

Investment Management Association



Asset Management in the UK 2009-2010

The IMA Annual Survey





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The IMA Annual Survey

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About the Survey

The survey focuses on asset management activity in the UK on behalf of domestic and overseas clients during 2009. The results are based on the questionnaire responses of 75 IMA member firms, covering the full range from global players to specialist boutiques. Between them, they manage £3.0trn in this country (90% of total assets managed by IMA members).

We also spoke to 24 senior practitioners from amongst our leading members, mainly at CEO level, between February and April 2010. We interviewed them in depth and their views are reproduced on an anonymous basis throughout the survey.

The survey is in five main chapters:

- 1 Overview of the UK Asset Management Industry**
- 2 Institutional Market**
- 3 UK Funds Market**
- 4 Regulation and Overall Business Environment**
- 5 Operational and Structural Issues**

A summary of the findings can be found in Appendix One. Questionnaire respondents are listed in Appendix Two and firms interviewed are listed in Appendix Three.

A number of general points should be noted:

- Unless otherwise specified, all references to 'Assets under Management in the UK' refer to assets under management by IMA members in the UK as at December 2009.
- Unless otherwise specified, the IMA survey and internal databases are the source of all data cited.
- Not all respondents have been able to provide information for all questions and not all questions have been answered on the same basis. Response rates have, therefore, differed across questions.
- The survey has been designed with comparability to the previous survey in mind. However, even where firms replied in both years, some may have responded to a question last year but not this year or vice versa. Where meaningful comparisons are possible, they have been made.

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

Foreword



Richard Saunders
Chief Executive

This year's IMA Asset Management Survey took place as the global financial crisis appeared to be steering into calmer waters. Nobody in the industry we spoke to thought it was over. And events in the eurozone subsequent to our interviews showed how right they were to be cautious.

The survey, the most comprehensive account of the UK investment management industry, looks at the period following the most severe phase of the credit crisis. Despite the economic difficulties, 2009 as a whole was a year of recovery for the UK investment management industry. Stock markets came back strongly from their lows in the first quarter of the year, although at the middle of 2010 the FTSE 100 index still stood only at its level 13 years previously. And a climate of low interest rates, economic uncertainty and a faltering housing market saw a resurgence of new investment by retail savers. Indeed retail inflows of £26 billion during 2009 were the largest in the industry's history. Even so, the industry's aggregate revenues were still less than in 2008, as capital markets failed to recapture their levels before the crisis.

How Investors have Responded to the Financial Crisis

We asked our interviewees how their retail and institutional clients had responded to the crisis in terms of their investment patterns.

Amongst institutional clients, once the initial shock at the turn of events had worn off, there has been a remarkably quick return to attitudes towards investment closer to those prevailing before the crisis.

The behaviour of UK retail investors through the crisis has been instructive. In stark contrast to the conventional wisdom that the retail investor buys at the top and sells at the bottom of the market, IMA's figures speak of an increasingly sophisticated UK retail investor. Almost immediately after the collapse of Lehman Brothers in September 2008, we saw strong inflows into UK funds. At first, many of these flows went into bond funds, suggesting that investors were seeking yield as interest rates fell, but from the middle of 2009, investors began to move into a wide range of funds, including equity, property and absolute return.

In the face of more than a decade of market uncertainty, there has been growing interest among investors in absolute return strategies. Since its launch in April 2008, the IMA's Absolute Return sector has consistently been one of the most popular with retail investors and was the second best selling in 2009.

2009 turned out to be a record year for fund flows, but one in marked contrast to the previous best year of 2000. Ten years ago, investors put their money largely into equities, but last year saw much more diversification across asset classes.

How the Investment Management Industry has Responded to the Financial Crisis

Overall the investment management industry seems to have weathered the financial crisis well. But that does not mean it wants or expects everything to return to the way it was. While there is a broad range of opinion on the detail, we found a widespread view among those we spoke to that there can be no return to the status quo as it existed before the crisis. This is seen in some of the ways in which the industry conducts itself. For example, our interviewees report a greater focus on questions of operational risk. While the industry regards itself as transparent and with strong internal controls, firms we spoke to highlighted risk management and the communication of risk to clients as areas where improvements could be made.

The industry also believes that wider reform – albeit proportionate and focused on those areas of greatest systemic risk – is needed. It was a widespread view among those we spoke to that the use of statutorily-insured bank deposits to fund own-account trading cannot be justified – as indeed we found the previous year. This is both as investors in the financial companies and from the point of view of their clients, for whom a stable capital market structure is an important prerequisite of investing. While some would go so far as full “Glass-Steagall” separation, the majority believe there are severe practical problems with such an approach and that a more subtle approach is required to bring about a clearer separation between the agency and principal activities of banks.

The UK as a Financial Centre

Another theme to feature strongly in our interviews is the competitive position of the UK in the global financial services industry. The emergence of London as a Premier League location in financial services has been a feature of the last 20 years. It is not going to go into reverse in a hurry. The members we spoke to are unanimously committed to London. But there are significantly more notes of caution sounded than in previous years.

Many firms in the UK have global operations and employ the best and the brightest from all over the world. A number of interviewees noted a rising trend in inquiries from individuals about relocation to lower tax regimes than the UK since the introduction of the 50% tax rate. We also heard concerns about attitudes to financial services and to workers from overseas. The numbers remain relatively low and in many cases are non-UK nationals with less attachment to the UK, but it is seen as a factor that might figure in due course in business location decisions. As a result, we detected more uncertainty that future business growth would focus on the UK than in the past.

Longer Term Trends

The survey also illustrates some longer term trends that have been apparent in the industry for some years. Investors have become steadily less domestic in their focus and the industry has followed suit. At the same time, the industry is increasingly emerging from its traditional home as the investment arm of banks and insurers, as a quite distinct sector of the financial services industry, with its own distinctive views.

1. The changing face of UK equity ownership

The last ten years have seen a reduction in the proportion of equities in pension fund portfolios to the benefit of other asset classes. This equity exposure has also become steadily more globally diversified, from an initially heavy bias towards UK equities, meaning that UK equities now account for less than 50% of overall equity portfolios.

Insurance assets have seen a similar shift out of UK equities. In addition, the assets of insurance funds represent a diminishing proportion of those managed by the industry overall. Five years ago, 30% of UK assets were managed for insurance companies, whereas now this is less than 23% of the total.

Overall we estimate that IMA members now account for about 40% of the share registers of UK companies. Pension funds and insurance companies each account for around 13%.

While the ownership of UK equities by UK institutional investors has been declining, the share of retail funds has been growing as the funds industry itself has expanded. We estimate that they now hold around 10% of UK equities, an increase by half over the 7% ten years ago. The UK funds sector as a whole has steadily grown from a specialist niche into a mainstream part of household savings, which comprised less than 5% of GDP in the early 1980s but is equivalent to more than 30% today.

The fact that UK investors now own a smaller proportion of UK companies has implications for the corporate engagement role that investment managers play in the governance of companies. There is concern amongst investment managers that there should not be unrealistic expectations about what they can achieve through engagement. The asset management industry does generally recognise that the engagement process needs to change and improve.

2. Other aspects of globalisation

As well as this globalisation in the ownership of UK equities, similar effects are found in other aspects of the investment management business. One example is the steady global reach of the industry's client base, where the number of asset management firms focusing mainly or wholly on the UK is diminishing.

Recent years have also seen a notable increase in global ownership of the industry. This year, the proportion of assets managed by firms whose ultimate ownership is outside the UK rose above 50% for the first time.

Within Europe, the UK asset management industry manages around 30% of total assets and nearly half of all the equities. The UK remains the largest and most diverse European asset management centre.

Although the UK has been a major beneficiary of globalisation of the investment management industry, one area where it has lost out is as a domicile for funds. Ten years ago, the total assets of Luxembourg and Dublin funds were just under twice those domiciled in the UK, but they are now four times as much.

Recent changes in UK tax rules, including the introduction of the Tax Elected Fund regime, the Property Authorised Investment Fund regime and the clarification for the investment status of authorised funds, are intended to arrest and if possible reverse this trend.

3. Changing shape of the investment management industry

For the first time, the majority of the UK industry in asset terms is owned independently of the retail and investment banks and life insurers. In the past, these institutions were the main distributors of investment products as well as owners of the vast majority of asset management functions. The acquisition of Barclays Global Investors by BlackRock Investment Management in 2009 had a considerable impact, but the longer term trend remains one of increasing independence.

Despite a number of mergers in the last year, however, the asset management industry remains remarkably unconcentrated in both the retail and institutional markets. The ten largest firms manage 54% of total assets. In the retail market, the top ten account for less than half of all assets, a situation which hasn't changed for many years.

Greater distance from distribution

As well as being less likely to be owned by distributors, investment managers in the UK are less likely to be dealing direct with retail investors. As distribution increasingly becomes intermediated by fund supermarkets and other platforms, so fund management firms act more like wholesalers than classical retail financial product providers. Both these trends are having the effect of distancing UK managers from distributors, and it is one which marks out the UK industry from those of other European countries – where many investment managers are owned by banks and other institutions on whom they rely heavily for distribution.

Component makers or solution providers?

A good number of firms, particularly among the smaller, more specialised houses, have embraced this changed role. They are happy to be ‘upstream’ producers of components that may be highly intermediated by the time they reach end consumers, particularly in the retail consumer market. The rise of platform-based distribution and of open architecture has been a key driver of change here.

Another view holds that in future, investment managers will become providers of ‘solutions’ (ie products which seek to meet specific liabilities or savings needs) as well as components. The institutional market is already seeing continued expansion of liability-driven investment (LDI) for defined benefit pension fund clients. Similarly, in the defined contribution (DC) pension market, investment managers offer more integrated products such as target date funds or strategies for the drawdown phase. Once the age 75 rule for annuity purchase in the UK is abolished, as proposed by the UK Government, we can expect the market for post accumulation pension products to develop further.

The ‘solutions’ business aims to ensure that the intellectual capital of the industry is employed in a way that helps the end client, whether retail or institutional. This approach starts to take the concept of asset management away from the increasing specialisation seen over the last decade. It also presents challenges, notably more responsibility for explicit outcomes for clients and a different competitive environment.

One tangible indicator of the growth of the ‘solutions’ approach is the increase in liability driven mandates from pension funds. We found this year that LDI mandates have grown over a third to some £175 billion, representing 18% of corporate pension fund assets.

A Very Different Industry

The picture which emerges from the IMA’s latest Asset Management Survey is of an industry very different from that of ten years ago. It is becoming more assertive as it takes a greater share of the long term retail savings market and seeks innovation in the institutional market. It is now overtly global in its outlook and its ambitions. It is very different from the banking sector, with which it is sometimes confused. Its distinctive business model, with its clear agency relationship with clients, has stood it in good stead during the crisis. The challenge for the asset management industry over the next decade will be to convert its renewed vigour and confidence into a leading voice in global financial services debates.



Richard Saunders

Chief Executive, Investment Management Association
July 2010

Key Data

£3.4trn

[£3trn in 2008]

Total assets managed in the UK by IMA firms as at December 2009

£503bn

[£500bn in 2008]

Of UK-managed funds domiciled offshore

£1.1trn

[£1trn in 2008]

Of assets managed on behalf of overseas clients

40%

[43% in 2008]

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

£481bn

[£362bn in 2008]

Managed in UK domiciled funds (OEICs and unit trusts)

£8.7bn

[£9.4bn in 2008]

Revenue earned by UK-based asset management firms in 2009

1. Overview of the UK Asset Management Industry

Key Findings

Overall size and location

- Assets managed in the UK by all IMA member firms totalled £3.4trn as at December 2009, a rise of 11% from 2008.
- Total assets under management rose much less sharply than UK investment funds under management, up 33% year-on-year to £481bn.
- Including a range of non-IMA firms, we estimate that total assets under management in the UK at close to £3.9trn.

Asset management activity

- IMA members run a full range of products out of the UK, including property and alternatives. Around 40% of respondents run hedge funds, but the alternatives industry is not strongly represented among the IMA membership.

International dimension

- Overseas clients (both institutional and retail) account for 31% of total assets under management. This proportion was unchanged year-on-year.
- Internationally, IMA member firms or groups of which they are a part managed a total of £17.3trn.
- UK-headquartered IMA firms managed £1.4trn in the UK as at December 2009, with a further £1.2trn managed internationally by these firms or groups of which they are a part. This is a marked fall year-on-year, but relates primarily to M&A activity.

- In asset management terms, the UK remains the largest centre in the EU (30% of total assets under management) but exchange rate movements have had an impact on comparisons. In the investment fund market, the UK is the fifth largest in domicile terms with a 9% market share.

Client type

- Institutional clients account for 77% of total assets under management. Retail and private clients account for 23%.
- The 'institutionalisation' of the fund management industry is transforming commercial relationships and seeing additional levels of intermediation. This is making it harder to capture the traditional retail/institutional split.

Overall asset allocation

- Of the £3.4trn under management by IMA firms, 46% was invested in equities, 35% in fixed income, 9% in cash/money market instruments and 5% in property. The remaining 5% is accounted for by a variety of alternative asset classes, currency overlay and structured products.
- Headline numbers show that UK equities accounted for 47% of total equity exposure. While little changed from 2008, this represented a fall to 40% as a proportion of total UK domestic market capitalisation.

1. Overview of the UK Asset Management Industry

Total Assets Under Management

Total assets under management in the UK were £3.4trn at the end of December 2009, up 11% from a year earlier. This was a return to the levels seen at the end of 2007.

The £3.4trn covers assets managed by IMA members in this country for both UK and overseas clients. It includes:

- All in-house and third party client assets.
- All segregated mandates.
- All pooled vehicles, including authorised unit trusts, open-ended investment companies (OEICs) and life funds.

Within the UK, we estimate that 13% of total assets (£445bn) are managed in Scotland, primarily in Edinburgh. Like their counterparts based in other parts of the UK, a number of Scottish asset management firms also have significant overseas operations.

Chart 1: Total assets under management in the UK and total UK-domiciled funds (2005 - 2009)

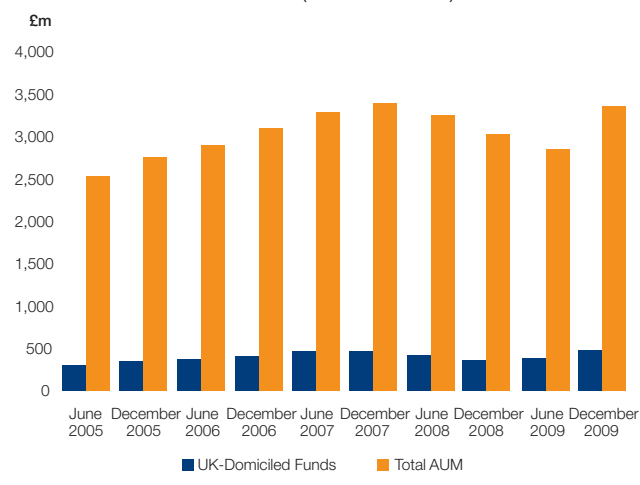


Chart 1 shows the progress of assets under management since June 2005. It includes one of the most important sub-components: the UK-domiciled investment funds (authorised unit trusts and OEICs) industry, which represents 14% of total assets under management.

As we explore further in Chapter Three, one particularly notable feature of 2009 was the strong recovery in UK-domiciled funds under management, rising by a third year-on-year to a record £481bn at the end of December 2009. This was partly a reflection of asset mix and market movements, but also results from significant inflows.

Wider Industry

IMA member firms operate across both the mainstream and alternative asset management spectrum. Chart 2 gives a profile of survey respondents:

- Almost all respondents manage equities, a substantial majority manage bonds and a substantial proportion (40%) run property mandates. A number of IMA firms have specialist cash management expertise as opposed to those who are holding cash within portfolios for operational or diversification reasons.
- Among alternatives, although private equity vehicles, commodity and infrastructure funds are not widespread, hedge funds are operated by 40% of all respondents. IMA members manage just under £30bn of hedge fund assets in the UK. Around 15% of respondents have more than £500m each of assets under management in hedge funds, a small increase from last year (12%).

Chart 2: Proportion of survey respondents managing different asset classes/products in the UK

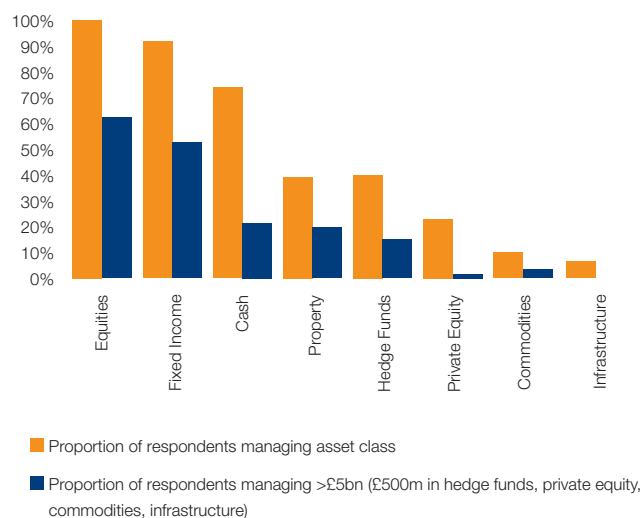


Figure 1: IMA member characteristics

IMA members fall into five general categories:

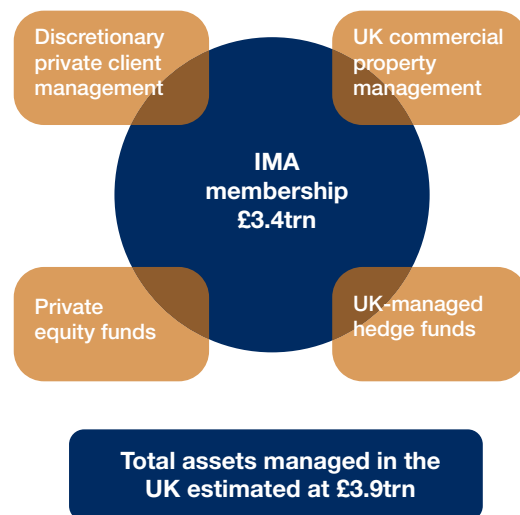
1. Asset management firms with a sizeable global footprint themselves, or which are part of firms with such a footprint. Such firms undertake a wide range of asset management activities across the institutional and retail market space and tend to have considerable overseas client money under management in the UK.
2. Large and medium-size firms, whose business is primarily UK/European-focused and which offer a diverse range of services.
3. Firms whose business is primarily based on investment funds.
4. Smaller asset management firms, which may be specialist boutiques or focused on the private client market.
5. Occupational Pension Scheme (OPS) managers running in-house asset management operations.

We estimate that IMA members account for around 85-90% of total assets managed in the UK, with the total being around £3.9trn. The main components not covered by this survey are a range of niche firms outside the IMA membership base, notably:

- Hedge funds.
- Private equity vehicles.
- Property funds.
- Discretionary private client managers.

As a proportion of total assets under management in the UK, hedge funds managed here remain a comparatively small part in asset terms (around £210bn in 2009), but significant in terms of export earnings and additional employment through around 400 firms based in this country.

Figure 2: Wider asset management industry

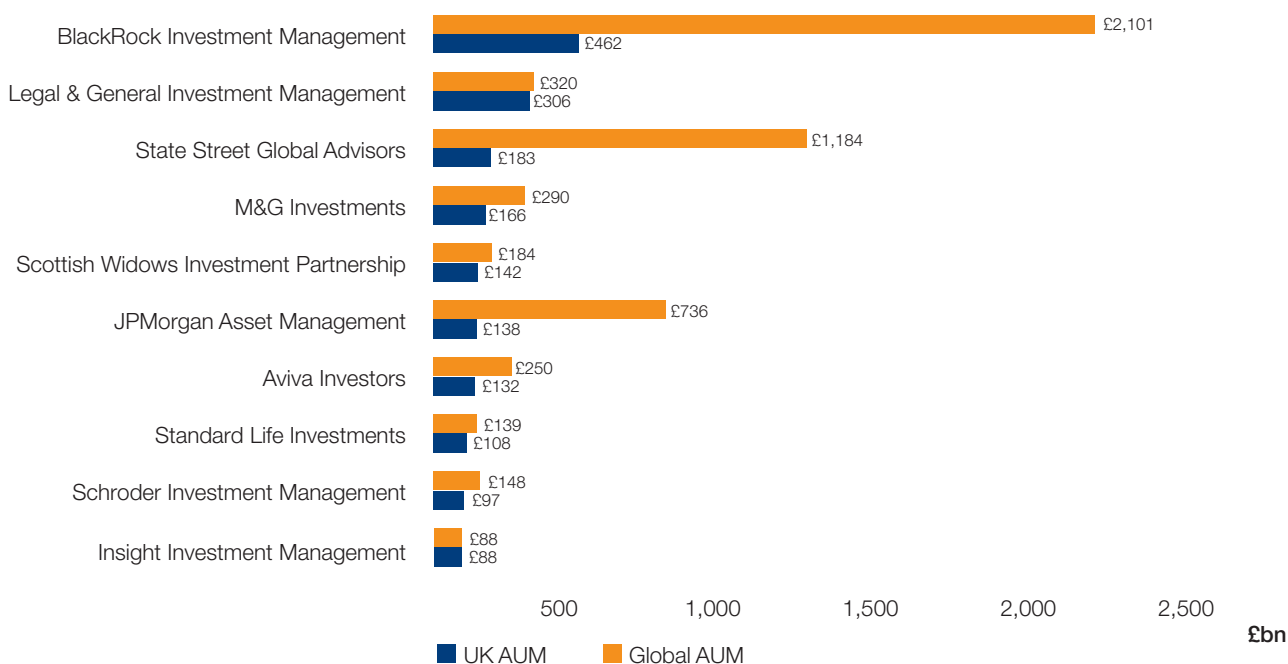


Looking at the largest firms (see Chart 3), clearly the major development since the last survey has been the merger of BlackRock and Barclays Global Investors. Although this has had a tangible impact upon the proportion of total assets managed by the top ten firms, the industry remains comparatively unconcentrated (see page 93).

The top ten is characterised by three key features:

- There is a marked contrast between a number of global players with very large overseas operations and those firms whose asset management activity is concentrated primarily in the UK.
- The three largest firms in the UK are distinguished by a significant beta capability through their indexing businesses, but their range of activities means that they should not be defined solely in these terms.
- While bank and insurance-owned managers are still prominent, we estimate that third party client business accounts for 75% of total UK assets under management.

Chart 3: Assets managed in the UK and globally – ten largest firms ranked by UK AUM (December 2009)

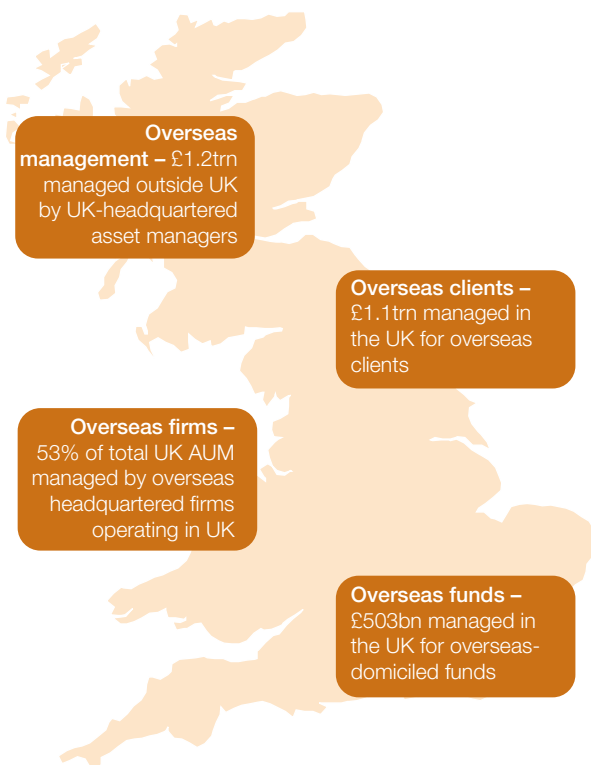


International Dimension

This survey captures asset management activity in the UK, regardless of the domicile of the client or the fund. The industry is extremely international and this can be seen in four main ways:

1. Overseas clients
2. Overseas-headquartered firms
3. Overseas domicile of funds
4. Overseas management of assets

Figure 3: International dimensions of the UK asset management industry

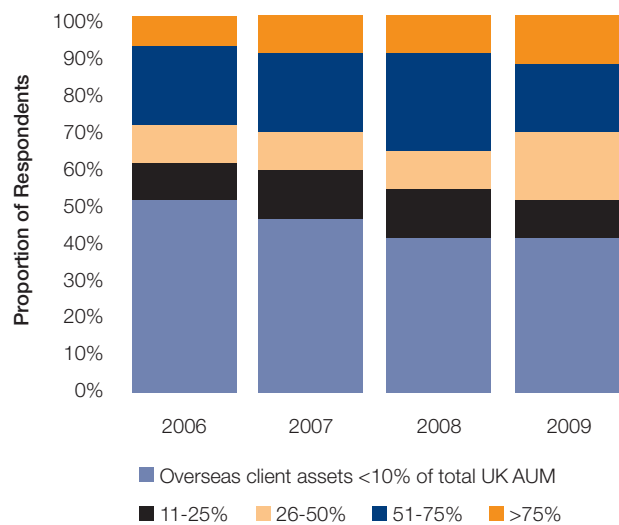


1. Overseas clients

The £3.4trn includes an estimated £1.1trn managed on behalf of overseas clients. This is 31% of total UK assets under management and has increased by around four percentage points since December 2006, although is unchanged year-on-year. We do not measure precisely the composition of the overseas client base, but it is highly diverse (for overall client analysis, see page 21).

International business appears to be a focus for an increasing number of firms. Looking at a consistent sample set, the proportion of survey respondents reporting that less than 10% of their client base (in UK assets under management terms) is overseas has fallen by around ten percentage points since 2006.

Chart 4: Overseas client assets as percentage of firm assets under management in the UK (2006 - 2009)



Asset managers based in the UK are tapping into four areas of opportunity, which have remained broadly unchanged over the past few years:

- Diminishing regulatory barriers and the success of UCITS as a European and global brand.
- A trend towards greater use of open architecture.
- An increasing variety of government asset pools.
- A gradual expansion in individual savings pools, particularly in Asia, where demographic and economic development trends point to substantial growth.

The speed at which these opportunities come to fruition, and the scale that they represent, varies substantially.

Looking at the continental European retail market, there were mixed views among those we spoke to about distribution opportunities and consumer outcomes in what has traditionally been a bancassurance-dominated structure:

- Some export-oriented firms are relatively positive about the evolution, seeing the trend towards open architecture as well-established and the direction of travel inevitable.
- Others are more cautious and some frustration was expressed about the pace of change and the characteristics of prevailing distribution networks. The perceived shift towards in-house products in banking groups at the height of the credit crisis served to focus attention onto characteristics that many IMA firms would like to change.

While a more open distribution structure is the desired end-game for a funds industry increasingly focused on manufacturing, other strategies are used by firms in seeking to extend their reach into Europe. These include white-labelling funds for established bancassurance networks and acquiring distribution capability in Europe.

The concern about European markets partly reflects the fact that while enormous potential exists in regions such as South-East Asia, that is a very long-term opportunity set compared to more immediate opportunities in Europe. This is true in both the retail and institutional marketplace, despite the gradual emergence of institutional business from Sovereign Wealth Funds (SWF), including social security and pension reserve funds. In terms of UK assets under management, SWF assets account for less than 2% of the total, albeit with significant year-on-year growth, which is expected to continue (see page 21).

Views on the European market

Some firms are satisfied with the direction of travel . . .

“ There are many in-house asset managers who will find themselves displaced by good quality third party provision, particularly as MiFID and other EU legislation forces the separation of distribution and manufacturing across European financial institutions. So, even if an institution is trying to feed its own in-house asset managers, it will be increasingly difficult to do that without a number of external options. Our aim is to ensure that we are the third party option of choice. ”

“ It's a bit like global warming. You can get a cold winter, but that doesn't negate the reality of climate change. The backdrop here is open architecture. That's just a fact – it has happened and will continue. But we had a cold winter, with banks in a panic about their liquidity and funding needs, and clients at the same time in a panic about safety. So they went into deposits. That's weather, not climate. You can't uninvent open architecture. It's just too obvious an answer from a consumer and regulatory standpoint. It's true that it hasn't fully happened, but the long-term trend is established. ”

Others remain frustrated . . .

“ I don't think we have seen any realistic progress in Europe for ten years. There are more third party funds being sold, but that does not necessarily make for progress. Until consumers have a more powerful voice, then the European market is going to remain problematic. There is case after case of consumers being sold low quality product where the asset management component is unlikely to deliver the scale of return to outweigh the fees and costs. ”

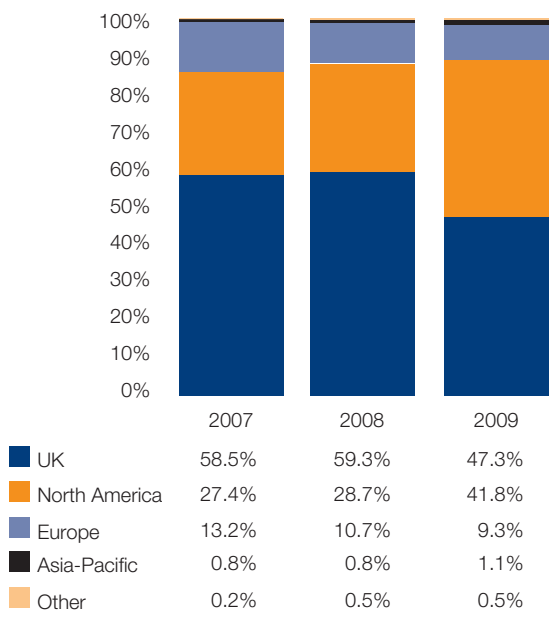


2. Overseas-headquartered firms

There are a number of overseas-headquartered firms with a sizeable global footprint operating in the UK. Chart 5 breaks down total assets under management in the UK by region of group (or parent group where relevant) headquarters and shows the evolution since 2007. This year sees some significant shifts as a result of several divestments by UK retail banks, primarily the BlackRock/BGI deal.

From accounting for almost 60% of total assets under management in 2008, UK-owned asset management firms now account for just 47%, which serves to underline the international nature of the industry. The direction of travel is not one way and the falling share of European parent groups in part reflects M&A activity by UK firms. As we discuss later, the greater significance of these changes is not in the geography of ownership but in their nature – ie the emergence of a larger body of independent asset management firms.

Chart 5: Assets under management in the UK by region of group headquarters (2007 - 2009)



3. Overseas domicile of funds

A considerable proportion of funds are domiciled overseas, with the asset management taking place in the UK. Data from the survey suggests that £503bn of assets (15% of total assets) are managed in the UK by IMA members for overseas-domiciled funds. This is broadly unchanged from last year. While asset movements would suggest a year-on-year increase, the estimate is complicated this year by operational change within the IMA membership, as a result both of M&A activity and other factors such as changes in asset management location.

Luxembourg and Dublin are key locations for overseas-domiciled assets. Responses to survey questions indicate that 80% of UK-managed overseas-domiciled fund assets are in Luxembourg and Dublin. Of the other 20%, 4% are in the Channel Islands with remaining funds in other locations such as the Cayman Islands.¹

In terms of the composition of overseas-domiciled funds, money market funds are the largest single component, accounting for around 35%.² Almost all institutional money market funds whose assets are managed in the UK are domiciled in Dublin and Luxembourg. Other overseas-domiciled vehicles comprise a range of institutional and retail products, including hedge funds and exchange-traded funds (ETFs).

¹ According to sources in Ireland (IFIA) and Luxembourg (CSSF), UK promoters account for 46% of total net asset value of Irish-registered investment funds (€345bn) and 12% of Luxembourg funds (€219bn), equating to €564bn (£499bn) at the end of December 2009. This gives a different distribution between location and implies a potentially greater proportion of overseas-domiciled assets than our numbers suggest. However, these local sources are likely to be picking up firms outside the IMA membership. There are also likely to be other promoters (notably US) managing assets in the UK for overseas domiciled vehicles.

² This is a much lower figure than last year's survey, but more accurately reflects IMA member UK management activity than earlier estimates. There are other firms outside the IMA membership base who manage institutional money market funds in London.

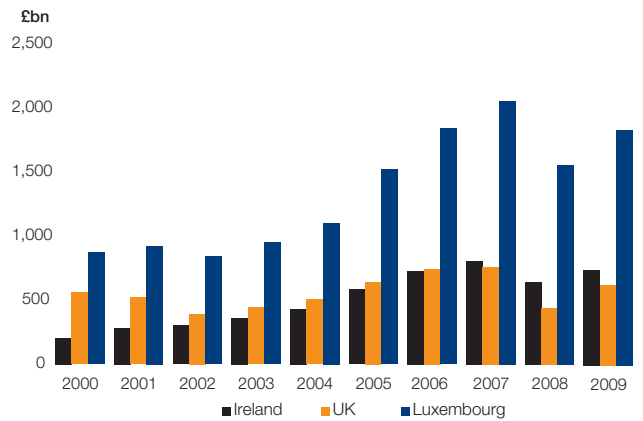
The £503bn would rise by a further £180bn for those hedge funds (the majority) not covered by IMA membership. There are also other fund types not fully covered by IMA members, including institutional money market funds. This would take overseas-domiciled fund assets managed in the UK closer to £700bn.

Overseas domiciled investment funds are promoted in Europe, Asia and other regions internationally. As yet, there is little sign of significant sales of overseas-domiciled funds into the UK retail market.

This is addressed further in Chapter Three of the survey (see page 60).

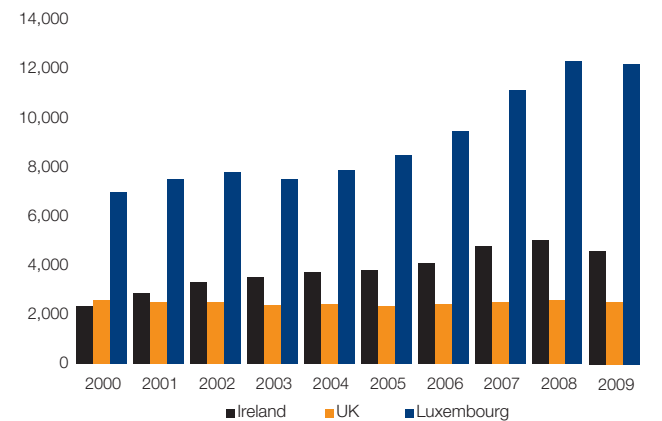
In terms of relative total assets and funds, it is clear that the UK continues to lose out as a fund domicile and administration centre (see Chart 6 and Chart 7). In making a historical comparison between the UK and eurozone fund centres, the data of the past decade shows very clearly the rise of other European fund domicile centres.

Chart 6: Total fund assets by domicile (2000 - 2009)



Source: EFAMA

Chart 7: Total number of funds by domicile (2000 - 2009)



Source: EFAMA/IMA

4. Overseas management of assets

Assets are managed outside the UK on behalf of both UK and international clients. While some firms centralise their asset management, many have the reverse philosophy (ie portfolio management and trading being located in the region of the asset rather than the client). The latter will either delegate formally or simply manage the assets directly in overseas offices in the relevant region: for example, regardless of client domicile, a firm might manage its UK and European equities out of the UK but run its US equities out of North America or its Asian equities out of Tokyo, Singapore or Hong Kong:

- UK-headquartered firms manage £1.4trn in the UK (from £1.8trn in 2008). Globally, they – or firms within their group – manage a further £1.2trn (£1.7trn in 2007).
- In total, we estimate that IMA members, or the groups of which they are a part, managed over £17.3trn globally at the end of December 2009 (from £16.7trn).

Year-on-year comparisons in both cases are affected by changes in the IMA membership base resulting from M&A activity.

Risks to international business

Firms we interviewed are in general optimistic about international opportunities over the medium to long term. However, while local regulatory/protectionist issues are anticipated to varying extents in different jurisdictions, several of those we spoke to pointed to risks arising from the credit crisis that could affect their ability to operate effectively internationally:

- The first is a greater focus by regulators on being able to obtain greater visibility over the manufacturing process, which could prove awkward for multi-jurisdiction operations (see also discussion on AIFMD, page 70).
- The second is a more general concern about the danger of a reversal in openness to global capital movements and trade, which would damage the industry's ability to operate effectively cross-border.

industryview

Fears about greater protectionism

“Nationalistic tendencies have increased and there has been a bit of jostling between jurisdictions. It goes wider than AIFMD and I don't know how we are going to put that back in the box. We manage money across a number of jurisdictions and there is now a greater sense that the local regulators need a chain of command that they can see with respect to activity taking place. Consequently, there's much less opportunity for a fluid investment management structure, which is somewhat disadvantageous to a firm like us. Where you run the money shouldn't matter and this puts sand in the gears of big, global operators.”

“I don't take anything for granted. The environment is more uncertain by the day and wider international changes – for example, any negative impact on globalisation – can have major consequences for what we do here.”

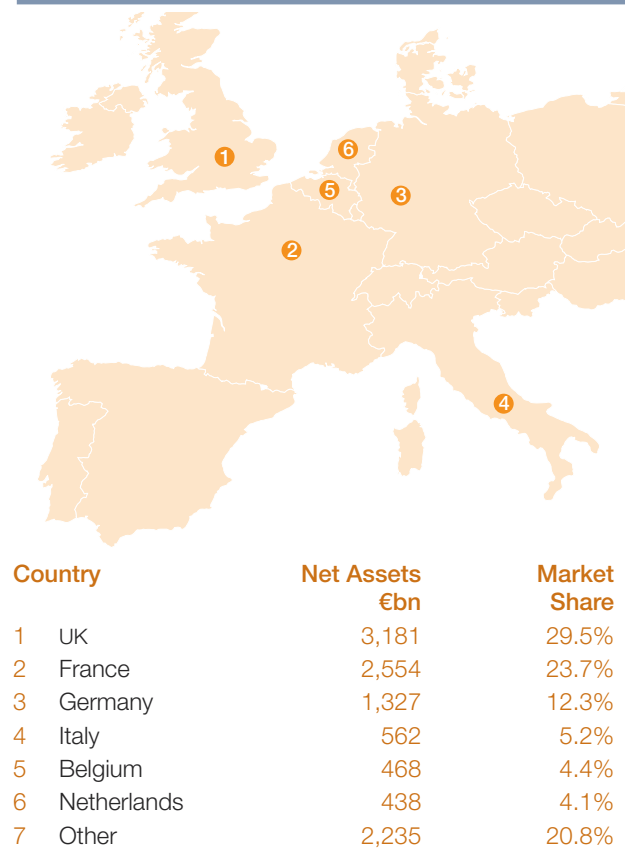
International Comparisons

Asset management

The UK continues to be the largest single asset management centre in Europe. As at December 2008 (the most recent year for which comparative data is available), the UK share of total European assets under management had fallen to 30%, from 34% in 2006-2007. Exchange rate effects are likely to be the major cause of this. During 2008, sterling fell heavily against the euro, losing almost a quarter of its value.

Accurate wider comparative data on a management location basis is not available, tending to be based on individual market sizes.

Figure 4: Assets under management in Europe (December 2008)



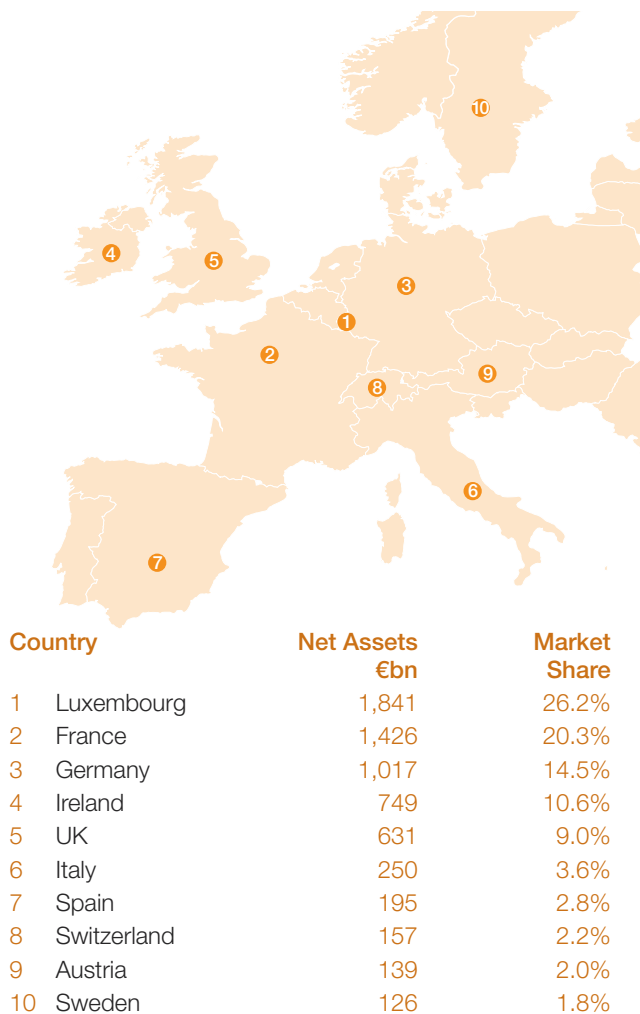
Source: EFAMA

Fund management

The combined net assets of the investment fund market in Europe (ie the market for UCITS and non-UCITS funds) stood at €7.0trn at the end of 2009, an increase of 16% year-on-year.³ The UK as a fund domicile accounts for just 9% of the total. Including overseas-domiciled funds whose assets are actually managed in the UK, that figure would almost double.

Overall internationally, the US is the largest market with a share of 44% of global fund assets, followed by Europe (including the UK) at 38%. The share of the UK as a fund domicile in the global market is similar to that of the UK's share of global GDP at around 3%.

Figure 5: European investment funds by country of domicile (December 2009)



Source: EFAMA

³ Data sourced from the European Fund and Asset Management Association (EFAMA)

Client Type

Chart 8 provides a general overview of assets managed in the UK by client type. This data includes both UK and overseas clients across all reporting categories:

- Institutional assets under management continue to account for just under 77% of the total, with the largest segments being corporate pension funds (28% of total assets under management) and insurance companies (23%). Local authority mandates (including overseas local government clients) are composed primarily of pension fund assets, taking the overall pension fund component closer to a third of total assets.
- After corporate pension fund and insurance mandates, retail (21%) continues to represent the third largest client type.⁴ The rise in retail assets relative to institutional (around two percentage points from last year's survey) is also seen in a matched sample. This may reflect both flows and asset mix, with UK retail investors more heavily invested in risk assets (see page 27).
- Private client money accounts for 1.5% of assets under management, but this category captures only those parts of the private client market visible to IMA members (ie where there are specific private client investment services). Overall private client investment (eg through authorised unit trusts or OEICs) is therefore much higher.
- Sovereign Wealth Funds (SWFs) account for a comparatively small overall proportion, but are slowly increasing in significance (accounting for 1.6% of total assets under management last year).

Chart 8: Assets managed in the UK - client type (2009)

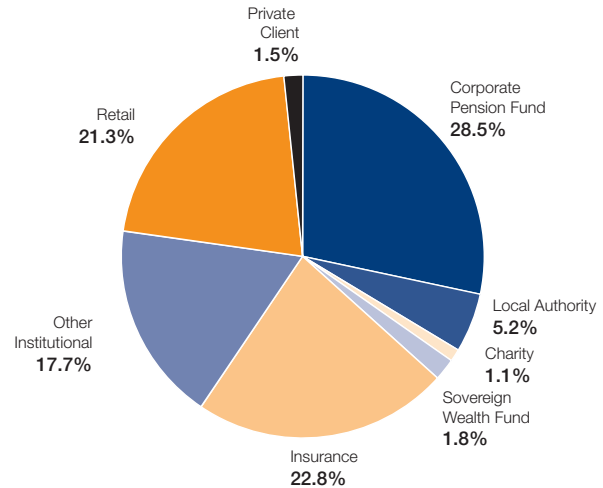


Chart 9 (overleaf) shows the split by client type since 2005 when the IMA started to collect the data in this specific format. These are headline numbers, so subject to some sample fluctuation. Nonetheless, they are highly representative of the industry and two features of the historic progression are quite striking:

1. Rise in the 'other institutional' category. The proportion accounted for by the 'other institutional' category has increased steadily in recent years. It contains a wide range of clients, which broadly fall into three main groups: corporate clients; government agencies (including central banks); and other parts of the financial services industry (including sub-advisory services to other fund management firms).

Its increase appears to reflect a number of factors. To some extent, there has been a broadening of the asset management industry's international client base beyond traditional institutional categories such as pension funds and insurance companies. Internationally, opportunities for third party asset managers are becoming ever more extensive.

There is also increasing use of pooled vehicles by institutional clients where it has not been possible to identify the ultimate client. Indeed, some money included in the 'other institutional' category may ultimately be retail, but unidentifiable behind an

⁴ The survey does not collect retail market data on the same basis as the IMA monthly statistics. It focuses on assets under management in the UK, regardless of where the fund or client is domiciled. In consequence, it picks up a wider range of retail funds, which will explain why the percentage share here is larger than implied by the IMA monthly data.

institutional mandate or holding from another asset manager or an asset gatherer. This reflects the way in which many firms see themselves as wholesalers both in the UK and overseas. It is part of the wider trend towards the blurring of the retail and institutional markets resulting from a range of developments – primarily open architecture on bank and insurance platforms, the emergence of new platform technologies and the growing popularity of funds of funds and manager of manager products (see also Funds of Funds section on page 56).

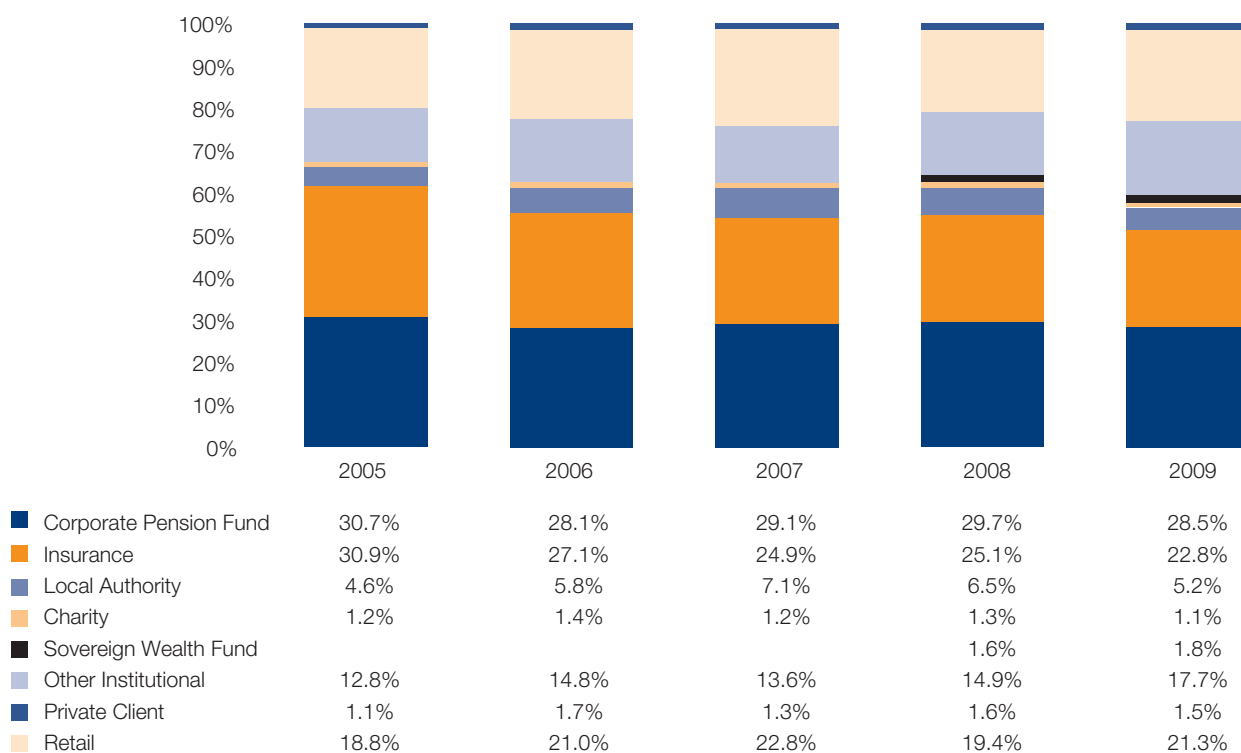
2. Fall in proportion of insurance assets. From just under 31% in 2005, the proportion of assets under management for insurance companies has fallen significantly over the past four years. These assets are primarily (80%) run for life insurance parent companies and include products such as life funds and annuities. Basing observations on stock rather than flow data (unavailable) makes it difficult to draw conclusions about the causes and nature of this change. The changing nature of distribution is likely to be one factor and it is clear that insurance-owned asset managers are also looking increasingly to third party business – both domestic and international – as a source of growth.

industryview

Changing nature of insurer-owned asset managers

“ The bar is rising and asset management is an increasingly competitive and winner-takes-all business, largely due to the changing nature of intermediation. There is an issue among insurance companies about what they are trying to do. They are often ambivalent. Do they have asset management to run in-house assets or do they want to make a third party business out of it? It’s difficult to create a model that stands somewhere in the middle. ”

Chart 9: Assets managed in the UK - client type (2005 - 2009)



An increasingly ‘institutional’ business

Over the past few years, we have outlined in the survey how the industry is becoming much more ‘institutional’ in the way in which firms structure their business relationships:

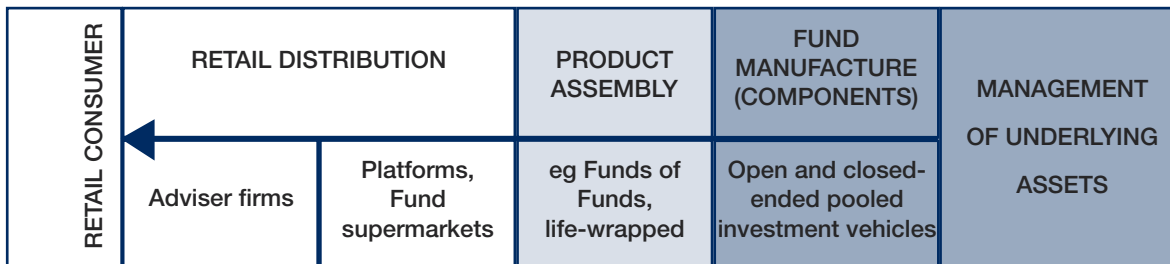
- The central driving force for this development has been the separation of manufacturing and distribution capability, which has seen the rise of platforms and fund supermarkets as a key form of intermediation structure.
- This rise of platforms has been facilitated by technological change, accompanied by a shift in the way in which vertically-integrated players in the long-term savings market operate. These players have also embraced the separation of manufacture and distribution through open (and guided) architecture, although this process is more advanced in the UK than in parts of continental Europe.
- At the same time, approaches such as consultant-designed target date funds, fund of funds and manager of managers products also insert a level of intermediation.

The result is an environment in which asset management firms are increasingly identified as the engine room of investment products, doing business with a wide variety of institutional or wholesale clients.

The effects are seen at a number of levels:

- Asset management firms feel increasingly distanced from their end retail clients, whose identity they may not even know as a result of wholesale relationships with platforms.
- Firms expect the velocity of fund holdings to continue to increase, with professional buyers responding rapidly to changes in performance. A move away from open architecture to more guided architecture may further accelerate this trend (see also page 83).
- In terms of the corporate structure of the industry, we discuss in Chapter Four how the industry is becoming defined increasingly by autonomous asset management houses. Even where firms remain formally part of larger financial groups, they are increasingly focused on third-party business. In some cases, insurance-owned firms are seeing in-house flows outstripped by new external business.

Figure 6: Greater distance between asset manager and end consumer

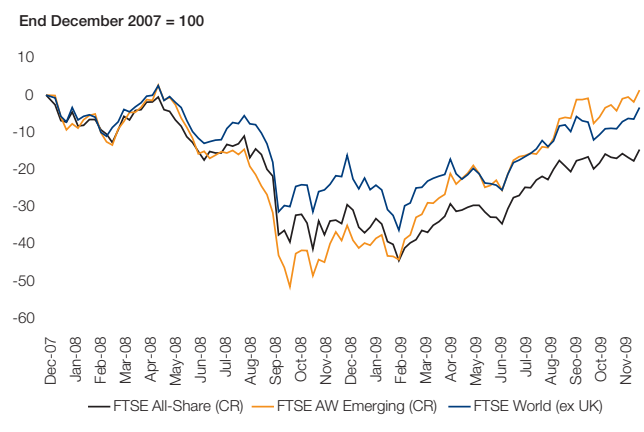


Assets and Markets

Despite the renewed market falls in the first quarter of 2009, the overall picture for the year improved considerably after an exceptionally volatile period through 2007-08:

- Over the course of 2009, the FTSE All-Share rose by a quarter, and recovered by over 50% from the lows of March 2009. In total return terms, the FTSE All-Share was up 30% (see Chart 10).
- International equity market indices also rose strongly, with particularly striking gains in emerging markets - the FTSE All World Emerging Markets index rose almost 60% over the year. However, sharp exchange rate movements have also been a feature and are having a significant impact on returns.
- In the fixed income markets, corporate bonds performed very strongly, with the IMA sterling corporate bond sector returning 14.3% over the year.

Chart 10: Equity market movements (December 2007 - December 2009)

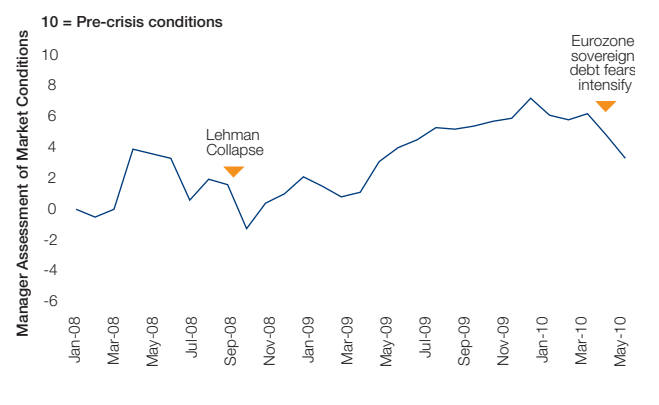


However, average stock market levels were still well down on those seen in 2008, which has a significant operational impact on firms. The average FTSE All-Share level was 15% below that seen in 2008 and 30% below 2007. Taking a longer perspective, it was still 20% lower than the average level seen ten years earlier.

As this survey went to press in the summer of 2010, there are mixed signals for the likely outcome for this year. Chart 11 shows data from an internal IMA survey of senior fund managers in the fixed income markets, mainly focused on sterling and euro corporate bonds. The survey started in early 2008, with managers asked to rank conditions on a scale up to ten, where this level represents pre-crisis market conditions.

Last year saw a steady recovery through the second half, although not returning to anything like a pre-crisis level. The movement since January 2010 has reversed this trend. Through the spring of 2010, liquidity provision has again dried up in credit markets. The sovereign credit crisis has caused the banks to unwind any risk on their balance sheets and consequently they are unwilling to facilitate transactions in the credit markets.

Chart 11: Asset manager assessment of general conditions in fixed income markets (January 2008 - May 2010)

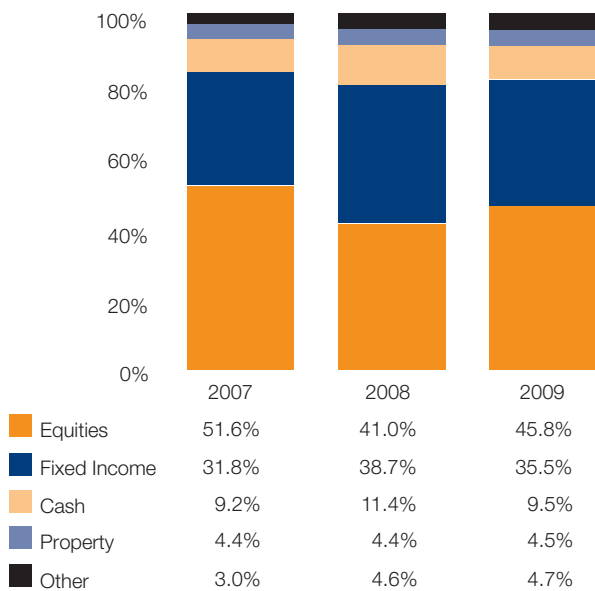


Overall assets under management in the UK

The overall mix of assets managed in the UK at the end of 2009 is shown in Chart 12, which also shows the progression from 2007:

- The changes from 2007-2008 were consistent with a shift out of equities towards fixed income, cash and LDI products (included in the 'Other' category).⁵ This appeared to result both from ongoing trends and a 'flight to safety response', reflected in the rise in cash holdings.⁶
- The 2008-2009 changes are less pronounced and more consistent with aggregate market movements than significant shifts in overall client asset allocations. However, as we discuss in the institutional analysis, there is evidence of ongoing change within individual client segments, notably corporate pension funds.

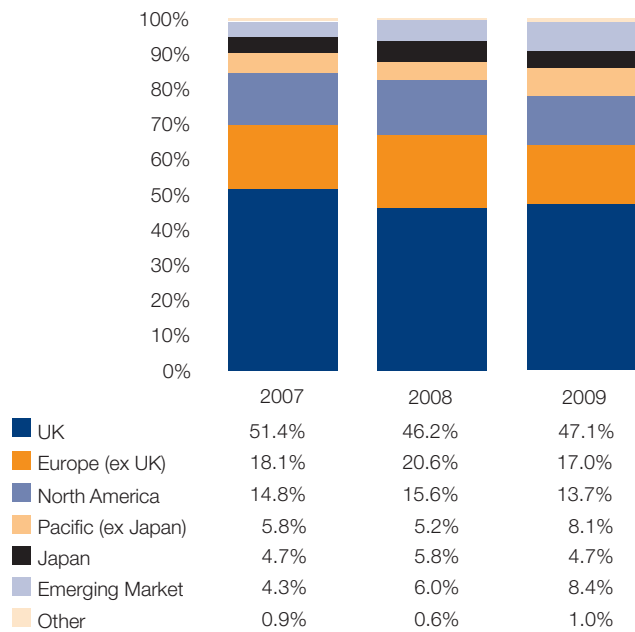
Chart 12: Assets managed in the UK - overall asset allocation (2007 - 2009)



The split by region is shown in Chart 13. It should be remembered that this reflects UK-managed assets, not UK client assets. Nonetheless, given that two-thirds of these assets are managed on behalf of UK clients, it does give some interesting indications of overall behaviour.

Most striking in recent years has been the decline within equity holdings of UK equities, as the erosion of home bias by institutions and retail investors has continued. Holdings are significantly smaller than two decades ago when UK pension funds and insurance companies accounted for a large proportion of UK equities (41% in 1999, compared to 26% in 2008).⁷

Chart 13: Assets managed in the UK - equity allocation by region (2007 - 2009)



While the proportion of UK equities relative to the overall basket of equities has not markedly changed year-on-year in 2009, this does translate into an ongoing fall in overall ownership of UK PLC. We estimate that IMA members now account for only just over 40% of UK domestic stock market capitalisation, equating to £725bn.⁸

⁵ Given that we are not recording new money flows, such observations are based on asset returns applied to matched samples from year to year. The findings must therefore be treated with considerable caution. It should also be remembered that this data contains both UK and overseas investors and is therefore not indicative of any individual geographically-defined client market.

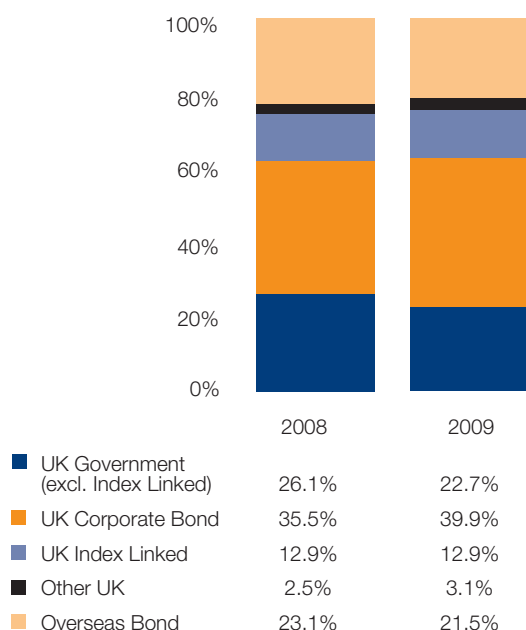
⁶ The cash category includes money market funds.

⁷ Source: Office for National Statistics, *Share Ownership Survey 2008*.

⁸ Last year we estimated this figure at 43% (£575bn).

In terms of fixed income, the overall allocation is illustrated in Chart 14. As one would expect, the majority is sterling investment, with government and index-linked accounting for just under 36% of the total.⁹ Taking into account fixed income returns, the increase in corporate bond holdings seems to reflect asset allocation changes as well as market movement. As we discuss in Chapter Three, retail investors were particularly active in this area in 2009.

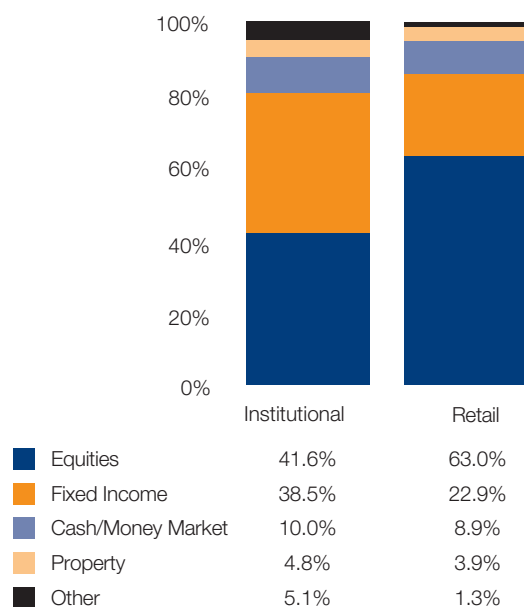
Chart 14: Assets managed in the UK - fixed income allocation by type and region (2008 - 2009)¹⁰



Retail vs institutional

We discuss detailed institutional asset allocation in the following chapter, but the contrast between retail and institutional assets under management is illustrated in Chart 15. The retail data included here includes both domestic and international clients and is to be distinguished from the UK investment fund universe examined in Chapter Three.¹¹ Nonetheless, this substantially reflects UK retail investor tendencies.

Chart 15: Assets managed in the UK - retail vs institutional clients (2009)



One of the observations often made about the UK retail market has been the high exposure of investors to equities. This is certainly true at a fund level, but retail investors will also hold other assets, eg property (usually their home or second homes), cash and direct stocks and securities.

⁹ With large insurance-owned asset managers strongly represented in the respondent sample, the implied gilt (incl. index-linked) holdings may somewhat over-state the true position. It is unlikely that UK managers account for over 80% of the total. The actual figure may be closer to 60%.

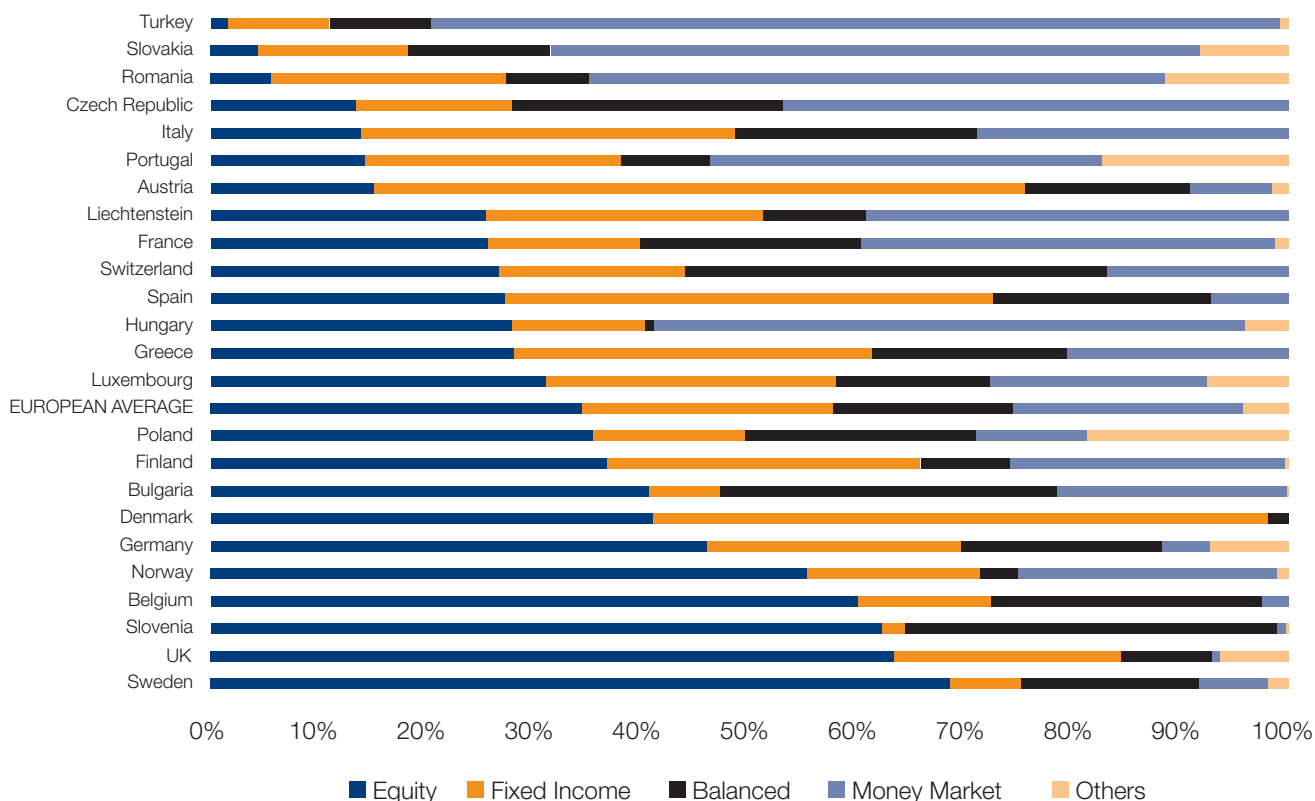
¹⁰ Earlier data is not available due to a change in reporting.

¹¹ The IMA survey splits data by client type (see Appendix One). IMA investment fund data is collected separately and on a different basis.

They will also often have separate pension provision, eg membership of an occupational defined benefit scheme. Overall retail portfolios are therefore likely to look very different to that suggested by fund holdings.

As a proxy for comparisons of retail investment across Europe, Chart 16 illustrates the asset mix of UCITS funds for those countries able to provide such a breakdown. The average equity weighting across Europe is about one-third and is much lower than that of the UK which has one of the highest.

Chart 16: Asset mix in UCITS funds - European countries (2009)



Source: EFAMA

2. Institutional Market

Key Findings

Client type

- Of total institutional assets under management (£2.6trn), the largest segments remain corporate pension funds (37%) and insurance companies (30%). Sovereign Wealth Fund money accounts for 2% of total institutional assets under management by IMA firms in the UK.
- Within the insurance component, there is still little overall change in the proportion of mandates accounted for by third party asset management firms (just under a fifth), although the longer-term trend is still seen as moving in this direction by those we interviewed.

Asset allocation

- Equities now account for 42% of total institutional assets under management and fixed income for 38%. However, the overall balance between equities and bonds in institutional portfolios does not appear to be shifting substantially.
- One area of notable change is in the 'other' category in the asset allocation breakdowns where there is a marked increase in structuring activities associated with LDI. LDI mandates continue to increase substantially – 15% of total pension fund assets (18% of total corporate pension fund assets managed in the UK).

Separation of alpha and beta

- There is a clear increase in institutional assets managed passively in the UK. On a revised methodology, this takes the total to 24%, an increase of four percentage points year-on-year.
- At the active end of the spectrum, clients are expected to reflect further on how to manage their high alpha exposure, particularly given problems in the absolute return environment.

Specialisation...still little sign of balanced resurgence

- Headline responses indicate that third party specialist mandates account for 90% of total institutional assets managed in the UK (excluding in-house corporate pension fund assets).
- Despite a number of firms suggesting that new balanced or diversified growth approaches were likely to increase in popularity, the aggregate picture is not tending in this direction. However, the headline specialist numbers also contain LDI mandates, and therefore give only a partial picture of what is happening.

Segregated mandates and pooled funds

- The survey data suggests that in terms of total third party institutional business, the proportion of assets in segregated funds is 61% compared to 39% in pooled funds. This reverses a shift towards segregated vehicles last year, but data from 2007 and 2008 suggests little overall change.

2. Institutional Market

More Normal Times?

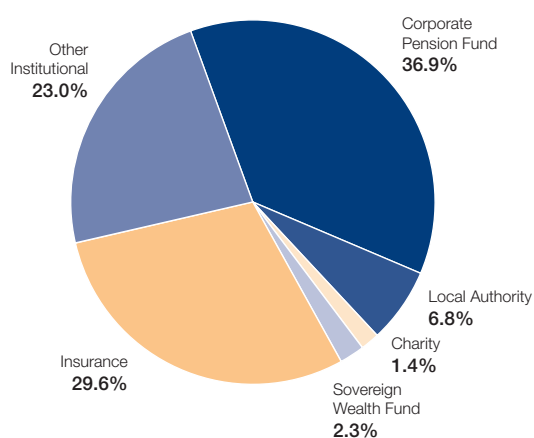
The last survey described a sense of “frozen intentions” that characterised the behaviour of many institutional clients in the face of the extreme market movements during the second half of 2008. Several managers this year also described additional derisking by international clients during the worst period of equity market turbulence of 2008-2009, some of it perceived to be driven by regulatory requirements.

However, the broad message is that some degree of normality began to return to the institutional marketplace in 2009, with a number of pre-existing themes apparent, notably:

- A significant institutional focus on liabilities.
- An ongoing move out of equities by occupational pension schemes.
- A continued erosion of home bias in remaining equity holdings.
- A greater interest in absolute/total return strategies.

For some of those we spoke to, it was almost a surprise how quickly confidence had returned among clients, albeit with a number of residual concerns about the broader outlook.

Chart 17: Client type - institutional assets (2009)



industryview

Greater elements of normality

“ Around the first quarter of last year, the institutional sector was totally frozen. Equity markets were so low and people were thinking that they couldn’t change strategy at that time. But since then, institutional search activity has risen materially. There is no major shift in institutional behaviour. ”

“ The evolution on the institutional side was complete paralysis, followed by a fleeting interest in more traditional investment ideas and then a quick return to how things were. The wheel has turned remarkably fast. ”

But some frustration over certain behaviours . . .

“ For pension funds and insurance clients, we have seen a significant derisking of portfolios, very often at the instigation of regulators across Europe. It is the traditional mistake of forcing institutional investors to derisk at the lows of the market. ”

“ It’s very frustrating. We had several institutional clients that sold out of equity positions within weeks of the bottom of the market and then a few months later came back. We’re a strong house, but it’s extremely challenging to do a good job for clients in such circumstances. ”

The aggregate data on institutional equity holdings during 2009 is broadly in line with market movements and there is little to suggest that the overall picture has significantly changed. However, this aggregate position disguises many different decisions among client groups. A more granular picture of institutional asset allocation by client is shown in Chart 18.¹² There is a marked contrast between the investment behaviour of local authorities (primarily pension funds and the majority UK-based) and that of corporate pension funds, where derisking has significantly affected equity holdings over the past decade. As one would expect given the product set within insurance companies, there is a much heavier fixed income weighting within the in-house insurance client group than any other institutional category.

Chart 18: Asset allocation – UK-managed institutional assets (2007 - 2009)

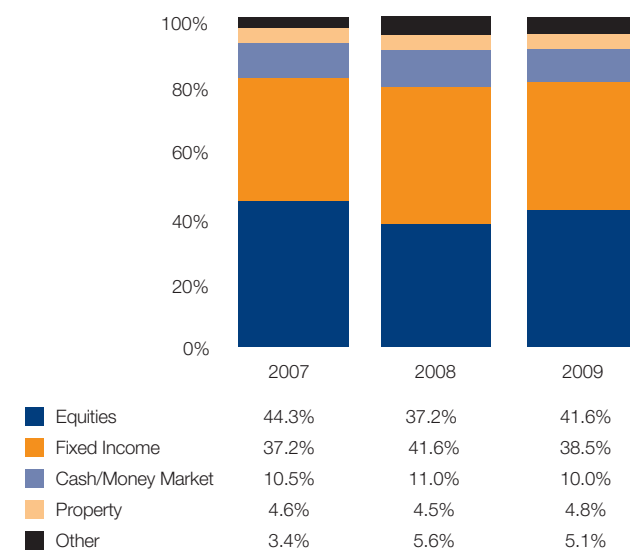
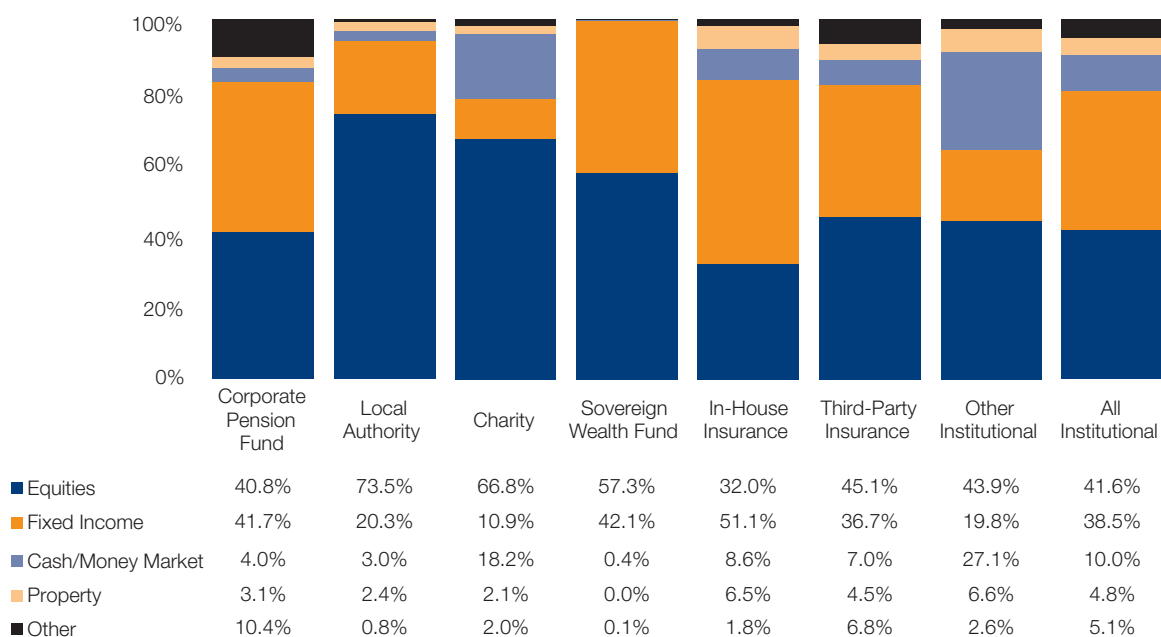


Chart 19: Institutional asset allocation by client type (2009)



¹² Several groups have restated figures for 2008 which has complicated the year-on-year comparisons in parts of the institutional analysis. With respect to asset allocation by client type, this year's dataset on charity and local authority clients appears to offer results more consistent with the 2007 survey.

1. Pension fund behaviour

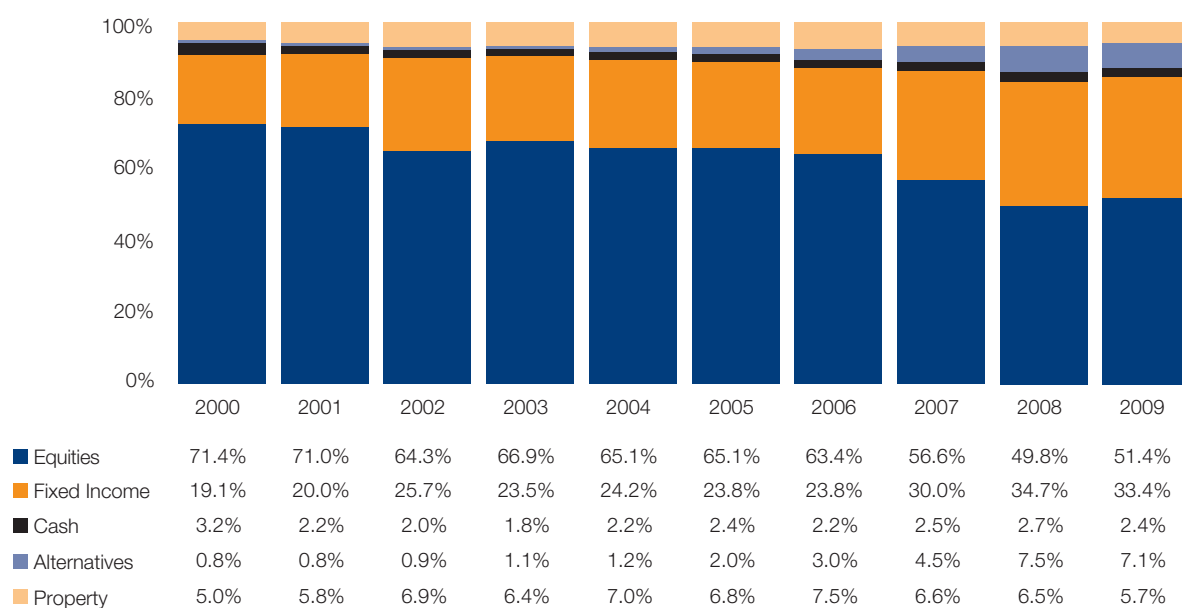
The trend among UK pension funds in recent years has been to scale back both equity exposure overall and UK equity exposure in particular. UK equities have increasingly been seen as a specialist area rather than a core holding and the use of global equity mandates is becoming increasingly widespread.

The IMA survey captures both UK and overseas pension fund assets managed in the UK and does not capture UK client money managed overseas. Therefore, our asset allocation figures cannot be taken as a firm indication of the specific behaviour of UK pension funds (or other UK institutional) clients.

Looking solely at UK pension funds, WM Performance Services estimates that funds saw their holding change from 49.8% equities in 2008 to 51.4% in 2009 (see Chart 20). Within this, UK equity mandates rose slightly from 20.7% to 22.0% (see chart 21). With equity markets rising significantly during 2009, an increase would be expected, but the WM data suggests ongoing disinvestment from equities.

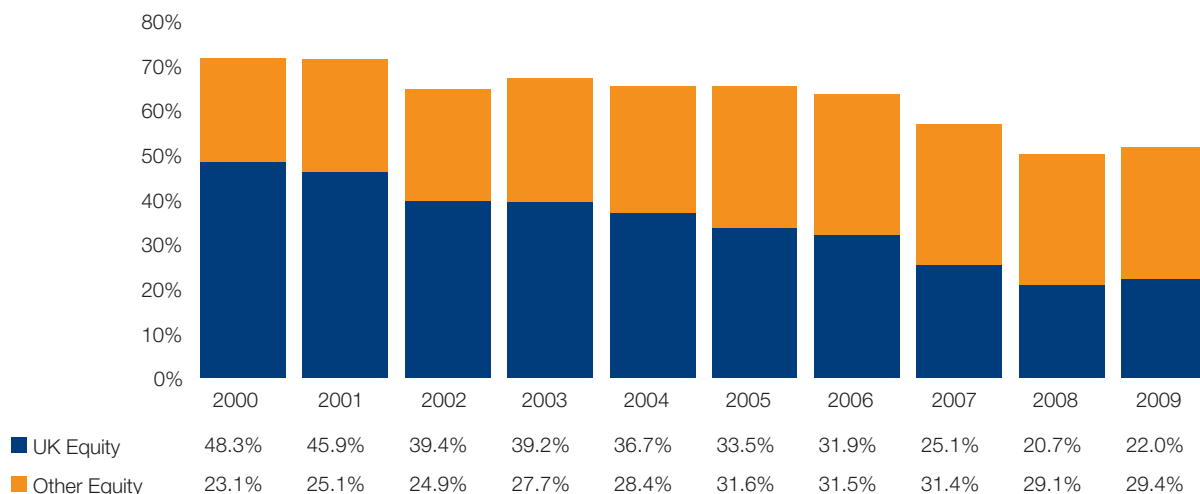


Chart 20: UK pension fund asset allocation (2000 - 2009)



Source: WM Performance Services: UK Pension Funds Annual Review 2009

Chart 21: UK pension fund equity asset allocation (2000 - 2009)



Source: WM Performance Services: UK Pension Funds Annual Review 2009

As we discuss further below, corporate pension funds both in the UK and overseas, notably the Netherlands, continue to move towards LDI strategies. Responses from the IMA survey questionnaire suggest that 15% of total pension fund assets managed in the UK are subject to an LDI mandate, up from 12% last year and 8% in 2007. The rate of growth is therefore considerable. Expressed solely in terms of corporate funds, where LDI business is overwhelmingly concentrated, the figure is much more striking at 18% (from 14% a year earlier). This is equivalent to around £175bn.

2. Moves into alternatives

With the IMA membership only partially capturing exposure to alternatives, it is difficult to draw conclusions about year-on-year changes in this area. There is a wide range of smaller firms not covered by this survey, particularly hedge funds and private equity firms. IMA survey data continues to show that private equity (unchanged from 0.5% last year), commodities (0.1% from 0.3%) and infrastructure funds (unchanged at 0.1%) remain a comparatively small proportion of total institutional assets under management in the UK. Hedge funds, which we do not count in the survey as an alternative asset class in and of themselves, account for 1% of total assets under management by IMA members.

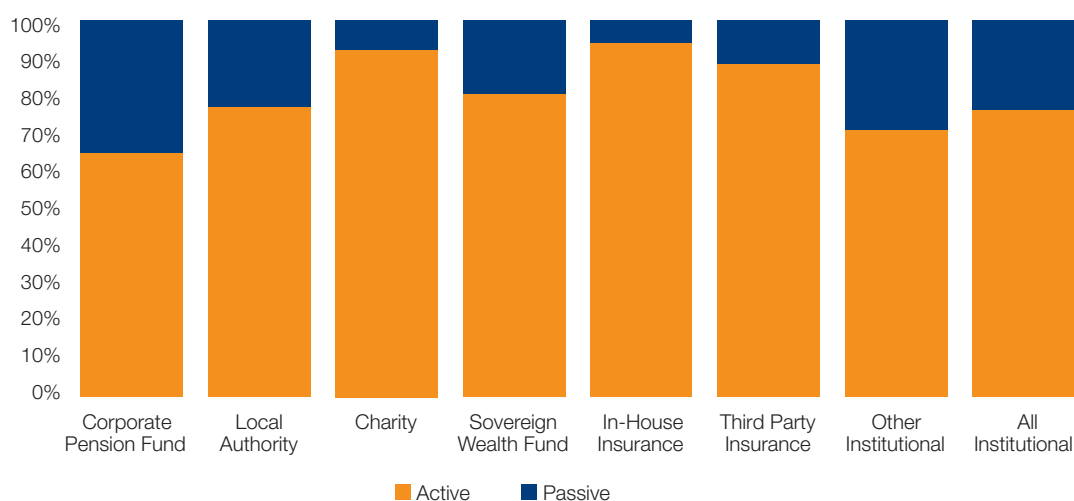
3. Separation of alpha and beta

The separation between alpha (value-added by active management) and beta (market return) has become an established part of the asset management landscape. One striking recent trend has been the increasing variety of vehicles and available asset classes, resulting from the significant growth of the ETF market. Estimates from a report by BlackRock suggest that the global total assets under management in ETFs have nearly doubled since 2006, from \$566bn to \$1,032bn by the end of 2009. However, total assets in UK-listed ETFs remain relatively small at £29bn.¹³ The base of ETF providers overlaps with the IMA membership, but only very partially.

Within the IMA headline institutional data set, there is a clear year-on-year change in assets managed passively with an increase to 24% of total institutional assets under management in the UK by the end of 2009.¹⁴ It is not clear whether this is primarily the result of relative asset price movements or actual client decisions to move from active into passive.

In terms of market dynamics, the largest three firms continue to account for over 90% of third party passive assets under management in the UK that we have been able to identify.

Chart 22: Use of passive and active management (institutional assets)



As in previous surveys, use of passive management is most widespread within the pension fund environment – both corporate and local authority (see Chart 22). Within the corporate pension fund landscape, passive mandates account for 35% of total assets managed in

the UK. Again, it is important to note that this is both a UK and international client base (defined benefit and defined contribution) and should not be taken as a direct indication of behaviour among UK pension fund clients.

¹³ Blackrock, ETF Landscape Industry Preview, December 2009.

¹⁴ Defined as non-discretionary stock and securities selection (excluding enhanced index products). While last year's headline number was 23%, we have revised our methodology. Calculated on a similar basis, total institutional assets in the UK managed passively were closer to 20% in December 2008, which implies a four percentage point year-on-year increase.

The substantial use of passive mandates in the pension fund environment stands in strong contrast to other parts of the institutional client base, particularly the insurance components which are primarily actively managed.

In the active space, specialist alpha based on a proven ability to outperform significantly and more innovative use of that alpha are likely to remain key features. In recent years, this has translated into:

- Demand for high alpha products relative to index benchmark.
- Increasing demand for index unconstrained strategies, for example, based on a 'best ideas' approach.
- Increasing demand for absolute return strategies.

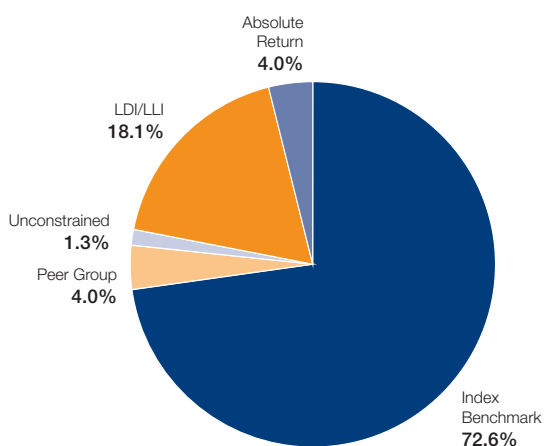
Unconstrained and absolute return strategies still account for a comparatively small proportion of institutional assets under management in the UK. Looking specifically at pension fund mandates (the largest institutional client group), the two approaches together account for less than 5% of total assets under management according to survey responses.

4. Specialisation...still little sign of balanced resurgence

In previous surveys, we have tracked the move towards specialist mandates, which has contributed to the growing fragmentation of the institutional market, creating a range of opportunities as well as adjustment challenges for asset managers. One feature of this change is that a number of retail-focused firms are finding greater interest in products that would in the past have been seen as predominantly retail oriented. At the same time, players from outside the traditional 'long only' industry have also found opportunities to win business.

There have also been strong suggestions in recent years that there would be an increase in 'new balanced' or diversified growth business, particularly in the context of liability driven investment, but also in the context of greater general interest in absolute or total return products.

Chart 23: Corporate pension fund investment objectives



The new balanced approach can differ from the 'traditional' balanced mandate in several key respects:

- **Benchmark.** In new balanced mandates, the portfolio is likely to be run against a cash or inflation benchmark.
- **Portfolio composition.** While balanced mandates would previously have been focused on a limited number of conventional asset classes, there is a greater tendency to include a wider spread of asset classes, including alternatives.

While a number of firms do appear to be winning more new balanced mandates, we continue to see little evidence of a move back towards balanced in the aggregate data. Survey responses indicate that specialist mandates account for 79% of total institutional assets managed in the UK (see Chart 24), with the figure rising to 90% for all third party business.¹⁵ Last year's headline result for total specialist mandates was 71% but matched samples suggest a shift of much smaller magnitude (around 2 percentage points) than the seven point change implied.

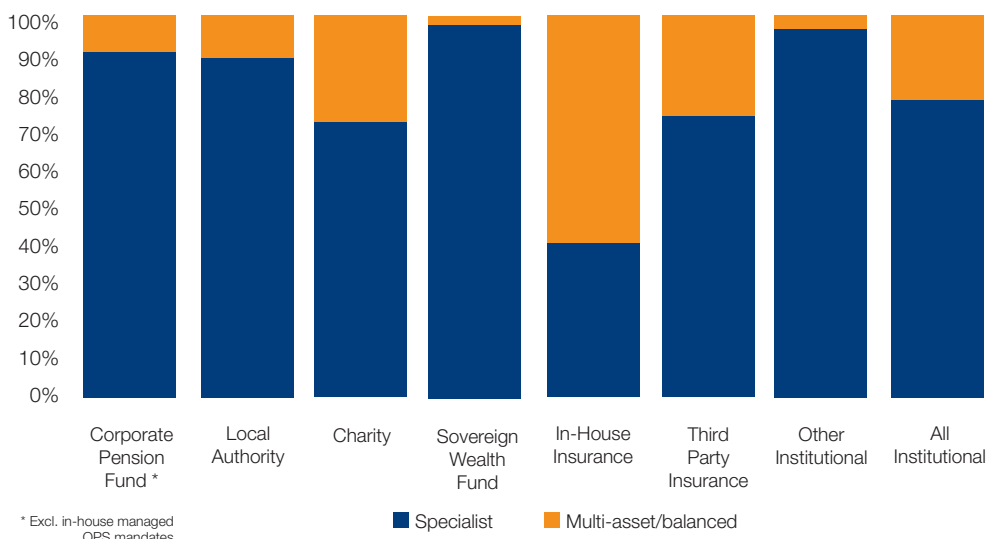
There is a significant caveat about this apparent move towards further specialisation. A number of firms see LDI as a specialist product. A straightforward split between specialist and multi-asset may therefore be decreasingly useful as a measure of the trend towards or away from greater component specialisation, where suppliers are chosen for their ability to perform against an investment measure (eg an emerging market equities index), as opposed to being given a more tailored liability target.

industryview

Back to multi-asset portfolios?

“ We think we need to run multi-asset portfolios. We are going back to where we were several decades ago. Instead of moving towards specialisation, you'd have been better looking for different balanced managers. All this has done is to add costs and complexity for the trustees. We are developing a product that swings between asset classes as you used to do. If there's a view that equities are going down, then we will act on that. The asset management industry can add tremendous value here. Stock picking is important, but asset allocation can be far more significant.”

Chart 24: Use of specialist and multi-asset/balanced mandates (institutional assets)



¹⁵ A restatement of client data has led to a significant reclassification, so direct comparison with last year's published figures should be undertaken with caution.

5. Segregated mandates and pooled funds

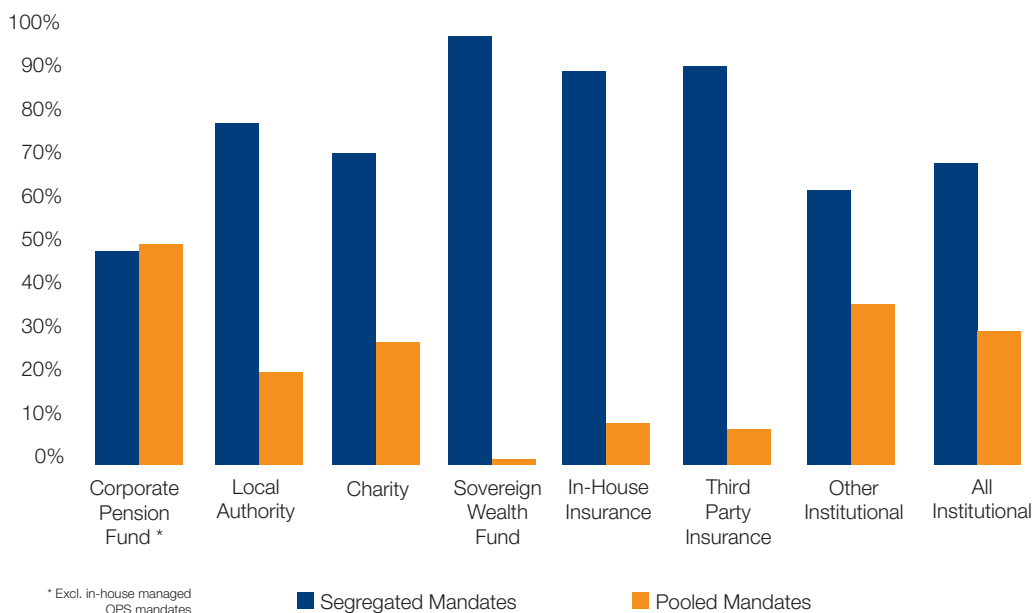
The survey headline data suggests that in terms of total third party institutional business (ie excluding in-house assets and those run by OPS firms), the proportion of assets in segregated funds is 62% compared to 38% in pooled funds, a shift back towards segregated mandates over the year. However, matched samples over the last three surveys suggest no clear direction of travel, with the overall split remaining around 60% segregated to 40% pooled.

In terms of the scale of different management operations, the survey continues to illustrate the dominance of larger players in the pooled institutional market. Of 52 firms managing pooled third party funds of £572bn, nine manage more than £10bn each and account for 83% of the total.

Looking at client type of segregated and pooled third party business identified in the survey, corporate pension funds have a particular tendency towards the use of pooled funds (see Chart 25). This largely reflects the presence of very large pooled indexing vehicles. While some of this money will be from DC occupational schemes (which will partly explain the contrast with local authority mandates), the overall stock of assets under management for defined benefit schemes dwarfs DC assets and will continue to do so for quite some time yet.

It is also striking that the sovereign wealth fund investment is overwhelmingly segregated. It may reflect the fact that with many SWFs having an in-house investment team, this client group may be looking to outsource very specific mandates direct to third-party managers.

Chart 25: Segregated and pooled third party institutional business by client type



Outlook for the Institutional Market

1. Consequences of the credit crisis

Those we interviewed pointed to a degree of normality returning to the investment behaviour of institutional clients. However, the interaction between clients and asset management firms was perceived to be changing.

i. Awareness of risks. In line with comments made last year, many firms reported greater interest among clients in the various dimensions of risk. The interest is moving well beyond investment risk into areas such as operational process and counterparty risk.

This is not just a question of due diligence on the part of clients. Firms are also continuing to make greater efforts to communicate better with clients both about the nature of the risks that different investment decisions entail and the wider process of asset management. This involves both a widening of the scope of communication and an examination of how best to ensure that documentation is easily accessible and understandable.

industryview

Greater focus on analysis and communication of risk

“Focus on risk has clearly intensified. It's a recognition that apparently sophisticated approaches like VAR or tracking error can give you a false sense of protection. You need to have a more multi-dimensional view. It doesn't stop at investment risk. You have to spend more time on operational risk, credit risk and counterparty risk. We also need to spend time educating our clients about the risks we take on their behalf and ensuring that they fully appreciate what they have signed up for.”

“We are much more demanding of our investment managers to ensure that clients fully understand the risks they are taking on. We are educating clients much more on the risk and rewards.”

“We've noticed a major increase in the operational due diligence process. It's really the post-Madoff, post-Lehman story. Previously, it would have been focused on the investment side. Your ops guys now have to be much better. Clients didn't necessarily understand where their money was. Now, there is much more focus on understanding the lines of defence and how an asset management company works.”

“Everybody is doing a better job at managing risk. We learnt things during the crisis and we have changed. Our discussions on securities lending have also changed. Everything was always there, but the questions are harder and the scrutiny higher now than it has been in the past. And it will never go back – you don't roll things like this back. It's a different environment.”

2

ii. Flight to safety in larger firms? Many of the medium and large-sized firms we spoke to emphasised that they were seeing a flight to safety response among institutional clients. This manifested itself in a desire to gravitate towards players with perceived balance sheet safety or the security of a parent company that had balance sheet safety. It is not clear how temporary such a reaction might be, with mixed views about how the boutique end of the industry is likely to fare over the next few years.

industryview

Perception that larger firms may be a safer choice

“Clients are prepared to consider new players, but these players are not boutiques, which have found the environment difficult. They are more ready than they used to be to go along with large players with a safe background. I am not saying that there will be no boutiques going forward, but they have to prove more in terms of their ability to comply with all the regulations and risk management than before.”

“For the first time, I had people telling us that we had won mandates because we were owned by an insurance company, which was interesting. A lot of institutions around the world are much heavier on the governance and the due diligence, particularly post-Madoff. There has been a general tracking to larger firms.”

Such observations about movement towards larger firms were not universally shared by those we spoke to. They are also difficult to measure using the IMA dataset, given that the boutique end of the wider investment management industry only partially overlaps with IMA members.

We have identified boutiques within our members, using a definition based on a range of variables:

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

On this basis, there were 21 firms meeting the criteria in both June 2008 and June 2009 (four joined and four left over this period).¹⁶ Looking at these members as a group, two of whom are now the object of acquisitions, total assets under management fell by 5% (compared to a fall of 12% for the wider IMA population). The reasons for this change are varied, including manager departure, and the experience was very uneven, as Chart 26 shows. The overall picture therefore is more one of effervescence than decline, and new firms are entering the market as others are leaving either through wind-up or acquisition.

Chart 26: Percentage change in UK-managed assets across 21 IMA boutique members (June 2008 - June 2009)



¹⁶ Although the survey is based primarily on a detailed questionnaire using December 2009 data, an internal IMA dataset provides the headline UK assets under management figure for all members every June.

2. Solutions vs components: a new bifurcation?

In the IMA surveys of 2006-2008, we suggested that the limitations of the component-driven, specialised approach were increasingly apparent to a number of players within the industry. We have also reported that a number of asset managers were looking to play a role in helping their ultimate clients achieve their investment goals, particularly in the pension fund environment.

Based on a range of evidence from both survey returns and interviews undertaken, we believe that there are growing signs of a bifurcation between firms with broad asset class capabilities focusing resources on investment ‘solutions’ and those who are primarily in the component manufacture space.

The ‘solutions’ approach is one that can be quite broadly defined, but the common thread in the comments of senior proponents within the industry is the need to be less driven by investment goals such as out-performing standard benchmark returns and more focused specifically on client investment objectives. We would emphasise three areas:

- i. **DB pension scheme liability matching.** DB schemes in the UK and elsewhere have faced significant and mounting challenges. While the central problem is increasing life expectancy, other factors such as low interest rates, local regulation and tax changes have also played a part. The consequence for many UK schemes has been closure to new members, or even to new accruals, and a greater emphasis on investment solutions that can better match individual scheme liability profiles. This has seen the rise of LDI strategies and is also now extending into fiduciary management. Both LDI and fiduciary management are established features in the Dutch pension market, which is served by a number of asset management firms operating in the UK.

As we reported earlier in this chapter, survey responses suggest that 15% of total UK-managed pension fund assets are subject to an LDI mandate. Looking solely at corporate fund assets, this figure rises to 18% equivalent to around £175bn.

It should be stressed that these findings include international pension fund clients, notably Dutch pension funds, and are not a reflection of the extent of penetration in the UK DB market, where LDI has grown comparatively slowly. Nonetheless, research has shown that LDI uptake continues to be strong in both the UK and particularly the Netherlands.¹⁷ One of the difficulties of measuring LDI in mandate terms is that many firms may run components of LDI strategies, but not necessarily classify these mandates as such. There are also firms outside the IMA universe – notably investment banks – operating in this space. Therefore, the true level of LDI as a proportion of total assets will be higher.

industryview

Move to outcome-driven products

“Clients now want things that deliver to an objective. The industry has failed in producing products that are truly outcome based. What it’s done is to say, ‘Well, we’ll tailor a little bit.’ However, people are increasingly talking to us about delivering a certain outcome. With the tailoring we provide, I would see what we deliver having greater utility for clients. How it plays out within the industry is very difficult to predict.”

¹⁷ See, for example, SEI 3rd Annual LDI Global Quick Poll, November 2009.

ii. **DC strategies.** DC provision is still at a comparatively early stage in the UK and Europe and likely to evolve considerably in the coming years as millions more savers are exposed to DC vehicles of one form or another. Given the widespread reluctance of individuals to make active investment decisions (or at least to depart from the default options), the design of default offerings will be critical. While traditional (automated) lifestyling has been the most prevalent approach to adjusting the risk and reward profile as savers approach retirement, there are signs of very different approaches to the DC accumulation phase starting to emerge in the UK:

- Already widely used in the US, target date funds are expected to become more commonplace. Target date sees asset allocation decisions executed at fund level and more dynamic approaches to investment opportunities and risk management may be used than seen in traditional lifestyling. While the performance of some US target date funds has been questioned a number of asset managers we have spoken to believe that the structure (eliminating the need continually to adjust an individual retirement portfolio at fund unit level) and investment flexibility (asset managers have greater control over strategic and tactical asset allocation) offers a promising foundation for DC products.

- Some providers are looking at alternative approaches that seek to manage volatility more actively throughout the accumulation phase of the retirement savings process, for example through diversified growth funds.

iii. **Broader risk mitigation strategies.** The more outcome-oriented approaches seen in both DB and DC pensions are also likely to be used elsewhere. Investors with a wide variety of goals may be attracted to funds that target a specific outcome, for example, an absolute or total return product. As we noted last year (and explore in the funds chapter on page 55), absolute return products proved extremely popular during 2008

and this continued during 2009. One can of course argue that a fund based on a cash or inflation benchmark is not a solution as much as a specific form of component. The point here, however, is that for a number of firms the growth of these approaches is part of a broader philosophical commitment to focus more explicitly on the investment needs of the end client.

Asset management intellectual capital in a complex marketplace

In competitive terms, this is partly about ownership of the intellectual capital that drives investment decision-making and product design in the pensions and long-term savings industry, and the associated commercial risks/rewards. This takes asset management firms back into areas, such as asset allocation, which lie at the heart of the provision of long-term client value. It also demands the development of new, more sophisticated approaches to address complex liability structures among institutional clients.

The 'solution providers' among asset management firms are entering a challenging environment, and one which will continue to be characterised by highly heterogeneous investment structures and involving a wide range of different players. Indeed, some individual asset management firms are likely to be acting in a number of capacities, both solution and component-driven, and competing in some circumstances with those who are also distributors of their products:

- i. **DB distribution landscape.** As we have been reporting for some time, there are a number of players – consultants, asset managers and investment banks – operating on similar territory, although not necessarily subject to comparable regulatory structures. Both consultants (through implemented consulting) and asset managers (through LDI and now fiduciary management) have encroached into areas that the other might regard as their own domain.

What has changed significantly this year is that fiduciary management does seem to be gaining some traction in the UK, although the IMA survey itself has not yet measured UK mandates specifically. Previously, those we had interviewed had expressed scepticism that what was essentially a Dutch model would be able to develop any roots in the UK. Now, firms report being invited to bid for fiduciary mandates with an expectation of further business ahead.

For investment managers who do not have distribution capability, either in-house (the overwhelming majority) or through a parent group, DC represents a potentially significant long-term opportunity both in the UK and internationally. With default funds expected to attract 80% or more of the flows, the key consideration will be either to become the default fund (for example, through a target date or other form of tailored approach) or a component of the default fund. In either event, relationships with consultants, platform providers and other forms of investment gatekeeper will be key.

What is fiduciary management?

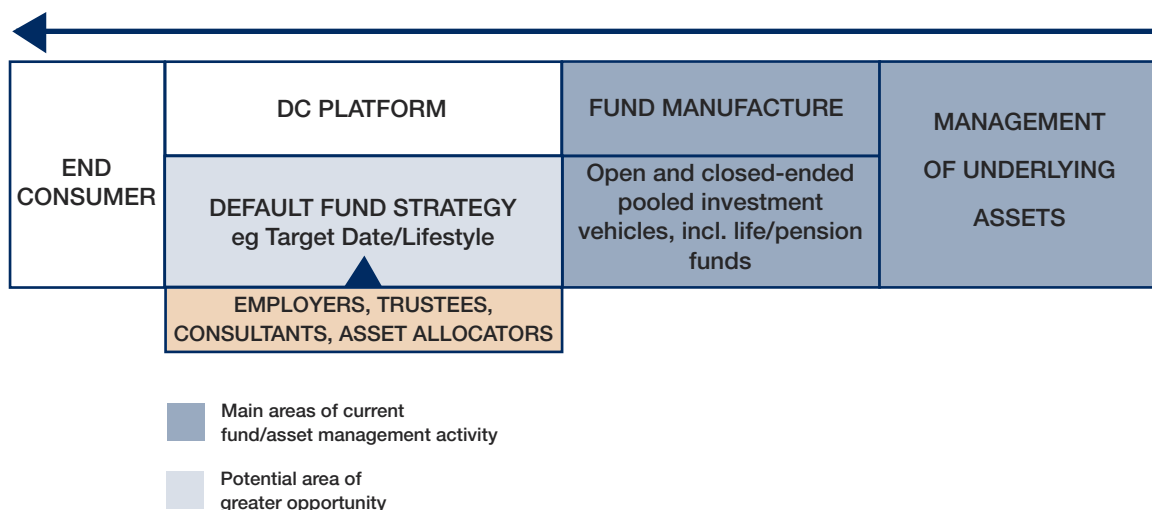
Definitions vary, but the common thread is outsourcing by pension fund trustees of aspects of investment decision-making. For asset managers, a fiduciary mandate means taking on key investment responsibilities, notably strategic asset allocation, risk budgeting, risk and performance management and external manager selection. This should not be confused with broader fiduciary responsibilities to act in client interests that are part of the asset management business model.

ii. **DC distribution landscape.** DC, by its nature, has a different set of liability structures related to an individual's own requirements. While a small minority of IMA members offer bundled DC contract-based products, the majority access the DC market via third-party platforms.

In both the DB and DC environments, those who wish to be a leading part in the 'investment solution' and those who see themselves simply as a component supplier appear comfortable with their respective positions, subject to the operation of an appropriately regulated, competitive market. Indeed, as some of the comments in interviews reflected, there is a risk and reward trade-off associated with the solution business that some firms appear not prepared to make, even if they have the investment capability.

More generally, it appears for now that the highly intermediated nature of the market for asset management services, combined with the specific needs of institutional clients, will continue to support a broad-based industry in which boutiques and larger component suppliers can flourish.

Figure 7: Potential opportunities in the DC pensions environment



The changing nature of asset management services

DB schemes

industryview

Greater focus on liability needs and a different set of relationships with clients and consultants

“ We try to build a long-term strategic partnership with the consultant. You are always going to need an advisor to help the institutional client with the form of their liabilities. However, rather than just being asked to pitch for a specific benchmark, we try to interact and understand the nature of the problem the client is facing and will bring our skills to bear. It needs a much more sophisticated partnership going forward.”

“ What we're saying to clients is tear up strategic allocation and think about scenarios – for example, what the world is going to look like in an inflationary or deflationary environment. Our modelling suggests that if you get a large jump in inflation, you would need to rethink your LDI arrangements so that you can realise the benefits of rising discount rates. I don't think this takes away the role of the consultant. These are big topics and you would want independent advice to spot the snake oil proposition from the real thing.”

Fiduciary approach starting to appear in the UK...

“ We've seen more signs of fiduciary mandates, but it's not for everybody. The largest funds are not going to do it because they have the embedded infrastructure around them. But the medium-sized funds may well be attracted. It's happening firstly because of a recognition that the demands being placed on trustees today may make it unrealistic for them to carry on with the current approaches. Second, asset allocation is really important. A huge amount of time is spent deciding which UK large cap equity manager to use. Getting it wrong will cost you far less than the wrong decision about whether you should be in bonds or stocks. With fiduciary, you have somebody looking at that all the time. It's a focus on that point. The markets are changing very rapidly. You need somebody at the helm.”

“ The fiduciary approach is starting to happen in the UK. I don't know how far it will go, but I think it ultimately means a change in attitude towards investment consultants. This is what has happened in the Netherlands - fiduciary management has disintermediated the consultants.”

DC schemes

industryview

Expectations of greater interest in DC solutions

“The nirvana for us in this environment is to sell whole portfolio products. If you make individual components, people will trade them on an asset allocation basis. The challenge for the manufacturing industry is to offer coherent portfolio products like lifestyle and target date products that offer an entire investment programme, and where there is not someone constantly adding and removing funds. And the way to do that is to have a coherent product, but to think about decumulation and how that links to annuitisation or drawdown.”

“The industry needs to produce more sophisticated target date solutions. It needs to work more on real-world, outcome-based strategies rather than trying to arm wrestle other managers in the relative return game.”

But caution in some quarters...

“Solutions are a dangerous business. You can have a client coming to you in 15 years time, with a product that hasn't delivered the level of pension they wanted. As an industry, we have to be very careful not to promise an outcome that might not be delivered. We're not a litigious society here in the UK, but you could find more legal challenges going forward as a result of perceived misallocation of assets. I don't know what the answer is, but we resist the idea of being in the solutions business. The word implies that you have solved somebody's problem. It's a lot more straightforward to say: 'Here are our products, this is what we do.' For asset managers like us, there's an opportunity that comes as a result of more open architecture and a reduction in the hold of insurance companies over the pensions market.”

2

3. UK Funds Market

Key Findings

Total funds under management

- Total investment funds – including both UK and overseas domiciled funds – managed in the UK are estimated at just under £1trn.
- UK domiciled funds totalled £481bn at December 2009, a 33% rise year-on-year.

Sales trends

- Total net sales (retail and institutional) of UK domiciled funds showed an inflow of £29.5bn compared to outflows of £2.1bn in 2008.
- This was the largest ever recorded inflow in our data, and was driven primarily by retail investors who invested £25.8bn during 2009.
- After strong net retail sales in 2008, corporate bond funds and absolute return funds were once again the best sellers of 2009.
- The data and comments from interviews suggest resilience and a gradual recovery in risk appetite from retail investors, who moved first into corporate bonds and then back into equities as 2009 progressed.

Asset mix in investment funds

- Equities account for the largest proportion of assets under management at 61% with bonds at 20%. Property funds represented just over 2% of total funds under management in investment funds.
- Despite a strong move into corporate bonds during the first half of 2009 as part of a search for yield, investors did not rush to sell equity fund holdings and recovered their risk appetite during the second half of the year.

UK industry concentration and structure

- The overall number of fund operators has fallen substantially over the last decade and continues to fall. While the market share of the top ten firms has increased to 46% during this period, it has been relatively stable over the past few years and the funds industry as a whole remains unconcentrated.
- The total number of funds fell by 3% compared to the end of 2008. At the same time, retail sales data shows that the proportion of firms recording positive net sales rose during 2009, reaching 63% in 2008. This was a major change, reversing the upward trend seen over the past six years. It suggests that market conditions would have to significantly worsen again before substantial consolidation takes place in the retail funds market.

European comparisons

- Inflows into UK-domiciled funds appear high compared to the wider European experience, with money market funds in particular seeing high redemptions on the Continent.
- The comparative asset class mix once again illustrates the difference across European markets. The UK has a much higher equity allocation (63%) compared to the average (34%).

3. UK Funds Market

This part of the survey covers UK-domiciled authorised unit trusts and open-ended investment companies (OEICs). These funds are thought of primarily as retail vehicles. However, institutional investors such as pension funds and insurance companies may invest in them and a small number of authorised funds are purely institutional vehicles. As we outline in Chapter One, changes in distribution structure resulting in greater intermediation also mean that it is harder to identify retail end-clients.

The analysis in this section is based on internal IMA funds data, which is both more detailed and has a longer history than the IMA Asset Management Survey questionnaire (which started in 2002). Most importantly, it captures flows data on a monthly basis.

As at December 2009, there were a total of 2,524 UK-domiciled funds (from 2,600 in December 2008) classified in the IMA universe. The IMA collected data on 2,411 of these funds.

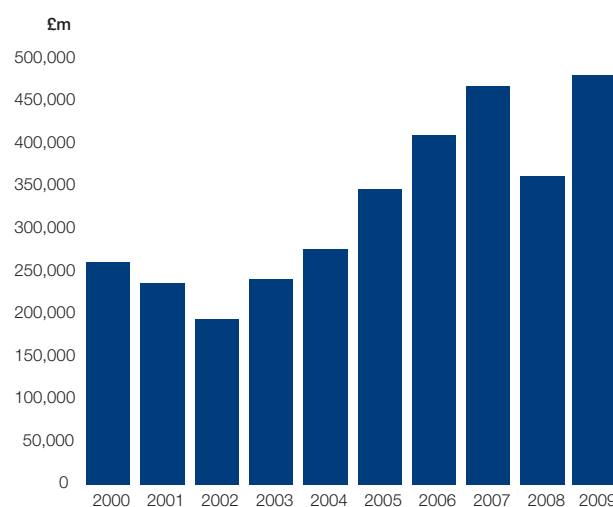
Total Funds Under Management

Total funds under management at the end of December 2009 were £480.6bn, an increase of 33% from a year earlier. This was the highest recorded year-end figure and just short of breaking the October 2007 peak in industry funds under management. Including overseas-domiciled funds managed in the UK (£503bn), total investment funds managed in this country are almost £1trn.

The annual rise in UK-domiciled funds under management was due to a combination of record net investment flows into the industry and robust market returns. With a strong equity component, market movements were responsible for 75% of the increase in annual funds under management, while new money accounted for the remaining 25%.

As Chart 27 shows, the industry has grown in nominal asset terms by nearly 75% over the last five years and by 90% since the end of 1999. During the past decade, despite the economic dislocation of the dot.com crash and the credit crisis, the compound growth rate is just under 7% in nominal terms and 4% in real terms.¹⁸ This compares to a compound rate for the FTSE All Share (TR) of 1.6% in nominal terms.

Chart 27: Total UK-domiciled fund assets (2000 - 2009)

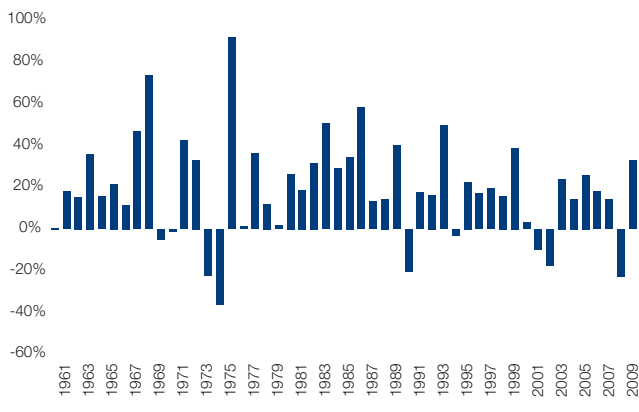


¹⁸ GDP deflator has been used to calculate the inflation impact.

An IMA data set extending back to 1960 allows additional comparisons to be made over a much longer time period in terms of UK-domiciled funds under management and total net sales (retail and institutional).¹⁹

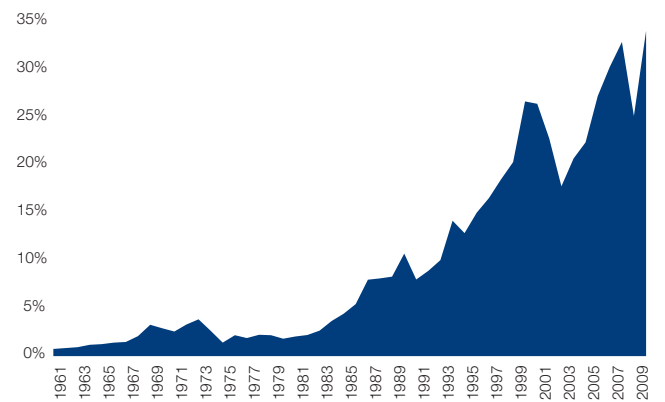
Chart 28 illustrates the annual percentage change in industry funds under management over the last 50 years, with 2009 seeing the largest year-on-year percentage increase in funds under management since the twelve months to the end of December 1999. Over a longer time frame, such high annual growth rates have not been unusual. There are in total thirteen periods since 1960 which had growth in excess of the 33% recorded during 2009. Clearly, market movements play a significant role.

Chart 28: Annual percentage change in industry funds under management (1960 - 2009)



The annualised growth rate calculated for the whole fifty year period is around 17% nominal and 10% real. Such expansion rates are clearly greater than those for UK GDP with industry growth rates particularly strong in the 1980s. At the end of 1960, funds under management equated to less than 1% of GDP (Chart 29). By the end of 2009, the figure was more than a third.

Chart 29: Industry funds under management as percentage of GDP (1960 - 2009)



¹⁹ Information prior to 1992 was not collected at a more granular level.

Investor behaviour

Total net investment (retail and institutional) into the UK fund industry was a record £29.5bn during 2009, comfortably beating the previous high of £20.7bn seen in 2006. This was a dramatic turnaround compared to the net outflow during 2008.

Chart 30 displays industry total net sales in monetary terms and as a percentage of average annual industry funds under management since 1960. Expressed as a proportion of average annual funds under management (7%), this was the best performance since the late 1990s.

The total net sales figure for 2009 was primarily driven by retail investors who invested £25.8bn, the highest retail sales on record. These flows came against the backdrop of unusually low interest rates and greater confidence in risk assets as the year wore on. Following two years of outflows in 2007-2008, net institutional investment turned positive and was the highest since 2006, totalling nearly £3.8bn.

Net retail investment benefited from both an increase in gross sales and a reduction in the level of repurchases throughout 2009. Gross retail sales rose by nearly 25% year-on-year to a record high of over £78bn while repurchases fell 12% to just over £52bn. This was the first year-on-year decline in retail repurchases since 2002-2003, suggesting investors were unwilling or advised against crystallising any paper losses they may have experienced during 2008. This resilience was noted by a number of those we spoke to in interviews, who contrasted it with the experience in continental Europe.

industryview

Retail investor behaviour

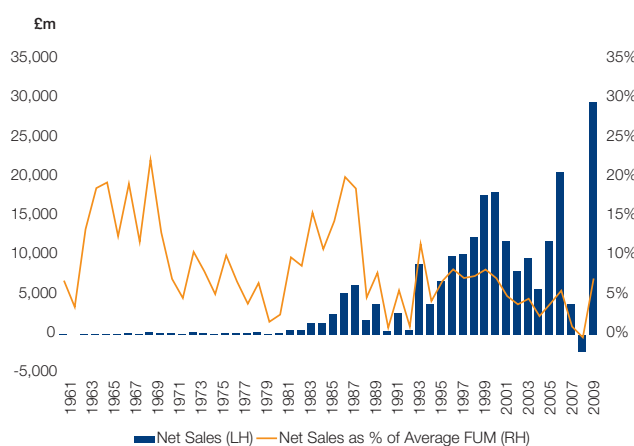
“Retail investors have been pretty smart in this cycle. They have bought risk assets – both corporate bonds and equities – at a good time and have done well. This is great. We are sometimes too hard on the British retail investor.”

“People are not moving into a new paradigm. If markets collapse, people become risk averse and move into cash. In the early part of the crisis, there is a ‘coming home’ mentality. After the rally, both in credit and equity, you saw a return to the market.”

“The general observation I would make is that UK investors understand risk and the cyclical nature of markets well. In the UK, people abandon ship less often, hold more equity anyway and stick fast with that equity. The European market tends to be much more exuberant when markets go up and much more despondent when markets fall.”



Chart 30: Total net sales and sales as a percentage of average annual funds under management (1960 - 2009)



In terms of the relative popularity of IMA sectors, Table 1 illustrates both the best and worst net retail selling sectors of 2009:

- The top two selling sectors remained unchanged from a year earlier with the £ Corporate Bond sector the best selling by quite a margin, taking close to £6bn of new retail money. The Absolute Return sector (UK-domiciled funds only) came second with net inflows of just under £2.6bn. In third place was the £ Strategic Bond sector with inflows of around £2bn.
- As in 2008, the Europe Excluding UK sector was also the worst selling sector of 2009 although the net outflows of around £0.4bn were more modest than the near £2bn outflows recorded during 2008. This sector has now suffered net retail outflows for each year since 2002.

Given severe stock market volatility throughout 2008 and low returns on bank and building society deposits, it is somewhat unsurprising that the largest net inflows from retail investors were again into bond funds during 2009 (£9.9bn). However, equity funds were the second highest net retail selling asset class over the year at £7.3bn indicating the perception of emerging buying opportunities and the gradual return of confidence. Of the broad asset classes, only money market funds saw retail outflows in 2009, albeit small. The balanced, property and 'other' fund sectors all attracted new money.

Although the monthly net retail flows were strong throughout 2009 (more than £2bn a month between April and December), the composition of the flows changed throughout the year. Chart 31 shows the evolution of quarterly net retail sales by asset class from 2008.

We examine the individual assets classes in more detail below, but the general shape of the flows is quite striking:

- **Signs of resilience during 'fear' phase.** Despite the collapse of Lehman Brothers in September 2008 and sharp stock market falls, equity sales in the fourth quarter of 2008 were fairly resilient especially when compared to earlier periods in the crisis when outflows were recorded. At the same time, with corporate bond spreads over gilts still wide by historical standards, bond fund sales started to accelerate.
- **A strong move to yield.** During the first quarter of 2009, equities resumed their downward fall and equity fund sales declined. As the Bank of England cut interest rates further and corporate bond yields looked increasingly attractive, there was a significant spike upwards in net bond sales sustained in the second and, to a lesser extent, the third quarters.
- **Return to risk assets.** The FTSE All Share index hit its lows in early March 2009, and from this point onwards investors started to move back into riskier assets. Equity fund flows increased significantly and

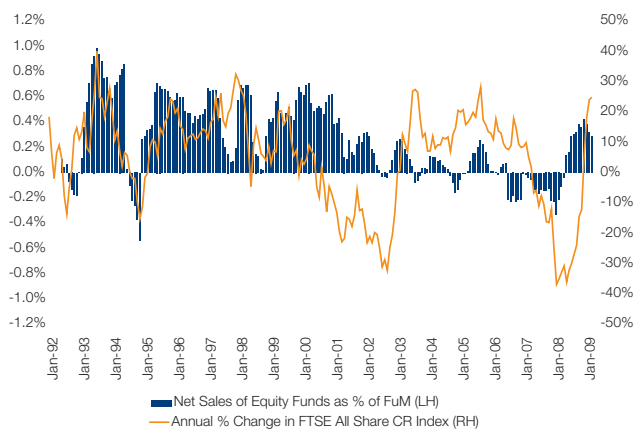
Table 1: Best and worst selling IMA sectors, net retail sales (2009)

| | Net retail sales (£m) | Percentage of total net retail sales | Total funds under management (£m) | Percentage of total funds under management |
|--------------------------------|-----------------------|--------------------------------------|-----------------------------------|--|
| Best selling sectors | | | | |
| £ Corporate Bond | 5,971 | 23% | 43,540 | 9% |
| Absolute Return - UK Domiciled | 2,550 | 10% | 8,419 | 2% |
| £ Strategic Bond | 1,963 | 8% | 17,029 | 4% |
| Worst selling sectors | | | | |
| Europe Excluding UK | -384 | – | 31,395 | 7% |
| Japan | -254 | – | 6,233 | 1% |
| UK Equity and Bond Income | -171 | – | 3,433 | 1% |

were the best selling asset class in the final two quarters of 2009, overtaking bonds as their sales started to tail off from the high levels of previous quarters. Property funds also started to benefit from increased investor confidence with sales improving with each quarter of the year.

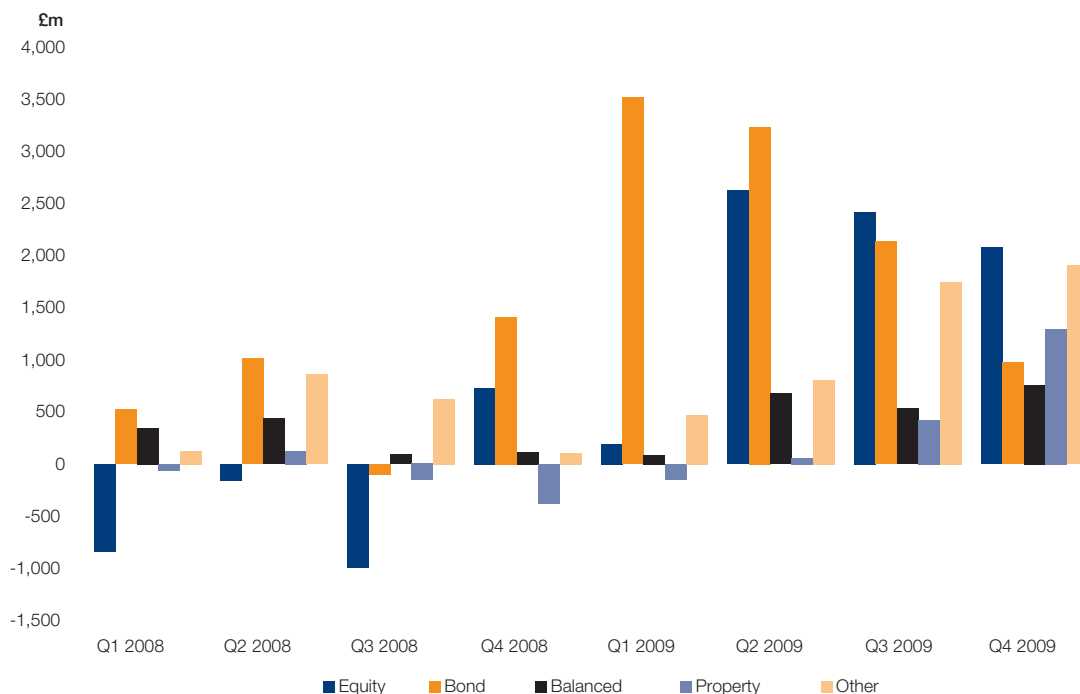
Chart 32 shows total (retail and institutional) net sales of equity funds in relation to the annual performance of the FTSE All Share index. It is clear that periods of reduced or negative net sales of equity funds have commonly corresponded to periods when recent stock market performance has been poor and vice versa. If net retail sales alone were used for this analysis, then similar trends would be apparent, suggesting that retail investor decisions were based to a certain degree on current market conditions and performance. However, it is notable that sustained outflows from equity funds have been fairly infrequent and that the sizes of outflows have been small in terms of equity funds under management, despite sometimes large annual declines in the stock market index.

Chart 32: Total net sales of equity funds vs FTSE All Share Index (January 1992 - December 2009)



Net sales of equity funds are charted as a six month moving average of total net sales as a percentage of equity funds under management over the period. FTSE All Share performance is charted as the year-on-year change of the FTSE All Share CR Index.

Chart 31: Quarterly net retail sales by asset class (2008 - 2009)²⁰



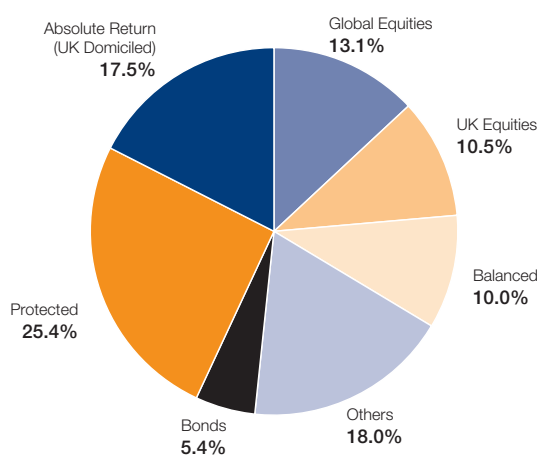
²⁰ Money Market asset class has been included within 'Other' in this chart.

Newly launched funds

During 2009, IMA collected data on 129 newly launched funds.²¹ Most launches were seen in the non-domestic (global) equity sectors (35) followed by those in the balanced sectors (29). Throughout the year, retail investors made a net investment of £5.9bn into newly launched funds and as can be seen from Chart 33, more than a quarter of this amount was channelled into protected funds. This was followed by UK-domiciled absolute return funds and 'others' (due principally to sales of funds in the unclassified sector) with a share of around 18% each.

Considering that bond funds in general were the best retail selling asset class on a net basis during 2009, it is interesting that sales of newly launched bond funds made up only a very small proportion of total bonds sales (just over £300m) as investors clearly opted for funds with more established track records. Net investment into new equity funds was higher than that for bond funds but also fairly modest at £1.4bn in relation to all retail sales of £7.3bn for this asset class, with retail clients favouring global funds over domestic equity funds.

Chart 33: Net retail sales of funds launched during 2009 by fund/asset type



industryview

Investors favouring established funds

“ We got the impression that people were parking their money in corporate bond funds where they trusted the provider. A small group of firms did very well. Traditional names were receiving the inflows. Certainly, the first quarter of this year has seen quite a lot of money coming out of corporate bond funds as people have decided where to put it.”

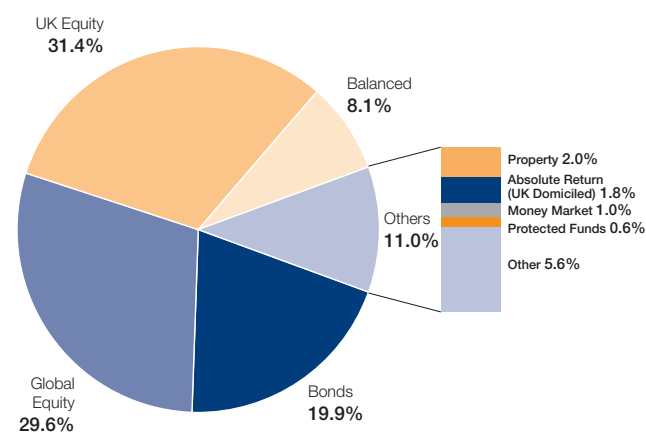
²¹ This figure is based on the number of funds launched which IMA collected data for during 2009.

Asset Classes and Sectors

The overall asset mix of UK funds at the end of December 2009 is shown in Chart 34. Equities continue to account for the largest proportion of funds under management at 61%, down from over 62% at the end of the previous year:

- Despite record net sales into bond funds during 2009, the year-on-year weighting actually fell slightly from 2008 (20.7%). This was primarily due to the general performance of funds within the IMA UK Gilts sector relative to other fund/asset types and negative net sales experienced for this sector.
- The market share of property funds fell slightly year-on-year to 2.0% (2.1% in 2008) and down from over 3% at their peak in 2007.
- At 1.8%, UK-domiciled Absolute Return funds saw a significant increase in their share of industry assets compared to one year earlier (1.0% in 2008) as funds under management more than doubled. Protected funds also increased their market share to 0.6%.
- Money Market funds (to be distinguished from the very large institutional money market fund business managed out of the UK) continue to account for a tiny proportion of funds under management at 1.0%.
- The 'Other' asset class now accounts for 5.6% of industry assets, principally due to funds in the IMA Unclassified sector. This allocation has grown from less than 1.0% at the end of 1999.

Chart 34: Funds under management by fund/asset type (December 2009)



Equity funds

£8.9bn was invested into equity funds during 2009, the first overall annual inflow since 2006:

- Retail clients returned strongly, investing £7.3bn compared to outflows of £1.3bn in 2008 (the first such net redemption since the early 1990s). Total net retail sales of equity funds in 2009 were the second highest on record and behind only the spectacular inflows seen during the dot.com period (£14bn into equities in 2000).
- Institutional investment into equity funds turned positive totalling £1.6bn. These investors had been net sellers for the six years prior to 2009.
- The best selling equity sector overall was the UK Equity Income and Growth sector with net inflows of £2.0bn while the worst selling was the Japan sector with outflows of more than £740m.

Chart 35: Annual net retail sales of equity funds split by UK/Global (1992 - 2009)

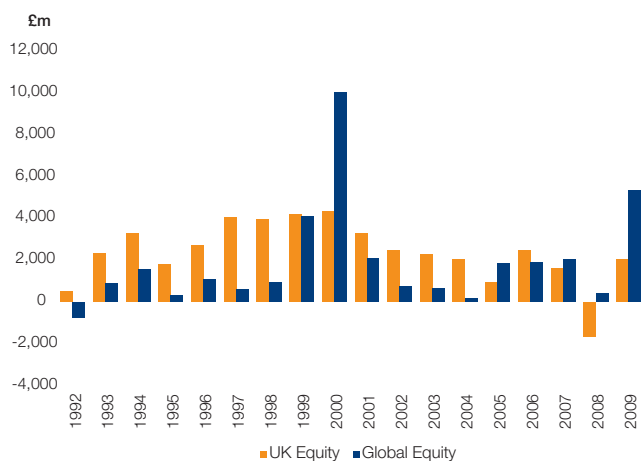


Chart 35 shows net equity retail sales since 1992 split by those classified as UK equity funds versus global equity funds.²² Global equity fund sales totalled £5.3bn in 2009, once again outselling funds investing in UK equities (£2.0bn) in what is a reflection of a wider trend of diversification by investors away from domestic equities. Global equity funds have now outsold UK equity funds in four out of the last five years compared to only once in the thirteen years prior to that.

However, the sharp rise in overall funds under management over the last ten years means that UK equities held by authorised funds accounted for an estimated 10% of UK domestic market capitalisation at the end of 2009 compared to just 7% in 1999.

The best selling equity sector in net retail terms in 2009 was the Specialist sector, which counts towards the global equity figure, taking in just under £1.5bn. Commodity funds which reside within the Specialist sector were responsible for nearly half of this, mostly invested during the first six months of the year. Institutional investment into commodity funds during the year was small at £22m and is half the level seen in 2008.

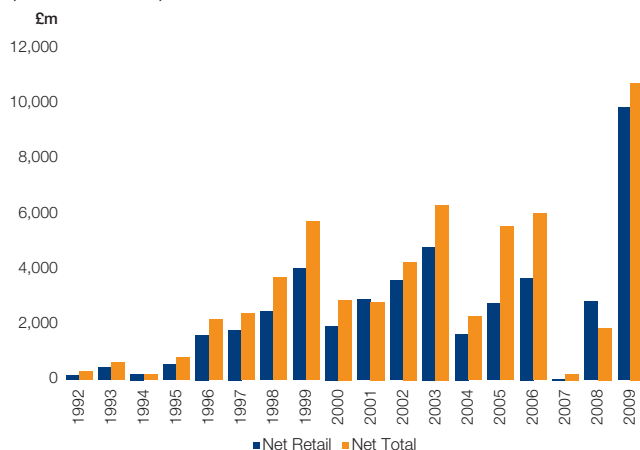
Bond funds

Funds under management in bond funds rose 27% year-on-year, and 2009 saw the highest ever annual net inflow of £10.7bn, over five times the amount invested during 2008. As Chart 36 shows, the annual net inflow into this asset class was driven nearly exclusively by retail investors, who invested £9.9bn (or more than 90%) of the £10.7bn total, compared to a retail inflow of just £2.8bn in 2008. In contrast, institutional inflows were fairly modest during 2009 at around £880m. However, these were the highest net sales since 2006 and partially offset outflows in 2008 of nearly £1bn.

There was a wide divergence in the performance of different bond categories during 2009:

- Investment and non-investment grade bonds performed well as confidence returned and spreads started to narrow. Government bonds saw negative returns (excluding index-linked) as quantitative easing programs started to wind down and added to expectations of large amounts of supply in the future, depressing prices to a degree.
- The performance outlook was mirrored in fund sales. The IMA UK Gilts sector was the worst selling bond sector with total outflows of nearly £1bn, while £ Corporate Bond, the best selling, had striking net inflows of £7.7bn in total (£6.0bn due to retail clients). The £ Strategic, £ High Yield and Global Bonds sectors also had strong sales, taking in a further £3.9bn between them.

Chart 36: Net total and net retail sales of bond funds (1992 - 2009)



²² The IMA global equities category includes regionally focussed funds – eg Europe ex. UK – as well as genuinely global funds.

Balanced funds

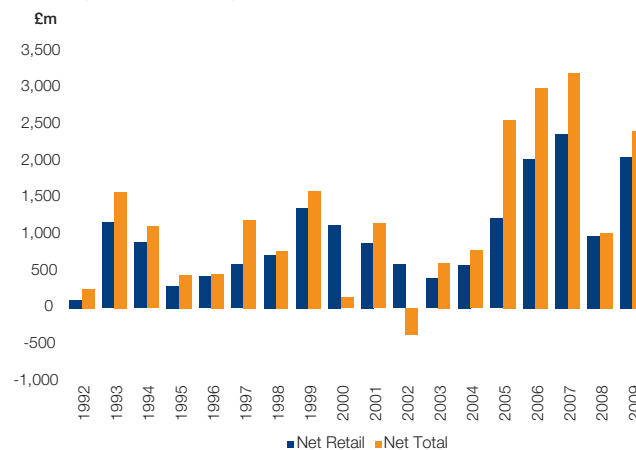
Balanced funds are characterised by a multi-asset approach and invest generally across equities, fixed interest securities and cash. Funds under management within this asset category increased more than 30% year-on-year to just over £39bn in total. However, the majority of funds classified into the balanced sectors are funds of funds, which are dealt with in a separate section on page 56.²³

Total net investment into balanced funds during 2009 of £2.4bn was more than double the amount of the previous year, with retail investors contributing £2.1bn. In fact, as Chart 37 shows, this retail investment was just 13% lower than the record retail inflows of £2.4bn in 2007 and much greater than £980m invested during 2008.

Funds within the Cautious Managed sector were the best selling for the balanced asset class, with retail clients accounting for almost all of the £1.3bn invested. Institutional net investment was strongest within the Balanced Managed sector at just over £300m for 2009. As in 2008, the UK Equity and Bond Income sector was the worst selling and saw outflows of around £200m overall.

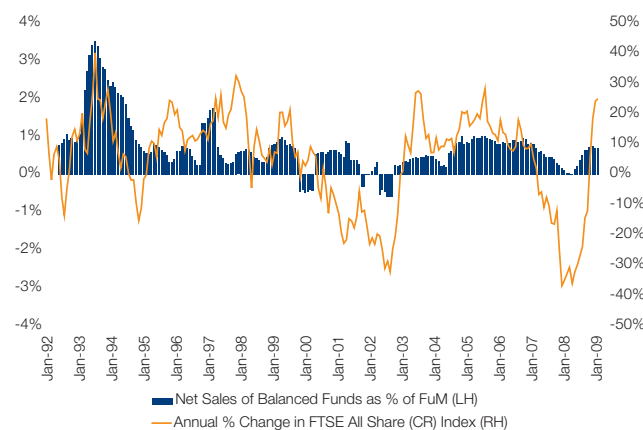
As Chart 37 shows, investment into balanced funds over the last five years has been particularly strong with total (retail and institutional) net sales surpassing £12bn (around 70% of this is retail). Total net sales over the last five years have been greater than the total investment recorded for 1992-2004, which was less than £10bn.

Chart 37: Net total and net retail sales of balanced funds (1992 - 2009)



Although it appears that net sales of these funds are broadly correlated with equity market performance (see Chart 38), the fact that balanced fund returns are not dependant on just a single asset class the variation in fund flows appear smoother than for pure equity funds as one may expect.

Chart 38: Total net sales of balanced funds vs FTSE All Share Index (January 1992 - December 2009)



Net sales of balanced funds are charted as a six month moving average of total net sales as a percentage of balanced funds under management over the period.

FTSE All Share performance is charted as the year-on-year change of the FTSE All Share CR Index.

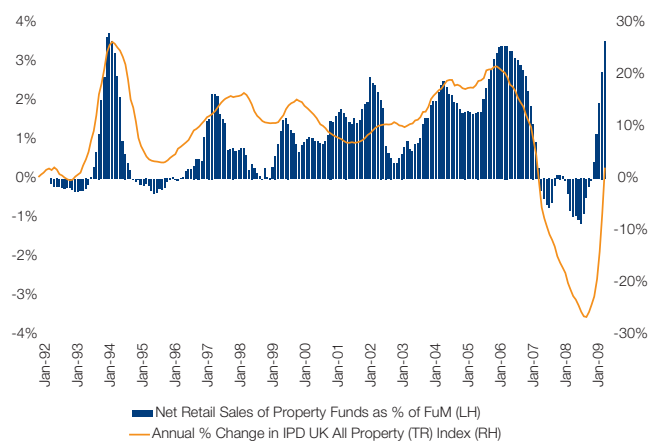
²³ The balanced category comprises the 'Managed' sectors (Active Managed, Balanced Managed and Cautious Managed) plus the UK Equity and Bond Income sector.

Property funds

Property funds represent only a relatively small proportion (2%) of UK funds under management at December 2009, but have attracted a lot of investor interest and media attention over the last five years:

- At the end of 2003, property funds under management stood at just over £1bn. This figure doubled each year until the end of 2006 and the number of funds available for investment also increased dramatically over the same period (from five in 2003 to 23 by the end of 2006). During 2006, retail inflows had taken off and a record £3.6bn was invested through the year, which represented almost a quarter of industry net retail sales. Institutions added another £1.5bn to these funds, taking the annual net investment to more than £5bn.
- Mid-2007 marked a turning point in the property cycle as funds under management peaked at around £16bn in June. Although total net sales remained positive for 2007 at £2.2bn, the year was characterised by strong inflows during the first half of the year followed by outflows in the second half as conditions within the property market, and the wider economy more generally, started to deteriorate.
- The outflows continued into 2008 as both retail and institutional investors redeemed their holdings in property funds as property valuations continued to decline. In total, outflows of nearly £1.2bn were recorded with institutional clients cashing in the most (£690m). Funds under management appeared to reach a trough in mid-2009. By this time, they had fallen by nearly 60% to £6.8bn.
- As appetite for risk assets started to return during 2009, property funds benefited and net investment for the year was again positive at £1.5bn. This was due entirely to retail investors (£1.6bn) as institutional net flows remained negative although at a much reduced level compared to 2008. In fact, the net inflows were concentrated in the fourth quarter of the year as retail clients invested £1.3bn which offset a small outflow during the first half of the year. By the end of the year, funds under management stood at £9.7bn, an increase of over 40% in just six months.

Chart 39: Net retail sales of property funds vs IPD UK All Property Index (January 1992 - December 2009)



Net retail sales of property funds are charted as a six month moving average of net retail sales as a percentage of property funds under management over the period.

IPD UK All Property Index performance is charted as the year-on-year change of the IPD UK All Property Monthly TR Index.

The launch of an IMA Property sector in late 2008 adds further granularity to the funds under management and sales data of different classes of property fund:

- At the end of 2009, direct property funds made up the majority (82%) of total property funds under management, followed by property securities funds (12%), with property funds of funds and hybrid funds making up the remainder.
- In terms of total net sales, only direct property funds and property funds of funds had positive inflows during 2009. Direct funds accounted for around £1.6bn of sales, while hybrid and property securities funds recorded modest outflows (£50m).

Absolute return funds

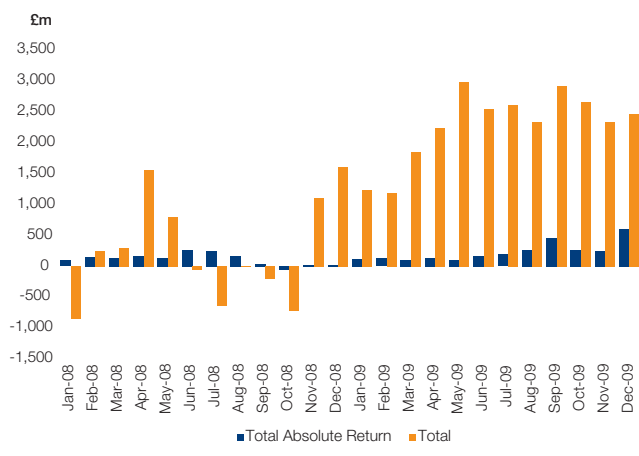
Absolute return funds have been represented by an IMA sector since April 2008. This sector uniquely contains funds that are domiciled both in the UK and offshore.

Total funds under management in absolute return funds have grown very rapidly to £9.9bn at the end of December (from £4.0bn in 2008). This growth is due to a combination of strong inflows and an increase in the number of funds in the sector, either because of new fund launches or funds reclassifying from other sectors.

Chart 40 illustrates the monthly sales pattern of these funds by retail investors throughout 2008 and 2009 in comparison to the fund industry totals:

- During 2009, net retail sales for absolute return funds (on and offshore) totalled £2.8bn, double the level recorded for 2008 (£1.4bn). UK-domiciled funds accounted for around 90% of the total.
- While industry net retail sales were negative during five months over the period (all during 2008), sales of absolute return funds remained positive on all but one occasion (October 2008 in the aftermath of the Lehman collapse).
- Institutional investors were also heavy net buyers of these funds with positive inflows into both on and offshore funds totalling £2.1bn during 2009 (£630m in 2008).

Chart 40: Net retail sales of absolute return funds vs total industry net retail sales (2008 - 2009)



Protected funds

Although a very small part of the overall IMA funds universe (0.6% of the total), protected funds have also experienced record positive net inflows and strong growth in funds under management as investors have sought a degree of capital preservation with upside potential.

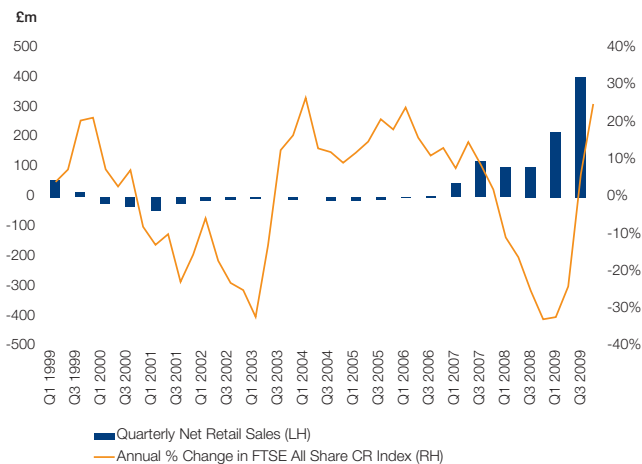
The investment strategies involved will normally be based on derivatives. They will aim to return a set amount of capital, typically explicitly protected or by using a strategy highly likely to achieve this objective, plus potential for upside returns.

At the end of December 2009, funds under management were more than £2.9bn, double the value of the same period a year prior and five times the level at the end of 2006. The bulk of funds under management within this sector held in funds classified as “Capital Protection at Maturity” (£2.2bn) funds with £0.5bn held within “Protection/Floor” funds.

Net retail sales during 2009 of £1.5bn were a record high for this fund type following the previous record of £410m in 2008.

Chart 41 shows retail sales into protected funds since 1999, illustrating how their popularity has grown over the last three years. This chart also shows a contrast between current investor behaviour and that observed in the bear market after the dot.com crash when retail investors were net sellers of these funds and remained so until 2006.

Chart 41: Net retail sales of protected funds vs FTSE All Share Index (1999 - 2009)



Funds of funds

Funds of funds under management hit their highest level on record by the end of the year, rising 42% year-on-year to £42.7bn, a higher rate of increase than the funds industry as a whole (33%).

While the market share of funds of funds is still relatively small in the context of the wider funds industry (9% at the end of 2009), it is growing rapidly from a low base:

- Ten years ago, the share was only 4% and just five years ago the figure was still less than 6%.
- Since the end of 1999, funds of funds assets have grown by 15% per year on average (7% for the wider funds industry), and by 23% (12%) over the last five years.

This rapid growth is reflected in the number of funds offered by fund companies.²⁴ This reached 373 at the end of 2009, nearly triple the number available ten years earlier (see Chart 42).

Chart 42: Funds of funds net sales and number of funds (1999 - 2009)

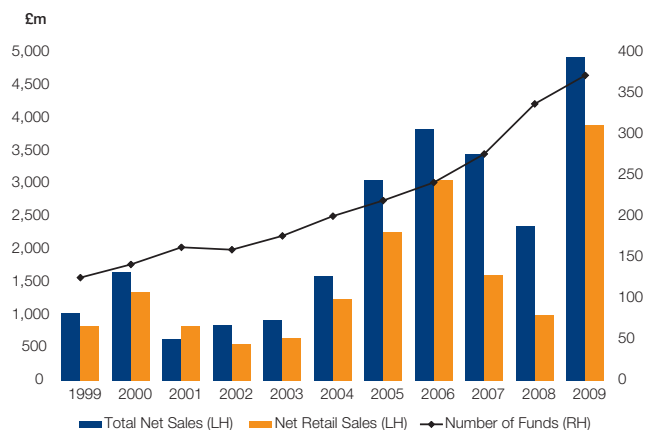


Chart 42 also illustrates net retail and net total (retail and institutional) sales since the beginning of 1999:

- During 2009, funds of funds attracted record amounts of new money (£4.9bn in total, of which £3.9bn was due to retail investors). Net retail sales

were approximately four times higher than the amount invested during 2008 and 27% higher than the previous record amount invested (£3.1bn during 2006).

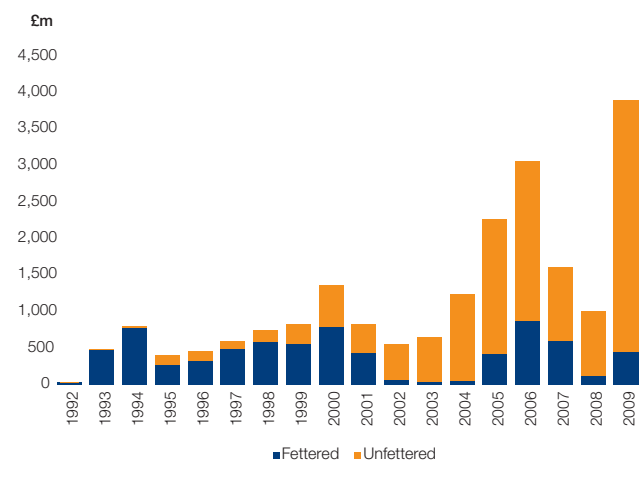
- Over the last five years, net retail sales have been particularly strong. Since the beginning of 2005, more than £11.8bn has been invested. If institutional money is also included, this figure rises to £17.6bn.

Chart 43 breaks down net retail funds of funds sales by fettered (internally invested) and unfettered (externally invested) funds since 1992.

In a break with the historical experience, retail investors have directed sales in recent years mainly into unfettered rather than fettered funds. In terms of institutional net sales, the pattern is more consistent over time and the majority of new sales are concentrated within fettered funds.

Overall, as the UK funds of funds market has matured, there has been a large shift away from fettered funds. The proportion of funds under management held within unfettered funds was 56% at the end of 2009 (53% a year earlier), very different to ten years earlier when the figure was only 21%.

Chart 43: Net retail sales split by fettered and unfettered funds of funds (1992 - 2009)

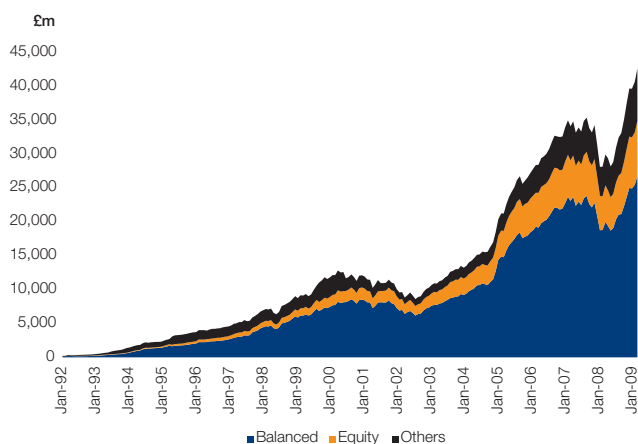


²⁴ Figures for number of funds here relates to the number of funds for which IMA collected data at the end of each year.

Looking at sectors, the best selling in terms of net retail sales over 2009 was the Cautious Managed sector (net inflows of £1.3bn). This sector has now been ranked first in each year since 2003. In contrast to the wider funds industry, the £ Corporate Bond was the worst selling sector over the year with retail outflows totalling just over £13m. Chart 44 shows that at the end of 2009, balanced funds continue to account for the majority of funds of funds assets at £26.7bn (63% of the total), followed by equities at £8.2bn (19%).

The asset mix over the last five years has shifted slightly with a move away from balanced funds (at the end of 2004, these represented around 70% of assets). The proportion invested in equity funds has remained fairly constant, although there has been an increase from 12% to 18% in the 'others' category, mainly due to funds under management in the 'Unclassified' sector.

Chart 44: Funds under management – funds of funds by asset type (January 1992 - December 2009)



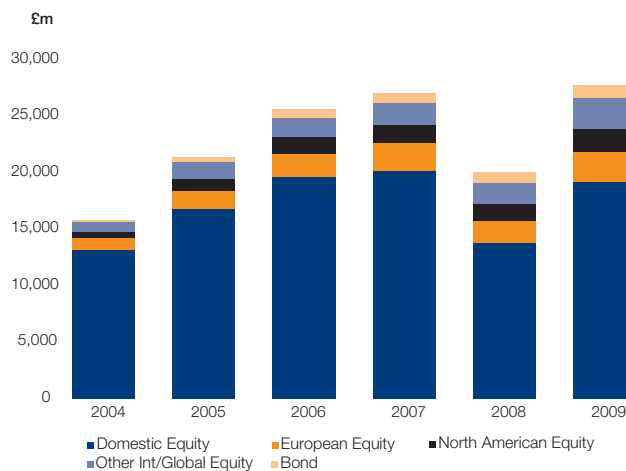
Index tracker funds

At the end of 2009, total funds under management in index tracker funds were £27.7bn, 38% up from the previous year, helped by rising stock markets around the world (see Chart 45).

These funds now represent approximately 6% of industry funds under management and over the last five years the average annual growth rate in tracker funds has closely matched that of the overall industry (around 12%):

- Funds under management in those funds tracking bond indices rose by the smallest amount (17%) while those tracking Other International/Global Equity indices increased their assets most (46%), closely followed by European Equity tracker funds.
- The performance differential between bond and equity trackers funds caused the market share of bond trackers to fall to 4% from 5% a year earlier, although this is still much greater than five years earlier (under 1%).
- Over the same five year period, the proportion invested in domestic equity trackers funds has declined from 84% to 69%. while all other categories increased.

Chart 45: Funds under management of tracker funds by index investment type (2004 - 2009)



Funds under management also received a positive impact from strong net sales in 2009 as retail and institutional clients invested £2.4bn into trackers funds in total (£435m in 2008):

- Retail sales were up from 2008 at nearly £406m and were the highest since 2003 (£548m) when equity markets were recovering from the lows of the previous bear market.
- The majority of the annual inflow was due to institutional investors as net sales surged to just under £2.0bn (£130m in 2008). Tracker funds remain popular products with institutions and they have been net annual buyers of these funds for the last thirteen years in a row.

Chart 46: Net retail sales of tracker funds by index investment type (2004 - 2009)

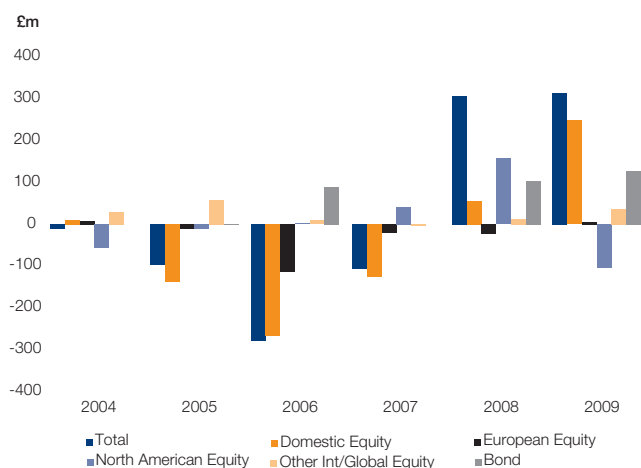


Chart 46 shows that sales by index investment type. Net retail sales of equity trackers during 2009 (around £283m) represents only a very small proportion of retail inflows into all equity funds (£7.3bn). It appears that investors may have had a desire to take on active management risk rather than just gain market beta exposure as the stock market recovered from its lows in early 2009. However, it is difficult to interpret this data in isolation as investors also have access to exchange-traded funds (ETFs). Although one large IMA member is a leading operator, ETFs are run largely by firms outside both the IMA membership base and outside the IMA funds universe (which does not include listed funds).

Ethical funds

At the end of 2009, ethical funds under management had increased by 26% year-on-year to £5.6bn while the number of funds was 54 (52 in 2008). As a proportion of total funds under management, ethical funds have remained fairly static for a number of years (a little over 1%). This is reflected in similar average annual growth rates over the last five years compared to the industry. However, growth rates over longer time periods show that ethical funds have grown strongly from a low base and their significance has therefore increased over time:

- Over ten years, the growth rate has averaged around 11% per year (7% for the industry).
- Since IMA records for this fund type began in 1992, ethical funds under management have grown by nearly 20% each year on average, again higher than the rate of increase for the industry.

Chart 47: Funds under management and net sales - ethical funds (1992 - 2009)

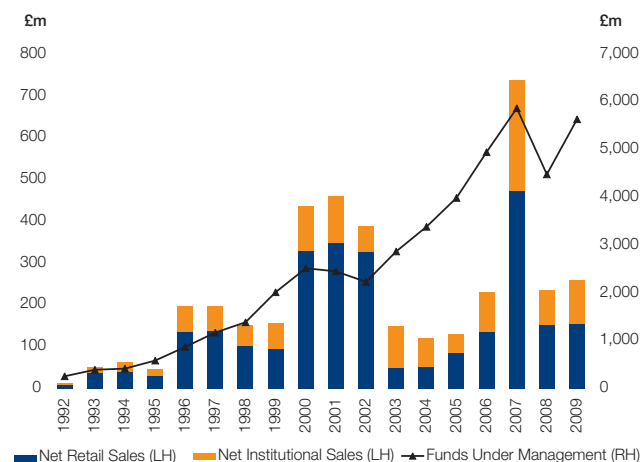


Chart 47 shows the progression of ethical funds under management and net sales from 1992 to 2009. Compared to 2008, total net sales of ethical funds during 2009 were up by 9% to £260m. Institutional net sales increased by a quarter to nearly £105m, while retail net investment remained flat at 2008 levels (£155m). The strongest net retail inflows into ethical funds went into non-domestic (global) equity funds followed by bond funds. UK equity funds saw outflows.

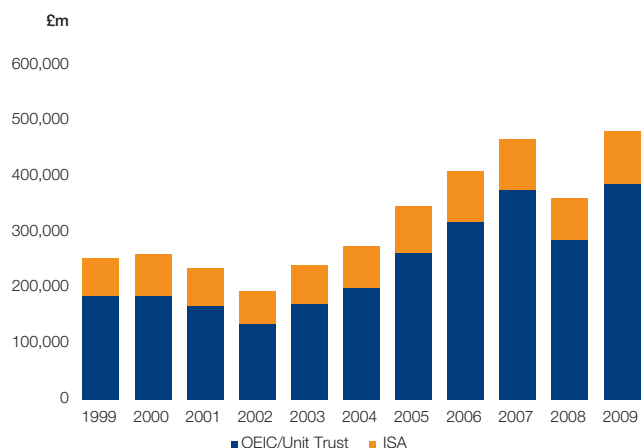
Institutional net flows were positive for each asset class

that ethical funds are assigned to. Despite growth in overall sales not matching the large increase in net sales for the wider industry during 2009, both retail and institutional investors appear to remain committed to ethical investment. Net sales for each investor type have been positive in each year from 1992, with retail clients investing more than £2.7bn net during this time with institutions adding a further £1.3bn.

Individual Savings Accounts (ISAs)²⁵

After five years which had seen higher levels of withdrawals than investments (historically mainly due to PEP redemptions) net ISA sales were positive for 2009 at £3.4bn, the best year since 2001 and comparing positively to the outflows registered during 2008.

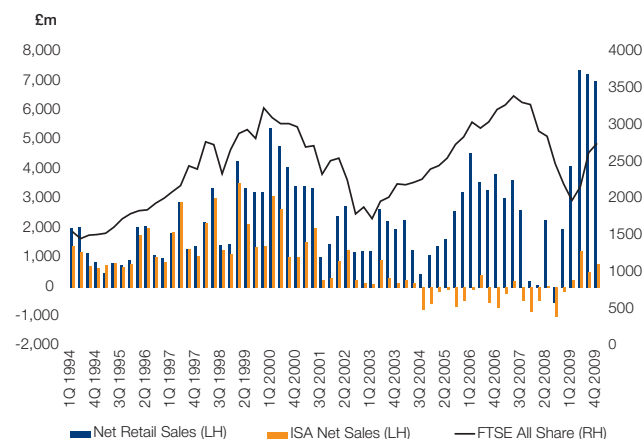
Chart 48: Funds under management by product type (1999 - 2009)



ISAs have clearly benefited from the low interest rate environment and subsequent record inflows to the fund industry during 2009. They may also be benefiting from the package of recent reforms to the ISA regime, which included making ISAs permanent beyond 2010, allowing transfers of cash into the stocks and shares component and raising the investment limit to £10,200 from April 2010 (with over 50s able to take advantage of the increase from October 2009).

Chart 49 illustrates the trend in sales on a quarterly basis showing industry net sales against net ISA sales going back to 1994. (Re-registrations, where an investor re-registers their holding from a firm to a fund supermarket may cause distortions in the data as some of the data may be lost.)

Chart 49: Quarterly net retail sales and net ISA sales vs FTSE All Share Index (Q1 1994 - Q4 2009)



The contribution to total funds under management from ISAs was just under 20% at the end of 2009. Although this percentage share rose very slightly between 2007 and 2008, ISAs have been on a broad downward trend since 2002 when they represented 30% of industry funds under management (see Chart 48).

²⁵ As of April 2008 PEPs were consolidated into stocks and shares ISAs. All ISA data shown for periods prior to April 2008 also combines PEPs and ISAs, except in the case of fund supermarkets where it reflects ISAs only.

Offshore domiciled funds distributed in the UK

Of the investment funds domiciled outside the UK, a number are FSA recognised and sold into the UK with distributor status. In the future, this will become “reporting status” – offshore funds will need to report their income to UK investors but will not have to distribute it.

IMA has collected data on these funds since July 2006 and has also announced that effective from April 2010 offshore funds meeting certain criteria can be submitted for classification to existing IMA sectors. This will allow more detailed analysis of funds under management and sales in future editions of the survey:

- The number of funds for which data is collected stood at 579 at the end of 2009, unchanged from a year earlier and represented funds from 29 firms. Total funds under management for UK investors in these funds were £24.9bn, an increase of 56% compared to December 2008.
- Total gross sales of non-UK domiciled funds into the UK were £11.7bn for 2009, up by a quarter on the previous year. Total (retail and institutional) net inflows during 2009 were just under £1.7bn almost entirely offsetting outflows of just over £1.7bn recorded for 2008. Net sales for 2009 were driven almost entirely by retail investment (£1.6bn).
- Total net sales of offshore funds within the IMA Absolute Return sector were positive, with total inflows of £710m of which nearly £500m was due to institutional investors.

The low level of assets in non-UK domiciled funds sold to investors in the UK contrasts strongly with the sizeable portion of non-UK domiciled funds whose assets are managed here (see page 17).

Distribution Dynamics and their Implications

In terms of the distribution of investment funds to retail clients in the UK, intermediated sales have grown enormously over the last ten years:

- In 1999, less than half of all gross retail sales originated from intermediaries.
- By 2009, intermediaries accounted for more than 87% of gross retail sales, up from 85% in 2008. The remaining 13% of industry retail sales were through the sales force/tied agents or other direct sales including to private clients.

One of the main drivers behind the upward trend for intermediary sales is fund platforms, which are continuing to grow in popularity and in importance to the industry.

IMA data has in the past been unable to achieve significant granularity of intermediary sales. During 2009 and effective from January 2010, IMA announced changes in the way in which it collects data on the funds industry. Part of these modifications involved changing the distribution channels to better reflect changes in the industry over recent years.

One change has been to create a separate channel for fund platforms. Other changes enable better identification of transactions with insurers, fund of fund managers and offshore intermediaries. Going forward, this will allow a much more detailed understanding of the origin of money flows into the industry.

The new data from IMA show that fund platforms accounted for 37% of gross retail fund sales in the four months to April 2010, with direct sales accounting for only 12%.²⁶ Splitting out gross ISA sales within this, the figure is much higher – 56% via platforms. For more detail on 2010 sales, see page 66.

²⁶ The platforms within the IMA dataset are defined quite specifically as 12 fund platforms. This data does not include insurance platforms, which are still counted within the IMA funds data as an institutional channel (ie fund managers have a wholesale relationship with what is effectively an insurance client).

One consequence of this changing distribution landscape towards fund platforms is the 'institutionalisation' to a certain degree of the retail funds market. Gross retail sales were a record £78bn during 2009 and have more than doubled in value compared to five years ago but so has the level of repurchases. This would indicate that funds are experiencing higher flow volatility, due in part to the changing decision-making structures associated with this process (for example, whether or not a fund is maintained on a platform offering). In the institutional market, poor performance is more exposed and money flows change quickly. It appears that the same thing may be beginning to occur in the retail market.

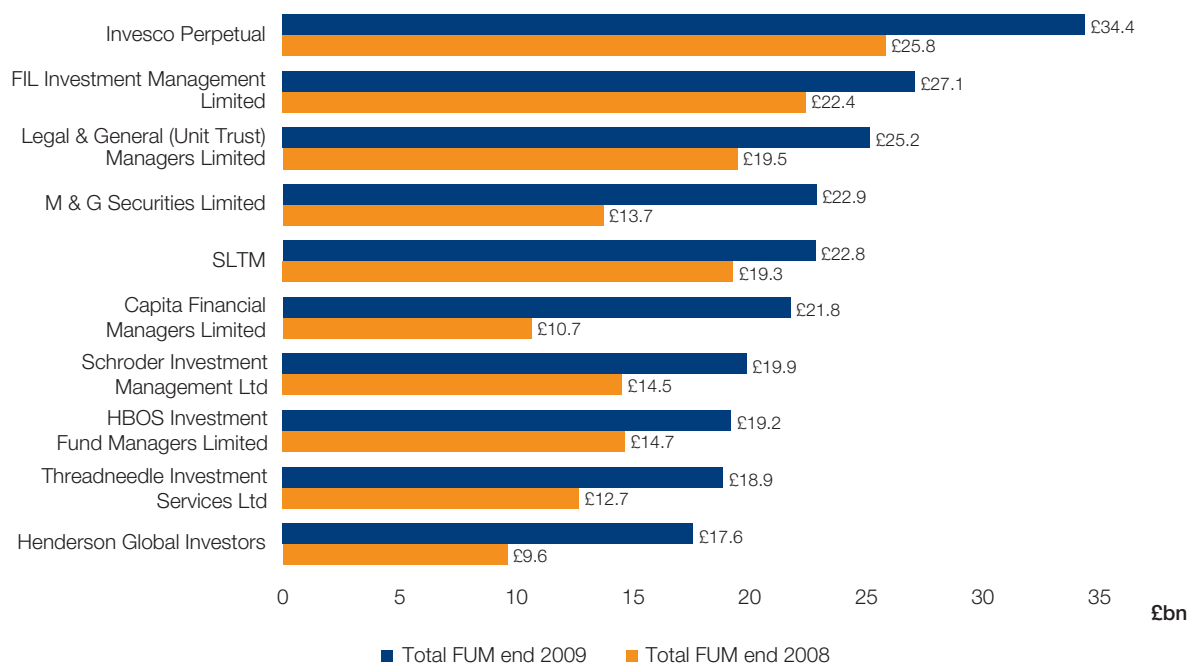
At another level, the changing distribution environment is also distancing asset managers from retail clients. Many of those we spoke to stress that they are able to work effectively with distributors and advisers in developing and marketing products. However, as we discuss in Chapter One, there is clearly a broader challenge to the industry in being simultaneously further away from its end clients via greater intermediation while likely to become ever more significant to their savings outcomes, particularly as the global move towards funded pensions continues.

UK Industry Concentration and Structure

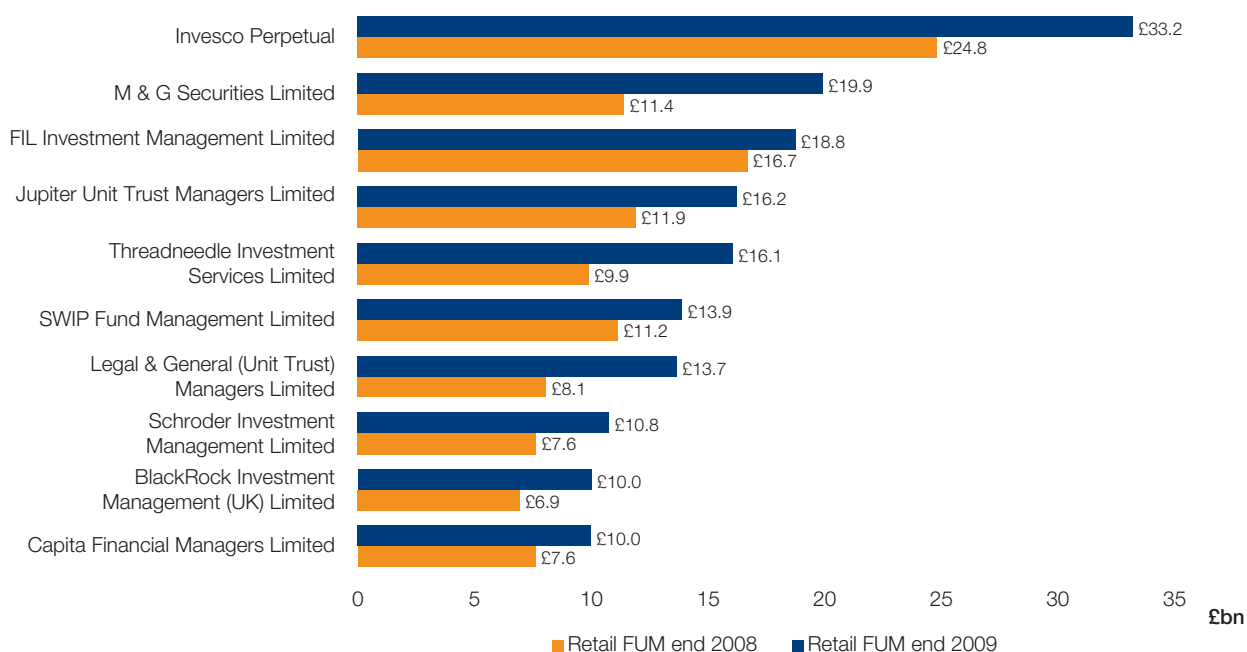
By the end of 2009, there were 108 fund companies (ie company operating the fund but not necessarily responsible for managing the assets) in the UK (down from 111 a year earlier). The drop in the number of companies is a result of the merger and acquisitions activity seen in the industry during late 2008 and early 2009 with some of the firms involved consolidating separate fund ranges (and operators) under single brands.

The UK fund management industry remains a highly competitive environment, with the top ten firms representing approximately 46% of total industry UK-domiciled funds under management at the end of December 2009, up only marginally on 2008. Chart 50 shows the top ten fund companies by total retail and institutional funds under management at the end of December 2009, while Chart 51 shows the top ten firms in terms of only retail funds under management.²⁷

Chart 50: Top 10 UK fund companies by total funds under management (December 2009)



²⁷ Retail in this context is calculated as funds that have a minimum lump sum investment amount less than or equal to £10,000 and at least one-third of gross sales over the preceding three years were retail.

Chart 51: Top 10 UK retail fund companies by retail funds under management (December 2009)

As Table 2 shows, the market share of the top five and top ten firms has remained relatively stable over the past fifteen years, while that of the top 25 has increased from around 66% to 78%. In earlier years, the concentration levels were somewhat higher. In 1980, the market share of the top five firms was 56% while that of the top ten corresponded to 72%. Just five years later, these market shares had fallen quite significantly to 37% and 54% respectively and have dropped further since.

Table 2: Number of fund companies and market shares of total funds under management (year end 1994 - 2009)

| Year | Number of companies | Largest 5 | Largest 10 | Largest 25 |
|------|---------------------|-----------|------------|------------|
| 1994 | 157 | 27% | 43% | 66% |
| 1999 | 152 | 24% | 39% | 64% |
| 2004 | 120 | 28% | 45% | 72% |
| 2009 | 108 | 26% | 46% | 78% |

Chart 52 illustrates industry concentration since 1992 using another popular metric, the Herfindahl-Hirschman Index (HHI), which applies a greater weighting to those firms with larger market shares.²⁸ Using this measure the clear conclusion is that the UK funds industry is historically and also currently very unconcentrated.²⁹

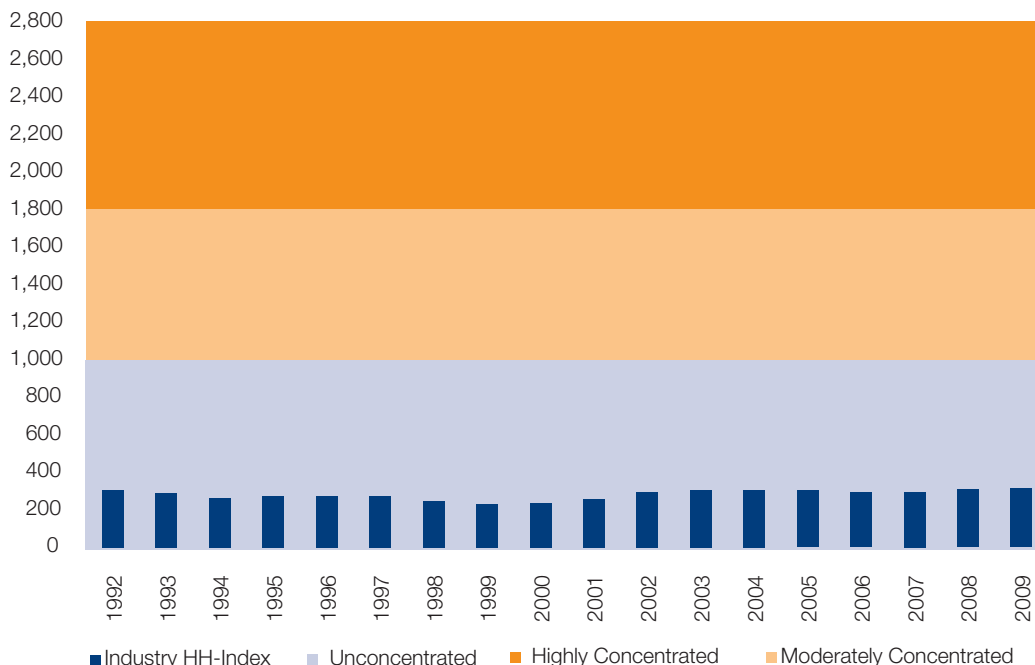
The reading at the end of December 2009 of 312 showed a small increase on a year earlier (2%). However, since 1992 there has been no distinct trend either up or down in concentration level and any year-to-year movement has not been significantly large. The figure for the UK industry compares favourably to indicators from the US fund market, which is the largest in the world, where the Investment Company Institute calculate the HHI figure for December 2009 to be 457.

At the end of 2009, average funds under management of fund companies in the UK were £4.7bn, compared to the median figure of just over £1.0bn. Together with the other concentration measures, this indicates that the distribution of firms is one where there are a large number of smaller companies with a few relatively large players.

²⁸ The HHI is calculated using the sum of the squares of the market shares (%) for individual firms within a market.

²⁹ Concentration level cut offs for the HHI are those used by the US Department of Justice methodology for anti-trust purposes.

Chart 52: Fund industry concentration - HHI (1992 - 2009)



Although overall industry concentration levels in terms of funds under management have remained broadly static since 1992, the number of fund companies in operation has shown a distinct falling trend, mainly due to consolidation. For example, at the end of 1994 there were nearly 160 fund companies compared to less than 110 currently (see Table 2).

Furthermore, there is some evidence that over recent years retail investors have concentrated their net purchases of funds into a smaller proportion of companies. As we have noted in previous surveys, there had been a striking upward trend observable since 2000 in the percentage of firms experiencing net retail outflows during a given year. This suggested that over time, greater consolidation pressures might build within the funds industry, either through M&A activity or exit. With aggregate 2009 net retail sales the highest on record at £25.8bn (nearly seven times the level of 2008), we have again examined the experience of individual firms.

Chart 53 : Annual net retail sales and percentage of firms recording net retail outflows (1992 - 2009)

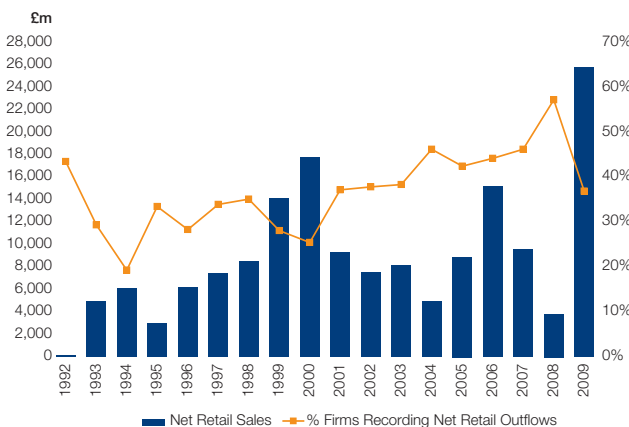
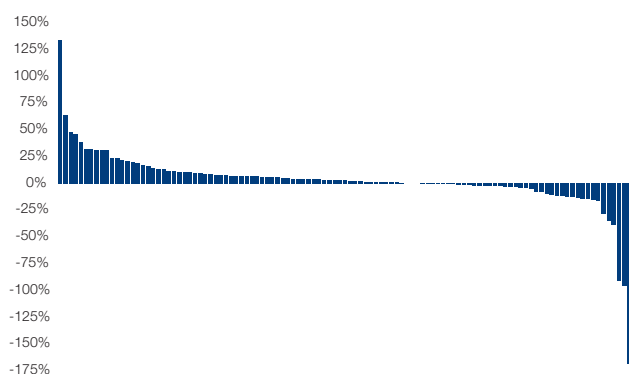


Chart 53 shows industry net retail sales since 1992 and it is striking that the momentum towards a concentration of sales in a small number of firms reversed significantly during 2009. Just 37% of firms experienced net outflows compared to 57% in 2008. Clearly, the large amount of new money entering the industry has benefited to some degree a larger percentage of firms. The last time such a significant change occurred was during 1999-2000, years which also saw very high net inflows albeit in very different market circumstances.



Breaking down the experience by retail sales operator, Chart 54 plots net retail sales as a proportion of average total funds under management during 2009. It shows that the vast majority of fund operators either attracted levels of new business to a modest degree compared to their asset base or lost business at a modest level. Nonetheless, there was a small number of firms which either attracted or lost significant retail flows in relation to their size.

Chart 54: Fund operator net retail sales as a proportion of average annual funds under management (2009)



It is unclear whether or not the reversal seen in the general trend of fund flows increasingly concentrating in a smaller proportion of fund companies will continue. There are a number of factors at work which would suggest it may not be sustainable:

- There is generally a high degree of competition between funds and other alternative investment products whether this be bank deposits, structured deposits, etc. Currently unfavourable interest rates available on most bank deposits are thought to be a key factor in explaining strong fund industry inflows. This may be expected to unwind at some point as monetary policy is tightened.
- Markets remain extremely volatile. Any resumption in a strong downward movement of equity markets may well subject those unable to cut their cost base further to very strong commercial headwinds.

Fund Level Trends

At the end of 2009, there were more than 2,500 UK-domiciled funds classified to IMA sectors, a fall of 76 year-on-year (see Table 3).³⁰ This negative net activity, the biggest fall in fund numbers since 2003, was the result of the number of fund launches during 2009 falling 40% compared to 2008 levels combined with the number of closures (including mergers) increasing by a similar percentage.

Looking at the figures for the last severe market downturn (2000-2003), there appears to be a slight time lag between weak market performance and fund launch/closure activity, as one might expect. Although the number of fund closures did rise during 2001, fund launches remained largely unaffected and did not start

Table 3: Number of fund launches/closures and number of funds (2000 - 2009)

| Year | Number of launches | Number of closures (incl. mergers) | Net activity | Number of funds (end of year) |
|------|--------------------|------------------------------------|--------------|-------------------------------|
| 2000 | 259 | 145 | 114 | 2,578 |
| 2001 | 255 | 326 | -71 | 2,507 |
| 2002 | 271 | 266 | 5 | 2,512 |
| 2003 | 209 | 340 | -131 | 2,381 |
| 2004 | 204 | 189 | 15 | 2,396 |
| 2005 | 233 | 275 | -42 | 2,354 |
| 2006 | 195 | 143 | 52 | 2,406 |
| 2007 | 232 | 139 | 93 | 2,499 |
| 2008 | 259 | 158 | 101 | 2,600 |
| 2009 | 153 | 229 | -76 | 2,524 |

³⁰ The figures for the number of funds presented in this table differ to those reported in IMA monthly statistics as these figures represent all funds classified to IMA sectors rather than just those funds for which IMA collect data for.

to decrease until 2003 when markets started to rally. In the same year, fund closures reached a peak of 340, translating into a net decrease of 131 funds over the year.

If a similar pattern were to emerge during the current market downturn, then some consolidation at fund level would be expected over the next few years as has already been seen during 2009. The latest figures have been influenced by weak markets, which directly affect revenue, forcing fund companies to assess whether or not their funds continue to be commercially/strategically viable. Merger and acquisition activity in the asset management sector will also affect fund numbers as firms involved assess whether to merge or close similar lines of funds due to duplication and excess capacity.

Table 4 shows mean and median fund sizes over the last ten years to the end of 2009 for all UK-domiciled funds for which IMA has collected data:

- The strong rebound in stock markets during the year caused funds to increase in size. The average fund increased by 31% compared to 2008 and has now risen to levels last seen around 2006.
- The median fund size (about 30% of the average size in each year) indicates that the distribution of funds within the industry is skewed in much the same way as that of the distribution of company size (ie a number of large funds in the universe but a long tail of many smaller funds).

Table 4: Mean and median fund sizes (year end 2000 - 2009)

| | Mean (£m) | Median (£m) |
|------|-----------|-------------|
| 2000 | 141.7 | 43.3 |
| 2001 | 126.5 | 39.1 |
| 2002 | 103.4 | 30.9 |
| 2003 | 131.1 | 40.6 |
| 2004 | 147.6 | 47.2 |
| 2005 | 185.1 | 63.0 |
| 2006 | 215.9 | 71.3 |
| 2007 | 230.6 | 69.6 |
| 2008 | 165.5 | 46.6 |
| 2009 | 217.0 | 59.6 |

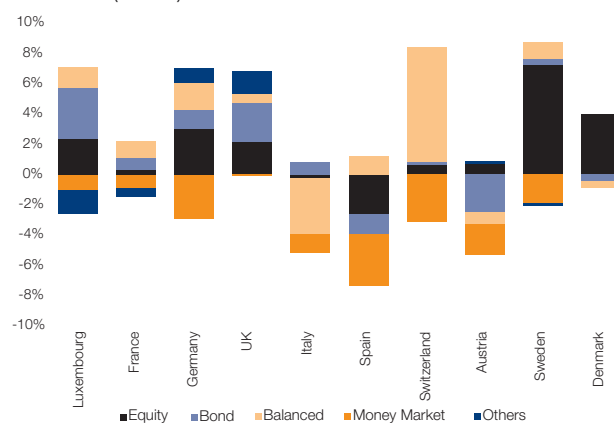
European Context

Focussing just on the market for UCITS funds, which accounts for 75% of funds under management across Europe, the industry saw a turnaround in net sales with inflows of €116bn during 2009 compared to outflows of €355bn in 2008. The domicile with the largest net inflows during 2009 was Luxembourg at €66bn, followed by the UK (€33bn). Given that the Luxembourg market is around three times the size of the UK and serves investors across Europe and beyond, the flows in the UK appear particularly strong.

Chart 55 displays net sales of European UCITS funds by asset class and by country for the top ten countries by total funds under management,³¹ expressed as a percentage of average UCITS assets over the 12 month period to end 2009. It is clear that money market funds, in general, suffered a high degree of redemptions across Europe in both absolute terms (€44bn) and relative to the size of many countries UCITS assets.

One of the exceptions to this is the UK where money market funds continue to make up only a very small proportion of funds under management in comparison to some other European fund centres. Relative net flows for the other asset classes across countries is a more mixed picture with equities, for example, selling very strongly in Sweden and some other countries compared to large outflows in Spain.

Chart 55: Net sales of UCITS by asset class as a percentage of average annual UCITS, selected countries (2009)



Source: EFAMA

³¹ The top ten countries in Chart 55 differ to those presented in Figure 5 as granular level asset data is not available for Ireland.

The fund market in the UK differs from other European countries in a number of ways, especially in the asset allocation and in the distribution network for retail clients. As we illustrated in Chart 16 (page 27), the average equity weighting across Europe is about one-third and is much lower than that of the UK which has one of the highest equity weightings (63%) and one of the lowest proportions of money market assets (less than 1%).

Outlook for 2010

The strong propensity to save within investment funds seen during 2009 continued into the first four months of 2010. In fact, net retail sales during the first four months of 2010 (£8.0bn) were the best ever for this period of the year and up by 29% on the same period in 2009. Institutional net flows, which tend to be more volatile than retail flows, were also positive during the first four months at £326m, but outflows were registered in both January and March.

By the end of March 2010, another milestone for the UK funds industry was reached when funds under management passed the £500bn mark for the first time ever, ending the month at just under £506bn.

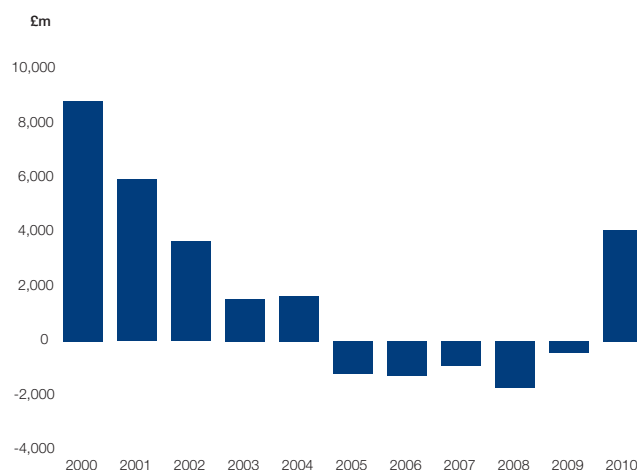
Looking at these sales flows for the first four months of 2010 in more detail:

- Bond funds were the best selling retail asset class (£2.1bn), although the composition of flows was mixed. The £ Strategic Bond sector was the best selling sector with retail inflows of more than £1.3bn, while global bonds also sold well. The £ Corporate Bond sector, which recorded net retail sales of close to £6.0bn during 2009 (the best selling sector), registered retail outflows of £250m.
- Equity funds received net retail investment of £1.8bn, with the largest flows into the Global Emerging Markets, Global Growth, North America and Specialist sectors. At the same time, retail investors and institutional made substantial withdrawals from the UK All Companies sector.
- At £2.2bn during the first four months of 2010, sales of funds within the Absolute Return sector (UK-domiciled funds only) were marginally lower than the last four months of 2009 (£2.4bn). However, this was still a comparatively high level. Retail clients

invested around £873m and institutional clients invested £1.3bn.

- The recovery in net retail sales of property funds appeared to be continuing and totalled £1.0bn in the first four months of 2010. While down by more than one-third on the final four months of 2009, the same period a year earlier saw redemptions of £140m.
- Net ISA inflows of £1.3bn during the ISA season (January to 5th April 2010) was more than double the £603m of 2009 and marked the strongest year since 2002 (see Chart 56 for full tax year sales). In contrast to the very strong early years of ISA sales, which saw a preponderance of equity investment in the context of the dot.com boom, recent data has seen more diversified investment. This is not surprising given the drivers of retail sales during 2009-2010, which we discussed earlier in this chapter.

Chart 56: Net ISA sales by tax year (1999/2000 - 2009/2010)



4. Regulation and Overall Business Environment

Key Findings

Credit crisis policy response

- The asset management industry would like to see well-coordinated, effectively targeted regulatory change in response to the credit crisis.
- The view of the industry is that some measures, notably the Alternative Investment Fund Managers Directive (AIFMD), do not seem to be appropriate and may end up harming the broader industry and its clients. It is also concerned that in areas such as remuneration, the nature of the industry's business model, which puts considerable weight on long-term performance, may not be sufficiently recognised.
- Asset managers have a three-fold interest in the banking sector: as owners of shares and other securities; as users of markets; and as investors looking for macro-level stability. With respect to the difficulties experienced in the banking system through 2008-2009, the industry has worked with Government and regulators to help engineer improvements in a number of areas, such as resolution tools and better safeguards for shareholders, creditors and counterparties.
- Looking at the broader shape of the banking sector, the majority of those we interviewed tend to favour regulatory reform that separates banking activities more clearly. However, there is no single specific view as to how best it can be achieved.

Engagement and the Walker Review

- The industry accepts that there are lessons to learn from the recent financial and economic crisis in terms of results achieved by engagement.
- A range of issues concern managers with respect to expectations of what can be achieved. These centre on the nature of their relationship with their clients (the paramount responsibility), the limitations of available information, practical and legal obstacles to acting collectively and the need for improved Board oversight.

The UK as a place to do business

- Interviewees generally continue to view the UK positively as an international asset management centre, given attributes such as talent pool, proximity to other parts of the financial market, language and time zone. However, concerns over taxation and, to a lesser extent, attitudes to immigration, have increased substantially over the last three years.
- The key issue is about the longer-term predictability of the UK fiscal regime. It centres not on fund taxation, where considerable progress has been made, but corporate and personal taxation. In particular, it is felt that changes to personal taxes last year have decreased the relative attractiveness of the UK. This has led to the departure of some personnel from the UK, but this is not yet widespread.
- While London currently has few rivals to match the breadth and depth of expertise, the feeling of those we interviewed is that if uncertainty continues, or increases, then a trickle out of the UK could turn into something more substantial in coming years. Equally, new capacity could go somewhere else.

Retail Distribution Review

- The asset management industry is supportive of moves to bring greater transparency for consumers in the pricing of fund products. However, strong worries were expressed in interviews about the potential practical ramifications of changes proposed in the RDR.
- A number of firms observed that the RDR could help to tilt the funds market towards more concentrated fund buying decisions and greater volatility of fund flows as the structure of platforms evolves.
- There are mixed views in the industry on the impact of RDR on the structure of the adviser market. One concern expressed was that the overall result could be that certain consumer segments are less well served.

4. Regulation and Overall Business Environment

The experience and consequences for the industry of the credit crisis have been addressed throughout this report. In particular, we looked at different patterns of interaction with institutional clients in Chapter Two and the behaviour of retail investors in Chapter Three. In Chapter Five, we examine some of the commercial and structural ramifications for the industry.

This chapter deals firstly with a number of initiatives and policy issues arising from the systemic shocks of 2007-2008. For the UK asset management industry, the following areas have had particular significance:

- The proposed Alternative Investment Fund Managers Directive (AIFMD).
- The Walker Review on corporate governance.
- Reforms of UK banking legislation and regulation, and the broader future shape of the banking system.

The chapter also looks at the broader UK operating environment. There were substantial changes in the UK tax system announced during 2009, notably with respect to personal taxation and allowances. This has had quite a significant negative impact on perceptions of the UK within the industry.

Finally, we look at the Retail Distribution Review (RDR), which has moved a further step forward but whose final shape and implications for the industry still remains unclear.

Credit Crisis Policy Response

The asset management industry is keenly interested in the broad policy response to the credit crisis, both in terms of UK decisions and the broader international environment.

The key unifying theme among those we interviewed was that it was essential for the regulatory response to the crisis to demonstrate a number of characteristics:

- It needs to be well coordinated internationally to ensure maximum effectiveness.
- It should concentrate on the root causes of the crisis and those elements of the financial system that were at the heart of the difficulties.
- It should be conducted in a way that does not polarise debate between the financial services as a 'guilty' party and the rest of society.

As part of the broader reaction to the crisis, a number of firms also emphasised points mentioned earlier in the survey. These include enhanced risk management, better communication with clients and the need for the industry to look again at the product set which it manufactures to ensure that it serves clients effectively.

industryview

Difficult way forward on regulatory reform

“My general concern is the animosity that seems to exist between the Government and Regulators on the one hand and the financial services industry on the other. It's not necessarily the fault of one side or the other. It is understandable that one side has to be the champion of certain things and the other defends its interests. But it is a less than satisfactory situation.”

“We are continually looking at things in terms of technical detail and through the rear mirror. In a sense, you end up putting sticking plaster on a regulatory system that is looking to support a heavily stressed set of capital markets. Those capital markets are in the triage stage. We've stopped the haemorrhage, there are signs of life and a pulse, but now we're trying to work out what's needed. But we do not know the medication that returns the patient to full health. I don't think we have an acceptance yet of what the deep fix is. There is no social or political concept of what needs to be done. However, it's time for the blame game to stop. It's understandable why it's happening, but bashing banks and financial markets is not going to help fix things.”

“This is an eco-system problem but I do not see any consensus on where we go. So we're not in the same situation of emergency landing that we were in a year ago, but the plane is badly damaged. I don't know how long this will last. There has been a lot of finger pointing, but perhaps the asset management industry should also indulge in more navel gazing. We need to reflect carefully on what we achieve and how we achieve it.”

1. Alternative Investment Fund Managers Directive

The Alternative Investment Fund Managers Directive (AIFMD) is one of the most significant pieces of legislation at European level to emerge to date as a response to the credit crisis.

However, the AIFMD is seen by firms we spoke to as a questionable piece of legislation applied to the wrong group of financial market participants. Furthermore, because its scope extends well beyond hedge funds and private equity vehicles, it risks having a disproportionate and damaging impact across the asset management industry and its clients, including retail consumers.

The broad feeling among those we interviewed was that the motivations for the directive were related to pre-existing hostility to certain parts of the asset management industry. Asset managers would instead like regulatory attention to be focused on what they regard as some of the core issues of the credit crisis, such as the structure of the banking system (see page 73).

industryview

AIFMD is not a well-targeted initiative

“Were alternative investment managers responsible for what happened? I don’t think so. They have been party to it, but they were not the guilty parties. The AIFMD poses a lot of challenges. It is far too broad in scope, was drafted very quickly and resulted in hundreds of amendments in the European Parliament. It’s one example of a potential regulatory over-reaction. If you regulate hastily after an event like this, are you doing the right thing for the long term? I’m not so sure.”

“There’s an element of ‘We’re not sure what to do, but we need to do something visible even if it doesn’t address the problem encountered’. The AIFMD is a great example of this.”

“The AIFMD is completely political, but the financial services industry has to pay for its sins.”

2. Remuneration

While firms recognise current public sensitivities over levels of remuneration, they stress that restrictions on the way in which remuneration packages are structured in the asset management industry would risk undermining business models that were not responsible for the crisis. The problem for the asset management industry is two-fold:

- The industry intrinsically has a relatively fixed cost base, with a highly variable revenue stream, given the nature of the business and the predominant charging structures (*ad valorem* fees). Where salaries have to rise in place of bonuses, this is generally considered potentially highly problematic. It would have an impact not just on base costs but the capital which many firms will have to hold, since these are based on three months of fixed overhead requirements.
- Firms consider that they already operate bonus structures that are linked to longer-term performance. Many of those we interviewed pointed to bonus structures that have a significant component linked to at least three-year performance records. In some cases, it is much longer than three years.

Nevertheless, the G20 has agreed principles for remuneration. The issue is how these are applied to asset managers. While it now seems clear that the Capital Requirements Directive applies the principles proportionally to the MiFID discretionary investment managers; it is still open how UCITS IV will apply these principles to UCITS managers, and be AIFMD to alternative investment fund managers.

industryview

Bonuses are linked to longer-term performance and the broader business model

“ Compensation is over a long period of observation, particularly with performance-related pay. So in our firm, about one-third of fund managers performance-related pay is related to their three-year track record, about one-third is related to their one-year record, and one third related to overall company performance. So, with that structure, you are protecting everyone from taking short-term risk. That’s very different to investment bank compensation, which is more transaction-oriented. The shortest period over which a fund manager will be assessed is over one year, and only for a part of the compensation.”

“ No matter how good your regulators are, at times like this it’s a highly political activity and there will be many sub-optimal outcomes and unintended consequences. Unfortunately, punishment also becomes a significant theme. If regulation attempted to link compensation to genuine long-term value-added, then I think we would be reasonably relaxed. We use very long-term performance periods to assess compensation. But if we were told that we could no longer make those payments in cash, then we would be scuppered.”

“ Having a bonus culture can be a good thing, not because of the amounts paid, but because it is ultimately linked to incentives and profitability. Now everyone is raising salaries. That’s a huge downside for us because we don’t have variability in costs. You make it much more difficult for businesses to manage across the business cycle.”

3. Banking and market reform

As agents of clients investing in banking securities, as users of market services provided by banks and as institutions which depend upon broader financial stability, asset managers have a clear interest in the future shape of the banking system.

We reported in last year's survey that asset management firms were severely affected by the difficulties experienced by the banking system at the height of the crisis of 2008-2009:

- They encountered extremely limited liquidity in certain markets, with much wider spreads, an absence of markets (or one-way markets) and considerable price uncertainty.
- The collapse of Lehman Brothers exposed wholly inadequate resolution mechanisms in the event of bank insolvency. Many IMA members found themselves with trades outstanding in the cash equity markets that did not settle, and have experienced considerable difficulty and delay in resolving the problems. Part of this is due to the fragmentation of the equity markets since MiFID; part through a lack of consistency in how trades are identified.
- As significant owners on behalf of end-clients of both bank equities and debt instruments, many asset managers were adversely affected by bank failures. While this is to some extent a consequence of market forces, there were particular concerns with respect to whether some banks could have been saved and to the treatment of bondholders in the Bradford & Bingley nationalisation.

Government, regulators and industry have worked to resolve some of these issues and there are signs that progress has been made in a number of respects.

The Banking Act 2009 not only placed bank resolution tools on a permanent statutory footing, but also introduced a series of safeguards better to protect shareholders, creditors and counterparties on a basis that is predictable *ex ante*. Moreover the creation of the Banking Liaison Panel (BLP), in which the IMA participates, has allowed a very open dialogue between the authorities and industry over remaining concerns (several being addressed by subsequent legislative amendment):

- One specific change is that the terms of bonds issued by a bank cannot be charged using the resolution powers, in the manner expressed in Bradford & Bingley.
- Another BLP sub-group is advising on changes to the Code of Practice, and changes to that may further improve the ability of market participants to predict how they will be treated in a resolution.

Working groups at HM Treasury have explored over the last year how best to overcome or ameliorate the problems seen in the collapse of Lehman. The IMA and its members have represented buy side views, including:

- Possible changes to Crest rules to delete unsettled transactions upon the default of a participant, since this allows managers to trade out of repudiated trades without custodians fearing they may have to deliver twice through Crest.
- Pressing for a consideration of applying Part VII rules across the markets, under which trades and claims would be closed and valued on a consistent basis.

4. Future architecture of banking system

At the same time, it is clear that the larger structural questions with respect to whether regulators should attempt to re-engineer the banking system have for the moment remained unanswered.

Despite much initial discussion of a Glass-Steagall rule, attitudes internationally remain highly mixed as to the future architecture of investment banks. The debate has moved on in the US with legislation to restrict trading activities by banks (a version of the 'Volker rule' designed to separate proprietary trading from other banking functions). It remains unclear exactly what the wider global response will be.

We asked those we interviewed for their views in this area. Out of the 24 firms, only a small proportion were clearly in favour of the formal separation that a return to a form of Glass-Steagall legislation might bring. However, the majority thought that there needed to be some form of mechanism that dealt with the risks that arise from the same institution being engaged in both principal and agency activities, particularly where trading activities might be supported by statutorily guaranteed deposits. A number of options were mentioned. As an alternative to the actual break-up of banks, this could take the form of ring-fencing, with capital requirements around specific activities depending upon their nature.

industryview

Different views on banking reform

“There's a real risk that we just return to business as usual and that we don't learn the real lessons of this crisis. The most fundamental question is whether the UK can afford to own a world-class financial sector. If the UK has to face another bail-out of the banking system at any point probably in the next 25 years, the country will be completely bankrupt. The UK regulators have been very thoughtful, but it's tough to reform in isolation. The world just does not want to learn the lessons. Banks will need more capital, their return on capital will fall and they will be more regulated. However, some of the big banks do need to be broken up. Too big to fail is not sustainable in the context of the UK economy.”

“Glass-Steagall is a bit of a blunt instrument. Does it really work today? There needs to be some other sensible approach. I agree with Volcker to the extent that speculative activities should not be supported with government-insured debt. There are other ways of achieving that goal than breaking up institutions. If you go back to Lord Turner's report, a lot of these issues are dealt with in a more nuanced way.”

“On investment banks, there is a real question – whether or not the solution is Glass-Steagall – as to whether you can be both an agent and a principal when you are looking after people's money. We agree with counter-cyclical capital requirements. But there also has to be a distinction in capital requirements between agent and principal businesses. If you do not have client money held by the firm, then there should be less need prima facie to require them to have big capital usage. But it's tricky because if you are too strict on capital requirements, you increase the barriers to entry and restrict customer choice.”

Views on engagement

Some firms are very positive about the role they can play through engagement

“ Walker has created an important debate as part and parcel of building a consensus about what is appropriate. The industry does need to accept that we are stewards of peoples’ money and we are allocating capital in a particular way. It needs to see itself as part of the fix and part of the guardianship that makes good governance happen.”

“ We are completely convinced that we have to be hands on, engaged owners of shares and we have large teams dealing with this.”

But most remain concerned that too much might be expected of asset managers

Ultimately, managers have a primary duty towards clients

“ Engagement is very good. But at the same time, we owe our clients an outcome that is related to how their investment performs. People tend to believe that businesses are like a democracy. That is simply not the case. If you’re faced with a company that is not properly managed or moving in the right direction, then maybe selling you shares is the best vote you can make for your clients.”

Engagement cannot substitute for Board oversight or good regulation

“ In the credit crisis, there were problems that the senior managers missed, the Board of Directors missed and the regulators missed. All of whom had access to privileged information that institutional investors did not. So what do they think that institutional investors should have come up with that these people did not?”

Acting collectively remains difficult, while a plurality of views can be tricky for companies

“ There are significant issues around concert party actions where we are not operating in a clear legal framework. There’s no European-wide guidance on this. We very rarely own a significant enough stake in a company to make a difference from a voting perspective. We are like the marginal voter.”

“ The problem is that a public market is divide and rule. That is intrinsic. If you want the luxury of liquidity and the ability to buy and sell shares, then the downside is that asset managers are going to have different views on the same subject, let alone different subjects. You can go round to 30 investors and gather a whole spectrum of views, so what is a company supposed to do?”

Balancing client interests can be challenging

“ There is a body of clients that do expect more from us in terms of corporate governance. But much of what we own is owned on behalf of overseas clients. If there are UK public policy objectives that we are expected to fulfil, this could create conflicts of views between different parts of our client base, many of whom will not have a major interest in UK corporate governance issues.”

Engagement and the Walker Review

In February 2009, the Government announced a review by Sir David Walker. Its remit was to examine corporate governance in the UK banking industry, including the role of institutional shareholders. Walker reported in November and made a series of recommendations. With respect to the behaviour of institutional shareholders, he suggested that they should be “less passive and prepared to engage earlier if they suspect weaknesses in governance.” To that end, investors are being asked to sign up to a new Stewardship Code, under the auspices of the Financial Reporting Council (FRC).

We reported in last year’s survey that firms recognised the need to ensure that better outcomes resulted from the engagement process, and that this required changes in behaviour from both companies and asset managers. The responses from asset managers we spoke to this year fall broadly into three categories:

- Firms strongly committed to the notion of company stewardship and a central role for the asset management industry in achieving better governance outcomes. This is seen both in value terms and, in some cases, broader consideration about the public good.
- Firms that recognise the need for engagement while being conscious of the limitations (the clear majority of those we spoke to).
- Firms that believe the benefits of engagement are over-stated and are sceptical about the governance debate.

The concerns about the limitations of what can be expected centre on six areas:

1. The wider context. Asset managers are agents acting on behalf of their clients. Their client responsibilities mean that their behaviour is determined first and foremost by the nature of their investment mandate, which will not usually include a specific series of considerations regarding engagement and governance issues. Most firms we spoke to believe that the question of so-called ‘ownerless corporations’ and the responsibilities of asset managers needs to be considered in the context of this agency role.

2. Available information. Asset managers do not run companies; company executives do, overseen by their Board. Most managers we interviewed stressed that it is very difficult for asset managers on the outside to be expected to pick up on risks that may not be fully apparent even to the Board.

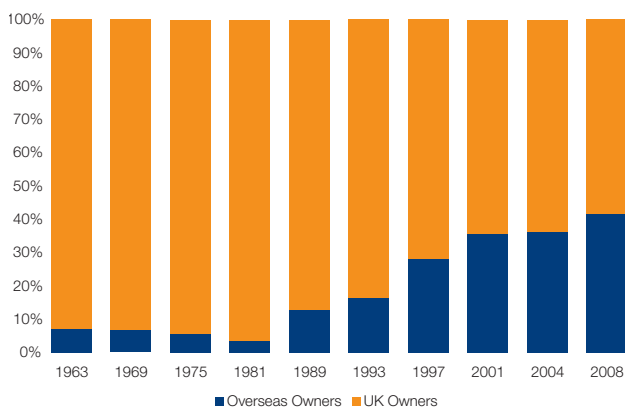
3. Size of exposure and influence. Ownership of investee companies is fragmented, with individual asset managers usually owning very small percentages of issued share capital of companies.

4. Difficulties in coordination and differences of view. With often small holdings by individual firms, one obvious solution would be joint action within the industry. However, coordination of positions between asset managers remains a challenge primarily because of concerns about concert party issues.

Interviewees also pointed out that different asset managers may well have very different views about individual companies – it is in the nature of active management and in the broader nature of the market. This may pose considerable difficulty for companies themselves in gauging what the appropriate way forward is on a given issue.

An additional challenge in terms of fragmentation and coordination is posed by the internationalisation of capital markets and the erosion of home bias among UK investors. UK pension funds and insurers are no longer the obvious ‘natural owners’ of UK equities. While there are difficulties in analysing patterns in ultimate ownership of UK shares, the ONS time series illustrates a striking shift away from domestic investors over the past two decades (see Chart 57). If the process continues at the same pace as it has over the past decade, it is likely that a majority of UK shares will be overseas-owned by 2020.

Chart 57: Overseas ownership of UK shares (1963 - 2008)



Source: ONS

5. Investee company responsiveness. The tools with which asset managers can hold companies to account may be limited in the event of a lack of response, particularly where selling individual stocks is not an option for asset managers. This will be the case for index-tracking products. However, active managers may also have problems if they have significant holdings that cannot easily be liquidated without price ramifications. One active manager we spoke to pointed to an example where they held a large proportion of stock of an investee company which was unresponsive to engagement on a corporate strategy issue. Considerable resource was expended by the manager trying to resolve the issue, while finding it difficult to sell the stock without significant market impact.

6. Improving oversight at board level. There is a need to ensure that Boards themselves are better equipped to deal with some of the challenges posed by the operations of complex financial institutions. However, the point was also made that this should not come at the cost of greater dissent between a Board and its management. There has to be sufficient trust in executives to behave in an appropriate way towards clients and shareholders, while also having the mechanisms with which to hold them to account.

The UK as a Place to do Business

The UK is one of the world's pre-eminent centres for asset management, probably unrivalled in the breadth and international nature of the activity taking place in the capital and elsewhere. Besides the 'mainstream' industry, the UK is one of the leading global locations for hedge fund managers.

The UK's natural advantages are well-known: time zone and language, complemented by an ability to attract talent internationally as well as a reasonably benign regulatory regime. The importance of being part of a wider financial cluster – in particular, proximity to the sell side – is still very important to many firms. In the short term, sterling devaluation has also been a boost for City of London earnings.

London's ongoing powerful position in asset management is reflected in a recent City of London Global Financial Centres report, which continued to rank it first.³² However, those we interviewed are increasingly worried about the relative attractiveness of the UK. Twenty two out of 24 expressed concern about a deterioration in business conditions (see Table 5). This focuses primarily on tax issues. However, firms are also wary of wider changes, such as immigration rules, that may have a negative impact on cross-border labour mobility. The international nature of the UK talent pool remains of major importance for the industry.

Table 5: Views among those we interviewed regarding the UK as a place to do business

| Rank | Number of respondents | UK AUM £bn |
|--|-----------------------|--------------|
| Expressed significant concern about deterioration in conditions, particularly over past year | 10 | 877 |
| Expressed some concern about deterioration in conditions | 12 | 1,158 |
| Did not express concern | 2 | 173 |
| TOTAL | 24 | 2,209 |

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Will London hold onto its position as a leading financial centre?

“It is the best of times and the worst of times. We love London. However, we love it despite the UK government's persistent and consistent attempts to force us to go somewhere else. There is an increasingly uncertain tax policy, tax levels are getting higher and we wonder whether the authorities will come after us as well as the banks. We have thousands of people around the world and move them where we get the best bang for our buck. There are plenty of functions that we do outside the UK. There are many good places to run businesses in other parts of the world.”

“The competitive position for firms has clearly deteriorated but London is still a massive draw for talent. There's a very deep and international talent pool and that won't change overnight. However, at the margin, it is going to affect people.”

“We feel more concern than last year, but there's no real competitor in Europe. You can manage money where there's no sell side, but it's a lot easier to do when the banks are in the same place.”

³² City of London, *Global Financial Centres 7* (March 2010)

Tax concerns

On tax issues impacting firms, asset managers have become increasingly concerned in recent years and believe that the situation has moved progressively towards ‘a red’ warning light. The key areas of concern have been two-fold:

- A perception of decreasing certainty with respect to the fiscal environment.
- A growing worry, partly as a result of tax but also as a function of wider changes, about the attractiveness of London for the talent pool on which it depends.

The problem often articulated is that there is an invisible ‘tipping point’ at which many more firms will consider relocating overseas. By the time the full impact is apparent, the policy remedies necessary to reverse the negative sentiment will be up against potentially well-established rival centres or simply sunk costs whereby the advantages to a firm of reversing potentially quite expensive location decisions are too significant.

There are two areas of location decision for asset management firms that are relevant here:

- Change in domicile of corporate headquarters, which may not go beyond shifting the corporate entity as opposed to core functions.
- Change in location of fund managers and/or other front or middle office activities.

We look at both of these in the following sections, as well as fund-level taxation where there are more positive signs.

industryview

A stable tax regime is essential

“ We need to be able to operate in an environment where there is some certainty. It’s not necessarily the levels that matter most. It’s the knowledge that the rules are not going to change all the time.”

“ The Government should focus on capital creation and savings, not changing tax policy and structure. You need a framework in which major change does not happen every year. Jurisdictions such as Switzerland have set a tax regime and stuck with it. This provides much needed stability for businesses.”

1. Fund taxation

Asset managers are supportive of changes to fund taxation that have been announced over the past twelve months (see Table 6). These have removed a number of obstacles to UK domicile. While some firms may find it easier to retain existing ranges, those we spoke to for the survey were still generally cautious about the outlook for the future. The view is that the comparative advantages of Luxembourg and Dublin, in particular, are well-established. Conversely, for the UK, perception lags fact and there is less promotion of positive developments.

One area of potential opportunity might be presented by the AIFMD directive described above. Despite the negative view regarding the likely impact of AIFMD, there is also a view within the industry that the directive could present an opportunity to bring offshore funds into the UK. However, that would require further change to the UK tax regime.³³

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Can the UK attract funds?

“All you hear about are Ireland, Luxembourg and more exotic destinations. Logic dictates that there is something missing here. Why can other parts of the EU attract the funds industry and not London?”

“If you’re looking at which country is likely to have a longer-term favourable structure view towards fund management, it’s going to be Luxembourg before the UK. The UK is not going to become an attractive fund domicile. It might retain what it has got, but it won’t go much further.”

Table 6: Significant changes to fund taxation in Budget 2009

| | |
|---------------------------------|--|
| Tax elected funds regime | The launch of a tax-efficient regime for funds investment in securities, which allows UK authorised investment funds to be marketed competitively to UK investors and worldwide. |
| Investing vs trading | Legislative change to provide certainty that transactions by UK authorised investment funds and equivalent offshore funds will be taxed as investing not trading. |
| Offshore funds regime | A reformed Offshore Funds Regime, which provides clarity on the approach to the taxation of UK investors in offshore funds and does not require funds to distribute income. |



³³ See also HMT/Asset Management Working Group, *Asset Management: The UK as a global centre, 2009*.

2. Corporate domicile

While some asset management firms have recently changed their corporate domicile, this is not yet a significant number. Nor does it appear likely in the short-term that many firms are about to make this kind of move. In particular, for some firms with significant UK client bases, it might not be desirable from a client relations perspective.

However, a number of chief executives emphasised that the issue itself is now on the agenda for discussion in a way that it was not previously, even if it goes no further than this for now.

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Corporate domicile now a question on many agendas

“*At corporate level, every company is having to examine whether you deliver better shareholder value by moving out of the UK. We have to now. As a publicly listed company, I have a fiduciary responsibility towards all our shareholders to be able to answer the question if it comes up. That's not to say that I personally wish to move the company. But I need the answer to that question. And if the answer is that the dividend would be higher if we domiciled somewhere else, we'd need to have a discussion about it. We are moving towards a solution where an increasing number of companies are going to say: 'Yes, we have to do it.'*”

A small number of firms have already acted...

“*We have moved our corporate domicile and have been able to give our investors the most stable environment possible. What we've done still means that we pay tax on our UK earnings, but it protects our earnings from overseas markets. Taxes should have a very clear roadmap. There can be tinkering at the edge, but we've had a Government that has tinkered constantly with taxes over the last five years.*”

3. Location of personnel

With personal taxation rising, all of those we spoke to expressed dissatisfaction with the growing uncertainty surrounding the UK fiscal regime. A number also expressed disquiet about the level of tax as well. Given the diversity of business models among IMA members, there will inevitably be different views on location decision as well as room for manoeuvre. Location choice with respect to physically shifting front office functions will be driven by considerations, such as:

- Proximity to clients.
- Proximity to markets and other market participants.
- Operating culture within firms and the extent to which it can easily support decentralised models.
- Comparative location advantage with respect to fiscal environment and broader quality of life decisions.

As the quotations (see page 81) illustrate, there is a variety of different responses from international firms about the question of whether relocation of staff will take place. For most firms, London remains an attractive centre, relocation of staff is not imminent and the current disquiet over tax policy is unlikely to precipitate significant short-term reorganisation. However, the long-term message is very clear: the industry needs greater stability. If the situation continues to deteriorate, then an increasing number of firms will look elsewhere. This may affect existing UK staff, but a number of international firms also indicated that they might now be more inclined to consider alternative locations for new capacity.

One point that was made by several interviewees is that asset management centres do not intrinsically need large international flows to be successful. In the US, New York and Boston are part of an extremely large domestic market. London, by contrast, is an international centre whose long-term growth will not come substantially from domestic sources. The importance, therefore, of maintaining a prestigious international reputation is paramount.

Responses to recent tax changes

Majority are not rushing to act, but are unimpressed and new capacity may go elsewhere

“The UK is definitely a less attractive place to do business, and it's to do with the changes in personal taxation. On average, everyone's keener than they were last year to work somewhere else, but whether they actually go is a different matter. Some people definitely would and staff retention is getting more difficult. Over the past few years, you have had no visibility of where the UK is going.”

“I wouldn't say anything grandiose about shifting corporate HQ or personnel. We make decisions on location all the time. At the moment, the factors are a little more weighted against the UK. It's not revolutionary, but a little bit of ballast has shifted over to the other side. We are going to become more comfortable about the idea of having some teams overseas.”

“London is the biggest agglomeration of asset management talent in the world. If it cannot retain that status, it is not going to be an efficient place to work from. Tax issues are currently very substantial. International firms will remain here, but with a global model, new hires and operations may be located overseas.”

For some, relocation is more than just talk

“People don't feel very good about being in London. We have a lot of staff from overseas and probably only about 10% of our investment professionals are British. The change in income tax is the key issue and it is now about levels, not just uncertainty as it was around the non dom changes. The effects will lag, but we are now starting to see professionals leave. By this time next year, some of our best paid managers will have left London. London has been an enormously attractive location within our group over the last decade. But talking to colleagues around the world, that has changed on a dime and we no longer see people wanting to come here.”

“I am worried about a brain drain, both now and in the future. It is vital for this industry to be able to recruit and retain talent. I have people here who have asked to relocate elsewhere – for example Geneva – in the light of the tax changes made this year. They don't have confidence that the situation will not get worse in the coming years. We are examining all our options, but having a dispersed workforce is not ideal in terms of our current operational model. While we are flexible in terms of our working environment, a decentralised operation would be challenging. But we will have to look at that.”

Retail Distribution Review

The RDR has sought to engender a changed environment for the distribution and purchase of retail products in the UK financial services industry. At the heart of the RDR lie proposals to address the potential for adviser remuneration to affect consumer outcomes. This has resulted in a series of proposals to change the way in which commission structures operate in the financial services industry. Other policy objectives include measures to improve adviser qualifications.

All the firms we spoke to supported the ultimate goal of greater transparency in how overall charges to clients are levied. However, concerns were expressed about how changes might be implemented, in particular the potential for firms to have to introduce multiple share classes as part of the unbundling of manufacture and distribution charges. Such a development, it was felt, would result in undue cost and complexity.

A view was also expressed that it would be helpful to have more international coordination on regulatory initiatives such as RDR, particularly in the context of increasingly harmonised EU financial services legislation. For cross-border fund management firms, significant variation in legislation can be particularly disruptive.

industryview

Support for the broad principles of RDR

“ Many clients think that the charges you see on the fund are what remunerates the fund manager. They don't realise that there is a distribution component in the AMC. While there will be complications, it is great to separate cost of distribution from cost of product.”

“ From the transparency perspective, the RDR is along the right lines. However, it is unacceptable when most funds are platform-intermediated to run multiple share classes. We envisage ending up with a platform share class and the platform as the administration unity. Their job is to implement whatever the customer agreed remuneration is.”

Potential impact on fund selection

In terms of the wider impact on the fund management industry, some we spoke to believe that the RDR could have quite profound consequences for flows, particularly in the wider context of platform-based distribution and an anticipated move away from open architecture to more guided architecture. This is presumed to be due to a reduction in the number of advisers and a change in the nature of the services offered by some platforms.

A move to guided architecture could lead to professional buyers and asset allocators having a greater influence over the funds purchased. The net result could be more concentrated fund buying decisions and also greater volatility of fund flows.

This could be offset by better services offered by the advice-giving community to the consumer. For example, in order to offer a complete service to the client, some IFAs will search widely across a range of fund providers.

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Impact of RDR on fund selection

“There’s no question in my mind that a move towards platforms and towards asset allocators will increase the volatility and velocity of assets. And RDR will add to that. It’s quite interesting that in a market that is quite idiosyncratic, where thousands of people guided by thousands of IFAs make thousands of decisions, the environment is quite stable. When you move to consolidate onto platforms and single asset allocation decisions affecting large amounts of assets, you get everybody in and everybody out at the same time. Under RDR, small IFAs will think: ‘I’m just an ordinary IFA and not a wealth manager good at constructing portfolios, I think I’ll hand over to someone else to do the selection and risk profiles.’ Everyone is going to end up buying and selling China at the same time. RDR is going to move people into an asset allocation environment and the market will get much more volatile.”

“It’s too early to tell how RDR will impact, but the whole idea of open architecture is dying quickly. Open architecture platforms deliver too much choice for consumers and create too much risk for platform providers. Going forward, we’ll be moving into a more guided architecture world. This might mean better margins for firms which can get their product onto somebody’s guided architecture platform.”

Possible consequences for the adviser market

A mixture of views were expressed about the likely impact on the structure of the adviser market:

- Expecting the overall number of advisers to fall, some asset management firms felt comfortable with the prospects of dealing with fewer firms operating under enhanced standards of competency.
- Several thought that the RDR could have a detrimental impact on the wider accessibility and practicality of advice delivery to parts of the current (and future) consumer base.
- Others were sceptical that there would be a significant reduction in the number of advisers, noting that such a prospect had been expected for many years but had not manifested itself.

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Impact of RDR on advice market

“The threat I see is irresponsible distribution. To the extent that distribution brings greater professionalism, I would see any monopsony issues as dwarfed by the fact that clients get a better service. I would prefer to deal with 20 really professional people in the UK and give away 5 more basis points than deal with several thousand people, some of whom are not sufficiently professional.”

“The RDR does potentially raise the issue of polarising the market. There’s a whole group of wealthier investors who will be better off on a fee-only basis. But if you have to pay a fixed fee for advice, you are effectively creating a hurdle in terms of total assets that you need to make it worthwhile. So, is this really going to be a positive move for the mass market?”

“We operate across the entire spectrum of IFAs. There’s a big group that are at the base of the pyramid that many specialist fund managers wouldn’t deal with, but the insurance companies will tend to deal with them. They are very reliant on commission and that is going, partly because the regulator wants it to, but also because we are in a world where capital is going to become increasingly scarce and expensive, and insurance companies can no longer sustain that model. At the top end, you’ve always got firms that are more like wealth managers and private banks, who are able to do their own research. They’ll come out of this well. The number of IFAs is going to fall, but I hope it doesn’t fall too much so that we retain the dynamism and competition of the sector. It could look very different and a large number of people may not get access to financial services advice. It’s quite difficult for the private sector to address this.”

5. Operational and Structural Issues

Key Findings

Revenue and fee structures

- Data from the survey suggests that net revenue fell to £8.7bn from £9.4bn, a fall of 7%. Despite the gradual recovery in market conditions during 2009, conditions remained difficult. Net revenue has now fallen 15% since 2007.
- With costs falling slightly less fast than revenue (5%), operating margins are not yet recovering. The operating margin across the industry was 33%.
- The commercial experience was uneven across the industry, with 40% of firms reporting revenue increases through 2009.
- Although the use of performance fees remains concentrated in the institutional market, performance fees are also being applied more widely to retail funds. Those who have seen greater use of performance fees over the past year expect this to continue in the coming year.

Employment

- Total direct employment is estimated at 24,000 (from 24,750 last year), a fall of 3%. With numerous activities outsourced to third-party providers, the overall level of employment associated with the asset management industry is considerably higher.
- The fall in headcount is likely to indicate both ongoing cost cutting and the impact of consolidation activity.

Industry concentration and consolidation

- Although the industry remains relatively unconcentrated, M&A activity during 2009 has seen the share of the top ten firms move above 50% of total assets under management. This is a clear shift, but one that has to be seen in the context of

an industry that is still highly unconsolidated and relatively fragmented.

- In terms of ownership, standalone asset managers are now the largest group. This reinforces an emerging trend over the past five years, which has also seen the focus on third party business increase within asset managers that are part of insurance and banking groups.
- While the scale in asset terms of the next wave of M&A deals is unlikely to match that of 2009, further consolidation is expected despite the widely-acknowledged cultural and structural challenges involved in integrating different asset management firms.

Market interaction

- The number of firms transacting on an execution only basis has changed only marginally year-on-year, perhaps reflecting some settling down after changes arising from the Markets in Financial Instruments Directive (MiFID). There is also little change in the number of brokers being used.
- A new question was introduced to establish the extent to which firms may be switching to agency brokers in the context of the poor functioning of the secondary markets during the credit crisis. Overall usage remains low compared to access to traditional market makers.
- For the first time, we asked about trading conditions in OTC derivatives. The responses confirmed that the proportion of derivatives being cleared centrally remains very low.
- We also asked a new question regarding the impact of MiFID. Two-thirds of respondents reported that post-trade transparency had deteriorated in the UK equities market and over 60% saw a deterioration in the European markets. Only a very small proportion reported an improvement.

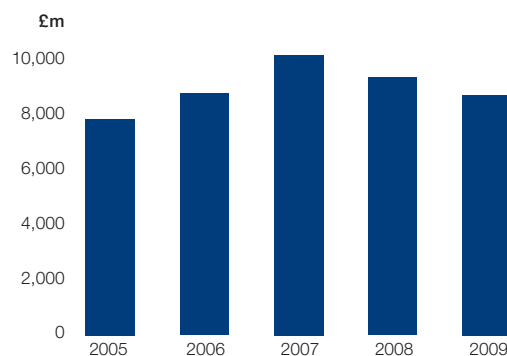
5. Operational and Structural Issues

Revenue and Costs

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

- Total net revenue fell 7% during 2009, having fallen 8% during 2008. This takes the overall estimated revenue to £8.7bn, from £9.4bn in 2008. Net revenue has now fallen 15% since 2007 (see Chart 58). Despite the sharp recovery in the markets during 2009, average levels were adversely affected by the further falls during the first quarter. The FTSE All Share was 15% lower on average in 2009 than 2008.
- Among the 40 respondents to the revenue question, the experience during 2009 was highly mixed. While 24 reported falling revenue, 16 saw revenues increase, in some cases significantly.
- Expressed as a proportion of GDP, industry net revenue represents 0.5%. However, the revenue contribution of the wider asset management industry (including hedge fund and private equity) is estimated to be closer to 1%. Factoring in downstream and outsourced activity will lead to a significantly higher contribution.
- Total costs fell by 5% during 2009 and are estimated at £5.9bn.
- The overall industry operating margin was 33% (from 34% in 2008 and 37% in 2007).³⁴

Chart 58: Industry net revenue (2005 - 2009)



³⁴ Calculated as net revenue minus costs divided by net revenue. Figures from previous years are revised to take account of more complete data.

Performance Fees

Just over 80% of respondents use performance fees in parts of their business (see Table 7). However, this accounts for a comparatively small amount of the total UK-managed asset base (16%).

Table 7: Proportion of assets under management subject to performance fees³⁵

| Proportion of total AUM subject to performance fee | Number of firms | Total UK AUM (£bn) |
|--|-----------------|--------------------|
| <1% | 10 | 47 |
| 1-10% | 25 | 1,945 |
| 11-25% | 7 | 113 |
| 26-50% | 5 | 212 |
| >50% | 8 | 356 |
| TOTAL | 55 | 2,673 |

We also asked firms to tell us in what parts of their business performance fees are most widely used:

- Two-thirds of respondents identified their institutional business.
- Just over a quarter pointed to absolute return and hedge funds.
- The remainder pointed to other areas such as retail funds and investment trusts.

While institutional business still predominates with respect to the use of performance fees, responses to this year's survey suggest that there is increasing interest in their application to retail products. Some 38% of respondents indicated that they were using performance fees for retail products, up from just over a quarter last year.

Table 8: Use of performance fees in retail products

| | 2009 | 2008 |
|-----|------|------|
| Yes | 38% | 27% |
| No | 62% | 73% |

The change in performance fee usage over the past year and expectations for future use are shown in Table 9:

- While the majority of respondents have not seen performance fees increase over the past year, those that have account for a much higher total asset base subject to performance fees.
- Those who have seen increases over the past year are also more likely to expect further increases in the coming year.

Table 9: Change over past year and expectations about future use of performance fees

| Has the use of performance-based fees in your product range become more prevalent over the past year? | % of respondents | Total UK AUM (£bn) | % Total AUM subject to performance fee |
|---|------------------|--------------------|--|
| Yes | 43% | 1,498 | 16% |
| No | 57% | 1,083 | 9% |
| Of those who answered Yes, do you expect further increases in the coming year? | | | |
| Yes | 87% | 1,323 | 16% |
| No | 13% | 175 | 17% |
| Of those who answered No, do you expect further increases in the coming year? | | | |
| Yes | 13% | 114 | 20% |
| No | 87% | 969 | 7% |

³⁵ Last year's headline numbers understated the number of firms using performance fees, which was comparable to the latest findings.

Employment

From questionnaire responses, we estimate direct employment numbers for UK-based asset management activity at 24,000, from 24,750 last year. Of these 3,850 are based in Scotland. The overall distribution is summarised in Table 10. The 3% fall in overall headcount is likely to be a combination of the ongoing fallout from the market dislocation of 2008-2009 and corporate restructuring, although outsourcing decisions may also play a role (see below). Since 2007, we estimate that direct employment has fallen by 6% from 25,500.

The data shows core asset management activities (fund management, research and dealing) accounting for

around 27% of total direct employment, with marketing and client services representing the second largest segment of employment (19%).

The personnel structure of the industry is complicated due to outsourcing of many aspects within the asset management value chain. Around 75% of asset management firms who responded to the survey outsource some of their activities. The directly-employed staff numbers, particularly in the middle and back office areas, therefore, significantly understate total employment generated by the sector in the UK:

- Many investment fund firms outsource a substantial amount of their other activities, notably fund administration and accounting. Such outsourcing

Table 10: Distribution of staff by activity

| Activity | Survey findings |
|--|-----------------|
| Marketing, Sales, Business Development and Client Services of which | 19% |
| Marketing, sales, business development | 70% |
| Client management | 30% |
| Fund Management of which | 27% |
| Fund management (strategic and operation) | 70% |
| Research/analysis | 22% |
| Dealing | 8% |
| Transaction Process of which | 4% |
| Transaction processing, settlement | 99% |
| Custody | 1% |
| Fund Accounting and Administration of which | 14% |
| Investment accounting, performance measurement and client reporting | 48% |
| Other fund administration (including CIS administration) | 52% |
| Compliance, Legal and Audit of which | 5% |
| Compliance | 57% |
| Legal | 32% |
| Audit | 11% |
| Corporate Finance and Corporate Administration | 10% |
| Corporate finance | 43% |
| HR and Training | 23% |
| Other administration | 33% |
| IT Systems | 11% |
| Other | 10% |
| TOTAL | 24,000 |

extends to larger firms (particularly for the retail aspects of their operations). Outsourced administration is often undertaken by specialist third party administration firms. It may also be undertaken by other asset management firms who offer such services (staff numbers for the latter were excluded in this survey).

- In common with practices in other industries, other activities – notably IT – are widely outsourced.

Total sector employment is also understated due to employment overseas emanating from UK-based asset management activity:

- With many IMA firms operating at a global level, some assets are managed outside the UK on behalf of UK-based clients, whose accounts are run from the UK.
- With a number of firms domiciling funds outside the UK and selling their products across Europe, middle and back office employment is created in other centres, notably Dublin and Luxembourg.

Ownership, Consolidation and Concentration

The financial crisis has, as expected, resulted in further consolidation at firm level within the industry. A dominant underlying theme here has been one of bank divestment of asset management subsidiaries, involving both UK and overseas banks (see Table 11). Much of this has been driven less by long-term strategic repositioning but by challenges to the capital base of these institutions posed by the financial crisis.

Table 11: Major deals in the UK asset management sector (2009 - 2010)

| Acquirer | Purchase |
|---------------------------|--|
| Aberdeen Asset Management | Parts of Credit Suisse fund management assets and businesses |
| | Parts of RBS Asset Management fund management assets |
| Artemis/AMG | Artemis Investment Management |
| BlackRock | Barclays Global Investors |
| BNP Paribas | Fortis Investments |
| BNY Mellon | Insight Asset Management |
| GLG Partners | Societe Generale Asset Management UK |
| Henderson | New Star Asset Management |
| Invesco | Retail funds business of Morgan Stanley |

There have also been suggestions that consolidation may also take place as a result of smaller firms disappearing and barriers to entry rising. As we discussed earlier (see page 38), it is difficult to measure this from the IMA dataset, but is something that we will monitor in subsequent surveys.

Significant consolidation through the merger and acquisition route is not straightforward. There are considerable challenges involved in attempting to successfully integrate firms:

- Asset management remains a human capital focused business, which results in very different and often independent-minded operating cultures. With comparatively low barriers to entry, retaining key staff can also be challenging in the event of acquisition.
- Buying an asset management business is no guarantee of being able to retain the assets managed by that business. The assets could move comparatively quickly and in circumstances beyond the control of the asset management firm, depending upon the behaviour of intermediaries.

Furthermore, some of those we spoke to believed that recovering market conditions in 2009 had prevented a larger wave of sales.

industryview

Rising markets may have prevented wider consolidation

“When you look historically at severe market crises, many owners became desperate to shed their asset management arms. You can do very little on the cost side without harming the business, revenues are not flowing and you lose a lot of money. We've not got close to that level of stress this time around. At one point in 2009, the S&P went down to around 666. If we had experienced one quarter more with levels like that, there would have been severe fallout and major consolidation. As it is, the S&P moved back towards 1200 and lots of people got 'get out of jail free cards'.”

The deals undertaken over the past 12-18 months demonstrate different operational approaches to the question of acquisition activity:

1. Towards scale. For some firms, it is clear that the acquisition strategy is predicated on building scale and wider capabilities under a single unifying brand and operating culture. However, true global scale is difficult to attain and a number of firms we interviewed also perceived challenges from a client relationship perspective. Furthermore, while economies of scale can be achieved in certain products, other parts of the market – eg certain alpha strategies – are more prone to diseconomies of scale. This suggests that, despite issues such as a greater regulatory and compliance burden, the boutique end of the market is likely to continue to be an important element.

2. Multi-boutique/consolidator approach. In contrast to the scale approach, a number of firms are pursuing a very different strategy whereby the brand and the operating culture of the target firm is maintained within a parent umbrella with perceived advantages of both revenue and brand diversification. Unsurprisingly, there are contrasting and strongly-held views on the pros and cons:

- For partisans of the multi-boutique approach, it offers a way to accommodate diverse investment approaches within a single larger entity. It can provide a way to give asset managers sufficient autonomy and independence within an over-arching supporting infrastructure.
- For its critics, it is an approach that does not show strong results in terms of asset and revenue growth, and the absence of a unifying culture within a firm is seen as a weakness rather than a strength.

3. Access to distribution. Beyond manufacturing capability, there are further considerations in some cases regarding distribution and several deals which have partly or wholly focused on accessing third party distribution networks.

An alternative approach for some firms is organic growth, which is seen as far more effective and an alternative route to consolidation through the growth in market share at the expense of poor-performing rivals.

Different views on the benefits of M&A activity

From the cautious . . .

“ Integrating asset management is difficult and unproven in terms of value added. Is there any way you can characterise the asset managers that consolidate as a certain type of institution as opposed to those who grow organically? We have the same goal, which is to acquire assets, but our methodology is different. We prefer to grow organically and win those assets by displacing under-performing asset managers.”

“ It’s hard to add value with consolidation. This is generally a people business. I can’t think of any reason why you would pay large amounts of money for a people business. If you buy a boutique and the key managers walk out, what have you got left? If people approach us for deals, then it means they could walk away from us again. It’s not an attractive proposition.”

“ If we bought something, we’d only want quality, and an entity whose growth is in front of it and not behind it, where the cultural issues can be managed and at a reasonable price. There’s no better way to spoil your return on capital than loading the balance sheet up with lots of goodwill.”

. . . to the more enthusiastic

“ M&A is hard, but our goal is not to do mergers, it is to have certain capabilities which we can offer to our clients. At times, you will do this through growth. At other times, you’ll do this through acquisition.”

“ It is hard to take a firm to a global scale, but there are some opportunities to expand our business, either through partnership or through consolidation. There will be more sellers, so consolidation is set to continue. We can build world-class players who will be well placed to operate out of the UK.”

. . .and a view that the industry will remain comparatively fragmented

“ The industry dynamics are such that we will always be very fragmented. Asset management is an attractive industry to be in. It’s a high return on capital business with low barriers to entry, low capital requirements. It attracts new players. For active managers, there are considerable diseconomies of scale.”

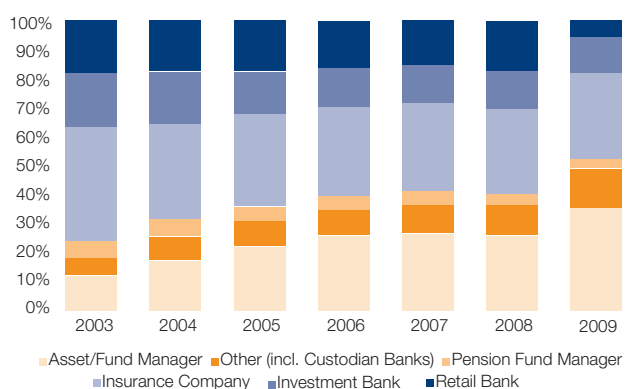
“ We are going to see greater consolidation. However, start-ups are one of the characteristics of the asset management industry. It’s always been dynamic like that. In contrast to the banks, which are increasingly concentrated, the industry tends not to require huge amounts of capital.”

Emergence of standalone asset managers

Looking at the combination of ownership and asset changes, Chart 59 shows assets under management in the UK split by ownership of firm since the survey began in this form in 2003. The increasing significance of asset management firms as standalone or autonomous businesses is striking:³⁶

- Looking back to 2003, the UK asset management industry was still defined by very strong insurance and banking ownership patterns. Standalone asset management firms accounted for 12% of total UK assets under management.
- Between 2003 and 2008, such firms have become far more prevalent at the expense of bank-owned and also insurance-owned companies, with their share of UK assets under management reaching just over 25% by 2006. At the same time, the 'other' category which contains diversified financial groups, primarily global custodian banks, also expanded.

Chart 59: Ownership of asset management firms by UK assets under management (2003 - 2009)



- While the pattern was reasonably stable between 2006 and 2008, a step change occurred in 2009. In asset terms, this is primarily defined on the basis of two transactions (the sale of BlackRock and Insight). This is discussed further in the section below and leaves the banking sector significantly smaller as an owner of asset management firms.

- Grouped together, the ownership categories that are traditional financial intermediaries (insurance companies, investment banks, retail banks) now account for less than 50% of assets under management.

There have also been other developments internationally that have reinforced the growing importance and visibility of standalone asset management firms. An alternative approach to full divestment was seen in France with the creation of Amundi in December 2009, combining the asset management businesses of leading French banks, Credit Agricole and Societe Generale. Still fully owned by the two banks, Amundi seems to go some way towards embracing the idea of more autonomous asset management while offering commercial upside and control for the parent group.

industryview

An industry with a growing independent identity

“ This is still a very young industry and for a long time, it was a function within an asset-capturing entity. We are gradually seeing investment management firms emerge from being within a distribution business to become large stand-alone firms. That's the dominant characteristic.”

At the same time, ownership categories by parent group are becoming less meaningful. First, cross-sector consolidation and expansion is tending to create a growing number of global diversified financial services firms, which will often combine a wide range of services to retail and institutional clients. Second, the business realities for the asset management subsidiaries are often quite different than the ownership structure might suggest:

- Some firms within larger banking and insurance groups have a longstanding or growing emphasis on external business as a defining element, as opposed to the more usual relationships which see strong internal commercial ties. IMA survey data suggests that in-house business accounts for an average of just under 50% of UK assets under management by insurance-owned firms.

³⁶ We include in this category listed asset management firms, where other groups (such as insurance companies) may still hold a significant stake, but where the business is characterised by a strong third party.

However, this average figure masks significant variations within individual groups.

- Open architecture in the insurance and banking sectors, and the rise of fund platforms, means that the notion of a bank-owned or insurance-owned asset manager is also less relevant for retail distribution than it may have been in the past. With parts of the UK insurance industry, there is now an increasing focus on asset gathering with the asset management frequently passing to third party managers outside the group.
- There is also an emerging trend for mandates related to life company balance sheets and products (as opposed to access via open or guided architecture) to be outsourced to external asset management companies.

These changing structures also mean that relationships between firms in the asset management and distribution arena are increasingly complicated. For example, an insurance-owned manager might be distributing through both a parent group's distribution network and that of other insurers via open architecture or a fund of funds/multi-manager product.

Overall industry concentration

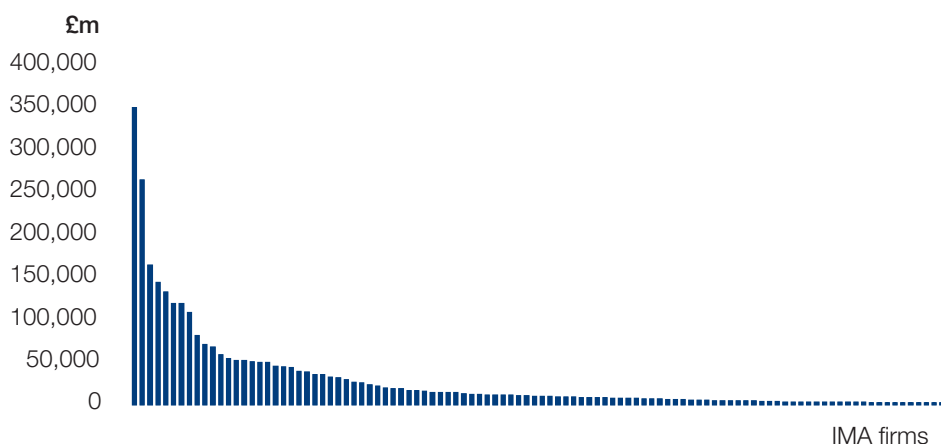
The size range of firms managing assets in the UK is illustrated in Chart 60.³⁷ The chart continues to show a steep curve downwards from a comparatively small number of very large firms, and a long tail:

- The average is £23.1bn with the median at only £6.2bn.
- While eight IMA member firms each managed in excess of £100bn (see Table 12), 87 managed less than £15bn, 26 of whom managed less than £1bn.

Table 12: Assets managed in the UK by IMA firm size (June 2009)

| Assets under management | Number of firms (June 2009) | Survey respondents (December 2009) |
|-------------------------|-----------------------------|------------------------------------|
| >£100bn | 8 | 9 |
| £51-100bn | 7 | 10 |
| £26-50bn | 14 | 7 |
| £16-25bn | 7 | 6 |
| £1-15bn | 61 | 33 |
| <£1bn | 26 | 4 |
| TOTAL | 123 | 69³⁸ |

Chart 60: IMA firms ranked by assets managed in the UK (June 2009)



³⁷ A full internal IMA data on UK assets under management is used for this analysis, and this is collected every June. The IMA membership includes a number of fund management firms who outsource their asset management operations, but we do not include here investment fund operators who outsource all their asset management operations.

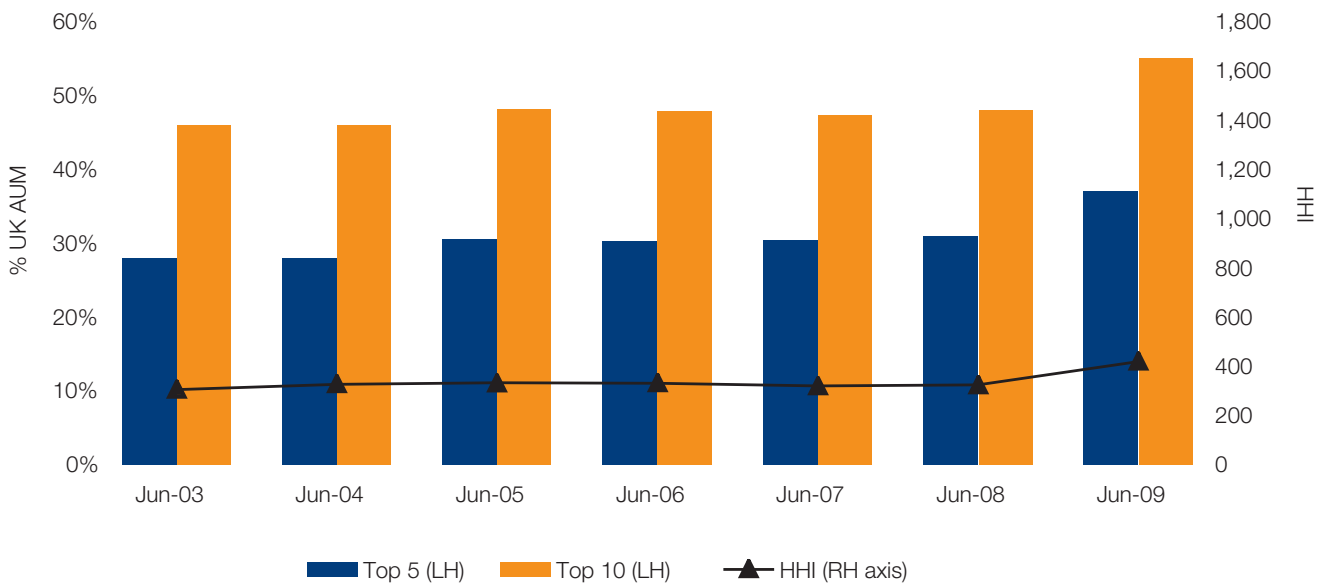
³⁸ Although 75 responses were received, six of the firms are mutual fund operators which undertake no in-house asset management in the UK.

Looking at the position of the largest firms (ranked by asset management conducted in the UK) as at June 2009, there are significant changes:

- The top ten firms accounted for 54% of assets managed in the UK by IMA members. This is a clear increase from a year earlier (48%) and reflects a combination of acquisition effects and relative asset growth.
- The market share of the five largest firms rose to 37% (31% in 2008).

As illustrated in Chart 61, until last year the situation had remained relatively unchanged for several years. At no time between 2003 and 2008 had the share of the largest ten firms exceeded 50% of the market. On the Herfindahl-Hirschman (HHI) measure, the asset management industry in the UK has been particularly unconcentrated. Even with a rise in the HHI from 324 to 417, this remains the case (see Chart 61). Markets with an HHI between 1,000 and 1,800 are considered moderately concentrated.

Chart 61: Market share of largest firms – UK assets under management (2003 - 2009)



Interaction with Markets

We have for a number of years asked firms quite detailed questions about their interaction with markets, in particular equity markets. Although a cost to underlying investors (including funds) rather than a performance issue per se, market usage and market access are an important part of the overall client service provided by asset managers. Moreover, inefficiency in market operations results in higher costs that, over time, can produce significant performance drag. That this may occur across the market, such that most asset management firms will suffer a similar impact, does not remove the fact that the end-investor ultimately bears the cost of any such inefficiency. For this reason alone it is a matter of some importance to managers and many have invested substantially in dedicated dealing staff and facilities over the past decade.

Collecting information about trading experiences also provides us with some insight into developing trends. This year we chose to expand the questions to include markets that have suffered strain over the recent past, such as fixed income, and are also the subject of proposed radical regulatory change, such as OTC derivatives.

Equity trading

Several questions look at usage of the secondary markets for equities. The significance of the questions is that they permit an approximate measurement of asset managers' utilisation of investment bank market services and of the general direction for trade handling. At a high level of generality, it also provides an indication of pressure points on both the managers and the banks.

Execution-only trades

Respondents were asked what proportion of trading by value was completed on an execution-only basis. "Execution-only" refers to trade execution where commission paid is for pure execution and not for other services. It includes execution-only brokers, crossing networks and direct market access (DMA), which managers will access through a broker.

Of the 56 respondents, a quarter do all of their business on an execution-only basis. The majority - 35

firms managing around £960bn of equities - do less than half of their business on an execution-only basis.

Table 13: Proportion of equity trading directed on an execution-only basis

| Proportion of trades | Number of respondents | Equity holdings (£bn) |
|----------------------|-----------------------|-----------------------|
| <1% | 1 | N/A |
| 1-25% | 23 | 741 |
| 26-50% | 11 | 218 |
| 51-75% | 3 | 119 |
| 76-99% | 4 | 159 |
| 100% | 14 | 65 |
| TOTAL | 56 | 1,302 |

Looking at a matched sample, there is little change in the proportion of firms which transact on an execution-only basis, and so it would appear that the recent trend of doing more execution-only business has flattened out. It is likely also to reflect some settling down in the market now the changes arising from MiFID have fully taken effect. The impact of the credit crisis also appears to have been absorbed in terms of dealing in difficult trading conditions.

Commission sharing arrangements

The introduction of the FSA's *Use of Dealing Commission* regime in 2005 restricted investment managers from using commission paid to brokers on client trades to the purchase of execution and research services only. The regime also required managers to disclose to clients how much of their commission was used to pay for execution and how much used to pay for research.

In assessing the value of these services, including the requirement to provide best execution for clients, managers began to unbundle what had previously been a full service commission rate into its two component parts of execution and research services. This then gave them the ability to execute trades with those brokers who were judged to provide best execution and to ask the executing broker to pay away an amount for the research or other execution services of a third party, who may or may not be another broker. In this way, managers can buy both high quality execution

and high quality research. This regulation removed one of the remaining areas of potential conflict within the managers' business.

It is clear from the responses received that the trend towards increased use of CSAs continues and that this is now well embedded in the industry.

Table 14: Proportion of equity trading through brokers subject to commission sharing

| Proportion of trades | Number of respondents | Equity holdings (£bn) |
|----------------------|-----------------------|-----------------------|
| <1% | 15 | 99 |
| 1-25% | 21 | 459 |
| 26-50% | 5 | 67 |
| 51-75% | 2 | 227 |
| 76-99% | 13 | 445 |
| 100% | 0 | 0 |
| TOTAL | 56 | 1,297 |

Use of brokers

Respondents were asked how many brokers they used for the majority of their equity trades by value. The results were very similar to those in 2008, possibly indicating that after reviewing their broker relationships after MiFID implementation and the consequent increase in the number of trading venues, firms have reached the optimum number of brokers in terms of their choice of trading strategies. The results did not differ significantly between brokerage usage for UK trades and that for Rest of World trades.

Table 15: Number of brokers used for the majority of trades

| Number of brokers | Respondents (UK equities) | Respondents (overseas equities) |
|-------------------|---------------------------|---------------------------------|
| <5 | 2 | 3 |
| 5-10 | 21 | 18 |
| 11-20 | 26 | 24 |
| >20 | 7 | 9 |
| TOTAL | 56 | 54 |

Bond trading

Given the poor functioning of the secondary corporate bond market during the credit crisis when market makers were unwilling or unable to provide liquidity to facilitate trading, many member firms sought to rely on agency brokers to match bargains. We introduced a new question to ascertain whether this is a new and sustainable trend.

Although the results suggest that agency brokers were used to access the bond markets during the worst period of the credit crisis, the overall usage remains low compared to direct access to traditional market makers. We shall see next year whether any sustained switch occurs, although anecdotal evidence separately obtained would tend to indicate not.

Table 16: Proportion of bond trading conducted with agency brokers

| Proportion of trades | Number of respondents | Bond holdings (£bn) |
|----------------------|-----------------------|---------------------|
| <1% | 8 | 77 |
| 1-25% | 30 | 724 |
| 26-50% | 2 | 28 |
| 51-75% | 1 | 0.5 |
| 76-99% | 1 | 0.3 |
| 100% | 3 | 1 |
| TOTAL | 45 | 831 |

OTC derivatives

For the first time this year we asked some questions about trading conditions in OTC derivatives. These were introduced because derivatives markets are in the course of seismic regulatory change, both in the US and in Europe. Radical new legislation is proposed here and across the Atlantic, focused around bringing as much trading as possible into central clearing and in due course, if possible, on exchange. The principle purpose is to reduce systemic risk, by introducing third party risk management through the clearing houses and permitting adequate information to flow to regulators. It is expected that these measures will act to price risk with a greater degree of accuracy, and that they will result in considerably more capital being brought to bear to support these markets.

Posting of collateral

As OTC derivatives have received much regulatory attention since the credit crisis began in 2007, we wished to establish whether this had had an impact on collateral demands made on firms in respect of their bilateral business with the banks.

Firms were asked whether for derivative trades that are bilaterally cleared, they were posting more, less or about the same collateral as a year earlier. It is clear from the answers that there has not been a significant impact. This is not really surprising in that default risk for authorised funds and segregated mandates has been and remains very low. These entities are generally asset rich and derivatives usage tends more towards implementing hedging and overlay strategies rather than trading. It is likely that there will be change next year when Basel III begins to have an impact.

Table 17: Collateral demands on firms

| Are you being asked to post? | Number of respondents |
|---------------------------------|-----------------------|
| More collateral than a year ago | 4 |
| Less collateral | 6 |
| About the same | 22 |
| TOTAL | 32 |

OTC derivative trades being centrally cleared

Firms were asked what proportion of their OTC derivative trades for each asset were being centrally cleared. Again, the question was phrased to provide a starting point for analysing change. It is clear from the responses that currently very few OTC derivatives trades are being centrally cleared:

- A very small number of firms (four out of 28 respondents) appear to have moved their credit derivatives into central clearing.
- A similarly small number (five) indicate that they have opted to clear their equity derivatives through a central clearing house (although currently these trades appear to relate to on-exchange equity derivatives rather than bilateral OTC derivatives).

Table 18: Central clearing of OTC derivative trades according to asset class

| CDS/CREDIT | Number of respondents |
|---------------------------|-----------------------|
| 0% | 23 |
| 1-99% | 1 |
| 100% | 4 |
| TOTAL | 28 |
| EQUITY DERIVATIVES | |
| <0% | 22 |
| 1-99% | 1 |
| 100% | 5 |
| TOTAL | 28 |

Terms for derivative trades

We have tried to understand whether the Lehman default, in particular, had led to a tightening up of contractual wordings sought by the banks, as the counterparties to the managers' OTC derivatives trades. The IMA had also heard anecdotally that managers were experiencing greater difficulty in agreeing terms with the banks.

Firms were asked whether they had found it more difficult to negotiate agreed terms for their derivative trades:

- Of 39 respondents, 15 reported that they were finding it difficult to agree terms for their OTC derivatives trades.
- Twenty four respondents reported no particular difficulty.

Looking across the 15 firms facing difficulty, we noted that this number covered firms from across the spectrum, including some of the largest asset management firms.

Transaction cost analysis

Seventy seven percent of respondents (43 out of 56) undertake transaction cost analysis as part of their internal assessment of achieving best execution, a similar proportion to last year. With the introduction of MiFID in 2007, there is a requirement on managers to act in the best interests of clients when placing orders resulting from decisions to deal. Over half of respondents provide transaction cost analysis on a regular basis to institutional clients.

Execution policy

MiFID states that an investment firm must provide a client on request with the firm's execution policy. We know that considerable discontent exists among asset management firms about the inadequacy of such execution policies generally supplied by their brokers to describe key components of the execution process. This has required firms to investigate and negotiate one-to-one to obtain more information. Most of the information collected is used to inform the firm's trading choices. However, the asset managers are themselves required to provide appropriate information on their execution policy to their clients on request, some part of which will reflect back what they receive from the brokers.

We asked whether the managers' clients had much appetite for the policies. We understand that many clients may be more interested in overall performance and look to that rather than to examining its component parts. The results did not indicate, as yet, a significant proportion of clients asking to see firms' execution policy itself.

Table 19: Clients asking for detail of execution policy

| Proportion of institutional clients asking for detail of execution policy | Number of respondents |
|---|-----------------------|
| <1% | 18 |
| 1-25% | 12 |
| 26-50% | 2 |
| 51-75% | 1 |
| 76-99% | 3 |
| 100% | 7 |
| TOTAL | 43 |

Post-trade transparency

MiFID requires that investment firms which conclude transactions in shares trading on public markets (whether or not they are themselves trading on a public market) must publish the volume, price and the time at which the transactions were concluded. This information is to be made public as close to real-time as possible in a manner which is easily accessible to other market participants; those who publish it must make it available on a reasonable commercial basis. Asset managers had expressed concerns well before MiFID was implemented that equity market data was at risk of fragmenting. This question tests out recent experience.

Respondents were asked whether post-trade transparency in equity markets improved, deteriorated or stayed the same since MiFID implementation:

- **UK equities.** Two-thirds of respondents report that post-trade transparency has deteriorated while a quarter report that it has remained the same.
- **Other European equities.** Just over 60% of respondents report that elsewhere in Europe it has also deteriorated.

Table 20: Post-trade transparency after MiFID

| UK equities | Number of respondents |
|--------------------------------|-----------------------|
| Better | 3 |
| Worse | 33 |
| Same | 13 |
| TOTAL | 49 |
| Other European equities | |
| Better | 5 |
| Worse | 28 |
| Same | 12 |
| TOTAL | 45 |

Compliance with Global Investment Performance Standards (GIPS)

Out of 56 respondents, 43 claimed compliance with GIPS, a similar proportion as 2008. It would appear that many firms choose not to become GIPS compliant, but the survey does include a number of firms who do not have the same commercial requirement (ie they have mainly retail clients).

Of the 43 respondents claiming compliance, 38 (90%) are independently verified, a similar proportion to last year. The 2010 GIPS revision is due to be adopted at the beginning of 2011 and the GIPS Executive Council decided not to include a requirement for independent verification, choosing only to encourage firms to have it done.

Appendix One: Summary of Main Responses – Headline Data ⁽¹⁾

Sample sizes vary between questions

| Client Type | TOTAL (£m) | INSTITUTIONAL | | | | | | | Third Party Institutional | All Institutional | Retail | Private Client |
|--|---------------|---|--------------------|----------------|-----------------------------|-----------------------|-----------------------------|------------------------|---------------------------------|----------------------|------------------|-------------------|
| | | Corporate Pension Fund ² | Local Authority | Charity | Sovereign Wealth Fund | In-House Insurance | Third Party Insurance | Other Institutional | | | | |
| Assets Under Management in the UK (£m) | 3,360,000 | 956,397 28.5% | 176,019 5.2% | 37,309 1.1% | 60,072 1.8% | 637,984 19.0% | 128,383 3.8% | 594,876 17.7% | 1,888,320 56.2% | 2,591,039 77.1% | 717,275 21.3% | 51,686 1.5% |
| Segregated (directly invested) or Pooled Institutional Assets (%) | | | | | | | | | | | | |
| Assets directly invested on a segregated basis | | 49.1% | 78.7% | 71.7% | 98.8% | 90.5% | 91.7% | 63.2% | 61.4% | 69.3% | | |
| Managed on a pooled basis | | 50.9% | 21.3% | 28.3% | 1.2% | 9.5% | 8.3% | 36.8% | 38.6% | 30.7% | | |
| Multi-Asset or Specialist (%) | | | | | | | | | | | | |
| Multi-asset | 21.0% | 9.6% | 11.2% | 27.9% | 2.4% | 59.7% | 26.5% | 3.6% | 9.5% | 22.2% | 14.2% | 51.7% |
| Specialist | 79.0% | 90.4% | 88.8% | 72.1% | 97.6% | 40.3% | 73.5% | 96.4% | 90.5% | 77.8% | 85.8% | 48.3% |
| Active or Passive (%) | | | | | | | | | | | | |
| Actively managed | 79.6% | 65.0% | 77.0% | 92.0% | 80.0% | 94.0% | 88.0% | 71.0% | 69.0% | 76.1% | 91.0% | 98.0% |
| Passively managed | 20.4% | 35.0% | 23.0% | 8.0% | 20.0% | 6.0% | 12.0% | 29.0% | 31.0% | 23.9% | 9.0% | 2.0% |
| Asset Allocation (%) | | | | | | | | | | | | |
| Equities of which: | 45.8% | 40.8% | 73.5% | 66.8% | 57.3% | 32.0% | 45.1% | 43.9% | 46.6% | 41.6% | 63.0% | 55.7% |
| UK | 47.1% | | | | | | | | | | | |
| Europe ex UK | 17.0% | | | | | | | | | | | |
| North America | 13.7% | | | | | | | | | | | |
| Pacific Ex Japan | 8.1% | | | | | | | | | | | |
| Japan | 4.7% | | | | | | | | | | | |
| Emerging Market | 8.4% | | | | | | | | | | | |
| Other | 1.0% | | | | | | | | | | | |
| Fixed Income of which: | 35.5% | 41.7% | 20.3% | 10.9% | 42.1% | 51.1% | 36.7% | 19.8% | 32.1% | 38.5% | 22.9% | 16.1% |
| UK Government | 22.7% | | | | | | | | | | | |
| UK Corporate | 39.9% | | | | | | | | | | | |
| UK Index-Linked | 12.9% | | | | | | | | | | | |
| Other UK | 3.1% | | | | | | | | | | | |
| Overseas | 21.5% | | | | | | | | | | | |
| Cash/Money Market | 9.5% | 4.0% | 3.0% | 18.2% | 0.4% | 8.6% | 7.0% | 27.1% | 11.0% | 10.0% | 8.9% | 26.8% |
| Property | 4.5% | 3.1% | 2.4% | 2.1% | 0.0% | 6.5% | 4.5% | 6.6% | 3.6% | 4.8% | 3.9% | 0.4% |
| Other | 4.7% | 10.4% | 0.8% | 2.0% | 0.1% | 1.8% | 6.8% | 2.6% | 6.6% | 5.1% | 1.3% | 1.1% |

¹ Caution should be used in undertaking direct year-on-year comparisons with previous surveys. Where relevant or possible, we have used matched results in the survey analysis to validate observations of change.

² The data in the segregated/pooled and multi-asset/specialist sections exclude responses from in-house OPS managers.

Appendix Two: Questionnaire Respondents

| | |
|---|---|
| Aberdeen Asset Management | Henderson Global Investors |
| Aberforth Partners | Hermes Fund Managers |
| AEGON Asset Management | HSBC Global Asset Management |
| Aerion Fund Management | Ignis Asset Management |
| Alliance Trust Asset Management | Insight Investment Management |
| AllianceBernstein | Invesco Perpetual |
| Allianz Global Investors | Investec Asset Management |
| Artemis Fund Managers | Invista Real Estate Investment Management |
| Ashmore Investment Management | J O Hambro Capital Management |
| Aviva Investors | JP Morgan Asset Management |
| AXA Investment Managers | Jupiter Asset Management |
| BAE Systems Pension Funds Investment Management | Lazard Asset Management |
| Baillie Gifford | Legal & General Investment Management |
| Baring Asset Management | Liontrust Investment Funds |
| Belgrave Capital Management | M&G Investments |
| BlackRock Investment Management | Marks & Spencer Unit Trust Management |
| British Airways Pension Investment Management | Martin Currie |
| Brooks MacDonald Asset Management | Morgan Stanley Investment Management |
| Canada Life Asset Management | Newton Investment Management |
| Capital International | Nomura Asset Management |
| Cazenove Capital Management | Octopus Investments |
| CCLA Investment Management | Odey Asset Management |
| Dimensional Fund Advisors | Old Mutual Fund Managers |
| Edinburgh Partners | Pall Mall Investment Management |
| Family Investments | Pictet Asset Management |
| Fidelity International | Premier Portfolio Managers |
| First State Investments | Principal Global Investors |
| Fortis Investment Management | Pyrford International |
| Franklin Templeton Investment Management | Rathbone Unit Trust Management |
| Gartmore Investment Management | Royal London Asset Management |
| GLG Partners | Santander Asset Management |

Schroder Investment Management
Scottish Friendly Asset Managers
Scottish Widows Investment Partnership
SEIC
Sharefunds Limited
Standard Life Investments
State Street Global Advisors
St. James's Place Wealth Management
The Co-operative Asset Management
Threadneedle Asset Management
UBS Global Asset Management
Vanguard Investments
Veritas Asset Management

Appendix Three: Firms Interviewed

Senior figures from the firms below were interviewed for the survey. With their agreement, selected quotations have been reproduced on an anonymous basis throughout the survey.

AEGON Asset Management
Aviva Investors
AXA Investment Managers
Barclays Wealth
BlackRock Investment Management
Capital International
F & C Asset Management
Fidelity International
Henderson Global Investors
Insight Investment Management
Invesco Perpetual
Investec Asset Management
Invista Real Estate Investment Management
JP Morgan Asset Management
Jupiter Asset Management
Lazard Asset Management
Legal & General Investment Management
M&G Investments
Newton Investment Management
Odey Asset Management
Schroder Investment Management
Standard Life Investments
State Street Global Advisors
Threadneedle Asset Management

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