in the UK or overseas. This area of the industry has seen significant growth in sales and investment return since the financial crisis of 2008. The Chapter covers a number of aspects of the retail market with particular focus on asset allocation, retail investor behaviour in terms of sector preferences and holding periods, the evolution of passive funds and the shape and concentration of the market.³⁶

BOX 6: CHANGES TO RETAIL FUND MARKET DATA FOR 2016

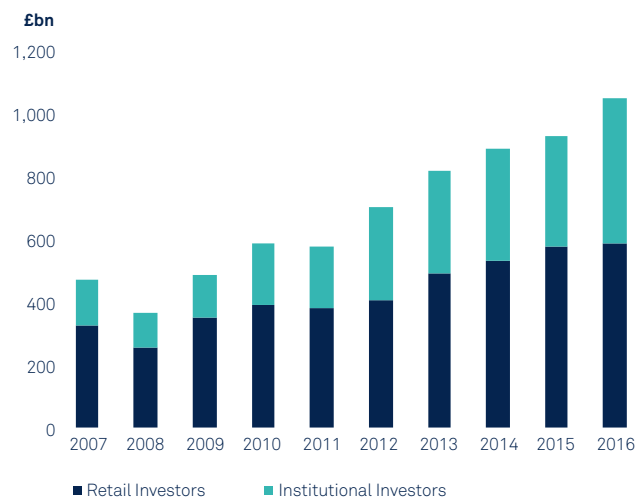
In 2016 the Investment Association changed the way it reports fund data from a UK domiciled basis to a UK investor basis. The UK investor basis provides greater insight into the investment habits of fund investors in the UK by assessing their investments in both UK and overseas domiciled funds. This is done by removing overseas investor flows and holdings from UK-domiciled funds and capturing UK investor flows and holdings in overseas-domiciled funds.

This dataset is the primary source of information for this chapter and includes monthly sales flow and fund asset information for 4,060 funds domiciled in the UK and abroad. The UK investor data set has been backdated to 2012. Prior to that figures are calculated on a UK-domiciled basis.

UK INVESTOR FUNDS UNDER MANAGEMENT

Funds held by UK investors surpassed the £1 trillion level in August 2016 and had reached £1,045 billion by the end of the year - an increase of 13% from 2015. In the five years since the IA began collecting data on a UK investor basis, funds under management have grown by 66% (see Chart 38).

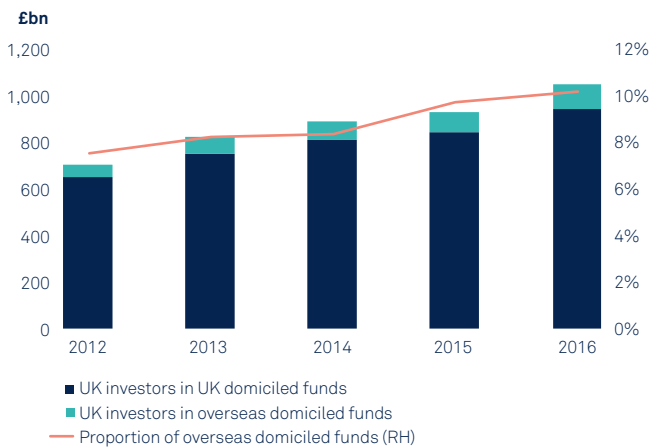
CHART 38: INDUSTRY FUNDS UNDER MANAGEMENT (2007-2016)



Looking at the assets UK investors have allocated to UK and overseas domiciled funds, Chart 39 shows that at the end of 2016 £940 billion was held in UK domiciled funds and £105 billion in overseas domiciled funds (see Chart 39). More importantly, the amount of money UK investors are investing in overseas funds has been increasing slowly but steadily in the last five years, rising from 8% in 2012 to 10% in 2016.

³⁶ Both retail and institutional investors can buy authorised funds; our data shows that in 2016 retail investors accounted for 65% and institutional investors for 35% of gross sales. Retail sales are made through various distribution channels, including sales made direct to the investor by the fund group, via IFAs and wealth managers or through fund platforms and stockbrokers. Sales made by insurance and life companies, pension funds and fund of funds are treated as institutional.

CHART 39: UK INVESTOR FUM BY FUND DOMICILE



By comparison, looking at the assets in UK domiciled funds, overseas investors held £66 billion at the end of 2016, equivalent to 7% of UK domiciled funds (see Chart 40). This proportion has also increased from five years ago albeit the last three years have been relatively unchanged at 7%.

CHART 40: UK DOMICILED FUM BY INVESTOR RESIDENCE

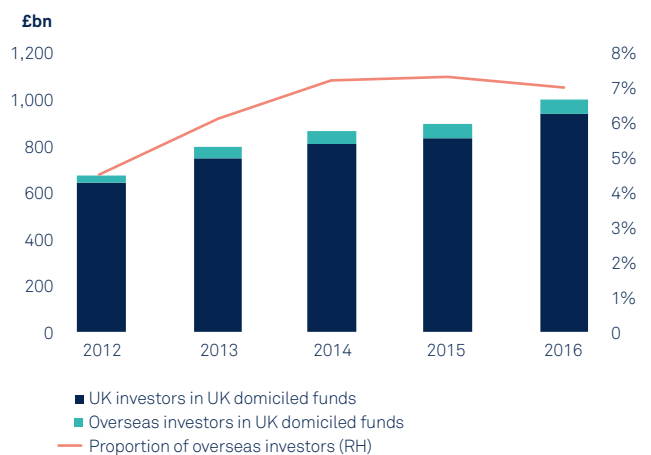
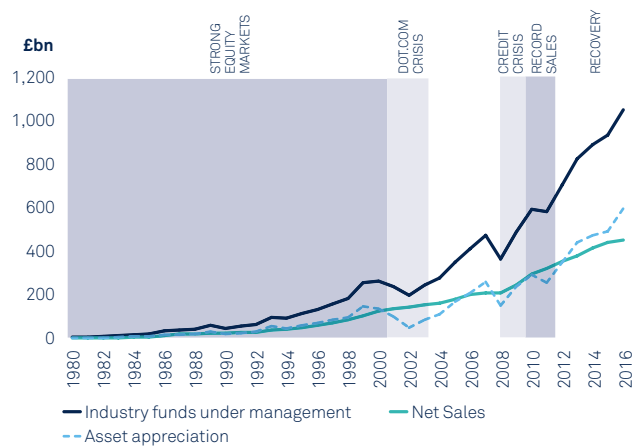


Chart 41 shows the industry FUM from 1980-2016 along with the two drivers of FUM growth, net sales and asset appreciation. Over this time period there has never been a year of negative net sales in the UK funds industry. Moreover, although returns have been volatile, and negative, at times, particularly around the dot com and credit crises, they contributed significantly to the appreciation of industry assets.

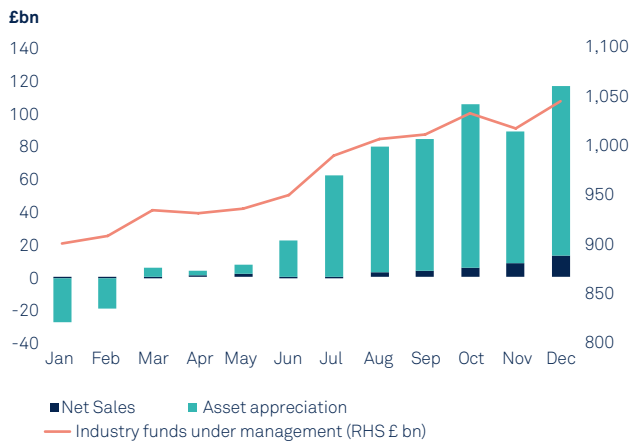
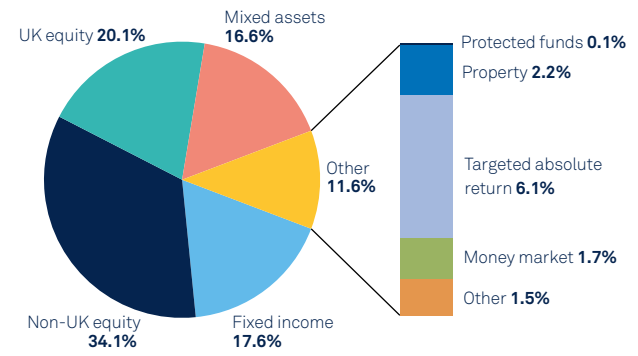
Net sales, both retail and institutional, were £11.3 billion in 2016 the lowest since 2008 when total net sales were £202 million. Asset appreciation, however, was the highest on record at £106 billion, providing an equivalent return to investors of 11% over the year.

CHART 41: DRIVERS OF INDUSTRY GROWTH (1980-2016)



Looking at industry growth throughout 2016, the asset appreciation occurred largely in the second half of the year. This reflects the depreciation of sterling that followed the EU referendum.

Chart 42 shows the impact of the cumulative monthly value of net sales and asset appreciation on FUM since the end of 2015.

CHART 42: CONTRIBUTION TO FUM GROWTH 2016 (CUMULATIVE MONTHLY)**CHART 43: FUNDS UNDER MANAGEMENT BY FUND/ASSET TYPE**

INDUSTRY FUNDS UNDER MANAGEMENT BY ASSET CLASS

The asset class breakdown of the UK funds industry has been largely unchanged since 2015, (see Chart 43), with only one exception. The UK equity market share fell by 3% while Non-UK equity funds grew by 2%. There are several reasons for this;

- Although net retail sales of non-UK equity funds were negative in 2016, they were not as negative as UK equity fund sales.
- Equity funds tend not to be currency hedged, and funds invested outside of the UK but valued in sterling benefited from the fact that sterling weakened versus all major currencies in 2016.

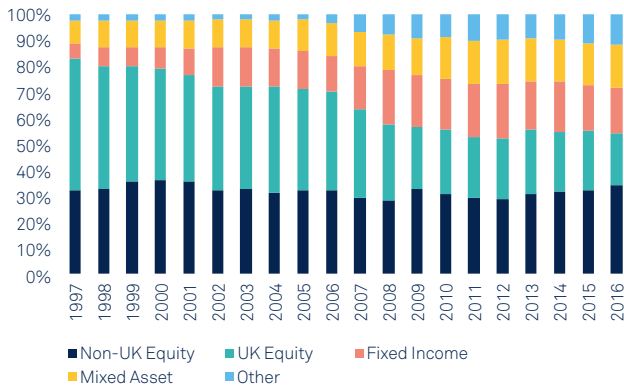
The longer term trend in asset class breakdown is shown in Chart 44. The market share of equity funds has been declining compared to other strategies. Over the last 20 years the equity fund share has fallen from 51% of FUM in 1997 to 20% in 2016. Notably however, Non-UK equities have remained relatively stable over that same time period, ranging between 28%-36%.

Mixed Asset funds grew at a steady rate to reach 17% in 2012, but have fallen below 17% in the last three years and their market share in 2016 stood at 16.6%. The market share of fixed income funds peaked in 2012 at 21% but has been declining slightly since, standing at 17.6% in 2016.

Funds in the Other category include Absolute Return and Property, which have been very popular with investors in recent years, and the IA Unclassified sector.³⁷ Volatility managed funds featured in this sector during 2016. This strategy has seen high growth in recent years and to reflect this change in the industry the IA launched a Volatility Managed sector in April 2017 consisting of 87 funds and accounting for £20 billion in FUM.

³⁷ Funds in the Unclassified sector may not meet the requirements of an existing sector, may not be widely available for retail investment or members may feel are not fairly comparable to mainstream strategies in our sectors.

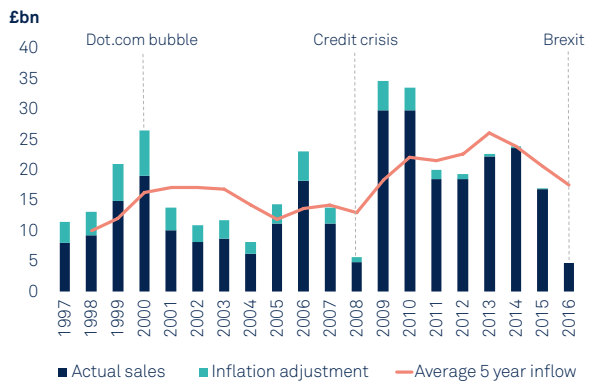
CHART 44: ASSET CLASS FUM % BREAKDOWN (1997-2016)



RETAIL FUND SALES

Net retail sales were £4.7 billion in 2016, the lowest since 1995 (not adjusted for inflation) and down by 72% from 2015.

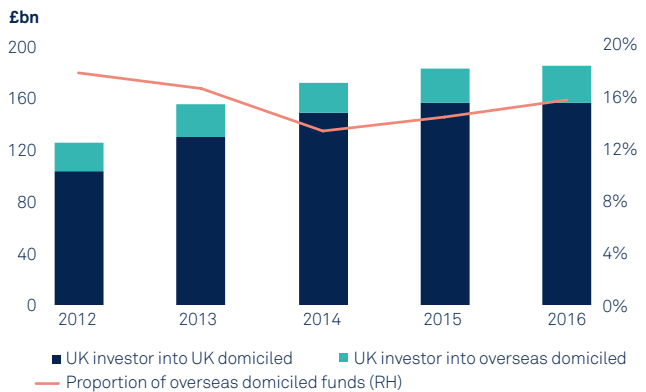
CHART 45: NET RETAIL SALES (1997-2016)



Source: IA, ONS

Chart 46 shows gross annual sales made by UK investors in UK domiciled and overseas domiciled funds. In 2016, 16% of UK Investor sales were made into overseas domiciled funds with the majority of the money going into money market funds. In absolute terms, £29 billion was allocated to overseas funds by UK investors in 2016, up from £22 billion in 2012.

CHART 46: UK INVESTOR GROSS SALES BY FUND DOMICILE (2012-2016)



A SHIFT IN INVESTOR OBJECTIVES

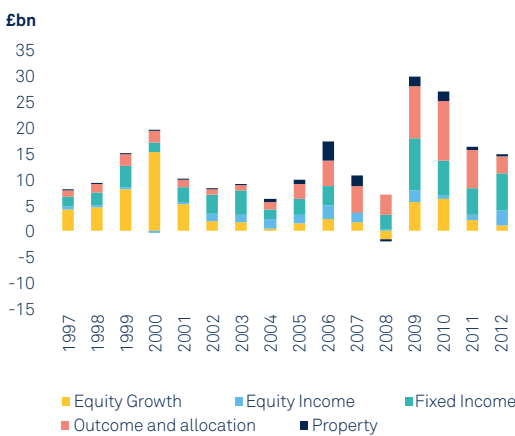
Chart 47 shows the annual net retail sales over 20 years for various strategies; Equity Income, Equity Growth, Outcome and Allocation, Fixed Income and Property.

Outcome and allocation funds are arguably an industry success story as they have received positive annual net retail sales each year in the last two decades. The peak was in 2011 when net retail sales into these funds were £11.4 billion while 2016 was the most successful year since then with £8.7 billion in net retail sales.

Fixed income funds have also been popular since the 2008 financial crisis. 2015 was the only time in the last 20 years that fixed income funds experienced a net retail outflow. 2016 was a better year with a net retail inflow of £3.8 billion.

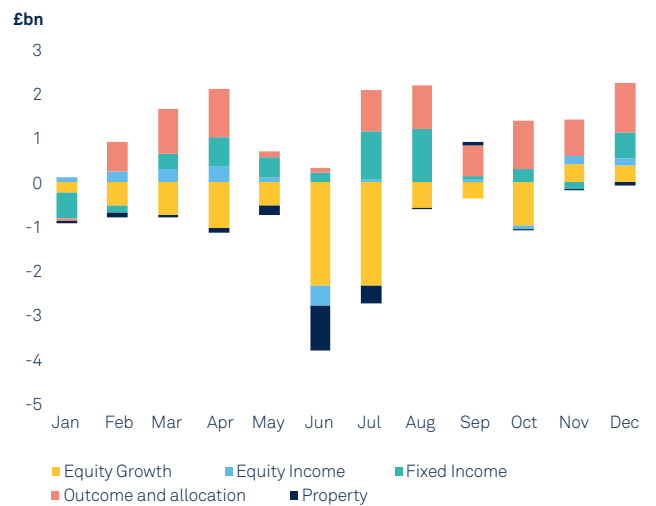
Notably, 2016 was a clear outlier for Equity Growth and Property funds. The only other year when there was a net retail outflow for these strategies was 2008. Although the outflows from these strategies look severe in this chart it should be noted that these are absolute sales numbers and the industry is three times as large in 2016 as it was in 2008.

CHART 47: NET RETAIL SALES BY DIFFERENT INVESTMENT OBJECTIVE (1997-2016)



Looking more closely into the monthly developments in 2016, it is clear that equity growth funds were consistently unpopular throughout 2016, but the large outflows occurred in June and July around the EU referendum, when there were also significant outflows from Property funds (see Chart 48). Flows into Outcome and Allocation funds were positive for the majority of the year, a sign that investors were probably seeking professional asset allocation skills. The relative safety of fixed income was also evident with investors allocating to bonds in the spring and again after the EU referendum.

CHART 48: NET RETAIL SALES BY INVESTMENT OBJECTIVE (2016)

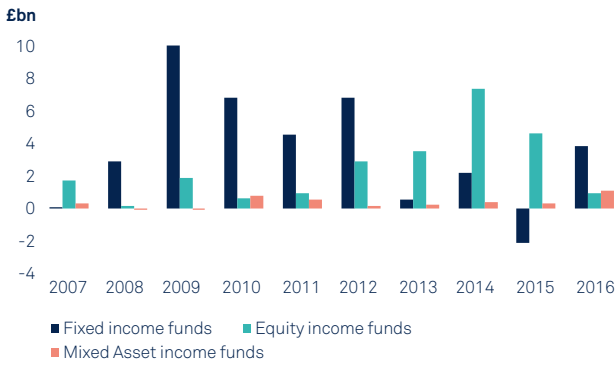


THE CONTINUING DEMAND FOR INCOME

Chart 49 shows that the demand for income generating investment strategies continues to be strong with a renewed interest in fixed income funds in 2016 despite valuation levels. Across equity, bond and mixed asset income-focused funds there was a total net retail inflow of £5.8 billion.

Investors were allocating to equity income funds even in light of the overall outflows from equity funds altogether in 2016. Demand for fixed income funds reversed from the net retail outflow in 2015, however investor demand for bonds is not necessarily driven by a need for income generation. Mixed Asset income funds are only a small part of the mixed asset universe but still contributed over £1 billion to net retail sales in 2016.

CHART 49: NET RETAIL SALES OF INCOME-FOCUSED FUNDS (2007-2016)



EQUITY FUNDS

Chart 50 showed that equities suffered their worst year on record in terms of net retail sales as investors pulled £8.1 billion from the asset class in 2016. During the months of June and July, which saw the biggest outflows, only two sectors, Japanese Smaller Companies and North American Smaller Companies had positive net sales with £17 million and £5 million respectively. In July there were small inflows into China, Global and UK Equity Income sectors.

Although 2016 was a difficult year in terms of sales, asset appreciation added £86 billion to the value of equity funds, equivalent to an annual return of 15% so that overall equity FUM increased (see Chart 50). FUM for equity funds, including fund of funds, grew by 5.5%, £30 billion.

CHART 50: EQUITY FUNDS CONTRIBUTION TO FUM GROWTH (2007-2016)

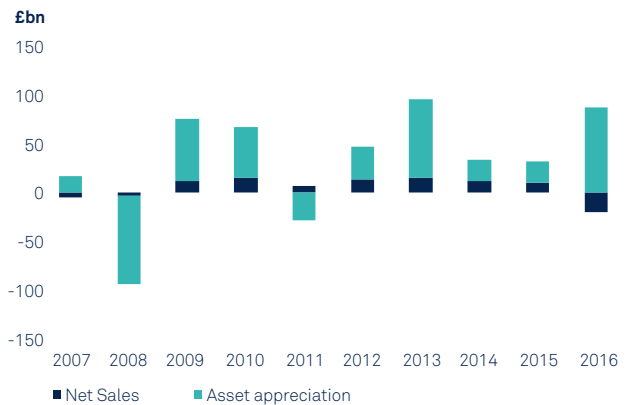
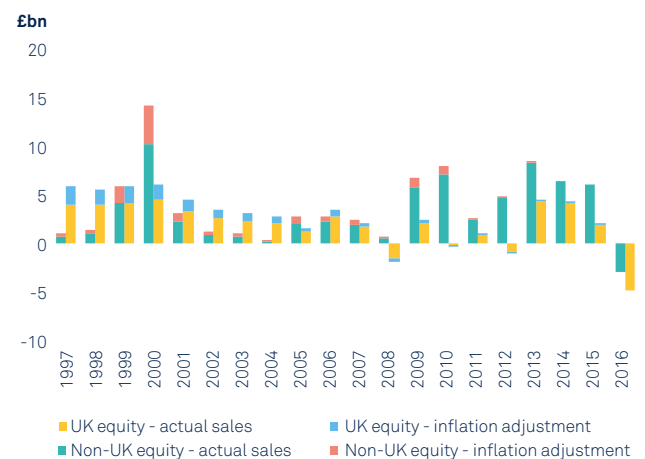


TABLE 5: SALES AND FUM OF EQUITY SECTORS

	Gross Retail Sales (£m)	Net Retail Sales (£m)	FUM (£m)
Global	13,000	2,458	85,718
UK Equity Income	10,594	935	57,555
Global Emerging Markets	3,122	295	19,032
North American Smaller Companies	557	103	2,210
Japanese Smaller Companies	317	63	641
Unclassified Sector	3,332	29	73,152
Global Equity Income	3,084	-4	15,593
Asia Pacific Including Japan	88	-48	563
Technology and Telecommunications	375	-54	1,741
Specialist	6,954	-133	44,679
China/Greater China	399	-299	2,040
European Smaller Companies	647	-330	2,893
Europe Including UK	195	-348	1,736
UK Smaller Companies	2,013	-495	12,501
North America	8,725	-502	47,314
Asia Pacific Excluding Japan	4,452	-602	30,585
Japan	4,604	-975	19,096
Europe Excluding UK	6,961	-2,890	49,158
UK All Companies	18,222	-5,357	162,982

GEOGRAPHICAL BREAKDOWN OF EQUITY FUNDS

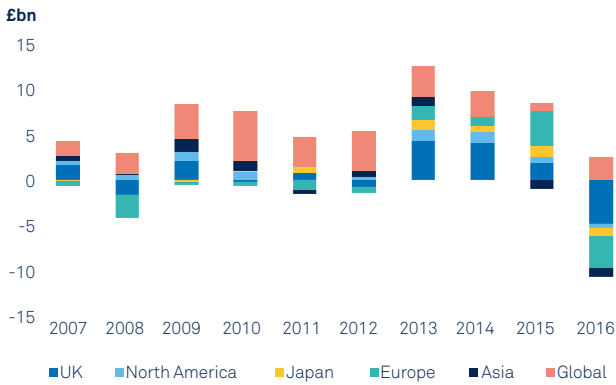
Net retail sales were negative for both UK and non-UK equity funds, however the outflows from non-UK equity funds were smaller (see Chart 51). More importantly, non-UK equity funds have sold more, or lost less, than UK equity funds every year since 2006.

CHART 51: NET RETAIL SALES OF UK AND NON-UK EQUITY FUNDS (1997-2016)

In terms of specific geographic regions, Global was the only equity region to record a net retail inflow in 2016 with £2.6 billion of new retail money flowing into that sector (see Chart 52). Within that, Global was the best-selling equity sector in 2016 with a net retail inflow of £2.5 billion. This is indicative of investors' preference for diversified funds and desire for professional asset allocation decision making, but also the recent strong positive returns.

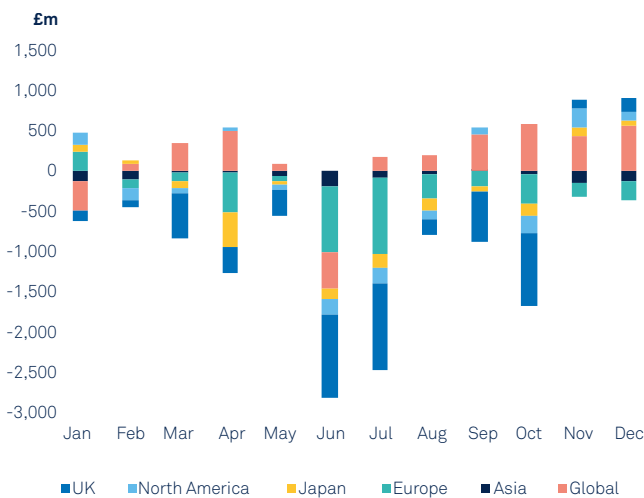
UK-focused equity funds were the worst affected as investors withdrew £4.9 billion. The UK All Companies sector took the brunt of the outflows with £5.4 billion being redeemed by retail investors. Moreover, UK Smaller Companies also experienced an outflow of £495 million. However, as discussed above, investor demand for income superseded other concerns as investors continued to allocate to the UK Equity Income sector which saw £935 million in net retail sales.

CHART 52: NET RETAIL SALES OF EQUITY FUNDS BY REGIONAL FOCUS (2007-2016)



European equities were particularly unpopular with UK investors in 2016 as they redeemed £3.6 billion from European-focused funds. There were monthly outflows from European equity funds every month in 2016 with the exception of January as investors were put off by the continuing economic problems in Europe and the spectre of another possible banking crisis (see Chart 53).

CHART 53: NET EQUITY SALES BY REGION (2016)



FIXED INCOME FUNDS

Fixed income funds received net retail sales of £3.8 billion in 2016, the highest annual sales into the asset class since 2012 as investors sought safety in bonds. There were negative net retail sales in the first two months of 2016 but flows were then positive until November. The relative safety of bonds and an expected interest rate cut attracted investors to fixed income funds in July and August following the EU Referendum with £1.1 billion and £1.2 billion in net retail sales respectively.

Chart 54 plots net retail sales for fixed income funds vs the benchmark 10 year gilt yield. It shows the trend for positive net sales into fixed income funds during periods of falling bond yields (2010-2012) and subdued sales in 2013 with rising yields. Q3 2015 is an anomaly in this pattern as a spike in corporate bond yields caused investors to reject the asset class.

The trend remains in place in 2016 as gilt yields fell throughout the year, particularly in the second half of the year following a rate cut from the Bank of England, net sales were highly positive.

CHART 54: TEN YEAR GILT YIELD VS. FIXED INCOME SALES (2010-2016)

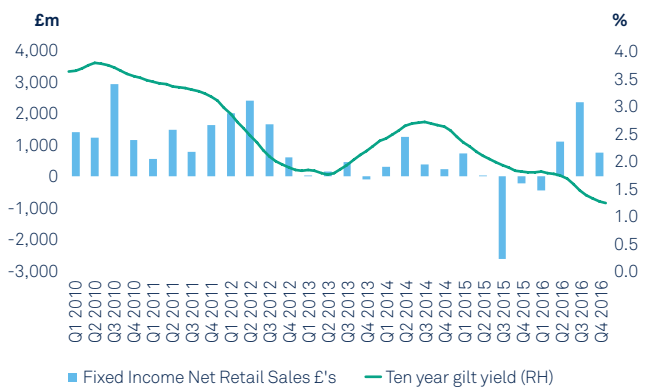


TABLE 6: SALES AND FUM OF FIXED INCOME SECTORS

	Gross Retail sales (£m)	Net Retail sales (£m)	FUM (£m)
£ Corporate Bond	11,242	1,583	60,084
£ High Yield	2,295	-247	10,988
£ Strategic Bond	8,526	910	36,827
Global Bonds	5,383	1,020	22,502
Global Emerging Markets Bond	971	-185	5,556
UK Gilts	2,684	728	20,917
UK Index Linked Gilts	1,521	135	5,719
Unclassified Sector	3,703	-138	42,175

CHART 55: NET RETAIL SALES OF FIXED INCOME FUNDS (1997-2016)

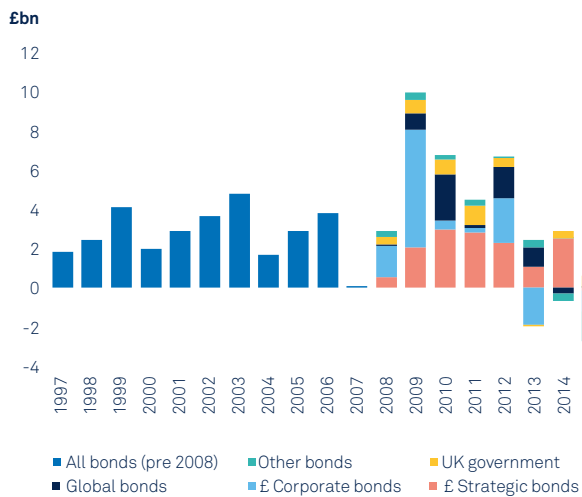
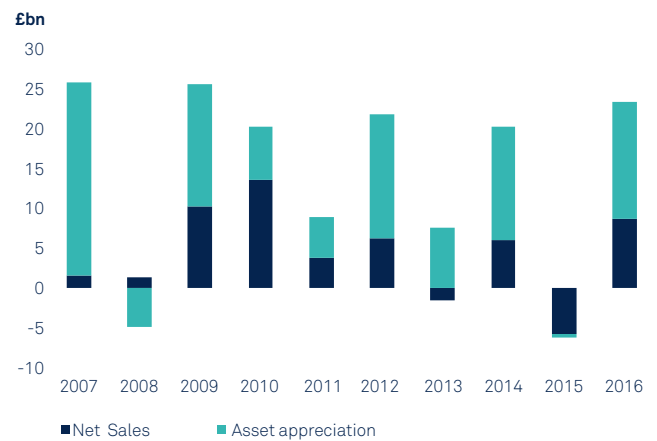


Chart 56 shows the contribution made to growth in fixed income FUM by sales and asset appreciation. In 2016 we saw that net sales, retail and institutional, contributed £8.7 billion to fixed income funds while assets grew by £14.7 billion, equivalent to a return of 8%. This is in sharp contrast to 2015 when both sales and asset appreciation were negative.

CHART 56: FIXED INCOME FUNDS CONTRIBUTION TO FUM GROWTH (2007-2016)



MIXED ASSET FUNDS

The popularity of mixed asset funds amongst retail investors did not lessen in 2016, as they received £2.6 billion of net inflows (see Chart 57). Mixed Asset funds are popular with regular savers and financial advisers as they can outsource asset allocation and research to professional investors. This has been crucial through recent uncertain times with the ever changing political and economic landscape.

CHART 57: NET RETAIL SALES OF ASSET ALLOCATION FUNDS (2007-2016)



Annual retail flows into mixed asset funds have never been negative, in fact there have only been five months in the past 15 years where mixed asset funds have experienced a net retail outflow.

TABLE 7: SALES AND FUM OF MIXED ASSET SECTORS

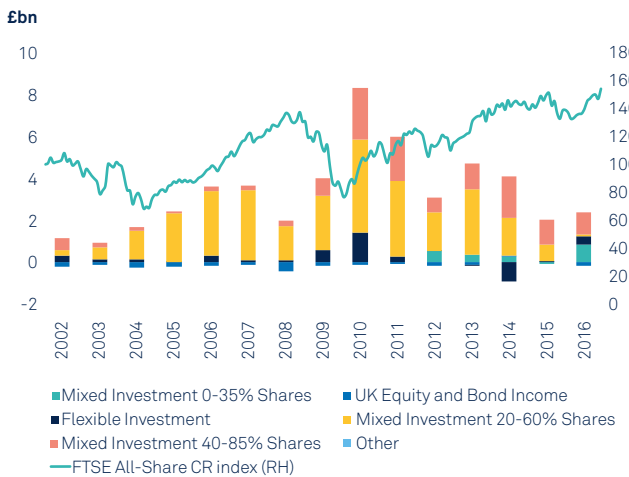
	Gross Retail sales (£m)	Net Retail sales (£m)	FUM (£m)
Flexible Investment	3,985	380	24,222
Mixed Investment 0-35% Shares	2,067	855	6,083
Mixed Investment 20-60% Shares	8,594	88	43,518
Mixed Investment 40-85% Shares	6,136	1,070	47,128
UK Equity and Bond Income	254	-143	2,405
Unclassified Sector	13,457	351	69,215



With the exception of UK Equity and Bond Income, all mixed asset sectors received positive net retail sales in 2016 (see Chart 58).

- The Mixed Investment 40-85% Shares sector received the highest inflow at £1.1 billion, similar to 2015's inflow.
- The Mixed Investment 0-35% Shares sector received £855 million in 2016, the highest annual net inflow since the sector was launched in 2012.
- £88 million of retail money flowed into the Mixed Asset 20-60% Shares sector, the lowest since the sector was launched, and a significant reduction on recent years when this sector has been the most popular and attracted net flows in the billions.
- Mixed asset funds in the Unclassified sector received £351 million in net retail sales.

CHART 58: NET RETAIL SALES OF MIXED ASSET FUNDS VS FTSE ALL-SHARE INDEX (2002-2016)

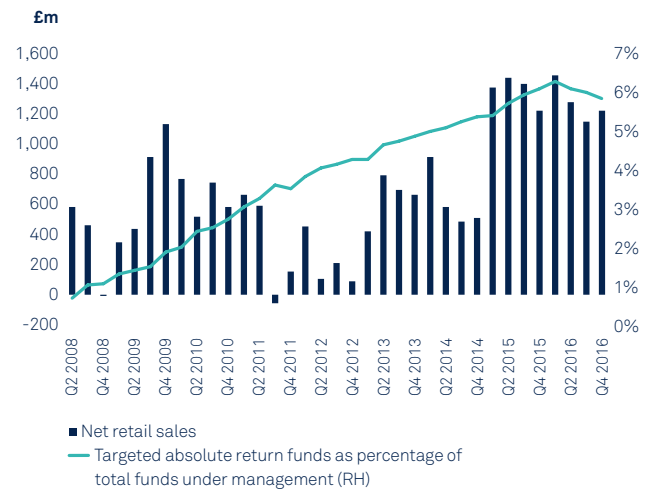


ABSOLUTE RETURN FUNDS

For the second year in a row Targeted Absolute Return was the best-selling sector amongst retail investors with £5.1 billion in net retail sales in 2016.

Chart 59 shows the net retail sales and market share of absolute return funds. Although targeted absolute return funds received a considerable amount of net sales growth they lost market share slightly as long-only funds in the IA's fund universe experienced higher growth in asset appreciation terms.

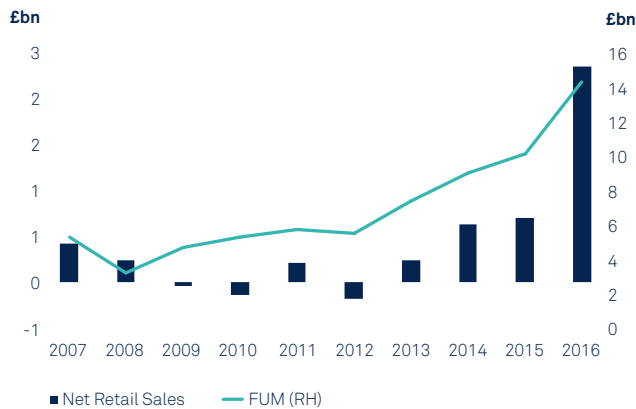
CHART 59: QUARTERLY NET RETAIL SALES OF TARGETED ABSOLUTE RETURN FUNDS VS TARGETED ABSOLUTE RETURN FUNDS UNDER MANAGEMENT (2008-2017)



MONEY MARKET FUNDS

Retail money market funds received their highest annual net retail sales on record in 2016, an indication of cautious investors allocating more of their portfolios to cash. Chart 60 shows UK retail investors allocated an extra £2.4 billion to money market funds in 2016, which was a 236% increase on 2015.

CHART 60: NET RETAIL SALES OF MONEY MARKET FUNDS (2007-2016)

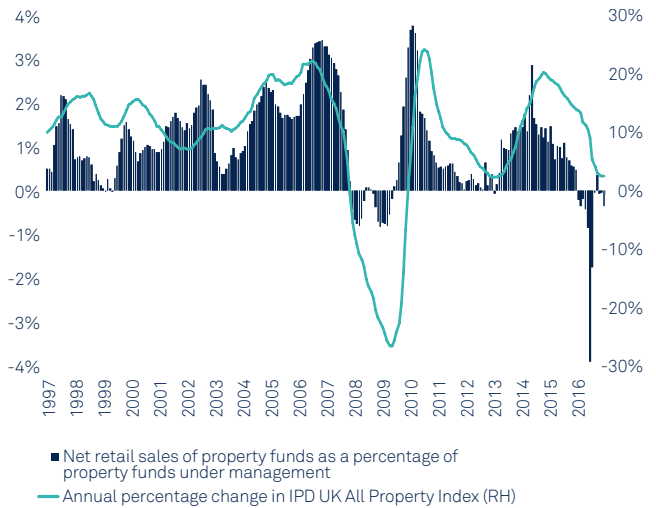


PROPERTY FUNDS

Property funds were negatively affected by the result of the EU referendum. Large scale redemptions meant many funds had to take action to slow or stop outflows. Prior to these actions there were net retail outflows of £1 billion and £419 million in June and July respectively.

Chart 61 shows the scale of these flows in historical context and June and July 2016 are clear outliers.³⁸

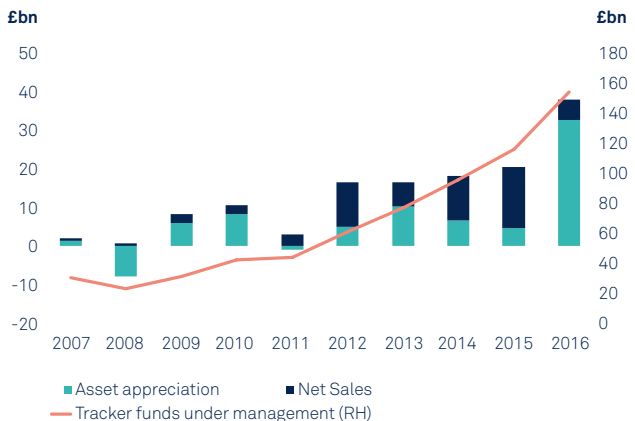
CHART 61: NET RETAIL SALES OF PROPERTY FUNDS VS IPD UK ALL PROPERTY INDEX (1997-2016)



PASSIVE FUNDS

Passive funds had another good year in terms of net retail sales as UK investors allocated £4.9 billion to them (£5.5 billion including fund of funds, which will also capture passively-managed mixed asset funds). FUM for passive products increased by £38 billion, or 33%. As Chart 62 shows asset appreciation was primarily responsible for this growth in assets, contributing £32 billion, a return equivalent to 28%.

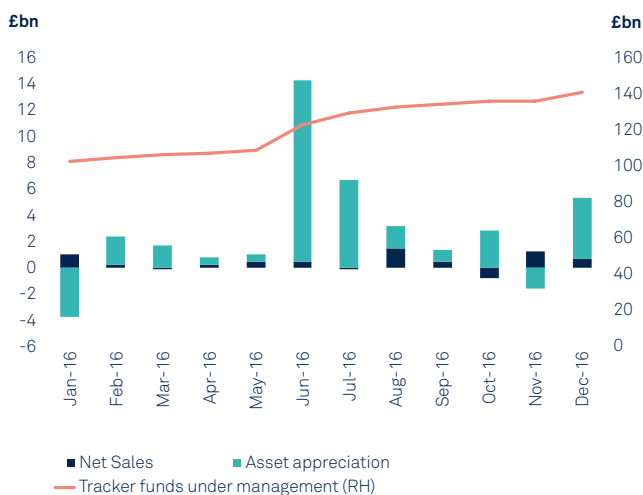
CHART 62: CONTRIBUTION TO FUNDS UNDER MANAGEMENT IN PASSIVE FUNDS (2007-2016)



³⁸ Net retail sales of property funds are shown 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 monthly total return index.

Examining how the passive FUM developed over 2016 in more detail, Chart 63 shows the high returns that were on offer in June around the EU referendum when UK equity markets initially dropped and were then boosted by the depreciation of sterling.

CHART 63: CONTRIBUTION TO PASSIVE FUM GROWTH (MONTHLY)



The composition of the passive fund market in the UK has changed considerably over the past ten years. In 2007 UK equities accounted for 70% of funds under management. By 2016 the UK equity market share had fallen to 36% (see Chart 64). The reallocation of assets across sectors is evenly spread, with all increasing their market share over the ten year period except European equities, which have retained a steady 8% market share throughout.

However, equity as an asset class still represents the largest part of the passive fund market with 94 out of 134 funds that account for 71% in passive FUM.

Another notable change is the introduction of mixed asset passive products, which are mainly passively managed funds of funds. The market share of these funds leapt in 2015 from 2% to 9%, and has remained at 9% in 2016.

CHART 64: FUNDS UNDER MANAGEMENT OF PASSIVE FUNDS BY INDEX INVESTMENT TYPE

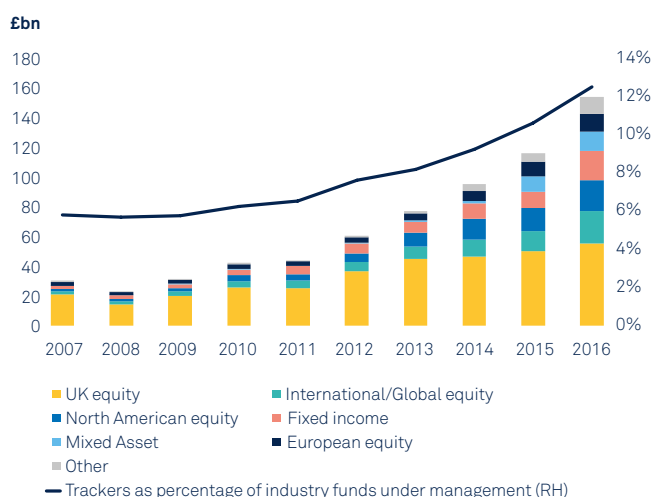


Chart 65 shows International/Global equity was the top selling sector within passive funds in 2016 as UK clients invested £1.8 billion into these strategies.

CHART 65: NET RETAIL SALES OF PASSIVE FUNDS BY INDEX INVESTMENT TYPE (2007-2016)

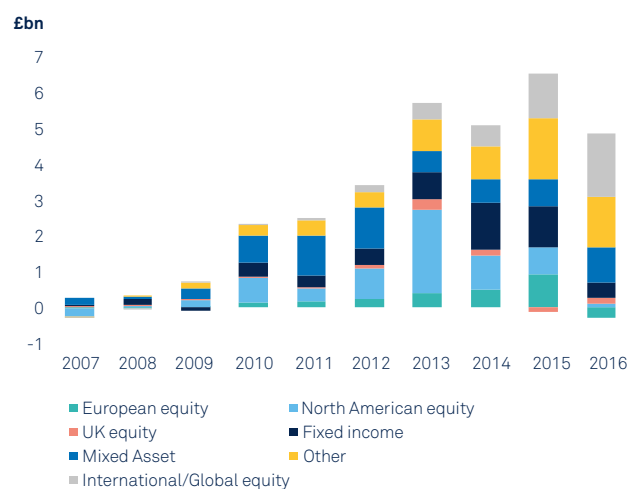
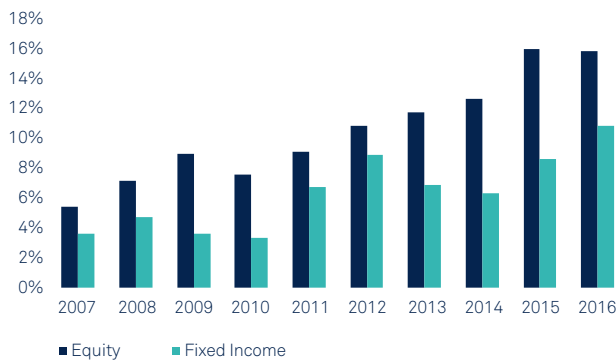


Chart 66 shows that passive funds have accounted for an increasing share of gross retail sales over the past ten years. In 2016 specifically, 16% of retail equity sales and 11% of retail fixed income sales were allocated to passives.

CHART 66: GROSS RETAIL SALES OF PASSIVE FUNDS AS A PERCENTAGE OF GROSS RETAIL SALES BY ASSET CLASS (2007-2016)



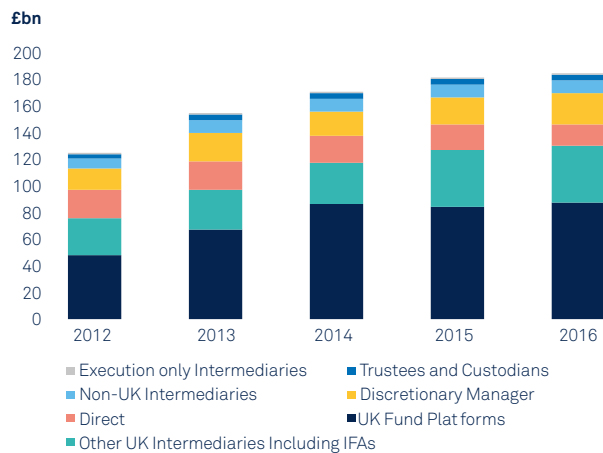
TRENDS IN FUND DISTRIBUTION

THE RELATIVE IMPORTANCE OF DISTRIBUTION CHANNELS

Fund platforms are, and have been for several years, by far the most important distribution channel for retail funds (see Chart 67). At the end of 2016, they channelled £87 billion of gross retail sales, making up 47% of the total (£184 billion). They became particularly prominent following the Retail Distribution Review in 2012 and have been close to the 50% mark for the last four years, reaching a high of 51% in 2014.

Whilst the share of the other distribution channels appears to have remained at broadly similar levels, the Direct channel appears to have been increasingly crowded out. Its share of gross retail sales fell from 18% in 2012 to 8% in 2016, when it channelled retail assets of £14.5 billion.

CHART 67: GROSS RETAIL SALES BY DISTRIBUTION CHANNEL

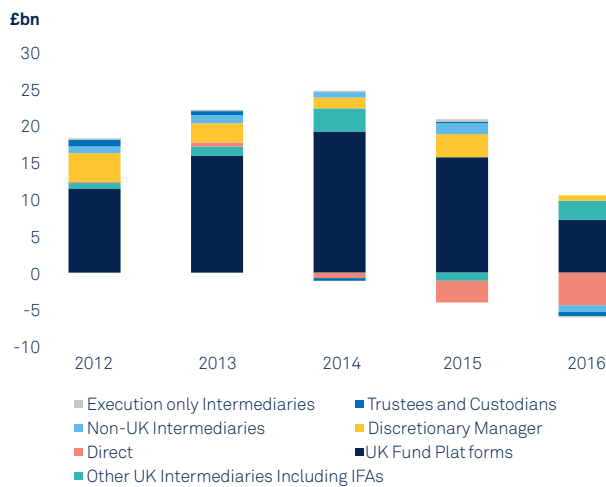


Net retail sales through fund platforms were £7.2 billion in 2016. UK based Intermediaries and Discretionary Managers were responsible for £2.7 billion and £816 million, respectively, however investors through Non-UK Intermediaries made net sales of -£828 million (see Chart 67).³⁹

³⁹ In 2016 Platforms accounted for 47% of gross retail sales while 23% came through UK Intermediaries, 13% through Discretionary Managers and 5% through non-UK Intermediaries. UK fund platforms covers fund companies' transactions (reported by fund companies) with the following: Ascentric; Avalon, Aviva Wrap; Cofunds; Fidelity; FNZ; Hargreaves Lansdown; James Hay Wrap; Novia; Nucleus; Old Mutual Wealth (including Selestia, Skandia Multifunds and Skandia Life); Parmenion; Standard Life Savings; Transact; Wealthtime.

Net retail sales made directly with the fund management company were negative at -£4.5 billion. This was the third year in a row that direct sales have been negative and it is not altogether a surprising trend as non-advised investors have many more options in the way they can invest their money than they used to, not least due to improvements in technology and the rise in platforms. It may also be the case that investors that formerly invested directly have decided to take on an adviser perhaps after retirement or as their investment needs have become more complex. In any case, this would appear to be consistent with the above finding that Direct has been increasingly crowded out by other distribution channels (see Chart 68).

CHART 68: NET RETAIL SALES BY DISTRIBUTION CHANNEL (ANNUAL)



THE ROLE OF FUND OF FUNDS

Chart 69 shows the fund of funds model still proves to be popular with investors as FUM increased to £123 billion in 2016 from £106 billion in 2015. Total sales into fund of funds were £6.1 billion in 2016, with £1.8 billion being through retail channels and £4.3 billion through institutional channels. Asset appreciation contributed £11.5 billion in FUM in 2016 translating to a return of 11% for fund of fund investors.

CHART 69: CONTRIBUTION TO FUM IN FUND OF FUNDS (2007-2016)

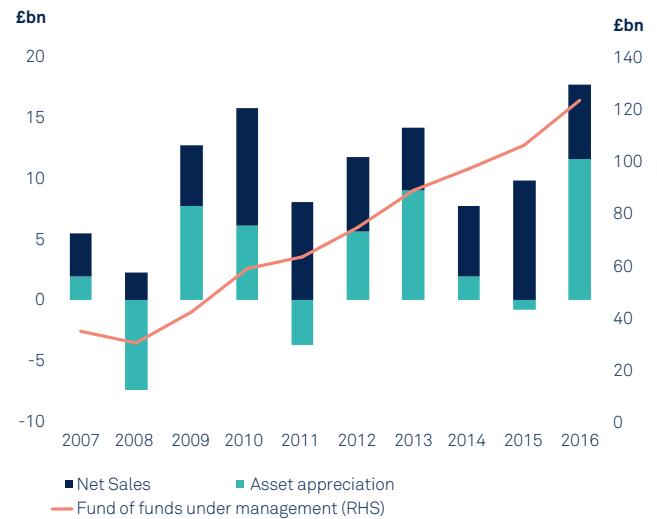
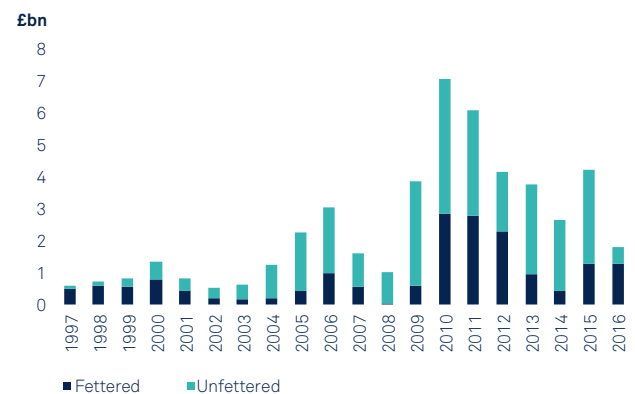


CHART 70: NET RETAIL SALES OF FETTERED AND UNFETTERED FUND OF FUNDS (1997-2016)



UK RETAIL FUNDS INDUSTRY STRUCTURE AND CONCENTRATION

The change in IA reporting from a UK-domiciled to a UK-investor basis has brought about a significant increase in the number of firms reporting to the IA (see Chart 71). In 2011, the last year of UK-domiciled reporting, there were 102 firms reporting data to the IA. This jumped to 144 in 2012 when the data includes the UK investor base of overseas-domiciled funds sold into the UK. This contrasts with the UK domiciled data where there has been a steady decline in the number of firms. There was an increase in 2013 to 150 and then a fall to 147 in 2016.

The decrease is due to M&A activity in the asset management industry and the increased use of third party CIS Operators. Although there have been several new fund company launches in recent years, they are not reflected in the IA's data as they sit under a third party already represented in the list.

CHART 71: NUMBER OF FIRMS REPORTING TO THE IA

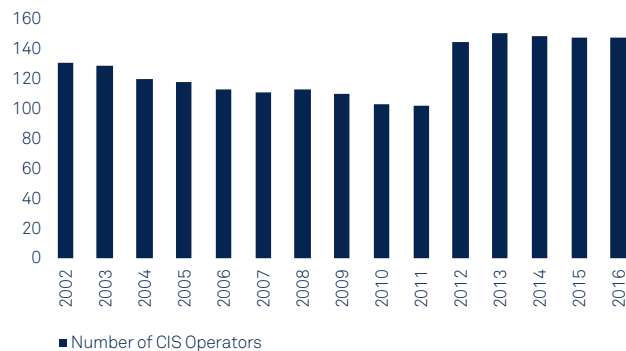


CHART 72: TOP TEN UK FUND OPERATORS BY TOTAL FUM AS AT END OF 2016 (UK-DOMICILED FUNDS)

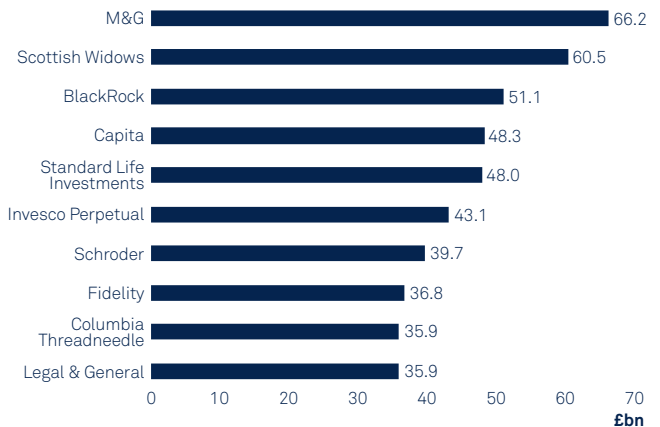
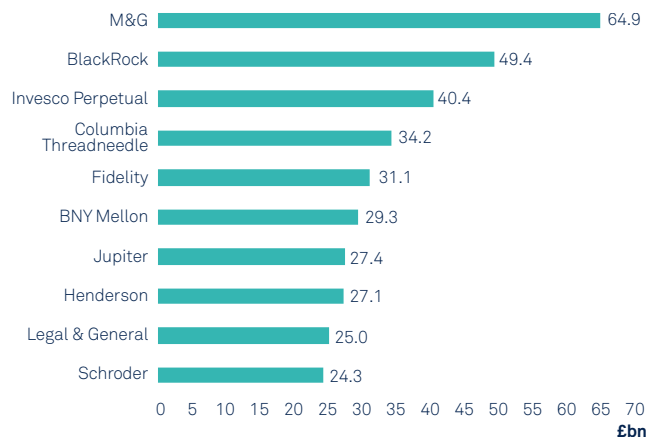
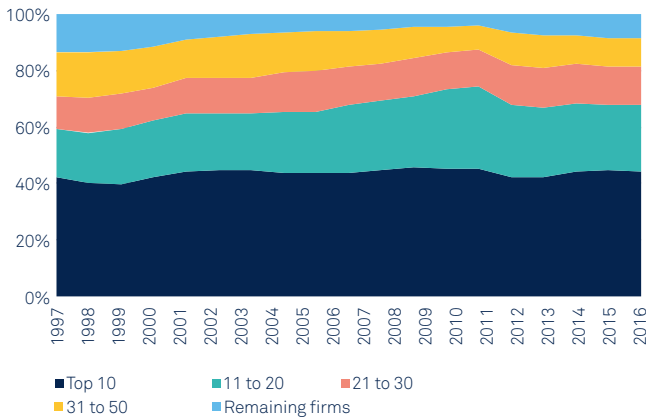


CHART 73: TOP TEN UK FUND OPERATORS BY RETAIL FUM AS AT END OF 2016 (UK-DOMICILED FUNDS)



In terms of industry concentration the ten largest firms in the retail funds industry accounted for 44% of assets managed on behalf of UK investors in 2016 (see Chart 74). From 2011 to 2012, when the UK investor data was introduced, there has been a three percentage point drop in the Top 10 market share which has been stable since then at around 44%. The market share of the 11-20 section has decreased as well, falling to 24% as of end 2016. The 21-30 section has remained fairly stable at 13%, whilst the 'remaining firms' section has slightly increased reaching a market share of 8%.

CHART 74: COMBINED MARKET SHARES OF TOP FIRMS BY FUM (1997-2016)



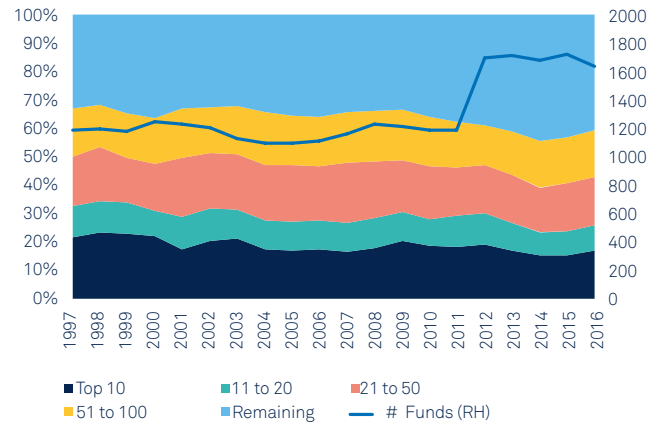
This indicates that despite increasing M&A activity, there is still a large number of fund operators and the top players are not dominating the market as smaller firms have been gaining ground, particularly from the top 11 to 20 firms.

CONCENTRATION AT ASSET CLASS LEVEL

Looking more closely at the degree of concentration at asset class level, the market share of the top funds tends to be fairly low. Charts 75, 76 and 77, show the market share of the top equity, fixed income and mixed asset funds respectively and the obvious change in 2012 reflects the one-off increase in the number of funds as we moved to UK Investor data reporting.

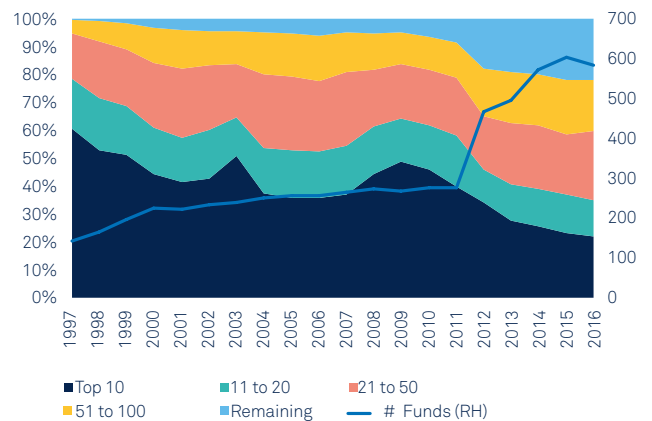
An immediate result of capturing the UK investor base of overseas domiciled funds is the decrease in the market share of the largest funds although this seems to be in line with the long-term trends we had already observed when reporting on a UK domicile basis.⁴⁰ For example, the top 10 equity funds accounted for 19% of gross retail sales in 2010 compared to 17% in 2016.

CHART 75: COMBINED MARKET SHARE OF TOP EQUITY FUNDS BY GROSS RETAIL SALES (1997-2016)



The change was more pronounced with fixed income funds. Namely, Chart 76 shows the market share of the top 10 falling from 46% in 2010 to 22% in 2016.

CHART 76: COMBINED MARKET SHARE OF TOP FIXED INCOME FUNDS BY GROSS RETAIL SALES (1997-2016)



⁴⁰ See The Investment Association, Asset Management in the UK 2015-2016, September 2016, Charts 69, 70, 71.



CHART 77: COMBINED MARKET SHARE OF TOP MIXED ASSET FUNDS BY GROSS RETAIL SALES (1997-2016)

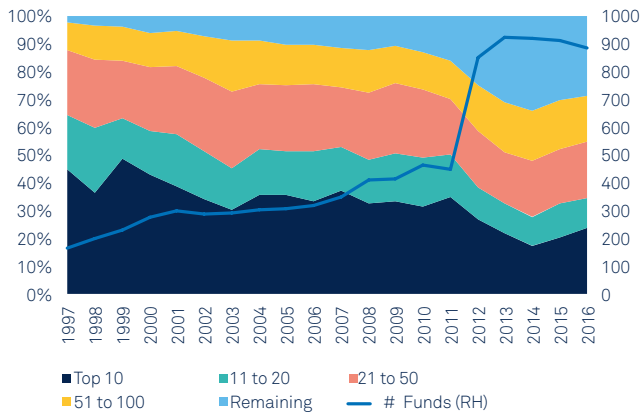
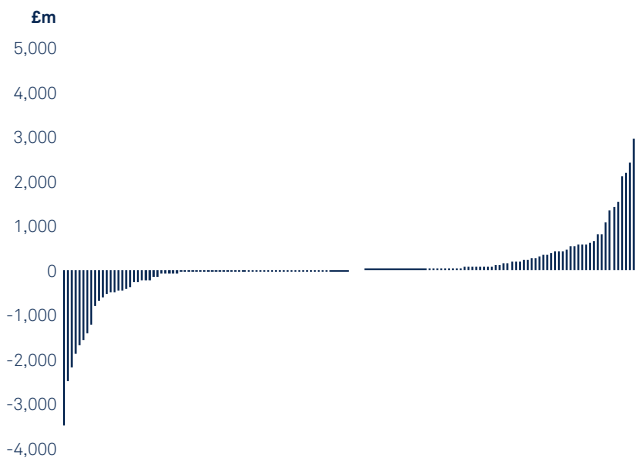


Chart 78 shows the 2016 net retail sales by fund operator for the 147 firms that report to the IA. In contrast to previous years, there was a certain degree of symmetry in 2016 both in terms of minimum and maximum outflow as well as the number of firms experiencing inflows and outflows. More specifically, the largest net retail inflow for a fund operator was £3.7 billion, and the largest net retail outflow was £3.5 billion. 74 firms reported positive inflows in 2016 totalling £29.8 billion and 73 firms reported a retail outflow totalling £24.6 billion.

CHART 78: FUND OPERATOR NET RETAIL SALES 2016

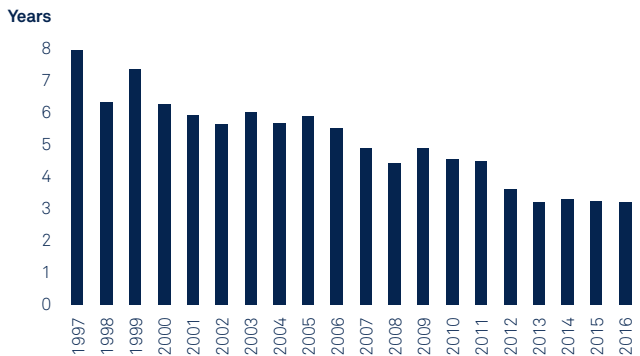


RETAIL INVESTOR BEHAVIOUR

The length of time that retail investors hold a particular fund has more than halved over the past 20 years from around eight years in 1997 to three years in 2016 (see Chart 79). The reasons behind this are numerous and include:

- Improved technology, namely platforms, allowing investors to move funds easily at little or no cost.
- Increased engagement as investors take more interest in managing their own money.
- An increase in the availability of independent research which can highlight new trends to investors.
- Increased concentration of fund selection through a variety of professional services designed to help investors and advisers.

CHART 79: AVERAGE HOLDING PERIODS OF RETAIL INVESTORS (1997-2016)

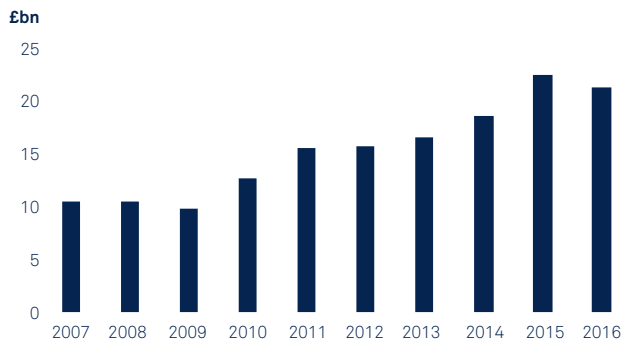


ISAS

Chart 80 shows that subscriptions into stocks and shares ISAs for the tax year ended 4 April 2016 were £21 billion, a slight drop from 2015 when investors put £22 billion into their ISAs. There was also a drop in the number of ISA accounts registered in 2015/6, the first year on year drop since 2008/09.

Cash ISAs still remain a more popular savings vehicle in the UK as, even with seven years of low interest rates, savers placed £59 billion into cash ISAs. However, investors in stocks and shares ISAs invest more on average - £8,322 vs £5,801 in cash ISAs.

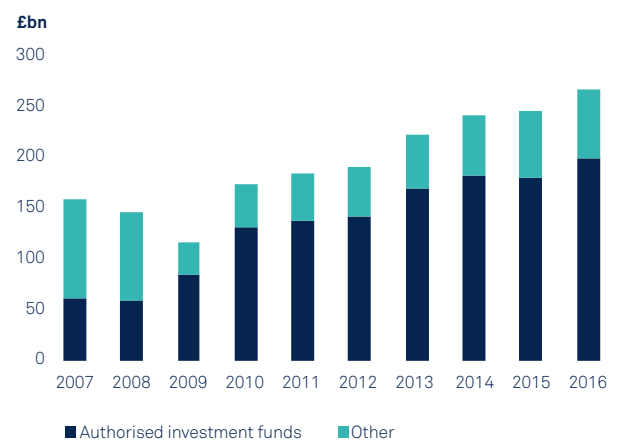
CHART 80: GROSS SUBSCRIPTIONS INTO STOCK AND SHARES ISAS (2007-2016)



Source: HMRC (tax year)

ISA funds under management in authorised investment funds totalled £198 billion at the end of the 2015/16 tax year, which accounts for 74% of stocks and shares ISA assets (see Chart 81).

CHART 81: FUNDS UNDER MANAGEMENT IN ISAS (TAX YEAR ENDING APRIL 2007-2016)



Source: HMRC



INTERNATIONAL CONTEXT

Globally, investment funds under management stood at \$40.3 trillion at the end of 2016. North America continued to be the largest fund market in the world with \$21.1 trillion held in US domiciled funds. European domiciled funds totalled \$14.1 trillion and there were \$5 trillion in funds domiciled in the Asia-Pacific region.⁴¹

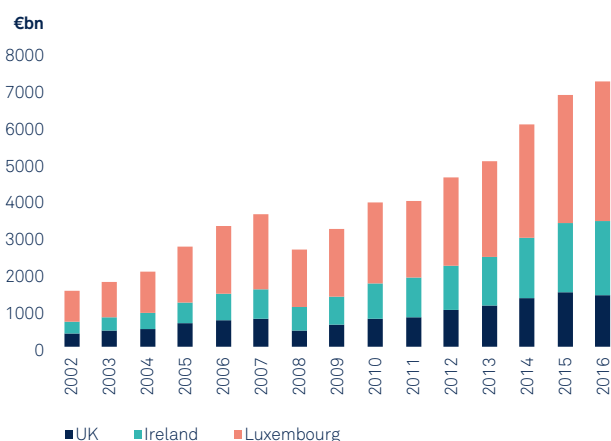
Figure 9 shows that, in euro terms, there were €14.1 trillion held in investment funds domiciled in Europe, a 12% increase on the 2015 total of €12.6 trillion.

The UK remained the fifth largest asset management centre in Europe with €1.5 trillion in funds under management (€1.5 trillion in 2015), however, as this is in euro terms, it is affected by the weakened pound. Luxembourg was the most popular European country for hosting funds with €3.7 trillion and Ireland second most popular with €2.1 trillion (see Chart 82).

FIGURE 9: EUROPEAN INVESTMENT FUNDS BY COUNTRY OF DOMICILE (DECEMBER 2016)



CHART 82: FUND ASSETS BY DOMICILE, UK, IRELAND, LUXEMBOURG (2002-2016)



Source: EFAMA

Country	Net assets (€bn)	Market share
1. Luxembourg	3,701	26.2%
2. Ireland	2,085	14.7%
3. Germany	1,885	13.3%
4. France	1,784	12.6%
5. United Kingdom	1,466	10.4%
6. Netherlands	801	5.7%
7. Switzerland	538	3.8%
8. Sweden	304	2.1%
9. Italy	298	2.1%
10. Denmark	276	2.0%
Other	1,003	7.1%
TOTAL	14,141	100%

Source: EFAMA

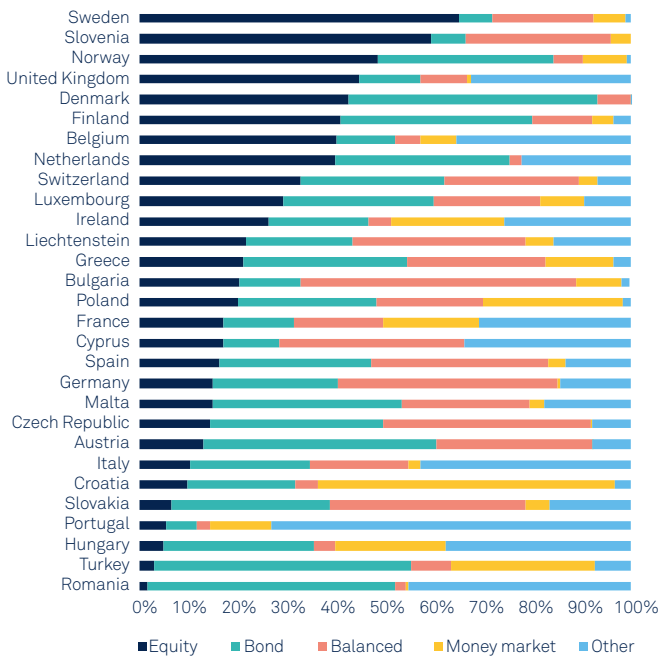
⁴¹ International fund data figures from EFAMA exclude some European funds. Consequently the European fund figures quoted by EFAMA in their international data do not correspond exactly to the figures quoted for the European funds industry in Figure 9.

Chart 83 provides some insight on investor choice across European countries.

Investors in the UK and Nordic countries show a clear preference for equity funds. Investors in these countries tend to have high levels of personal wealth in savings and property ownership which would allow greater risk taking.

German investors have traditionally held large amounts of their wealth in bonds, but have over recent years moved toward multi-asset products.

CHART 83: BREAKDOWN OF FUNDS UNDER MANAGEMENT BY FUND DOMICILE



6 OPERATIONAL AND STRUCTURAL ISSUES

KEY FINDINGS

REVENUE AND COSTS

- » Average industry net revenue grew around 2% in absolute terms. However, it fell as a proportion of total assets as a consequence of the strong asset growth post Brexit referendum (down 2bps since 2015 to 28bps).
- » Total operating costs in 2016 increased by slightly more than revenue, up by 5%, year on year. This is equivalent to 19bps of total assets, down 1 bp from 2015.
- » As a result, operating margin fell slightly to 32% (from 34% in 2015).

EMPLOYMENT IN THE ASSET MANAGEMENT INDUSTRY

- » We estimate that the UK asset management industry directly employed 37,700 people at the end of 2016 up by around 2% on the 2015 figure.
- » Jobs in the asset management industry vary by location, with the largest proportion in London being employed in investment management and operations and fund administration being of greater importance in Scotland.
- » Staff in Compliance, Legal and Audit have grown most significantly over the past five years with the proportion of staff employed in these roles being almost 50% higher than at the start of the period. In absolute terms the figure has doubled to around 2,700.

INDUSTRY CONCENTRATION

- » The UK asset management industry remains relatively unconcentrated although there are signs of increasing concentration. Assets managed by the top five firms increased to 40% from 39% in 2015, while assets managed by the top ten firms increased slightly to 56%.
- » The number of small firms, with assets below £15 billion, has fallen from 95 in June 2012 to 84 in June 2016. At the same time the number of largest firms, over £50 billion increased from 24 to 28.
- » The median figure for assets managed by IA member firms was £12 billion compared to a mean figure of £48 billion. This indicates that in spite of consolidation the industry remains skewed towards smaller firms.
- » The number of boutique managers, with assets below £5.5 billion has dropped to 21, a consequence of asset growth and M&A activity.

ASSET MANAGER OWNERSHIP

- » The proportion of assets run by independent asset managers was down slightly on 2015, at 38%.
- » Asset managers that are owned by a UK parent now represent 43% of assets under management, down from 60% in 2004. US owned managers represent 47% of assets under management.

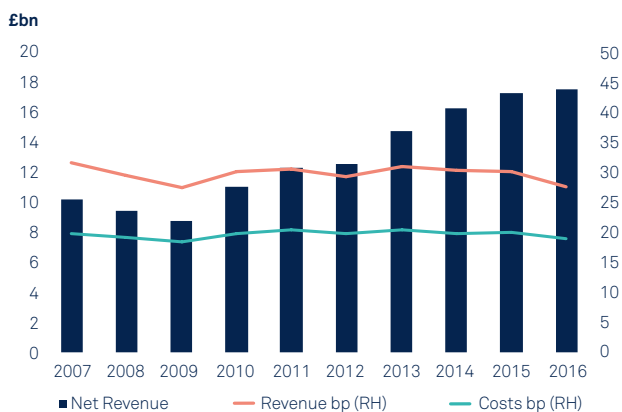
This Chapter moves away from the products and services offered by the industry across the institutional and retail sectors and rather focuses on asset managers as firms. It covers a broad range of factors, from changes in earnings and costs, to more practical issues such as staffing levels and the way that firm ownership is being impacted by the continuing merger and acquisition activity.

REVENUE AND COSTS

Chart 84 reports aggregate revenue and cost figures for the industry, covering both in-house and third party business.

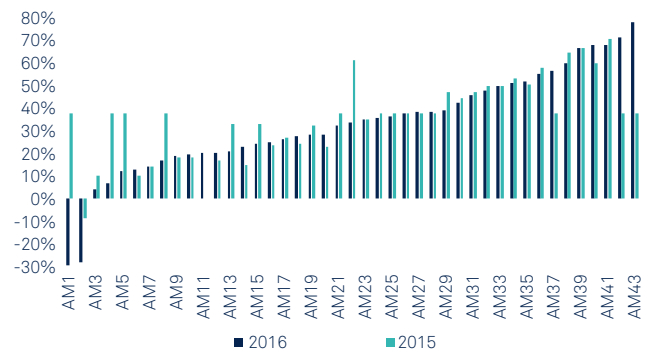
- Total average industry revenue after commission stood at £17.5 billion in 2016, a 2% increase in nominal terms. This equates to 28bps of total assets, a 2bps fall from last year, resulting from the fact that asset manager revenues in general did not increase at the same rate as assets under management.⁴²
- Total operating costs in 2016 increased to just under £12 billion. In basis point terms this represents a fall from 20bps to 19bps.
- As both average revenue and operating costs increased, but costs increased at a faster rate, these figures imply an operating margin of 32%, down from 34% in 2015.⁴³

CHART 84: INDUSTRY NET REVENUE VS. REVENUE AND COSTS AS PERCENTAGE OF AVERAGE ASSETS UNDER MANAGEMENT (2007-2016)



Looking in more detail across a sample of 43 firms for which we have operating margin figures for both 2015 and 2016, it is clear that the average hides a significant degree of year-on-year variability at a firm level. The simple average operating margin across this sample fell from 36% in 2015 to 33% in 2016. In this time, 25 out of the 43 firms saw their margins decline by an average of 10% whilst 18 firms saw their margins increase by an average of 8% (see Chart 85).

CHART 85: DISTRIBUTION OF FIRM-LEVEL OPERATING MARGINS 2016⁴⁴



Moreover, it is evident in Chart 85 that there is also variability across firms. In 2016 alone, 21 firms had below average margins and of these, nine were below 20% while two had negative margins. At the same time, 22 had above average margins with ten firms being above 50%.

Regarding the use of performance-based fees, 80% of respondents this year reported that they used them, in line with the average of recent years. However, just under one fifth of respondents reported that performance fees were becoming less prevalent to their business as the assets managed according to this fee type fell to around 10% of the total.

⁴² Revenue is measured on AUM calculated as the average of AUM at the beginning and end of each calendar year.

⁴³ Calculated as net revenue less costs divided by net revenue.

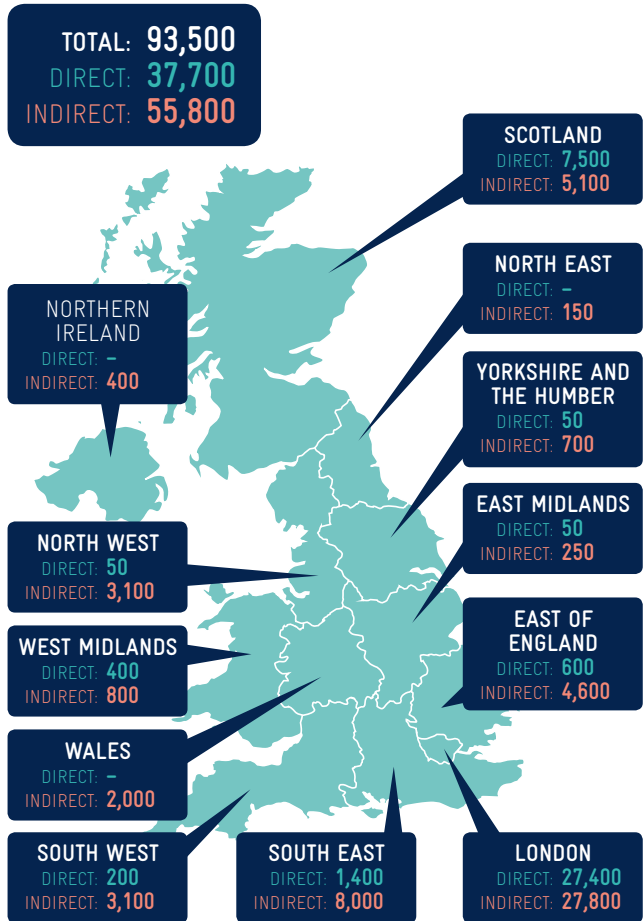
⁴⁴ Operating margin figures for 2015 have been added for comparison purposes.

EMPLOYMENT IN THE ASSET MANAGEMENT INDUSTRY

The IA estimates the UK asset management industry supports around 93,500 jobs in the UK both directly and indirectly in fund and wider administration services and securities and commodities dealing activities. The bulk of this resource is concentrated in London and South East England but Figure 10 makes clear that the regional footprint extends beyond this.⁴⁵

Furthermore, there are an estimated 24,000 financial advisers in the UK, many of whom are involved in the distribution of asset management services and they are separate to the figures captured here.

FIGURE 10: DIRECT AND INDIRECT EMPLOYMENT IN ASSET MANAGEMENT IN THE UK



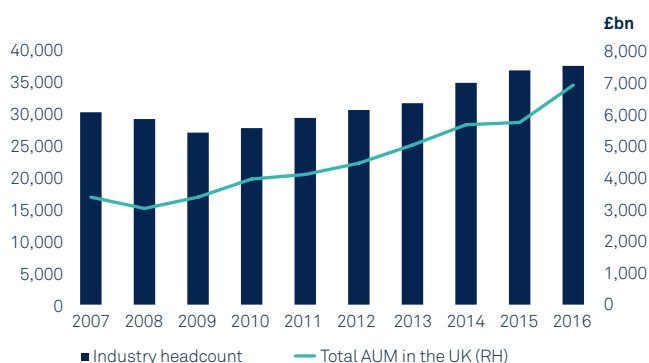
Source: IA estimates from information provided by members and publicly sourced information. All regional number have been rounded to the nearest 50 and therefore may not add to exact total

⁴⁵ It is difficult to identify jobs associated with asset management among firms that have a remit that extends wider than their asset management support, such as consultants, lawyers and accountants. In addition, a substantial number of roles in areas such as IT are outsourced to third party organisations and cannot be discretely measured. The figures provided below should therefore be viewed as a conservative estimate of those employed in asset management related roles.

DIRECT EMPLOYMENT

We estimate that the number of people directly employed in the asset management industry in the UK increased again during 2016, albeit at a slower rate than has been seen in recent years. The number of staff directly employed by asset managers in the UK grew by 2% in 2016 reaching 37,700 (see Chart 86).

CHART 86: INDUSTRY HEADCOUNT ESTIMATE VS. UK ASSETS UNDER MANAGEMENT (2007-2016)



Around three quarters of asset management firms outsource at least some of their staffing to external organisations and so these figures are likely to understate the numbers working to directly support asset management activity.

London and Scotland are the most important centres for asset management activity in the UK. However, IA members have offices all over the country, as reflected previously in Figure 10. More specifically, IA members reported that this year they had offices in a wide range of locations including Bristol, Birmingham, Bournemouth, Chelmsford, Guildford, Harrogate, Henley, Leeds, Manchester, Norwich, Oxford, Peterborough, Southampton, Swindon and York.

DISTRIBUTION OF STAFF BY ACTIVITY

Table 8 provides more detail on the number of employees directly employed by asset managers in the UK by function. The breakdown of staff activity was little changed from 2015. The proportion of staff in frontline investment management continued to fall, albeit slowly, and now stands at 24%, down from a recent high of 28% in 2014. No sectors changed by more than one percentage point over the year.

TABLE 8: DISTRIBUTION OF STAFF BY ACTIVITY (DIRECT EMPLOYMENT)

Activity	Percentage of total headcount
Investment Management of which	24%
Investment management (asset allocation and stock selection)	67%
Research, analysis	26%
Dealing	7%
Operations and Fund Administration of which	18%
Investment transaction processing, settlement, asset servicing	32%
Investment accounting, performance measurement, client reporting	45%
Other fund administration (incl. CIS transfer agency, ISA administration etc.)	23%
Business Development and Client Services of which	22%
Marketing, sales, business development	73%
Client services	27%
Compliance, Legal and Audit of which	8%
Compliance	36%
Risk	34%
Legal	22%
Internal audit	7%
Corporate Finance and Corporate Administration of which	12%
Corporate finance	36%
HR, training	23%
Other corporate administration	41%
IT Systems	12%
Other Sector	4%

Over the longer term some trends in staffing levels do emerge. Chart 86 and Tables 9 and 10 illustrate the changes using a matched sample of respondents that have all provided data for each of the last five years. On a like-for-like basis over the last five years Chart 87 shows the following changes:

- In proportionate terms, staffing in investment management has fallen by around 8% since 2011 (from 27% to 25%).
- Despite increases in total staff employed, operation and fund administration as a proportion of total staff have seen a fall (14%). Both areas are likely to have been subject to outsourcing in recent years.
- In stark contrast, the levels of staffing in compliance, legal and audit have increased dramatically in relative (60%) and absolute terms (207%), consistent with feedback from members on the increased levels of regulation to which they are now subject. In absolute terms the number of staff in these roles has increased from 1,300 to 2,700 (see Table 10).

“EVERY YEAR THERE’S SOME NEW REGULATION AND IT’S QUITE MAJOR SO IT’S ALMOST BECOME NORMAL. I WOULD SUSPECT MOST INVESTMENT MANAGERS HAVE DOUBLED IF NOT TREBLED THEIR COMPLIANCE AND REGULATORY TEAMS OVER THE LAST 10 YEARS.”



CHART 87: DIRECT EMPLOYMENT BY STAFF SEGMENT (2012-2016)

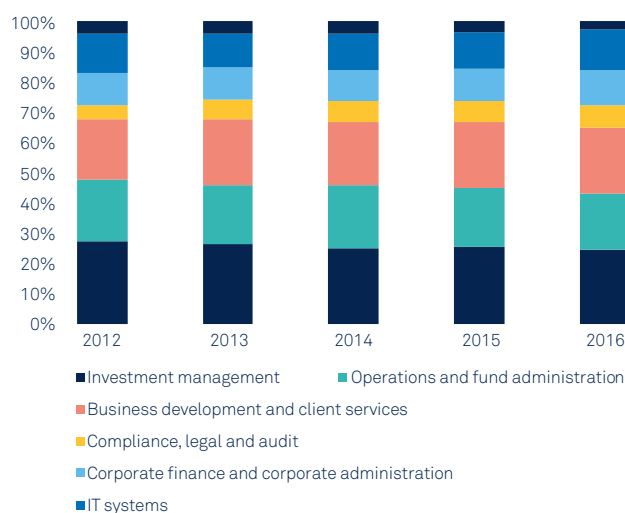


TABLE 9: DISTRIBUTION OF STAFF BY ACTIVITY (DIRECT EMPLOYMENT)

	2011	2012	2013	2014	2015	2016
Investment management	27%	27%	27%	25%	25%	25%
Operations and fund administration	21%	20%	19%	21%	20%	18%
Business development and client services	20%	20%	22%	21%	22%	22%
Compliance, legal and audit	5%	5%	7%	7%	7%	7%
Corporate finance and corporate administration	11%	11%	10%	10%	11%	12%
IT systems	13%	13%	11%	12%	12%	13%
Other sector	3%	4%	4%	4%	4%	3%

TABLE 10: ESTIMATED NUMBERS OF STAFF EMPLOYED BY ACTIVITY (DIRECT EMPLOYMENT)

	2011	2012	2013	2014	2015	2016
Investment management	7,900	8,200	8,400	8,700	9,400	9,300
Operations and fund administration	6,300	6,000	6,000	7,300	7,300	6,900
Business development and client services	6,000	6,400	7,200	7,400	8,000	8,200
Compliance, legal and audit	1,300	1,400	2,100	2,400	2,600	2,700
Corporate finance and corporate administration	3,200	3,200	3,300	3,500	4,000	4,400
IT systems	3,700	3,700	3,500	4,200	4,400	5,000
Other sector	1,000	1,300	1,400	1,600	1,300	1,100

Table 11 shows that the type of activity undertaken in different locations differs widely. London is the main centre of asset management activity and business development. However operations activities and finance are more important outside of London. IT plays a particularly important role in asset management employment in Scotland, with only operations and fund administration services being more significant.

TABLE 11: DISTRIBUTION OF ASSET MANAGEMENT JOBS BY REGION

	London	Scotland	Elsewhere in the UK
Investment Management of which	28%	18%	9%
Investment management (asset allocation and stock selection)	65%	74%	68%
Research, analysis	28%	20%	14%
Dealing	7%	6%	17%
Operations and Fund Administration of which	15%	24%	30%
Investment transaction processing, settlement, asset servicing	43%	19%	4%
Investment accounting, performance measurement, client reporting	45%	60%	26%
Other fund administration (incl. CIS transfer agency, ISA administration etc.)	13%	21%	71%
Business Development and Client Services of which	24%	16%	19%
Marketing, sales, business development	77%	57%	79%
Client services	23%	43%	21%
Compliance, Legal and Audit of which	8%	6%	10%
Compliance	37%	36%	32%
Risk	35%	31%	33%
Legal	21%	24%	29%
Internal audit	7%	9%	6%
Corporate Finance and Corporate Administration of which	10%	15%	23%
Corporate finance	36%	42%	23%
HR, training	24%	30%	7%
Other corporate administration	40%	28%	70%
IT Systems	11%	19%	9%
Other Sector	4%	2%	1%

INDUSTRY CONCENTRATION

Chart 88 illustrates that the asset management industry in the UK continues to comprise a small number of very large firms but a long tail of medium- and small-sized organisations. This has historically been the pattern within an industry that has been characterised by a diversity of operating models and comparatively low barriers to entry, although many within the industry believe this may be changing post-2008 due to higher cost of regulation.

AVERAGE ASSETS UNDER MANAGEMENT AT JUNE 2016

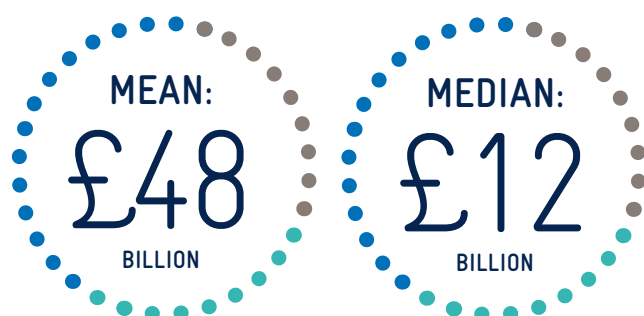
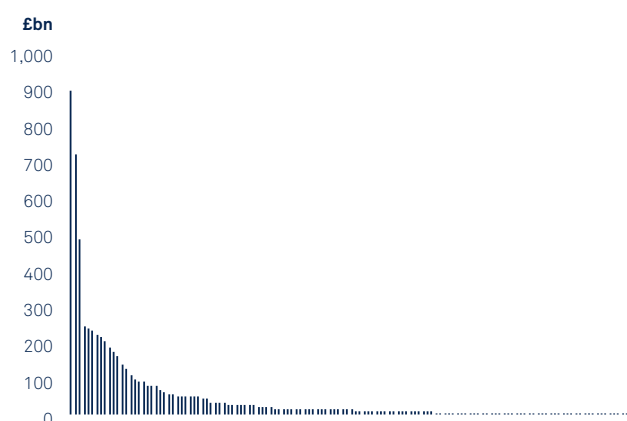


CHART 88: IA MEMBER FIRMS RANKED BY UK ASSETS UNDER MANAGEMENT (JUNE 2016)



The IA monitors the distribution of member firms by the level of assets they have under management. Looking at the data for the last five years there is a clear reduction in firms with assets under management of £15 billion or less, and an even more substantial decrease in firms with less than £1 billion under management. At the same time the number of larger firms has increased. Namely, the number of firms with more than £50 billion under management has increased from 24 to 28, as the number of firms overall has reduced from 143 to 138.

We have seen a significant amount of M&A activity in recent years (see Appendix 4). This is entirely consistent with the shift from smaller to larger firms that is evident from IA data (see Table 12).

TABLE 12: ASSETS MANAGED IN THE UK BY IA MEMBERS BY FIRM SIZE

AUM	No. of firms (June 2016)	No. of firms (June 2015)	Members (June 2014)	Members (June 2013)	Members (June 2012)
>£100bn	15	13	11	12	12
£50-100bn	13	14	14	15	12
£25-50bn	15	13	14	13	10
£15-25bn	11	13	14	14	14
£1-15bn	70	68	70	69	72
<£1bn	14	15	22	18	23
Total	138	136	145	141	143

Nevertheless, the UK asset management industry remains relatively unconcentrated, although there has been a slightly upward trend in concentration over the last ten years. A figure of less than 1,000 on the Herfindahl-Hirschmann Index, a standard measure of competition, represents low concentration. The value for the asset management industry in June 2016 stood at 534 and has increased from 350 a decade ago (see Chart 89).

The five largest firms represented 40% of assets, up from 39% in 2015, and the ten largest firms represented 56% of industry assets, up slightly from the end of 2015.

CHART 89: MARKET SHARE OF LARGEST FIRMS BY UK ASSETS UNDER MANAGEMENT VS. HHI (JUNE 2007-2016)

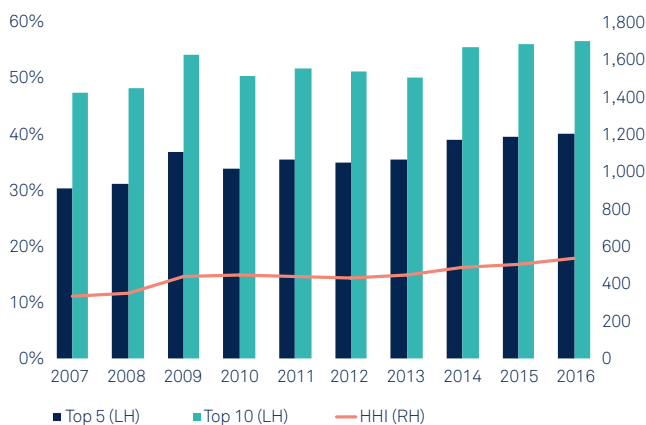
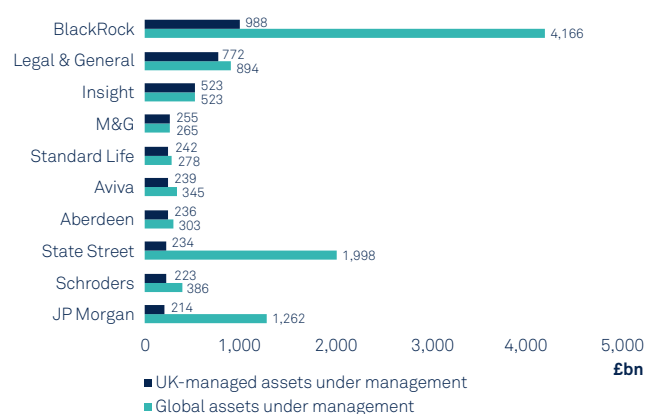


Chart 90 shows the ten largest firms in the UK, measured by UK assets under management supplied to the IA in response to the Survey questionnaire.⁴⁶ The top ten includes a mix of active managers and managers whose primary business is in managing on a passive basis. There is also a wide variety of group types in the top ten, including independent asset managers, as well as managers that are part of a larger insurance group, or bank.

As the difference between UK and global assets shows, a number of the largest asset managers are primarily UK focused, whereas others have a much wider global footprint.

CHART 90: TOP TEN FIRMS BY UK-MANAGED AND GLOBAL ASSETS UNDER MANAGEMENT⁴⁷



⁴⁶ Based on headline data supplied to The IA in response to the Survey Questionnaire

⁴⁷ Assets under management figures may reflect the value of wider economic exposure managed for clients in addition to securities within segregated or pooled portfolios.

BOUTIQUES

The IA membership contains a number of boutique managers. The definition of a boutique firm is not based purely on the size of the firm. There are four broad criteria:

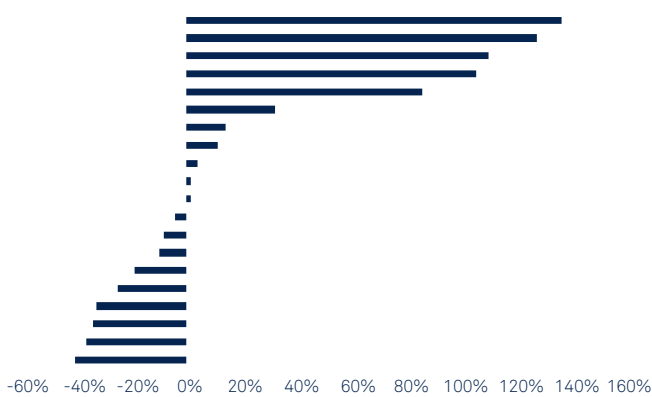
- Being independently owned
- With assets below £5.5 billion⁴⁸
- Providing a degree of investment specialisation
- Self definition

According to this definition the number of such firms in the IA fell once again from 24 in 2015 to 21 in 2016. The fall in numbers results from several factors:

- A number of boutique members being acquired by other asset managers.
- Others whose rate of growth no longer qualifies them for boutique classification according to our criteria.

In recent years, assets managed by boutique managers have grown much more strongly than other firms, to some extent moving firms out of the boutique category. This was true again in 2016, but there was much greater dispersion in the growth of different boutique firm. Chart 91 shows that those at the upper end performed extremely well, meaning that assets for boutique member firms increased by 33%.

CHART 91: PERCENTAGE CHANGE IN UK-MANAGED ASSETS ACROSS BOUTIQUE IA MEMBERS FIRMS (2015-2016)⁴⁹

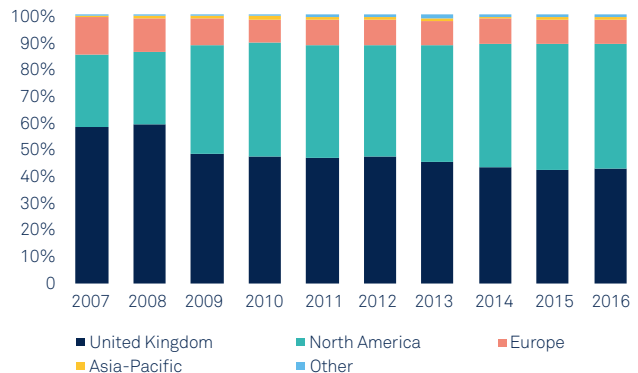


ASSET MANAGER OWNERSHIP

Over the last decade an increasing proportion of assets managed in the UK have been managed by organisations headquartered overseas, especially those in the US. Despite the ongoing high levels of merger and acquisition activity, Chart 92 shows there has been little change on the geographic breakdown of ownership since 2015:

- UK-owned asset managers now account for 43% of assets managed in the UK, down from a high of 60% in 2004.
- The proportion of assets managed in the UK for US-owned asset managers stands at 47%, up from a low of 23% when the IA first began collecting data in 2003.
- Assets managed by European-owned firms remain a relatively low proportion of total assets managed in the UK. In 2003 this stood at 15% but, following the financial crisis in 2008 a number of European bank-owned asset management firms underwent restructure and/or sale. As a result the proportion of assets managed by European-owned firms has remained relatively stable since 2010, at around the 9% mark.

CHART 92: ASSETS UNDER MANAGEMENT BY REGION OF PARENT GROUP HEADQUARTERS (2007-2016)



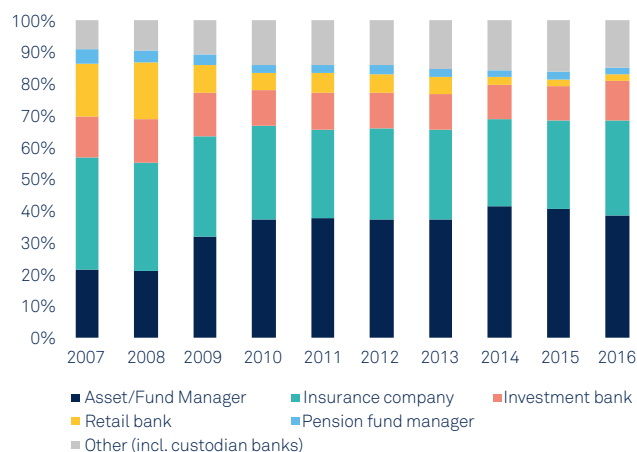
⁴⁸ Increased after 2013 from £5bn in line with overall asset growth.

⁴⁹ One boutique manager was not a member in 2015. Therefore this chart includes % change for 20 boutique firms

CORPORATE CHANGE

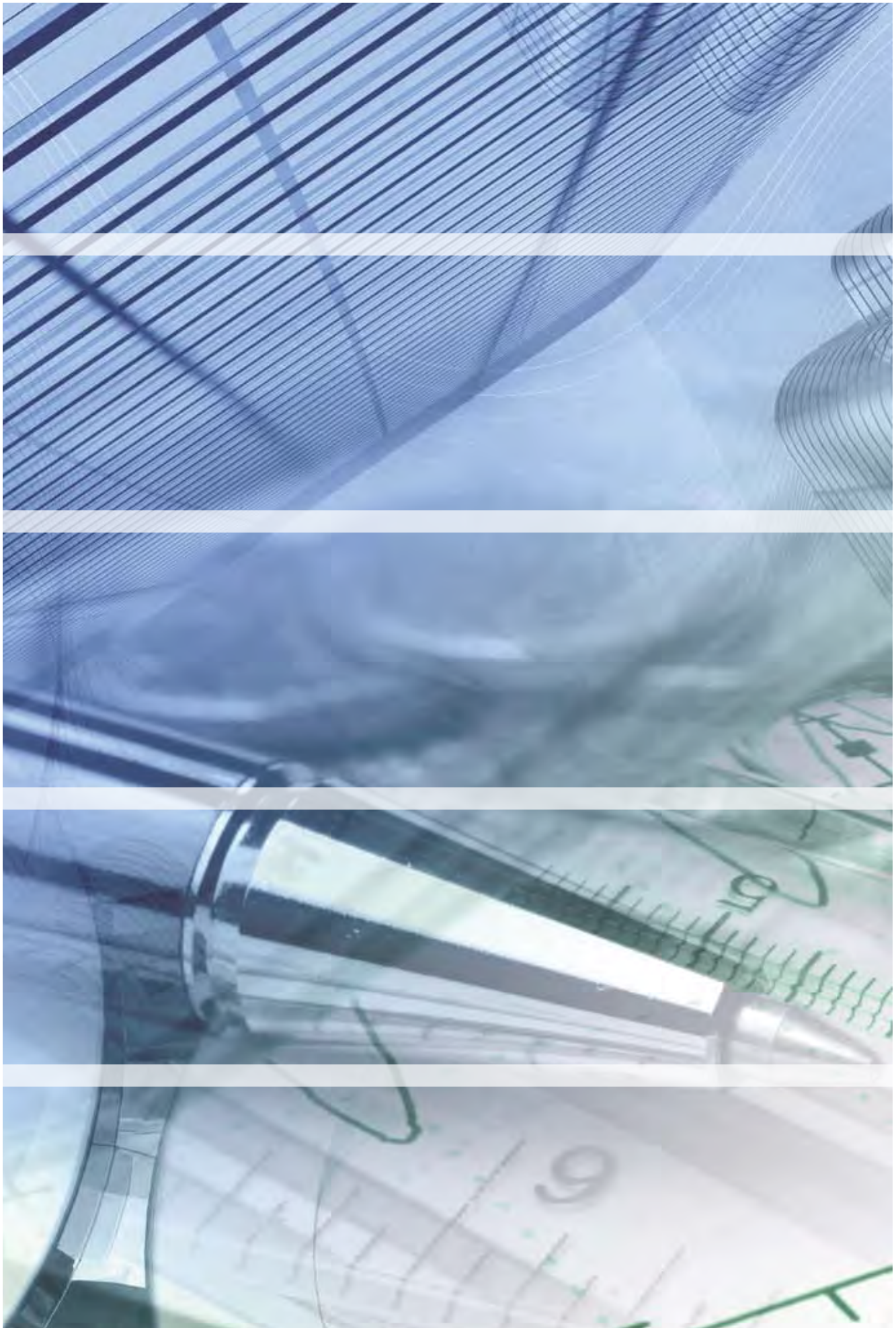
There has been a structural shift in the ownership of asset management companies. Chart 93 illustrates the number of independent asset managers now stands at 38%, down slightly from 2015 but still up from 18% ten years ago.

CHART 93: BREAKDOWN OF UK ASSETS UNDER MANAGEMENT BY PARENT TYPE (2007-2016)



Appendix 4 contains highlights of the merger and acquisition activity that has taken place in the UK in the past few years. Acquisition activity may take a variety of forms:

- Outright purchase and rebranding by the new parent of the acquired firms product set.
- A 'multi-boutique' approach where individual brands co-exist and compete with a shared set of common resources provided by a parent company.
- Variations of the above, where groups contain distinct brands with their own separate operations.
- Purchase of specific capabilities through the lift-in of investment teams from rival companies, which some see as much more efficient than purchasing an entire company, which was likely to come with a number of unwanted elements.



APPENDICES

APPENDIX 1

SUMMARY OF ASSETS UNDER MANAGEMENT IN THE UK¹

	TOTAL
Assets under management in the UK (£m)	6,919,566
Segregated or pooled (%)	
Directly invested on a segregated basis	57.1%
Managed on a pooled basis	42.9%
Active or passive (%)	
Actively managed	74.5%
Passively managed	25.5%
Asset allocation (%)	
Equities of which:	39.3%
UK	31.1%
Europe (ex UK)	23.2%
North America	20.8%
Pacific (ex Japan)	7.6%
Japan	5.5%
Latin America	1.0%
Africa	0.2%
Emerging market	7.1%
Other	3.5%
Fixed Income of which:²	32.1%
UK government (ex index-linked)	19.8%
Sterling corporate	22.7%
UK index-linked	10.6%
Other UK	7.0%
Overseas	40.0%
Cash/Money market	5.0%
Property	2.4%
Other	21.2%

¹ This includes all assets under management in this country, regardless of where clients or funds are domiciled.

INSTITUTIONAL								ALL INSTITUTIONAL	RETAIL	PRIVATE CLIENT
Pension funds	Public sector	Corporate	Non-profit	Sub- advisory	In-house insurance	Third party insurance	Other institu- tional			
3,044,759	299,018	325,289	85,773	214,525	598,459	489,781	425,980	5,483,584	1,307,762	128,219
44.0%	4.3%	4.7%	1.2%	3.1%	8.6%	7.1%	6.2%	79.2%	18.9%	1.9%

APPENDIX 2

SUMMARY OF DATA FROM THE UK INSTITUTIONAL CLIENT MARKET²

	TOTAL
Total Institutional Market (£m)	3,592,461
Segregated or pooled institutional assets (%)	
Assets directly invested on a segregated basis	71.5%
Managed on a pooled basis	28.5%
Active or passive (%)	
Actively managed	68.9%
Passively managed	31.1%
Multi-asset, LDI or specialist (%)	
Multi-asset	13.5%
LDI (notional)	28.5%
Single-asset / specialist of which:	58.0%
Equities of which:	
UK	26.5%
European (ex UK)	5.6%
North American	8.0%
Asia-Pacific	3.1%
Japan	2.6%
Latin America	0.1%
Africa	0.0%
Emerging market	3.1%
Global	44.1%
Other	6.9%
Fixed Income of which:	
Sterling corporate	25.3%
Sterling corporate and government	6.3%
UK government	16.1%
UK Index-Linked	9.2%
Global	26.2%
Other	16.9%
Cash/Money market	8.5%
Property	6.1%
Other	7.6%

² 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							
	1,859,193	211,596	113,553	28,390	108,889	44,230	72,134	539,672	420,769	194,035
	51.8%	5.9%	3.2%	0.8%	3.0%	1.2%	2.0%	15.0%	11.7%	5.4%
	71.8%	56.8%	38.4%	72.4%	59.0%	56.7%	87.6%	93.6%	84.9%	20.3%
	28.2%	43.2%	61.6%	27.6%	41.0%	43.3%	12.4%	6.4%	15.1%	79.7%
	64.5%	69.4%	36.1%	94.3%	57.9%	79.4%	85.0%	93.5%	88.8%	52.9%
	35.5%	30.6%	63.9%	5.7%	42.1%	20.6%	15.0%	6.5%	11.2%	47.1%
	10.0%	7.4%	8.6%	8.4%	10.8%	44.9%	19.1%	10.6%	38.8%	3.9%
	50.0%	10.7%	19.6%	27.2%	14.1%	0.0%	0.7%	1.6%	0.6%	5.7%
	40.0%	81.9%	71.7%	64.4%	75.2%	55.1%	80.2%	87.8%	60.6%	90.4%
	39.5%	61.7%	62.2%	18.5%	35.0%	61.6%	58.3%	22.1%	23.7%	27.7%
	19.8%	24.4%	13.1%	18.7%	25.7%	22.1%	33.3%	49.5%	32.0%	40.7%
	5.3%	7.6%	2.2%	31.9%	8.5%	3.0%	4.3%	5.2%	7.1%	4.1%
	7.1%	11.8%	7.9%	2.5%	17.5%	1.6%	8.3%	7.1%	7.1%	6.3%
	2.6%	2.4%	1.2%	3.8%	1.1%	4.0%	4.1%	2.1%	4.8%	8.6%
	2.3%	3.5%	1.1%	0.3%	2.8%	0.5%	2.7%	2.1%	3.4%	3.9%
	0.0%	0.0%	0.0%	2.8%	0.0%	0.0%	0.0%	0.2%	0.0%	0.6%
	0.0%	0.0%	0.0%	1.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	3.3%	2.9%	5.8%	12.5%	4.3%	0.3%	0.9%	1.0%	3.6%	3.4%
	51.7%	43.7%	63.7%	26.0%	39.9%	62.4%	31.4%	32.3%	22.0%	30.9%
	7.9%	3.6%	5.0%	0.1%	0.3%	6.1%	14.9%	0.3%	20.0%	1.5%
	45.6%	20.2%	18.2%	46.5%	26.7%	10.4%	32.3%	59.1%	53.4%	8.6%
	27.9%	17.7%	32.5%	0.7%	1.2%	32.3%	18.7%	19.8%	36.3%	0.2%
	7.8%	13.5%	9.5%	0.6%	3.0%	37.9%	7.2%	2.8%	6.4%	2.3%
	17.0%	9.7%	12.1%	0.1%	5.8%	11.1%	4.4%	20.9%	7.5%	64.8%
	14.2%	29.5%	23.3%	2.4%	0.5%	3.2%	13.4%	3.0%	2.0%	3.0%
	22.0%	21.7%	20.2%	86.4%	60.8%	14.4%	28.7%	39.0%	13.7%	3.4%
	11.1%	7.9%	2.4%	9.8%	28.6%	1.1%	27.5%	14.5%	34.1%	26.3%
	2.6%	0.6%	0.4%	23.2%	15.0%	17.8%	4.9%	6.7%	8.4%	47.0%
	5.0%	4.8%	2.3%	7.3%	17.1%	3.4%	0.6%	9.3%	3.5%	6.9%
	7.3%	12.7%	16.9%	4.5%	6.2%	6.8%	3.9%	2.9%	11.1%	9.8%

APPENDIX 3

MAJOR UK AND EU REGULATORY DEVELOPMENTS AFFECTING ASSET MANAGEMENT

CAPITAL MARKETS AND INVESTMENT

CSDR

- The Central Securities Depositories Regulation was adopted in September 2014.
- It seeks to harmonise the regulation and supervision of Central Securities Depositories in Europe and harmonise securities settlement practices.
- The initial measure was to impose a maximum settlement cycle of T+2 for trades executed on-exchange in Europe.
- The other key changes that will impact asset managers are standardisation of the penalties regime for late settlement and mandatory buy-ins where the seller is unable to deliver the stock. These are expected to apply from late 2019.

EMIR

- After a long delay, the European Commission endorsed ESMA's proposed changes to the trade reporting obligation in October 2016. They will now apply from November 2017.
- The variation margin (VM) requirements for non-cleared Over The Counter (OTC) derivatives came into force on 1 March 2017. The FCA issued a statement giving a further six month window for application.
- The Commission issued the EMIR Review in May 2017. This has a number of implications for firms and will recalibrate both the clearing and reporting requirements.

MiFID II

- MiFID II is set to take effect from 3 January 2018
- Client Reporting
 - The scope, detail and requirements of the new obligations for firms are becoming clear following dialogue between firms, the FCA and ESMA. There is considerably more detail set out in MiFID II, and there is less flexibility in terms of differentiating between professional and retail clients.
- Best Execution
 - MiFID II will require firms to publish extensive information on where they execute trades and details of the quality of execution achieved. This represents a significant data gathering exercise, including obtaining information published by venues which must then be analysed and used by asset managers.
- Transaction reporting
 - Transaction reporting - ESMA published its final Level 3 guidelines for transaction reporting in September 2016.
 - The new transaction reporting regime will extend the data that firms are required to report, as well as widening the scope of instruments covered.
 - The FCA has indicated its intention not to extend the reporting obligations to certain non-MiFID firms that undertake their own portfolio management, including UCITS/AIF managers and OPS firms, as it does under MiFID I.
- Research
 - MiFID II will have profound implications for the purchase of research by asset managers. There will be significant changes in the market for research. MiFID II requires, among other things, that there is a clear and demonstrable demarcation between the payment for execution and payment for research.

- Transparency
 - MiFID II brings enhanced transparency requirements in both the equities and fixed income world. In addition it provides a Europe-wide standard definition of spot FX v financial instruments.
- Trading Obligations
 - The trading obligation for both equities and derivatives will potentially have a large impact on asset managers. This requires that instruments listed in the EU are traded on an EU trading venue.
- Product Governance
 - The MiFID II rules are two dimensional. They aim at product development and oversight on the one hand and closer oversight of distribution of financial instruments to ensure robust investor protection throughout the supply chain on the other.
 - Firms will be required to put in place robust product governance procedures. The product governance rules oblige manufacturers to maintain, operate and review a process for the approval of each product. Additionally, firms will have to review their products and choice of distribution channels regularly. However, for this to be possible, distributors will have to share some level of sales data with the manufacturers.

MAR

- MAR was implemented on 3 July 2016, but certain aspects tied to MiFID II will not apply until 3 Jan 2018.
- A steady drip of the necessary clarification of scope and interpretation is slowly being provided by the FCA and ESMA.
- The IA continues to work with the FCA/ESMA to clarify a few outstanding issues of interpretation/implementation.

SFTR

- During 2016, ESMA issued discussion and consultation papers on the trade reporting regime for securities financing transactions (repo, securities lending etc). Its final report and draft technical standards have since been published and currently await endorsement by the European Commission, ahead of scrutiny by the Parliament and Council and entry into force. Reporting by asset managers for their clients is unlikely to commence before mid-2019.

FUNDS AND DISTRIBUTION**PRIIPs**

- In late 2016 the European Commission proposed the delay of application of the PRIIPs Regulation by one year (to 1 January 2018) following rejection of the draft implementing rules (Regulatory Technical Standards) by the European Parliament. During the first half of 2017 the European Co-legislators adopted revised Regulatory Technical Standards (level 2) measures laying out methodologies how to calculate measures of risks, performance and costs and presentation requirements for the new PRIIP Key Information Document (KID). Subsequently, Level 3 Q&As were published in summer 2017 to provide further guidance for firms.

- UCITS, and AIFs where national regulators have extended the UCITS KII requirements (as the FCA has on a voluntary basis for NURS), are exempt from the PRIIPs Regulation until December 2019.
- However, if other PRIIP providers (such as insurers) are using UCITS or NURS, they will require information about the product from manufacturers that are compatible with the PRIIPs regulation.

UCITS V

- The UCITS V Level 2 Regulation came into force on 13 October 2016. This completed the implementation of UCITS V which broadly extends the AIFMD requirements on manager remuneration policy, depositary liability and sanctions.
- The FCA has maintained the UK's current approach to ensuring that the management company and depositary act independently. It does this through retaining its current guidance regarding depositary independence.

AIFMD

- The Directive and related Regulation has applied since 22 July 2013.
- AIFs are any collective investment undertaking that are not UCITS (irrespective of legal structure, listing, authorisation or domicile).
- The Directive therefore captures a wide range of UK vehicles, including NURSSs, QISs, unauthorised unit trusts (UUTs), charity funds, investment trusts, and specialist vehicles (e.g. hedge funds, private equity funds, venture capital funds and real estate funds).
- It provides a passport for the marketing of AIFs to professional investors and imposes detailed regulation on the managers of AIFs (AIFMs).
- ESMA has been working on identifying third countries which should be deemed to be sufficiently equivalent that the AIFMD passporting regime should be extended to them. In 2016 they submitted advice to the Commission regarding twelve third countries, however the Commission has yet to publish its proposals. This process has proven politically contentious, which may be further impacted by the Brexit negotiations.
- The Commission is required to begin its review on AIFMD this summer and has issued a tender for an external report on the effectiveness of the AIFMD implementation, to be completed by summer 2018.

Venture Capital Funds and Social Entrepreneurship Funds

- The EuSEF (European Social Entrepreneurship Funds) and EuVECA (European Venture Capital Funds) Regulations approved in March 2013, created labels or "designations" for small AIFMs and internally managed AIFs that comply with the organisational requirements and investment rules.
- The regimes created a passport enabling registered managers to market their EuVECA and EuSEF to professional and "semi-professional" investors throughout the EEA.
- There has been a reasonable take up of the EuVECA label, with 70 EuVECA funds being notified to ESMA to date. However, the EuSEF label has achieved little success to date, with only four EuSEF funds having been notified to ESMA.
- On 14 July 2016, the Commission published a proposal to amend the EuVECA and EuSEF regulations intended to improve the take up of these funds. This followed a public consultation issued in September 2015.
- The proposed changes extend the range of managers eligible to market and manage EuVECA and EuSEF funds, increase the range of companies that EuVECA funds can invest in, and make cross-border registration and marketing of these funds easier and cheaper.

	<ul style="list-style-type: none"> The proposed changes to the EuVECA and EuSEF regulations have recently been agreed by the Council and the European Parliament following the trilogue process.
ELTIFs	<ul style="list-style-type: none"> The ELTIF Regulation came into force on 8 June 2015 and took effect from 9 December 2015. ELTIFs are a regulated sub-set of AIF that invest into long-term illiquid investments such as infrastructure, transport, sustainable energy and small or unlisted companies. The fund must be domiciled in the EU, have an EU manager, be closed-ended and of a fixed term. Limited redemption rights may be offered to retail investors from half-way through the lifecycle of the fund. Funds authorised under the ELTIF regulation are able to use the label 'ELTIF' and market across Europe to professional investors and certain categories of retail investors. ESMA provided its proposed Regulatory Technical Standards (RTS) to the Commission on 8 June 2016. The RTS cover eligible derivative contracts for hedging risk, determining the lifecycle of a scheme, the orderly disposal of assets, cost disclosure and the facilities available to retail investors. To date, no UK ELTIFs have been launched and only a small number of ELTIFs have been launched in Europe.
Money Market Funds	<ul style="list-style-type: none"> Commission proposals for Money Market Funds (MMFs) were issued September 2013. There were polarised opinions when the dossier was debated in the European Parliament and the Council. The European Parliament agreed on a text on 29 April 2015. Member States agreed their final approach in the Council in June 2016, and following trilogues political agreement was reached in on the text in November 2016. The text has now been formally adopted and is expected to enter the Official Journal in mid-2017. The Regulation provides for both Variable Net Asset Value (VNAV) and Constant Net Asset Value (CNAV) MMFs. Two designs of CNAVs are provided for, Low Volatility Net Asset Value MMFs (LVNAV), and Public Debt CNAVs. The final Regulation also includes transparency requirements to ensure all MMF investors are aware of risks that may result in MMFs being revalued, restrictions on eligible assets, diversification and concentration limits, prohibitions on external support (eg. from a parent bank), requirements on MMFs to calculate their NAV on a daily basis and requirements for LVNAVs and CNAVs to have liquidity fees and redemption gates available for use in stressed periods. ESMA issued a consultation on 24 May 2017 covering various Level 2 and 3 measures. The US Securities and Exchanges Commission (SEC) adopted new Money Market Funds Reform rules on 23 July 2014. The new rules require a floating net asset value for institutional prime money market funds and introduce contemporaneous changes to accounting and tax rules to make the shift work.
Sunset for legacy commission payments	<ul style="list-style-type: none"> The FCA decided not to impose a sunset clause in relation to the grandfathering of ongoing commission payments to advisers for undisturbed business written before the adviser charging rules came into force on 1 January 2013. While a 6 April 2016 sunset clause that affects all provider payments to platform service providers will mean that the payment of commission to advisers through platforms will end at that date, commission on legacy business that is paid directly by the provider to the adviser would not be affected.

- The FCA does not intend to end these trails via the MiFID II implementation into UK regulation.
- The FCA Market Study interim report indicated the FCA was not intending to introduce a sunset clause for legacy commission payments to advisers.
- However, in a consultation paper in (CP17/18) published alongside the Final Report, the FCA is inviting stakeholders to submit further evidence and is consulting on whether it should re-consider this.

LGPS

- In November 2015 the Government announced proposals to require English and Welsh LGPS funds to establish, and invest through asset pools, each with at least £25bn of Scheme assets. These pools rather than the underlying LGPS funds will, from 2018, procure asset management services.
- By July 2016 detailed proposals had been submitted to Government for the creation of 8 pools, with assets ranging from £13bn to £36bn. Local authorities are currently working towards implementing their proposals with a view to the first pools of assets being operational from April 2018.
- Under MiFID II local authorities will be automatically classified as retail clients and will need to opt-up to elective professional status in order to access the investment services they currently benefit from. This applies both to the treasury management and pension scheme functions of local authorities, which will have to be opted up separately. The FCA published final rules in early July with details of the final opt-up test. The test has a quantitative and qualitative element, both of which must be met. The quantitative test requires clients to have a minimum portfolio size of £10 million and in addition to meet one of three criteria, the relevant one for LGPS funds being that they must confirm that they are administering authorities of a local government pension scheme within the meaning of the 2013 LGPS regulations. The qualitative test requires the investment firm to undertake an assessment of the expertise, experience and knowledge of the client and be reasonably assured that the client is capable of making its own investment decisions and understands the risks involved. Firms will be able to re-assess the categorisation of local authority clients between 3 July 2017 and 3 January 2018 when MiFID II enters into force.
- The LGPS Scheme Advisory Board has developed a cost disclosure template for use across the LGPS in its Code of Transparency, launched in May 2017. This has been designed to help the LGPS measure its investment costs (fees and transaction costs) on a consistent basis across individual funds.

DC pensions charge cap review

- The Department for Work and Pensions announced in March 2017 that it intends to review the charge cap on DC workplace pension default strategies later in 2017. The review will consider whether the current cap of 75bps should be lowered and/or whether it should include some or all transaction costs.

FIRM REGULATION

EU Benchmark Regulation

- The Regulations will apply from 1 January 2018. The Level 1 text has been finalised, with the stated aim of restoring confidence in the integrity of benchmarks.
- Much of the Level 2 text is almost finalised, but awaits formal publication.
- Firms will need to identify all the indices that they use (as defined in the Regulation) for their funds, and work to ensure that these will be available to them when the Regulation comes in to force.

Fourth Money Laundering Directive

- The Level 1 text has been finalised. The Directive, which extends and tightens up the Third Money Laundering Directive, is scheduled to apply from 26 June 2017.
- Implementing regulations are awaited, one set of guidelines has been published while others are still awaited.
- The HMT Regulation has been consulted on, but the final version not published.
- The JMLSG Guidance has been consulted on, the final version will depend on any changes to the HMT Regulation following consultation. This means that the timelines are still prohibitively tight.
- An amending directive has just been published which, among other things, will amend the treatment of PEPs and beneficial owner registers. It is still not clear when this will come into force.

GDPR

- After more than four years of discussion, the new EU data protection framework has finally been adopted and takes the form of a Regulation applying from 25 May 2018.
- GDPR will replace the current Directive and will be directly applicable in all Member States without the need for implementing national legislation.
- However, as the regulation is not specific to financial services and contains some onerous obligations, it will have an immediate impact.
- Some aspects of GDPR will cause issues for asset management and other financial services:
 - Expanded territorial reach – particularly where controllers and processors are outside the EU
 - Additional data protection officers required.
 - Additional documentation and record keeping.
 - Change in the role of data processors.
 - Individuals must be allowed to withdraw consent more easily.
 - Changes to data breach notification, with additional internal reporting procedures.
 - Increased penalties with a tiered percentage approach to fines.
- There may also be some additional financial crime aspects relating to record keeping and sensitive information.

SMCR

- Regime already implemented in banks and building societies from March 2016, with a modified version for insurers.
- Key new requirements for asset management firms, planned for implementation in 2018:

- Senior Managers Regime replacing the Significant Influence Function, with senior managers individually responsible and accountable for every area of a firm's activities.
- Certification Regime that applies to employees who could pose a risk of significant harm to the firm or any of its customers - new Significant Harm Function.
- In July 2017, the FCA issued a paper (CP17/25) consulting on extending the SMCR regime to all FSMA authorised firms.

Enhanced transparency of charges and costs

- Requirements under MiFID II, PRIIPs and UK pensions law will lead to enhanced disclosure of investment charges and transaction costs across all client segments of the asset management industry.

INTERNATIONAL ISSUES

Interaction of MiFID II Research provisions and SEC Securities Exchange Act section 206(3)

- MiFID II dictates that payment for research must be explicit and separate from execution.
- However, under the SEC Securities Exchange Act section 206(3), US brokers cannot receive direct payment for research unless they register as an Investment Advisor in the US. Registering as an Investment Advisor is problematic for brokers as it places restrictions on their ability to trade on a principal basis and creates a fiduciary duty to act in the best interests of their clients. As it stands, EU asset managers will be unable to pay US brokers for research whilst, at the same time, complying with their MiFID II obligations.

APPENDIX 4

NOTABLE M&A DEALS IN THE UK ASSET MANAGEMENT SECTOR (2009-JULY 2017)

2016-2017

ACQUIRER	PURCHASE
Aberdeen	Arden Asset Management, Parmenion Capital
Aegon	Cofunds
AJ Bell	Indexx Markets Ltd, Allium Capital, Mansard Capital
AllianzGI	Rogge Global Partners
Amundi	Kleinwort Benson Investors (majority stake), Pioneer Investments
Blackrock	First Reserve Energy Infrastructure Funds
Brewin Dolphin	Duncan Lawrie Asset Management
Columbia Threadneedle	Emerging Global Advisors
Courtiers	JRH Asset Management
Crux Asset Management	Oriel Asset Management
Franklin Templeton	AlphaParity
FundRock	Fund Partners
Henderson Global Investors	Janus Capital Group (merger)
Legg Mason	Clarion Partners, Financial Guard
Liontrust	Alliance Trust Investments
Momentum	London and Capital adviser business
Schroder	Adveq Holding AG
Standard Life	Aberdeen Asset Management (merger) AXA Elevate
State Street Global Advisors	GE Asset Management
Stonehage Fleming	FF&P Wealth Planning

2015

ACQUIRER	PURCHASE
Aviva	Friends Life
BNY Mellon	Cutwater Asset Management
Henderson	90 West (increased holding to 100%)
	Perennial Fixed Interest Partners/Perennial Growth Management
Broadstone	Blythwood
Brooks Macdonald	Levitas Investment Management Services Ltd
Legal and General Investment Management	Aerion
GAM	Singletery Mansley Asset Management
Maitland	Phoenix Fund Services
Stonehage	Fleming Family
Threadneedle	Columbia (merger)
Vontobel	TwentyFour

2014

ACQUIRER	PURCHASE
Aberdeen	Scottish Widows Investment Partnership
Bank of Montreal	F&C
Broadstone	Blythwood
Brooks Macdonald	Levitas Investment Management Services Ltd
Family Investments	Engage Mutual
GAM	Singletery Mansley Asset Management
Legg Mason	Martin Currie
Octopus	MedicX
Rathbones	Jupiter Asset Management Limited's private client and charity investment management business
River and Mercantile	P-Solve (merger)
Standard Life	Ignis Asset Management
Thomas Miller	Broadstone Wealth Management

2013

ACQUIRER	PURCHASE
Aberdeen	Artio Global Investors Scottish Widows Investment Partnership
Aviva	Solar portfolio from Ecovision Renewable Energy
Barings	SEI Asset Korea (SEIAK)
BlackRock	Credit Suisse ETF Business
Bank of Montreal	F&C
Henderson	H3 Global Advisers Northern Pines Capital (50%) 90 West (33%)
Liontrust	North Investment Partners
Miton	PSigma
PSigma	Axa Framlington private client business
Royal London	Co-Operative (Insurance and asset management businesses)
Schroders	Cazenove Capital Management STW Fixed Income
Standard Life Wealth	Private client division of Newton

2012

ACQUIRER	PURCHASE
Brooks Macdonald	Spearpoint
Bridgepoint & Quilter	Quilter (MBO)
Broadstone	UBS Wealth's corporate pension arm
Franklin Templeton	K2 Advisors
Goldman Sachs	Dwight
Insight	Pareto
Legg Mason	Fouchier Partners
Liontrust	Walker Crips
Natixis	McDonnell
Punter Southall	PSigma
Rathbone	Taylor Young

2011

ACQUIRER	PURCHASE
BT	JO Hambro
Close	Cavanagh Wealth Management
Close	Allenbridge Group
Cyrun Finance	SVM Asset Management
Franklin Templeton	Rensburg
Henderson	Gartmore
Investec	Evolution
Liontrust	Occam
Principal	Origin
Punter Southall	Brewin Dolphin's corporate pension arm
Royal London	Royal Liver
SGBP Hambros	Barings' private client business
Threadneedle	Liverpool Victoria
Williams de Broe	BNP Paribas' private client business

2010

ACQUIRER	PURCHASE
Aberdeen	RBS' multimanager and alternatives business
Alpha Real Capital	Close Brothers' property fund management business
AMG	Artemis
Aviva Investors	River Road
Close	Chartwell Group
F&C	Thames River Capital
Investec	Rensburg Sheppards
Man Group	GLG Partners
Marlborough	SunLife Financial of Canada's funds
Schroders	RWC Partners (49%)
State Street	Bank of Ireland

2009

ACQUIRER	PURCHASE
BlackRock	BGI
BNP Paribas	Fortis
BNY Mellon	Insight
Henderson	New Star
Ignis	Axial
Invesco	Morgan Stanley's retail fund business
Marlborough	Apollo
Neuberger Berman Group	Management buyout of Lehman asset management business
Rathbone	Lloyds' RBS PMS client portfolio and two private client portfolios
Sumitomo Trust	Nikko

APPENDIX 5

DEFINITIONS

CORPORATE CLIENTS

Institutions such as banks, financial corporations, corporate treasuries, financial intermediaries and other private sector clients. Asset management services for fund products operated by financial corporations are included under 'Sub-advisory'.

FUND OF FUNDS

Funds whose investment objective is fulfilled by investing in other funds rather than investing directly into assets such as cash, bonds, shares or property. These may also referred to as 'multi-manager products'.

IN-HOUSE INSURANCE CLIENTS

Refers to assets that insurance-owned asset management firms manage for their parent company or an insurance company within the parent group.

INVESTMENT FUNDS

All pooled and listed vehicles regardless of the domicile of the client or fund (ie. unit trusts, investment companies with variable capital including ETFs, contractual funds, investment trusts, and hedge funds) but it does not include life or insurance funds.

LIABILITY DRIVEN INVESTMENT (LDI)

Defined as an approach where investment objectives and risks are calculated explicitly with respect to individual client liabilities.

MULTI-ASSET MANDATE

Also called 'balanced', these types of mandate invest across a range of asset classes and geographies without a specific focus on a particular universe..

NON-PROFIT CLIENTS

Includes charities, endowments, foundations and other not for profit organisations.

'OTHER' CLIENTS

Assets managed on behalf of client types that cannot be classified under any other category as well as unidentifiable client types, eg. closed-ended funds or institutional pooling vehicles.

OVERSEAS BONDS

Include overseas government bonds as well as debt denominated in overseas currencies.

OVERSEAS CLIENT ASSETS

Assets managed on behalf of non-UK clients. Includes assets delegated to the firm from overseas offices and assets directly contracted in the UK.

PENSION FUNDS CLIENTS

Incorporates both defined benefit (DB) and defined contribution (DC) provision, where the respondent has a relationship with a pension fund, irrespective of type. Where the DC provision is operated via an intermediary platform, particularly a life company structure wrapping the funds, the assets are reflected in 'Insurance'.

PUBLIC SECTOR CLIENTS

Encompasses central banks, supranational bodies, public sector financial institutions, governmental bodies, public treasuries and sovereign wealth funds as well as the non-pension assets of local authorities and other public sector clients.

PRIVATE CLIENTS

Comprise assets managed on behalf of high-net-worth and ultra-high-net-worth individuals as well as family offices.

POOLED

Comprises investment vehicles operated by a manager for several clients whose contributions are pooled. It also includes assets in segregated portfolios that are held indirectly via pooled vehicles managed by the respondent.

RETAIL

Includes investment into unit trusts, open-ended investment companies (OEICs) and other open-ended investment funds irrespective of domicile. It incorporates assets sourced through both intermediated sales (ie. made through fund platforms, supermarkets and other third parties) and direct retail sales. It does not include life-wrapped funds, which are classified under 'Third Party Insurance'.

SEGREGATED

Assets directly invested within segregated portfolios, and managed on behalf of one client. This would also include mandates run on behalf of a single pooled vehicle (eg. a 'pooled' insurance fund run for an insurance parent company).

SINGLE-ASSET

Also called 'specialist', these types of mandate are overwhelmingly focused on one asset class, and therein usually a specific sub-type (either geographic or other; eg. a US equity mandate or an index-linked gilt mandate).

SOLUTIONS-BASED INVESTMENT

Strategies, typically multi-asset, that are designed to achieve a customised client outcome. Examples would include a mandate designed to meet the specific liabilities of a pension scheme or a retail fund that looks to smooth the growth of savings while targeting an income in retirement.

STERLING CORPORATE DEBT

Exposure to Sterling-denominated debt, irrespective of whether it is issued by UK or overseas companies.

SUB-ADVISORY

Business as part of which the respondent provides investment management services to third party fund products. It may therefore include business that is institutional to the respondent, but may ultimately be retail (eg. 'white-labelled' funds or manager of managers products).

THIRD PARTY INSURANCE CLIENTS

Assets sourced from third party insurance companies (ie. from outside the respondent's group), where the mandates are seen as institutional. It includes both unit-linked assets (ie. funds manufactured by the respondent and distributed with the respondent's brand through a life platform) and other third party assets.

UK ASSETS UNDER MANAGEMENT

Assets where the day-to-day management is undertaken by individuals based in the UK. This includes assets managed by the firm in the UK whether for UK or overseas clients contracted with the firm. It also includes assets delegated to the firm's UK-based asset managers by either third party asset managers or overseas offices of the company or group. With respect to fund of funds and manager of managers products, the figure only includes the size of the underlying funds managed by the firm's UK-based managers

UK FUND MARKET

This primarily covers UK authorised and recognised unit trusts and OEICs, which are by the far the largest part of the UK retail fund market, but also used by institutional investors. A small but growing part of the fund market is represented by funds domiciled overseas though often with portfolio management performed in the UK. There are also some UK-domiciled funds that are sold into overseas markets.

UK INSTITUTIONAL CLIENT MARKET

Covers mandates or investment in pooled funds by UK institutional clients. We analyse this market on the basis of client domicile, not domicile of funds invested in or location of asset manager. This is in contrast to the analysis of UK assets under management, which covers assets managed in the UK regardless of domicile of funds or clients for whom firms manage money.

APPENDIX 6

SURVEY RESPONDENTS

Aberdeen Asset Management
 AB
 Aberforth Partners
 Artemis Fund Managers
 Aviva Investors
 AXA Investment Managers
 Baillie Gifford & Co
 Barings Asset Management
 BlackRock Investment Management
 Brewin Dolphin Holdings Ltd
 Canada Life Asset Management Ltd
 Carvetian Capital Management
 CCLA Investment Management
 Columbia Threadneedle Asset Management
 Edinburgh Partners
 EFG Asset Management
 FIL Investment Services
 Franklin Templeton Investment Management
 Guinness Asset Management
 Henderson Global Investors
 Hermes Fund Managers
 HSBC Global Asset Management
 Independent Franchise Partners
 Insight Investment
 Invesco Perpetual
 Investec Asset Management
 JO Hambro Capital Management
 JP Morgan Asset Management
 Jupiter Asset Management
 Kames Capital
 Lazard Asset Management
 Legal & General Investment Management
 Lindsell Train Ltd
 Liontrust Fund Partners
 M & G Securities
 Man Group plc
 Manulife Asset Management (Europe) Ltd
 Martin Currie Unit Trusts
 McInroy & Wood
 Miton Group
 Momentum Global Investment Management
 Morgan Stanley Investment Management
 Newton Investment Management
 Natixis
 Nomura Asset Management UK
 Odey Asset Management
 Old Mutual Fund Managers
 Pictet Asset Management
 PIMCO
 Pioneer Investment Management
 Premier Portfolio Managers
 Principal Global Investors
 Pyrford International
 Rathbone Unit Trust Management
 RBS CIF
 Royal London Asset Management
 Ruffer
 RWC Partners Ltd
 Santander Asset Management
 Sarasin & Partners LLP
 Scottish Friendly
 Schroder Investment Management
 Skagen
 Smith and Williamson
 Standard Life Investments
 State Street Global Advisors UK
 T Rowe Price International Ltd
 Troy Asset Management
 TwentyFour Asset Management
 UBS Global Asset Management Funds
 Vanguard
 Virgin Money Unit Trust Managers Ltd
 Wellington Management International
 Zurich

APPENDIX 7

FIRMS INTERVIEWED

Allianz Global Investors

Aviva Investors

Axa Investment Managers

Baillie Gifford & Co

BlackRock Investment Management

Carmignac Gestion

Columbia Threadneedle Investments

FIL Investment Services

Henderson Global Investors

HSBC Asset Management

Investec Asset Management

JP Morgan Asset Management

Jupiter Asset Management

Kames Capital

Legal & General Investment Management

Old Mutual

Premier Portfolio Managers Ltd

Schroder Investment Management

Vanguard Asset Management

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September 2017